



TWELFTH FEDERAL RESERVE DISTRICT

# MONTHLY REVIEW

SEPTEMBER 1950

FEDERAL RESERVE BANK OF SAN FRANCISCO

## REVIEW OF BUSINESS CONDITIONS

**T**HOUGH relatively few defense contracts have been awarded, the prospects of future spending for military purposes added to the already strong civilian demand have forced many lines of activity past their previous record levels. Employment has been rising rapidly in the nation and the District. Unemployment, which was dropping rapidly particularly in this District, has continued to fall. The pressure on prices after a very brief easing prior to August 15 has resumed its upward march. Evidence of inflationary pressures is so pervasive and obvious that it needs little recounting. Bank loans to business, consumer credit, and real estate credit have all been moving upward rapidly.

To permit some measure of control Congress passed the Defense Production Act of 1950. Implementation followed quickly for two sectors—inventories and consumer credit. Additional action on real estate credit and other sensitive segments of the economy will probably follow shortly. Such measures that have been taken and that are in prospect are likely to improve the short-run situation. It need not be forgotten, however, that the defense requirements so far are relatively modest. If any very large expansion should be required, much more forceful action to restrict consumption and much higher taxes to pay for military output out of current income will be required.

In this District employment continued to expand and the increased activity turned up several bottlenecks. Freight-car shortages had a considerable effect on the lumber industry and on wheat storage in the Pacific Northwest. In addition, District power facilities are being utilized to their fullest limit and temporary measures may be required in some areas to make power available for vital industries. Despite this factor industrial expansion has taken a sharp turn upward. Also moving ahead very strongly is construction activity which in August exceeded the same month a year ago by more than 60 percent.

### *The Defense Production Act of 1950*

In order to deal with problems arising out of the Korean conflict and the ensuing expansion of defense production, Congress embodied in the Defense Production Act of 1950 most of the powers originally requested by the President plus powers over prices and wages.

Generally, the powers are vested in the President to be assigned to existing departments or agencies or to such new agencies as he may deem necessary. A major exception exists only with reference to consumer credit controls granted directly to the Board of Governors of the Federal Reserve System.

The Act provides powers for priorities and allocation, rationing, requisitioning, price and wage stabilization, settling of labor disputes, and control of consumer and real estate credit. It also includes enabling legislation for Government-supported expansion of productive capacity through direct loans or through guarantee by Government agencies. The provisions of the Act in many respects permit controls as effective as those applicable in World War II, but farm prices are again accorded more lenient treatment than other commodities. Rents are exempted from provisions of the Act. The powers over priorities and allocations, for requisitioning, and for expansion of productive capacity expire on June 30, 1952, but the controls over prices and wages, labor disputes, and consumer and real estate credit expire on June 30, 1951.

*Implementation of the Act:* On September 10, 1950 the President issued an executive order to carry out the terms of the Act. The President divided the authority over priorities, allocations, and requisitioning as follows: to the Secretary of the Interior—for petroleum, solid fuels, and electric power; to the Secretary of Agriculture—for food, farm equipment, and fertilizer; to the Interstate Commerce Commission—for domestic transportation, storage, and port facilities; and to the Secretary of Commerce—for all other materials and facilities. The Secretary of Commerce established, based on the President's order,

### Also in This Issue

**Income in the Twelfth District, 1949**

**The Farm Debt Situation**

**Mortgage Recordings in the Twelfth District—  
1941 and 1949**

**What the Federal Reserve System  
Is Trying to Do**

an agency called the National Production Authority. Price and wage stabilization were assigned to a new organization called the Economic Stabilization Agency. Subordinate to the Economic Stabilization Administrator will be a Director of Price Stabilization and a Director of Wage Stabilization. The functions with reference to labor supply have been assigned to the Secretary of Labor. Control over real estate loans is vested in the Board of Governors of the Federal Reserve System for loans not insured or guaranteed by the Federal Housing Administration or the Veterans' Administration. Decisions of the Board are subject to concurrence of the Housing and Home Finance Administrator. The latter also receives the authority to regulate FHA and GI loans. At the same time the President granted authority for loan guarantees to the Departments of the Army, Navy, Air Force, Commerce, Agriculture, and Interior and to the General Services Administration. The Federal Reserve Banks, subject to regulation by the Board of Governors of the Federal Reserve System, will act as fiscal agents for the guarantee agencies. The Reconstruction Finance Corporation was empowered to make loans pursuant to the Defense Production Act. The Chairman of the National Securities Resources Board was named Defense Coordinator and was given the general responsibility of integrating the several phases of the program.

*Regulations issued:* Effective September 18 the Board of Governors of the Federal Reserve System issued Regulation W providing for the control of consumer credit. Articles subject to regulation were divided into four groups. Automobiles require a one-third down payment and the balance must be repaid in 21 months. Major household appliances require a down payment of 15 percent and the balance must be repaid in 18 months. Furniture and floor coverings are subject to a 10 percent down payment and the maturity cannot exceed 18 months. A 10 percent down payment is required for residential repairs, alterations, or improvements and the balance must be repaid in 30 months. Instalment loans to individuals for purposes other than the purchase of a listed article are subject to a maturity of 18 months. An attempt by the public to beat the gun resulted in very high retail sales during the week of September 16. Department store sales in this District were up 28 percent and in the country as a whole 17 percent from the corresponding week in 1949.

The Administrator of the National Production Authority issued his first order effective September 18.<sup>1</sup> Regulation I of this agency restricts the accumulation of inventories and the placing of orders for goods by business firms which would result in their possessing stocks above that required as a practicable working minimum. Inventory requirements of the recent past will form the basis for determining excess accumulation. The order provides for adjustment of the inventories in accordance with operating needs, but here the relationship between inventories

<sup>1</sup> Rubber consumption controls became effective on September 1 based upon authority contained in the Rubber Act of 1948 and exercised by the Secretary of Commerce.

and operations in the past will have to be adhered to. An extensive list of materials is subject to the order. The major categories involved include some or all types of building materials, chemicals, lumber, plywood, wood pulp, iron and steel, nonferrous metals, rubber, and textiles.

#### **Price rises continue**

Between mid-August and mid-September wholesale prices increased almost 2½ percent. Farm prices led the way, except for imported items which continued rising at a rate that kept them in a class by themselves, but non-farm products went up considerably too. Prices of textiles, building materials—particularly lumber, and chemicals increased much more than the average for nonfarm items. Fuel and lighting materials remained fairly steady.

The price increases since mid-August followed a brief interlude during which prices declined slightly. The resumption of the price rise after August 15 reflects higher incomes, or at least their anticipation, but it also reflects the fact that there is a higher degree of certainty as to the future possibilities for sales and employment. In such situations there is greater competition for goods on the buying side and sellers are considerably less likely to put pressure on to make sales. Regulation I of the National Production Authority is designed to reduce the impact of inventory accumulation on the part of both business buyers and sellers, and thereby to counteract some of the effects of a high degree of certainty concerning future sales possibilities.

#### **District approaches condition of full employment**

A state of virtual full employment characterized most District labor markets at the end of August. Expansions in employment made over a wide range of industry divisions were reported for all District states. (Utah and Washington employment experienced a poor showing earlier this year and through July lagged behind the first seven months of 1949). This very high employment level is the result of the interaction of two major factors. On the one hand there is the continuing and apparently increasing boom level of activity in the purely civilian sector of the District economy. The construction industry, for example, has reached a level of activity even higher than the already unprecedented level attained in July. Through August there was no sign of an abatement in this high level of activity despite sharply rising construction costs and restrictions already placed upon mortgage credit. In September, however, some evidence began to appear that home building may slacken. Applications for FHA loans, for example, were substantially below the high August level. Further restrictions are contemplated under the provisions of the Defense Production Act of 1950, and these, along with the possibility of allocations reducing the supply of materials for many types of construction, may have stimulated some construction in recent weeks.

