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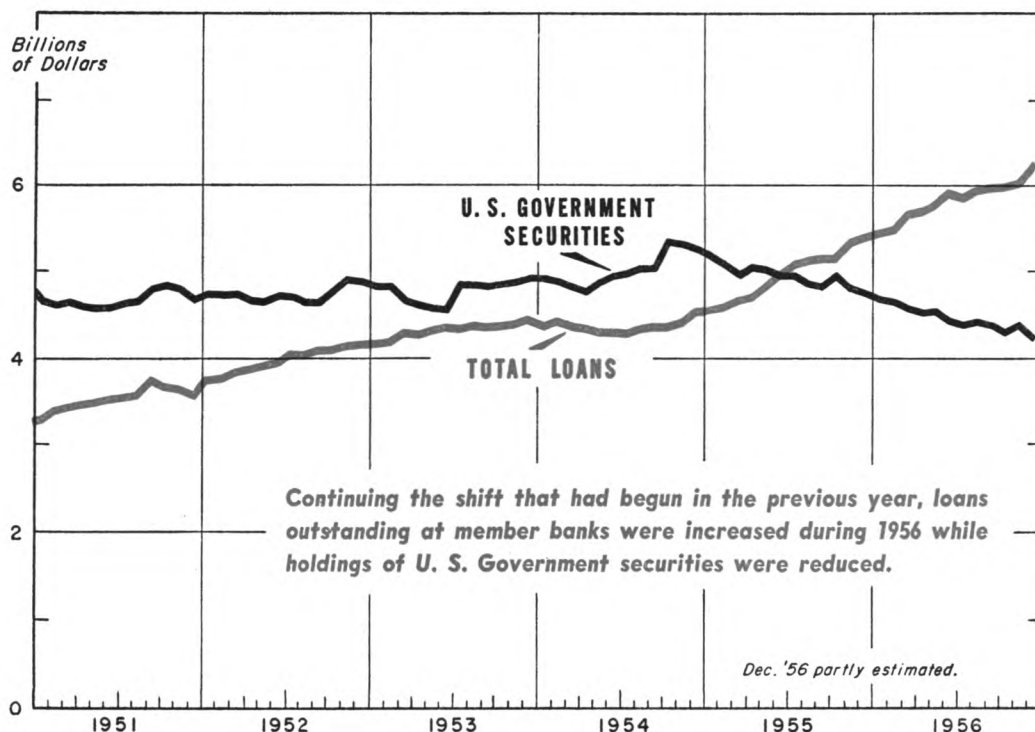
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LOANS OUTSTANDING AND HOLDINGS OF U. S. GOVERNMENT SECURITIES

Fourth District Member Banks



The Year In Fourth District Banking

"TIGHT MONEY" will probably endure as a popular description of banking conditions in 1956. Like most short-cut descriptions, it glosses over the underlying pressures that brought about the condition of tightness in money and capital markets.

Sparked by an unprecedented expansion in plant and equipment expenditures, the economy moved from record levels in 1955 into new high ground in 1956. Despite a reduction in the output of houses and autos, and a five-week strike in the steel industry, the nation's

productive resources ran at or near capacity. Financial resources, especially those of commercial banks, were strained by growth in the unrelenting demands of businessmen and consumers for credit.

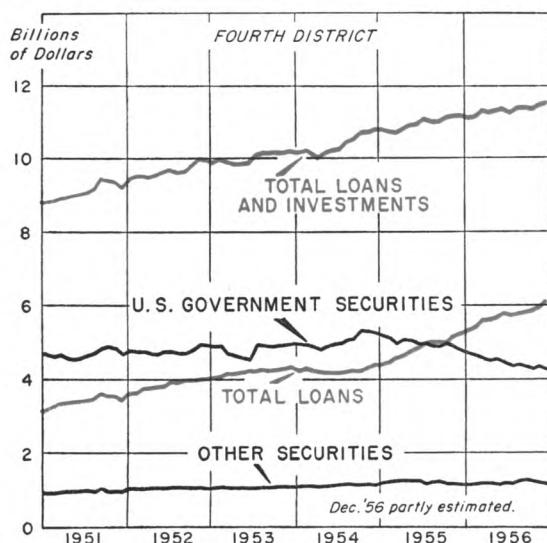
The growth of savings lagged behind the pace set by the demand for savings. Only a part of the gap was closed by an increase in the supply of money and credit, as the Federal Reserve continued to moderate the expansion of bank credit. Thus, tightness developed from an excess of the demand for funds over the available supply; it was reflected in higher interest rates and in the postponement of plans by some borrowers.

