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MONEY MARKET IN DECEMBER

Treasury transactions overshadowed all other developments in the money market during the past month. Among these transactions were the cash redemption of one-half billion dollars of certificates of indebtedness, representing the unexchanged portion of an issue maturing on the first of December, and the cash redemption of 3.3 billion dollars of notes maturing at the midmonth, Treasury withdrawals of more than 3½ billion dollars from War Loan accounts to provide funds with which to effect these redemptions, interest payments in excess of 700 million dollars on the public debt, and heavy collections of quarterly instalments on income taxes which it is estimated amounted to more than 2 billion dollars (including Savings notes presented in payment of taxes). Finally, heavy interest disbursements and the redemption of a considerable volume of securities held by nonbank investors resulted in a shift of deposits from reserve-free War Loan accounts to private accounts against which reserves must be maintained, and member bank reserve requirements rose markedly in the three weeks ended December 18. In the following week, however, the decrease in private deposits associated with tax payments caused a sharp decline in required reserves. Other important money market developments included a substantial seasonal increase in money in circulation which tended to bring pressure on reserves, and sizable gains of funds by the market through payments out of foreign deposit accounts with the Federal Reserve Banks and through a seasonal increase in "float".

The operations of the Treasury had the effect of inducing very large shifts of funds between various parts of the country, particularly between New York and the rest of the country. In making disbursements connected with public debt operations the Treasury transferred large sums withdrawn from War Loan accounts in "out-of-town" banks to New York City where such payments were heavily concentrated. Banks outside New York and nonbank investors then withdrew large amounts of funds from the City to replace reserves lost through Treasury War Loan calls and to meet quarterly tax payments. In the four weeks ended December 24, the New York City banks gained more than one billion dollars through Treasury transactions, but lost nearly 1.4 billion dollars through banking and business transfers of funds to other areas.

It was inevitable with such large movements of funds that the losses of reserves of some banks exceeded their gains and that the gains of others were larger than their losses. Thus, while some banks were increasing their use of Federal Reserve credit in order to adjust their reserve positions, others were retiring Reserve credit or acquiring excess reserves. In the two statement weeks ended December 11, most of the demand for Federal Reserve credit came from the New York City banks. In the following week, when the metropolitan banks gained funds heavily through Treasury operations, they repurchased a large amount of Treasury bills from the Reserve Bank and purchased certificates of indebtedness in the open market from out-of-town banks. The latter institutions also made net sales of short term Government securities directly and indirectly to Federal Reserve Banks, but most of the Federal Reserve credit they obtained in this period came from a sharp expansion of about 440 million dollars in the "float". (This increase in float is a seasonal development which is attributable to delays in the mail at Christmastime that temporarily lengthen the time required to collect checks, while the Reserve Banks continue to give commercial banks credit according to the regular time schedules for checks presented for collection.)

Retirement of the unexchanged portion of December 1st certificates of indebtedness on December 2 (close to 500 million out of a total of 3.8 billion dollars), was accomplished without material effect on the reserve positions of member banks, as the Federal Reserve Banks exchanged all their holdings for the new issue. Cash redemption of the entire issue (3.3 billion dollars) of 1½ per cent Treasury notes during the week ended December 18 was also accomplished with little strain on the reserve positions of the member banks in the aggregate, as the notes held by the Federal Reserve System were, in effect, redeemed with funds previously accumulated in the Treasury's balances with the Federal Reserve Banks. However, this redemption operation, together with large interest payments on the public debt and the heavy withdrawals from War Loan deposit accounts, gave rise to distortions in the reserve positions of individual banks and groups of banks and led to the heavy shifts of funds mentioned above.

The major impact of the note redemption on the money market was felt on December 16 when interest payments were also made on outstanding Treasury obligations. As a result the New York money market experienced the largest one-day turnover of funds ever recorded, with the possible exception of the payment dates for subscriptions to new securities offered in some of the later War Loan drives. About 1.6 billion dollars or one half of the notes redeemed and 400 million dollars or two thirds of the interest on the public debt were paid in New York, while the City banks were only required to make payment, to the Treasury, of 700 million dollars out of War Loan accounts. This was less than one fourth of the call for all banks of the country. As a partial offset to this gain of funds by New York City banks, however, there were withdrawals of the proceeds of redeemed notes held here by out-of-town customers of New York banks, and large withdrawals of funds by banks in other parts of the country to enable them to meet the Treasury's War Loan call. These transactions resulted in a loss to the New York money market of about 700 million dollars in a single day. Nevertheless, the New York banks had the benefit of a net gain of approximately 600 million dollars which greatly eased their reserve positions. The funds were used largely to repurchase about 250 million dollars of Treasury bills sold to the Reserve Bank earlier in the week and temporarily to augment excess reserves, which reached 350 million dollars on December 16. This excess was quickly absorbed by further repurchases of Treasury bills from the Reserve Bank, the acquisition of other short term Government securities in the open market, and further transfers of funds to other localities, so that by the end of the statement week (December 18), the surplus had turned into a deficit of about 70 million dollars.

In the week ended December 24, the Treasury built up its deposits with the Federal Reserve Banks, chiefly out of income tax collections, and public demand for currency continued strong. Banks both in New York and other parts of the country were affected and consequently were compelled to seek Federal Reserve credit in adjustment of their reserves.

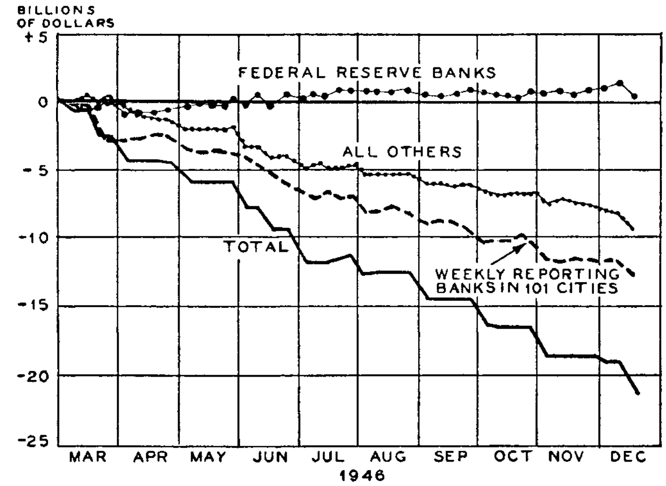
The increase in currency circulation was a constant source of pressure on member bank reserves during most of the month, but public demands for currency were much smaller than in 1945. Outstanding currency rose by about 350 million dollars in the four weeks ended December 24, 1946, as compared with 480 million in the corresponding weeks of the preceding year. The current increase in demand for cash was smaller despite the fact that in 1945 cash payment for subscriptions to Savings bonds and other securities offered in the Victory Loan served to retard the growth of currency, a factor that was of course absent in December of 1946.

Retirement of Public Debt

December redemptions brought to a total of approximately 23.3 billion dollars the amount of called or matured marketable Treasury securities retired by the United States Government since the end of February. In that period the Treasury's deposits in War Loan accounts were reduced from 24.4 to 2.2 billion.

The effects of the debt retirement program on the major

Changes in the Ownership of the Public Debt*
(Cumulative weekly from February 27, 1946)



* Total interest-bearing debt exclusive of special issues, Savings notes, and Armed Forces leave bonds.

classes of investors, as far as they can be determined from currently available figures, are shown in the accompanying chart. The data represent the total interest-bearing debt, less special issues which are available to Government agencies and trust funds only, tax Savings notes, and Armed Forces leave bonds. Savings bonds, the issue of which has increased about one billion dollars since the end of February (thus providing some offset to the retirement of public marketable issues), are included in the data.

Government security holdings of the weekly reporting member banks in 101 cities declined almost 13 billion dollars between February 27 and December 18, an amount equal to more than half the redemption of public marketable issues in the corresponding period and well in excess of their probable holdings of redeemed securities. Sales of Government securities by these banks for the purpose of adjusting their reserve positions, principally to meet the losses of funds resulting from the redemption of securities held by the Federal Reserve Banks, account for the difference. About 7½ billion dollars, or close to 60 per cent of the decrease in reporting member bank Government securities, consisted of certificates of indebtedness. Treasury notes accounted for 4.8 billion, or more than one third, and Treasury bills for one-half billion dollars. Bond holdings showed a small net decline of 200 million dollars, indicating that, in contrast to the heavy open market purchases of previous years, the weekly reporting banks did not fully replace the Treasury bonds lost through retirements, owing to the pressure on their reserves exercised by the redemption program and the expansion of alternative outlets for bank credit, particularly customer loans.

The decline in the Government security holdings of the weekly reporting banks brought about a lengthening of the average maturity of their Government security portfolios. This was attributable primarily to the redemption of large amounts of their short term securities, together with substantial sales of such securities to obtain needed reserves, and was only secondarily the result of purchases of medium term bonds.