Normal seasonal factors have been in full operation in the food processing and textile manufacturing industries

and have thus contributed heavily to the large employment increases in many areas of the District. The other major factor of prime importance is, of course, the general over-all stimulation given to many District industries and Government activities by the war in Korea. Aircraft, shipbuilding and repair, and to a lesser extent machinery manufacturing have experienced a particularly pronounced upswing in activity directly due to the Korean situation. Stimulation given the mining industry by rising metal prices has resulted in increased activity and has led to the removal of the Park City area of Utah from the list of areas with critical levels of unemployment.

As a result of the aforementioned employment advances, unemployment has been reduced to a very low level throughout the District. Usual in situations of very tight labor supply are the appearances of severe shortages of workers to fill openings in key or highly skilled job classifications. Reports of this type are becoming quite common in the daily press and in reports of the various state employment services. The large number of unfilled skilled and semi-skilled job openings in Oregon, which were reported in the August issue of this *Review*, has been substantially increased and has now reached a figure more than half again larger than that reported in July. The aircraft industry in the Los Angeles area, as in World War II, is resorting to large-scale training programs to satisfy its requirements for vital skills. Needed employment expansion in the large military supply establishments in the Ogden, Utah area is being held up pending training of key personnel not available among the unemployed in the area.

The expansion in District industrial employment has been generally reflected in a tightening of the agricultural labor market. As August, September, and October are

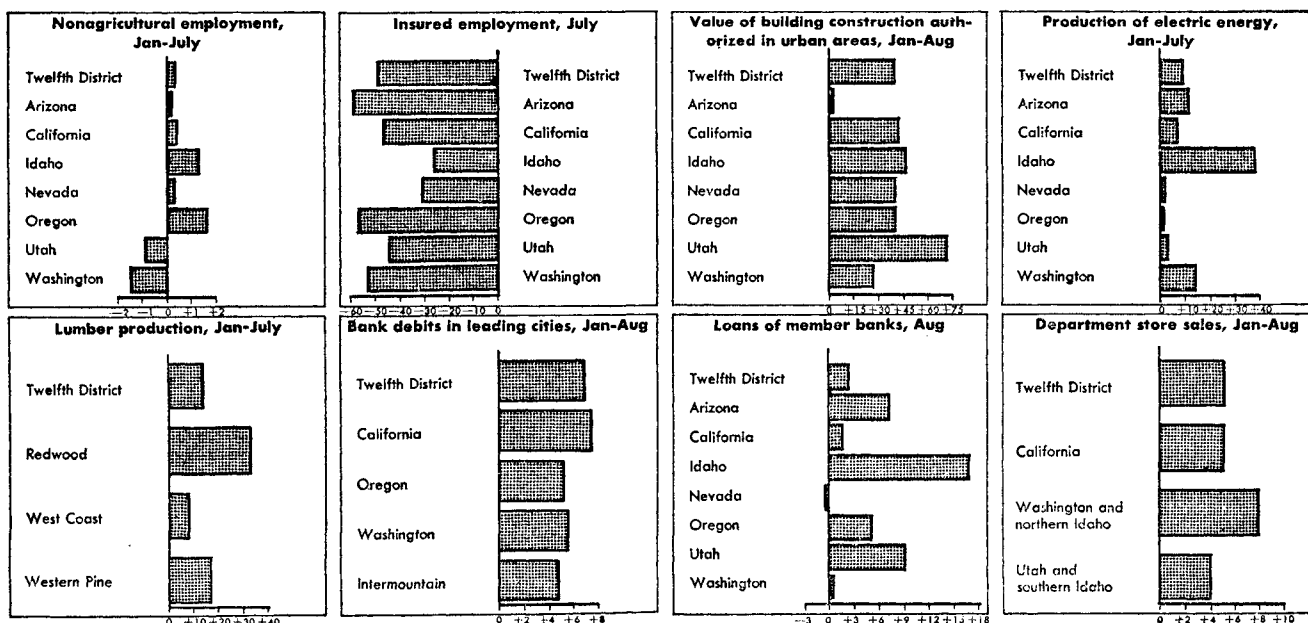
the peak harvest months, the movement of workers from the District farm areas to industrial jobs is being more keenly felt at the present time than will be the case in the approaching winter months. Relative shortages of labor are most noticeable at present in the cotton fields of the San Joaquin and Salt River Valleys, in the Central Valley fruit and tomato areas, and in the apple harvest in Washington.

**Railroad car shortage develops into the worst in history**

In August, Pacific Northwest lumber producers were faced with what threatened to become the most severe freight-car shortage in the history of lumbering in the area. It was estimated that only a relatively small proportion of the cars needed by Douglas fir sawmills in Oregon was forthcoming from the railroads. This shortage of cars resulted in the complete closing of some mills and in a sharp curtailment in the number of days of operation per week at others. Lumber prices, reflecting unprecedented demands from the construction industry and the extremely difficult car situation, continued to climb, and by the end of August had reached a level that was substantially above that of mid-1949. Reports in mid-September, however, indicated an easing in the price situation, especially for 2 x 4's. In spite of all the difficulties faced by the lumber industry, production this season appears to be shattering all previous record highs.

The storage of wheat on the ground in Washington, directly traceable to the shortage of cars which prevented its shipment to storage facilities, reached some six million bushels at the end of the harvest and fears are mounting that spoilage will claim this wheat unless cars are forthcoming in the very near future.

SELECTED INDICATORS OF BUSINESS ACTIVITY--TWELFTH DISTRICT  
Percent change, 1949-1950



Railroad freight car shortages, reflecting an over-all need for more cars than the railroads have had in service, have been an annual experience at peak seasons for many years. The extreme severity of the seasonal shortage this year is a direct result of the necessity of moving needed military supplies to Korea at the fastest possible speed. As a result of the urgency of this requirement railroad cars have been returned east without delay and have not been available for loading Twelfth District products for eastbound shipment. The sharp drop in the index of total carloadings in the District from 148 in June to 125 in July reflects this situation.

#### **Industrial expansion plans accelerated**

Particularly noticeable over the past month has been a sharp rise in the publicly-announced plans for the expansion of a wide range of District industries. Undoubtedly most of these plans were "in the mill," so to speak, prior to June 25, Korea Day, but it is equally clear that events from that date to the present have tended to solidify and to hasten their execution. Fears that developments would follow the pattern of World War II when construction for civilian purposes reached an extremely low ebb have resulted in a rush to expand while it still seems possible to do so.

The most significant of these expansions in terms of basic necessity are those contemplated for the electric power industry. The District power industry has expanded intermittently, but in rather substantial amount over the past several decades. Population and power-using industries, particularly aluminum, have also expanded and have managed to absorb virtually all available power supplies. During the intervals between these expansions in power supply many areas of the District tend to have little reserve power. When the current plans for expansion mature, the added output of electrical energy will help relieve this situation at least for a time. The expansion of electricity-using industries will probably absorb any reserves in a fairly brief period, however. Indicative of the present shortage of power are the proposed dim-out regulations in Washington designed to provide some additional power to the aluminum industry heavily concentrated there. The further expansion of aluminum production in that area, which is essential to the new defense effort, is almost entirely dependent upon increased power supplies.

#### **Bank loans rise sharply**

The increase in general business activity has been accompanied by a sharp rise in bank loans in both the Twelfth District and the nation. The upturn in business demand for bank credit started in June and has steadily gained momentum since then. In the week ending September 13, commercial, industrial, and agricultural loans outstanding at weekly reporting member banks rose by \$398 million in the country as a whole and by \$64 million in the Twelfth District, the largest weekly increases on record.