Although the expansion of bank credit in the Fourth Federal Reserve District, as well as in the nation, was restrained, Fourth District member banks increased the total of their loans and investments by about 3 percent, a somewhat smaller gain than a year ago. Nevertheless, they managed to meet a substantial share of the demand for loans by increasing loans by about 15 percent and reducing holdings of U. S. Government securities by about 10 percent.

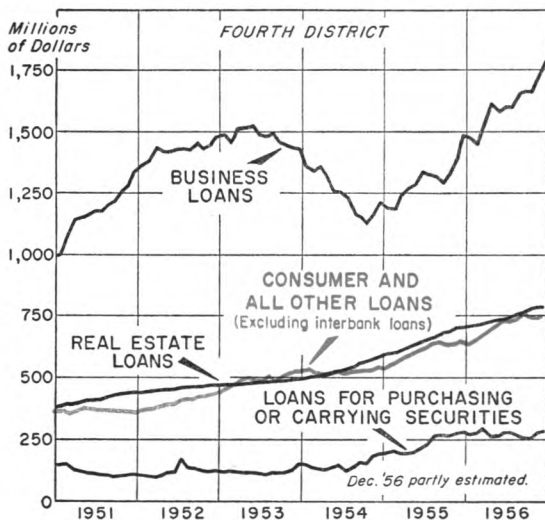
Demand for Bank Credit

As shown on the following chart, *business loans* in 1956 at Fourth District weekly reporting banks continued the upward movement that began in mid-1954. After the usual lull early in the year, business loans began a vigorous expansion that led to an increase in

During 1956, total loans and investments at member banks posted the smallest annual increase of the past six years.



All types of loans at weekly reporting banks increased in 1956, but only business loans maintained the pace set in 1955.



outstandings of nearly 20 percent during the year. The unprecedented expansion in expenditures for new plant and equipment, although financed mainly through security issues in the capital market, markedly affected business demands for bank credit. Bank loans to business increased, as firms borrowed in advance of actual security flotations and others borrowed in order to continue plans to expand while delaying security flotations in anticipation of a decline in issuing rates.

Business financial managers also found it necessary to go to banks for more of their working capital requirements. Current expenditures rose during 1956 under the influence of higher costs and larger inventories to meet a growing volume of sales. Accelerated corporate tax payments under revisions of the Internal Revenue Code of 1954 added further to business needs for funds.

It would seem likely that amounts borrowed to meet tax deadlines or in anticipation of long-term security financing would be repaid within several months. Such repayment is not evident in the aggregate figures for weekly reporting member banks in this District. For example, after a net increase in outstanding

business loans of \$89 million around the March tax date, an addition of \$72 million followed in April, with only slight retrenchment in subsequent months. Moderate reductions in business loans outstanding at Fourth District weekly reporting banks were made in only three of twelve months of 1956. This suggests that a considerable volume of loans was rolled over as corporate financial managers delayed new security issues with the expectation that lower rates could be obtained at a later date.

Weekly reports from a sample of large banks in the Fourth District indicate that nearly every type of business shared in the increased volume of business loans. (See accompanying chart.) Manufacturers of *metals and metal products* set the pace with a \$120 million addition to their outstanding bank debt between January 1 and December 5, the latest date for which reports were available at press time.

Public utilities were second largest borrowers in 1956. By December 5, they had made a net addition of nearly \$58 million to their bank-held debt in contrast to a net reduction of about \$28 million during the comparable year-ago period. On the other hand, *sales finance companies*, net borrowers to the tune of \$83 million a year ago, made net repayments of \$64 million in 1956. Repayments by sales finance companies occurred when funds were obtained from nonbank investors, but did not reflect reduced credit extensions to consumers.

