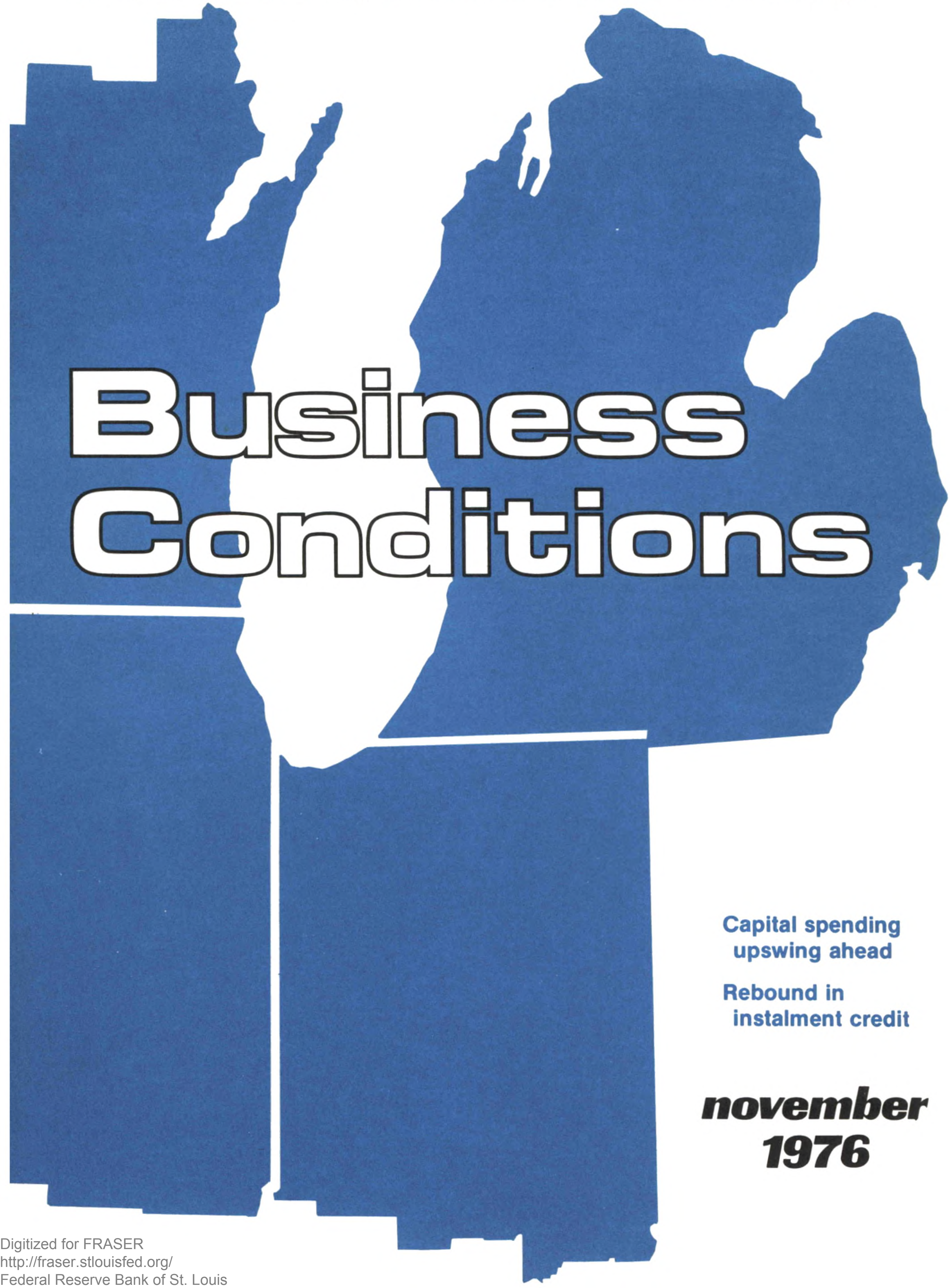
an economic review by the Federal Reserve Bank of Chicago



Business Conditions

Capital spending upswing ahead

Rebound in instalment credit

november 1976

Contents

Capital spending upswing ahead 3

Investment in new plant and equipment has increased since early 1975, but not nearly so fast as the economy as a whole. Emphasis has been on efficiency and modernization, rather than expansion of capacity. Recent surveys suggest a significant rise in investment outlays in 1977, with virtually all industries participating. Full recovery in capital goods, however, will require a firming of business confidence, which was undermined by the recession and a variety of national and international uncertainties.

Rebound in instalment credit 6

Increased consumer spending has been the driving force in the business expansion thus far. Outlays on goods and services will rise about 10 percent this year with a substantial boost from increased use of instalment credit. Although banks continue as the prime lenders of instalment credit, credit unions are expanding their share of outstandings. Instalment credit has expanded faster than income since early 1975, but a further acceleration in these loans would be in keeping with historical experience.

Subscriptions to *Business Conditions* are available to the public free of charge. For information concerning bulk mailings, address inquiries to Research Department, Federal Reserve Bank of Chicago, P. O. Box 834, Chicago, Illinois 60690.

Capital spending upswing ahead

Like most other sectors in the economy, business plant and equipment spending has increased from the sharply depressed levels recorded last year, but the extent of the rise has been disappointing to most observers. Further gains in capital spending are regarded widely as the key to a substantial rise for the total economy in 1977.