Since the beginning of June, the dollar increase in consumer loans at District weekly reporting member banks has been nearly as large as the increase in commercial, industrial, and agricultural loans. Percentage-wise, the increase in consumer loans has been larger. In the country as a whole, however, the dollar increase in consumer loans at reporting member banks has been only about a third as large as the increase in business loans. This is due partly to the fact that banks in other sections of the country do not engage in consumer lending as extensively as do Twelfth District banks. Of more importance, however, is the fact that the Twelfth District is less heavily industrialized than many other sections of the United States, and consequently business loans account for a smaller proportion of total bank credit extended in the District than in the country as a whole.

Real estate loans outstanding at weekly reporting member banks have also grown more rapidly during the summer months than they did earlier in the year.

#### **Liquid assets cashed in**

It is evident that consumers have used savings as well as credit to finance the big flurry of buying that followed the outbreak of war in Korea. Time deposits at reporting member banks have declined continuously since the end of June in both the District and the country as a whole. Savings in savings institutions also declined during July and August. The decline in all cases was a function of larger withdrawals than usual though the inflow of new savings continued high. The sale of Series E bonds fell short of the volume of redemptions in both July and August. This was a reflection of both larger redemptions and smaller purchases than usual.

---

### **INCOME IN THE TWELFTH DISTRICT, 1949**

**E**VERY year the Department of Commerce presents us with figures on state income payments for the previous year. These figures are always received with mixed emotions by state chambers of commerce, businessmen, and bankers, depending upon how their favorite state fared in comparison with its neighbors or more distant rivals and with the nation as a whole. People interested in any of the Twelfth District states are pleased to learn from

the latest figures<sup>1</sup> that most of these states fared better than the nation as a whole in 1949. This is in contrast to earlier postwar years when income payments to individuals in the Twelfth District, though always higher than in the previous year, failed to increase as much as in the nation. Income payments in 1949 were smaller than in

<sup>1</sup>The present discussion is based on the estimates which appeared in the August 1950 *Survey of Current Business*, pp. 11-24.

TOTAL INCOME PAYMENTS TO INDIVIDUALS—TWELFTH DISTRICT,  
1939-49

	(amounts in millions)				
	1939	1944	1946	1948	1949
Arizona .....	\$ 227	\$ 591	\$ 644	\$ 835	\$ 839
California .....	5,047	13,739	15,180	17,003	17,005
Idaho .....	213	537	608	735	707
Nevada .....	84	213	239	279	277
Oregon .....	587	1,672	1,777	2,143	2,095
Utah .....	243	644	694	816	825
Washington .....	1,012	3,240	3,139	3,545	3,529
Twelfth District .....	7,413	20,636	22,281	25,356	25,277
United States .....	70,601	153,306	170,962	202,385	197,531
<b>Percent change</b>					
Arizona .....	+242	+270	+ 42	+ 30	0
California .....	+226	+237	+ 24	+ 12	0
Idaho .....	+207	+232	+ 32	+ 16	- 4
Nevada .....	+274	+230	+ 30	+ 16	- 1
Oregon .....	+247	+257	+ 25	+ 18	- 2
Utah .....	+203	+240	+ 28	+ 19	+ 1
Washington .....	+220	+249	+ 9	+ 12	0
Twelfth District .....	+226	+241	+ 22	+ 13	0
United States .....	+139	+180	+ 29	+ 16	- 2

Note: The above figures supersede those that have been published in previous years. Revisions have been made by the Department of Commerce to incorporate the more complete income data that have been made available by the states.

1948, the first year-period decline since before the war. In the nation they fell 2 percent, but in the District they fell only a fraction of 1 percent. Hence the District's share of the national total rose slightly, from 12.4 percent to 12.8 percent. California remained the second highest income state, a place she has held only since 1944. Despite continuing large population gains, District per capita income also made out slightly better than the national average.

**Reasons for the District's relative gain**

The main factors contributing to the income decline in the nation were agricultural income and manufacturing payrolls. Agricultural prices were considerably lower in 1949 than in 1948, and crops themselves were slightly smaller, though still at near-record proportions. Agricultural income is as important in the Twelfth District as in the nation (8 percent of total income), but it declined less from 1948 to 1949—about 16 percent in the District, compared to 22 percent in the nation as a whole. A sharp increase in the value of cotton production and moderate increases in the value of citrus crops brought about an increase in agricultural income in Arizona and kept California's decline at half the national rate. The crops that showed the sharpest declines in the nation were wheat, corn, and oats. Oregon and Washington, where much of the District's supply of these crops is grown, matched or exceeded the sharp national decline.

Manufacturing payrolls account for only 14 percent of the District's total income payments, compared to 22 percent in the nation. In addition, they declined only 2 percent here compared to 6 percent in the nation as a whole. The national decline was largely a result of the inventory recession in highly-processed durable goods. These goods are less important products of District manufacturing, and hence the effects of the slowed-down inventory buying were less severe here than in the nation.

**Utah's small gain, Idaho's decline, mark the range of District changes**

Utah's 1 percent gain in income payments placed her among the eight states in the nation whose incomes were higher in 1949 than in 1948. Income in Arizona and California was virtually unchanged. Income declined in the other four District states, but Idaho was the only state in the District with a greater decline than the nation's. Agricultural income is a more important component of total income in Idaho than in any other District state, and increases in nonagricultural income were not sufficient to offset declines in agricultural income. Arizona's agricultural income, boosted by the improved cotton situation, combined with an increase in government income payments, offset declines in private nonagricultural income. California's 14 percent increase in government income payments served to offset declines in all other major components of income. Gains in government income payments were not sufficient to offset declines in other income sources in Oregon, Washington, and Nevada.

**Per capita income also declines less in District than in nation**

Though per capita income declined fractionally more in California than in the nation, an increase in Washington, the District's second largest income state, kept the District decline smaller than the nation's. The District's lead over national per capita income increased slightly as a result—from 16 percent in 1948<sup>1</sup> to 17 percent in 1949. Even so, this is considerably below the 27 percent lead the District had over the nation during 1944, the peak year of wartime activity. Revised 1948 figures indicate

## PER CAPITA INCOME PAYMENTS—TWELFTH DISTRICT, 1939-49

	1939	1944	1946	1948	1949
Arizona .....	\$ 461	\$ 985	\$1,059	\$1,179	\$1,165
California .....	741	1,564	1,653	1,743	1,665
Idaho .....	411	1,025	1,185	1,283	1,221
Nevada .....	767	1,430	1,732	1,594	1,731
Oregon .....	544	1,375	1,414	1,562	1,448
Utah .....	443	1,061	1,066	1,220	1,213
Washington .....	588	1,518	1,321	1,441	1,469
Twelfth District .....	657	1,472	1,511	1,615	1,560
United States .....	539	1,161	1,212	1,387	1,330
<b>Percent change</b>					
Arizona .....	+103	+153	+ 18	+ 10	- 1
California .....	+ 76	+125	+ 6	+ 1	- 4
Idaho .....	+136	+197	+ 19	+ 3	- 5
Nevada .....	+112	+126	+ 21	0	+ 9
Oregon .....	+126	+166	+ 5	+ 2	- 7
Utah .....	+126	+174	+ 14	+ 14	- 1
Washington .....	+106	+150	- 3	+ 11	+ 2
Twelfth District .....	+ 91	+137	+ 4	+ 3	- 3
United States .....	+ 96	+147	+ 15	+ 10	- 4

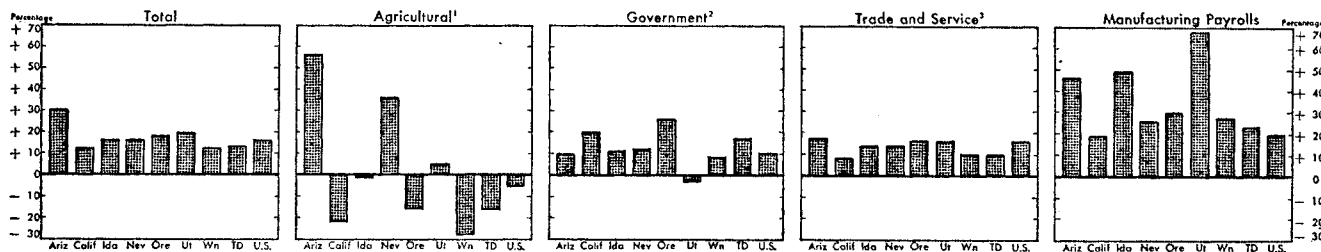
Note: The above figures supersede those that have been published in previous years. Revisions have been made by the Department of Commerce to incorporate the more complete income data that have been made available by the states and adjustments of population estimates to the 1950 census. The revised estimates would imply a population decline for Nevada and Washington from 1948 to 1949.

that California was the second highest per capita income state that year. It dropped to fifth place in 1949, while Nevada climbed from the eighth place it shared with New Jersey in 1948 to third place in 1949.<sup>2</sup> Nevada's gain from

<sup>1</sup> Estimates of per capita income for the past several years have been considerably revised on the basis of the 1950 census of population.