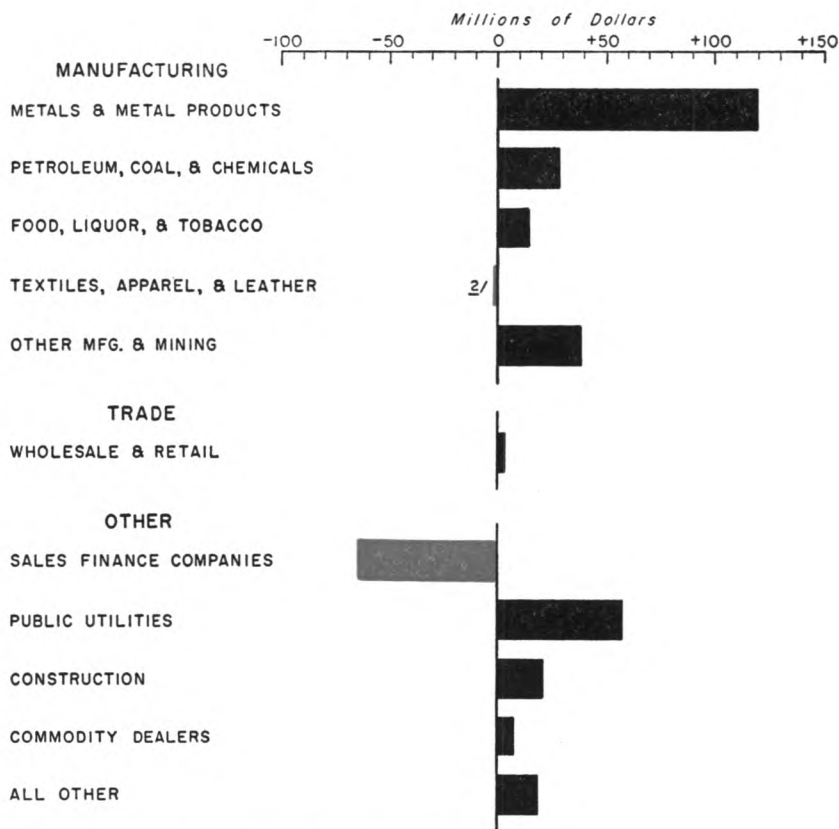
In 1955, *consumer and all other loans*, largely loans to individuals, had risen more than 20 percent at Fourth District weekly reporting member banks. It is somewhat remarkable that such loans at Fourth District weekly member reporting banks continued to increase during 1956, rising an additional 17 percent.

During the postwar period, the borrowing experience of individuals has been enhanced by steady incomes and increases in incomes that made it easier to pay off old bills. The past year was no exception. As individual in-

NET CHANGE IN LARGE BUSINESS LOANS OUTSTANDING¹

By Type of Business, Jan. 1—Dec. 5, 1956

Fourth District



¹ Includes loans of \$50,000 or more at 14 weekly reporting banks.

² Less than \$2 million.

comes rose, expenditures for consumer durables, partly affected by price increases, also rose, and borrowing directly from banks or indirectly through sales finance companies continued to move upward.

Unlike business loans, *real estate loans* lost some of the spark of recent years, though they continued to rise during 1956. Increased costs and a larger average size of housing units partly overcame the decline in sales insofar as the demand for real estate credit was concerned. Real estate loans at Fourth District weekly reporting member banks rose \$76 million in 1956 in contrast to a \$118 million in-

crease in 1955. These figures do not include bank loans to real estate mortgage lenders, often called "warehousing" loans, which declined about \$12 million during the twelve months ended November 16, 1956.

Meeting the Demand

Inasmuch as the commercial banking system is a fractional reserve system, its capacity to handle growing pressures for loan expansion, without reducing security holdings, depends upon the excess of reserves over the volume of reserves it is required to maintain. At this point, decisions of the Federal Re-

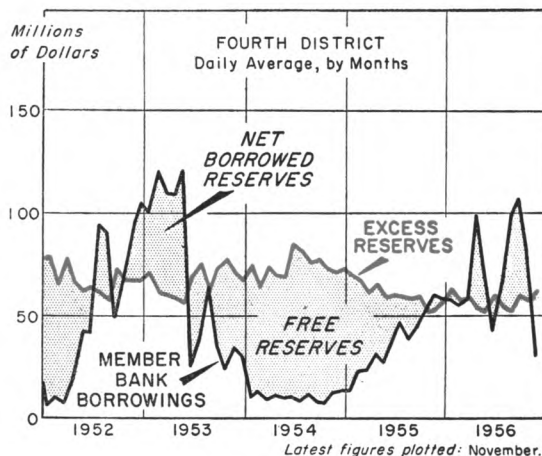
serve System become of strategic importance. Reserves might be freed by lowering the required ratio of reserves to deposits. Additional reserves might be supplied through purchases of U. S. Government securities by the Federal Reserve System. Reserves can also be obtained for short-run emergency or seasonal needs by borrowing from the Federal Reserve Banks.¹ Also, commercial banks within a specific region, such as the Fourth Federal Reserve District, might gain reserves at the expense of declines in other regions.

During 1956, the Federal Reserve System followed a policy, typified as "active restraint," designed to hold the expansion of the money and credit supply within the nation's capacity to grow without inflationary excesses. As a result, reserves were supplied sparingly to the banking community to meet seasonal, emergency, and long-run growth needs. Further, there is no evidence of a significant net gain in reserves at Fourth District banks as a result of a net loss from the rest of the nation.

The accompanying chart reveals the varying degrees of tightness felt by Fourth District member banks since 1951. When banks have substantial free reserves, i.e., excess reserves less borrowings from the Reserve Banks, they actively seek new business. This free-reserve situation prevailed in 1954 and to a steadily decreasing extent in 1955. On the other hand, when bank borrowings are greater than excess reserves, commercial bankers are generally more conservative in their lending and investing operations. This is the position Fourth District member banks found themselves in during most of 1956.

