

MAY 1953

business review



FEDERAL
RESERVE BANK OF
PHILADELPHIA

FREE MARKETS AND THE FEDERAL RESERVE SYSTEM

In a free-market economy, where the consumer is king, the problem of maintaining balance between spending and output is acute. The Federal Reserve works to achieve this goal in a manner consistent with preservation of economic freedom.

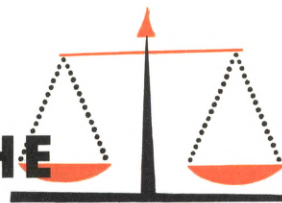
MEN AND MONEY ON THE MOVE

Since the early 1940's, many shifts in population and deposits have occurred among Third District counties. Here are the trends.

CURRENT TRENDS

Today's record output of automobiles carries a lot of weight in the current high rates of production, employment, and income.

FREE MARKETS AND THE FEDERAL RESERVE SYSTEM



The recent relaxation of direct controls on prices, wages, and output, coupled with the impending reduction of Governmental expenditures on national defense, poses a question of crucial importance to all citizens of our democracy. Can a free-market economy such as ours continue to function at high levels of output and employment even though the artificial prop of defense spending is removed or reduced?

The answer to this critical question lies in the future. But the threat to the existence of our way of life which is embodied in the spread of Communism makes it imperative that we as individuals recognize both the strengths and weaknesses of a free-market economy so that we can take steps to reinforce the strengths and eliminate the weaknesses. The purpose of this article is to present briefly a picture of the free-market mechanism and to discuss the role of the Federal Reserve System in a society of this type.

The economic problem

An economic system—whether it be capitalism, fascism, socialism, or communism—is the procedure that people follow in using limited resources to satisfy unlimited desires. The economic problem confronts the individual as well as society as a whole. The housewife, for example, faces the continuing problem of living within her budget; thus she must be economical.

The businessman is in essentially the same position—he realizes that his funds are not unlimited and he must therefore economize. First things come first and the less essential expenditures must be deferred in favor of those which are more pressing.

In society as a whole the economic problem arises from the fact that human wants are, for all practical purposes, unlimited while the means of satisfying these wants are relatively scarce. The available means are sometimes referred to as our total economic resources or the factors of production. They consist of natural resources, producers (both workers and management), and plant, equipment, and inventories (capital goods which have been produced in the past and are used for current production). The economic problem, simply stated, is to use these scarce factors so that they will yield a maximum satisfaction of human wants.

Once the nature of the economic problem is grasped another difficulty becomes apparent. Who is to decide when maximum satisfaction prevails? Phrased differently, the question is one of what and how much of any given economic good will be produced. To a large extent, the way in which this question is answered determines the type of economic system. Under some systems, the decision is made by the State; under ours, however, the decision is made primarily by the consumer. If satisfaction of human

wants is the ultimate goal, only the consumer can say when he is most satisfied.

The consumer is king

If the consumer calls the signals as to what and how much is to be produced, the consumer is king in the economic system. This conclusion has some far-reaching ramifications. In the first place, the fact that the consumer decides what is to be produced means that he is at the same time directing our economic resources into the channels of his choice. He is, in effect, performing the crucial function of allocating these resources among the millions of competing uses. In the second place—and this brings us to another distinguishing characteristic among economic systems—the consumer can perform this function only if he has some means of transmitting his wishes to producers. In a free-market economy this is accomplished through the price mechanism.

The free market

Markets are free when buyers of goods and services are free to get together with sellers to buy, sell, trade, haggle and, in general, do pretty much as they please in attempting to maximize their own positions. There is, of course, no such thing as an absolutely free market. The fact that some people refuse to accept the responsibilities that must accompany freedom requires that society intervene when the rights of some groups are threatened. A variety of legislation has been set up for this purpose. Nevertheless, individuals still conduct their economic affairs under generally free conditions. In our economy the free market is the rule and the controlled market the exception.

The focal point in any free market is price; it is through the price mechanism that the consumer exercises his sovereignty over the alloca-

tion of resources. To see how this works, let us take as an example two economic goods, “widgets” and “gadgets.” What happens if people, for some reason, want more widgets and fewer gadgets? They express this change by spending more on widgets and less on gadgets. If the markets for these commodities are free, the price of widgets will tend to rise while the price of gadgets falls. These price changes will make it profitable for producers of widgets to step up their output, and this will require that they bring more resources into their industry. In the gadget industry, opposite tendencies are at work. The decline in demand, if expected to be permanent, will reduce profit potentialities and induce producers to release resources. Thus the extra resources which are needed in widget production tend to shift from the gadget industry—and the desire on the part of consumers is fulfilled. In other words, consumer demand determines how our resources shall be used.

A prime advantage of the market mechanism

It is not strictly true . . . that in our complex world we can have absolute freedom in human affairs. The goal of the greatest good for the greatest number requires as a minimum a Government of laws, and, human nature being what it is, that means some regulation of our daily lives. There is this minimum in monetary management. Nevertheless, the aspiration remains to have as much freedom of choice and action as is compatible with the common good. This is true in economic as in other affairs.

WILLIAM McC. MARTIN, Jr., Chairman,
Board of Governors of the
Federal Reserve System

is that it is impersonal. It is obvious that so long as we have free choice on the part of consumers—that so long as the consumer is king—adjustments will have to be made which are painful for certain groups. But these adjustments can be avoided only by forfeiting free choice. It is therefore much better that such adjustments be made through an impersonal market mechanism rather than through the decisions of a Government agency.

Interference in the market

What happens when we interfere with the operation of the market and the price mechanism? During periods of national emergency we have at times suspended the operation of the price mechanism in certain markets by introducing direct controls over prices and output. During such emergencies the ideal of allocating resources in accordance with free consumer choice has been modified to meet pressing immediate ends. At other times, we have supported the prices of some goods, particularly agricultural commodities.

To illustrate the effects of such actions, let us assume that the Government decrees that the price of widgets shall not be allowed to fall below the level currently existing in the market. If consumer demand and the conditions of production do not change, the Government's action will have no especial economic effect. But consumers are fickle; and price supports are not likely to make their wants more stable. Suppose, therefore, that despite price support the demand for widgets declines. The reduced expenditures by consumers are not permitted to be reflected in a drop in price. The consumers' signal to curtail output is not received by the producer, who continues to produce widgets as before. As a result, excess supplies build up and the Government is forced to supplement consumer demand

to remove the excess widgets from the market. Thus widgets accumulate in Government warehouses and, in all probability, direct controls over output will be established in order to curtail the supply.

A price-support operation of this type is significant for several reasons. Most important, however, is the fact that the preference of consumers to shift resources out of widget production has been ignored and free choice no longer prevails. The consumer is no longer king.

