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FRATERNAL LIFE INSURANCE CONGRESS
INVITED TO SUPPORT VOLUNTARY CREDIT RESTRAINT

An Address by Oliver S. Powell, Member,
Board of Governors of the Federal Reserve System,
Before the National Fraternal Congress of America,
Chicago, Illinois.
September 26, 1951.

FRATERNAL LIFE INSURANCE CONGRESS
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Your program committee has asked me to discuss with you one very important part that is now going on in the fight against inflation. This fight has many aspects, but one in particular can only be carried out by private lending institutions, insurance companies, commercial banks, savings banks, savings and loan associations, finance companies, investment bankers and others. It is my purpose this afternoon to tell you something of this fight which has begun and which must be broadened this Fall and Winter if we are to do our part in this important campaign.

The nub of the inflation problem is that we are now facing rapid expansion in the preparation for national defense. A larger part of the nation's output will be channeled into defense production and will not be available for civilian purchase and consumption. At the same time our individual incomes are growing as we receive wages and other income arising from our share in putting out the goods. Thus, an inflation gap is created with more money to spend than there are civilian goods to be bought.

This inflation gap itself will create great pressure toward higher prices. There are two other pressures tending to raise prices in which financing institutions have a direct interest. The first is the use of savings to buy goods in this period of preparation for defense. The person who cashes savings bonds or draws down a savings account or borrows against the cash value of his life insurance is obtaining ready cash for spending which adds to inflationary pressures on prices. The second addition to inflationary pressures through financial means is through the medium of

borrowing. The individual, or the business firm or State or municipality which borrows to make current expenditures, is adding to the spending stream of dollars at a time when the supply of goods cannot keep pace. Some borrowing is essential. Firms engaged in the defense effort or in highly essential civilian production must borrow to manufacture. Cities with growing populations must frequently borrow for essential services such as sewer systems, but a large part of borrowing by the public is nonessential and should be postponed or set aside until the danger of inflation is past.

The fight against inflation must take place on many fronts. The principal counterattack against the inflationary gap due to the growing portion of the nation's production which is flowing into national defense must be the collection of adequate taxes. Government deficits should be kept at a minimum by Government economy and by the postponement of less essential public programs. Profit margins and wage increases should be held to sensible levels. Inventory and commodity speculation should be avoided. The public--individuals and businesses alike--should be encouraged to increase its savings. Finally, nonessential borrowing should be discouraged.

The Federal Reserve System has made important moves in the direction of discouraging credit expansion. Time does not permit a discussion of these moves except to mention their nature. They have included an increase in the discount rates in the Federal Reserve Banks, an increase in reserve requirements for member banks, the re-establishment of the consumer credit regulation, the institution, with the Federal Housing Administrator, of a real estate credit regulation, a tightening of margin requirements in the securities markets, and the use of federal open market powers to alter the market price of Government securities.

Today I wish to tell you about another phase of the campaign against inflation which is in the hands of private lenders and in which lending institutions can be valiant comrades-in-arms of the public authorities in this fight. This is the program for voluntary credit restraint authorized by Congress in the Defense Production Act of 1950 and re-authorized in the extension of that Act last Summer.

Under that Act and by direction of the President of the United States, the Federal Reserve Board, last Winter, worked out a program of voluntary credit restraint in consultation with a group of leaders in various kinds of finance. This program met with the approval of the Attorney General of the United States as required by the law and last March the Federal Reserve Board requested all lenders to accept the program and to live up to its principles. Every lending institution received a copy of this formal request and, as expediency required, various organizations of lenders have been requested to lend their support to the program.

The setup for administering the Voluntary Credit Restraint program is as follows:

The Federal Reserve Board has appointed a national committee of lenders--commercial bankers, savings bankers, savings and loan associations, insurance companies, and investment bankers--to study the inflation problem and to make recommendations to the Federal Reserve Board as to changes in the statement of principles governing the voluntary program. The National Committee also has two other functions--one is to interpret the statement of principles as it applies to special lending problems of national importance, the other function is to set up a regional organization of committees which in turn maintain contact with individual lending institutions.

