<u>CREDIT WHERE CREDIT IS DUE</u>

Address
By
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CREDIT WHERE CREDIT IS DUE

I should like to begin my address this evening by giving credit where credit is due. When I received your president's gracious invitation some weeks ago, I had not a moment's hesitation in accepting it. It is a privilege to honor you who, by giving of your own free time and energy, add so much to your personal capital, thereby adding also to the human resources and thus the total resources of the banking institutions which you represent.

There is little question, of course, that your AIB work, if you see it through, will be rewarding. None of us can escape the sense of satisfaction which comes with the capacity to relate our job and the work of our institution to the complex economic world about us. Nor can I agree with a certain Spanish philosopher, (Unamuno), that all knowledge must have an object other than the pleasure of acquiring knowledge for its own sake. We may wish to learn some things merely for the thrill of acquiring new vistas, and not simply to complete our fund of knowledge nor to achieve some practical end. It has nonetheless been my observation that serious attention to furthering one's education does bring material rewards. Many of my acquaintances who were unable to complete their formal academic training have made great successes in banking in large part because they were able to pursue such programs as the Louisville Chapter of AIB is affording you.

Nothing about an individual impresses me more than a willingness to forego pleasures for the sake of long-run improvement. It is not easy. After a day's work at a place of business, night work is onerous, and formal academic effort may sometimes seem not worth the candle. It is hard to forego an evening of relaxation and entertainment in favor of hours in a dingy classroom. Whatever the rewards that lie in some distant future, it takes strength of character and a genuine loyalty to one's bank to bring about the sacrifices which you have made and are making. Credit is indeed due you, and I believe in bestowing credit where credit is due.

But I am sure you did not gather here this evening to hear me say nice things to you about yourselves. I assume your purpose in exposing yourselves to my artless speech was to hear a discussion of a worth while topic in the field of money and banking. Therefore, the subject of my address this evening is no idle play on words. I wish to talk with you seriously and as fully as a brief time will permit about some broad principles by which, in today's economy, we give credit in the financial sense where credit is due.

When one first examines the mechanism by which credit is allocated in an economy, it may seem that the business of determining who shall receive credit is a function of the commercial banks alone. Indeed, in the short-term sectors of the credit market the commercial banks are the major suppliers of funds. As we shall presently see, however, both suppliers of long-term funds and the Federal Reserve System have their parts to play in deciding how credit shall be allocated and, if need be, rationed. But the commercial banks are so important in this regard that we must pause first to reflect on their role.

It is to the commercial banker that the business firm seeking short-term credit normally comes for accommodation. Upon the commercial banker falls the responsibility of deciding in each case whether or not that particular demand for credit is worthy and should be satisfied. At this point it may be well to recall that the true concept of creditworthiness is dual; it is actually two concepts rolled into one. A credit is worthy in one sense if the grantor can reasonably expect fulfillment of the specified terms of repayment. Credit is worthy in another sense if it will enable the borrower to make a contribution to the community and the nation.

No banker is likely to neglect the responsibility which is his in the first sense. He may make mistakes of judgment about the risks involved, but he will not often be unmindful of these risks. It is true that in times of easy money and continuously rising prices - when inflation is the order of the day and its end is not yet in sight - the concept of creditworthiness in the sense of collectibility tends to become dimmer and dimmer. In such times money is easy to come by and collection problems are the least of a banker's worries. On the other hand, in times of falling economic activity, the threat grows daily more real that some borrowers may not be able to meet their obligations as they fall due. Bankers are then likely to take a less optimistic view of the general outlook for business and prices, and applications for loans are more carefully screened. Bankers are human, notwithstanding occasional rumors to the contrary, and their attitudes are likely to reflect the tempo of the times.

Now for the other branch of our dual concept of creditworthiness. The traditional duty of the banker, perhaps his highest duty, has been to make such allocations of the credit at his disposal as will best serve society. This is where judgment, wisdom, and courage are required to a great degree. When available credit has some limit, the banker's task of selection and allocation calls for private statesmanship of the highest order. But when money is so easy that there is more than enough credit for all at going rates, the necessity to make hard and often unpleasant decisions recedes. Under such circumstances the second of our twin concepts of creditworthiness, like the first, becomes less operative.

Just a little over three years ago we returned to a more normal money climate, something different than obtained for nearly a decade during and after World War 11. Since the spring of 1951, when the Federal Reserve System ceased to convert automatically, at or above par, the Government securities of banks into reserves, commercial bankers have operated under the old rules of the game. It has not always been possible to accommodate all credit demand which meets only the first test of creditworthiness (reasonable expectation of repayment). The banker had at those times to resurrect and refurbish his powers of selection; he again faced the opportunity and the responsibility to see that sound credit demands were supplied in order of priority of contribution to community and nation and, of course, to see that unsound demands were denied. In other words, the banker had to return to the traditional dual concept of creditworthiness and govern himself accordingly. Historically, bankers have done this well, and under changed circumstances they have quickly relearned half-forgotten techniques. This real, down-to-earth function of bankers requires skill, know-how, and courage.

In emphasizing, at the beginning of my remarks, the crucial role of commercial bankers in determining the recipients of credit, I did not mean to imply that the burden rests exclusively upon the commercial banks or that the central bank can or should avoid participation in the allocation process. It is to the function of the Federal Reserve System in this regard that I would next invite your attention.

