FEDERAL RESERVE BANK OF NEW YORK

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International Developments

The progress achieved in strengthening the international monetary system in the last few years was demonstrated during the United States "quarantine" of Cuba in late October. In past years, major political disturbances—such as the 1961 Berlin crisis—had induced very large international flows of short-term capital which led to substantial swings in gold market prices and leading exchange rates. Following the imposition of the Cuban quarantine, however, the disturbances in the gold and foreign exchange markets were held to a minimum. The unprecedented uncertainties and dangers of the situation probably limited the volume of "hot" money flows. But central bank cooperation in the markets clearly played an important role in stabilizing market expectations. The various central banks maintained almost continuous telephone contact during the early phases of the crisis, and their firmness at critical moments prevented undue distortions in existing market patterns.

As usually happens at times of international political crisis, funds moved into Switzerland and the franc rose sharply to the Swiss National Bank's current buying rate for dollars. However, the total amount of funds seeking safe haven in Switzerland remained surprisingly small. Despite the Berlin problem, the German mark declined only moderately and the outflow of funds from Germany was kept to relatively small proportions. At the same time, the pound sterling eased somewhat but stayed above par. Although the dollar remained at its lower limit in France and Italy, there was no significant new pressure against it in either country.

Gold was the other refuge sought by nervous investors, and there was a sharp flurry of activity in the London gold market for two days. Reflecting official intervention, the London gold price was kept from rising unduly and then fell back sharply as tension eased. All in all, the cooperative action of the various central banks helped prevent the snowballing of these hot money movements into a flight of much greater proportions.

The resources available to defend exchange stability, already strengthened during 1962 by the currency arrangements between the Federal Reserve System and the Treasury and various foreign monetary authorities and the Bank for International Settlements,[1] were substantially enlarged in October when the International Monetary Fund's supplementary borrowing arrangements came into force following United States adherence. Under these arrangements, up to $6 billion of additional resources may be made available to the Fund by ten industrial countries if needed to forestall or cope with an impairment of the international monetary system. Thus, the Fund for the first time is assured access to sufficient convertible currency reserves to meet even a very large United States drawing should the need ever arise. The availability of these additional reserves, coupled with the other measures to strengthen the monetary mechanism taken during the past two years, has provided the monetary authorities of the leading countries with powerful weapons to ward off or counter any speculative or other short-run threats to exchange stability. The stability of the international financial system displayed during the Cuban crisis seems clearly to have reflected awareness of these developments.

The extent and usefulness of international monetary cooperation were reviewed in September by a leading European central banker, Hubert Ansiaux, Governor of the National Bank of Belgium. In discussing the problem of international liquidity and the defense of exchange stability, Governor Ansiaux made the following remarks:[2]

> [With respect] to the question of international liquidity, I wish to say first that to my mind there is no problem regarding a shortage of liquidity. . . . If more liquidity is necessary in the future to ensure the smooth financing of international transactions, the International Monetary Fund is available with ample resources to intervene. . . . I do not know what may happen in ten, fifteen, or twenty years, this is the future, and it does not seem to me necessary to try to define now new techniques

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[1] For a discussion of these and other Federal Reserve and Treasury foreign exchange operations, see this *Review*, October 1962, pp. 131-40. Reprints of this article are available from this Bank's Public Information Department.

[2] From a speech given to the Belgian Chamber of Commerce in the United States on September 13, 1962.

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or solutions for a problem which does not yet exist. . . .

There may [however] be temporary movements in the balance of payments requiring certain exceptional measures—as, for instance, in case of speculation or simply in case of large seasonal fluctuations. To cope with such events several measures have been designed. First of all, a very great and very satisfactory degree of cooperation has developed between the Federal Reserve System and the European central banks. Belgium is participating in these arrangements for a not negligible amount, taking into consideration its own resources, and I think this is perfectly right because the United States and the Europeans have a common interest in maintaining international monetary stability and in maintaining stable conditions in foreign exchange markets. Therefore, we are prepared, as we already have shown on several occasions, to cooperate fully with the Federal Reserve, and on the other hand we feel quite sure that we will get the cooperation of the Federal Reserve if . . . we are ourselves in need of assistance. We firmly believe . . . that all necessary steps should be taken to make impossible any speculative movement of funds which would be detrimental to the functioning of the international monetary system. . . . I wish to stress in this connection that cooperation among the central banks is an important factor. . . .

I wish to express finally . . . my view on two questions which are widely discussed. The one is the price of gold and the second is the proposal for a gold guarantee for key currencies. On the price of gold, my position is very clear and firm. Not only am I absolutely convinced that a change in the price of gold would serve no useful purpose, but that on the contrary it would be very detrimental to the whole of the Western world. My conviction is based on several reasons, the main one being that any change in the price of gold would initiate and develop very dangerous tendencies to inflation because all of the world's gold reserves would be revalued.

Insofar as the gold guarantee is concerned, I feel personally that it is even more dangerous than to change the price of gold. Giving a gold guarantee to any currency, and more especially to a key currency, would have the effect of depriving the holding of such currency of any kind of risk. Therefore all the corrective measures which would normally have to be taken would most probably not be taken or would be taken too late. I think it is an essential part of our monetary system that, especially since convertibility has been re-established, there should be no gold guarantee attached to any currency so that the normal working of settlements between countries can take place and that, whenever it is necessary, the corrective measures may be taken in time. . . .

Great progress has been made over the past ten years. Convertibility has been achieved. Freedom of trade and payments has been nearly completely restored, at least among the industrial countries of the world. Everything must be done and no effort spared to maintain the stability that is necessary not only for the present welfare of our people, but also for the future of mankind.