Developments in capital spending are particularly meaningful to the region of the Seventh Federal Reserve District. Illinois, Indiana, Iowa, Michigan, and Wisconsin, with 16 percent of the nation's employment, manufacture about 30 percent of its producer equipment. This region is especially important in motor vehicles, machine tools, and equipment for construction, agriculture, mining, and handling materials.

The picture is mixed

The Department of Commerce survey released in September indicated that business spending on new plant and equipment in the United States would be 7.4 percent higher this year than in 1975. After adjustment for inflation the survey suggests a rise of only 2 to 3 percent. A broader concept of capital spending, the "nonresidential fixed investment" component of the gross national product (GNP) may rise 9 percent this year, but only about 4 percent in real terms.

Strength in capital spending varies greatly among sectors this year. Nonresidential construction activity has shown much less recovery than outlays for equipment. Among industries, airlines, railroads, steel mills, and nonferrous metals producers apparently will spend less this year than last even before adjustment for inflation. By contrast, electric and gas utilities, telephone companies, machinery producers, and the motor vehicle, food, oil, and paper industries will increase spending more than the average. In some cases the stronger sectors in 1976 were among the weakest last year, and vice versa. Virtually all industries are likely to show gains in 1977.

A recent Merrill Lynch survey indicates a rise in capital outlays of 14 percent in 1977 for large companies, while a McGraw-Hill survey places the gain at 13 percent. Perhaps half of these projected gains reflect expected price inflation.

Charting the lag

The accompanying charts attempt a graphic presentation of the current status of capital spending relative to the past.

In the third quarter output of business equipment (Chart 1) as measured in physical terms by the Federal Reserve's index of industrial production was up 8 percent from the recent low in the second quarter of 1975, but still 6 percent less than the all time high set in the third quarter of 1974. Interestingly, output of business equipment was higher relative to total manufacturing in the third quarter than in the years prior to the 1973-74 boom.

Outlays on nonresidential fixed investment in constant 1972 dollars divided between structures and equipment (Chart 2) shows a modest but steady gain in the past five quarters. However, both components are well below the high levels of

Chart 1. Business equipment component of the industrial production index still well below 1974 peak

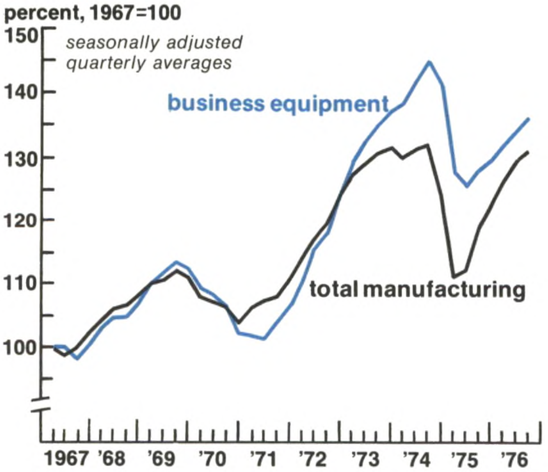
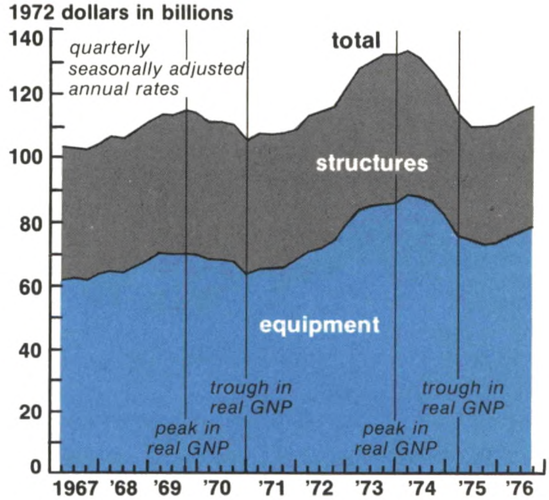


Chart 2. Capital spending, in constant dollars, has made partial recovery



1973 and 1974, with structures showing a substantially larger deficit than equipment. This is consistent with statements of business executives that their capital spending programs now emphasize modernization, efficiency, and compliance with health and safety regulations, rather than expansion.

In real terms outlays on producer equipment were 6.2 percent of gross national product in the third quarter. This ratio compares favorably with business recoveries in the past and even exceeds the proportion recorded for periods of high prosperity in some earlier business fluctuations.

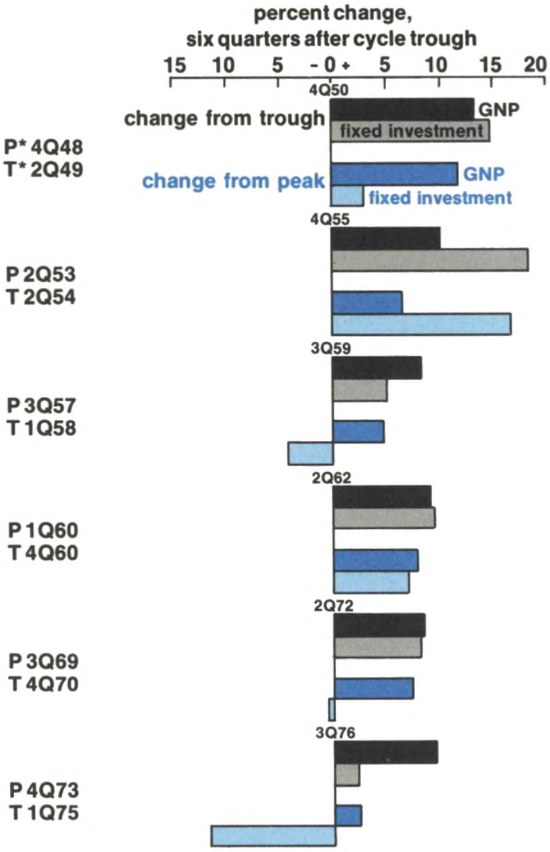
The recent recovery in real business fixed investment appears sluggish relative to the very high levels prior to the recession (Chart 3). In the third quarter of 1976 fixed investment was only 2.4 percent above the level of the business cycle trough reached six quarters earlier in the first quarter of 1975. At the six-quarter mark in five earlier expansions the average rise in fixed investment was 11 percent. When compared to the peak quarter of real GNP, the fourth quarter of 1973, fixed investment in the third quarter was still down 11.6 percent! This compares with an average *increase* of over 4 percent relative to the prior peak at the same stage in five earlier recoveries. There was much variation in the past, however. No two business cycles are the same. The current picture most closely resembles the recovery from the relatively sharp 1957-58 recession.