<sup>2</sup> After the District of Columbia and New York.

PERCENTAGE CHANGE 1946-49 IN TOTAL INCOME PAYMENTS AND SELECTED COMPONENTS, UNITED STATES  
AND TWELFTH DISTRICT STATES



<sup>1</sup> Net income of farm proprietors (including value of change in inventories of crops and livestock), farm wages, and net rents to landlords living on farms.

<sup>2</sup> Federal, state, and local government income payments.

<sup>3</sup> Wages and salaries and proprietors' income.

1948 to 1949 was the greatest in the nation. Within the District, Oregon had the greatest loss in per capita income payments from 1948. Oregon's total income payments, 2 percent smaller than in 1948, combined with a larger population to bring this decline.

#### District's postwar gains smaller than nation's

The same factors which led to a bettering of the District's relative position in 1949 over 1948 have operated to bring about a smaller over-all gain in income since the end of the war here than in the nation. The large nationwide expansion in manufacturing after the war was not reflected to so great an extent in District income as it was in the nation as a whole. This was the result of the less important position of manufacturing in the District total, since manufacturing payrolls rose more here than in the nation from 1946 to 1949. Utah, Idaho, and Arizona, for example, had the greatest gains in manufacturing payrolls in the nation from 1946 to 1949; yet manufacturing accounts for so small a part of their total income payments that the effect on total income of these very large increases was small.

Agricultural income, while as important in the District as in the nation, suffered sharper declines here from 1946

to 1949. Washington had the greatest decline in the nation, owing largely to lower fruit prices. At the same time, Arizona's 57 percent increase was surpassed only by the 71 percent increase in Texas. A large cotton crop in 1949 coupled with favorable prices compared to the small crop in 1946 accounted to a great extent for the improvement in those states. The good cotton crop in California, however, was unable to offset the large declines arising from lower fruit prices in 1949 compared to 1946.

Income from trade and services advanced much more slowly in the District than the nation from 1946 to 1949, and from 1948 to 1949 it declined relatively more here. This component of income is more important in the District than in the nation. Utah was the only District state in which it increased from 1948 to 1949. Government income payments make up a considerably larger part of total income here than in the country as a whole, and increased more here in 1949 over both 1946 and 1948 than they did in the nation.

Arizona made the greatest income gains in this District from 1946 to 1949 and, in fact, tied with Louisiana for the second largest gain in the nation after New Mexico. Arizona has also made the greatest income advances in the District since 1939.

### THE FARM DEBT SITUATION

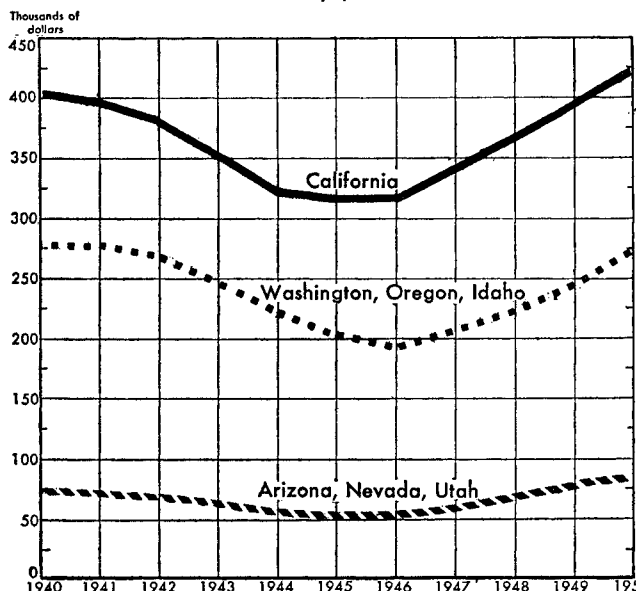
**T**HE first reversal in the long decline of farm mortgage debt outstanding in both the District and the United States occurred in 1946. Since then, farm mortgage debt has grown progressively larger each year and has continued to expand during 1950. In the District, the average yearly rise since 1946 has been over 8 percent. For the United States as a whole the increase has been slower: 2 percent in 1946 and 1947, 5 percent in 1948, and 6 percent in 1949. Farm mortgage debt rose much more rapidly following World War I, when there was an annual average increase of about 16 percent between 1918 and 1921.

By the time this country became involved in World War II, total United States farm mortgage indebtedness was about half as large as it had been during the early 1920's. With the steady rise in net farm income after 1940 resulting from war-inflated prices and increased crop yields, farmers were able to utilize a large share of their high net cash receipts for debt retirement, thereby accel-

erating the downward trend in total mortgage debt. The trying experiences following World War I and the depression of the 1930's were vividly recalled, and farmers generally were less prone to over-expand their capital debt. The fact that land values rose rapidly during World War II also discouraged excessive capital expansion which might have been expected to occur in a period of such high cash farm income. Moreover, increases in indebtedness for equipment and farm improvement were necessarily kept at a minimum because of scarcity of materials.

Farm mortgage debt started upward once again in 1946 as the increased availability of farm equipment, construction materials, and other necessary supplies led farmers to spend a larger share of their net income for such items than was possible during the war years. Living costs rose sharply. These expenditures had the double effect of decreasing the amounts repaid on existing mortgages and

TOTAL FARM MORTGAGE DEBT, TWELFTH DISTRICT  
as of January 1, 1940 to 1950



Source: United States Department of Agriculture, Bureau of Agricultural Economics.

also of stimulating new mortgage borrowing in order to finance some of the purchases.

For the District, the lowest total farm mortgage debt in over 25 years was recorded at the end of 1945, which at that time amounted to nearly \$570 million, or 12 percent of the national total. By the first of January of this year, the District's debt had increased to over \$722 million, 14 percent of the United States total. Within the District, there has been considerable variation in the rate of increase since total farm debt turned upward. The upswing has been sharpest in Nevada with an average annual increase of nearly 17 percent between 1945 and 1950. Arizona likewise showed a relatively higher increase than the District generally, followed by Utah and Oregon.