THE QUALITY OF BANK LOANS

A report entitled "The Quality of Bank Loans: A Study of Bank Examination Records" has just been published by the National Bureau of Economic Research. The 88-page report, based on the examination files of three Federal Reserve Banks, represents the first systematic statistical analysis of such data. The study was prepared for the National Bureau by A. M. Wojnilower, Chief of this Bank's Domestic Research Division, under the Bank's Program for Advanced Education.

Copies may be obtained from the National Bureau of Economic Research, 261 Madison Avenue, New York 16, N. Y., at $1.50 each.

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The Business Situation

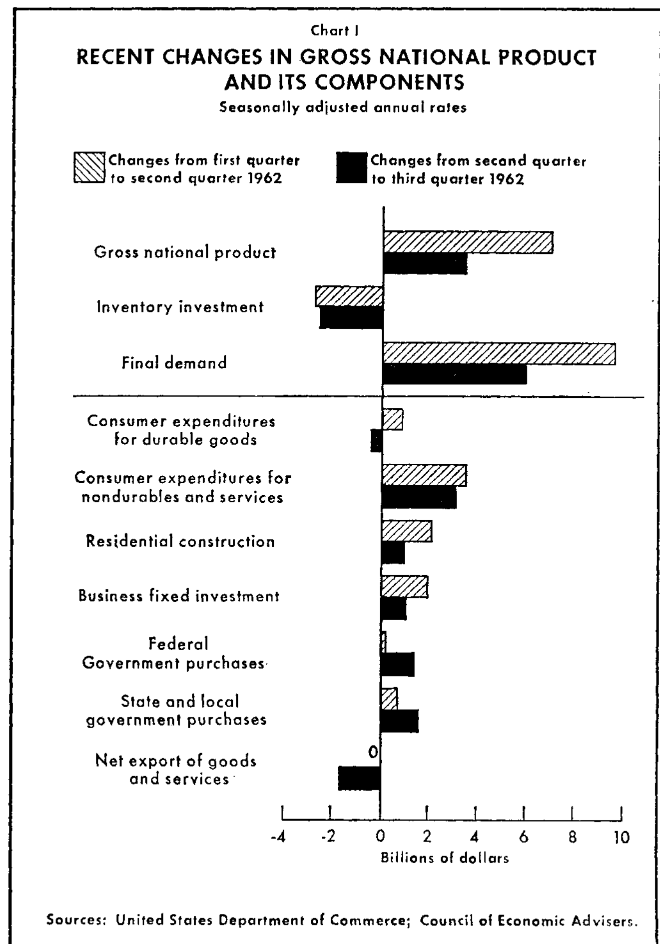
The economy entered the final quarter of the year with most key measures of aggregate activity continuing to mark time. Industrial production, payroll employment, and personal income all were virtually unchanged in September. Retail sales advanced moderately but did not fully regain the peak level reached two months earlier. The overall picture was reflected in the estimate of third-quarter gross national product which, after adjustment for price changes, showed only a very small increase from the preceding quarter. Fragmentary data for October suggest a seasonal rise in steel production and the possibility of a stronger than seasonal performance in the automobile sector following the introduction of the new models. Auto dealers reported a substantial increase in sales, and production totals showed a continued rise in assemblies. The Cuban crisis, of course, introduced new elements of uncertainty which could alter the underlying forces affecting the economy.

INDICATOR OF CURRENT ACTIVITY

Gross national product advanced by $3.5 billion in the third quarter to a seasonally adjusted annual rate of $555.5 billion, according to preliminary estimates by the Council of Economic Advisers. The rise was the smallest in the current upswing and, after adjustment for price changes, amounted to only $1.7 billion. As was true in the second quarter, a major factor holding down the rise in GNP was the marked reduction in inventory investment (see Chart I), in large part related to the decumulation of steel inventories. At the same time, the increases in the other major components of private demand were only about the same or somewhat smaller than in the preceding quarter. Outlays on consumer durables and net exports of goods and services even declined. Only in the government sector did expenditures rise by a larger amount than in the preceding quarter.

The various monthly measures of aggregate activity for the most part showed virtual stability during August and September. The index of industrial production, for example, showed no change at all in August, after adjustment for the normal seasonal influences, and rose by only $\frac{1}{10}$ of a percentage point in September. However, while there was little strong upward push from any sector in September, the number of industries showing declines in production was not so large as a month earlier. Of the seventeen separate industries for which data are available, only two showed decreases in September, compared with eleven in August. In October, automobile production moved upward, as producers stepped up their original schedules in response to the record rate of sales. Steel ingot production continued to feel the effects of the overhang of steel inventories, and the weekly figures point toward only a seasonal movement upward.