Establishment of price ceilings would tend to have the opposite effects. Price would not be allowed to rise in response to increased demand, and thus extra resources would not be drawn into the widget industry. Excess demands would build up, giving rise to black markets, deterioration in quality, and the necessity for devising a system of rationing in order to achieve equitable distribution of widgets. Again consumer preferences are ignored and free choice is impaired.

The big picture

It is apparent that in spite of the frictions and imperfections which exist, the market mechanism will, if allowed to do so, tend to allocate economic resources in accordance with consumer desires. We like this system because it is we consumers who run the show. And history proves that it works pretty well in practice over wide segments of the economy, except where there is a tendency toward monopoly.

When we transfer our attention from the problem of allocating resources among different industries to the efficient use of all our resources, certain difficulties arise which threaten to destroy the whole system. These difficulties involve the problem of inflation and deflation or boom and depression, and it was the tendency for these fluctuations to occur which led Karl Marx to

predict over one hundred years ago that the capitalistic system would ultimately destroy itself.

Inflation and deflation

Why is it that the price mechanism works fairly well where individual commodities are concerned but often breaks down in the case of total demand (spending) and supply (output)? Basically, the answer lies with the decisions made by the three important groups of purchasers in our economy—consumers, business, and government. When these groups increase their total spending faster than we increase the output of goods and services, prices tend to rise and we have inflation. When spending contracts in relation to output, prices tend to fall and we have deflation.

It might seem that an expansion of spending would be offset by an automatic increase in output (as was true in the case of widgets when demand rose) which would prevent a rise in the price level. This may well occur when there are sufficient idle resources to permit an over-all increase in output. But when we have relatively full employment of economic resources, output can expand only by small amounts and at a limited rate. When total spending contracts and prices in general tend to decline, however, there is nothing to prevent producers from releasing resources and reducing output. These actions, as discussed below, will tend to cumulate and if allowed to proceed far enough, may pull the economy into a full-scale depression.

The flow of money

We can gain an understanding of the forces leading to inflation and deflation by observing how money flows through the economy. The flow is roughly circular. Purchasers (consumers, business, and government) receive incomes from

production (or taxes, in the case of government) and in turn spend these incomes on the goods and services which are produced. Thus money flows in a continuous stream, and it is the size of the stream relative to the flow of goods and services which is important to economic stability. Since the total of incomes generated in production is just equal to the value of the goods produced, the price level need not rise or fall if income recipients spend all of their incomes. This does not mean that saving does not take place, because savings may be used to purchase capital goods. Thus savings which are invested remain in the money flow and exert the same effects on the price level and total output as that portion of income which is not saved but is spent on consumption goods.

The flow of expenditures may expand or contract relative to the flow of goods and services because people may spend either more or less than the total of their incomes arising out of current production. The likelihood of these occurrences depends primarily on the decisions of spending groups to hoard or dishoard, to reduce their indebtedness to banks or go deeper into debt to banks.

Hoarding and dishoarding

Hoarding is usually thought of as the placing of currency in a coffee can or under the mattress. This is indeed hoarding but, except in crises, it is not the most important form in an advanced credit economy such as ours. Most hoarding takes the form of idle bank deposits. It is not, of course, the banker who does the hoarding; it is the depositor. A moment's reflection on what would happen to the flow of money if all depositors were suddenly to cease writing checks will indicate what is meant by saying that deposits can be hoarded. Such hoard-

ing may be thought of as a decline in the velocity or rate of turnover of the existing money supply.

When people hoard they do not spend. In effect, dollars which they receive as income are withdrawn from the spending stream and accumulate in a "stagnant pool." People who hoard are actually saving, but since the savings are not invested the money flow tends to diminish. Incomes are reduced, prices decline, output is curtailed, incomes fall further, hoarding may be stimulated even more (people tend to withhold expenditures in anticipation of lower prices), and so on until finally the economy finds itself in an economic depression.

People can make the opposite decision and dishoard; funds set aside from past income are activated and sent into the spending stream. In this instance the velocity of circulation of the money supply increases, prices and incomes tend to rise, and so on. If idle resources are available so that output can be increased, the increase in spending may be offset by a greater flow of goods and services. After idle resources are exhausted, however, the increase in spending is likely to be dissipated in higher prices. As the spiral continues, dishoarding is stimulated even more (people tend to speed up expenditures in anticipation of higher prices) and the inflationary bubble may continue to swell until it bursts.

Net reductions and increases in bank credit

The flow of spending may be altered not only by changes in the speed with which an existing stock of money is spent, but also by changes in the quantity of money. Since most of our money is in the form of bank deposits, it is important to describe how the volume of deposits changes.

Banks are essentially dealers in debts. Most of their assets are debts owed to them in the form of loans and investments. Most of their liabilities are debts to customers in the form of deposits. It is important to remember that most of the activity of banks is reflected in changes *within* these accounts; new loans are extended, old loans are repaid; new investments are bought, old ones are sold or mature; some deposit accounts are being enlarged, others reduced. Our interest, however, is not in the offsetting changes within the several accounts but in the *net* effect of all transactions, particularly in how they produce changes in the total volume of deposits. We can trace such effects by analyzing what happens when customers as a whole borrow more than they repay and when they repay more than they borrow.

Typically, of course, customers borrow deposits and repay by writing checks on their deposit accounts; so that a net increase in loans results in an increase in deposit totals and net repayment of loans results in a reduction of deposit totals. It is apparent that when the net effect of the decision of the lending staff of the bank and of the borrowing customers is to increase the volume of loans, deposits will increase also; and when the net effect is to reduce loans, deposits will decline also.

Since purchases of goods and services are influenced by the amount of money available for spending, a rise in bank lending will tend to increase spending and a fall will tend to reduce spending. As in the case of hoarding and dishoarding, an initial move in either direction tends to feed on itself. A reduction in bank lending tends to reduce spending which leads to lower prices and, in turn, to further reductions in bank lending. Similarly, an initial increase in bank lending tends to reinforce itself.

The role of the Federal Reserve System

The preceding discussion reveals the nature of the dilemma that confronts us. On the one hand, we favor an economic system in which freedom of choice prevails and in which the basic economic decisions are made by individuals. In such a system, consumer desires, working through the price mechanism, guide the allocation of our economic resources. On the other hand, such a free-choice society may be susceptible to wide swings in total economic activity—swings which we cannot allow to take place if the system as we know it is to survive.

This is where the Federal Reserve System enters the picture. In the words of William McC. Martin, Chairman of the Board of Governors of the Federal Reserve System, “the long-run purpose which the System seeks to further is to minimize economic fluctuations caused by irregularities in the flow of credit and money, foster more stable values, and thus make possible the smooth functioning of monetary machinery so necessary to growth of the country and to improve standards of living.” Mr. Martin is careful to point out that even though it is not sufficient, credit and monetary policy is an indispensable element in the achievement of stable progress.