For that reason, loan expansion depended heavily upon commercial banks' willingness and ability to reduce investments and cash resources. For the year as a whole, the decline in holdings of U. S. Government securities at Fourth District member banks amounted to more than half of the rise in loans. (See cover chart.) To some extent,

The cushion of free reserves available to member banks for loan expansion in 1954 and most of 1955 changed to the restraining influence of net borrowed reserves in much of 1956.



especially for short periods of adjustment, Fourth District member banks also reduced their vault cash and balances with other banks.

Effects on Deposits

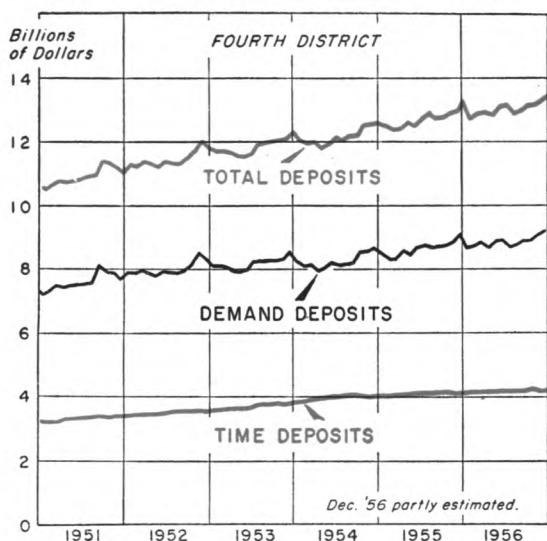
Reflecting the tighter reserve position and the limited capacity to increase loans and investments, demand deposits at Fourth District member banks increased only slightly during 1956. However, holders of demand deposits made more intensive use of existing balances. Demand deposits, excluding bank and U. S. Government deposits, at banks in 28 reporting centers in the Fourth District were turned over at an annual rate of 23.2 in 1956 in contrast to 21.3 in 1955. Time deposits at Fourth District member banks increased 3 percent during 1956.

Effect on Bank Liquidity and Earnings

In addition to the fact that the shift from securities, and to some extent from cash resources, to loans has enabled Fourth District member banks to increase their loans by a substantial \$835 million in 1956, the shift from securities to loans has other important results.

¹ Other operating factors that affect the level of reserves are taken into account when Federal Reserve System policy is put into effect through open market operations.

Monetary restraint in 1956 was reflected in a slower rate of growth in demand deposits at member banks than had occurred in the previous year.



First, bank liquidity has been lowered. Liquidity, of course, is a relative concept. It is sometimes measured as the ratio between cash resources and U. S. Government securities to total assets. At the end of the war, this ratio was unusually high at 79 percent. By the end of 1955, it had declined to 53 percent and it fell below 50 percent in 1956.

The decline in liquid assets was largely concentrated in short-term U. S. Government securities, i.e., bills, certificates of indebtedness, and notes, which commercial banks consider a secondary reserve. During 1956, Fourth District weekly reporting member banks reduced their holdings of short-term Governments about 12 percent, to the lowest level since 1949. The reduction in liquidity, which includes a smaller volume of secondary reserves, contributes to a greater degree of responsiveness by member banks to credit-restraint actions taken by the Federal Reserve System.

Bank earnings have been influenced both by the large demands for loans and by the portfolio shift from securities to loans. The lag in the supply of loanable funds has resulted in an upward movement in the rate structure. For example, prime loans to top-rated corporations were 4 percent at the year end, the highest level since 1933. Also, loans typically earn higher rates than securities. Thus, the increased volume of loans and the relatively larger share of assets in loans have both contributed to an increase in operating earnings during 1956. However, the shift has a two-edged effect on earnings, as losses have been sustained on sales of securities in a market where yields were rising and prices falling.

In addition, commercial banks have, like business firms, been affected by rising costs, primarily salaries, and by a continuation of large tax payments. Nevertheless, early estimates indicate that net profits, after taxes, earned by Fourth District member banks for the year 1956 will aggregate 10 to 15 percent larger in dollar volume than in the previous year.

Banking Structure

A marked change in the banking structure since the end of the war has been an increase in the number of banking offices, with the number of banks declining through consolidation and merger and the number of branches increasing, largely through new additions. Although the merger movement has abated somewhat, 1956 was not an exception to the postwar trend.

