

REVERBERATIONS OF '55

Address
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REVERBERATIONS OF '55

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At the turn of each year it is the habit of thoughtful observers to reflect on the events of the past year and to assess the gains or losses, as the case may be. The reverberations of the old years continue for indeterminate periods of time. They are of many tones and overtones blending into a complex which is perhaps beyond the capacity of most ears to hear and minds to comprehend in its entirety. Different ears are attuned to different components. Different minds select different aspects of the whole upon which to meditate. As senior officers of major commercial banks throughout the country your ears are, of course, most sensitively tuned to the economic and business tones in the reverberations of 1955, to the overtones of credit demand and supply, to the throbbing rhythms of economic growth and development. As attention is focused for the next few minutes on some of these things, we shall not be slighting all the rest that happened in 1955. We shall be doing what comes naturally to American bankers convened in a National Credit Conference.

I hardly need say to this audience that the year 1955 was one of remarkable achievement. It was, of course, a year of prosperity, of pulsing activity in which scarcely a significant business indicator took an adverse turn. It was more than this, however. 1955 was a year in

which the tremendous regenerative power of the economy impressed even the least optimistic observers. What I call regenerative power, let me hasten to add, is not the same as recuperative power. The economy has always been able eventually to recover from depression. What was of special interest in 1955 was the ability not only to recover lost ground but beyond that to achieve nearly 100 per cent of an expanding potential in so short a time. By way of comparison, our emergence from the 1948-49 recession, though apparently accomplished by early 1950, has always been clouded by the possibility that the Korean war strongly assisted the outcome. No similar doubt could be raised about our emergence from the recession of 1953-54. Only a tremendous, spontaneous vitality of the economy could account for it.

From the third quarter of 1954 to the fourth quarter of 1955 the gross national product soared from an annual rate of \$355 billion to an estimated rate of \$398 billion, a rise of 12 per cent. During five successive quarters there was a jump in GNP averaging more than \$8 billion per quarter. Total product for the year 1955 approximated \$387 billion, a gain of \$27 billion over 1954. Changes in the volume of physical production were likewise spectacular. From a low point of 123 in July and August of 1954 the seasonally adjusted Federal Reserve Index rose to 144 late in 1955, an increase of one-sixth. At the year's end, though increases in

output were still possible in many lines, some key industries had rammed up against capacity.

Toward the end of 1955 we all looked intently behind these great economic aggregates to see what had made the economic machine accelerate with such power. To which of the major categories of income-generating expenditures could so brilliant a recovery be attributed? Certainly not to government purchases of goods and services. Outlays of the Federal Government fell a little from the 1954 figure, being about offset by a slight increase in state and local expenditures. Moreover, the Federal budget was closer to being in balance than it had been in several years, preliminary estimates indicating that the cash deficit for the year was probably under a billion dollars. Although exports and imports both rose during the year, the net effect of the change on economic activity was not great. The 1955 addition to income can be accounted for only by greatly enlarged consumption expenditures and by increases in private investment, particularly outlays on new capital goods.

A closer inspection of the data tells us that 1955 was in a sense dominated by the consumer. Of the some \$27 billion of new gross product created during the year, more than one-half resulted from increased

expenditures of households for durable and nondurable goods and for services. And if outlays on residential construction also are considered as consumption expenditures, perhaps two-thirds of 1955's new gross product was accounted for by the rising budgets of American families.

Changes in business expenditures were also important, to be sure. Especially was this true of amounts spent on producers' durable equipment, which moved up sharply from the second quarter on. But the most noteworthy characteristic of 1955 business expenditures was the relatively low rate of inventory investment during most of the year. In fact, in most major manufacturing industries sales advanced at a more rapid rate than inventories, so that in the latter months of 1955 stock-sales ratios in some lines were at their lowest levels in years. Consumers simply took final products from the market in greater quantities than ever before.

In the brief minutes available to me this afternoon we can not examine in detail the various reasons for the boom in consumer spending. After generally surveying the more important ones - rising incomes, a persistent postwar tendency on the part of households to budget more for durable goods, intensified selling efforts, and so on - one central fact stands out: a large proportion of American families demonstrated an unprecedented willingness to go into debt. Total consumer credit outstanding at the end

of the year, according to preliminary estimates, amounted to about \$36 billion, of which at least \$28 billion was instalment credit. An increase in instalment credit of more than \$5 billion, or 20 per cent, over the past year greatly exceeded estimates as of the end of 1954. Scarcely less impressive was the increase of about 18 per cent (to \$89 billion) in mortgage debt outstanding on urban residential properties.