The credit market

The Federal Reserve System, in attempting to maintain balance between spending and output, operates through the credit market. The credit market is much like any other market. The same three groups of purchasers referred to earlier want credit. Consumers want it to pay current expenses, to purchase durable consumer goods such as automobiles, television sets, and refrigerators, or possibly to finance the purchase of a home. Businesses borrow money both for working capital and for long-run expansion of plant

and equipment. Government (Federal, state, and local) is continually in the credit market either to raise new money or to refinance outstanding debt.

There are two major sources of credit. One is saving, or that portion of the income which is not currently spent on consumption. Some of these savings are invested directly by the savers themselves; this is true of most business savings. Most of them, however, flow through the large institutional investors such as insurance companies, savings departments of commercial banks, mutual savings banks, and savings and loan associations. The other source is, of course, commercial banks which, when reserves are available, have the power to create deposits which are lent to the spending groups.

To a borrower it makes little difference whether the funds are supplied by an increase in total bank loans, by a repayment of other bank loans, or by saving from income. But there is a big difference from the standpoint of economic stability. Credit supplied from savings or repayment of old loans involves no creation of new money; there is merely a transfer from people who were borrowing or who have income which they do not wish to spend in the present to people who need funds for spending. Additional credit supplied by commercial banks, as noted earlier, involves the creation of deposits. Thus a net increase in bank credit contributes to inflationary pressures, and a net decrease exerts deflationary forces.

Finally, the credit market is much like any other market in that it has a price—in this case, the interest rate. The interest rate, as the price of credit, reacts to the forces of supply and demand in much the same way as the price of widgets or the price of gadgets. When the demand for credit increases relative to the sup-

ply, the interest rate rises, and when supply increases relative to demand the interest rate falls.

Bank reserves and credit policy

The Federal Reserve System can do little directly to influence the amount of hoarding or dishoarding, although, as will be pointed out, its operations may have considerable effects indirectly. The chief statutory responsibility of the Federal Reserve is to influence the lending activities of commercial banks. This influence is exerted primarily through control over the terms on which it will make funds available.

If a commercial bank wishes to increase its loans, it must either have excess reserves (surplus cash) on hand or be willing to meet the conditions to acquire reserves in order to meet the withdrawal that normally follows the extension of credit. The cost, availability, and supply of reserves are affected by the ways in which the Federal Reserve uses three primary instruments of credit control—discount policy, open market operations, and reserve requirements.

Federal Reserve authorities can make reserves either more or less expensive by varying the discount rate, which is the price charged on loans to member banks. Or the Federal Open Market Committee can create or destroy reserves by buying or selling Government securities in the open market. When securities are purchased, the Federal Reserve pays for them with a check which the Government security dealer deposits in his bank. The bank sends the check to its Reserve Bank for collection, and its reserve account is increased by the amount of the check. A sale of securities by the Open Market Committee has the opposite effect. Finally, by raising or lowering reserve requirements, or the portion of their own deposits that member banks must

hold on deposit at the Reserve Banks, the Board of Governors can directly increase or decrease the volume of reserves available to banks for lending.

Credit policy and the flow of expenditures

When inflationary pressures are dominant, the Federal Reserve uses its instruments to curtail the expansion of bank credit and to stabilize the flow of money relative to the flow of goods and services. In particular, the discount rate may be raised, securities may be sold in the open market, and reserve requirements may be increased. (This last power is limited by statute; requirements are currently at or near the legal maximum for most banks.)

These actions will be effective in several ways. A tight money policy of this type, which increases the cost and reduces the availability of bank reserves, will tend to cause an increase in interest rates. This means that it costs more for borrowers to obtain funds and thus tends to reduce the amount of credit demanded. Even more important, however, is the fact that banks upon finding their reserves in short supply will become more cautious in lending. In particular, they will screen their loans more carefully and decline the riskier applications. The bankers, in effect, ration the reduced supply of funds which is at their disposal. This of course tends to reduce spending.

With higher interest rates, saving will be more attractive also; but this effect may be small. Indirectly, however, an effective anti-inflationary credit policy can do much to stimulate saving. A major factor which tends to reduce saving is the expectation of higher prices. To the extent that an aggressive credit policy contributes to a reduction in this expectation, saving will tend to be stimulated. Thus Federal Reserve

policy may be quite effective in respect to saving and dissaving, hoarding and dishoarding. If saving is stimulated, more of the funds demanded by spenders will be transfer funds (from savings), as contrasted with created funds (from banks). This reduces inflationary pressures.

When deflationary forces tend to dominate the economic scene, Federal Reserve policy will be the reverse of that described above. Much has been written about the ineffectiveness of credit policy during *depression*, and there is much truth in the argument. But the inference that for the same reasons credit policy (when properly conceived) is ineffective during a *recession* is open to question. A study of history indicates otherwise. The emergence of deflationary forces calls for purchases of securities by the Reserve Banks, lowering of the discount rate, and relaxation of reserve requirements. These actions tend to ease credit conditions—interest rates fall and credit is easier to obtain. Spending with borrowed funds is thereby made more attractive.

The need for flexible interest rates

This description of the way in which Federal Reserve credit policy operates brings out an important point. Federal Reserve policy cannot be fully effective unless interest rates are flexible. There are two reasons for this conclusion. First, it was pointed out that credit control operations tend to increase or decrease market rates, and these increases and decreases affect the demand for lendable funds and, to a lesser extent, the sources of supply. If market rates are not permitted to fluctuate as credit policy changes, however, these effects will not be realized. Second, and much more important, is the fact that the pegging of interest rates at a predetermined level (such as the par rate on Government securities) transfers control over reserves from the

Federal Reserve to holders of Government securities. This results from the fact that the technique of keeping interest rates down (security prices up) is for the Federal Reserve to purchase all securities offered at the pegged prices. An example will help clarify this point.

During most of the period from 1942 to 1951, the Federal Open Market Committee followed policies designed to keep rates on Government securities from rising above certain levels. The selected levels varied as to maturities and over time. For example, rates on the shortest term instruments (Treasury bills) were allowed to move upward on a “stair-step” basis. The support levels for the longest term bonds were somewhat above par until December 1947, at which time they were lowered to just above par (a yield of about 2½ per cent). During the war period proper, the purpose of the policy was to facilitate financing the war, and it was eminently successful in this respect. Afterwards, support operations were prompted by the fear of precipitating a panic in the market for Government securities and a desire to assist the Treasury in managing the public debt.

But the more effective the support policy was in facilitating Treasury operations the more it hampered the System’s ability to dampen the strong inflationary pressures which were present during most of the post-war period. Of the three major spending groups, only government was living within its income during most of the period. Consumers and business were spending heavily. At first, they drew upon their wartime accumulations of liquid assets. Later, they sought credit to support their expenditures. Under normal conditions, the Federal Reserve would have made this credit more expensive and harder to get by keeping a fairly tight rein over bank reserves. But in following its policy

of supporting the price of Government securities the Federal Reserve made new reserves available on what the market considered to be very easy terms. Banks, insurance companies, and other lenders sold their Government securities to the Reserve Banks, excessive spending was encouraged, and the dollar shrank in value.