If projections for 1977 are realized, the gain in real fixed investment will be much larger than the gain in real GNP (Chart 4). This would mean a relatively favorable relationship between investment and total activity. The ratio of investment to GNP would approach 10 percent, close to the average of the past decade.

Confidence is crucial

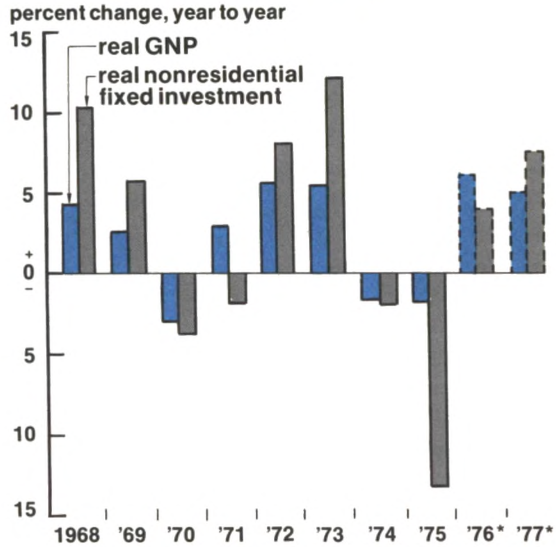
Expectations of a substantial rise in capital spending next year are based partly on plans already announced by major companies and partly on the improving

Chart 3. Changes in real GNP and real nonresidential fixed investment in six business cycles



*Peak and trough of business cycle.

Chart 4. Surveys of business plans suggest that capital spending will outpace GNP in 1977



*Estimate.

order picture for important capital goods, such as machine tools, aircraft, and energy-saving equipment. Optimism is also supported by narrowing margins of unused capacity, sharply higher corporate profits and total cash flow, improved business liquidity, ample availability of short- and long-term credit at rates lower than had been projected by most experts several months ago, and a slower than expected rise in costs of construction and producer goods.

A prerequisite for accelerated capital spending is business confidence. The mere fact that funds have been "appropriated" does not necessarily mean that projects will proceed as scheduled. Many executives were deeply shaken by the length and depth of the recent recession. Planning has been hampered by energy shortages, world political and economic unrest, and a variety of new laws, agencies, and regulations. Favorable developments related to these uncertainties will provide the environment conducive to stable economic growth and higher levels of business investment.

George W. Cloos

Rebound in instalment credit

American consumers will spend almost $1.1 trillion on goods and services in 1976, up over 10 percent from last year's record. Perhaps half of the rise will represent a real gain, the other half reflecting inroads of inflation. Higher spending will be financed mainly out of higher disposable (after-tax) personal income, but many outlays, especially for autos and other big-ticket durables, will require extensions of instalment credit by banks and other lenders. New instalment credit extensions probably will exceed $180 billion in 1976, far more than ever before. Some mortgage loans also are used, in part, to purchase consumer goods and services.

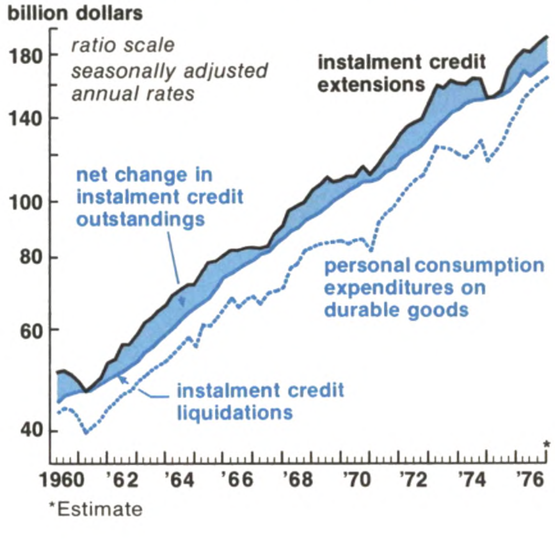
The willingness and ability of consumers to buy "on time" has played a major role in lifting the economy from the depressed levels of the first quarter of 1975, low point of the recent recession. Further growth in instalment credit will be required if the economy is to continue the expansion through 1976 and into 1977 as foreseen by virtually all analysts. This article reviews recent developments in instalment credit—patterns of use, shifts among lenders, and changes in regulatory environment—and evaluates the potential for further growth.