The decline in bank holdings of Government securities also was primarily responsible for a reduction of 17 per cent in their total loans and investments since the end of 1945. Toward the close of 1946, Government securities had fallen to 64 per cent of total earning assets, against 72 per cent a year previous.

Despite the fact that cash redemptions of Treasury obligations held by the Reserve Banks amounted to approximately 4½ billion dollars, the holdings of these banks have risen about 200 million dollars since February 27. Federal Reserve purchases of about 4.7 billion of securities, directly or indirectly from commercial banks, provided the latter with more funds than were withdrawn from them by the Treasury to redeem securities held by the Reserve Banks. Thus, while the redemption program involved recurrent pressure on the reserve positions of member banks, the banks had little trouble in meeting all needs for reserves, because of the ready availability of Federal Reserve credit.

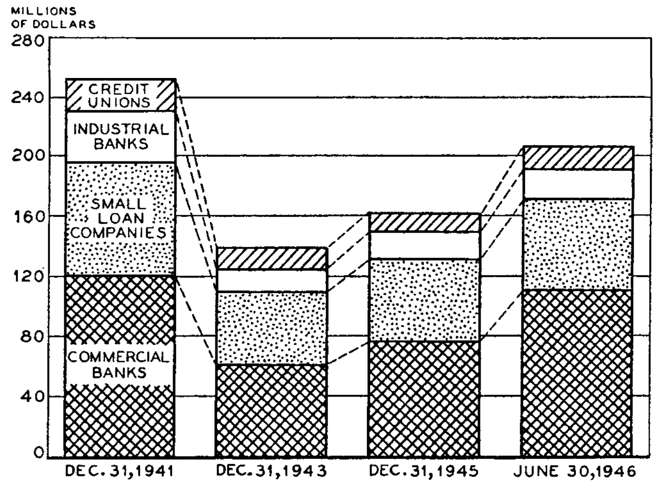
All other investors, including nonreporting member and nonmember banks, as well as nonbank investors, show a decline in their holdings of Government securities of about 9½ billion dollars during this period. It appears that in this group nonbank investors replaced part of their losses by buying other Treasury obligations in the open market.

SMALL LOAN COMPANIES IN NEW YORK STATE

Today competition in the consumer instalment lending field is so keen that it is difficult to realize that only fifteen or twenty years ago loan facilities available to the small individual borrower were extremely limited. Many individuals could get accommodation only from lenders operating without supervision, some of whom belonged to the category of loan sharks lending at exorbitant rates. In the last decade and a half this gap in our credit system has been filled by the rapid growth of small loan companies and the development of personal loan departments of commercial banks. The importance of these facilities in the field of instalment lending in the State of New York today is indicated in the accompanying chart, showing the amount, by type of lender, of consumer instalment loans outstanding in the years 1941 to 1946. At the end of last June the commercial banks and the small loan companies are estimated to have held about 55 and 30 per cent, respectively, of the dollar volume of such loans outstanding.

Small loan companies in this State operate under the New York Licensed Lenders' Act, which was passed in 1932 with the purpose of meeting the needs of the small borrower. It provides for the licensing of small loan companies by the State Superintendent of Banks, authorizes them to make loans of 300 dollars or less, and sets maximum interest charges for such loans. Because of the higher operating costs and greater risks involved in the small loan business, the maximum rates are considerably higher than the limits fixed by the general interest laws. The majority of the customers of small loan companies belong to the lower income groups, and many of them are wage earners whose credit ratings usually do not

Consumer Instalment Loans in New York State by Lending Agency, 1941-46*



* Amount outstanding, December 31, 1941-45, and June 30, 1946. Loans of commercial banks and all data for June 30, 1946 estimated by Federal Reserve Bank of New York; other data from New York State Department of Banking.

enable them to obtain loans elsewhere. The loans which they seek are often too small to be handled by other lending institutions.

The most frequent reason why people borrow from small loan companies is to meet emergencies, such as doctors' or hospital bills, or to consolidate debts. Purchases of major consumers' durable goods, such as automobiles, ordinarily require larger loans than the small loan companies are permitted to make. The contraction in the volume of such companies' business during the war, therefore, although marked, was not as sharp as the reduction which occurred in loans by other lenders. The amount of consumer instalment loans outstanding held by the commercial and industrial banks in New York State declined approximately 50 per cent between the 1941 peak and the low point; the corresponding decline for the small loan companies was less than 40 per cent. New instalment credits extended by small loan companies began to exceed repayments in 1943, several months earlier than in the case of other lenders, but those extended by the commercial banks have been rising more rapidly.

As is indicated in the accompanying table, the expansion of the past few years in the volume of loans made by small loan companies in New York State has not occurred as the result of any significant increase in the number of loans made. In 1945, 633 thousand loans were made, only slightly above the low point reached in 1943. Although preliminary figures for 1946 indicate a substantial increase in the number of loans, the number is still undoubtedly well below the prewar peak of over 900 thousand. Rather, the increase in volume has been the result of a substantial rise in the size of the average loan, which in turn is a reflection of the rise in the general price level. While this trend has been in evidence since the beginning of the war, it has been greatly accelerated in the past three years.

Loans Made by Small Loan Companies in New York State, 1939-45

Year	In thousands: Number of loans made	In millions of dollars: Amount loaned	Amount outstanding at end of year	Size of average loan
1939	843	130.3	65.1	$155
1941	900	148.9	75.5	166
1942	694	112.9	57.8	163
1943	627	102.7	46.6	164
1944	627	108.5	48.8	173
1945	633	117.0	54.8	185

Source: New York State Department of Banking.

A breakdown by size groups of the loans made by small loan companies in New York State shows strikingly this trend toward larger individual loans. In 1939 close to 42 per cent of the total number of loans made were for amounts of 100 dollars or less, and only 28 per cent were for more than 200 dollars. By 1945 these proportions had been very nearly reversed, and only 183 thousand, or 29 per cent of the total number of loans granted, were for 100 dollars or less; 243 thousand, or 38 per cent, were over 200 dollars. In 1945 the smaller loans represented only 12 per cent of the total *amount* loaned, while those over 200 dollars accounted for 59 per cent. Comparable statistics are not readily available for other States, but the size of the average loan in New York appears to be larger than in most of the other States which still restrict small loan companies to loans of 300 dollars or less.

The number of loans made by the small loan companies is, however, not a particularly good indication of the number of customers they serve. Renewals or repeat borrowings constitute a very large fraction of their business. A special study made some time ago by the State Department of Banking revealed that in 1941 renewals accounted for 60 per cent of the number of loans made, and 70 per cent of the total amount loaned, by small loan companies. Renewals granted by personal loan departments of the commercial banks and by industrial banks in that year represented 30 and 34 per cent, respectively, of the total number of loans made by these agencies.

Another significant trend in the small loan business is the increasing substitution of unsecured personal notes for household chattel mortgages. In 1945 nearly 40 per cent of the number of loans made by the small loan companies were unsecured, compared with about 10 per cent in 1936, while the percentage secured by household chattel mortgages dropped to 43 from 67 per cent. (The trend is more evident in New York City and its suburban area than in other parts of the State.) Of the remaining loans those secured by chattel mortgages on automobiles (usually made for purposes other than the purchase of a car) have accounted for anywhere from 8 to 12 per cent of the business in recent years, while endorsed paper, wage assignments, and loans secured in other ways have played only a very minor role.

The loss experience of the small loan companies has steadily improved over the period for which we have data, although it should be noted that this has occurred in a period of relative prosperity. Recoveries have increased substantially in recent years. For the ten-year period from 1936 through 1945 loan balances charged off less recoveries were equal to 0.67 per cent of the total volume of loans made, and the companies collected between 96 and 98 per cent of the interest due them. Losses in some individual years, of course, were much higher; in 1942, for example, net charge-offs amounted to 1.13 per cent of the year's loan volume.

Profitable operation of small loan companies depends primarily on efficient management, since maximum interest charges are fixed by statute. The distribution of overhead costs over as large a volume of loans as possible and the size of the average loan are both important factors in determining earnings. Because of the premium on the transaction of a large volume of business, large chains of loan companies have tended to be the most successful. At the end of 1944, the 197 branches of national chains operating in New York held approximately 86 per cent of the total amount of loans outstanding in the 270 loan offices in the State. Two companies alone, the Household Finance Corporation and the Personal Finance Company, operated 114 offices and held 49 per cent of the dollar volume of loans outstanding. Chains with branches only in New York State held 9 per cent of the total, and the remaining 5 per cent was distributed among the 27 single-office lenders in the State.