Since total farm mortgage debt started its upward movement, all District states have recorded noticeably higher yearly increases than the national average. Although it is difficult to identify exactly the factors which contributed to the higher rate of increase in the District, the following have probably been the most important. The more rapid declines in fruit prices prior to 1949 and the sharp fluctuations in the prices of truck and specialty crops may have had an effect in some District localities. Where the margin between gross income and operating expenses has narrowed, less net income has been available for mortgage debt retirement. The fact that a large share of the District's production is in non-price-supported crops may also have caused more conservatism among agricultural lenders, with a consequent request for sounder collateral secured by land rather than by crops or open notes. Development of new irrigated crop acreage in the Pacific Coast states has been encouraged by the high level of agricultural commodity prices which has

PERCENTAGE DISTRIBUTION OF TOTAL FARM MORTGAGE DEBT BY  
TYPE OF HOLDER—TWELFTH DISTRICT

	January 1							
	1940				1950			
	Insured commercial banks	Insurance cos.	Federal agencies	Other	Insured commercial banks	Insurance cos.	Federal agencies	Other
Idaho .....	1.5	10.9	49.7	37.9	5.1	20.3	23.8	50.8
Arizona .....	3.6	6.4	38.1	51.9	5.6	21.0	18.6	54.8
Utah .....	7.7	1.6	58.7	32.0	19.2	6.2	28.0	46.6
Nevada .....	3.8	5.3	38.7	52.2	7.4	25.2	12.7	54.7
Washington ...	4.5	14.3	41.6	39.6	14.5	15.7	17.3	52.5
Oregon .....	2.5	9.2	42.7	45.6	8.4	15.0	16.1	60.5
California ....	25.4	3.7	34.4	36.5	18.5	15.5	14.6	51.4
Twelfth District	15.3	6.6	39.4	38.7	14.7	15.9	16.7	52.7
United States..	11.5	14.9	41.9	31.7	16.4	21.7	21.3	40.6

generally prevailed in recent years. This type of development requires high capital investment in land, land preparation, and water facilities, and has been financed in many cases by mortgage credit.

#### Composition of farm mortgage holdings

Significant shifts have occurred since 1940 in the proportion of farm mortgage debt held by the various types of lenders. The principal sources of farm mortgage credit are Federal lending agencies, life insurance companies, insured commercial banks, and individual or miscellaneous lenders. Whereas in 1940 Federal agencies<sup>1</sup> held 42 percent of the total United States farm mortgage debt and nearly as much in the Twelfth District, by 1950 their proportion had decreased by a half. During the decade of the 1930's, Federal lending agencies became a major source of farm mortgage credit and by 1940 held the largest share of total volume of farm mortgages both in the nation and the District.

The lower rate of interest and the longer terms of Federal farm mortgage loans overbalanced the convenience and minimum delay of obtaining funds from commercial banks during a time of low prices and reduced income in the prewar decade. Rising farm income and the stronger financial position of farmers in general after 1940, however, were influential in drawing a larger proportion of the nation's farm mortgage credit into other than Federal financing channels. Federal agencies by 1945 held 35 percent of farm mortgage debt in the United States and 29 percent in the District, whereas by 1950 their holdings had been reduced to 22 percent and 17 percent respectively.

Insured commercial banks in the United States increased their proportionate share of total farm mortgage debt from 11 percent in 1940 to over 16 percent in 1950—an increase of \$350 million. For the Twelfth District as a whole, the position of insured commercial banks remained little changed in 1950 from a decade earlier, and represented 15 percent of the total mortgage debt of the area. This unchanged position of District insured commercial banks was largely the result of a sharp reduction in the total dollar volume of loans outstanding on farm and

<sup>1</sup> Federal Land Banks, Federal Farm Mortgage Corporation, Joint Stock Land Banks, and Farmers Home Administration.

ranch lands in California between 1940 and 1945 and the subsequent slower rate of increase in this state than in the rest of the Twelfth District. California carries the larger part of the dollar volume of District farm mortgage debt held by insured commercial banks, though its dollar volume in 1950 was considerably below the 1940 total. In 1940 farm mortgage debt held by insured banks in California represented 89 percent of the District total for such banks, in 1945, 79 percent, and on January 1, 1950, 68 percent. All other District states recorded increases in the proportion of commercial bank loans to total farm mortgage debt between 1940 and 1950 with the sharpest increases occurring in Idaho, Oregon, and Washington.

Individual and miscellaneous lenders, that is, lenders other than commercial banks, Federal agencies, and life insurance companies, held a considerably larger share of and the increase was more pronounced in the District than in the country as a whole. It is probable that much of the increase in the debt held by individuals is being carried by the sellers of farm and ranch lands who are willing to carry balances which pay higher interest rates than can generally be obtained on alternative investments.

For the District as a whole, life insurance companies since 1940 nearly tripled their proportion of the total farm mortgage debt. Dollar volume held by insurance companies rose from \$50 million in 1940 to over \$123 million in 1950. The greatest increase in life insurance company holdings of District farm mortgages has occurred during the last five years. Whereas insurance holdings increased from 6.6 percent of the District total in 1940 to 7.2 percent in 1945, by 1950 they accounted for 16 percent of the total.

#### *Non-real estate loans to farmers*

On January 1, 1950, non-real estate agricultural loans held by commercial banks and principal Federal lending agencies (other than CCC price-support loans) amounted to \$2.8 billion in the country as a whole. This represented a rise of 75 percent during the five years following the end of the war. After the war, operators made use of short-term credit for farm repairs, building and fence improvements, and purchases of machinery and household goods—things which had been difficult to do during the period of shortages. The decline in net farm income which started in 1948 as a consequence of lower commodity prices and increased production costs contributed also to a greater use of short-term loans.

At the start of 1950 the non-real estate farm debt was twice as large as the low point of 1935 but was still 26 percent under the record levels of 1921. The ratio of total farm indebtedness to total farm physical assets over the country as a whole nevertheless was still well below that recorded in 1940, a time of relatively favorable farm income.

Non-real estate loans to farmers held by commercial banks rose less in the first half of 1949 and decreased more sharply in the second half than was the case in 1948. Whereas in the first six months of 1948 these loans in-

creased 26 percent, they were up only 16 percent in 1949. From June 30 to December 31 the rate of decline in 1949 was 11 percent as against 3 percent a year earlier. Banks of the Twelfth District increased their portfolios of short-term farm paper 5 percent during the first half of 1949 but decreased the total 13 percent during the last six months. The slower rate of increase in early 1949 compared to 1948, and the sharper drop during the latter half of the year, were partly the result of refunding some short-term debt with longer-running mortgage obligations.

Twelfth District member banks on January 1, 1950 held \$244 million in non-real estate loans to farmers, or 9 percent less than that recorded a year earlier. The \$25 million held by District non-member banks on the first of the year, however, represented an increase of 6 percent during the same period. During the latter half of 1949 for both member and non-member District banks, short-term farm obligations were reduced approximately 13 percent.

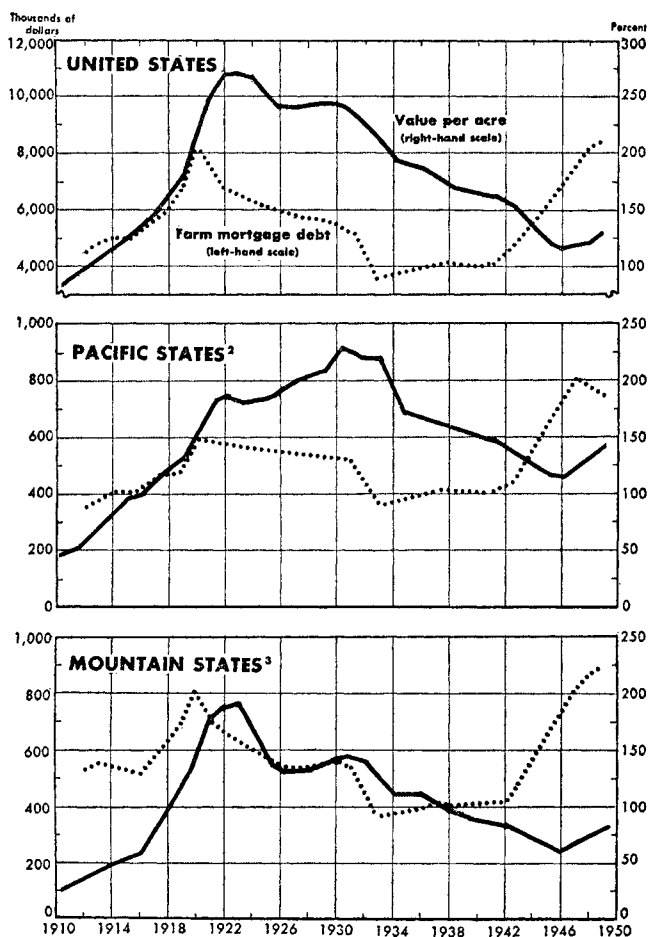
#### *Farm mortgage debt and farm land prices*