The Treasury-Federal Reserve accord

In a recent public statement, Chairman Martin referred to the accord between the Treasury and the Federal Reserve System which was reached in the spring of 1951 as a landmark in monetary history. The major result of this agreement was to remove the pegs from the prices of Government bonds. Removal of the pegs enables the Federal Reserve to follow policies of expansion, restriction, or neutrality as the situation warrants. Under present conditions, the Federal Reserve instead of buying or selling securities in order to stabilize their prices can engage in open market operations for the purpose of affecting banks' reserves and, in the manner indicated above, the volume of lending and expenditures. In effect, the Federal Reserve has regained control over the money supply.

The past two years

Credit demands have continued at a very high level since the accord was reached, but at the same time the Federal Reserve has held bank reserves in check. As a result, interest rates have risen substantially and bond prices have declined. At the same time, individuals and businesses have maintained a high rate of saving. Thus a large portion of the high demand for credit has been satisfied through the transfer rather than the creation of funds.

The record shows that spending and output have been fairly well in balance during the period since the accord. Consumer prices have

risen only slightly and wholesale prices have declined. Production has risen considerably, thus contributing to a rising standard of living while at the same time providing large quantities of goods and services for national defense. The experience lends support to the judgment that Federal Reserve policy since the accord, although certainly not solely responsible, has helped in the attainment of the high level of economic activity under conditions of stable prices.

Direct vs. indirect controls

The influence over the total volume of expenditure exerted through Federal Reserve policy is to be contrasted sharply with the direct control over prices and output referred to earlier. The Federal Reserve is not concerned with the price of widgets relative to the price of gadgets, nor does its primary task involve the allocation of resources among the millions of competing uses which exist in an advanced industrial economy. The price of widgets relative to the price of gadgets and the ultimate allocation of economic resources is properly influenced by the decisions of millions of individuals living and working in a free market. The Federal Reserve is obliged, however, to concern itself with the problem of the full use of economic resources and stability of prices in general. As we have seen, it attempts to promote these ends by influencing the cost, availability, and supply of credit. It is true that the Federal Reserve is interested in the price of credit, or the interest rate. But even here its primary concern is with the over-all flow of credit, with the interest rate free to rise or fall as conditions in the credit market tighten or ease.

The Federal Reserve is not only consistent with the free-market approach to the solution of the economic problem; it is essential to it. For if we are unable to prevent inflation and

deflation, the chances are that we shall not be able to keep free markets. If we can avoid booms and busts, however, we can then create a favorable environment in which the free market can

work. Then we can have the best of two worlds—the freedom that has long been the tradition of the American economic system and stability at high levels of economic activity.

MEN AND MONEY ON THE MOVE

People and dollars usually do not stand still—at least not for long periods of time. Not only do they move from place to place but as they increase in numbers they accumulate in some places faster than in others.

This is especially true when abnormal economic conditions prevail, such as those engendered by war and inflation. During times of war, the nation is patriotically driven to employ its resources to the fullest for self-preservation. Money, including deficit dollars created to finance the effort, allocates some resources. Controls allocate others. As for manpower, not only do workers and their families move to highest paying markets but the rapidly expanding supply of dollars accelerates their movements as bidding rises within limits set by temporary controls for labor's services. Inflation, which intensifies the ability of money to bid, causes additional aberrations in the market place. Some of these changes tend to become permanent.

Recently an increasing number of signs have led some observers to believe that the economy is settling down. Markets are freer, competition stronger. Prices, though steadier, are being maintained not by edict but by more natural (and therefore more sensitive) forces of demand and supply. We have had some rolling adjustments

in industry and agriculture; others may occur. The successive waves of war financing and private debt expansion, which pushed the money supply two and a half times as high as in 1941, have subsided. Member bank reserves, which make deposit expansion possible, are not being enlarged by the Federal Reserve except for seasonal needs of business and agriculture and to meet the long-run growth of the economy.

County trends

This means that the time may be appropriate for bankers and businessmen to take a look at some of the trends which have developed county by county in the district since we entered World War II. This article will focus particular attention on (1) the trend of population in the sixty counties of the district from 1940 to 1950, (2) the trend of deposits* by counties from the end of 1941 to mid-1952, the latest date for which county figures are available for all types of banks, and (3) shifts in ownership of demand

* "Deposits" in this section include demand and time deposits of individuals, partnerships, and corporations in all banks (commercial, mutual savings, and other types combined) and exclude inter-bank and governmental deposits. Deposit data by counties, states, and Federal Reserve Districts are taken from a compilation published at irregular intervals by the Board of Governors of the Federal Reserve System with the cooperation of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, state bank supervisory authorities, and the Federal Reserve Banks.

deposits. Where people and dollars have been going since the early 1940's, and how fast, is useful information to bankers and businessmen interested in consolidating their positions for the future.

To the banker, awareness of longer-term trends in population and deposits in his county contributes to his confidence in carrying out the three-fold responsibility of protecting depositors' funds, providing sound credit and banking services, and operating profitably for stockholders and staff. More specifically, awareness of trends can help direct his loan and investment policies along sound lines.

To the businessman—whether farmer, manufacturer, wholesaler, or retailer—the shifting of people and deposits have a bearing on his markets, labor supply, plans for expansion, consumer preferences, and on many other estimates and decisions which mold his efforts.

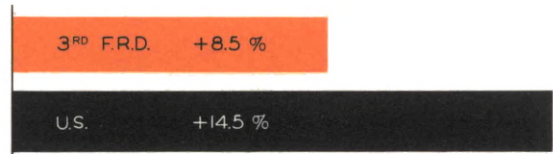
District growth has been slower . . .

The over-all picture shows that the growth in population and in deposits of individuals and corporations since about the time the United States entered World War II has not been so great for the Third Federal Reserve District as for the country as a whole. The Third Federal Reserve District includes the three counties of the state of Delaware, the nine counties which make up the southern half of New Jersey, and the forty-eight counties in the eastern two-thirds of Pennsylvania.

As indicated in the chart, the number of people in this area increased about three-fifths as fast as in the United States between 1940 and 1950, and bank deposits rose about four-fifths as fast as in the country from December 31, 1941 to June 30, 1952. By 1950, there were 14.5 per cent more people living in the United

POPULATION

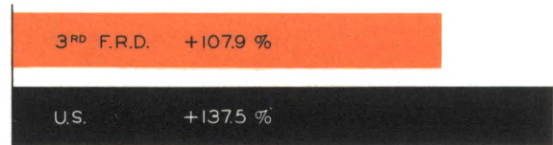
1940-1950



In this district, population increased about three-fifths as fast . . .