With so large a proportion of the business transacted by concerns operating in several States, it is difficult to compute the earnings and capital return attributable to the operations of small loan companies in New York alone. However, in 1940-41 and 1946 the New York State Department of Banking made special studies of the earnings of representative companies in an effort to determine the reasonableness of the interest rate limits in force. It was found that in 1939 small loan companies in New York State averaged after taxes a return of about 10.8 per cent on their average assets. Believing that such a return was higher than necessary to attract an adequate amount of capital to the small loan field, the Banking Department recommended that interest rates be reduced from 3 per cent per month on that part of the unpaid balance not exceeding 150 dollars and 2½ per cent per month on the remainder (the rates prevailing since the Licensed Lenders' Act was first passed in 1932), to 2½ per cent monthly on the first 100 dollars of unpaid balance and 2 per cent monthly on the remainder. These maximum rates were voted by the State Legislature and became effective on July 1, 1941. In its most recent study the Department found that, as a result of both this reduction in rates and the wartime decline in the volume of business, net earnings after taxes on average assets had declined to approximately 7.5 per cent in 1944.

These ratios do not, however, show the actual rate of return to the owner or stockholder, since small loan companies generally borrow a relatively large proportion of their total funds from commercial banks or through the sale of debentures. Since the cost of borrowed funds is relatively low, the larger the proportion of borrowed money to total employed funds, the higher the profits on equity capital. In 1941 approximately 44 per cent of the total funds employed in the small loan business in New York State was borrowed. With the wartime decline in demand, lenders required less working capital, and temporarily repaid a portion of their borrowings. In 1944 the proportion of borrowed funds was down to about 31 per cent. During the four years 1941-44 small loan companies paid an average of 2.3 per cent for borrowed funds and about 5.7 per cent on their preferred stock. The latter accounted for roughly 20 per cent of their total funds. At the low point in 1944, earnings on equity capital before taxes were about 11.8 per cent, compared with 17.6 per cent in 1942 (the first full year after the lowered interest rates went into effect). After taxes, the corresponding figures were 6.8 and 11.1 per cent, respectively. The 1945-46 expansion in loan volume and in the size of the average loan has reversed this trend in earnings and final figures for 1946 will undoubtedly show a considerable improvement.

The outlook for the small loan business is tied to the general level of business activity and to the total demand for consumer credit, but present indications point to a rising volume of business for some time to come. Over-all consumer borrowing is low in relation to disposable income as judged by prewar standards; the number of loans currently being made by the small loan companies is still considerably below prewar levels; and the size of the average loan is continuing to increase. Furthermore, the State Department of Banking on the basis of its most recent study of the operations of small loan companies has recommended that the maximum loan limit be raised to 500 dollars. If this recommendation is adopted by the State Legislature, it should open a new and profitable field to the small loan companies. It is not possible to foresee just how the commercial banks' drive for a larger share of the consumer loan business will affect the small loan companies. However, a considerable proportion of the borrowers served by these companies are probably too great a credit risk to be handled by the banks or other lenders at the rates which they are permitted to charge.

THE HOUSING PROGRAM IN 1946

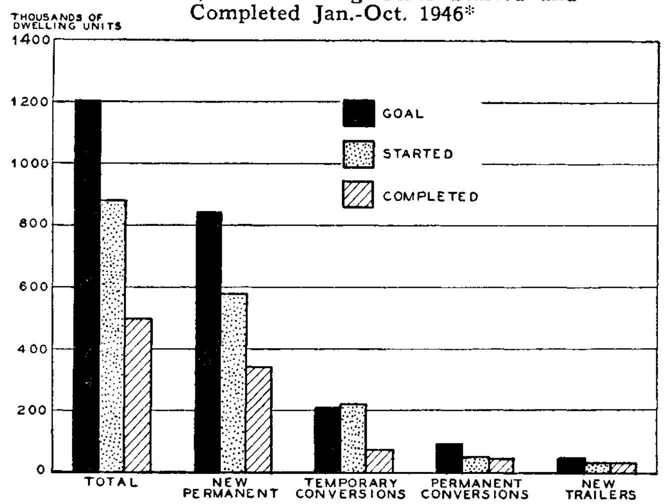
Mid-December marked a turning point in the national postwar housing program. Following the resignation of the National Housing Expediter, Mr. Wilson Wyatt, early in December, President Truman announced that controls on housing construction would be greatly modified, and, in effect, shifted the emphasis in the program from Government control to private enterprise. The postwar housing program had been launched in January 1946 under the President's emergency powers and was strengthened in May 1946 by the passage of the Veterans' Emergency Housing Act, which provided for premium payments for certain building materials, purchase priorities for veterans, allocation of scarce materials, guaranteed markets for prefabricated homes, and the restriction of nonresidential and high-priced home construction. During the year under review, the national housing program has moved from the blue-print stage to a point where a considerable acceleration in the volume of residential construction may be expected.

With the end of the war and demobilization of the Armed Forces, the shortage of housing, which had already been a pressing problem in wartime, reached emergency proportions. In the decade before the war, the volume of new housing had been insufficient to keep up with the normal replacement demand and to provide for population growth. During the war years residential construction was sharply curtailed, so that even by normal standards a substantial backlog of demand for housing had accumulated by late 1945. Furthermore, because of wartime conditions and the accompanying prosperity, the number of marriages and births had risen sharply. This increase in the number and size of families, coupled with a high level of income and savings, drew an unprecedented number of persons into the market for new or enlarged living quarters. In addition to these general trends, substantial migration of population within the country accentuated the local shortages in many metropolitan areas. Through Government-guaranteed loans to veterans and liberalized mortgage insurance by the Federal Housing Administration, the market for low cost housing has been increased still further. In the face of this pressing demand and the extremely low supplies of building materials and skilled labor prevailing at the end of the war, the Veterans' Emergency Housing Program was inaugurated in order to increase residential construction for the benefit of veterans by giving it a preferred place in the nation's reconversion program.

In appraising the accomplishments of the housing program, it is important to take into account the obstacles confronting the building industry. From the time of our entry into the war, residential construction activity was curtailed to meet urgent demands of war industries for both men and materials. Residential building in 1944 and the first half of 1945 was at the lowest rate since the depths of the depression in the early thirties. Many plants producing building materials had reduced considerably their scale of operations. In the light of these shortages, the goals set by the housing program were very ambitious. In 1946 it was planned to start construction on 1,200,000 dwelling units, of which 838,000 were to be new permanent housing; in 1947, 1,500,000 permanent homes were to be started. The greatest previous output of housing in the nation's history was the total of 937,000 dwelling units constructed in 1925, the climax of the building boom which followed the First World War. The 1946 goals of the Veterans' Emergency Housing Program and the accomplishments of the program during the first ten months of the year are shown in the accompanying chart.

The goal for new permanent housing included both conventional housing and prefabricated units. Originally it was hoped that Government-guaranteed markets and priority assistance in obtaining materials would result in the production of as many as 250,000 factory-built homes in 1946 and 600,000 in 1947. The 1946 goal was subsequently cut to 100,000, but by October 30, only 30,300 had been shipped by manufacturers. The number of conventional homes started in 1946 is running about 10 per cent short of the goal, with 549,600 units started in the first ten months of the year. However, the total number of new dwelling units started in 1946 will almost certainly be the greatest for any year since 1928, except 1941.

Federal Housing Program: Goals for Work Started in Year 1946, and Dwelling Units Started and Completed Jan.-Oct. 1946*



* Starts and completions for temporary re-use and conversion of war housing ("temporary conversions") include both the emergency housing under the Federal Public Housing Authority and the projects of State and local governments and educational institutions.
Source: National Housing Agency.

Toward the end of 1946 the program of transforming temporary war housing and military installations for emergency use by veterans was approaching the goal of 212,000 units originally set. In the first ten months of the year the Federal Public Housing Authority had started the equivalent of 191,600 dwelling units. However, commitments of funds had reached the maximum possible under present legislation and increasing building costs were causing curtailment of some projects, so that the number finally completed may be somewhat less. An additional 23,400 temporary units have been started by local governments and educational institutions, but only a small proportion of these have been completed thus far. About 87,000 more dwelling units have been made available by the conversion of existing homes and the manufacture of house trailers.

Altogether, work was started on 882,200 dwelling units of all types in the first ten months of 1946, and 500,400 units had been completed by October 31.

Despite measures taken to control prices of building materials and wages of construction workers, building costs have risen steadily in the past year. Shortages of materials and the consequent delays in completions (as well as purchases of materials at black market prices) raised the cost of housing far above prewar levels. One of the main objectives of the housing program was to stimulate the production of scarce materials by premium payments for output in excess of certain quotas, and by allocation of raw materials to building supply plants. By October the output of most building materials was at a new postwar peak and in several cases production exceeded prewar levels. President Truman has announced that the outlook is now sufficiently favorable for priorities and allocations to be discontinued in the near future. Subsidies will continue until the dates originally scheduled.

The Wyatt program did not encourage private rental construction. In the entire New York City area, for example, not a single apartment house was completed in the first ten months of 1946, although several large projects have been started and are expected to be completed some time in 1947. The new liberalized housing policy announced by the President will emphasize rental housing through financing aids and greater flexibility in the establishment of rent ceilings for new construction. It will also allow non-veterans to build for their own occupancy. The ceiling of $10,000 on new residential housing has been eliminated and replaced by a limitation of floor space to prevent the building of luxurious homes during the life of the program. It is anticipated that there will be an increase this year in the amount of nonresidential construction, which had been sharply reduced under the Wyatt program.