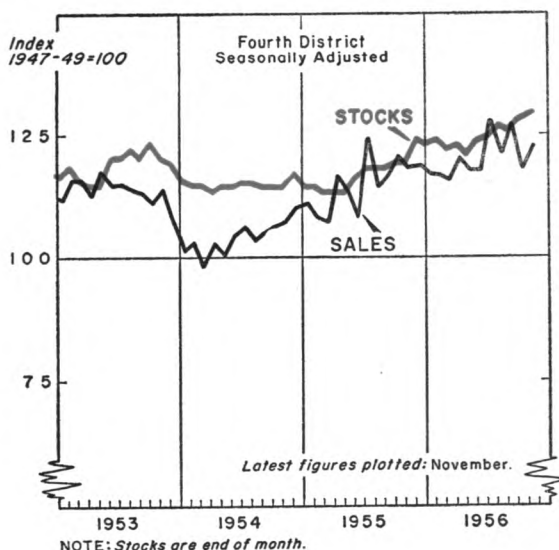
At the end of 1955, there were 999 insured commercial banks with 567 branches operating in the Fourth District. By the end of 1956, the number of banks had declined to 984 and the number of branches had increased to 666.

Department Store Trade—Review of 1956

DEPARTMENT store trade during the past year reflected stability of employment and rise of disposable personal income. As consumer confidence continued high, buying at department stores overtopped the all-time high of 1955. Part of the rise in sales, however, must be attributed to the rise in prices.

For the Fourth Federal Reserve District, the increase in total department store sales between 1955 and 1956 is estimated (at press time) as about 5 percent. Since there are grounds for believing that the over-all in-

Department store sales reached new high ground in 1956, with the second half of the year stronger than the first half. Stocks also rose.



crease in the department-store price level amounted to only one or two percent during the same interval, the gain in physical volume of sales must have been appreciable.

Month-to-month changes, seasonally adjusted, are shown on an accompanying chart. At the beginning of the year, there was an easing off from the high position of December 1955. By March, seasonally adjusted sales were nearly 3 percent below the adjusted December position. Unfavorable weather and several days of heavy snowfall in March over much of the District cut into pre-Easter shopping. Moreover, this year's early date of Easter reduced to some extent the aggregate of sales during the Easter season. By April, department store sales had moved upward again.

During the second half of the year, although the monthly path of the adjusted sales index showed a marked pattern of zigzag, the general level was higher than in the first half. Sales in the Fourth District showed considerable strength through the summer, in spite of the impact of the steel strike; in fact the July showing (seasonally adjusted) marked the peak for the year. It was also the highest July on record—one percent above the previous record July in 1950.⁽¹⁾

Adjusted sales during August declined from the exceptionally high July showing, but there was a rebound in September. Unseasonably warm weather during October

(1) It should be emphasized that this statement refers to seasonally adjusted sales. Unadjusted sales are always low in July.

brought sales down to 118 percent of the 1947-49 average daily sales—2 percent below those of October 1955. November and December, however, brought renewed improvement. (December is not shown on the chart.) Sales totals for the Christmas shopping season were somewhat above the record Christmas volume of the previous year.

Inventories

End-of-month inventories of Fourth District department stores (shown by the colored line on the accompanying chart) registered a slight decline during the first five months of the year, after seasonal adjustment. However, in June they reversed direction, and continued to rise moderately for the rest of the year.

For the past several years, department store inventories have followed a generally orderly pattern. Wide fluctuations caused either by heavy buying or by liquidation of inventories have been absent. On the average, inventories during the year were about 6 percent higher than for the previous year. This build-up in inventories was broadly in line with expanded sales during the year.

New Orders

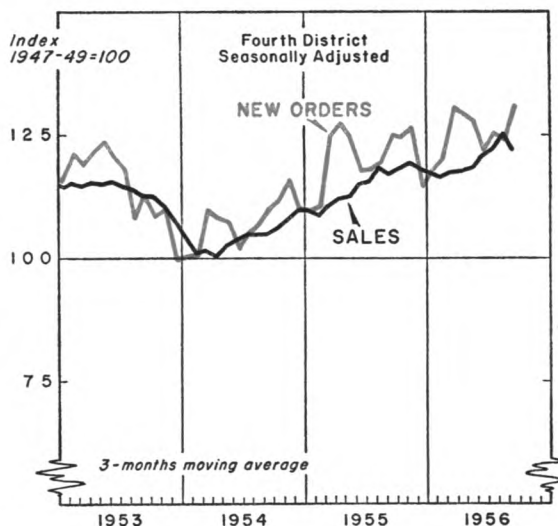
Toward the end of 1955, new orders placed by Fourth District department stores had dipped sharply from the levels of the preceding three months, after adjustment for seasonal variation.⁽²⁾ During the first quarter of 1956, however, new orders moved upward and in March exceeded the year-ago figure. After another decline during the second quarter, they turned up again in July and by early autumn they were reaching into new highs.