A sharp difference occurred in the relationship of farm mortgage debt to farm land prices during the periods of World Wars I and II. In the first period, farm mortgage indebtedness and farm land values moved upward rapidly throughout the country. After the break in farm prices in 1920, however, the value of farm land fell sharply. It was to be expected, in view of the large mortgage indebtedness then existing, that farm land prices would contract with the deflation of the prices of agricultural commodities. Following the initial break, however, the downturn in land prices was cushioned somewhat by more stable net farm incomes during the latter half of the decade. Nevertheless, a further reduction in incomes in the early depression years was again reflected in farm land prices as they fell to the lowest point of the interwar period. Though the smaller earnings of farmers reduced the amount available for debt retirement during this time, foreclosures and the writing-off of a large amount of agricultural paper during the period eliminated much recorded indebtedness and contributed to the reduction of total farm debt for the nation generally and in the Mountain states of the District. After 1932, Federal emergency lending to farmers, the reduction in interest rates, and the consolidation and refinancing of farm mortgage loans reduced debt charges for many operators. These factors, in conjunction with improved farm commodity prices which after 1934 raised farm incomes, were responsible for a continuation of the downward trend in farm mortgage debt. Numerous elements therefore contributed to the general decline in total farm mortgage debt following World War I.

In the Pacific states, farm mortgage debt and farm land prices behaved at sharp variance with the trend of these elements in other parts of the country up until 1931. Farm land values in the coastal area continued high between the peak of 1920 and the sharp break eleven years later. While



FARM MORTGAGE DEBT AND INDEX<sup>1</sup> OF FARM REAL ESTATE VALUES—UNITED STATES, PACIFIC STATES, AND MOUNTAIN STATES, 1910-49



<sup>1</sup> 1935-39 = 100.

<sup>2</sup> California, Oregon, and Washington.

<sup>3</sup> Arizona, Idaho, Nevada, and Utah in the Twelfth District, and Colorado, Montana, New Mexico, and Wyoming.

Source: United States Department of Agriculture, Bureau of Agricultural Economics.

total farm mortgage debt in other regions was being reduced in varying degrees, borrowing in the Pacific states rose to higher levels, reaching a peak in 1931 of over \$907 million or 24 percent above 1920 levels. This occurred at a time when the total for the United States had decreased 8 percent.

Farm mortgage debt and farm land prices in California, Oregon, and Washington maintained their comparatively high levels up to 1931 as a result of a number of causes. Increases in population, land and water development, improved farming techniques which increased production, expansion in the acreage of intensive cultivation, farm improvements—these are all factors which tended to maintain high land values and extensive farm mortgage debt in the Pacific area. Since the depth of the depression in 1933, mortgage debt and land values in the District coastal states have closely paralleled the national pattern.

Thus, in contrast with trends associated with World War I, when farmers overexpanded and mortgage debt reflected the inflation in land values, during World War II farmers used their increased incomes to reduce their obligations. They came out of the war in a strong position to finance farm developments and improvements with cash and the ample credit available. Although farm mortgage debt has risen steadily during the postwar years and land prices have continued at high levels, mortgage debt by 1950 represented only 8 percent of the total value of farm real estate as against 19 percent both in 1930 and 1940. Moreover, the nation's agricultural production plants have reached a new peak in efficiency.

#### Ratio of farm debt to farm assets

The combined volume of non-real estate debt and farm mortgages outstanding on January 1, 1950 represented approximately 8 percent of the total value of farm assets, including land, chattels, personal property, bank deposits, and investments, as against 18 percent in 1940. The generally rising trend in the short-term obligations of farmers and in their mortgage incumbrance, in the face of declining incomes in 1948 and 1949, contained some elements of apprehension for those financing the nation's agriculture. With the strengthening of most farm commodity prices during 1950, more particularly since July, and the possible siphoning off of a large portion of the Government commodity surpluses as a result of an unstable world situation, increased net farm income is likely in the foreseeable future. Higher net incomes would place farmers in a position to reduce their debt, so it would seem that the present obligations owed by the nation's farm operators are not out of line with a strong agricultural financial structure.

### MORTGAGE RECORDINGS IN THE TWELFTH DISTRICT—1941 AND 1949

**S**IGNIFICANT shifts in the pattern of mortgage lending, as well as evidence of the relatively rapid expansion of real estate financing activity in the Twelfth District, are revealed by estimates of nonfarm mortgage recordings of less than \$20,000 made by the Home Loan Bank Board.

While the data include mortgages on nonresidential properties, the omission of loans of \$20,000 or more causes the estimates to reflect primarily trends in home financing operations—possibly more so in 1949 than in 1941, when prices were lower and presumably a larger proportion of

nonresidential mortgages were in the under-\$20,000 category. The estimates are compiled from reports of cooperating institutions in areas containing about three-fifths of the total nonfarm population.

#### Mortgage recordings increase more in District than in nation

In the Twelfth District,<sup>1</sup> the amount of nonfarm mortgages of less than \$20,000 recorded in 1949 was estimated

<sup>1</sup> Excluding Nevada, since data for that state are not available for 1949.

to be 186 percent above the 1941 figure, compared with a 150 percent increase for the country as a whole. The District accounted for 17 percent of the United States total in 1941 and 19 percent in 1949. These figures reflect a rate of mortgage lending in the Twelfth District considerably in excess of its share as indicated by population and income statistics. District residents comprise 11 percent of the nation's population and receive about 12 percent of the national income. In contrast, the District's share of the nation's private residential construction expenditures was 17 percent in 1941 and 20 percent in 1949. A basic reason for the relatively high rate of home-building and hence of mortgage lending is the more rapid rate of population growth in the western states. Movement of people from other areas into the Twelfth District means new housing construction, which results in a greater per capita demand for mortgage funds than in areas where the population is comparatively stable. Within the District, the Pacific Northwest states and Arizona recorded the most spectacular increases in real estate financing activity between 1941 and 1949.

**Commercial banks most important mortgage lenders in District**

Analysis of the estimates by type of lender reveals interesting differences between the Twelfth District states and the nation as a whole, as well as changes during the nine-year period in the role played by various types of mortgagees. (It should be noted that these estimates are made on the basis of the originating mortgagees and thus may not always reflect the ultimate source of mortgage credit when mortgages are resold.) Commercial banks are the most important mortgage lenders in the Twelfth District, and are relatively much more important in the District than in the nation. This difference reflects the greater development of commercial banks' savings departments in this District. In the rest of the country savings and loan