Credit and consumption

Instalment credit is defined as advances of purchasing power to consumers, including finance charges where applicable, intended to be liquidated in two or more payments. Revolving credit accounts of retailers also are included. Single-payment loans, charge accounts other than revolving credits, and oil charge cards are excluded. Multiple-payment loans usually are associated with purchases of relatively high-priced durable goods, but they also include advances for home improvements, medical treatments, vacations, education, consolidation of accumulated debts, and other purposes. Bank credit cards, now included in instalment credit, are used for a wide range of payments, even for cash advances.

The typical instalment sales contract provides for a "conditional sale" with loan payments scheduled to keep the outstanding balance below resale value in case of default and repossession. Clear title passes to the purchaser upon completion of the payments. When intangibles are financed,

Instalment credit extensions closely parallel hard goods outlays



*Estimate

security may be based on a wage assignment or simply on the creditworthiness of the borrower.

Some consumers make a point of avoiding instalment purchases under any circumstances, but this "puritan ethic" is much less common than in the past. By contrast, other consumers are perenially unable or unwilling to accumulate the savings necessary for relatively large outlays. A third group prefers to borrow, even at high rates of interest, rather than draw down savings for fear that the sum will not be replaced. Many users of instalment credit are encouraged by the fact that finance charges are deductible for income tax purposes.

It is frequently argued that mass markets, and, therefore, mass production economies of scale, would not be possible without widespread use of instalment credit. Instalment loans in the modern sense were first used extensively a century ago to facilitate the sale of sewing machines, which might "pay for themselves" in time. Instalment buying was an essential ingredient in the development of the market for automobiles in the 1910-30 era. This was the period when some of the large independent and "captive" sales finance companies of today started operations. Since World War II instalment credit has assumed a growing role in the economy with more borrowers participating and with lenders financing an ever-wider variety of goods and services.

Onward and upward

At the end of September instalment credit outstanding reached $173 billion, up $15.5 billion, or 9.8 percent, from a year earlier. This total has increased every year since World War II except for a slight drop in the recession year 1958. A decline probably would have occurred in 1975, but for the substantial rise in prices of most goods and services.

At the end of 1946 outstanding instalment credit totaled only $4 billion and was less than 3 percent of disposable personal income (DPI) for that year. Debts had been repaid during World War II when production of most consumer durables was prohibited and maturities and downpayments on instalment credit were controlled by the Federal Reserve Board's Regulation W. Availability of autos and some other consumer goods was limited for several years after V-J day and credit controls were retained with modifications. The Korean War further postponed the return to normal market conditions.

Despite various limiting factors in the years following World War II, the ratio of outstanding instalment credit to disposable income grew almost every year. In 1955 outstandings totaled $29 billion and the ratio to DPI reached 10 percent. By 1965 outstandings had more than doubled to $71 billion and the ratio to income reached 15 percent.

Since 1965 outstanding instalment credit has increased rapidly, but the ratio to DPI has stopped its secular advance and has fluctuated near the 15 percent level. Using quarterly income data, the income/debt ratio hit a peak of 15.6 percent at the end of 1973 following the surge in sales of autos and various other consumer durables. In 1975 and thus far in 1976 the ratio has averaged about 14.5 percent.

Auto credit leads

Auto instalment credit, which includes loans on passenger vehicles purchased by consumers, totaled more than $59 billion and accounted for 34 percent of all instalment credit outstanding at the end of September. This proportion has been fairly stable since the late 1960s, varying somewhat according to the relative strength of auto sales. Auto loans had accounted for 47 percent of instalment credit at the end of 1955, but this ratio declined gradually in the following 15 years, as other uses became more significant.

In the Federal Reserve instalment credit data the "all other" category totals over $80 billion and includes loans for non-automotive consumer durables, personal loans, and a variety of other purposes. Personal loans may be for any purpose, even to purchase autos or to rebuild liquid reserves depleted by such purchases.

Separate totals are published for a number of specialized types of instalment loans. Mobile home loans total $11.6 billion; home improvement loans over $8 billion. Outstandings on bank credit cards (almost entirely BankAmericard and Master Charge) now total $10 billion, after rapid growth, and bank check credit almost $3 billion.

Although further detail would be useful and interesting, the impact on consumer buying power is similar no matter what the purpose of the loan. Borrowing to purchase a sailboat, for example, may permit a consumer to use available cash to purchase appliances or furniture.

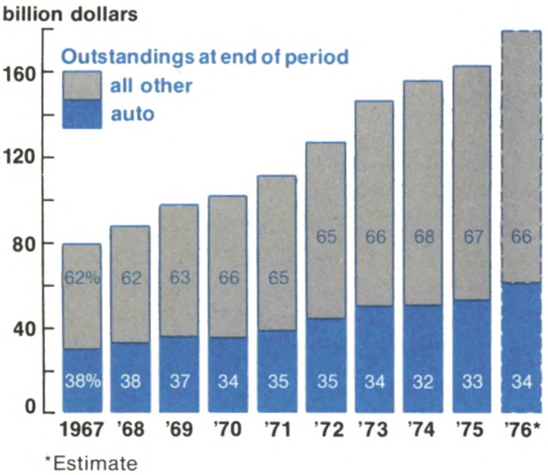
Banks main lenders

Commercial banks currently hold $84 billion of instalment loans, about 48.5 percent of the total outstanding. Finance companies hold 22.5 percent, credit unions 17 percent, and other lenders, mainly retailers, about 12 percent. These proportions have changed significantly through time. Most savings and loan associations are now permitted to make instalment loans, but their holdings are still relatively small.