Total nonagricultural employment also was virtually unchanged in September, according to the Bureau of Labor Statistics payroll survey. The near stability, however, primarily reflected a rise in state and local government employ-



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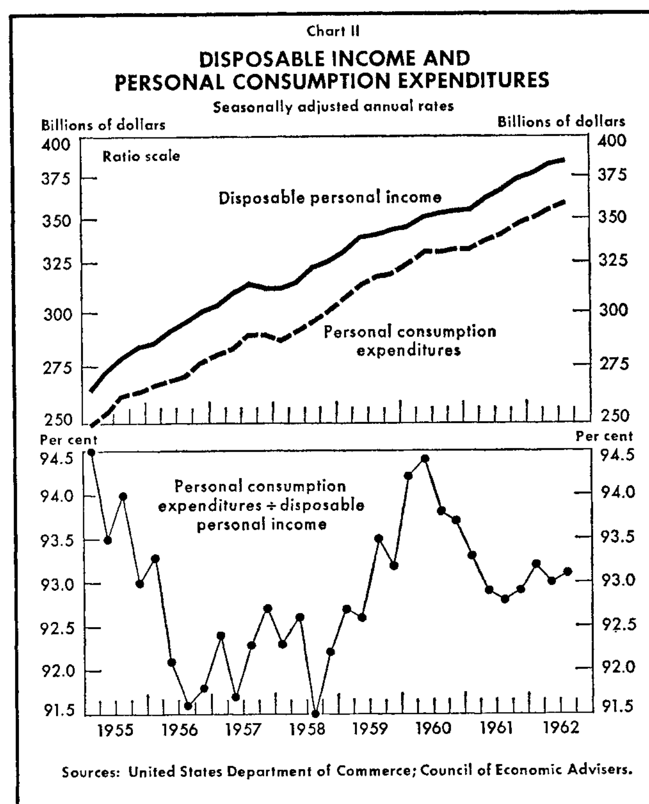
ment which about offset small declines in most other sectors. Moreover, in spite of the return of teachers to their classrooms and of automobile workers to the assembly lines for production of the new models—two groups that had shown higher than usual unemployment in August—unemployment in September remained at 5.8 per cent of the labor force. In October, the unemployment rate fell to 5.5 per cent, but this largely reflected a decrease in the number of persons looking for work rather than any marked improvement in the employment situation.

Proper interpretation of the employment figures requires taking into account the proportion of the population in the labor force. This proportion has declined rather steadily since 1956, with the result that the actual number of persons in the labor force has fallen more and more behind the Labor Department's long-term demographic projections. Part of the decline, of course, reflects the earlier retirement now permitted under social security legislation and the fact that students are remaining in school longer than in the past. To some extent, however, as has been noted by the President's Committee to Appraise the Employment and Unemployment Statistics, the decline may also reflect a lack of job opportunities, which would imply that the actual unemployment statistics may understate the magnitude of the current unemployment problem.

Indicators that tend to foreshadow future activity continue to present a mixed picture and by themselves give little sign of any substantial change from recent levels. Partly reflecting the unusually small number of working days this September, the number of new housing starts fell sharply, following two months of increase. New orders for durable goods increased by 1 per cent in September, with a large part of the rise caused by the sharp upswing in orders for motor vehicles associated with model changeovers. (Since deliveries of new cars to dealers are used as a proxy for new orders for automobiles, such a series has no necessary implication for the future course of automobile production.) On the other hand, it appeared that the Defense Department had placed a substantial volume of new contracts for space-related projects. Federal spending, according to budget estimates, is scheduled to continue upward throughout the current fiscal year. Developments stemming from the Cuban crisis could, of course, lead to some modification of earlier budget projections.



THE CONSUMER SECTOR

The performance of consumer spending will be a major determinant of the course of future economic activity. Aside from directly absorbing nearly two thirds of total output, changes in such spending can induce substantial changes in business spending both for inventories and for plant and equipment. To a great extent, the level of consumer spending is determined by the amount of income which consumers have left over after deduction for social security and payment of Federal, state, and local income taxes. (The rate at which consumers use credit to augment income is, of course, also an important factor.) The quarterly rate of consumer expenditures has varied between 91.5 and 94.5 per cent of disposable personal income during the past eight years, with the ratio in the most recent quarter at 93.1 per cent (see Chart II). The 3 percentage point spread, however, can be of crucial significance in that, at the current level of disposable income, it represents about $11.5 billion of spending.

Of the three main components of consumer spending, the one of least concern from a cyclical standpoint is spending for services, currently accounting for slightly more than two fifths of total consumption expenditures. Consumption of services has risen in every single quarter of the postwar period. To be sure, the rate of increase has tended to slow down somewhat during periods of slack over-all demand, but even so the smallest quarterly increase in any of the past three business downturns still amounted

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to 1 per cent, or about $1.5 billion (seasonally adjusted annual rate) at the current level of spending.

In contrast to the rather steady upward trend in the consumption of services, expenditures for goods—and especially for durable goods—have been much more subject to fluctuation, and the variation in such expenditures has largely determined the over-all behavior of consumer spending. Among the major durable items, in turn, the dominant influence through most of the postwar period has been purchases of automobiles. For example, sales of new cars were off markedly in both August and September of this year and over-all durables consumption declined in the third quarter. At the same time, the swing in durables consumption from an increase in the second quarter to the third-quarter decline accounted for more than half of the slowdown in the growth of total consumer expenditures. While there have been periods when purchases of other items have tended to offset declines in consumption of automobiles, it appears that when consumers are in the mood to buy cars they are also quite likely to be in a mood to increase their total spending. Conversely, slackening in over-all consumer spending has tended to accompany weakness in purchases of automobiles.

Trade reports suggest that automobile sales in October were the best on record and substantially higher than the third-quarter average. While this in part probably reflects a bunching of retail deliveries as the 1963 models became available, recent surveys of consumer buying plans indicated that intentions to buy new cars remain relatively strong. The continued strength in buying intentions may in part reflect the fact that, in spite of the near-record automobile sales so far this year, the proportion of disposable income spent on automobiles has been below the ratios set in five of the past seven years. At the same time, although the recent substantial increase in consumer credit has been accompanied by some uptrend in the proportion of new cars bought on credit, this proportion remains below the levels set in the earlier peak sales years of 1955 and 1957. The surveys were, however, taken before the development of the Cuban crisis which could alter consumer attitudes and the whole pattern of their spending behavior.