Some weeks ago a member of the staff of the Federal Reserve Bank of St. Louis discussed with your Louisville AIB group the means by which the central bank can affect the reserves of commercial banks and thus influence the supply, availability, and cost of credit. Through changes in the required reserve ratios of member banks, by open market operations, and, to a limited extent, by changes in the rediscount rate it is a matter of financial mechanics to effect changes in the reserve position of the commercial banking system. A comprehension of these technicalities is essential to an understanding of the vital control function of the central bank. Yet I would speak a word of caution. We must not fall into the error of thinking that the monetary authorities, in taking decisions to increase or decrease member bank reserves, need consider only the quantitative effects of these changes along with their proper timing. Federal Reserve authorities, as well as commercial bankers, must accept the responsibility of bestowing credit where credit is due.

That the Federal Reserve authorities must share this responsibility follows in part from what I have just said about the responsiveness of bankers to changes in the availability of credit. It is true that the Federal Reserve achieves its objectives of maintaining a stable and growing economy by affecting directly the amount of reserves available to the banking system and indirectly the rate of interest. But when the central bank takes steps to impose restraints on the granting of credit, it cannot avoid imposing on commercial bankers the necessity of being more selective. And, contrariwise, an easing of reserve positions and a lowering of interest rates relieves the banker's problem of credit rationing. In short, commercial bank selectivity is related closely to Federal Reserve policy decisions.

In the market for long-term funds the effects of central bank action are even more readily apparent, as witness the effects on both borrowers and lenders of the credit restraints of last spring. A rise of only 1/2 of 1 per cent in the yields of intermediate and long-term Government securities during late 1952 and the first half of 1953 resulted in constricted capital and mortgage markets. State and local government units and private firms were forced to postpone contemplated investment, for so small an absolute change in the cost of long-term funds meant large additions to total interest changes over a period of years. The impact on the urban residential mortgage market was especially pronounced.

On the other hand, as the policy of monetary ease inaugurated in the late spring of 1953 began to take effect, borrowers sensitive to rate changes have come back into the market for long-term funds. Businesses with high investment-sales ratios, such as railroads and public utilities, as well as municipal and state governments, have been encouraged to borrow in order to carry out their plans for expansion. As bond yields started to decline in the fall of 1953, the yields of urban residential mortgages became more attractive to institutional investors. By early this year the mortgage market had eased perceptibly, and since March mortgage money has become readily available.

It is in the market for long-term funds, perhaps more than in any other area, that Federal Reserve authorities exercise the most direct influence on the allocation of credit among alternative uses. We must remind ourselves, however, that the actual decisions are made by individuals in their private capacities as borrowers and lenders.

Let me summarize briefly. Both commercial bankers and central bankers play their roles in giving credit to those to whom credit is due. As commercial bankers, you will keep certain broad principles in mind. You will continue to finance sound and essential projects; you will be cautious about marginal credits and reluctant to go too far with marginal producers. As bankers you will never forget that the men of utmost importance to your community, region, and nation are the efficient entrepreneurs. Financing which helps make them more efficient, which helps them become stronger, is the kind of financing that is both profitable to your institutions and useful to the country. The economic strength of our nation rests on the efficient producer in all his counterparts, be he farmer, manufacturer, wholesaler, or retailer, and bankers stand in better position than anyone else to discover these elements of strength in their communities and to assist in their development through sound financing and sound advice.

We who are associated with you in the whole institution of banking and working within the Federal Reserve System must likewise be conscious of the principles by which we are guided. The System's role today is to provide for the nation the best monetary device it is possible to create. The System's objective, which implies deliberate counter-cyclical adjustments in the money supply, is to promote such economic growth as is consistent with economic stability. This objective we are striving to attain through adjustment of the total supply of reserves available to member banks. The allocation of reserves among banks and the rationing of credit to customers we would leave as nearly as possible to competitive market processes.

Now, suppose we stop and catch our breath. I have deliberately and with malice aforethought led you for the last few minutes on an expedition into terrain over which the going can be pretty rough. You may wonder why I did this to you on a beautiful evening in May when there are so many other things to be done, perhaps more pleasurable. The decision to do it was not easy. It would have been so much easier to indulge in a few minutes of relaxed story telling and verbal pleasantries, followed shortly by music and dancing. Indeed I am told that music and dancing are to follow, and I shall not much longer stand in their way. If I appear to regard with great seriousness the duties and responsibilities of banking and bankers in our time and in the time to come, I do not object, for I do, and I have distinguished company. A few days ago I sat in an audience of bankers and listened to an address by the Vice President of American Bankers Association, who by tradition will succeed to the presidency of the Association next autumn. He is a banker of outstanding accomplishment and understanding. In the core of his address he flung at his hearers a long list of questions,"Do you know this?" "Do you know that?" "Do you know?" "Do you know?" One after another of those questions dealt with the things I have been talking to you about tonight and closely related subjects. It was a resounding challenge to all of us who assume or aspire to the proud title of banker.

The point, as I see it, is that we who decide to make our careers in the institution of banking owe a duty, not alone to ourselves and the banks we serve, but to our communities and the nation, to know as much as we reasonably can about the characteristics and the functions of our money system and our banking system. We must not fall into the erroneous belief that banking is a mere housekeeping operation. Of course, bankers must know how to accept deposits and deal with depositors, to cash and clear checks, to make loans and collect them. I do not underrate these things.

They are tremendously important. But unless we know also how our money system works and what its importance and significance are to the economic, business, and social life of our country, we shall be in grave danger, I fear, of falling short of maximum usefulness to our banks, our depositors, our communities, and the national welfare. If we who make money and banking our business fall short, how shall the public interest in this area be served?

In this AIB group, before which I am so proud to appear, I apprehend that the present generation and the succeeding one have found and will find their banking leadership for the Louisville area and doubtless elsewhere. That is so, in my judgment, because you are not content with what you now know but seek to expand and enlarge your knowledge of the field in which you have cast your lot. For that I commend you and give you credit, for it is your just due.

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