At the end of 1955 commercial banks held 37 percent of all instalment loans. This proportion rose steadily in following years, reaching a peak of 49 percent at the end of 1973. Since then it has changed only slightly. However, shifts have occurred among other lender groups, with credit unions continuing to increase their share of the market.

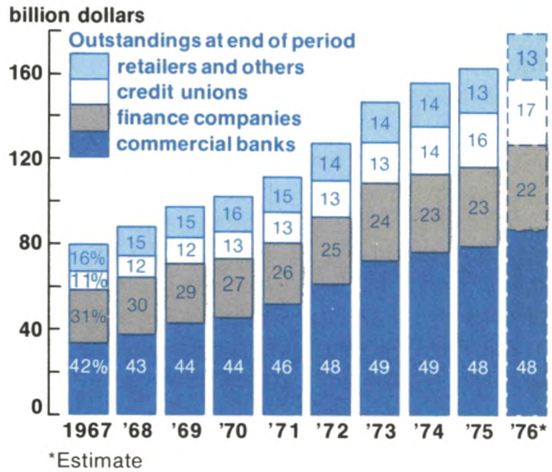
In recent years instalment credit has accounted for about 10 percent of total loans and investments of all commercial banks. This ratio varies greatly among

Auto loans are about one-third of total investment credit outstandings



*Estimate

Banks continue as leading holders of instalment credit



*Estimate

banks, however, depending on the degree of emphasis placed on "retail" banking and the extent to which downtown banks have branches, especially in outlying suburbs. Many banks have 20 percent or more of their loans and investments in consumer instalment loans, while others have less than 5 percent.

Large Weekly Reporting banks (over $100 million in deposits) currently hold instalment loans equal to 9 percent of their total loans and investments, not far below the ratio for all commercial banks. For Indianapolis Weekly Reporting banks this ratio is 14 percent, for Detroit 9 percent, for Milwaukee 8 percent, and for Chicago—with very large banks restricted from having outlying branches—it is only 3.5 percent.

Commercial banks are especially important in auto loans, holding almost 60 percent of total outstandings. Moreover, auto loans represent about 40 percent of all instalment credit held by banks. In addition, some bank holding companies own finance companies that make auto loans.

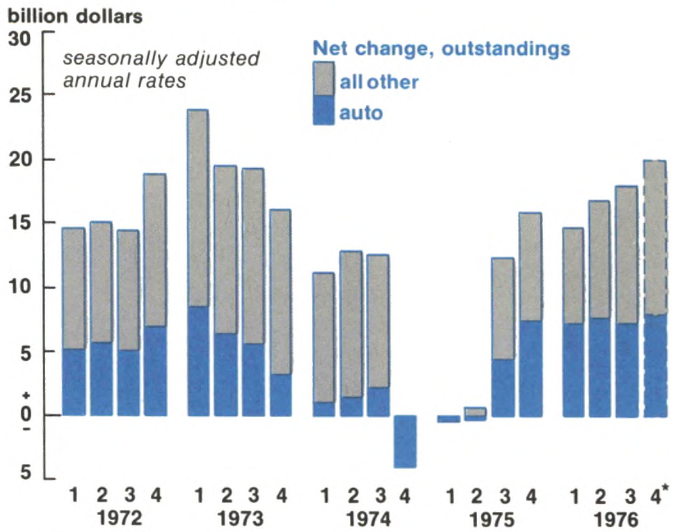
Auto paper held by banks includes direct loans and paper purchased from others, usually auto dealers or finance companies. From 1960 through 1965, 65 percent of auto loans held by banks represented purchased paper. Since then this proportion has declined—to 58 percent at the end of 1975 and to 56 percent at the end of September 1976. Direct lending allows banks to keep closer control over the credit they extend, with individual evaluation of each loan. Increasing concern over credit regulations relating to consumer protection has caused some banks to restrict the number of auto dealers, especially used car dealers, with whom they do business. Banks commonly make "floor plan" or inventory loans to car dealers from whom they purchase consumer instalment paper as the cars are sold.

Commercial banks also are important in personal loans, loans for home repair and modernization, loans to purchase mobile homes, and overdraft privileges in the form of revolving credit. They are the exclusive lenders on bank credit card debt, although savings and loan associations and credit unions may enter this field in the near future.

Finance companies' share declines

Finance companies held $38.6 billion of consumer instalment debt at the end of September. This was a record amount, up 7 percent from a year earlier. But the finance company share of outstandings has declined sharply in the past two decades. In the mid-1950s their share of the total was 41 percent and exceeded that of the commer-

Instalment credit has increased sharply since early 1975



*Estimate

cial banks. Currently, the finance company share is 22 percent. The decline in the relative importance of finance companies is most striking in the case of auto credit. Their share of auto loans was 53 percent in 1955. Since 1973 it has been less than 22 percent. The share of instalment credit held by the finance company group has been fairly stable for the past four years after the long decline. In fact, their share of auto credit has increased slightly this year.

The finance company group includes three very different types—"independents" (which may be subsidiaries owned by holding companies or other corporations), "captive" finance companies owned by the big auto firms, and "personal" finance companies, often called "small loan" companies. The Federal Reserve data does not provide breakdowns for these three types of finance companies.