DEPOSITS

December 31, 1941—June 30, 1952



. . . and deposits, four-fifths as fast as in the country

States than in 1940; in this district, 8.5 per cent more. The tremendous rise in bank-financed debt between late 1941 and mid-1952 increased deposits 137.5 per cent in the nation compared with 107.9 per cent in this district.

. . . but growth varied widely in the district

On a state-by-state basis, however, taking into account only those sections of New Jersey and Pennsylvania in this district, changes in population and deposits varied widely. Southern New Jersey saw the greatest growth in both population and deposits. It had 20.9 per cent more people in 1950 than in 1940, and 163.7 per cent more dollars on deposit in its banks by mid-1952 than at the end of 1941. In 1941, it held about 8 per cent of the deposits of the district and in mid-1952 about 10 per cent. Percentage-wise, more people moved into the southern half of New Jersey during the decade of the 1940's than into the northern half of the state.

Delaware, on the other hand, though increasing in population faster than the national average—19.4 per cent against 14.5 per cent—had a much slower rate of increase in deposits than either the national or the district average. Its deposits went up 85.6 per cent, those in the United States rose 137.5 per cent, and in the district 107.9 per cent. The reason for Delaware's slower rate of deposit change was that New Castle County, which holds about 83 per cent of the deposits in Delaware, had next to the lowest rate of growth among the sixty counties of the district—76.2 per cent—and of course heavily weighted the picture for that state.

As for that section of Pennsylvania in the Third District, population increased slower than for the district and less than half as fast as for the United States. Deposits in this part of Pennsylvania slightly more than doubled from the end of 1941 to the middle of 1952. Because banks in this section of Pennsylvania hold about 84 per cent of all deposits in the district the rate

of change in this area just about determines the rate of change for the district. To go one step further, since \$42 out of each \$100 on deposit in district banks are held by the banks in Philadelphia County, the trend in Philadelphia governs, to a large extent, the trend of deposits in the district. And deposits in Philadelphia County have risen at a relatively slow rate—78.5 per cent compared with 137.5 per cent for the United States. In 1941, about half of all deposits of businesses and individuals in this district were held in Philadelphia County banks; by mid-1952, this proportion had declined to about 42 per cent.

People on the move

The map on page 14 shows where people have been increasing in numbers most rapidly in this district since the 1940 census. In general, they seem to have been drawn in greater numbers from the mountainous sections of the district to the Delaware valley and to the flatlands and coastal areas of New Jersey and Delaware.

There are exceptions, of course; for example, in Cumberland County, Pennsylvania, large military and naval establishments have provided workers with hundreds of jobs and the banks and other financial institutions, progressing with the area, have provided the funds for people to build and buy homes. In Centre County, in central Pennsylvania, 43.4 per cent more people were employed in 1950 than in 1940 as the number of manufacturing establishments increased from 52 to 76 and older firms grew larger. Demands of a rapidly expanding student body attracted people to the borough of State College.

With these two exceptions, the counties which grew fastest are located in the southeastern section of the district. Here are the counties with

POPULATION CHANGES

	1950	1940	Per cent change
United States . . .	150,697,360	131,669,275	+ 14.5
Third District . .	8,437,034	7,777,910	+ 8.5
Delaware . . .	318,085	266,505	+ 19.4
New Jersey (9 counties)	1,122,418	928,426	+ 20.9
Penna. (48 counties)	6,996,531	6,582,979	+ 6.3

DEPOSIT CHANGES

(Millions \$)	June 30, 1952	Dec. 31, 1941	Per cent change
United States . .	\$151,261	\$63,688	+137.5
Third District . .	8,510	4,094	+107.9
Delaware . . .	501	270	+ 85.6
New Jersey (9 counties)	857	325	+163.7
Penna. (48 counties)	7,152	3,500	+104.3

increases of 25 per cent or more people since 1940:

Ocean	+50.2%
Burlington	+40.1
Bucks	+34.3
Delaware	+33.3
Cape May	+28.4
Gloucester	+27.0
Cumberland, Pa.	+26.3
Centre	+25.3

Thirteen of the seventeen counties of the district in which populations declined during the decade of the forties are in the region known as the

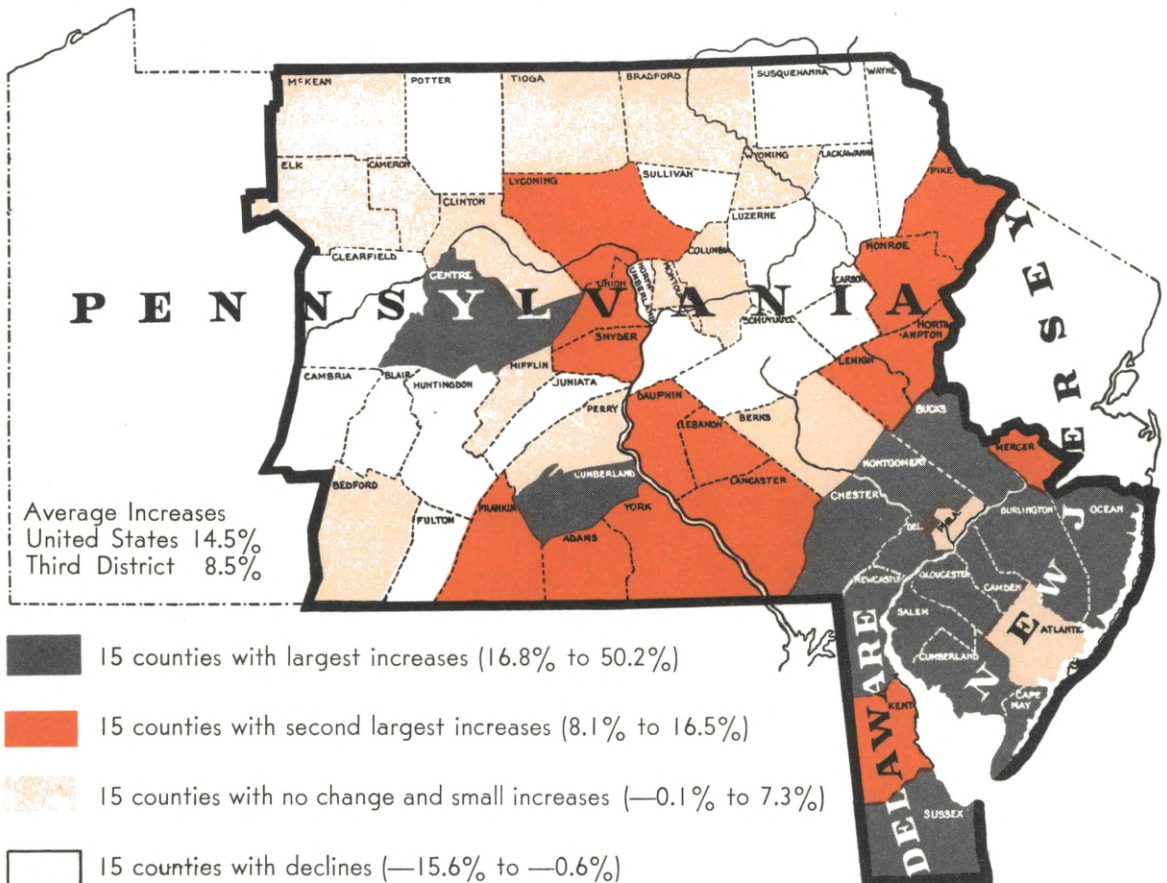
Newer Appalachians, which run diagonally from the southwest to the northeast corner of the district. Among these seventeen counties are the great anthracite and bituminous coal producing counties of the Third District.

