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Statement by

SENATOR HUBERT H. HUMPHREY

ON INTEREST POLICY

Floor Speech

Mr. President, on April 18 I wrote the Secretary of the Treasury for information about the basis of the Administration's decision to increase interest rates on government security offerings. I have a reply from Mr. Randolph Burgess, Deputy to the Secretary. I request that the correspondence be included in the record of my remarks at this point.

Mr. Burgess has made it quite clear that the $3\frac{1}{4}\%$ interest rate on \$1 billion of 30-year bonds issued May 1 was set with the advice of large investors, writing:

> "...the Treasury and representatives of important investor groups meet on an informal roundtable basis whenever the situation appears to call for it..."

He further explains:

> "...the Treasury must adjust the terms of its offerings to conditions as they exist in the investment markets. The Treasury like other borrowers cannot attract any significant amount of genuine savings unless it offers an interest rate and other terms which are adjudged adequate by the owners of available funds."

In the Washington Post's report on May 19 of the Treasury's decision to pay a 2-5/8% interest rate on more than $5 billions of one year Treasury bills -- a rate 3/8% above a similar issue in February and 3/4% above a year ago -- this significant paragraph appears:

> "A Treasury spokesman said the rate for the new certificates was the lowest at which the new issue could be sold in the existing market. He said this determination was made after conferring with investment bankers."

Mr. Burgess' statement that the government "must" adjust to the requirements set down by these large investors is true only if it is the policy of the Treasury of the United States, in effect, to manage the federal debt by surrendering that management to the New York investment bankers.

On Thursday, May 14, the New York Journal of Commerce said in its leading editorial:

> "The Treasury is potentially so large a borrower that if it undertakes to compete freely in the market for funds with private borrowers, without any Federal Reserve assistance, a very sharp rise in interest rates is bound to result at a time when private demands for funds are large, too.

> "Such a rise in interest rates, past experience has shown, is bound in time to precipitate a depression."

The Journal of Commerce editorial states, of course, what is a fact: there is no "must" about meeting conditions set down by the big New York bankers. The United States government does not have to ask the National City Bank, Chase National Bank, Bankers Trust Company or the big insurance companies what interest it must pay.

The effect of large government offerings on interest level can be neutralized by Federal Reserve bank operations — and that is exactly the course which the Journal of Commerce advocated in its editorial. It said:

> "There is a middle course open to the Treasury that would avoid both these extremes of debt management policy ...
>
> "...under the middle-of-the-road policy, Treasury borrowing would take place at the interest rates set by private demands for funds. Treasury borrowing in and of itself would not be permitted to raise interest rates further, since there is no practical limit to the increase in interest rates that would occur when the Treasury insists on selling long-Term

bonds for new money or refunding regardless of the available supply of funds. The Federal Reserve Banks would provide only enough assistance to neutralize the effect of Treasury borrowing on interest rates."

I ask consent to have printed at this point in my remarks the full Journal of Commerce editorial, which is a complete refutation of any claim that the United States "must" do as Wall Street financiers say.

As a matter of policy, it is clearly the intention of this Administration to permit the "investment market" to jack up government interest rates. Mr. Burgess has made that quite clear both by his assertions in this reply to my inquiries, and in public declarations. In a speech to the National Association of Mutual Savings Banks here in Washington, he stated, according to the press, that it is a "first principle" of the Treasury in this Administration that the Federal Reserve Bank shall not support Treasury borrowing operations.

In his next paragraph, Mr. Burgess contends that the market confirmed the wisdom of Treasury setting the interest on the Government's long term offering at a 3¼% interest rate was exactly right; that trading in the new bonds has remained around par.

Any such conclusion arises from the erroneous assumption that the market somehow inexorably sets the rate; that the new high interest rate on the government offering did not, of itself, set the market; and that it makes no difference whether the United States puts 2% or 5% coupons on its bonds.

There is abundant evidence that the latter, and not the former assumption, is true.

