

## F E D E R A L   R E S E R V E   B O A R D

## S T A T E M E N T   F O R   T H E   P R E S S

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BUSINESS AND CREDIT

Since the opening of the year there has been continued growth in the volume of production, further increases in the prices of basic materials, and a larger demand for credit. Though the general credit trend has been somewhat obscured by seasonal influences, the differences between the developments this year and at the beginning of 1922 indicate an increase in the credit requirements of business. The reduction in loans at member banks during January was only half as large in 1923 as in 1922, and the decrease in reserve bank discounts was much smaller than a year ago. Also, the return flow of Federal reserve note currency was not so pronounced this year as last, and came to an end a week or two earlier. Borrowing for commercial purposes, which has increased steadily since midsummer of 1922, showed no seasonal decline, but continued to increase during January and February. The effect of this larger credit demand was felt early in February in a higher level of money rates in the financial centers.

In considering the present condition of industry and trade and the prospective demand for credit, it is important to give attention not merely to the financial situation, but to influences affecting the current volume of production and trade. Credit changes tend to lag behind

changes in productive output, and consequently the immediate financial developments do not adequately reflect the extent of present industrial activity. The factors of primary importance in estimating the present outlook are the volume and character of goods being produced and marketed, and the sources of demand for these goods.

It is well known that the trend of production has been upward since the middle of 1921, and that the current output is large, but the extent of recovery and the magnitude of the present volume of production compared to earlier periods of business activity are not so fully realized. During the last quarter of 1922 production was greater than at any similar period during the past five years. The Federal Reserve Board's index of production in basic industries, which measures the changes in the output of 22 commodities, shows that in September, 1922, production was equal to the monthly average for 1919, and that since that month there has been an almost continuous advance. During so short a period as the last five months there has been a 20 per cent increase in output, and in January the level of production rose above the peak of 1920. During this period industrial disturbances have been few, mining has proceeded on a larger scale, and traffic conditions have improved. The relatively mild winter and the continued demand for housing facilities have led to a continuance of building operations. Greater efficiency, both of labor and of factory equipment, has made larger output possible, and the sustained demand for basic materials at advancing prices has made production profitable.

The chief factor in the larger production during January was the increased output of iron and steel. This output during the first month

of 1923 was double that of the same month last year; the output of steel ingots was, in fact, the largest on record for any January and with the exception of March, 1920, the largest for any month since 1918. Recent estimates of the consumption of steel by important lines of industry indicate the character of present demand. Railroads used approximately 25 per cent of last year's steel production; transportation and storage of oil, gas, and water consumed 15 per cent; buildings and bridges approximately 12 per cent; the automobile industry 9 per cent, and the export demand about 8 per cent. Larger steel production during January has been accompanied by a growth in the volume of unfilled orders and by an increase in the price of steel.

A somewhat similar situation exists in the building industry and in the industries producing building materials. Since the latter part of 1922 the volume of orders placed for lumber has exceeded production, some weeks running as high as 50 per cent in excess; in December and January shipments of lumber exceeded production by about 20 per cent. Production of lumber, cement, and face brick during January, 1923, average about 45 per cent greater than a year earlier, and prices of building materials advanced 19 per cent during the same period. The advance in prices of these materials during the past year has been greater than for any other group represented in the index number of the Bureau of Labor

Statistics, but the increase in their production has been still greater. The demand for basic materials and for house furnishings resulting from the present building activity has played a large part both directly and indirectly in creating the current volume of production and trade. The construction industry and, in fact, the production of equipment goods in general are fluctuating in character, and the influence of the additional demands arising from such industries upon the volume of employment, and hence on the buying power of workers, is greatest during periods of changing business activity.

While the production of consumers' goods ordinarily fluctuates less than that of basic materials, yet their output has also responded to the recent increase in business activity, and to the larger purchasing power resulting from fuller employment. At the beginning of 1922 the production of textiles, shoes, and food declined, but during the latter part of the year the output of these goods again increased. For the year as a whole, cotton consumption at textile mills was the largest since 1918; woolen mills were particularly active during the last quarter of the year and maintained their production during January. The output of food products was greater during 1922 than in either of the two preceding years, although in general less than during 1919. It is estimated that during last year more meat was consumed in the United States than during any previous year. The domestic demand for consumers' goods is the largest market for American products and the increase in the money income of the nation during the past year has been reflected in that market.

PRODUCTION AND STOCKS: In order to determine the economic significance of the large volume of current production, it is important to know whether the output is being marketed as it is produced or is accumulating in large quantities. A comparison of the stocks of basic materials in January, 1923, with those for the corresponding month a year ago indicates, as far as information is available, that they are not accumulating. As this conclusion bears an important relation to the current business and credit situation, the evidence is presented in some detail,

The fact that stocks of many basic materials at the beginning of the year were less than a year ago indicates that increased output has been accompanied by active trading and that the goods produced have moved steadily into the channels of trade. A further indication that no large physical volume of goods has been accumulated by industrial corporations is furnished by the recently published annual statements of a considerable number of those concerns, including both those engaged in the production of raw materials and of finished goods. These statements show that inventories at the close of 1922 averaged somewhat less than in 1921, notwithstanding the fact that prices are higher than a year ago. Information concerning stocks in hands of retailers is less comprehensive, the only available data being the reports received by Federal Reserve Banks from 500 department stores in over 100 cities. The merchandise stocks held by these stores at the end of the year were relatively low and during January declined slightly.