Apparel and Homefurnishings

While sales of apparel, which represents the greater portion of department store busi-

(2) The new order series shown by the colored line on the accompanying chart is derived by combining information on outstanding orders, inventories, and sales as supplied each month by a substantial group of cooperating department stores. The sales index depicted in the same chart is based on a somewhat larger sample of reporting stores. Both series are seasonally adjusted and are smoothed by use of three-months moving averages.

By early autumn of 1956, after a decline in the second quarter of the year, new orders placed by District department stores were reaching into new highs.



ness, recorded a moderate rate of increase for the year 1956, sales of homefurnishings showed greater relative strength, along with marked fluctuations.

Sales of homefurnishings are shown by the colored line on the chart on the opposite page, and sales of apparel by the black line. (Both are seasonally adjusted monthly values.)

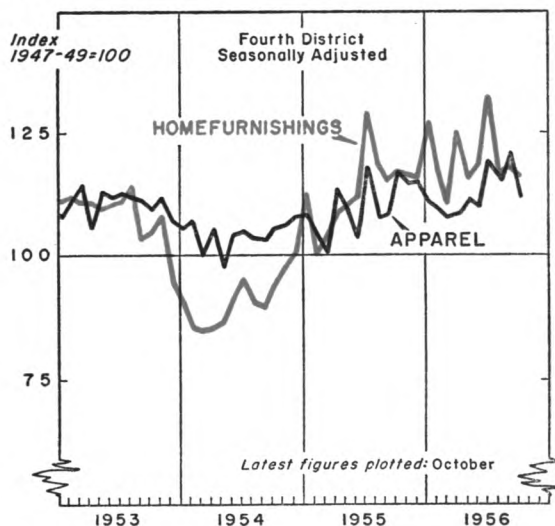
The range of fluctuation for homefurnishings from the low to the high position for the year amounted to nearly 20 percent. On the other hand, District apparel sales have followed closely the path of total sales and have been far more stable than sales of homefurnishings. During the 1954 recession, apparel sales had declined approximately 15 percent from the peak reached in 1953, while sales of homefurnishings had slipped nearly 26 percent below the 1953 highs. After the revival, sales of homefurnishings kept a brisk pace and recorded an irregular but definitely upward trend. The 1956 peak was 56 percent above the low point of March 1954.

SALES BY DEPARTMENTS, 1956
Percent Change From 1955
Fourth District Department Stores

Department	% Change From 1955
Records, Sheet Music, Pianos, Instruments, etc.....	+24
Books and Magazines.....	+11
Candy.....	+11
Upholstered and other Furniture.....	+10
Juniors' Coats, Suits, and Dresses.....	+10
Radios, Phonographs and Television.....	+10
Furs.....	+ 7
Toilet articles and Drug Sundries.....	+ 7
Knit Underwear.....	— 2
Aprons, Housedresses and Uniforms.....	— 2
Toys and Games.....	— 4
Cotton Yard Goods.....	— 4
Linoleum.....	— 9

January through November

Sales of homefurnishings showed greater relative strength during the year than sales of apparel. However, homefurnishings sales also showed wider fluctuations.



Sales by Departments

Most of the departments in 1956 posted gains over the exceptionally high showings of 1955. It is well to note, however, that consumers have been spending relatively more money on such items as records, books and magazines, phonographs and television sets, as well as furs, toilet articles, and drug sundries. (See table.) Increased sales of such articles might be taken to highlight a rising standard of living.

There were relatively few departments that slipped below year-ago sales; these appeared to include goods which suffer a rather strong competition from substitutes. Thus, for example, sales of silk and cotton goods seem to have been losing ground to synthetic fabrics which have been aggressively promoted and have enjoyed increasing acceptance by the consuming public.

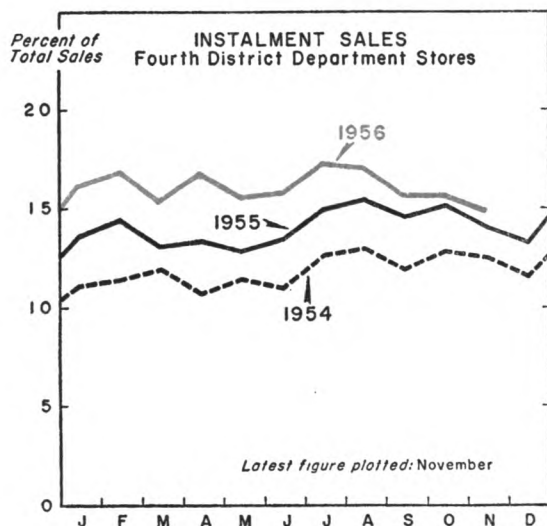
The fall in sales of linoleum could well be attributed to consumers' tastes for higher priced floor coverings, since the sales of domestic floor coverings in general increased by approximately 8 percent.