Although many families are currently being priced out of the market for new homes by rising building costs, the current outlook for construction in general is that of a high level of activity during the coming year. Even if large groups of potential buyers are eliminated by high prices and other groups are not satisfied with the values offered, there will still remain a considerable pressing demand for residential rental construction. There is also a large backlog of demand for commercial and industrial building and public works. Recently published estimates, including that of the Department of Commerce, point to record-breaking construction activity in 1947, with the total value of all types of building perhaps approaching 22 billion dollars.

AGRICULTURAL PRODUCTION IN 1946

Agricultural economists agree that farmers' cash receipts from marketing during the year just ended will be found to have reached a record peak not likely to be surpassed or even equaled in the years immediately ahead. Farmers in the country as a whole received more than three times as much cash in 1946 as in an average prewar year. This postwar prosperity of farmers resulted from a combination of two favorable factors—record crops, and a level of farm prices which in recent months approached the peak attained after World War I. The very large output was due primarily to unusually favorable weather conditions and also to large plantings. After a period of uncertainty immediately following the end of the war, the Department of Agriculture recommended that farmers not reduce production schedules, but aim instead at a maximum output to meet this country's increased domestic needs and foreign obligations. As the industrial reconversion progressed more rapidly than anticipated, domestic demand for all kinds of food was well sustained; prices climbed to higher levels, with particularly sharp increases following the end of price controls.

Reconversion from wartime to peacetime conditions, which has been practically completed in most manufacturing industries, still lies ahead for agriculture. For farm production, conversion to war spelled mainly increased production all along the line. Shifts to products for which demand was generated or considerably increased by the war (such as oil-bearing crops) affected only a small minority of farmers; no notable shifts of this type took place within the Second District. The majority of farmers continued to raise much the same products they had marketed before the war.

The considerable increase in farm production during the war —nearly one-third over the average for the five-year period 1935-39, measured in physical terms—has been aided significantly by favorable weather conditions. More importantly, however, much of the increase is due to improved farming methods. The effects of better breeding and seed selection, improved stock, increased numbers of tractors and farm machines on farms, contour plowing, and the spread of mechanization into new areas of farm production, have permanently increased the farmers' ability to produce larger quantities of food and of other agricultural products. Most of these wartime developments must be viewed as an acceleration of prewar trends.

In the past, when higher levels of output were reached as a result of improvements in technique or increases in acreage, farmers did not react to lower prices by limiting production. Year-to-year fluctuations in output tended to reflect changes in weather conditions and other influences independent of human action rather than farmers' willingness to adjust output to demand. Farm production on the whole is rather inelastic. Shrinking demand is more likely to result in downward price adjustments than in reduction of output. Viewed in this light, the postponed adjustment of our agriculture to reduced demand is expected to lead to a decline from the present price levels in some not too distant future. Whether such a decline will be limited to 10 or 15 per cent, as anticipated by the Department of Agriculture, will depend on a number of factors, including future trends in the money income of nonagricultural workers.

The December 1, 1946 estimates for the major field crops are given in the table below, together with the final estimates for 1945. Percentage changes given in the last column show eloquently that in the first full peacetime year production of all major crops, with the exception of cotton, was considerably above the average harvest of the last prewar years. The decline in cotton production was due mainly to a reduction of acreage devoted to this crop.

Production of livestock and livestock products fell slightly in 1946. The Department of Agriculture expects the year's meat production to decline to 21.9 billion pounds from 22.9 billion in 1945, mainly because of a drop in cattle slaughtering. Milk production in 1946 was within two per cent of the previous year's record volume, while the output of creamery butter was about 25 per cent below, mainly because of the unfavorable price situation prior to the lifting of price controls. Egg production during the first eleven months of 1946 was within one per cent of the high level of a year ago. Mild fall weather favored both milk and egg production, and the large output was achieved in spite of a reduced number of milk cows and layers on farms.

Production of Major Field Crops in the United States

Crop	Unit	1945	1946*	Percentage change, 1935-39 average to 1946
Corn	*Millions of bushels*	2,881	3,288	+42
Oats	*Millions of bushels*	1,536	1,510	+44
Wheat	*Millions of bushels*	1,108	1,156	+52
Cotton	*Thousands of bales*	9,015	8,482	—35
Tobacco	*Millions of pounds*	1,994	2,235	+53
Potatoes	*Millions of bushels*	418	475	+34

* December 1, 1946 estimate.
Source: U. S. Department of Agriculture.

The value of agricultural production in the Second District in 1946 is estimated to have exceeded one billion dollars. New York State customarily accounts for more than 80 per cent of the District's agricultural output and of its cash income from farm marketings. In recent years New York State has ranked eleventh or twelfth in farm production, and has been surpassed by only Texas, California, and the large midwestern agricultural States. The field crops harvested last fall in this State were large compared with prewar averages, but short of the peak harvests of some war years. At close to 27 million bushels the corn crop was the third best on record. The oats crop was considerably better than average, and the potato yield exceeded the previous year's very large crop. Among the major crops, wheat alone, with 5.6 million bushels harvested, fell considerably short of both the wartime level and prewar averages.

Dairy production in New York State was apparently maintained throughout the year at levels only a few per cent below a year ago. A larger proportion was sold as fluid milk, however, and the output of creamery butter during the first eight months of 1946 fell to little more than half of the production in the corresponding period of 1945. Egg production in New York State in 1946 advanced somewhat over the year-ago record level, compared with a slight decline in the country as a whole.

The fruit crop, on which many up-State farmers depend for a considerable part of their cash income and which had been particularly poor in 1945, owing mainly to late frost, was quite satisfactory in 1946. The apple crop was about normal; more than six times as many bushels were brought in as in the previous year. Twice as many cherries were harvested, the 1946 volume representing an average crop. Also, twice the previous year's tonnage of grapes was gathered, a better than average crop. Only pears fell short of prewar averages, although they, too, were considerably above the poor 1945 crop.

Farmers throughout the country apparently take an optimistic view of prospects for 1947. During the fall planting season they expanded by 8 per cent their seeded acreage of winter wheat. A record 1947 crop exceeding 1.2 billion bushels (including spring wheat) is estimated, nearly twice the 1935-44 average. The rye acreage was also increased and the condition of rye is reported excellent.

DEPARTMENT STORE TRADE

December sales of department stores in the Second Federal Reserve District fell somewhat short of the expectations of some of the leading store executives. Although the dollar volume of sales is estimated to have run 28 per cent above a

Department and Apparel Store Sales and Stocks, Second Federal Reserve District, Percentage Change from the Preceding Year

Locality	Net sales		Stocks on hand
	Nov. 1946	Jan. through Nov. 1946	Nov. 30, 1946
Department stores, Second District....	+28	+31	+43
New York City..................	+26	+29	+39
Northern New Jersey.............	+32	+33	+44
Newark.........................	+29	+30	+44
Westchester and Fairfield Counties..	+40	+38	+53
Bridgeport.....................	+37	+34	+47
Lower Hudson River Valley........	+34	+37	+49
Poughkeepsie...................	+29	+35	+52
Upper Hudson River Valley........	+34	+36	+54
Albany.........................	+35	+46	+60
Schenectady....................	+33	+25	+47
Central New York State...........	+33	+35	+53
Mohawk River Valley............	+29	+28	+37
Utica........................	+27	+25	+36
Syracuse.......................	+35	+38	+62
Northern New York State..........	+29	+36	—
Southern New York State..........	+32	+31	+50
Binghamton.....................	+19	+32	+56
Elmira.........................	+30	+23	+43
Western New York State...........	+27	+29	+49
Buffalo........................	+25	+29	+43
Niagara Falls..................	+17	+13	+44
Rochester......................	+33	+31	+59
Apparel stores (chiefly New York City).	+ 9	+25	+61

Indexes of Department Store Sales and Stocks Second Federal Reserve District (1935-39 average=100 per cent)

Item	1945	1946		
	Nov.	Sept.	Oct.	Nov.
Sales (average daily), unadjusted.........	235	214	202	301
Sales (average daily), seasonally adjusted..	182	202	177	233
Stocks, unadjusted......................	173	216	217	247
Stocks, seasonally adjusted..............	152	200	192	217

year ago, this is a smaller rate of increase than in the first part of the year. The reduced rate of increase occurred despite the price advances which have taken place on many items since the end of OPA controls and despite the stores' larger receipts of "big-ticket" items (such as refrigerators, furniture, etc.). The seasonally adjusted index of sales for December remains at about the same level as for November—10 per cent below the all-time high reached in August. Total Second District sales during the year 1946 are estimated at 1,195 million dollars, an increase of 30 per cent over 1945.

