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## BUSINESS RECOVERY AND INDUSTRIAL LOANS

There are three principal aspects to be noted in the credit situation during the last three years. These are:

1. The growth of bank reserves.
2. The increase in the volume of bank deposits.
3. The limited use by business and by individuals of the funds which banks have available.

### Growth of bank reserves

Since June 1933 the reserves of member banks have shown exceptional growth. They now stand at the highest levels on record, \$5,800,000,000. Between June 1933 and March of this year total member bank reserve balances had increased \$3,500,000,000. Required reserves increased in that period by about \$1,000,000,000, which left an increase, therefore, of about \$2,500,000,000 in excess reserves. Excess reserves are now about \$3,000,000,000.

The growth of reserves has resulted principally from the movement of about \$3,300,000,000 of gold to this country from abroad.

Since June 1933 the public debt has increased about \$9,000,000,000. Banks (including Federal Reserve banks, member banks, mutual savings banks, and other non-member banks) increased their holdings of Government obligations by nearly \$6,000,000,000, or 2/3 of the total increase of the public debt. These funds borrowed by the Government from the banks have been expended to provide relief and employment. They increased bank deposits.

### The increase in the volume of bank deposits

The deposits of the general public, excluding inter-bank and United States Government deposits, but including deposits at non-member as well as at member banks, now total about \$45,000,000,000. There has been an increase of about \$11,000,000,000 since June, 1933. Deposits at present are still below the 1929 peak by about \$5,000,000,000. However, since that time Postal Savings deposits not redeposited in banks have increased by nearly \$900,000,000, and money in circulation outside of banks has increased by \$1,500,000,000. Accordingly, the available cash resources of the public are altogether only about \$3,000,000,000 - or 5 percent - less than they were in 1929.

The increase of \$11,000,000,000 in deposits since June 1933 is due largely to an increase of about \$4,000,000,000 in monetary gold and silver stock and of about \$5,500,000,000 of Government expenditures from the proceeds of direct obligations purchased by banks, including the Federal Reserve banks, and by the Postal Savings System.

The limited use by business of the funds which banks have available

Although the volume of bank deposits is now almost as large as at the peak in 1929, the rate of turn-over is still relatively small; deposits turned over about fifteen times per annum in 1935 as compared with twenty-seven times in 1929, and as compared with twenty times in other years more normal than 1929. Accordingly, although it is to be expected that deposits will increase still further this year, as the result of government borrowing and expenditure, it does not necessarily follow that the rate of turnover will increase.

It is unusual for banks to have any large amount of excess reserves such as they now have. Prior to 1931 they never had excess reserves of more than \$75,000,000 or \$100,000,000 altogether for any great length of time. With excess reserves in such an amount as \$3,000,000,000 it is natural that the banks should be seeking ways of putting these funds to use.

It is obvious that the possible expansion that may take place on the basis of present reserves is far greater than may be needed for sound business conditions. On the present basis, credit could be extended and bank deposits thereby increased to \$90,000,000,000 or \$100,000,000,000. This would be about twice what deposits are now, and about twice the amount that they were in 1929 at the peak. These deposits would represent funds immediately available for use.

The possibility of increasing the use of funds and also the amount of funds to be used depends upon two things: First, it depends upon the desire of owners of existing deposits to use what they have either for spending on a freer scale or for permanent investment. In the second place, it depends upon the desire of business to use the funds already available and to borrow still more for the purpose of expanding operations.

In the past year developments in capital markets were marked by a sharp increase of activity. Stock market trading increased and securities prices rose by over 50 percent. New security issues in 1935 were the largest since 1930. The principal issues however were for refunding; these totaled \$3,300,000,000. Issues to raise new capital totaled only \$1,400,000,000, of which \$1,000,000,000 represented issues of States, municipalities, and Federal land banks. Corporate issues for new capital totaled only \$400,000,000. This compares strikingly with the figures in the late twenties when corporate issues for new capital amounted to \$4,000,000,000 or more a year.

Although the greater portion of the financing indicated has been for refunding of existing indebtedness, this refunding has been at lower interest rates and consequently has tended to decrease costs and to increase the profitableness of enterprise. The small volume of issues for new capital is not in any event an accurate measure of business expenditures for plant and equipment, since not all the proceeds of such issues are used for this purpose, and since, on the other hand, corporations have a large volume of idle funds available. Moreover, developments in the business situation indicate that these funds are being more freely used.