Instalment Sales

The importance of instalment selling by department stores has become more evident with an increase of homefurnishings sales. Homefurnishings include such high-priced items as major household appliances, furniture and bedding, as well as radios, phonographs, and television sets. Sales transacted on an instalment basis continued to expand both in dollar volume and in proportion to total sales.

During 1954, instalment sales fluctuated between 11 and 13 percent, as shown by an accompanying chart. However, a year later the range moved up between 13 and 15 percent and in 1956 instalment sales ranged between 15 and 17 percent of the total. Ten years ago, in 1946, instalment sales transacted by department stores accounted for only 5 percent of total sales.

Instalment sales as a share of total sales expanded further in 1956.



Instalment sales have been expanding at the expense of cash sales rather than charge account sales. For the past ten years, sales transacted on a charge-account basis ranged between 48 and 51 percent of the total (yearly averages) with the exception of 1946 when charge-account sales amounted to only 46 percent. (However, 1946 can hardly be considered a normal year, since consumers were spending cash balances accumulated during the war.) During the same ten-year period, the share of cash sales steadily declined from 49 percent in 1946 to 35 percent in 1956.

DEPARTMENT STORE SALES

Percent Change From 1955*

Metropolitan Area	Percent Change
Wheeling-Steubenville.....	+ 8
Canton.....	+ 7
Pittsburgh.....	+ 7
Columbus.....	+ 6
Youngstown.....	+ 5
Eric.....	+ 5
Cincinnati.....	+ 4
Cleveland.....	+ 4
Akron.....	+ 4
Lexington.....	-0-
Toledo.....	-0-
Portsmouth.....	-0-
Springfield.....	-0-
FOURTH DISTRICT TOTAL.....	+ 5

*January through November

Metropolitan Areas

The year-to-year increase in sales during 1956 was shared by most of the major reporting centers, with the margin of increase ranging from 4 to 8 percent. The largest increase, 8 percent, was reported by the Wheeling-Steubenville area. The Canton and Pittsburgh areas each scored a 7 percent gain over 1955. In Lexington, Toledo, Portsmouth, and Springfield, sales were on a par with 1955.

Statement of William McChesney Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

(before the Subcommittee on Economic Stabilization
of the Joint Economic Committee, December 11, 1956)

ON BEHALF OF MY ASSOCIATES of the Federal Reserve System I want to express our appreciation for these periodic opportunities to appear before committees of the Congress. The Congress has placed a great responsibility upon the Federal Reserve System—a trusteeship, as I conceive of it, over money.

The Reserve System has always benefited from thoughtful inquiry. These hearings are not merely a public forum—and that is all to the good. They provide a means of keeping the monetary machinery of the country abreast of the times. The Federal Reserve Act provides that we shall report directly to Congress and thus, through it, to the country.

The task of the Federal Reserve System, under today's conditions, is to determine the volume of credit that needs to be made available in order to keep the economy running in high gear—but without over-strain. Too much credit would intensify upward pressures on prices. Too little could needlessly starve some activities. We have to rely on human judgments in this determination. There are bound to be differences in judgment—sincere differences. We do not undertake—and I do not see how it could be otherwise, short of some form of dictatorship—to say how a given supply of credit shall be allocated.

Experience would seem to demonstrate that allocations of credit determined through the market process are to be preferred to judgments—or guesses—of public authorities, however well-intentioned. I was told recently of a tongue-in-cheek sign that hung in a Washington office some years ago. It read: "Our guess is always best." It may be that collective judgments expressed through the market process are not always best, but that process is consistent with our heritage and our institutions under which direct governmental intervention in economic affairs is confined largely to broad, general policies necessary to protect and promote the public interest.

At any given time the economy is capable of producing a volume of goods and services limited by currently available resources, human and material. The difficulty throughout this year has been the attempt to crowd too much into a given time period—

demand, in brief, has been pressing strongly against the supply of labor and materials.

Creating more money won't produce more things when the economy is running at peak levels. A choice has to be made—and the public in the end has to make the choice of whether we shall have more of this and less of that. We can have, in a given period, just so many houses, automobiles, household appliances, schools, manufacturing plants, and a myriad other things, including ships, planes, submarines, and other essentials of defense. Under present conditions, something has to be given up at least for a time. Throughout this year the combined demand for funds—for credit—coming from virtually all sectors of the economy has been at an all time high. It has outrun the available supply. Contrary to some impressions, the Reserve System has not reduced the money supply; in fact the money supply has continued to increase this year though at a lesser rate than in 1955. Moreover, the turnover—the velocity—of the existing money supply has greatly increased. Although the so-called "tightness" of credit is often attributed to an insufficient supply of money, the fact is that the tightness results from the volume and intensity of demand.