When the new 3¼% bonds were announced, the offering was oversubscribed somewhere between 7 and 8½ times. Free riders applied for hundreds of millions of dollars worth, expecting to make a quick profit from the lush interest. But then the bankers and the market started adjusting to the new interest policy. Lower interest federal securities declined. Victory $2\frac{1}{2}\%$ bonds dropped down near 92. Prices of corporate bonds and stocks went down. The big New York City banks raised their prime commerical interest rate to the government level.

By the time the new governments were actually issued, they were selling fractions of a point under par -- not because Mr. Burgess had guessed too low on what the market demanded as to interest, but because the markets had adjusted themselves to the new high interest policy of the Administration.

I cannot believe that Mr. Burgess himself would seriously contend that "the market itself confirmed the fact that the Treasury offered what was necessary to attract long-term funds, in competition with other borrowers -- and no more than was necessary."

In answer to my question whether the Treasury had considered the losses that might be suffered as a result of the decline in the market value of Government and other securities, Mr. Burgess said:

> "The very fact that market prices of long-term securities have fallen and that interest rates have risen may work toward strengthening rather than weakening the financial institutions... A reduction in the prices of existing long-term Government issues provides these institutions with opportunities to invest newly accumulated funds in these issues through market purchases, at higher rates of return. As a result their financial structure may be strengthened and at the same time increased dividends may be provided to millions of policy holders and savings depositors."

A very differnt view of the "advantage" of a situation which has depreciated securities values is taken by Business Week magazine, whose publisher is the former New York state Superintendent of Banking. In their editorial of May 9, "Time to Ease the Money Squeeze", the magazine said:

> "...the fall in the price of government bonds has carried the victory 2½'s down from above par to almost 92 last week. With over $3.8 billion of that issue outstanding, the aggregate market depreciation suffered by holders of that one issue alone now totals about $350 million.

"As the price of Governments has dropped the market prices of all other high grade bonds have likewise dropped. Every ... moneyed institution has an unrealized depreciation in its bond portfolio that feels like a lump of lead in the stomach and results in the freezing of a portion of the assets of these institutions. The cost of borrowing — whether in the new issue market or at the banks — is now higher than it has been since the panic year 1933."

Mr. Burgess' letter to me indicates that the loss of value in old Governments and other high grade bonds was of little or no concern to the Treasury because /...

"...the reduction in the market prices of Government securities does not result in a real loss until the securities are sold. Those government agencies which are responsible for the supervision of financial institutions of this type agreed on August 11, 1938 that in the appraisal of bonds in bank examinations that neither appreciation nor depreciation of what they call Group I securities 'will be taken into account in figuring net sound capital of the banks. Group I securities are marketable obligations in which the investment characteristics are not distinctly or predominantly speculative.'"

Most of us have long understood that such an agreement is in effect, but there is also understanding that the agreement is not in any way a bar to taking cognizance of depreciation of values when they reach significant proportions; that the agreement is not intended to close the eyes of supervisory officials to such considerable declines as an 8-point drop in a group of securities in the bank portfolios.

If there is agreement that no decline in Group I securities shall be appraised by supervisory officials, this Congress ought to be advised of it.

Mr. Burgess' communication to me indicates t hat commercial banks of the nation hold $63.3 billion of government securities. The capital accounts of the commerical banks aggregate $12.9 billions. For every point decline in government securities in bank portfolios, there is therefore an unrealized loss in the marketable value of bank securities equal to approximately 5% of their total capital account.

The decline brought on by the increased government interest rates extends, as Business Week has pointed out, to other Group I securities. I am advised that total Group I security holdings of commercial banks, which includes governments totals $76 billions. Every point decline in total value therefore means a $760,000,000 depreciation in marketable value of Group I securities held by the commercial banks, or more than 5% of their total capital accounts.

If bank supervisors are unconcerned by the present situation — and I am told that at least some of them are concerned by it — then certainly it is time that this Congress assure itself that this "lump of lead in the stomach" is digestible.