Neither supply nor labor shortages seem to have set limits for the increase in sales. Supplies of merchandise available for Christmas buying were much larger this season than in 1945. At the end of November the dollar value of stocks on hand in Second District department stores was more than 40 per cent greater than on the same date a year ago; in some individual departments the increases were even larger. Stocks of homefurnishings and of men's clothing were 50 and 60 per cent, respectively, above those of a year previous, and stocks of piece goods, linens, and bedding were 85 per cent greater. Stocks of women's wear, which were already abundant during the Christmas trade period a year ago, increased at the same rate as inventories as a whole.

In November the dollar volume of sales of Second District department stores was 28 per cent larger than a year earlier. Sales of homefurnishings were 40 per cent greater than a year previous and piece goods, linens, and bedding sales increased 50 per cent. Sales in these departments reflected the more ample supply situation. Sales of men's wear increased 25 per cent, but sales of women's wear advanced only 17 per cent.

As stocks increased more rapidly than sales during November, ratios of stocks on hand at the end of the month to sales during the month were larger in nearly all departments. This increase was not uniform. The stock-sales ratio for the women's wear group was 2.1, compared with 1.8 in November 1945; for the men's wear group it was 2.6 compared with 2.0 in the previous year; while in the homefurnishings group the stock-sales ratio, at 2.4, was little changed from the November 1945 figure of 2.2. A large number of pre-Christmas clearance sales featuring furs and other women's apparel, men's robes and sports shirts, costume jewelry, and expensive handbags and linens indicate that the stores had overstocked some soft goods items, especially high-priced goods. A shift to the prewar pattern of consumer spending, with a larger proportion of income spent on durable goods, might be expected to result in some drop in the demand for soft goods.

Outstanding orders of Second District department stores declined about 25 per cent from the end of October to November 30, 1946; it was the largest month-to-month percentage decline since November 1941, and the only October to November decline since 1942. A part of the decrease was due to the inflation of orders at the end of October as a result of the delivery strike in the New York Metropolitan area, but it is probable that outstanding orders also are returning to the prewar seasonal pattern.

Indexes of Business

Index	1945	1946		
	Nov.	Sept.	Oct.	Nov.
Industrial production*, 1935-39 = 100..... (*Board of Governors, Federal Reserve System*)	168	180	181	182*p*
Electric power output*, 1935-39 = 100..... (*Federal Reserve Bank of New York*)	187	204	206	212*p*
Ton-miles of railway freight*, 1935-39 = 100 (*Federal Reserve Bank of New York*)	180*r*	199	193*p*	181*p*
Sales of all retail stores*, 1935-39 = 100..... (*Department of Commerce*)	220	257	259*p*	
Factory employment				
United States, 1939 = 100............. (*Bureau of Labor Statistics*)	128	147	147	149*p*
New York State, 1935-39 = 100......... (*New York State Dept. of Labor*)	117	129	130	131*p*
Factory payrolls				
United States, 1939 = 100............. (*Bureau of Labor Statistics*)	223	284	286*p*	
New York State, 1935-39 = 100......... (*New York State Dept. of Labor*)	220	265	267	269*p*
Income payments*, 1935-39 = 100........ (*Department of Commerce*)	236	247	256*p*	
Composite index of wages and salaries*# 1939 = 100.......................... (*Federal Reserve Bank of New York*)	147	164	164*p*	
Consumers' prices, 1935-39 = 100......... (*Bureau of Labor Statistics*)	129	146	148	152*p*
Velocity of demand deposits*, 1935-39 = 100 (*Federal Reserve Bank of New York*)				
New York City.......................	85	91	85	84
Outside New York City...............	74	85	83	87

* Adjusted for seasonal variation. *p* Preliminary. *r* Revised.

\# A special monthly release tabulating the complete set of 15 indexes, supplanting the index of "wage rates" formerly computed by this bank, will be sent upon request. A general discussion of the new indexes appeared in the November 1946 issue of this *Review*. Tabulations of the monthly indexes, 1938 to date, and description of component series, sources, and weights may be procured from the Research Department, Federal Reserve Bank of New York. A mimeographed article discussing some of the technical problems involved is also available on request.

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Monetary Management

and

Credit Control

Remarks of ALLAN SPROUL,

President, Federal Reserve Bank of New York

at the

EIGHTEENTH MID-YEAR TRUST & BANKING CONFERENCE

NEW JERSEY STATE BANKERS ASSOCIATION

December 6, 1946

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December 6, 1946

HAVING been given freedom of choice—an important freedom which those who are interested in other freedoms sometimes neglect—I have decided to talk with you tonight about money management and credit control. This is not an easy subject for popular presentation, but it is the most important subject which confronts me as a central banker and, in these critical days, I feel that I would not be justified in taking up your time with lesser matters. Before I embark on this discussion, however, I should make two statements and one confession.

My first statement is that while my talk must include observations on the management of the public debt, I cannot and do not speak for the Secretary of the Treasury. He speaks for himself. My second statement is that I cannot and do not speak for the Federal Reserve System. The Federal Reserve System as created by the Congress of the United States is, in fact, a Federal system. There is the Board of Governors at Washington having broad powers of policy-making, supervision, and coordination. There is the Federal Open Market Committee composed of the members of the Board of Governors and representatives of the Federal Reserve Banks, which has specific authority over the open market operations of the banks. There are the twelve Federal Reserve Banks and their boards of directors, which have been given certain statutory powers and which have certain powers of advice and counsel growing out of those statutory powers. This is a Federal system; it is at one and the same time national and regional; some powers have been given to the central agency, some to the constituent parts, some to a combination of the two, and some have been reserved, as usual, to the people, including the Federal Advisory Council. I cannot speak for such a system; certainly not with regard to the future. I can try to interpret policy once it has been fixed by the appropriate body within the System but, if I go beyond that, I am merely giving you my personal views. I can only speak as one individual who participates in the work of the System.

My confession is that I do not relish these speaking jobs and like to avoid them when I can do so without dodging my responsibilities. Central bankers have long been known as members of the silent service. We have preferred, traditionally, to let our acts speak for us and not try to explain them. This approach has its advantages—many of our actions are difficult to explain. It also has its disadvantages, the chief one perhaps being that in a country such as ours you are likely to go out of business if you do not explain what you are doing in the public domain. At any rate, I followed tradition in May and resisted the blandishments of the program chairman for your annual meeting, only to be caught in December by your persuasive President.

I embark on this discussion of money management and credit control with some hesitation. I am not unmindful of the fact that there was an election recently, and the voters seemed to express impatience with controls of various kinds which they had borne with varying degrees of resignation during the war. But money management or credit control is not a war baby; it is the product of many years of growth and development; at least since the establishment of the Federal Reserve System in 1914. It was made necessary by the key position which money and credit occupy in our democratic society and our capitalistic economy. And, by the same token, the powers of money management and credit control must be so limited and so administered as not to hamper that society; not to destroy that economy.

Our primary job is the overall credit administration of the country, and our objective must be to make credit policy serve the demands of sustained high production, high income, and high employment, while preserving public faith in our currency and our credit. We have long since learned, of course, that credit policy is not the sole determinant of economic health or sickness. The high hopes of a specific treatment of our economic ills, which concentrated on central bank operations in the '20s, and which tended to center around fiscal policies in the '30s, have been disappointed in the past, and, I believe, will be disappointed in the future. An integration of all of our various economic programs is necessary and then, if we are to avoid totalitarianism, or State capitalism, or State socialism, we have to relate these programs to the social habits and individual desires of millions of human beings without too detailed compulsions. It is an intricate, complicated, difficult task. It suggests that humility should be combined with hope if we, in the Federal Reserve System, are to play our part well.

I believe that over the past thirty years the Federal Reserve System has acquired the experience which should enable it to acquit itself decently. And I anchor that belief in the unique Federal character of our System. It has been said, in the past, that the only way to insure the proper participation of the Federal Reserve System in any reordering of our financial affairs, is to deprive the System of all taint of private participation. The Government, so the argument runs, would be willing to place full reliance in the System's existing powers, or to grant it new powers, only if every vestige of private participation in its management were removed. I know that this is what is happening to central banks in other countries, and that it appears to be a growing political philosophy abroad. But so far as we are concerned it seems to me to be a misreading of the longer term future and a miscalculation of the policy which will best serve us now. Rather than seek powers by trying to make the Federal Reserve System just another Government agency, we should be able to claim powers because we are a successful working example of Government functioning in the economic field, with the aid and support of private business. Our experience in Government-business cooperation—Government having the dominant voice as it should have in the field of monetary and credit policy—may be a signpost along the way to solution of one of the major economic problems of the postwar years: the relation between Government and business in our whole economy.

What are these powers I am talking about which the Federal Reserve System tries to exercise? In laymen's language, and we are all pretty much laymen in this field, they are the powers of "money management". That is a term which is likely to arouse the sensibilities of all those who deny any interference with what they call "natural economic laws". And "natural economic law" in this case usually is thought of, if only vaguely, in terms of restoration of an automatic gold standard—nationally and internationally.