Deposits on the move

Comparison of the maps on pages 14 and 15 indicates that seven of the fifteen counties which had the greatest growth in population were also among the fifteen counties with largest increases

CHANGES IN POPULATION BY COUNTIES

1940-1950



in deposits since the end of 1941. They are:

Cape May	+264.4%
Ocean	+250.4
Bucks	+200.0
Cumberland, Pa.	+180.9
Centre	+180.3
Burlington	+165.1
Sussex	+164.3

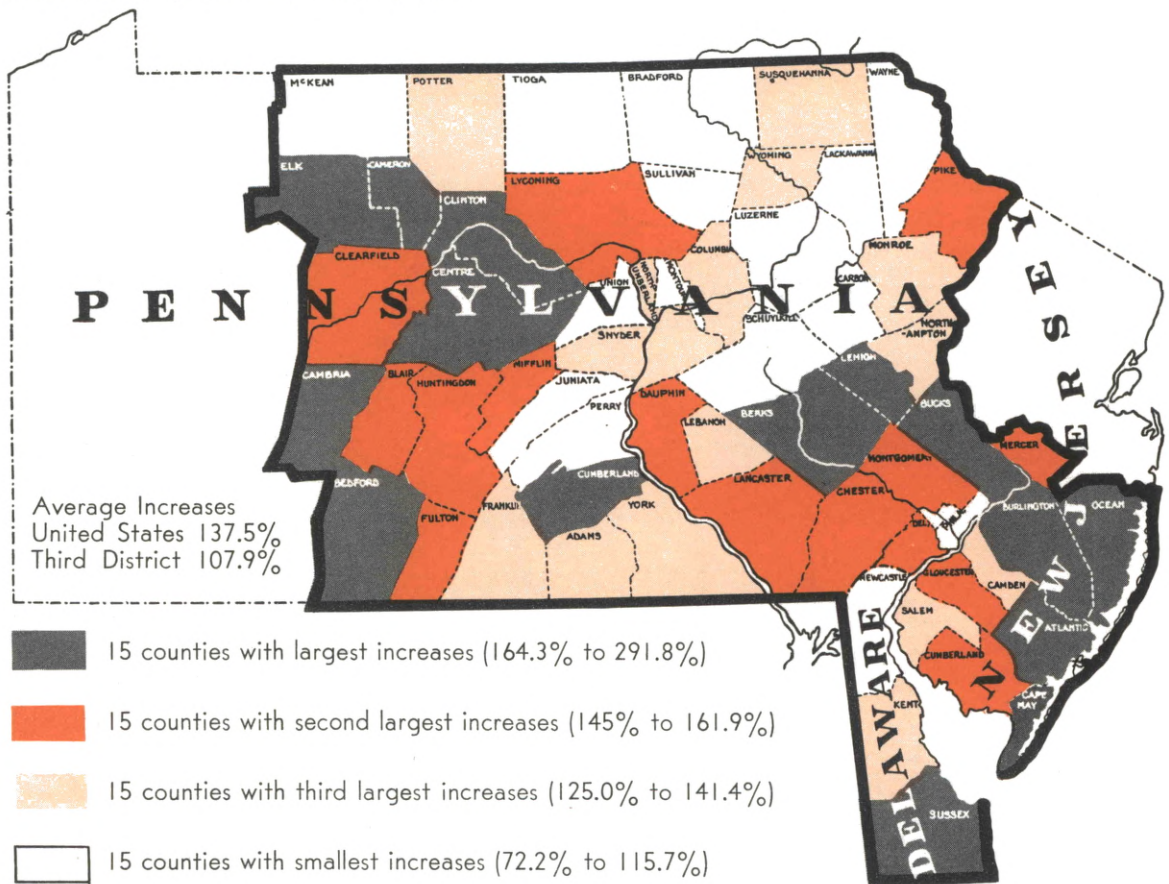
Atlantic County and Cameron County, where deposits went up 291.8 per cent and 281.0 per cent, respectively, had the sharpest increases in deposits in the Third District for the period. In

each of the three Atlantic Coast resort counties, deposits rose to three-and-a-half to four times their levels of 1941, the greatest increases in contiguous counties in the district.

Of the seventeen counties which had net declines in population since 1940, six—Cambria, Bedford, Clearfield, Blair, Huntingdon and Fulton, all in the southwestern and western sections of the district—showed increases in deposits greater than the average increase for the country as a whole, that is, greater than 137.5 per cent.

CHANGES IN DEPOSITS OF INDIVIDUALS AND BUSINESS BY COUNTIES

December 31, 1941—June 30, 1952



On the other hand, all the counties in the anthracite region which had losses in population, also had relatively slow increases in deposits.

Most northern-tier counties—McKean, Tioga, Bradford, and Wayne—were among the counties having smallest increases in deposits.

Who owns the deposits

In the foregoing sections, attention has been focused on the growth by counties of both demand and time deposits of individuals and business firms. The distribution of deposits among various classes of owners is not available on a county basis but is available for the district as a whole. Periodically since 1943 this Bank has published data based on information supplied by a group of representative banks in the district which provide clues as to the ownership of demand deposits.

The latest survey of the ownership of demand deposits of individuals and businesses in this district was taken January 31, 1953. It revealed no major changes in the distribution pattern which has been developing in recent years. More than half of all demand deposits are owned by businesses and more than one-third by individuals, including farmers. In the last five years this

DISTRIBUTION OF DEMAND DEPOSITS, JANUARY 31, 1949-1953 ALL COMMERCIAL BANKS—THIRD DISTRICT

	1953	1952	1951	1950	1949
Manufacturing and mining	23.0%	22.4%	21.6%	21.4%	20.9%
Public utilities	4.2	4.4	5.3	5.3	5.6
Trade	13.9	13.7	13.7	14.0	14.2
Other non-financial	6.3	6.0	5.3	5.4	5.4
Total	47.4%	46.5%	45.9%	46.1%	46.1%
Insurance	3.1	2.9	2.8	2.8	2.6
Other financial	6.1	6.5	6.5	6.3	5.7
Total	56.6%	55.9%	55.2%	55.2%	54.4%
Trust funds	4.0	4.0	4.5	4.5	4.7
Non-profit organizations	4.3	4.2	4.2	4.0	4.1
Personal	35.1	35.9	36.1	36.3	36.7
Foreign	—	—	—	—	0.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%

pattern has indicated a gradual increase in demand deposit balances owned by business concerns and a similar decline in balances held in personal accounts, including those of farmers. Since the proportion of demand deposits owned by business firms increases with the size of bank, the significance of this trend to the banker is apparent.