These large upswings in consumer and mortgage credit have given rise to some concern. It is true that the stimulus they gave to household spending has not produced a sharp rise in consumer prices, which remained almost constant throughout 1955. Also there was no clear evidence that consumer and residential mortgage debt, at present levels of disposable income, had seriously aggravated collection problems.

Nevertheless, some serious doubt does arise as a result of these large expansions of debt. Encouraged by credit so readily available, were not consumers, as distinguished from business firms, too rapidly accumulating "inventories" (i. e., holdings) of durable goods? Periods of swift durable goods formation, whether at the producer or consumer level, have in the past been followed by periods of retardation in the rate of accumulation. A question which has been asked so frequently of late, and which is still reverberating in 1956, is this: can consumers continue

to add to their present huge stocks of durables at anything like the rate they maintained in 1955?

In the producers' market, as I have already said, inventory accumulation presented no serious problem in 1955 with the exception of a few lines toward year's end. Indeed, in this market the boom was manifested in quite a different way. As production generally increased throughout the year, manufacturers at first utilized more fully their existing plant and their already employed work force, and prices of industrial materials remained quite stable until about mid-year. But as activity went on apace, unemployment fell, and in many industries, especially in those supplying essential materials, output approached the limits of existing capacity. The result was a slow but nonetheless persistent upward pressure on industrial prices. Furthermore, by the third quarter of the year, world industrial production was up more than 10 per cent from a year before, and in world markets, particularly in metals, prices rose rapidly.

The stability of the price record for 1955 as shown by the index of wholesale prices is illusory, for the index of all commodities rose less than two points during the year. However, the rather severe downward

movement of farm prices and the somewhat less pronounced fall in the prices of processed foods exerted a drag on the whole index. From June through October industrial prices rose by approximately one index point per month. The rise has since been gentler, but the increase for the year was in the neighborhood of 4 per cent, with some further increases pending in industries which have reached capacity output.

No one familiar with the facts of economic life would argue that in a period of great prosperity all prices should remain rigid. If the pricing mechanism is to perform its essential function of allocating scarce resources, an increase in the price of a material for which there is heavy demand serves to moderate the demand and thus to assist in keeping the productive process in balance. Yet price rises of the magnitude observed in late '55 remind us of a familiar proposition in economics: once resources are utilized as fully as may be consistent with normal efficiency, increasing money demand for goods generally results in price increases proportionately greater than production increases. To date it may be thought that inflationary pressures have been contained fairly well. Nevertheless, a second question sounds loud and clear in the reverberations of 1955: if growth in demand for goods continues in the near future as it did in the last year, can the recent relative stability of consumer and wholesale prices be maintained?

How the two pressing economic questions of the day, which we have stated, will be answered depends on a variety of factors. I wish to speak of but two of them during the remainder of this talk: first, the actions of the central bank, and, second, the actions and reactions of commercial bankers. In coming months these forces will influence strongly the course of economic life in this country. Indeed, in the events of the past twelve months we can see how they helped shape the trends of 1955.

The broad outlines of Federal Reserve policy in 1955 are by now familiar. When the magnitude of the recovery in the fourth quarter of 1954 became apparent, in December of that year, the Federal Reserve shifted away from a policy of active ease. Business, of course, continued to show strong expansionary force as the year advanced, and System policy gradually became more restrictive.

You all know what actions were taken. Member bank borrowings were made progressively more costly as the discount rate was raised four times, from 1 1/2 per cent in April to 2 per cent in August, to 2 1/4 percent in September, and to 2 1/2 per cent in November. Open market operations were conducted with a view of restricting the total supply of reserves available to the commercial banks.

The results of System policy and action coupled with the increasing demand for credit were reflected in money rates and credit availability.

Short interest rates responded to the upward movements of the discount rate and rose rather sharply relative to long rates. The slope of the yield curve thus changed substantially, a development which apparently came as a surprise to some people who had forgotten, or had never seen, a yield curve that was nearly horizontal. And yet such a development is quite natural in a period of rapid expansion where attempts are made to hold down the supply of reserves.