The Money Market in October

The money market was relatively comfortable during October. Although firming somewhat during the midmonth period, when the Treasury raised $500 million in new money through enlarging its offering of one-year bills, the market did not tighten substantially at any time. Nationwide reserve availability was about unchanged, and member bank borrowing was moderate. Federal funds traded in a 2¾ to 3 per cent range, while rates posted by major New York City banks on call loans to Government securities dealers ranged between 2¾ and 3½ per cent. Rates on directly placed finance company paper, commercial paper, and bankers' acceptances were reduced by ⅛ to ¼ percentage point during the month.

Following the close of business on October 18, the Board of Governors of the Federal Reserve System announced a reduction from 5 per cent to 4 per cent in the reserve requirement against time and savings deposits. The reduction took effect on October 25 for reserve city banks and November 1 for other member banks, releasing an estimated $767 million total of required reserves. The Board's action was designed to help meet the heavy seasonal reserve needs that normally appear in the closing months of the year and to provide for the longer term growth of bank deposits. The announcement noted that "this method of supplying reserves will minimize downward pressures from System purchases upon short-term market rates, which is desirable in the present circumstances in order to keep incentives for short-term capital flows abroad from becoming stronger".

Treasury financing operations during the month included the auction on October 9 of $2.5 billion of one-year bills at an average issuing rate of 2.97 per cent to replace $2 billion of bills maturing October 15. In addition, the Treasury announced after the close of business on October 25 the offering of three new issues in exchange for four issues called for or maturing in November and December. The four issues eligible for exchange include the 3¾ per cent Treasury notes dated November 29, 1957 and the 3¼ per cent notes dated August 1, 1961, both maturing November 15, 1962, the 2¼ per cent bonds dated November 15, 1945 and maturing December 15, 1962, and the 2¾ per cent bonds dated December 15,

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1938 and called for redemption December 15, 1962. The three new issues, all dated November 15, 1962, are 3⅛ per cent Treasury certificates maturing November 15, 1963, 3½ per cent notes maturing November 15, 1965, and 4 per cent bonds maturing February 15, 1972. Subscription books for the exchange were open from October 29 to 31, with holders of any of the old issues permitted to take any of the new issues on a par-for-par basis.

The market for Treasury notes and bonds showed a firm underlying tone during October. Some intermittent and mild price declines occurred in the middle of the month, largely representing profit-taking following earlier advances. There was also a decline in the October 22-24 period, following the sudden heightening of tensions over the Cuban arms build-up, but this adjustment was notably mild and orderly. Toward the end of the month, a more confident tone returned to the market and a particularly receptive atmosphere built up around the Treasury's exchange offering described above. The market for Treasury bills was also firm during the month, despite the enlargement of supplies, as corporations remained active buyers. Although there was some increase in the volume of current and prospective new offerings, prices of corporate and tax-exempt bonds moved upward during much of the month, and new issues were well received in most cases.

BANK RESERVES

Operating factors absorbed a substantial volume of reserves over the month, owing primarily to a large contraction in float and also to a sizable increase in currency in circulation in the middle of the month. The effects of these movements were only partly offset by an increase in vault cash. The reduction in reserve requirements against time and savings deposits at reserve city banks was mainly responsible for the decline of $462 million in required reserves in the final statement week of the month. System open market operations supplied reserves in the early part of the month and absorbed reserves during the balance of the period. From the last statement week in September through the last statement week in October, average outright holdings of Government securities rose by $513 million, while average holdings under repurchase agreements rose by $36 million. From Wednesday, September 26, through Wednesday, October 31, System holding of securities maturing in less than one year rose by $824 million while holdings maturing in more than one year increased by $275 million.

Over the five statement weeks ended October 31, free reserves averaged $406 million, compared with $407 million in the four weeks ended in September. Average excess reserves declined by $22 million to $469 million, while average borrowings from the Federal Reserve Banks declined by $21 million to $63 million.

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, OCTOBER 1962

In millions of dollars; (+) denotes increase, (—) decrease in excess reserves

Factor	Daily averages—week ended					Net changes
	Oct. 3	Oct. 10	Oct. 17	Oct. 24	Oct. 31	
Operating transactions						
Treasury operations*	+ 16	— 37	+ 42	— 40	— 32	— 51
Federal Reserve float	— 429	— 102	— 12	+ 450	— 608	— 701
Currency in circulation	— 27	— 193	— 154	+ 141	+ 76	— 157
Gold and foreign account	+ 2	— 27	+ 29	— 12	— 42	— 50
Other deposits, etc.	— 34	+ 12	+ 12	+ 54	+ 16	+ 60
Total	— 469	— 348	— 86	+ 594	— 587	— 896
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 606	+ 600	— 161	— 454	— 78	+ 513
Held under repurchase agreements	+ 13	+ 122	— 40	— 94	+ 35	+ 36
Loans, discounts, and advances:						
Member bank borrowings	— 78	— 19	+ 27	— 15	+ 23	— 62
Other	—	+ 1	— 1	—	+ 1	+ 1
Bankers acceptances:						
Bought outright	—	— 1	—	+ 1	+ 1	+ 1
Under repurchase agreements	—	—	—	—	—	—
Total	+ 543	+ 702	— 175	— 563	— 17	+ 490
Member bank reserves						
With Federal Reserve Banks	+ 74	+ 354	— 261	+ 31	— 604	— 406
Cash allowed as reserves†	— 91	— 191	+ 227	+ 24	+ 62	+ 31
Total reserves†	— 17	+ 163	— 34	+ 55	— 542	— 375
Effect of change in required reserves†	— 41	— 128	+ 37	— 33	+ 462	+ 297
Excess reserves†	— 58	+ 35	+ 3	+ 22	— 80	— 78
Daily average level of member bank:						
Borrowings from Reserve Banks	63	44	71	56	79	63‡
Excess reserves†	446	481	484	506	426	469‡
Free reserves†	383	437	413	450	347	406‡

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† These figures are estimated.
‡ Average for five weeks ended October 31, 1962.