CHANGES IN OWNERSHIP OF DEMAND DEPOSITS ALL COMMERCIAL BANKS—THIRD DISTRICT

(In millions of dollars)	Dollar balance January 1953	Changes in year	
		Dollars	Per cent
Manufacturing and mining.....	1,173.5	+ 67.3	+ 6.1
Public utilities	213.2	— 2.7	— 1.3
Trade	708.9	+ 33.9	+ 5.0
Other non-financial	323.2	+ 31.6	+10.8
Total	2,418.8	+130.1	+ 5.7
Insurance	156.6	+ 14.0	+ 9.8
Other financial	311.1	— 12.4	— 3.8
Total	467.7	+ 1.6	+ 0.3
Trust funds	207.5	+ 11.6	+ 5.9
Non-profit	220.8	+ 16.1	+ 7.8
Personal	1,797.3	+ 29.1	+ 1.6
Foreign	1.8	— .5	—23.2
Grand total	5,113.9	+188.0	+ 3.8

The deposit level throughout the district rose from January 1952 to January 1953 by about 4 per cent. With the exception of public utilities, financial businesses other than insurance companies, and foreign-owned balances, all other groups showed increases in deposits. Of these groups, however, personal deposits was the only one which rose at a rate slower than the district rate.

Summary

The shifts of dollars from place to place and among groups of owners in this district have been highlighted in the preceding maps and tables. Deposits are not only constantly changing owners but they move geographically to places where the most wanted goods and services are available. Though they tend to move with population, there have been a number of exceptions

in the district. In a society where consumers themselves decide where they want to live and work and what goods and services they want to buy with the dollars they own, an aware-

ness of longer-term trends can help bankers and businessmen make the kind of decisions most profitable to them and ultimately to the consumer.

CURRENT TRENDS

If you have the time and patience to scan the business records, you will notice that most of them look good. Profits of industrial concerns are higher than last spring. Wages also are higher and so are pay rolls, employment, production, spending, saving, and borrowing.

There are those who think the boom is getting tired. They point to the fact that prices are no longer rising, that the defense program is no longer expanding, that the rate of family formation is over the peak, and that plant expansion programs have about run their course. Nevertheless, many of our basic industries are continuing to operate at very high rates, and some of them are expanding output still further. One of these is the automobile industry.

Motor vehicles throw a lot of weight in our economy. The production of automobiles is one of our largest industries by almost any yardstick. Current employment is in excess of 900,000 workers, or almost 6 per cent of all manufacturing employment. The industry is taking almost a quarter of the country's current output of steel and it also is the largest consumer of rubber, plate glass, nickel, lead, and mohair. It is one of the best customers for aluminum, copper, zinc, cotton, machine tools, and chemicals. So widespread are the ramifications of the industry — including production, distribution, financing, and maintenance of cars—that about one out of every seven gainfully employed work-

ers in the country is estimated to be associated directly or indirectly with the automobile industry. The dollar value of retail sales of the automotive group of industries is about 20 per cent of all retail sales, and automobile paper accounts for one-third of total consumer credit and almost one-half the installment credit. In view of the importance of automobiles, it is particularly significant to note what the industry is doing and what it may do in the months just ahead.

As if equipped with automatic transmission, manufacturers quickly shifted into high gear in the early months of this year. During the first four months, the industry produced 2.2 million passenger cars, which was 50 per cent above the output for the corresponding months of last year. Total output in 1952 was 4.3 million cars compared with 5.3 million in 1951 and 6.7 million in 1950, which was the all-time peak. At rates prevailing in the latter weeks of April, total output for 1953 would be in excess of 7 million units. A more realistic view for the year as a whole, however, according to market forecasters, is 5.5 million to 6 million cars. There is no doubt that the industry has the capacity to go over the top, assuming adequacy of labor and raw materials, but how long demand will support present levels of output is a matter that lies largely in the lap of the consumer.

Since automobile dealers are in the best posi-

tion to appraise the temper of consumers, we have interviewed a number of representative dealers throughout the Philadelphia Federal Reserve District. Their observations and opinions, presented herewith, are particularly helpful in sharpening the focus on the outlook for this vital industry.

WHAT AUTO DEALERS TELL US

New cars generally are moving along rapidly from assembly lines to dealers, to customers. Spring is the top selling season of the year and most dealers report sales in line with seasonal expectations. To be sure, experience differs from one dealer to another. One reports sales for the first four months 60 per cent above the like period of last year. At the other extreme is the dealer of a popular-priced car who reports that sales are "only fair" with little improvement in prospect for the next ninety days. Between these extremes is the vast majority experiencing brisk demand and active buying.

There is increasing evidence, however, that the character of the market is beginning to change. While still essentially a sellers' market, many dealers admit that more selling effort is being required to move the cars. Comparatively few dealers have large backlogs of unfilled orders and where such conditions exist it is usually a case of awaiting factory delivery of cars with automatic transmission or a special model type. Competition is reasserting itself and, as is to be expected, the products of some manufacturers are receiving better public acceptance than those of their competitors. One up-state Pennsylvania dealer sized up the market with the remark, "demand is strong now but it can't last forever."

Terms

Customary terms of sale are one-third down pay-

ment and twenty-four months time for the balance. In some areas, however, there are departures from this practice. In order to clinch sales, terms are sometimes extended to thirty months and on rare occasions as much as thirty-six months. Banks and other lending agencies generally frown on long-run deals and are even more concerned with an adequate down payment. Lenders are becoming more risk-conscious and are paying much more attention to the credit standing of the applicant.

Another evidence of the changing complexion of the market is the preferential treatment awarded to cash customers. More and more dealers are offering cash discounts to customers not trading in an old car and requiring no financing. Those not offering a cash discount usually "throw in" an extra such as a radio, heater, or some other additional equipment.

Inventories

Dealer inventories of new cars are rising but thus far there is little or no evidence of serious overstocking. The over-all picture is a healthy one. As is frequently the case in an expanding market, however, some dealers have a surplus of certain models and a shortage of others. Most dealers are eager for more cars to display in a larger variety of models. Though cars are coming in faster from the factories, the distribution by models in various price ranges is still somewhat distorted. For most dealers, inventories have not yet reached a point where banks have thought it necessary to curtail their floor planning.

Used-car market slipping

"Backing up," "a little tough," "in bad shape," "spotty," "very spotty," "a headache"—these are the terse and typical dealer characterizations of the used-car market. The trouble with used

cars is that there are so many new cars. If the potential customer has the down payment, he can buy a new car with a schedule of monthly payments only a little higher than would be required to finance a recent-model used car. There is a lot of shopping but sales are below par for this time of the year.