Nationally, I make the assumption that the gold standard, in terms of a currency freely convertible into gold, has disappeared and is not likely to return. This I do, not because I am fearful of what might happen if we resumed specie payment, but because I fail to see the advantage of such resumption. There is no lack of faith in our currency or our credit without domestic gold convertibility, and the restraints of such convertibility are not needed to insure wise administration of our monetary affairs. In fact, if reimposed, they would not guarantee such wisdom. This has been amply demonstrated in the past. Restoration of gold circulation within the country would seem to me to be a step backward in the historical evolution of "money".

Internationally, the gold standard still persists and performs a useful function, but it is not automatic. And in so far as it ever was automatic, it was at a particular time and in a particular set of economic circumstances. Except in its earliest and most rudimentary form it was a gold standard applicable to the time and circumstance of England's 19th century position in the world. It rapidly became more of a sterling standard than a gold standard, and it flourished with London as the acknowledged financial center of the world, with Great Britain as the great exporter of capital and the great importer of raw materials, and with the rest of the trading world largely revolving about the center. In essence it was an adjustment between one economy and the rest of the world.

Quite early, and more clearly as it became necessary to cope with simultaneous efforts of many nations to adjust their economies during cyclical depressions, elements of management crept into the gold standard even while it was still referred to as and considered to be automatic. Central banks became more and more aware of their powers and responsibilities. They said that they were working on the lender of last resort theory, but this in itself interfered with the automatic working of the gold standard. And they went beyond this conception because events forced them to do so. Perhaps the most striking example of this transformation was the recognition, during the interwar period of the present century, that movements of capital might be perverse—that instead of redressing international balances they might accentuate unbalance. This did not conform with gold standard theory—but the "hot money" of the years between the wars did not respond to theory; it responded to speculative urges and political fears.

Certainly since the end of the first World War we have had more and more management of money in the international sense, even though a return to the gold standard was one of the early goals of that period. The central banks of the world, under the leadership of the Bank of England and the Federal Reserve Bank of New York, were in the ascendant during the decade following that war, and they were the accepted instruments of money management internationally. They still had respect for the gold standard, but they thought it necessary and desirable to supplement its working. Sometimes they acted to alleviate seasonal strains, or temporary shortages of foreign exchange on the part of one or another of the countries of the world. Sometimes they acted to accelerate the effects of an inflow or an outflow of gold, which was relatively easy because of the multiplied effect of the fractional reserve system.

Obviously they failed to restore either the pre-1914 gold standard or international monetary stability. But we should not be too hasty in attributing that failure to men or to the semi-private character of the institutions they served. They were pioneers, and gallant and courageous pioneers, in the development of common international economic policy through consultation and cooperation. They were the legitimate forerunners of world organizations such as the International Monetary Fund; and that institution, which is now beginning to function, will do well to profit by their experience. Their failures were not so much failures of men and institutions—they were failures resulting from the tendency we have to place too much emphasis on financial arrangements, not enough on underlying economic conditions and the individual problems of particular countries. A world organization run solely and directly by national governments will not solve the problem any better than did the semi-public central banks, if the problem itself is misconceived.

That is why the successful outcome of the negotiations on trade and economic arrangements which have recently been the subject of preparatory meetings in London, and which will be continued during the coming year, is so important, so essential, to the success of the international financial organisms already created. International monetary instability, and currency devaluations, and exchange controls have been, most often, the reflection of basic disturbances in a country's international position, or of international cyclical movements of wide amplitude. Statesmen and economists could condemn currency devaluation or exchange controls, as they condemned war, but these phenomena still persisted. It doesn't do much good to tell a primary producing country, of small means, which has suffered two or three bad harvests, or which has had its exports drastically contracted because of depression in a major industrial country, that it must avoid exchange control or currency devaluation because that would not be "cricket"— would not be "gold standard".

It is true, of course, that there has also been a shift of emphasis in "money management" from the maintenance of international exchange stability to the maintenance of domestic economic stability. Monetary policies are coming to be less and less defined with reference to the state of the national gold reserves and the international balance of payments, and more and more in terms of domestic economic stability. It is the difficulty of reconciling domestic stability and prosperity with international balance which is the core of the exchange problem today—the one which the International Monetary Fund and the International Bank for Reconstruction and Development are setting out to help to solve. It means a considerable degree of management of money internationally. But it also requires a recognition of the fact that the problem, fundamentally, is not financial—it is a problem of production and trade, of costs and prices, and of the maintenance of a stable, growing economy in the principal countries of the world.

What we need to retain from the gold standard days, whether pure and automatic, or adulterated and only semi-automatic, is a realization that we cannot escape wholly from the disciplines which the international gold standard imposed on domestic action. Persistent unsound national policies in the fiscal and monetary field, persistent deficits in a country's current balance of payments, will end up in international instability no matter how much management you have. As in many other situations, the late English economist, John Maynard Keynes, has said it, has said it well, and has said it, perhaps, to the confusion of some of those young disciples, who followed but could not always correctly interpret the master; who have not been as agile of mind and as free to shift their position as he was. In his last essay which discussed the United States proposals for consideration by the International Conference on Trade and Employment, Lord Keynes said:

". . . We have here sincere and thoroughgoing proposals, advanced on behalf of the United States, expressly directed towards creating a system which allows the classical medicine to do its work. It shows how much modernist stuff, gone wrong and turned sour and silly, is circulating in our system, also incongruously mixed, it seems, with age-old poisons, that we should have given so doubtful a welcome to this magnificent, objective approach which a few years ago we should have regarded as offering incredible promise of a better scheme of things.

"I must not be misunderstood. I do not suppose that the classical medicine will work by itself or that we can depend on it. We need quicker and less painful aids of which exchange variation and overall import control are the most important. But in the long run these expedients will work better and we shall need them less, if the classical medicine is also at work. And if we reject the medicine from our systems altogether, we may just drift on from expedient to expedient and never get really fit again . . ."

Nationally or domestically, I think most of us will agree that the question of "money management" was thoroughly studied and calmly decided by the review of our national experience, the examination of the experience of other countries, and the investigations of our existing banking and credit system which preceded the adoption of the Federal Reserve Act in 1913. How successful we have been in the administration of the Act, and of the various amendments which have been adopted, particularly the Banking Acts of 1933 and 1935, may well be a matter of some difference of opinion. But I know of no serious body of opinion which seeks to abandon money management, as it has developed over the past thirty years. The Federal Reserve System has made a place for itself, as a part of our banking and credit machinery, and has fortified its position by performing services which could not have been otherwise rendered during two struggles for our national existence.

The principal new problem which now faces us in the successful management of money grows out of our participation in World War II. It has been created by the tremendous increase in the size of the Federal debt and by the extent to which public debt obligations have become a part of our banking and institutional assets. On the one side this has emphasized the relative importance of fiscal policy and debt management, as contrasted with monetary policy, as a means of economic control, and on the other side it has greatly reduced the area in which monetary policy is free to work or can work effectively.

The cost and the availability of credit were the twin weapons of domestic money management as practiced by central banks. In my opinion, substantial changes in interest rates, affecting all maturities, such as were formerly employed for purposes of monetary control, are now impractical. I deem them impractical because of their effect on the prices of public debt obligations, and therefore on all those holding such obligations, and their effect on the cost of public debt service. At the same time control over the availability of credit has been substantially relinquished, for the time being, by obligations or responsibilities which have been assumed in support of the Government security market.

At the beginning of the recent World War it was decided that our expenditures for war purposes should be financed at stable, not rising, rates of interest such as the pressing needs of previous wars had produced. To make this decision effective, a pattern of rates for Government securities was established, with Federal Reserve support. The almost inevitable consequence of the fixing of this pattern, which meant supplying the commercial banks with whatever funds were necessary to maintain the pattern, was pretty constant pressure on the longer term rates. Actually, therefore, the war was financed not at stable rates of interest, but at declining rates. We came out of the war with short-term rates still pegged where they were when we went in, but with the longer term rates under steady downward pressure. So long as differences in maturity, and the risks which longer maturities are supposed to involve, are deprived of their significance, the tendency of interest rates is to come together at one figure for all maturities. If the short end of the rate curve is fixed, that means that the long end will tend to decline. So much for loss of control over the cost of credit.

Similarly with the control of the availability of credit. In its simplest terms, our support of the Government security market has meant and still means that the commercial banks, in large part, have the initiative in determining whether or not reserve bank credit is to be created or extinguished. If the commercial banks sell Government securities and the market will not absorb them at somewhere near the going prices, we are the residual buyers. If the commercial banks have surplus funds, and Government securities of the kinds they want are not available in the market, at least without a substantial run-up of prices, we are the ultimate sellers. In either case we are not the masters in our own house.