THE GOVERNMENT SECURITIES MARKET

The market for Treasury notes and bonds generally displayed a firm underlying tone during the month. Market confidence in the prevailing level of prices was buoyed by press discussion of a lack of vigor in the domestic economy and of what seemed to be an improvement in the international position of the dollar. Against this background, prices advanced in the opening days of the month, continuing the upward trend that had been maintained with few interruptions since early August. Subsequently, some profit-taking developed but was absorbed with only moderate declines in prices. Sizable price gains were recorded

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on October 18 and 19. These seemed to be, in part, an aftermath of the October 17 meeting at this Bank at which Under Secretary of the Treasury Robert V. Roosa indicated that the Treasury's auction of $250 million of long-term bonds would not occur before late December, and of the Board's announcement of a reduction in reserve requirements—which was initially interpreted in some quarters as indicating a shift to an easier monetary policy. By Monday, October 22, these influences were overshadowed by the sharpening of international tensions as a result of the Cuban situation. Bond prices moved lower in the next few days, but the adjustment was modest in extent as selling was not pressed aggressively in the market. The impending announcement of the terms of the Treasury's refunding also was a factor tending to reduce activity during this period. In the last few days of the month a steadier and more confident atmosphere returned to the market, and a good reception was given to the three-way refunding offering described above. "Rights" rose to premium levels, and prices of the new issues advanced in "when-issued" trading. The new three-year 3½ per cent note appeared to be regarded as particularly attractive by the market, with many observers expecting the largest portion of public holdings of rights to be turned in for that issue. Over the month as a whole, prices of other outstanding intermediate- and long-term bonds ranged from 4/32 lower to 1 point higher.

The market for Treasury bills was generally firm during October, reflecting a steady corporate demand that readily absorbed further additions to supply. These additions included continuing increases of $100 million in the regular weekly bill auctions as well as the $500 million addition to the one-year bills mentioned previously. Rate movements were narrow during most of the month, particularly in the three-month area, where dealers were cautious as rate levels approached the lower limit of the recent trading range. Longer bill rates rather consistently tended downward, however, as investors showed an increased willingness to extend maturities in order to gain slightly higher yields, and toward the close of the month three-month rates also moved below their recent range of variation. Thus the average issuing rates on three-month bills ranged from 2.74 to 2.76 per cent in the first four weekly auctions of the month, but declined to 2.69 per cent in the final auction on October 29. The issuing rates on six-month bills moved steadily lower through the month, from 2.94 per cent in the last auction of September to 2.77 per cent in the final October auction. Similarly, the one-year bill, which was auctioned on October 9 at an average issuing rate of 2.97 per cent, closed the month at a bid quotation of 2.89 per cent. (The one-year bill auctioned last July, which was $500 million smaller, sold at an average issuing rate of 3.26 per cent.)

Following the weekly auction on October 29, at which an aggressive bidding interest partly reflected demand from sellers of refunding rights, market rates edged very slightly upward. At the end of the month the newest three-month bill was bid at 2.72, compared with 2.74 at the end of the previous month, while the six-month bill was bid at 2.80, as against 2.89 at the close of September.

OTHER SECURITIES MARKETS

Although there had been a minor increase in dealer inventories during September and the calendar of current and forthcoming issues expanded somewhat during October, the markets for corporate and tax-exempt securities strengthened during the latter month under the influence of a general expectation that these markets would continue to reflect some slackness in the domestic economy. As a result, prices rose somewhat, while trading activity also tended to expand. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds fell by 5 basis points to 4.26 per cent, while the average yield on similarly rated tax-exempt bonds fell by 12 basis points to 2.88 per cent.

Several new corporate and tax-exempt issues offered during the month met with excellent investor response. Others, however, encountered some initial resistance, as underwriters had bid aggressively and set relatively high prices. The largest corporate issue was the $250 million offering of Aaa-rated bonds, maturing in 1996, by the American Telephone and Telegraph Company, for which competitive bidding took place on October 23—the first day after President Kennedy's urgent message on the Cuban situation. Despite the uneasy market atmosphere, the bonds were successfully marketed at a reoffering yield of 4.30 per cent, only moderately above the yield that most observers had expected before the crisis erupted. The largest municipal offering was a $107.9 million issue of A-rated New York City bonds, reoffered to yield from 1.50 per cent in 1963 to 3.40 per cent in 1992. The issue was fairly well received. The total volume of new tax-exempt securities reaching the market during October amounted to $600 million, compared with $395 million in the preceding month and $595 million in October 1961. New corporate bond flotations during the month totaled $540 million, or $385 million more than in the previous month and $205 million more than a year ago. Despite this increase in the volume of new issues, dealers' inventories increased only moderately. The Blue List of advertised dealer offerings of tax-exempt securities declined by the end of the month by $22 million to $403 million.