Let me interpolate a point here which most, if not all, of you know. There is some lack of understanding as to the responsiveness of commercial banks to a central banking policy of credit restraint. Commercial bank lending in its day-to-day operation is responsive to Federal Reserve restraint, but as a practical matter that restraint does not, and should not, bring the financial community to a sudden standstill.

Federal Reserve restraint of the flow of credit is something like the slowing of an automobile in motion. "Adjustment of the volume, availability, and cost of bank credit" is a meaningful phrase only if the economy is in motion. Given that premise, Federal Reserve restraining actions can and do affect the flow of bank credit; restraint tends to retard the flow. Existing momentum alone will carry the economy forward even after the brakes have been applied, and in some boom periods it seems that factors other than credit, or at least factors other than Federal Reserve action, still keep a fairly heavy foot on the accelerator even

while the credit brake is being applied.

During 1955, Federal Reserve policy and action were designed to furnish some net additions to bank reserves and thereby to permit additions to the nation's credit supply coming from commercial banks. In other words, System policy did not aim at reducing outstanding credit, but did aim to keep the rate of credit expansion within reasonable bounds.

The policy of monetary restraint seemed to attain its immediate objectives. The money supply increased by less than 3 per cent in 1955. Such a modest growth in the money supply during a boom period would not of itself guarantee the abatement of inflationary pressures, but taken in conjunction with other data it was helpful. The relative scarcity of money was evidenced in part by a moderate increase in deposit turnover, an indication that a given amount of money was being put to more intensive use. Perhaps a more significant indicator of the restraint upon the commercial banking system was the decreasing liquidity of member banks. As total assets and total deposits rose slightly during the year, banks disposed of liquid assets, so that the ratios of liquid assets to total assets and of liquid assets to total deposits continued a decline which has been going on with only minor interruptions since 1952.

So much for Federal Reserve policy and action. Now, let us

consider the second influence: the actions and reactions of commercial bankers who play their role against this background.

I want to come at this second point in a sort of roundabout way and begin by a simple description of the study of economics. This intellectual field is concerned with the allocation of scarce resources. Scarcity, of course, is a relative term; it implies that supply is less than demand, regardless of how large the absolute supply is. And scarcity also implies that resources be used in the best way, that is, that we economize in their use. In a time of monetary restraint bank credit is a scarce resource, and it is the job of bank lending officers to allocate it.

A realistic view of the bank lending process recognizes that there are a number of other forces influencing the bank lending officer in addition to the current legal reserve position of the lending bank, its probable inflow of funds and the cost and source of additional reserves. Every lending officer wants to make loans that will be repaid; he wants to see the economy grow; he wants to serve his customers and make new ones; he wants to make profits for his bank. In short, he is motivated by normal, competitive forces.

He does his job by screening borrowers, by meeting credit worthy needs in his community and, perhaps, elsewhere as well. He tries to

take care of good customers of long standing and to take care of new borrowers who have prospects for growth and who can in time become good customers of long standing. He tries to pick the best borrowers to accommodate first simply because they can use the funds most efficiently and thereby contribute to community growth and general economic expansion.

Let us put together Federal Reserve policy, the need to economize in the use of a relatively scarce resource (in this case, lendable funds) and the motives and actions of bank lending officers during 1955. Federal attempted to keep the supply, cost and availability of bank reserves in line with sound and sustainable high level economic activity. Demand for funds was larger than supply and thus the resource was, and became, more scarce. The lending officer's job of allocating this scarce resource became progressively harder to carry out in 1955 because of the pressure of demand. By and large, however, he seems to have done his job reasonably well.

I am sure that most or all of you recognize that by merely performing your economic function you aid in effectuating monetary policy. In fact, under our economic system monetary policy simply cannot be applied smoothly except when the nation's commercial bankers do a good job as bankers. Their multitudes of individual decisions, the essence of a free

market, bring about better allocations of funds than any other system yet devised.

In this past year we have bent our efforts, in commercial banking and in central banking, to restraining a headlong rush of the economy into possible inflationary dangers. We must make the monetary and credit instruments do their part in sustaining consumer demand and halting the rise of industrial prices. If we discharge our responsibilities well, the reverberations of '55 will merge with the quiet sounds of an economy undergoing capacity changes consistent with the maintenance of stable prices.

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