

CAPITAL SUPPLIES AND INTEREST RATES

Many Financial Currents Affect the Borrower of the Future—Available Money for Development

In estimating the effect of the war on future interest rates it is essential to state in a clear-cut way precisely what interest rates are meant. If one studies, for example, the figures of money rates on the New York market it is found that there is not one, but a variety, of rates quoted on capital, states Professor W. W. Swanson, discussing future interest rates in the *Journal of the Canadian Bankers' Association*. There will be found quotations under the head of "call loans" at the stock exchange and at the banks and trust companies; quotations under the head "time loans"; namely, 30, 60, and 90-day, and 4, 5, 6, and 7-month; and rates under the heading of "commercial paper"—double name, choice 60 to 90-days; and single name, prime 4 to 6-months, and good 4 to 6-months. It will be seen, therefore, that one cannot speak simply of the interest rate, but of interest rates for specific and definite kinds of loans. Moreover, a distinction must be drawn between bankers' loans and long-term investment loans. It is with these latter that we wish particularly to deal.

The United Kingdom has been for years the chief investigating nation in the world. Its foreign loans amounted to approximately \$20,000,000,000 as against \$9,000,000,000 for France, and \$5,000,000,000 for Germany. Its annual savings available for investment—aside from building and other private enterprises at home—amounted to some £220,000,000 annually. This huge sum was invested in the Near and Far East, in India, America and, latterly, in Russia. A fortunate circumstance for Britain, it may be mentioned in passing, is the fact that comparatively little of her capital was placed in the territories at present controlled by the Teutonic Allies.

Methods of Employing Capital.

In the United Kingdom, before the war at least, wealth was increasing at a rate out of proportion to the increase in population, consequently, there was always a large fund of newly created capital looking for favorable investment.

All the various methods of employing capital had been pushed to the extreme in Europe and in America. Canada in particular found itself equipped with a productive plant out of all proportion to her immediate needs. The outbreak of war put a sudden stop to the borrowing process which would have come about, more slowly to be sure, but no less certainly, in any event. What is true of Canada, moreover, is generally applicable to most borrowing countries. The productive equipment of the world is well able to take care of the immediate demand for products. This in turn must react upon the demand for capital, and hence must tend to equalize the demand for capital, notwithstanding the huge losses occasioned by the war.

Several of the estimates of the cost of the war do not take into account the enormous indirect costs of the war, which cannot be estimated with any degree of accuracy. There are also great economic losses to the nations involved in the destruction of able-bodied producers; but these losses also cannot be definitely determined. A future factor that must not be overlooked is the fact that not less than one-thirtieth of the population of the nations involved is withdrawn from productive enterprise. As each soldier on the firing line must be supported by three to four men in reserve, it is possible that one-sixth of the productive population of the belligerent nations is engaged in warfare, and hence withdrawn from the ordinary fields of production. The indirect costs of the war cannot be estimated with any degree of accuracy, but it is plain that they must be great.

Increases in Rates.

Taking all these factors into consideration, Mr. Charles A. Conant makes the following predictions:—

"The fact that such enormous sums to pay the costs of the war are gotten almost exclusively by means of government loans will make it impossible to obtain capital for other purposes, except at a rate of interest considerably higher than that paid by governments.

"The financial disturbances which will occur during the process of distribution of these government loans to investors, extending over several years, will involve the sale on the American market of railway and industrial securities, now outstanding, to an amount which will in itself absorb so much

of the new capital available in the United States, that it will be extremely difficult to obtain any for new enterprises.

"If, therefore, American railways and industrial enterprises are to obtain any new capital whatever, during the next few years, it will be necessary to make issues of securities very attractive, not only in respect to the rate of interest, but in respect to the evidence that the interest and dividend payments are absolutely secured by adequate earnings."

Dr. E. E. Pratt, chief of the United States Bureau of Foreign and Domestic Commerce, stated recently that:—

"The first ultimate effect of the war, and one which does not depend upon its duration, will almost immediately be an increase of interest rates in Europe. As you are doubtless aware, the income expected and obtained on investments in Europe, has been much less than that prevailing or expected in this country. The war, however, will be succeeded by a period of high interest. It will be succeeded by a period of intense demand for capital for reconstruction purposes. The railroads alone will need vast sums. The stock of capital is being depleted, and it is more than likely that financial exhaustion, rather than military exhaustion, will determine the final results."

Spending Four Years' Savings.

It is impossible to attempt even to estimate the future interest rate for investment loans without taking into consideration the annual supply of, and the demand for, capital. One of the most careful analyses of the annual supply of capital is that made by the Belgian financial journal, "*Le Moniteur des Interets Matériels*." Its estimate shows that the average annual supply of capital available for investment is about \$4,000,000,000. Thus one year's war will consume approximately four years' savings. There will, therefore, be no funds available, in the immediate future, for industrial expansion, except such as are saved out of earnings. This item, however, will be materially decreased because of the slackening of trade throughout the world, and the decreased need of making improvements out of earnings.

The demand for capital, at the present time, is mainly for financing the war. After hostilities have come to an end, the chief need for capital will be for reconstruction purposes. If we assume that the war will last two years, it will be evident, taking as a basis for calculation the figures presented, that it will require eight years' savings to cover the cost of the war alone. However, the important fact to keep in mind is that none of the nations involved will attempt to finance the cost of the war in so short a period.

Money for Industrial Requirements.

There will be available, in all probability, at least \$2,000,000,000 a year to take care of industrial enterprises. The question of the future trend of interest rates on investment loans then resolves itself into a consideration of the needs of the world in maintaining, improving or expanding its industrial equipment. A survey of the present situation would lead us to believe that, on the whole, productive equipment in several important lines has exceeded immediate needs; and hence there must be a slackening in the demand for investment capital to that extent. It is possible that there will be a marking of time in most countries during the next decade while population and trade are overtaking production, and in that event it is unlikely that there will be any considerable increase in interest rates for long-time loans. Moreover, the habits of thrift engendered by the war, among the masses, and the accumulated savings resulting from the slowing down of industry are bound to increase the loan fund and to minimize fluctuations in the interest rate.

Interest rates on short-time or bankers' loans will depend largely upon the briskness of trade, and the demand or banking accommodation. As bankers' loans are, in general, not investment loans at all, there need be no scarcity of capital, for, as is well known, the banks, through credit, coin the borrowers' future property or income into a present means of payment. The rate of interest in this field, therefore, will depend upon the amount of capital attracted to banking, on the one hand, and the state of trade on the other. In all cases, risk, the quality of paper offered, and the demand for banking accommodation, will be the determining factors affecting discount rates. At present, there are no indications that such interest rates will, in the immediate future, be other than normal in Canada.

The £20,000,000 loan of Australia for war purposes will be issued at par, and will bear interest at the rate of 4½ per cent. per annum.