Some of the largest independent finance companies withdrew almost completely from the auto credit field several years ago after having deemphasized this type of lending in the previous decade. They reported that other outlets for their funds, such as accounts receivable financing for business firms, offered better profit prospects. In contrast, the largest captives owned by General Motors (GMAC), Ford, and Chrysler have continued to play a vital role in auto credit, sometimes leading the way with innovations. They were formed for the very purpose of promoting sales of vehicles produced by their parent companies, and continue to devote most of their resources to this end. Personal finance companies have never played a large direct role in auto loans.

Credit unions surge

Credit unions have been one of the fastest growing financial institutions in the past two decades. There are over 20,000 such organizations with almost 30 million members operating under federal or state charters. Members or "shareholders" are united by a common bond, usually their place of employment or their membership in a labor union. Increasing about 15 percent annually in recent years, they now have almost $40 billion in assets. A prime outlet for these funds always has been instalment loans to members.

Credit unions currently hold $29.6 billion in instalment loans, 17 percent of the total. This ratio has grown steadily from less than 6 percent in 1955. Moreover, in the 12 months ending in September, they accounted for a third of the rise in total outstandings, compared to 43 percent for banks, and only 17 percent for finance companies.

The increased importance of credit unions as instalment lenders is especially significant in the case of auto loans. From 4 percent in 1955, their share of auto loans has increased to 19 percent, currently, compared to 59 percent for banks and 22 percent for finance companies.

The rise of credit unions has been facilitated by their tax status as cooperatives, by subsidies provided by sponsoring businesses or other organizations, and by their direct contacts with shareholders and borrowers. In certain industrial centers dominated by a single employer, the associated credit union may be the preeminent instalment lender. Credit unions have been expanding and diversifying their services to members. There is no indication that their share of instalment credit outstanding will not continue to rise.

Auto credit trends

About two-thirds of all new car sales are financed. Since the late 1960s auto loans have accounted for about 35 percent of total instalment credit outstanding. This proportion fluctuates somewhat with the strength of auto sales. In September, for example, auto loans accounted for 34.3 percent of all instalment credit, up from 32.9 percent a year earlier. This gain reflects both higher sales of new cars and higher prices. Unit sales of new cars in 1976 are expected to exceed last year by almost 20 percent and prices average about 6 percent higher, according to the consumer price index. Sales of light trucks, of which perhaps 40 percent are purchased by consumers, have been at record levels. Further substantial gains in sales of both cars and trucks are projected for 1977.

The average amount financed on new car loan contracts by major finance companies in June was $4,500, up 9 percent from a year earlier. The average amount financed has increased almost 50 percent since 1971, although the consumer price index for new cars rose only 20 percent in this period. The average loan-to-value-ratio has remained quite stable at 87 percent. Part of the difference between the rise in the amount financed on new cars and the rise in new car prices as measured by the consumer price index reflects adjustments made by the Bureau of Labor Statistics for equipment added to cars to improve safety and reduce emissions.

Prices of used cars of comparable ages have increased even faster than prices of new cars, partly because many buyers do not like various features added in recent years. In September the used car price index was 180 (1967=100), compared to 134 for new cars.

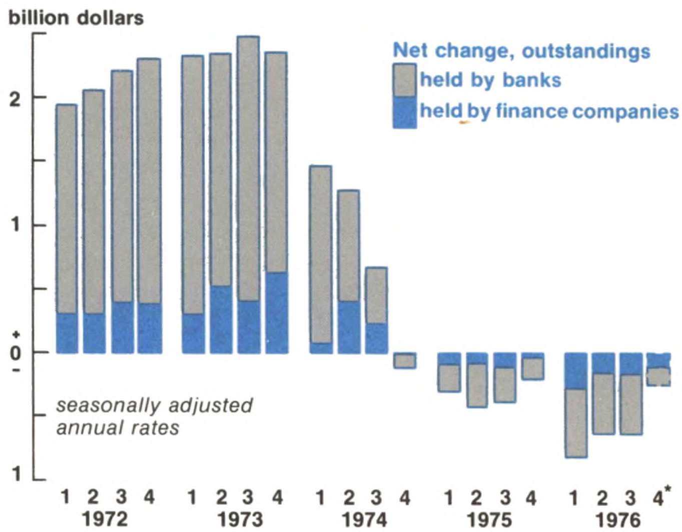
Higher prices for cars and other motor vehicles have helped promote a stretch-out of average maturities on new loans. A longer payment period, of course, reduces required monthly payments. Prior to 1955, 24 months was the typical maximum on a new car loan. Competition pushed this out to 36 months in the late 1950s. Until recent years the 36-month limit was rarely exceeded. Lenders feared still longer maturities would be too risky because the wholesale value of the cars might fall significantly below the outstanding loan balance before the payout period was completed.

Despite some qualms a trend toward 42-month loans and even 48-month loans or longer became apparent starting in 1974. In June of 1976, 33 percent of all new auto loans made by finance companies carried maturities in excess of 36 months. This compares with 25 percent a year earlier and 8 percent in June 1974. Banks have followed the lead of the finance companies in lengthening maturities on car loans, but this trend appears less marked in the Seventh District than in some other regions.

Mobile home loans decline

From mid-1971 to mid-1974 mobile home loans, carrying maturities of eight

Mobile home loans outstanding have declined since late 1974



*Estimate

years, and later 10 and 12 years, were one of the fastest growing classes of instalment loans. Although mobile homes provide permanent housing for most purchasers, the pattern of financing has followed closely the lines laid down by auto credit—including floor plan loans for dealers' inventories.