One way out of the dilemma—the loss of control over the cost and availability of credit—would be to transfer our interest and our affections from quantitative credit controls to qualitative credit controls. We have two such now, the control of credit used in the stock market and the control of consumer credit. Our experience with these controls has not been altogether happy, but it is my opinion that they are worth continuing—that we need them, at least until something better has been devised. Our economy is peculiarly susceptible to the influence of wide swings in the use of credit in the stock market and in the mass distribution of consumers' durable goods. These swings have tended to accentuate our booms and our depressions, and in so far as they can be moderated by credit controls, it is a contribution to stability. The administration of these controls is possible without interfering too greatly with that independence of decision which will permit individuals and business enterprises to adapt their practices to the needs of a dynamic expanding economy. When you think of extending such controls into other fields, however—and this would be necessary if qualitative controls are entirely to supplant quantitative controls—you find yourself wandering perilously far from the kind of private enterprise economy we are trying to preserve. I think we must still try to see what we can do with quantitative controls.

In current thinking the quantitative approach has had at least two expressions. The Board of Governors of the Federal Reserve System in its 1945 annual report to the Congress suggested that the present powers of the Federal Reserve System, granted in very different circumstances, are inadequate to deal with present or possible future situations, and that we shall have to have new powers if we are to be held responsible for credit control—for "money management". The Board suggested that consideration might be given (1) to requiring banks to maintain a secondary reserve in the form of Treasury bills and certificates of indebtedness, which would be superimposed on our present cash reserve system, (2) to the control of long-term security investments of commercial banks, and (3) to an increased authority to change cash or primary reserve requirements of banks. I am not going to try to explain, analyze or discuss these proposals. Information concerning them has been sent to you and their discussion could form the content of one or more separate speeches. I can only say that I think they have little relevance as far as meeting present problems is concerned. I do not believe we can expect Congressional consideration of and action upon such fundamental changes in our banking system in the near term future.

It has seemed profitable to me, therefore, to concentrate on what we might do with our present powers and our present skill, combining our resources of power and skill with those which the Treasury uses in managing the public debt. Money management and debt management, as distinguished from fiscal policy which depends largely on Congressional action, are today's Siamese twins of effective and usable power and influence in the hands of those who have executive authority and responsibility. I think that it is possible to do something with them as they stand. What we do need not be spectacular nor drastic. It has not been sufficiently recognized, perhaps, that the very size of the public debt and of the bank holdings of the public debt have made the money market much more sensitive to relatively modest action than was formerly the case. The fact is, of course, that we have been using the modest approach in debt and money management—elimination of the preferential discount rate, retirement of Government debt out of Treasury balances, increases in acceptance buying rates—and that so far this approach has been measurably effective in the economic situation in which it has been used. Aggressive bank bidding for longer term Government bonds has been diminished, at least temporarily, the pressure on longer term rates of interest has been reduced, the banks have been in intermittent need of reserve funds, and some short-term rates of interest have risen slightly.

It is true that this is weak medicine in terms of combating inflation—it has done little to reduce the volume of funds already created and in the hands of the public, and nothing to increase the supply of goods and services available to the public. I have heard of no practical program of credit control which would accomplish these purposes. So far as inflation is concerned, ours is essentially a holding operation.

There is only one final and compelling and satisfying answer to the present lack of balance between the supply of goods and services and the supply of money, and to the present danger of our climbing another loop in the cost-price spiral. That is an increased supply of goods and services growing out of increased production per man hour—out of increased efficiency of men and machines. That is the only way we can validate the increases in costs which have already taken place in our economic structure. That is the only way we can prevent a further increase in prices, or bring about a decline in prices, without the hardship and suffering of depression and unemployment. Responsible management must know that this is the problem; that putting into effect a price increase to meet every wage increase is no real solution. Responsible labor must recognize that its own interests, as well as the interests of the whole community—our standard of living—are bound up in the same package with output per man hour. Recognition must lead to action, however, or little will be accomplished. And action will require consideration of our incentives to investment and to work, and of the penalties for slackness in production, whether of management or labor. Without adequate incentives for superior performance and without observable penalties for inferior performance, it is flying in the face of human experience to expect increased production per man hour.

Unfortunately, the whole world will be affected if we ride the roller coaster of boom and bust. We shall not be the only ones to suffer for our sins. America's national income represents perhaps two-fifths of the world's total income. It is certainly the most dynamic and significant factor in the world economy. If we exhibit a lack of responsibility in our domestic economic affairs, we shall betray a world which is looking to us for leadership, and which depends on us, in large part, for its own stability. Those who are concerned with the direction of American business and American labor need to ponder this, not only because of its economic implications but because of its international political implications. If we are to lead the world toward enduring peace, we cannot afford to dissipate our influence and weaken our world neighbors by economic irresponsibility. No one who lives, as we all do, in the shadow of the atomic bomb, should forget that fact for one instant.

This partial digression should make clear, I think, that I attribute to money management only a very secondary role in meeting the major problems of today. It is important, however, that it be free to work in the right direction. That is the significance of what might be called the next step in the modest approach to restoring credit control—breaking out of the strait-jacket of the pattern of rates, in which we voluntarily allowed ourselves to be tied and fastened during the war. By that I mean, specifically, the defrosting of the presently frozen short-term rates on Government securities. I do not suggest this as an urgent matter of the moment; other actions and other factors have given us and are giving us time to consider the problem. And I recognize that the benefits of such a move are not certain; there are few certainties in credit administration. But it seems to me that if we are again to have a credit policy worthy of the name, and if we are to be able to support and supplement a constructive policy of debt management, we must sooner or later get out of the strait-jacket of the pattern of rates. We cannot indefinitely leave with 14,000 commercial banks the determination of how much Federal Reserve credit will be used; how much further the money supply may be expanded. And it makes little difference, in terms of the money supply, whether the action of the banks is motivated by a desire to shift from short to long Government securities, as was the case early this year, or whether it represents a shift from Government securities to private credits, as has been the case more recently.

I do not mean, of course, that so long as anything like the present situation exists, we should abandon the short-term market to its own devices. And I do not mean that we should relax our controls so far as to breach the 2½ per cent rate on long-term Government securities. The former is not necessary and the latter is not desirable. But it is necessary and it is desirable that we regain a position in which we shall be able to apply the brakes to credit expansion when inflation threatens, even if we can only apply them ever so gently. That is why we should look forward to restoring some flexibility to the interest rate structure. It can be argued that flexibility of interest rates in a supported market merely means changing the peg. But surely there is a vast difference between supporting a market at your own discretion, at rates which can move up or down, and supporting a market at fixed rates which you have announced in advance your determination to maintain. In the former case, all the advantages of initiative and uncertainty will be working to make policy effective. In the latter case, betting against the house is a sure thing. If it is not known in advance exactly what we are going to do, we may well find that very little pressure will have sizable and beneficial results. If reserve funds can be made a little less readily available, and the certainty as to their future availability in any amount at a fixed price, can be removed, banks as lenders may be deterred from inflationary lending, such as lending to finance excessive inventory accumulation or consumer spending. And banks as investors may be deterred from reaching out for the longer term bank eligible bonds if the safety of premiums is no longer guaranteed.

Nor should there be any reason for Treasury concern, if short-term rates are unfrozen. The Treasury would still be able to sell its short-term securities for refunding purposes just as it does now. Banks and other investors would hardly prefer to hold idle funds, from month to month, in anticipation of a minor change in rates which might not be forthcoming. The market for intermediate securities would be subject to greater uncertainty and therefore less attractive, especially to banks, but the Treasury's long-term market need not be affected. Historically, there is no fixed relationship between long and short rates, and certainly so long as the Federal Reserve System gives its support, the long-term rate can be kept where it is. Downward pressure on the long rate would be relieved, but upward pressure, if it developed, could be successfully resisted. Finally, the cost of servicing the debt need not be increased by a rise in the shortest term rates. It has been estimated that the annual interest charge on the $65 billion of marketable Government securities maturing or callable before the end of 1950, excluding bills, is about $1 billion, or 1½ per cent. If all of these securities were refunded with an average rate less than 1½ per cent, there would be a reduction in the annual service cost. Inasmuch as the major part of these short securities are held by the banks, or will be when they mature, this is not an impossible program! Refundings of Government securities within the banking system could well be made with shorter maturities and at lower rates than during the war—we do not need to finance through the banks with 2% bonds.

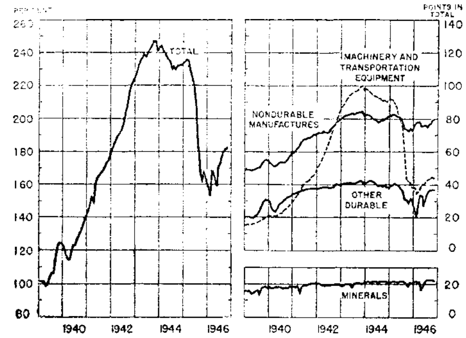
Such a program, of course, would seem to be the reverse of funding some of the debt but, in present circumstances, the only funding of debt which has real meaning is the sale of securities to non-bank investors, and retirement of bank-held debt with the proceeds. That could still be accomplished, so long as it is economically desirable, by stepping up sales of Savings Bonds faster and further, and by sales of long-term 2½ per cent bonds—with rollover removed—to institutional investors. This is the kind of debt management which really increases the cost of servicing the debt, but what you get is worth what you pay for it.