I ask permission to insert at this point in my remarks the full text of the Business Week editorial.

I also offer for inclusion at this point in my remarks a column by Doris Fleeson, which appeared in the Washington Star and other newspapers, commenting on the Treasury high interest policy, and on its description by Business Week as "ignominy" for the Treasury, and by the New York Times as a "fiasco that had been handled ineptly."

Mr. President, it has been apparent from the protests of manufacturers and such spokesmen for industry as Business Week and the Journal of Commerce that the interest rate increases are regarded at least as excessive and untimely in the productive, industrial segment of our economy.

The only beneficiaries to whom Mr. Burgess points in his letter are "policyholders and savings depositors", which means, of course, insurance companies and banks.

It is obvious from the letter that the Treasury has no answer as to how the depreciation of security values, or how the increased interest revenues, would be distributed within the commerical banking structure. He explains that any calculation of losses on holdings of Government securities as a result of declines in the market price would require a detailed examination of the records of the individual institutions. The Treasury does not seem to know what banks are heavily in Governments, in governments and other Group I securities, or if there is a group of banks which are in position to take greater than average advantage of the new higher interest rates.

An~~y~~ analysis of recent reports of 1952 bank profits indicate that they have been quite uneven.

According to the National City Bank letter, the profits of banks, which are a major beneficiary of the general rise in interest rates rose very sharply in 1952 in contrast to the experience of the country's leading industrial corporations. They are going to have to pay more interest for capital, and their profits in 1952 were 7 percent below 1951.

The 315 leading commercial banking corporations in the National City Bank's tabulation had an aggregate net income of $512 million in 1951. This was increased to $553 million in 1952, for a gain of after-tax profits of 8 percent.

A study by Kidder, Peabody and Company, Inc., entitled "The Case For Bank Stocks", which is restricted to the 28 large banks in the largest cities, including 14 of the largest New York City banks, discloses even larger profit increases in this group than in the 315 leading commercial banking corporations studied by the National City Bank.

According to the Kidder-Peabody study, the average net operating earnings of the very large city banks, such as those in New York City, rose 13% between 1951 and 1952. This is considerably more than the average gain of only 8 percent for the larger National City Bank group.

If we go further and examine the individual earnings experience of the select 28 large banks, all of them within the 50 largest banks in the nation, we find even more striking differences.

For example, on the basis of net operating earnings per share the Bankers Trust Company of New York City showed the largest 1951-to-1952 gain. It amounted to 34%. Chase National

Bank had the second largest increase in net earnings, 31 percent. Some of the others which exceeded the 8% average increase in earnings of the 315 surveyed by National Bank include the following:

Security First National, Los Angeles	28%
Chemical Bank & Trust Co, N. Y.	20%
Hanover Bank, New York City	16%
Guaranty Trust, New York City	13%
National City Bank, New York City	13%
Philadelphia National Bank	11%
First National Bank of Chicago	11%
Continental Illinois National, Chicago	9%
National City Bank of Cleveland	9%

Actually this record of profit for the nation's leading commerical banks understates the true profit rate at the end of 1952, just prior to the Treasury's increasing of interest rates, for several reasons. During the first half of 1952 loan volume was restricted by Regulation W which limited the volume of lending to individuals. The lull in business activity in the early part of 1952 was reflected in a decline in business loans outstanding. The effect of the increase in prime commerical loan rates (from 2-3/4% to 3%) was not reflected until term loans which had been made at the lower rate had matured and were rewritten at the higher rate. In addition, the bank earnings in the first half of 1952 from yields on Government securities were effected by the decline in yields on short term issues.

The major portion of the large city bank portfolios is invested in short term issues, which brought higher interest yields toward the end of the year, further improving the large banks profit position.

In my opinion, this Congress should be advised very fully on the nature of Group I security holdings in various classifications of banks. Ours is the final policy responsibility. This far reaching Treasury decision to start an interest rate spiral was taken without consultation with the appropriate committees of the Congress, without advice from a Council of Economic Advisors or report and explanation by them to the Congress, and apparently without, as we have seen, even a careful analysis of its effect on various classes of financial institutions.