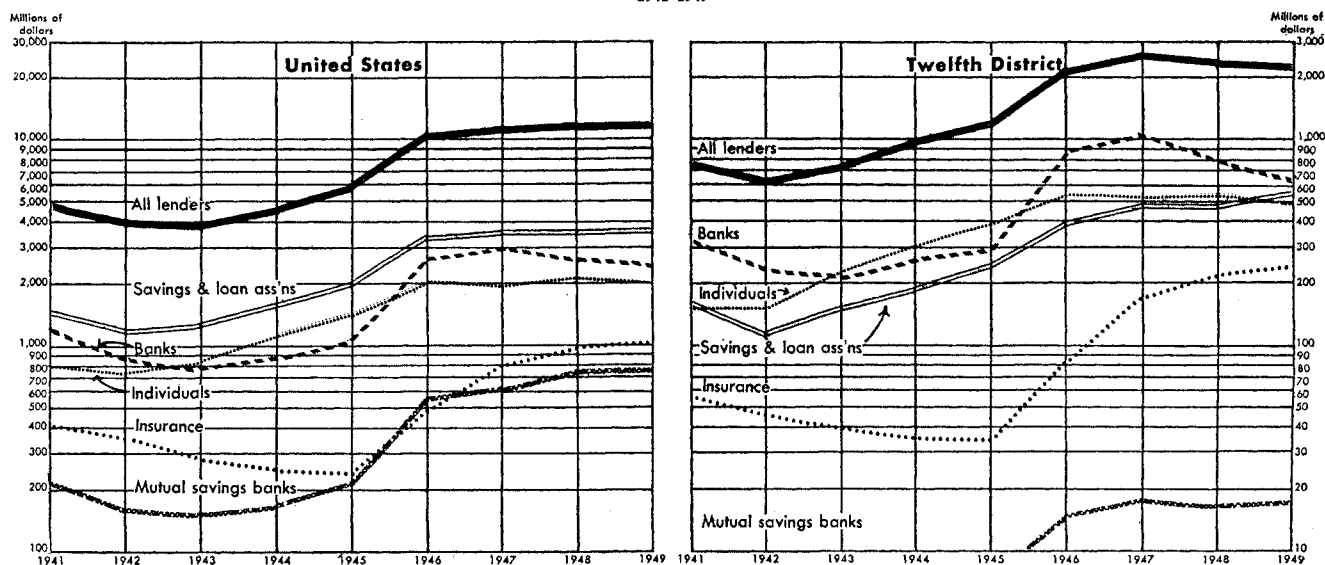
associations, and in some areas mutual savings banks, play the leading role in residential financing.

Since 1941, the importance of Twelfth District commercial banks as home-mortgagees has declined relative to other lending institutions, even though the dollar volume of their mortgage recordings has doubled. The shift from commercial banks to other lenders was similar to the national experience and was concentrated in California. After shrinking steadily throughout the war years, the District commercial banks' share of total recordings recovered sharply in 1946 and 1947 from the 1945 low point. Since 1947, however, the banks' proportion has dropped abruptly, and in 1949 they accounted for not quite 30 percent of the District total compared with a high of over 40 percent in 1941 and 1947. While only the California figures (which dominate the Twelfth District data) conformed rather closely to the 1941-49 pattern for all United States commercial banks combined, commercial bank experience in the other District states varied more or less widely from the pattern. In Utah and Washington commercial banks declined somewhat in relative importance as mortgagees, but in Arizona, Idaho, and Oregon they gained moderately between 1941 and 1949. Despite the substantial drop in California, commercial banks remained the leading source of home mortgage funds in 1949 in all Twelfth District states but Washington and Oregon. In those states, savings and loan associations had a larger share of recordings than any other type of lender.

**Other lenders increase their share of mortgage loans**

While banks reduced their percentage of total mortgage recordings, savings and loan associations, individuals, and insurance companies expanded their share of the District total. Though less important in the six states than nationally, savings and loan associations accounted for almost one-fourth of Twelfth District recordings in 1949. Individuals ranked third as a source of mortgage

**PRINCIPAL TYPES OF MORTGAGEES—NONFARM MORTGAGE RECORDINGS OF LESS THAN \$20,000  
1941-1949**



PERCENTAGE DISTRIBUTION OF NONFARM MORTGAGE RECORDINGS OF \$20,000 OR LESS, BY TYPE OF MORTGAGEE, 1941 AND 1949—  
TWELFTH DISTRICT STATES

	Savings and loan assns.		Insurance cos.		Commercial banks		Mutual savings banks		Individuals		Other mortgagees		All lenders	
	1941	1949	1941	1949	1941	1949	1941	1949	1941	1949	1941	1949	1941	1949
United States .....	31	31	8	9	25	21	5	6	17	17	14	16	100	100
Twelfth District <sup>1</sup> .....	20	24	7	11	41	29	1	1	20	22	11	13	100	100
Arizona .....	19	10	3	14	32	36	..	..	40	33	6	7	100	100
California .....	18	25	7	11	45	31	..	..	21	24	9	9	100	100
Idaho .....	25	19	5	17	27	35	..	..	21	21	22	8	100	100
Oregon .....	31	24	12	8	13	17	1	1	21	25	22	25	100	100
Utah .....	30	29	6	15	51	41	..	..	8	9	5	6	100	100
Washington .....	30	21	7	9	22	19	8	5	8	9	25	37	100	100

<sup>1</sup> Excluding Nevada, since data for that state are not available for both years.  
Source: Home Loan Bank Board.

funds in the District, providing over one-fifth of the total. Individual investors gained in relative importance during the war when private investment opportunities were somewhat limited, but they have played a lesser role since 1946.

**Share of insurance companies more important in District than in nation**

Insurance companies increased their share of mortgage recordings in every Twelfth District state except Oregon between 1941 and 1949. After an uninterrupted wartime decline not only in their share of the District total but in the dollar volume of their home financing activity—a decline which paralleled the national trend, they began a rapid postwar expansion of operations in 1946. Insurance companies provided 7 percent of District mortgage funds in 1941, only 3 percent in 1945, and then expanded each year to 11 percent by 1949. The national pattern was similar, but postwar gains have been relatively modest. The insurance companies' share of the national total was less than their share of the District total in 1949, which is especially interesting in view of the comparatively small amount of insurance company assets held in the District, most home offices being in the east. Only in Oregon, where insurance companies had accounted for 12 percent of 1941 recordings, did their share of the total amount decline in the nine-year period. In Arizona, Idaho, and Utah, the net rise from 1941 to 1949 in dollar volume of insurance company recordings aggregated over 1,000 percent, since the 1941 volume was nominal.

PERCENT CHANGES, 1941-1949, IN AMOUNT OF NONFARM MORTGAGE RECORDINGS OF \$20,000 OR LESS BY TYPE OF MORTGAGEE—  
TWELFTH DISTRICT STATES

	Savings and loan assns.	Insurance cos.	Commercial banks	Mutual savings banks	Individuals	Other mortgagees	All lenders
United States .....	+145	+ 159	+110	+243	+160	+183	+150
Twelfth District <sup>1</sup> ..	+243	+ 329	+101	+164	+217	+245	+186
Arizona .....	+120	+2,055	+369	..	+233	+366	+312
California .....	+276	+ 305	+ 78	..	+201	+162	+163
Idaho .....	+219	+1,219	+439	..	+299	+ 48	+310
Oregon .....	+198	+ 146	+419	+170	+352	+338	+281
Utah .....	+166	+ 569	+121	..	+194	+230	+174
Washington .....	+155	+ 386	+221	+164	+302	+445	+271

<sup>1</sup> Excluding Nevada, since data for that state are not available for both years.  
Source: Home Loan Bank Board.

**Regional differences within Twelfth District**

Among the District states, wide variations in the relative importance of different types of mortgagees exists. In California, for example, savings and loan associations accounted for one-fourth of all 1949 mortgage recordings under \$20,000, while in Arizona they made only one-tenth of the total. Individuals varied in importance as home financiers from one-third of 1949 recordings in Arizona down to 9 percent in Utah and Washington. The residual category "other mortgagees," which presumably includes mortgage companies, industrial banks, finance companies, endowed institutions, and credit unions, as well as private and state benefit funds, is comparatively important in the Pacific Northwest; in Washington, "other mortgagees" were the source of 37 percent of all mortgage recordings in 1949.