In mid-1971 commercial banks held $4 billion in mobile home loans and finance companies had $2.5 billion. By mid-1974 these totals had increased to $9 billion for banks and $3.5 billion for finance companies. By this time, however, disillusionment had set in. Many loans were foreclosed as owners abandoned or stopped payment on mobile homes in which they had little or no equity.

Mobile home shipments hit their peak level in 1972 and 1973 with factory shipments totaling about 570,000 each year. A decline already under way was accelerated by the 1974-75 recession. Shipments dropped to 330,000 in 1974 and 210,000 in 1975. This year has seen a partial comeback in shipments of mobile homes.

Outstanding mobile home loans at banks and finance companies began to decline in late 1974. The gradual decline continued through September of 1976 when outstandings totaled $8.3 billion at banks and $3.3 billion at finance companies.

Mobile home lending is expected to revive in time. Savings and loan associations may become more active participants in the market. However, these loans will be evaluated with greater caution and subjected to stricter standards than those employed by many lenders in the boom years.

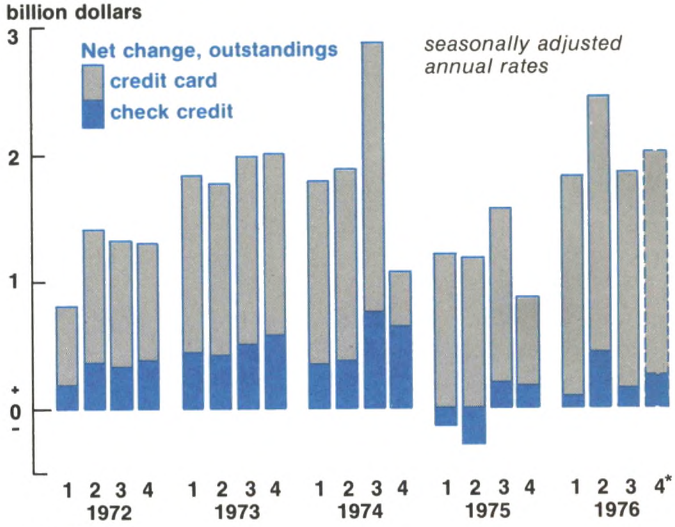
Credit card boom

Unlike mobile home loans, bank credit cards constitute an innovation in instalment credit that has continued to expand. Bank credit cards are not strictly instalment loans but "revolving credits," under which consumers can incur debts for purchases of goods and other purposes up to the limit of an approved line of credit.

Outstanding balances on bank credit cards, almost entirely BankAmericard and Master Charge, have increased steadily from $3.8 billion in early 1971 to over $10 billion in September 1976. In the 12 months ending in September outstandings rose over 17 percent, compared to an increase in total retail sales of about 10 percent. Purchases on bank cards this year will approach $26 billion, 25 percent more than in 1975.

Many bank credit card holders pay each month's billing in full within the prescribed period (usually 25 days from the billing date) and incur no finance charge. In these cases participating banks must

Bank credit card growth continues at rapid pace



*Estimate

look for their compensation to the commissions charged sellers of goods and services who honor the cards. If cardholders choose the alternative of paying a portion of the oustanding balance (usually a minimum of 10 percent), a finance charge is imposed, usually 1½ percent per month.

A growing number of consumers and sellers of goods and services have accepted the bank credit card as a convenient method of financing a variety of transactions. Some banks have joined these systems after observing developments over a period of years. Experience since 1971 suggests that bank credit card volume will continue to grow, probably at a faster pace than total consumer expenditures.

Interest charges stable

As interest rates in the money and capital markets have hit new highs in recent years rates on instalment credit have increased only slightly. In fact, these rates have not changed substantially since World War II. In part, state laws limiting rates charged consumers are responsible; but more importantly, relatively stable rates reflect the large share of the finance charge on typical instalment loans that must compensate lenders for the high cost of originating and administering these credits as opposed to prime business loans, or even home mortgages.

Interest on instalment loans is usually calculated on an "add-on" basis. The add-on rate is multiplied by the number of years and is included in the total credit extended. For example, a $5,000 loan for four years on a new car calculated using a 6 percent add-on rate involves $1,200 in interest payments over the life of the loan. Because the principal is paid down through the life of the loan, the average outstanding balance on the principal is only about $2,500. The calculated effective "annual percentage rate," therefore, is much higher than the add-on rate—just under 11 percent in this case, assuming monthly payments. Because it was thought that many consumers were misled by quotes of low add-on rates, the Federal Reserve Board's Regulation Z, promulgated under the Consumer Credit Protection Act (the Truth in Lending Act of 1968 and effective July 1, 1969) requires lenders to quote annual percentage rates and forbids quotation of add-on rates.

For August 1976, reporting banks charged an average of 11.07 percent on new car loans with 36-month maturities. This was slightly less than 11.31 percent in August 1975 but up from 10.02 percent in August 1972 when the series was started. Finance companies, on average, charge slightly higher rates on car loans than banks, but often provide longer maturities and/or larger loans relative to value. Rates on used cars charged by finance companies average almost 18 percent, about the same as on bank credit cards, and on non-auto consumer goods. Rates on small personal loans may range up to 36 percent, depending on state laws.