Prices of used cars are weakening almost everywhere. To increase the turnover on new cars, some dealers are offering \$100 to \$200 more than market value for trade-ins. The great out-of-door used-car lots are filling up. You can observe for yourself. For a while dealers hold out to get their price but eventually some of the used cars go on the auction block, and there the price declines are the sharpest. The situation has by no means gotten out of hand, nor are many dealers going overboard on their trade-in allowances but potential buyers are finding more bargains and an ever-widening selection in used cars.

Financing of used cars is available if the down payment is adequate and if the buyer is a good credit risk. But terms are getting more rigid and eighteen months is about the limit. Models of 1949 and older vintage sometimes are hard to finance.

To summarize, it is quite evident that the automobile industry is already in a genuinely competitive market—a situation that has been unknown for at least a dozen years. This is not to say that the industry is facing hard times.

On the contrary, manufacturers feel that there is a good market for automobiles, that it can be expected to continue for some time. It is on this basis that they justify today's abnormally high rate of output. The lines are being drawn tighter. Consumers are more discriminating, dealers are again forced to do a selling job, and suppliers of credit are becoming more exacting.

POSTSCRIPT ON HOAGIES

The editor has been deluged with mail asking about hoagies, mentioned in our March *Business Review*. Correspondents say they cannot find "hoagies" in the dictionary. They are right. The nearest word is the Spanish "hogaza" meaning "long loaf of bread."

The natural habitat of the hoagie is the quickie restaurant. It is a food—a kind of sandwich, made from a long loaf of Italian bread, sliced lengthwise, and heavily laden with anything readily available, like cheese, salami, onions, lettuce, tomato, peppers, oil, vinegar, etc. In short, it's a Dagwood delight.

Extensive and exhaustive research seems to establish South Philadelphia as the origin of hoagies. They are slowly moving westward across the country and have already been observed in West Philadelphia.

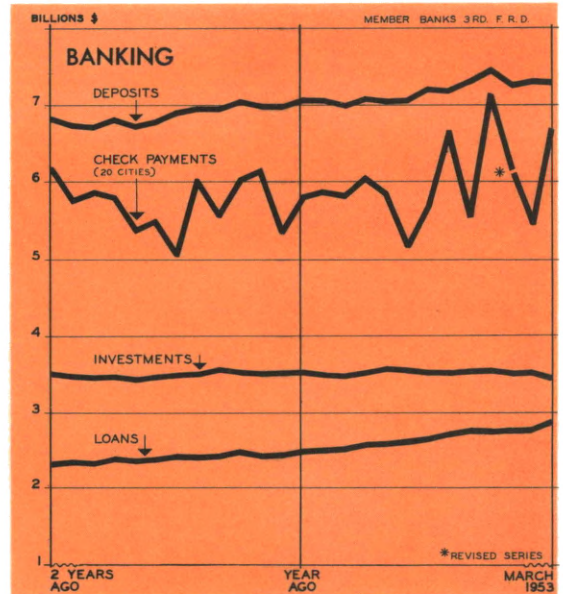
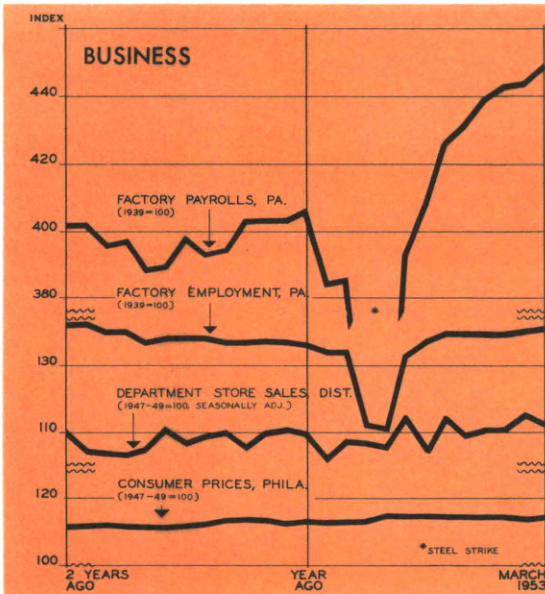
Additional copies of this issue are available

upon request to the Department of Research,

Federal Reserve Bank of Philadelphia,

Philadelphia 1, Pa.

FOR THE RECORD...



SUMMARY

	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	March 1953 from		3 mos. 1953 from year ago	March 1953 from		3 mos. 1953 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production...	+ 1*	+ 3*	+ 3*	+ 2	+11	+10
Construction contracts†	-18	+46	+54	0	-9	+6
Coal mining	-14	-23	-25	-3	-14	-19
EMPLOYMENT AND INCOME						
Factory employment	+ 1*	+ 3*	+ 3*	+ 1	+ 6	+ 6
Factory wage income	+ 1*	+11*	+10*			
TRADE**						
Department store sales	- 3	+ 3	+ 4	+ 2	+ 8	+ 5
Department store stocks	- 1	+ 1		- 1	+ 6	
BANKING (All member banks)						
Deposits	0	+ 3	+ 4	- 1	+ 3	+ 4
Loans	+ 3	+15	+13	+ 2	+13	+12
Investments	- 2	- 2	- 1	- 2	- 1	+ 1
U.S. Govt. securities	- 2	- 3	- 1	- 2	- 2	- 1
Other	0	+ 1	+ 1	+ 1	+ 6	+ 6
Check payments	+23‡	+17‡	+ 7‡	+19	+13	+ 8
PRICES						
Wholesale				0	- 2	- 2
Consumer	0†	+ 1†	+ 1†	0	+ 1	+ 1

*Pennsylvania †Philadelphia ‡20 Cities
 **Adjusted for seasonal variation. †Based on 3-month moving averages.

LOCAL CHANGES

	Factory*				Department Store				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change Mar. 1953 from		Per cent change Mar. 1953 from		Per cent change Mar. 1953 from		Per cent change Mar. 1953 from			
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago		
Allentown	+1	0	+1	+6					+16	+13
Harrisburg	0	+8	+1	+13					+19	+19
Lancaster	+1	+6	0	+14	+47	+14	+5	+5	+22	+8
Philadelphia	+1	+7	+2	+15	+21	+8	+5	-3	+24	+19
Reading	+1	+4	+4	+16	+24	+23	+11	+6	+25	+25
Scranton	+1	+8	+4	+14					+20	+13
Trenton	+1	+10	+1	+25	+18	+14	+13	+7	+2	-4
Wilkes-Barre	-1	+3	-1	+7	+33	+5	+6	+6	+22	+9
Wilmington	+1	+9	+2	+18	+20	+6	+11	+1	+31	+8
York	+1	+6	+4	+20	+31	+24	+20	+14	+11	+29

*Not restricted to corporate limits of cities but covers areas of one or more counties.