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The Growing Role of Credit Unions in the Consumer Savings and Loan Market *

A credit union is a cooperative association organized to promote saving among its members and to create for them a source of short-term consumer loans at relatively low interest rates. Although credit unions still play only a relatively small role in the over-all flow of funds through financial intermediaries, they have shown a quite substantial rate of growth during the past three decades. By the end of 1961, credit unions were in operation in all fifty states, had a total membership of nearly 13 million persons, and commanded assets totaling $6.3 billion. While credit unions are still small relative to most other financial institutions, they have become increasingly important in the consumer savings and loan market. In 1961, credit unions held total personal savings amounting to $5.6 billion, and their loans outstanding to members stood at about $5.0 billion—equal to about 9 per cent of total consumer credit outstanding. This article summarizes the development of credit unions and the reasons for their growing importance.

Each credit union is an independent, nonprofit organization, chartered and supervised by a state or by the Federal Government. In general, any interested group is able to obtain a charter, but membership in the union is limited by law to a group of persons who must have a bond of association consisting of a common occupation or place of employment, residence, or religion. In addition, the regulations have generally required that the proposed union show that it has some reasonable chance for successful operation.

Any person within the eligible group may become a credit union member by paying an entrance fee of 25 cents and pledging to purchase one share of stock at a price of $5.00. The share may be bought on an instalment basis, with payments as low as 25 cents per week. Usually no limit is placed on the number of additional shares of stock a member may purchase (that is, the size of his savings account), but each member is restricted to a single vote at all times. Any member who has purchased and paid for one share of stock is eligible to apply for a loan; the amount of the loan or whether it will be granted is in no way associated with the number of shares owned. Rather these decisions are left entirely to the discretion of the union's credit committee, and this committee in turn is guided by the board of directors and certain limits stipulated by law. A member's liability is limited to his shareholdings or the unpaid amount of his loan, whichever is greater. The board of directors as well as the credit committee is elected by members of the credit union, and only members of the union are eligible for election to either body.

* Neal Riden, Jr., had primary responsibility for the preparation of this article.

HISTORY OF CREDIT UNIONS

The first credit unions were organized in 1909, following the enactment of enabling legislation in Massachusetts. By the time of the Federal Credit Union Act of 1934, thirty-seven other states had passed similar legislation and the number of credit unions in existence had grown to nearly 2,500. At the end of 1961, 21,000 unions were in operation—more than the number of commercial banks, of mutual savings banks, or of savings and loan associations. Most credit unions, however, remain very small.

The initial organization of credit unions received its impetus largely from a desire to provide a source of relatively low interest loans for those consumers who could not readily obtain such credit from other sources. Credit unions were viewed as a means to combat the high interest rates then prevailing on consumer credit. Although later legislation governing interest charges on small loans and the increased participation of commercial banks in the consumer credit market have brought down these rates, credit unions have continued to grow by virtue of certain competitive advantages. Primarily, these consist of lower costs of operation, greater convenience for members, and exemption from Federal taxation. Except possibly for a token salary paid to the treasurer, the work of running the union is typically performed by members without compensation. In addition, some firms or organizations give free office space to their employees' credit union and

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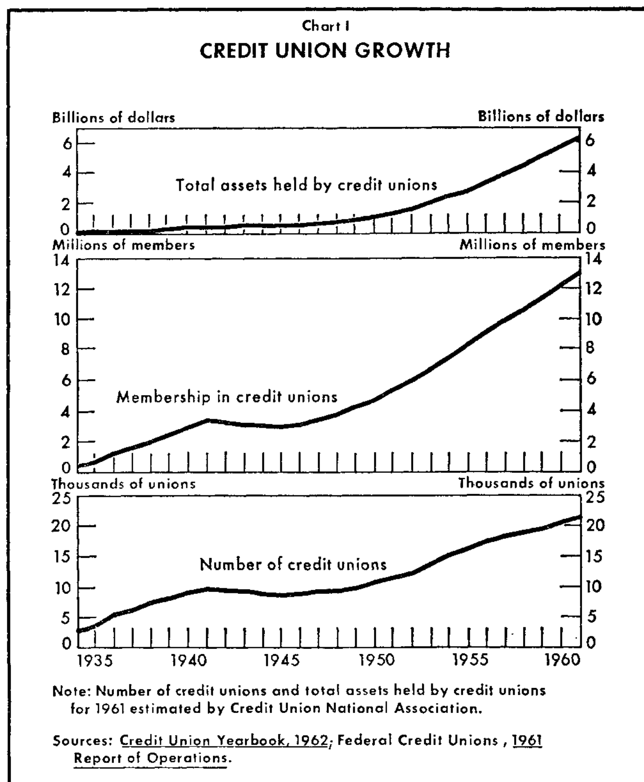


Note: Number of credit unions and total assets held by credit unions for 1961 estimated by Credit Union National Association.

Sources: Credit Union Yearbook, 1962; Federal Credit Unions, 1961 Report of Operations.

permit the transaction of credit union business on company time. Moreover, exemption from Federal taxation, while not too important at the outset, has over later years become increasingly important as a source of competitive advantage, mainly because of the higher corporate tax rates instituted during World War II and because of expanded coverage of the tax laws which has subjected all other financial institutions to some form of Federal taxation.