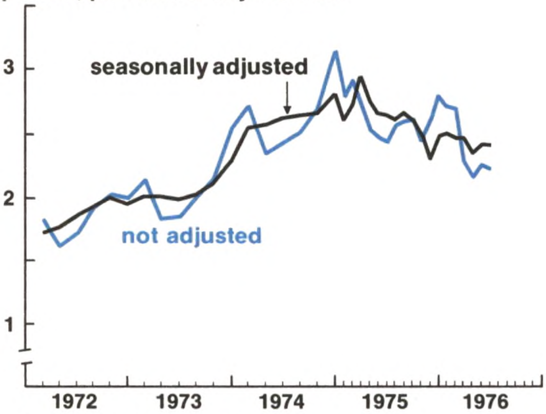
Delinquencies recede

Through the years the lenders' experience with consumer credit has been generally favorable, even in recession years. For example, repossession rates of 3 percent per year for cars or other vehicles are considered high. Consumers typically strive to maintain payments for fear of losing prized possessions. Lenders are also protected because risks are spread over large numbers of borrowers and by the fact that instalment loans, unlike some business loans, rarely involve continual renewals simply to avoid total loss. Of course, instalment loans must be monitored continually to maintain payments on a current basis, and this involves substantial costs to lenders.

American Bankers Association data show 2.2 percent of all instalment loans

Delinquencies decline in bank instalment loans

percent, past due 30 days or more



Source: American Banker's Association

held by banks to be more than 30 days delinquent as of midyear. A year earlier the ratio had been 2.6 percent, and in late 1974 it had reached 3.1 percent, partly for seasonal reasons but also because of the sharp recession. In the years 1970-72 the delinquency rate usually was under 2.1 percent.

Regulatory developments

In addition to Truth in Lending, previously discussed, Congress and various states have passed a number of laws in recent years to protect consumers in their dealings with creditors. Regulations and procedures are modified from time to time to bring instalment credit operations into closer conformity with the public will.

The National Conference of Commissioners on Uniform State Laws published the Uniform Consumer Credit Code (UCCC) in 1968 to replace the uneven structure of state laws. Several states have adopted the code, as amended, some with various changes.

In 1970 a federal law prohibited unsolicited distribution of credit cards and limited card holders' liability on lost or stolen cards. The Fair Credit Reporting Act, effective in April 1971, attempted to control use of incorrect or outdated information by credit agencies.

The Equal Credit Opportunity Act (ECOA) of October 1974 prohibits credit discrimination based on sex or marital status. The Federal Reserve Board's Regulation B—effective October 28, 1975, and since amended—implements this act. Amendments to the ECOA enacted in March 1976, to be effective March 22, 1977, prohibit credit discrimination based on race, religion, national origin, or age. Amendments to Regulation B further implementing the Equal Credit Opportunity Act currently are under consideration.

On November 14, 1975 the Federal Trade Commission issued its Trade Regulation Rule "Preservation of Consumers' Claims and Defenses," which limits the application of the "holder-in-due-course" doctrine. This doctrine prevents consumers from asserting claims or defenses relating to purchases against third parties who acquire their debts. The FTC's rule became effective May 14, 1976, and methods of implementing it are under discussion. Prior to 1975 more than 30 states already had restricted holder-in-due-course. In addition, the 1974 version of the UCCC effectively eliminates holder-in-due-course while simultaneously raising rate ceilings (in most states) to help lenders shoulder risks. Developments relating to third-party liability have caused many lenders to evaluate more closely the sellers from whom they buy paper and, in some cases, to increase use of recourse agreements.

In accordance with increased concern over consumer credit protection, the Federal Reserve Board and other federal regulatory authorities in early 1975 established divisions of consumer affairs to deal with complaints. Each Federal Reserve Bank has a section involved in this work. On October 5, 1976 the Federal Reserve Board announced the names of 25 persons who will serve on the Federal Reserve's new Consumer Advisory Council.

Credit use and confidence

Instalment credit expansion depends both on the willingness of lenders to lend and the willingness of consumers to borrow. The dominant factor usually is the consumer because relatively few households fully exploit their ability to incur instalment debt at a given time.

Total outstandings typically decline early in the year following the Christmas season, but, seasonally adjusted, extensions of instalment credit have exceeded liquidations almost every quarter since World War II except for brief recessionary periods.

Some instalment credit contracts are for only a few months, while others are for several years. The average maturity appears to be about one year because annual liquidations have about equaled average outstandings for the past decade. Instalment credit extensions include related finance charges as well as the amount financed. Liquidations include regular payments, advance payments (often from the proceeds of new loans), and charge-offs. Liquidations follow a fairly steady upward course. Fluctuations in the net change in oustandings, therefore, largely reflect changes in extensions, although in a much magnified form.

Instalment credit extensions rose from 10 percent of disposable personal income in 1950 to 14 percent in 1955. Declining in recession years, this ratio reached a record high of 18.3 percent in the first quarter of 1973 on an annual rate basis. It then declined to a low of 14.4 percent in the second quarter of 1975, before rebounding. In the third quarter of 1976 it was about 15.5 percent. Although credit extensions have been at record levels in 1976, they have been lower relative to income than in the 1972-73 boom.

The net change in instalment credit (the excess of extensions over liquidations, seasonally adjusted) expressed as a ratio to DPI is used by some analysts as a measure of consumer confidence, reflecting willingness to incur debt to satisfy wants. Recently this net change ratio has been about 1.4 percent, much less than 2.8 percent in the first quarter of 1973, but much improved from a *negative* 0.2 percent in the fourth quarter of 1974.

Consumers have the ability to expand their use of instalment debt substantially from recent rates. If optimistic forecasts for 1977 are realized, and consumer confidence strengthens, instalment credit extensions probably will expand, not only in dollars, but also in relation to income.

George W. Cloos
William R. Sayre

Excess of extensions over liquidations reflects consumer confidence