The relation between production and stocks is ordinarily regarded as of great value in throwing light upon business and credit

conditions and tendencies. In a period of business revival, when prices are advancing, there comes a time when the expectation of further increases in prices furnishes a powerful incentive to manufacturers and merchants to enlarge the volume of their purchases of materials and merchandise, and so to accumulate stocks. Such practice, if generally pursued, may for a time be itself the cause for bringing about the expected increase. The policy of purchasing far in anticipation of demand because of expected price advances, and of ordering materials in excess of requirements because of fear of shortages, introduces an element of unhealthy speculation into production and trade. Such policies, furthermore, ordinarily lead to increased borrowing to finance the larger inventories, and borrowing for this purpose accounts in part for the enlarged demand for credit which accompanies a rise in prices. How large a volume of credit at any given time is required to maintain a healthy condition of productive industry is not always easy to determine, particularly in a country of such varied and complex economic activity as the United States. But it is well to emphasize that an economic use of credit is to facilitate the production and orderly marketing of goods, and not to finance the speculative holding of excessive stocks of materials and merchandise. So far as the available indications go, the increased demand for credit during recent months appears to have arisen from the larger financial requirements of current production and trade, and not from speculation in inventories.

Further evidence as to present marketing is furnished by the car loadings of merchandise and the volume of wholesale and retail sales.

Railroad loadings of merchandise in the last quarter of 1922 were about 10 per cent larger than those of the last quarter of 1921. During January there was a further increase of merchandise loadings, and the total for the month was 23 per cent larger than the corresponding month of last year. The volume of wholesale and retail merchandising increased in the last quarter of 1922, but the increase of wholesale trade was not unusually large for the season of the year. For 1922 as a whole, however, the volume of wholesale trade was substantially greater than in 1921. In retail trade the sales, both of department stores and mail-order houses, were considerably larger in the fall of 1922 than in 1921. During the last quarter of the year department stores increased their sales over the corresponding period of the previous year by approximately 6 per cent, while, comparing the same periods, mail-order houses reported sales 31 per cent larger. Mail-order sales, however, which reflect the merchandise demand in rural districts and which declined heavily during 1920 and 1921, were still smaller in dollar value than they were in 1919, whereas department store sales, representing city trade, were much larger. December sales of reporting department stores reached the largest monthly figure of the last four years, and in January were 12 per cent larger than in January, 1922.

INCREASED BUYING POWER. The increased buying which made possible this larger marketing of goods came chiefly from fuller employment and the larger pay rolls and from some increase in the net proceeds to the farmer from the sale of his products. Restoration of buying

power resulting from reemployment after the industrial inactivity of 1921 is one of the causes for the sustained demand that has supported the increase in that activity. During the past year the pay rolls at industrial establishments increased approximately 25 per cent. Moreover, this increased money income was not offset by corresponding increases in the cost of living. Retail prices rose very little during the year, so that the advance in wholesale prices has not yet been fully reflected in the prices of goods bought by the ultimate consumer. These conditions have enabled wage earners to make savings, as is evidenced by the growth of savings deposits throughout the country. The increase during the year in savings deposits for about 880 reporting banks distributed through the 12 Federal Reserve Districts and holding approximately one-third of the total time and savings deposits of the country was \$445,000,000. About 60 per cent of this increase took place during the last three months. The accumulation of these savings represents partly the deposit of funds arising from the redemption of Victory Notes and War Savings Certificates, but it indicates more particularly that current money income has not only been sufficient to purchase a large volume of consumers' goods, but also to contribute to the funds now being invested in houses and other capital goods. It is generally true that in years when production is large both consumption and saving are also greatest.

The curtailed buying power of European purchasers under present conditions raises the questions as to the extent of dependency

of various lines of industry upon foreign buyers and the relative importance of domestic and foreign markets.

Very wide differences exist in the relative amounts of various products shipped to foreign markets. The relatively large proportion of certain farm products marketed abroad explains the connection between the condition of world markets and the prosperity of the American farmer. The relation between the total foreign trade and total domestic production is difficult to estimate with accuracy, but both on the basis of physical units and of dollar value it is clear that no large proportion of the country's production during 1922 was marketed abroad. It should not be assumed, however, that the foreign trade of the United States is unimportant because, however measured, it is only a small part of our combined domestic and foreign trade. The cotton growers of the South and the farmers of the Middle West depend to a considerable extent upon foreign demand to insure marketing their crops at profitable prices. Moreover, even for manufacturers, the existence of a foreign market ready to absorb surplus products is an important price stabilizing factor, even though the actual volume of certain kinds of goods sold abroad may not be large.