The known fact that large city banks have been getting a more than average share of increased banking profits, and that they are the heavier investors in short term government securities, which mature and are replaced within a few months by higher interest securities, is indicative that smaller "country" banks may have suffered a disproportionate share of the unrealized depreciation in market values, and will benefit least from the higher interest yields.

Certainly it is a matter of sufficient concern to us that Congress should not blindly permit this high interest policy to be further pursued; it should not permit the spiral to move up another notch and then another and another, without advising itself of the facts.

I have not anywhere seen a careful appraisal of the cost of this higher interest policy to the users of credit — the consumers.

There is evidence that it was extremely ill-timed in some quarters.

Agriculture is one of them.

Prices received by farmers dropped 2% from March 15 to April 15, 1953. In the same period the new Administration dealt a double-barreled blow at agriculture through its new high interest rate policy.

The farmers have been hit:

1. By a boost in interest on Commodity Credit Corp. supported loans from 3½% to 4%. This applies to loans on such commodities as cotton, tobacco, rice, peanuts and grains "put in loan" at the price support level.

2. By a boost in the interest charge by the Export-Import Bank of Washington on loans made to foreign nations to permit those nations to purchase U. S. agricultural commodities. (A $40 million Japanese cotton credit announced April 14 was at 3½% interest compared to 2-3/4% on previous similar loans).

The untimeliness of these two actions should have been apparent to the Administration even though it is operating without the advice of a Counsel of Economic Advisors.

With the 2% decline in prices received by farmers in the March 15 to April 15 period, farm prices are down totally 10.5% in a year, and they are down 17% from the 1951 peak. The parity ratio (relationship of prices received by farmers to prices paid by them) now stands at only 93. The increased interest charges imposed on the farmers -- and the Administration's increase in price support loans is only the beginning of an upward spiral of all farm credit -- will further worsen agriculture's economic position.

Agricultural exports are down. They dropped from $4 billion in 1951 to $3.4 billion in 1952. The new Administration pledged an all-out effort to increase exports. But, instead, its first concrete move in this field is a stiffening of terms on credit to foreign nations to aid in their purchase of American farm commodities.

The 27% increase in rate on the Japanese cotton credit was made in face of these facts:

Cotton exports dropped from 5.3 million bales in 1951 to 4.2 million bales in 1952.

Cotton exports from August 1952 through February 1953 have dropped 51% under the same period a year before.

Export-Import Bank credit has played a major role in preventing even greater cotton export declines. (The bank extended $173 millions in cotton credits in the fiscal year ended June 30, 1952 -- a sum large enough, according to bank estimates, to finance export of approximately 750,000 bales of cotton).

The increased interest charges are of doubtful necessity to the sound operation of the Bank. (The bank made profits in calendar year 1952 of $50.7 million after deducting operating expenses and $21.6 million interest paid to the Treasury.)

Farmers now face an additional threat of further interest rate burdens from their own government, entirely aside from these actions already taken.

Apparently seeking to "climb aboard" the Administration's tight money policy, a new Republican member of the House of Representatives has introduced a bill to double the interest rate on loans made by the Rural Electrification Administration. If that bill, H. R. 5356, were ever enacted by a short-sighted Congress, it would raise the power costs to farmers of America, set back progress of electrifying agriculture, and virtually block the rural telephone program just getting under way.

The bill is just one more example of the spiraling effects of the Administration's high interest-tight credit policies.