Such a modest approach to money management would have to lean on and to support a complementary program of debt management, just as it has in the recent past. Since early this year the Treasury policy of using surplus balances to retire outstanding debt, held largely by the Federal Reserve Banks and the commercial banks, has subjected the reserve position of member banks to moderate pressure at frequent intervals. This has been the result of Treasury withdrawals of funds from its war loan account at the banks, to redeem securities maturing in the portfolios of the Federal Reserve Banks. Reserve funds were temporarily taken out of the market and this limited, to some extent, the ability or the inclination of banks to expand their loans and investments, at least in the fringe areas of credit. The program also directly disposed of $23 billion of Treasury deposits which, if spent for other purposes, would have increased by that amount the already large supply of money in the hands of the public.

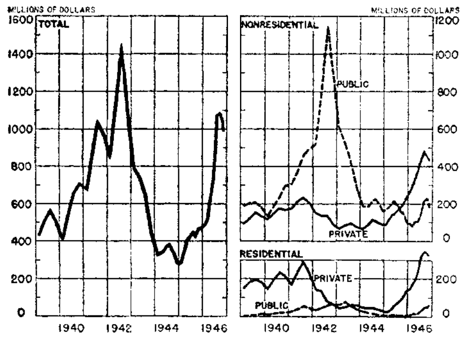
This phase of the debt retirement program will come to an end this month. With the redemption of $3,261 million of Treasury notes maturing on December 15, Treasury balances in war loan account growing out of the tremendous sale of Government securities in the Victory Loan Drive a year ago will have been largely eliminated. Hereafter, reduction in the total Federal debt will depend primarily upon an excess of current income over cash disbursements. While the effect of debt retirement thus far has been mildly anti-inflationary, further redemptions of bank-held securities, if financed by an excess of tax receipts over Government disbursements, will be actively deflationary. Money will be taken from individuals and corporations and used to extinguish bank credit, thus reversing the wartime process of credit creation.

A similar effect can be obtained by net sales of Government securities to non-bank investors, the proceeds being used to pay off bank-held debt. Such shifts of securities from bank to non-bank investors would also extinguish bank credit, and in addition would provide an outlet for accumulations of funds which otherwise would have to seek employment elsewhere, quite possibly with inflationary effects. So long as inflation, or the threat of inflation, is our adversary, this aspect of increased sales of Savings Bonds to individuals, and possible sales of long-term restricted bonds to institutional investors, should not be overlooked. If we should enter a deflationary period, of course, a reversal of these public debt operations would probably be appropriate and quite readily attainable. Debt management as well as Federal Reserve policy must be responsive to changing economic conditions.

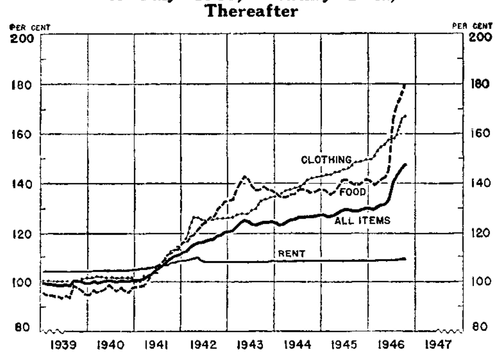
Right now, faced with a violent resurgence of labor troubles, we can do no more than stand fast. Nevertheless, problems of money management and debt management should have our consideration as we enter a new phase in our financial affairs. I have outlined a modest approach to the restoration of credit control. There is opposition to, disbelief in, and timidity with respect to this modest approach, but it seems to me it may be the best approach available to us in the circumstances in which we find ourselves. For the longer term we may need new methods or new powers. I am only concerned that we do not get into the habit of seeking "just one more power" until we have powers beyond our wisdom and our skills.



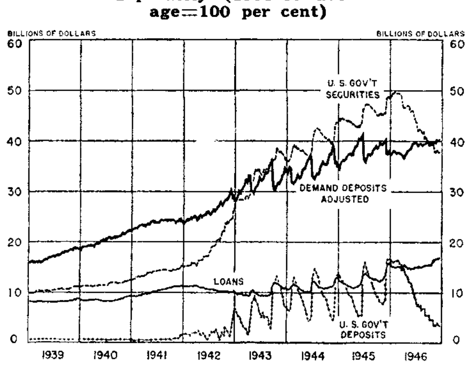
Indexes of Physical Volume of Industrial Production, Adjusted for Seasonal Variation, 1935-39 Average=100 Per Cent (Groups shown are expressed in terms of points in the total index)



Value of Construction Activity. Figures Beginning in 1944 Are Joint Estimates of the Departments of Commerce and Labor; Earlier Figures Estimated by Department of Commerce. Data Exclude Repair and Maintenance Work. Monthly Averages from Quarterly Totals Prior to July 1944; Monthly Data, Thereafter



Indexes of Consumers' Prices Compiled by Bureau of Labor Statistics. "All Items" includes Housefurnishings, Fuel, and Miscellaneous Groups Not Shown Separately (1935-39 average=100 per cent)



Member Banks in Leading Cities. Demand Deposits (Adjusted) Exclude U. S. Government and Interbank Deposits and Collection Items. Government Securities Include Direct and Guaranteed Issues. (Latest figures are for December 11)

National Summary of Business Conditions

(Summarized by the Board of Governors of the Federal Reserve System)

INDUSTRIAL production and employment in most lines of activity continued to be maintained at record peacetime levels in November. Department store sales in November and the early part of December were larger in dollar amount than the holiday trade last year, reflecting mainly increased prices. Prices of industrial commodities have generally advanced further, while a number of important farm products and foods have declined from previous peaks.

Industrial Production

Total output of manufactured goods and minerals, as measured by the Board's seasonally adjusted index, was 182 per cent of the 1935-39 average in November. This was about the same as in October notwithstanding the sharp drop after November 20 in coal, coke, iron, and steel production as a result of work stoppages in the bituminous coal industry. After the resumption of bituminous coal ouput on December 9 activity at steel mills, which reached a low of 60 per cent of capacity in the first week of the month, rose sharply and in the third week was scheduled at 84 per cent.

Output of steel in the month of November was at an average rate of 84 per cent of capacity as compared with 89 per cent in October. Activity in the nonferrous metals and machinery industries continued to increase in November and output of most other metal products was maintained at a high level. Lumber production showed less than the usual seasonal decline.

Output of manufactured food products was maintained in November at an exceptionally high level for this season of the year, reflecting chiefly further sharp increases in meat production and larger output of flour and sugar products. Production of cotton and rayon textiles, paperboard, rubber products, and some other nondurable goods showed further small gains in November.

Output of minerals declined 5 per cent in November. Bituminous coal production dropped sharply as a result of work stoppages in the latter part of the month, while production of anthracite and crude petroleum was maintained at high levels and output of metals showed less than the usual seasonal decline.

Construction

Estimated expenditures on construction projects in November were maintained close to the peak levels reached in August and September. Contracts awarded for nonresidential construction, however, were at the lowest level since the end of the war, according to reports of the F. W. Dodge Corporation; residential building awards were sharply below the peak rate reached in the spring, but were still considerably above last year's level.

Distribution

Department store sales in November and the early part of December were about one-fifth larger than during the same period of the holiday shopping season last year. The total value of retail trade outside of department stores increased somewhat further in the fourth quarter, reflecting chiefly higher prices and larger expenditures for foods.

Loadings of railroad revenue freight declined in November owing to the sharp drop in bituminous coal shipments at the end of the month. Loadings of manufactured products and most other classes of freight showed substantial gains, after allowance for seasonal changes.

Commodity Prices

Following the initial sharp increases in basic commodities which occurred with the elimination of Federal price controls on November 11, price changes have become more selective. Prices of copper, lead, steel scrap, and cotton gray goods for immediate delivery have advanced further, while prices of hides, turpentine, and silk have declined. During the past week there has been a sharp drop in hog prices. Wholesale prices of foods have decreased somewhat further from the sharply advanced levels reached in the middle of October. Prices of industrial products have continued to advance. In retail markets prices of women's wear and some other items have declined but in general retail prices have continued to advance.

Bank Credit

Commercial, real estate, and consumer loans increased further at banks in leading cities during November and the first half of December. Government security holdings declined considerably reflecting Treasury cash retirement of notes and certificates. Deposits of businesses and individuals increased somewhat and currency in circulation rose by the usual seasonal amount.

The Treasury retired for cash during November and the first half of December 5.8 billion dollars of Government securities held largely by the banking system. Withdrawals from War Loan deposits at commercial banks to redeem securities reduced U. S. Government deposits at banks to a level of about 2 billion dollars in mid-December as compared with 24 billion dollars before the retirement program was begun in March.