

This does not mean that we will experience less easy conditions in credit markets. What happens will depend on many things—most importantly on the rate of activity in the economy: credit conditions may be tighter, or easier, or the same.

It is also helpful to recognize that in the American banking system there is an important distinction between total bank credit *expansion* and that portion of it which can be traced to the *creation* of money and credit.

The loans and investments of commercial banks in the United States can grow in two ways: one, through people placing more savings in banks in the form of time and savings deposits; or, two, through the creation of demand deposits. Hence, bank credit can expand substantially, without any significant money creation, as it has done in some periods—and in my judgment this is true of the first half of 1962. Alternatively, growth in bank assets can be—as at times it has been—associated almost entirely with money creation.

Analysis of these processes would be simpler if we had an institutional structure in this country in which the money creation function was entirely separate from what is called the savings intermediary function—the collection of small savings and their investment for the benefit of depositors, of shareholders, and of policyholders—but that is not the case. To the extent that individuals place their savings with banks and that banks, in turn, invest these savings in Government securities, the deficit which led to the issuance of the securities is being financed by real savings just as surely as if the individuals had purchased savings bonds in the first instance.

Moreover, a certain amount of money creation to meet the legitimate needs of a growing economy is a necessary and normal function of the banking system, and it is expected reserves will be provided for expansion to meet such needs. That is why we have the Federal Reserve System. Some part of the normal growth in banks' assets which accompanies this money supply expansion must, as a simple matter of banking prudence, take the form of additions to the secondary reserves of the banking system, which consist largely of Government securities. Additions to banks' holdings of Government securities due to additional flows of savings through this particular intermediary or to normal growth in the money supply do not represent the financing of Government deficits with bank-created or "printing press" money. Such additions are not inflationary and do not pose any threat to the soundness of the dollar.

What would be damaging to the strength of the dollar would be the deliberate expansion of the credit base, above and beyond the needs of the economy, in order to provide a ready market for the Government's borrowing. This was done in the United States during World War II, and in other countries both at that time and during the economic chaos that followed. It is still being done in some unfortunate countries today. The results have invariably been bad, and have ranged from damaging, as they were here, to nearly disastrous, as they have been in some other countries. The process of withdrawal and correction is always painful and difficult.

The only sure safeguard against the financing of deficits through bank credit creation lies in careful control over the process by which bank credit and money are created. As I have said, the Federal Re-