Since eight Senators on April 13 joined me in calling for further study of the timeliness and advisability of instituting the new high interest policy, evidence of the untimeliness of the action has appeared day after day in the press. For example:

> Bureau of Labor Statistics reported for the week ended April 14:
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> "Spot market prices continued downward for the fourth consecutive week. Average primary prices declined" and "the drop of 0.6 percent in farm products resulted from lower prices for cattle, lambs, copra, green coffee and many fresh fruits and vegetables."
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> The Washington Post reported in an editorial April 19:
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> "But some leading economists, including Marriner S. Eccles who was a vociferous advocate of higher rates in 1950-51, now maintain that the Treasury is running the risk of damaging the economy by advancing the top rate on government bonds from 2-3/4% to 3-1/4%. The boost appears to be a steep one, and the offering last Monday was so judged by investors who rushed to buy."
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> (Financial papers report subscriptions ran $6 to $7 billion for the $1 billion issue).
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> New York Journal of Commerce reports (4/21/53) that Dr. Marcus Nadler, professor of Banking and Finance at New York University and consultant to large banks, in an address to New York State Society of Certified Public Accountants said: "...there was no need for the recent adoption of a deflationary debt management policy by the Treasury since inflationary forces have to a large extent run their course."

> <u>New York Times</u> of April 24, 1953, reports that James Nance, president of Packard Motors, says the "automobile industry is going to be getting to the end of the road." He estimated current output 27% above sales — a gap that must be bridged by a sharp increase in sales or a sharp downward adjustment in output and employment.

> <u>Secretary of the Treasury Humphrey</u> told members of the Associated Press in New York City on April 20 that there will be no "depression" but qualified with the statement: "There will be <u>readjustments</u>, of course. There are always readjustments taking place in any active economy, sometimes to the advantage or detriment of one group and sometimes to another."

One week after Secretary Humphrey predicted readjustments, they were well under way. New York City banks raised interest charges on loans to borrowers with the best credit ratings from 3% to 3¼%, the highest point in 19 years, an action which was quickly followed in Chicago, Philadelphia and other major cities and will, of course, spread to banks in all the towns and villages in the nation.

Within two days the increase had spread to consumer lenders. On May 1 the Wall Street Journal gave its leading news column to a story by Lindley H. Clark, Jr. announcing that the top three consumer financing corporations in America, C.I.T. Financial Corp., General Motors Acceptance Corp. and Commodity Credit Corp., had already moved to "hike" their basic rates. One of them was increasing from 5½% to 6% — actually an increase from 11% to 12% on a 24-month loan since the interest is charged on the full sum for the full period of the loan rather than on the balance due after each installment is paid.

The day before this increase in consumer rates was announced, the Wall Street Journal reported that net profit of C.I.T. Financial Corp. in the first quarter of the year had increased 12% over the like 1952 period. The president, Arthur O. Dietz, had told the annual meeting of the Corp. that outstanding consumer credit was not excessive. He warned that some persons "would apparently seek to curtail installment buying, without realizing the extent to which this would jeopardize the present level of employment and production of those durable goods which are customarily sold on the installment plan." Commenting the following day on his company's interest increase to consumers, Mr. Dietz explained that it was necessary "in order to keep pace with rising costs, including the cost of borrowing money..."

Other consequences of the interest rate increases can be seen in the Business and Finacial column of the Wall Street Journal. On April 28 it reported:

> "Production cutbacks hit the appliance industry and some basic metals. Two big manufacturers applied the brakes to refrigerator and freezer output. Nash-Kelvinator Corp. slashed assemblies of Kelvinator and Leonard refrigerators and laid off 400 workers at its Grand Rapids plant. In Cincinnati, the Crosley Division of Avco Manufacturing Corp. announced it has made 'some reductions in refrigerator and freezer output because of slow market conditions.'
>
> "United States Smelting, meantime, is reducing its work week from six days to five days at Utah lead and zinc mines and at the Midvale, Utah, reduction plant. Prices for these metals, the company said, are now unprofitable for most U.S. producers. American Zinc

closed one mine in Tennessee and declared additional shutdowns will be considered if the decline in lead and zinc prices continued."