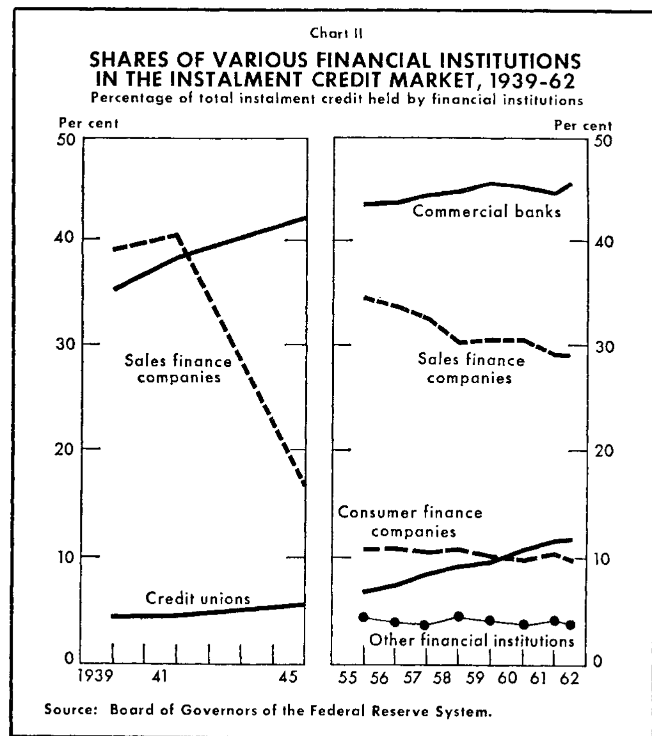
Partly as a result of these advantages over other financial institutions, the average membership of credit unions has risen from 172 persons in 1934 to 614 persons in 1961. Total membership in all unions expanded more than thirtyfold over the period (see Chart I). In 1961, one out of fourteen persons in the United States belonged to a credit union.

The growth of credit unions has been even more striking in terms of financial size. Taking all unions together, total assets rose from about $40 million in 1934, when credit unions began to grow more rapidly, to nearly $6.3 billion in 1961 (see Chart I). This represents a compound growth rate of more than 20 per cent per year over the 1934 through 1961 period. In 1961, the largest credit union had assets of about $32 million, and six credit unions were in the $25-million-and-over class. However, the average asset size for all credit unions was slightly less than $300,000, and half of all credit unions had assets of less than $92,000.

CREDIT UNIONS IN THE INSTALMENT LOAN MARKET

Credit unions largely confine their loan activities to the consumer instalment credit market. For many years, credit unions held such a small amount of total instalment credit outstanding that they were ignored in the collection of statistics. The first available data, for the end of 1939, show that unions held $132 million in instalment credit, equal to 4 per cent of the total amount held by financial institutions. By mid-1962 the volume of instalment credit held by unions had advanced to $4.6 billion, and amounted to 12 per cent of the total held by financial institutions (see Chart II). As a result of this growth, credit unions are now the third most important financial institution operating in the instalment credit market. Although they remain well behind commercial banks and sales finance companies, they have since 1960 ranked ahead of consumer finance (small loan) companies in total loans outstanding.

While statistical data on the purposes for which loans have been made to members have not been collected for all credit unions, such data are available for Federally



Source: Board of Governors of the Federal Reserve System.

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chartered unions for the years 1948, 1956, and 1961 and are probably fairly reflective of loans made by all credit unions. State chartered and Federally chartered credit unions are about equal in numbers, membership, and loans outstanding, and the distribution of their assets and membership is generally similar.

The major portion of loans made by credit unions is to finance the purchase of nondurables and services. In recent years, however, there has been some shift toward granting more loans for the purchase of durables. In 1961, loans to finance consumer durable goods accounted for about 30 per cent of the loans made by Federal credit unions; about two fifths of these, in turn, were loans to purchase automobiles (new and used). Loans for the purchase of nondurables and services largely accounted for the balance, although a few loans were also made to finance investments. By way of comparison, in 1961 about 64 per cent of the total instalment credit extended consumers by commercial banks was for the purchase of durable consumer goods; about one half of such credit, in turn, was for the purchase of automobiles (new and used).

Statistical information on the income level of credit union borrowers is scarce. Some indication is given, however, by a 1956 study made by the Michigan University Survey Research Center. This study indicates that about 60 per cent of the spending units with instalment debt to credit unions had before-tax incomes of between $4,000 and $7,500, with about 20 per cent having incomes below $4,000 and about 20 per cent above $7,500. These findings indicate that the income level of credit union borrowers is roughly the same as that of instalment borrowers served by other financial institutions.

LOAN SIZE

Despite their rapid growth, credit unions have continued to make relatively small loans. Members' needs for larger loans are presumably satisfied by other financial institutions. The average size of loans made by Federally chartered unions in 1961 was $740, compared with $1,182 for instalment loans made by commercial banks. However, the average size of credit union loans varies considerably with the total assets of individual credit unions and with the purpose of loans. In 1961 the average ranged from $129 for credit unions with assets of less than $5,000 (of which there were about 1,200) to $891 for the fifty unions in the $5-million-and-over group. The average loan in 1961 for financing new and used automobiles was $1,093 and for furniture and household appliances $368—in both cases well below the comparable figures of $1,409 and $453 for commercial banks.

Although the average size of loans made by credit unions has increased over the years, closely reflecting changes in the law which raised the maximum amount a credit union may lend on an unsecured basis, it seems unlikely that the average size of loans made by credit unions will come to exceed the average instalment loan made by commercial banks. Several provisions in the Federal Credit Union Act tend to limit the average size of loans made by Federal credit unions. Individual loans are restricted to not more than 10 per cent of a credit union's unimpaired capital and surplus. For one out of four unions this means a maximum secured loan of $1,000 or less. Unsecured loans are limited to $750. Furthermore, loan maturities are not permitted to exceed five years. This latter provision virtually excludes credit unions from the real estate lending field.