The great bulk of loanable funds represents savings of the community made available to borrowers directly or through financial institutions other than commercial banks, such as mutual savings banks, insurance companies, savings and loan associations, private and public pension funds, finance companies, corporations, and individuals. It is often forgotten that when the commercial banking system expands its loans and investments, it generates new money. When, as has been the case this year, aggregate demands for credit have exceeded savings, the only way to finance them all would be by an even greater expansion of bank credit—that is, by generating still more money. And as I have emphasized, creating more money will not create more goods. It can only intensify demands for the current supply of labor and materials. That is outright inflation.

The Reserve System—and it is a nationwide system of 12 Federal Reserve Banks with 24 branches having all told some 260 directors representing varied walks of life—is united in the conviction that the best

course is to do what the System can do, to restrain excesses arising from monetary causes. It has been estimated that a rise of only one point in the consumer price index (BLS) would cost the American public two and a half billion dollars a year.

The Federal Reserve System has been devoting its efforts, through varying times and circumstances, to assuring monetary and credit conditions that would help to foster high levels of business and employment, maintain the stability of the currency, and promote sustainable growth in the economy.

The System has sought to keep constantly alert to changes in economic and financial conditions, and to adapt its operations accordingly—leaning against the breezes of inflation and deflation alike, as I have put it a number of times.

Thus, when the economy had a downturn in 1953, the Reserve System acted promptly to stimulate credit expansion to help halt the decline and foster the recovery that began in 1954 and carried through into 1955. As we moved from recovery to boom in 1955 and on through 1956, and as the economy in general pressed against the limits of immediate capacity, the System took steps to keep expansion of credit within the limits of the growth in resources so as to discourage excesses that would inevitably produce higher prices and severe economic maladjustments.

Focusing more closely on the events of 1956, it was apparent there were positive inflationary dangers inherent in superimposing a massive increase in business investment on an economy already featuring high utilization of resources and upward price pressures. In this situation, to supply on easy terms all of the credit desired by prospective investors would have increased inflationary bidding for available resources, especially in the sectors of capital equipment and construction. It also would have involved a rise in the volume of outstanding credit, and in commercial bank credit and demand deposits in particular, that would compound the threat to economic stability and sustained growth.

Despite the restraint on credit growth and spending capabilities imposed by monetary policy, demands in many sectors have risen more rapidly than was consistent with price stability. The price advances that began in 1955, after several years of stability, continued during 1956, as output in a number of key areas pressed against the limits of capacity. Price increases have been particularly marked in sectors affected by investment expenditures, in machinery

and construction lines and, affected in part by them, in metals and metal products. These are the areas in which the restraint imposed upon current expenditures by monetary policy was, quite possibly, the heaviest. It is in these sectors that such additional demand as would have resulted from easier credit would have been concentrated.

Despite the strength of credit demands, growth in total commercial bank credit was limited to a moderate rate, below the average of the postwar period and somewhat lower than in the corresponding period in 1955. Thus, the increase in total loans and investments of commercial banks in the 12 months ending with October was held to 2 per cent, and growth in the privately held money supply—demand deposits and currency—to about 1½ per cent.

Restraint on expansion in bank credit and the money supply this year contrasts with the rapid increase that occurred from mid-1953 through 1954, even though loan demands then were generally less active. During that period, policy was directed toward assuring ready availability of credit in the economy generally, and toward creating liquidity conditions favorable to revival and expansion. In part the developments since 1954 should be interpreted as a transition from a time of ready availability of resources, reduced demands for credit, and a monetary policy of active ease to a time of intense utilization of resources, very strong credit demands, and a monetary policy directed to restraint of inflationary forces.

Just now, the year is coming to a close with demands still out-pacing savings, with personal income at a new high annual rate of over 332 billion dollars in October—21 billion dollars above the rate a year ago—and international disturbances that could add to further overstraining of our resources. It is a situation that calls for alertness, as well as prudence and restraint, on the part of Government, business, finance, labor, and agriculture.

Basically, the problem confronting us now—in contrast to that of the early 1930's—is not one of creating millions of jobs overnight to cure mass unemployment, but one of sustaining the millions of jobs we have today and fostering new job opportunities for an expanding working force tomorrow.

Meeting that problem requires that the efforts of all of us be directed to preserving the stability of the economy, and the stability of the dollar that underlies it, so that we may move steadily along the road to a higher standard of living for all.