These regional committees are in a large measure the working heart of the program. They are the committees which encourage the individual lenders to cooperate with the program and keep them informed as to desirable attitudes toward credit. They are also the groups from which individual lenders may obtain advice as to loan applications if they are in doubt as to whether such loans are desirable under today's conditions. Committees have been set up in various parts of the United States for these purposes-- a separate set of committees for each of the important kinds of lenders. In other words advice as to individual loans may be obtained from a group of lenders in the inquirer's own field of finance. These committees know the problems of their own lending field as well as the national inflationary problems and thus are in a position to give competent advice. At the same time I should emphasize the fact that the individual lender makes up his own mind as to whether or not to grant a loan. Neither the statement of principles sent out by the Federal Reserve Board, nor the interpretations of the National Committee, nor the advice of the regional committees is intended to override the judgment of the boards of directors and lending officers of financial institutions.

In effect the statement of principles of voluntary credit restraint injects an additional aspect into the decision as to whether or not to make a loan. Credit men have always screened loans as to soundness--that is whether the loan is likely to be repaid. Now financial institutions are requested to screen their loans as to purpose. Does the loan contribute directly to the defense effort? Does it assist in the production or marketing of essential goods? On the other hand, does the loan assist a purchaser to buy something which he does not need at the present time? Does the loan

assist in the production of some nonessential goods, structures or services? Finally, does the loan provide buying power with no increase in production? It is my firm belief that lenders who understand the inflationary problem under today's conditions and who have the national welfare at heart will have little difficulty in deciding which loans to make and which to set aside under the recommended screening process of the voluntary credit restraint program.

The National Committee has expressed its views as to the voluntary restraint of credit in a number of fields, many of which are of direct interest to insurance companies. Here are a few examples:

In its second bulletin, the National Committee pointed out, last Spring, that plans for plant expansion appeared to be larger than the available materials and employment to carry such plans during the current year. Thus it seemed essential that credit institutions should exert their influence to see that only essential plant expansion was adequately financed while nonessential plant expansion would be postponed if it required the use of borrowed money.

In its third bulletin, the National Committee requested lenders to screen loans to states and municipalities so that credit flowing to them would not be used for nonessential purposes no matter how worthy such projects might be under ordinary conditions. Simultaneously, the Director of Defense Mobilization directed a letter to all Governors of States and Mayors of principal cities requesting them to use their influence against borrowing for nonessential purposes such as war memorials, recreational centers and soldiers' bonus issues.

In its fourth bulletin, the National Committee expressed its views as to the lending standards of real estate loans desirable to hold down inflationary pressures in that field. Separate recommendations were made as to residential real estate loans, commercial real estate loans and industrial and farm real estate loans.

The program of voluntary credit restraint, working hand in hand with the controls instituted by the Federal Reserve Board has had a large measure of success. Corporate and municipal securities issues in recent months have been limited almost entirely to the financing of essential projects. The loans of the larger commercial banks have shown less than the normal seasonal expansion since mid-summer. An analysis of the loan expansion at banks shows that the increases have been principally in loans to firms directly connected with defense, metal working, public utility, oil, etc., or in loans to commodity dealers and food manufacturers to finance the new crop.

I regret that I cannot report to you statistically the progress being made by the life insurance industry in cooperating with the voluntary credit restraint program. A number of the larger life insurance companies have recently begun reporting their new acquisitions of securities and certain types of mortgages and their commitments for future purchases. Our experience with these figures is so short that I cannot interpret them for you in the light of the voluntary credit restraint program as yet.

The real purpose of my appearance before this convention today is to relay to you a cordial invitation for your association to come to the active support of the voluntary credit restraint program. I know that individually your institutions are supporting the program, but there is much

that your organization can do. At the meeting of the National Voluntary Credit Restraint Committee on September 5, I was authorized, by unanimous vote, to issue you this invitation. I am looking forward with great pleasure to the privilege of requesting representative members of your organization to serve actively on the working committees of the voluntary credit restraint program.