Average losses on personal loans to members have amounted to less than ⅕ of 1 per cent, a figure that is considerably below those for consumer finance companies and sales finance companies, respectively, and slightly below that for commercial banks. This low loss rate may in part be explained by the very nature of the credit union organization. In many cases, credit union members work in the same plant side by side, have lunch together, and discuss family problems. A member who fails to meet a loan obligation to the credit union is likely to feel the disapproval of his fellow workers and may be reprimanded by the management. Moreover, the common-bond-of-association requirement for membership often means that loan officials have a more intimate knowledge of the character and capacity of their borrowers than might be possessed by their counterparts in other lending institutions. The more intimate knowledge which credit union loan officials have of their borrowers, the fact that the loan officials are also savers in the union, and the importance of protecting the members' savings combine to produce a prudent loan policy.

CREDIT UNIONS IN THE PERSONAL SAVINGS MARKET

The increased importance of credit unions in the instalment market, of course, largely reflects their success in attracting personal savings (see table). In general, credit unions have no other source from which they obtain funds. Although credit unions still hold only a small proportion—3.0 per cent—of personal savings held by financial institutions, their rate of growth since 1945 has been significantly faster than that of commercial and mutual savings banks and slightly above the growth rate for savings and loan associations. Credit unions have had a compound growth rate of about 18 per cent, compared with about 6 per cent for commercial banks and mutual savings banks and 16

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per cent for savings and loan associations.

Several factors explain why saving through credit unions has grown so rapidly. First, as reflected by their low loan losses, credit unions have been successful in protecting members' savings. This has led to growing confidence in their soundness, notwithstanding the fact that savings in credit unions are not insured as are such savings in most other financial institutions. Second, in recent years credit unions have been able to pay attractive dividend rates on savings (which, of course, at least in part reflect the tax and other cost advantages already discussed). In 1961 nearly 60 per cent of all credit unions paid a dividend rate of more than 4 per cent, and a few paid as much as the 6 per cent maximum set by law. As long as credit unions are able to maintain and perhaps improve their dividend rates, they will have a potential for growth. Third, many people join credit unions to become eligible to borrow at relatively low rates of interest. The highest loan charge that a Federal credit union may levy is limited by law to 1 per cent per month on the unpaid balance, equivalent to 12 per cent per year. In 1959, the latest year for which comprehensive comparative data are available, the average annual charge per $100 of outstanding loans for Federal credit unions was $9.13, compared with a $10.04 charge for all consumer loans made by commercial banks, $16.59 by sales finance companies, and $24.04 by consumer finance companies.[1] Finally, the expansion of the Credit Union National Association[2] has given a continuing impetus to credit union growth. Credit unions operating through this organization are able to extend savings and loan life insurance to members, offer a complete line of life insurance contracts to members at rates which usually result in savings, and draw upon the research and advice of CUNA for the development of promotional ideas and programs.

There are, however, also factors that may slow credit union growth in the future, notably proposed changes that might be made in their preferred tax status and stiffer competition from banks and other competing institutions, especially through in-plant banking and payroll deduction plans. While any statement in reference to the future tax-exempt status of credit unions would be highly speculative, it is clear that their more rapid rate of growth relative to competing financial institutions might be retarded if they were subjected to Federal taxation of their earnings. Even if their tax status remains unchanged, moreover, the introduction and advertising of new services by other institutions may have important effects on credit union growth.

PERSONAL SAVINGS IN SELECTED INSTITUTIONS IN THE UNITED STATES
In billions of dollars

Year	Savings and loan associations	Commercial banks	Postal savings	Mutual saving banks	Credit unions	Total for the five institutions	Savings in credit unions as a percentage of total selected savings in the United States
1945	7.4	29.9	3.0	15.3	0.4	56.0	0.7
1946	8.5	33.4	3.4	16.8	0.4	62.5	0.6
1947	9.8	34.7	3.5	17.7	0.5	66.2	0.8
1948	11.0	35.0	3.4	18.4	0.6	68.4	0.9
1949	12.5	35.1	3.3	19.3	0.7	70.9	1.0
1950	14.0	35.2	3.0	20.0	0.9	73.1	1.2
1951	16.1	36.6	2.8	20.9	1.0	77.4	1.3
1952	19.2	39.3	2.7	22.6	1.4	85.2	1.6
1953	22.8	42.0	2.5	24.3	1.7	93.3	1.8
1954	27.3	44.7	2.2	26.3	2.0	102.5	2.0
1955	32.1	46.3	2.0	28.1	2.4	110.9	2.2
1956	37.1	48.5	1.7	30.0	2.9	120.2	2.4
1957	41.9	53.7	1.4	31.7	3.4	132.1	2.6
1958	48.0	60.0	1.2	34.0	3.9	147.1	2.7
1959	54.6	62.9	1.0	34.9	4.4	157.8	2.8
1960	62.1	67.1	0.8	36.3	5.0	171.3	2.9
1961	71.0	76.0	0.6	38.4	5.6	191.6	2.9

Source: Federal Home Loan Bank Board.

[1] Paul Smith, "Cost of Providing Consumer Credit", Occasional Paper No. 83, National Bureau of Economic Research, 1962, p. 4.

[2] Credit Union National Association was organized in 1934; it is a nonprofit, self-supporting association of leagues of credit unions. Credit union leagues are voluntary, dues-supported associations of credit unions in any state, county, or other governmental unit having its own laws.

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