On April 30 the same column reported:

"ARMCO Steel Corp. expects its operations to average less than 90% of capacity in the final six months this year. This was disclosed by H. H. Tullis, financial vice president, in a speech at Cleveland. Armco is presently operating at 101%, he said, and this rate will continue until June 30 and possibly into the third quarter.

"But 'we have our fingers crossed for the second half,' Mr. Tullis declared. 'It appears now we will operated slightly under 90% of capacity during that period because of what looks like weaknesses in the white market.' He was referring to recent soft spots in refrigerator manufacturing, dryers and smaller appliances."

There are repercussions also in the financial world.

Detroit Edison Company's $40 million issue of 35 year general and refunding bonds offered April 30th were sold at the highest interest yields of any public utility bond since December 1935, according to the New York Times.

The Chicago Great Western Railroad was forced to decline the single bid it received on a $6 million bond offering.

On April 27 Sears Roebuck and Company postponed the sale of 1 million additional shares of capital stock because of the decline in its stock prices which followed the Treasury interest rate boost.

I ask consent at this point in my remarks to have printed in the Record an article from the Wall Street Journal of May 14, which deals with the interest rate increase as a brake on business, and reports numerous specific instances of the policy's effect on industry and commerce.

There is another aspect of this matter — increased cost to the government of carrying our national debt. The Public Affairs Institute has supplied me with a preliminary table of Increased Costs to Borrowers From Interest Rates Increases, January 2, through May 19, 1953.

This table indicates that the increased annual cost to the government of issues between January 2 and May 19 alone will be $132 million dollars.

That would be a back-breaking sum if some member of Congress were to suggest that it be added to the budget. He would be denounced as obstructing "economy". But this extra cost -- and there is more to come -- has been incurred without consultation with the Congress.

I request that the table, which covers some propsective interest cost increases to farmers, home owners, consumers and foreign borrowers, be included in my remarks at this point in the Record.

Mr. President, I feel very strongly that appropriate committees of the Congress should investigate and report on the effect, and prospective additional effect, of the new interest policy on our economy.

There is no Council of Economic Advisors. There have been newspapers reports that a reorganized Council would be proposed to us. But we are now within a month of time when a mid-year Council Report is due, and there is no assurance that one will be forthcoming.

The current situation is one in which the objective advice of professional economic advisors would be of great value — to the Administration as well as this Congress.

Certainly it is not wise to turn fiscal policy over to the large investing institutions and others who seem to think that the government "must" pay their price for the use of money. Neither do I think that fiscal policymaking should be turned over entirely to borrowers.

In my opinion, the Council of Economic Advisors should be immediately reconstituted. It should be manned with economists of the greatest competence and objectivity, able to appraise the timeliness of shifts in fiscal policy and to keep them appropriately moderate. There should be a mid-year Economic Report and hearings on it, before any further fiscal policy steps are taken.

In the absence of the Council, and of investigations and hearings by the Joint Committee on the Economic Report which arise from the Council reports, it seems to me urgent that the Congress itself initiate a study of fiscal policy.

There is pending a joint resolution by Senator Murray and Congressman Patman directing the Federal Reserve Bank to support government securities which might be the basis for such study if a legislative basis is necessary.

> The New York Journal of Commerce has warned: "If this policy of offering long-term issues at whatever rate is needed to attract buyers, without Reserve Bank aid, were to be pursued further, there can be no question that it would lift interest rates to a level where business conditions would be profoundly affected."

As I read the letter from the Deputy to the Secretary of the Treasury, who appears to be in charge of debt management, it is his position that, to meet the requirements of the times, we <u>must</u> adjust the terms of government offerings to the requirements of the market, without Reserve Bank aid, as those requirements are reflected to the Treasury by the large investing institutions themselves.

Certainly in such a situation, Congress should proceed at once to advise itself very fully on the wisdom of the Treasury policy.

Even if the Council of Economic Advisors were reconstituted at once, it would lakk time to make an adequate mid-year economic report covering this field. And Joint Committee hearings would normally come after such a report. I see no proper alternative but for Congress to start its own study without further delay.