## Industrial loans

In this connection I think it will be interesting to mention the experience of the Federal Reserve banks in making industrial loans. In June 1934 the Federal Reserve Act was amended by the addition of a new section, namely 13b, authorizing the Federal Reserve banks to make credit available for working capital purposes to established industrial and commercial enterprises on maturities not exceeding five years. This authorization was made because it was felt that as a result of the depression a good many business enterprises had suffered such depletion of working capital that they were unable to take advantage of new business opportunities. It was also felt that the local banks in many instances were still reluctant to make credit advances. Under these circumstances the Reserve banks were authorized to discount such paper for local banks, and also to grant commitments to local banks insuring such paper up to as much as 80 percent of its face value. The Reserve banks were also authorized, in exceptional cases where credit was not available from the usual sources, to make loans for working capital purposes direct to the borrower. This was a marked departure for the Federal Reserve banks, which hitherto had held only short term obligations or marketable securities, and had not made loans direct to the borrowing public. The new functions seemed required by the emergency however, and the Reserve banks set out energetically to make the fact known to the business public that credit for working capital purposes was amply available. Local banks were also informed of the exceptionally favorable conditions upon which they could make loans for such purposes. At the time banks were especially anxious to maintain a highly liquid condition, and would not have been interested in long term loans unless there were provision for their liquidity. This was provided however by the commitments granted by the Reserve banks. Under their terms, the Reserve banks would agree to purchase such loans from local banks practically on demand, provided of course the loan had been approved in advance by the Reserve bank. When it is considered that beside this provision for liquidity, there was also a provision that the local bank might be relieved of 80 percent of the risk, it is apparent that the terms were calculated to give substantial encouragement to the local banks to make the loans which the depleted condition of many businesses made necessary. By the same token it is clear that the Reserve banks were in no sense entering into competition with local banks.

As of April 29 the Federal Reserve banks had approved 2,139 applications for working capital credit in the amount of \$131,000,000. In recent months there has been very little increase in the amount of such applications approved. At the same time, however, there has been a distinct falling off in the number and the amount of applications received. In the first three months of last year 841 applications were received and the total amount was \$29,000,000. In the first three months of this year the number of applications received was only 347 and the amount was only \$13,000,000. Both in number and amount, applications were less than half what they were in the corresponding period last year. Moreover, there has been an almost uninterrupted decline every quarter since the beginning of last year.

Repayments, on the other hand, show marked increases. In the first quarter of last year they amounted to about \$1,700,000; in the second

quarter, \$2,100,000; in the third quarter, \$1,600,000; in the fourth quarter, \$3,600,000; and in the first quarter of this year, \$3,500,000.

The Federal Reserve banks still stand ready to make this credit available wherever it can be done on a reasonable and sound basis and local institutions are unwilling to advance it. In this connection, however, it is important to emphasize that the law permits the Reserve banks to make this credit available only for working capital purposes and only to established industrial and commercial businesses. The credit is not available for permanent capital, nor to refund existing indebtedness (except in minor amounts incidental to provision of working capital), nor to new enterprises.

#### Increased production and trade

In 1935 there was a large increase in production and trade following an irregular upward movement since 1932. The index of industrial production for 1935 as a whole averaged 90 percent of the 1923-1925 average and rose to 104 in December, partly because of an unusually large output in the automobile and related industries. There has since been some decline, February and March showing an index of 94. There appears to have been an advance in the index since that time. It appears, therefore, that the recovery in industry reached in 1935 is being maintained in 1936.

This recovery appears in many lines of industry. It is apparent to some extent in non-durable goods, comprising mostly articles of everyday consumption, which declined but moderately in the depression. It is apparent principally in durable goods, comprising building material, industrial equipment, automobiles, and more lasting household equipment.

The greatest decline in the depression occurred in the field of construction. Residential building, which in 1933 declined to 11 percent of the 1923-1925 average, did not increase until 1935. Then, however, contracts almost doubled those of the previous year. In the first quarter of 1936 there was an important increase in private construction other than residential. The greatest hope for expansion lies in the field of private construction. Shortages of residences have developed; new and improved types of housing are available; financing costs are lower; the burden of financing as a whole has been lightened; and the facilities for financing have improved. Construction costs are also somewhat lower.

In the field of trade, consumer purchasing has increased. Department store sales in 1935 were at 79 percent of the 1923-1925 average, compared with 67 percent in 1933. Sales in March of this year were up to 88 percent. In rural areas sales have shown a marked increase in recent years, which indicates that the status of farmers has improved. In recent weeks automobile sales have been at high levels, and gasoline consumption has been the largest on record. Wholesale sales have increased considerably, particularly in the durable goods lines - agricultural implements, hardware, and household equipment.

These, then are the facts and figures on business recovery as of today.

Let me suggest in connection with industrial loans under section 13b that you avail yourself of the willingness of the Kansas City Federal Reserve Bank to give you further and more detailed information on the subject for the general good of your community.