The physical volume of exports in 1922, according to the foreign trade index of the Federal Reserve Board and other available data, was slightly less than in 1921, but the movement of goods was in general well maintained and was highest in the last three months of the year. The rise in those months was due entirely to increased exports of raw materials, chief among which was raw cotton. The

quantities of foodstuffs and manufactures, on the other hand, showed a tendency to decline in the latter part of 1922, following large movements of those classes of goods earlier in the year. The lower priced cereals, such as corn, rye, and oats, were exported in larger quantities than in the previous year, but wheat exports fell sharply on account of strong competition from Canada, which tended to discourage foreign buying. In December, however, wheat exports showed a decided recovery from the level of November and preceding months.

Manufactured goods were shipped abroad in about the same quantity during 1922 as in the preceding year, exports having increased steadily in volume from the summer of 1921 until about the middle of last year. Since then the gain in that direction has not been sustained. Export trade in textile manufactures was larger in 1922 than a year earlier, but shipments of iron and steel manufactures and machinery were smaller. The downward trend of manufactured exports during the latter half of 1922, at the same time that production in this country was expanding, indicates that American manufacturers have not depended upon foreign markets to any large extent as an outlet for the recent increase in output.

PRICES AND PRODUCTION: While production and prices have both been increasing during the past year, for many commodities the rate of increase in production has been greater than the rate of advance in price. Wholesale prices, as measured by the index of the Bureau of Labor Statistics, have advanced 13 per cent in the course of the past year, while the volume of production in basic industries has increased 40 per cent. Prices of raw materials taken as a group have advanced 20 per cent during this period, while the prices of consumers' goods have risen only a little more than 6 per cent. During the three months ended January, 1923, the diverse price movement among different groups of commodities had balanced one another, so that the combined index has shown no net change. In January it remained unchanged at 156 per cent of the 1913 average. Prices of many basic commodities, however, advanced during January and February to new high levels for the current movement, in some cases reaching the highest points since 1920. During the past year price advances have been effective in calling forth larger output, and the expansion of production has been supported by the larger use of credit. When, however, production reaches the limits imposed by the available supplies of labor, plant capacity, and transportation facilities - in fact, whenever the productive energies and resources of the country are employed at full capacity - output can not be enlarged by an increased use of credit and by further increases in prices.

With production at its present volume, prices of many basic materials advancing, and the buying power of the public apparently considerably strengthened, the question arises, what will be the trend in the demand for credit and how soon will increased loan activity at banks result in a larger demand for accommodation at the Federal Reserve Banks?

CREDIT CONDITIONS: As stated in the beginning, the credit developments during the early part of this year differ in some significant particulars from those during the corresponding period a year ago. The extent of seasonal liquidation was less this year than last, and the movements in various classes of loans indicate the difference in the character of present borrowing compared with that of a year ago. Last year liquidation was chiefly of commercial loans, while this year it was for the most part confined to loans secured by stocks and bonds, commercial loans continuing to increase. At reporting member banks between the close of the year and the middle of February, loans secured by corporate obligations declined about \$47,000,000, while other loans, largely commercial in character, increased by about \$243,000,000. The larger part of these commercial loans were made by banks in the industrial and financial East, where the increased demand for credit has been reflected in higher money rates.

The extent to which this increased demand for credit may be met by other means than borrowing at Reserve Banks is limited. Although during the period between the beginning of 1921 and midsummer of 1922 member banks in leading cities used funds arising from loan liquidation in the purchase of securities to the extent of over \$1,000,000,000, it is doubtful how far they will be able to meet the increased financial requirements of business by the sale of these securities. While a portion of these securities might be absorbed by ultimate investors out of current savings, a large volume of sales within a short period is not likely to result in any considerable increase in the total volume of funds available for current operations. The fact/<sup>is</sup> that member banks have made use of all their available funds either for loans or investments, that a reduction in investments will result in increased demand for loans, and that the

growing demand for commercial credit will lead member banks to apply for additional accommodation at Federal Reserve Banks.

The increased demand for credit for commercial purposes is beginning to reflect itself in increased borrowing from certain of the reserve banks, particularly those in the larger centers where borrowings reflect most sensitively the greater industrial demands. The outstanding fact in reserve bank developments during the first eight weeks of 1923, taking the system as a whole, is that seasonal liquidation of discounts this year was negligible compared with last year, the net aggregate reduction this year being only about \$2,000,000. Member banks reduced their borrowings at eight of the reserve banks, but these reductions were offset by increases at the Philadelphia, Dallas, San Francisco, and New York reserve banks. The largest increase in discounts for the period was at the Federal Reserve Bank of New York, where member banks increased their borrowings by \$96,000,000. To better adjust its relation to the altered condition of the money market thus evidenced, the New York reserve bank has raised its discount rate from 4 to  $4\frac{1}{2}\%$ . Action which was also taken at the Boston and San Francisco reserve banks brought the rates of these banks to the uniform level of  $4\frac{1}{2}\%$  now obtaining at all Federal Reserve banks. Expansion in the volume of reserve <sup>bank</sup> /credit at a time when physical production is approaching maximum, particularly if the growth of business extends to all districts, will bring the reserve banks into a closer relationship through their rediscount operations to the movement of production, trade, and prices, than they have sustained for more than a year.