**FHA figures concur, add other information**

In the Annual Report of the Federal Housing Administration for 1949 are certain statistics which provide an interesting comparison with those discussed above. The FHA report contains percentage distributions of types of mortgagees by geographical divisions, based on FHA-insured mortgages secured by single-family homes and originated in the second half of 1949. Separate distributions are listed for new homes and for existing homes. As in the case of mortgage recordings, the data indicate the relatively important role played by western commercial banks. In the Mountain states, commercial banks originated 36 percent (new homes) and 41 percent (existing homes) of all FHA mortgages, and on the Pacific Coast,

PERCENTAGE DISTRIBUTION, BY TYPE OF MORTGAGEE, OF FHA-INSURED MORTGAGES SECURED BY SINGLE-FAMILY HOMES,  
JULY-DECEMBER 1949

	Savings and loan assns.	Insurance cos.	Commercial banks	Mutual savings banks	Mortgage cos.	Other lenders	All lenders
<b>New homes</b>							
Total United States ..	13	20	25	5	31	6	100
Pacific Coast <sup>1</sup> .....	17	18	49	1	11	4	100
Mountain states <sup>2</sup> ..	20	20	36	0	16	8	100
<b>Existing homes</b>							
Total United States ..	11	30	31	5	23	2	100
Pacific Coast .....	7	25	48	5	15	1	100
Mountain States ..	17	27	41	0	14	1	100

<sup>1</sup> California, Oregon, and Washington.

<sup>2</sup> Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, and Wyoming.

Note: Figures may not add to totals because of rounding.  
Source: Federal Housing Administration.

nearly half in each category. For the nation as a whole, the figures were 25 and 31 percent respectively. Both in the West and nationally, insurance companies appear to be more important as originators of FHA loans than as real estate lenders in general. Savings and loan associations, on the other hand, account for a smaller proportion of FHA-insured home loans than of total mortgage recordings. Mortgage companies are listed separately, accounting for nearly one-third of United States FHA

mortgages on new homes and over one-fifth on existing houses, but in the Pacific Coast and Mountain states they are considerably less active in FHA financing.

---

*Correction:* On page 101 of the August issue of the MONTHLY REVIEW, the statement was made that Los Angeles failed to displace Philadelphia as the second largest city in the nation. The word "second" should read "third." Our apologies to Chicago, which is the second largest city.

---

### WHAT THE FEDERAL RESERVE SYSTEM IS TRYING TO DO

WHAT steps must we take to prevent inflation? That is the paramount economic question that has confronted us as a nation since the outbreak of war in Korea. Inflationary forces had already begun to exert themselves with renewed vigor prior to June 25, and they have gained enormously in strength since then.

While some ground has been lost in the present battle against inflation, the more important part of the fight still lies in the future. We have already embarked upon a program of attack which has three main features to it: (1) a more stringent monetary and credit policy; (2) a more rigorous fiscal policy; and (3) the authorization of direct controls, such as allocation, rationing, and price controls, very few of which have as yet been put into use. If inflationary forces continue to grow in strength, and it is likely that they will, more extensive and vigorous use of all three types of controls will probably be necessary to forestall further inflation, although it is hoped that monetary and fiscal policy can avoid or minimize the use of direct controls. Monetary and credit policy only will be the subject for further discussion at this point, however.

The Federal Reserve System has the responsibility for formulating and implementing national monetary and credit policy as it affects the activities of our commercial banking system. In times such as the present, when inflation threatens, the System attempts to restrict the amount of bank credit in use by altering the supply, availability, and cost of such credit. The significance of attempting to do this arises from the fact that bank credit furnishes one of the three sources of funds available for spending by business and consumers. The other two sources are current income and liquid savings. Some of the liquid assets, such as Government securities, can be converted into new money only through their sale to banks.

If business and consumers rely extensively upon borrowed funds and liquid assets to increase their purchases beyond the limits permitted by their current income, strong inflationary pressures will arise if the supply of goods cannot be readily increased to balance the larger demand. Relatively little increase in over-all output is possible at the present time, since our economy is operating at virtual capacity. In fact, increased defense requirements will necessitate some reduction in the volume of certain types of consumer goods which use materials available in limited supply and essential to military out-

put. Moreover, the production of military goods and the general operation of our military establishment provide people with spendable income without a corresponding output of civilian goods. The result is that in a wartime economy operating at capacity the amount of disposable income normally exceeds the volume of available consumer goods unless prices are allowed to rise in a manner which carries with it all the hardships, inequities, misdirection of productive effort, and diminishment of incentives to save that are associated with a strong inflationary trend.

The situation today calls, therefore, for a reduction in the amount spent by consumers and business for civilian goods and services. This reduction may be accomplished in part by absorbing a greater portion of personal and business income through higher taxes. Not only does this serve to reduce private expenditure, but it also provides the Federal government with additional revenue and lessens its necessity for borrowing. The reduction might also be accomplished in part by encouraging saving and discouraging private spending financed by the use of liquid assets. This is a type of approach that we have done little, if anything, to implement, however. Finally, the reduction may be accomplished in part by restricting the amount of bank credit that business and consumers may obtain to finance their purchases. The responsibility for implementing this policy rests with the Federal Reserve System.

The System has at its disposal both selective and general credit controls. The consumer credit controls that went into effect on September 18 are of the selective type, as is the control exercised by the System over the use of credit for the purchase of corporate stocks on organized exchanges. These controls restrict the use of credit by setting minimum down payments that must be made and, in the case of consumer instalment credit, by prescribing the maximum maturities allowed. In this way the effective demand for the goods covered by this type of credit control is reduced below what it otherwise would have been, and credit and monetary expansion and the upward pressure upon prices is reduced as a consequence. It is hoped that much the same purpose will be served in the housing market by the forthcoming regulation of mortgage credit.

General credit control, as the name implies, is used to affect the cost, availability, and supply of all bank credit

(Continued on page 118)



### WHAT THE FEDERAL RESERVE SYSTEM IS TRYING TO DO

(Continued from page 116)

irrespective of the use to which it is put. The possibility of exercising general credit control rests upon the relationship which exists between bank loans, bank deposits, and bank reserves. When an individual or a business firm borrows money at a bank, typically the immediate effect is to increase the deposit of the borrower at the bank by a corresponding amount. As checks are drawn against this additional deposit, they are deposited to the accounts of others, some no doubt at other banks, and the net result is that deposits in the banking system as a whole have increased as a result of the loan. If some of the funds are withdrawn in currency, then the amount of money in circulation has increased. In either case, the loan has added to the total money supply and hence to the amount of funds available for spending on goods and services. If no corresponding increase in goods and services is forthcoming as a result of the loan, it contributes to inflationary pressures.

Banks must, however, keep reserves against their deposits. In the case of banks that are members of the Federal Reserve System, the required reserve ratio is subject, within prescribed limits, to the discretion of the Board of Governors. The higher the ratio, the larger must be the dollar reserve behind a deposit of a given size. The average ratio at present is about 16 percent, which means that one dollar of reserves will support about six dollars of deposits.

In addition to varying the required reserve ratios for member banks, the Federal Reserve System may also affect the total supply of reserves available to member banks. This is accomplished through open market opera-

tions. The sale of securities in the open market by the System diminishes member bank reserves, while the purchase by the System increases reserves.

Open market operations and changes in rediscount rates may also be used by the System to alter the cost to member banks of acquiring additional reserves. Member banks may obtain additional reserves either by borrowing from Federal Reserve Banks or by selling securities in the open market. By increasing rediscount rates and by allowing yields to rise in the open market, the System may increase the cost to member banks of acquiring additional reserves. This, in turn, may lead banks to increase their rates to customers, some of whom may be discouraged from borrowing because of the higher rates. Moreover, a tighter reserve position for banks results in their using a more selective lending policy, which also serves to restrain the expansion of bank credit.

The general credit policy employed by the Federal Reserve System in recent weeks has been designed to restrict the undue expansion of bank credit. Rediscount rates have been raised and, through open market operations, yields on short-term Government securities have been allowed to rise in an effort to limit Federal Reserve purchases of Government securities, and thereby limit increases in bank reserves. Member banks find the acquisition of reserves more costly as a consequence, and some of them have raised their customer rates.

To the extent that these increases in rates will check the expansion in bank credit, to that extent will consumers and business find one of their sources of spendable funds reduced, thereby diminishing inflationary pressures.

