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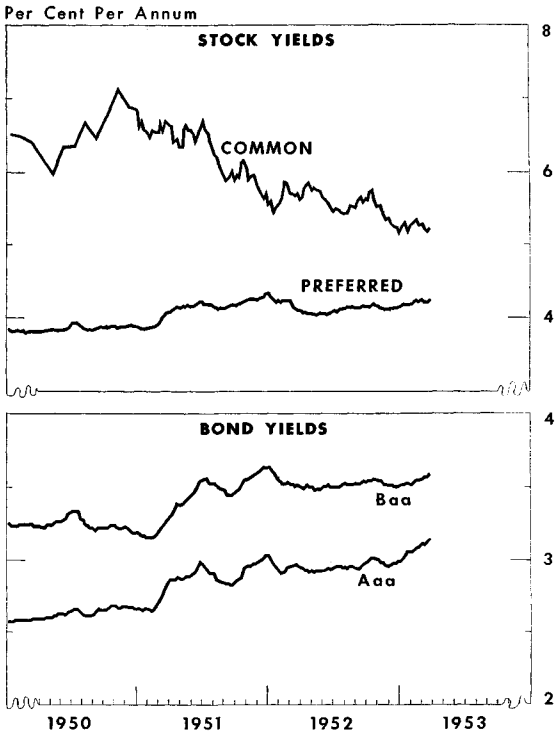
CORPORATE DEMANDS ON THE CAPITAL MARKET

Corporate demands on the capital market have been extraordinarily large in recent years. Corporate security offerings for new capital totaled 9 billion dollars in 1952, and were sustained at a relatively high level in the first quarter of 1953. In addition, some corporations have obtained funds for financing plant and equipment expenditures and other longer term needs by borrowing from commercial banks on a term loan basis.

This demand on the capital market, which in large part reflected increased plant and equipment expenditures and lower retained earnings, was concentrated in the manufacturing and electric and gas utility industries. Of the 9 billion dollar total of corporate security issues for new capital, nearly 4 billion were offered by manufacturing industries, with over half accounted for by the machinery, petroleum, and chemical industries alone. Electric and gas utilities offered 2.6 billion dollars of securities.

Despite further narrowing of the spread between bond and stock yields during 1952, debt obligations accounted for nearly four-fifths of all corporate security offerings—roughly the same proportion as in 1951 and 1950. Over half of these debt offerings were placed privately with life insurance companies and other institutional suppliers of long-term funds. While the volume of stock offerings remained unchanged from 1951, the proportion of preferred issues declined and that of common stocks rose.

CORPORATE BOND AND STOCK YIELDS



NOTE.—Weekly figures. Common stock and bond yields from Moody's Investors Service; preferred stock yields from Standard and Poor's corporation. Common stock yields are for 125 industrials and are monthly through 1950; preferred yields are for selected high-grade issues. Latest figures shown are for week ending April. 4.

Savings of individuals have increased in each of the past two years. Part of the enlarged individual savings has been in the form of financial assets, including direct investment in corporate securities; part has

gone into pension and trust funds, purchases of life insurance and annuities, and deposits in savings institutions. These savings, together with funds obtained from repayment of existing loans and investments, enabled financial institutions to supply a large share of the long-term funds sought by corporations.

Factors in Demand for Long-term Funds

Record expenditures for new plant and equipment and increased working capital requirements associated with high level business activity and higher cost levels have added substantially to corporate needs for funds during the past several years. These needs have been met in large part with funds obtained from operations. The supply of such funds, however, decreased by nearly one-third from 1950 to 1952, making it necessary for many corporations to seek additional funds from outside sources. Also, much of the recent expansion of productive capacity has been undertaken by electric and gas utilities, which customarily rely heavily on external sources for financing their capital expenditures.

Plant and equipment expenditures. Total corporate and noncorporate business expenditures for new plant and equipment rose sharply following the outbreak of Korean hostilities and reached a record 26½ billion dollars in 1952, roughly 3 per cent more than in 1951 and 28 per cent more than in 1950. Manufacturing and electric and gas utility industries accounted for most of the increase from 1950 to 1952. Increases from 1951 to 1952 for these industries more than offset declines in expenditures of the mining, railroad and other transportation, and commercial and miscellaneous industries. Within manufacturing, expenditures of the primary iron and steel, nonferrous metal, machinery, motor vehicle, chemical, and petroleum industries rose from 1951 to 1952. Increases in these industries more than offset declines in expenditures of the food and kindred product, textile, paper, rubber, fabricated metal products, and stone, clay, and glass industries.

Business Expenditures for New Plant and Equipment

[In billions of dollars]

Industry	1951		1952		1953 [1]	
	1st half	2nd half	1st half	2nd half	1st half	2nd half
All industries	12.0	13.7	12.9	13.5	13.5	13.5
Manufacturing	*4.9*	*6.0*	*5.8*	*6.2*	*6.2*	*5.8*
Primary iron and steel	0.4	0.8	0.7	0.8	0.7	0.6
Primary nonferrous	0.1	0.2	0.3	0.3	0.3	0.3
Machinery	0.4	0.6	0.5	0.6	0.6	0.6
Chemical	0.6	0.7	0.7	0.8	0.8	0.8
Petroleum	0.9	1.2	1.3	1.3	1.5	1.4
Other	2.4	2.5	2.3	2.3	2.3	2.2
Mining	0.4	0.5	0.4	0.4	0.4	0.5
Electric and gas utilities	1.6	2.0	1.7	2.1	2.2	2.1
Railroads	0.7	0.8	0.7	0.6	0.7	0.6
Transportation, other than rail	0.8	0.7	0.7	0.6	0.6	0.8
Commercial and other [2]	3.5	3.7	3.5	3.5	3.3	3.7

[1] Anticipated by business. Second-half figures derived from annual and first-half anticipations.
[2] Includes communication, trade, service, finance, and construction.

Note.—Estimates of Department of Commerce and Securities and Exchange Commission for corporate and noncorporate business. Details may not add to totals because of rounding.

The record volume of business plant and equipment expenditures in 1952 may be surpassed this year. A recent SEC/Commerce survey revealed that outlays totaling an estimated 27 billion dollars are anticipated by business for 1953. The increase from 1952 reflects some carryover of projects whose completion was delayed by the steel strike, as well as some recent increases in 1953 capital expenditure programs over those reported in a survey made last fall. To a greater extent than last year, plant and equipment expenditures anticipated for 1953 are concentrated in industries such as public utilities, petroleum, chemicals, and machinery that rely heavily on external financing.

Business plant and equipment expenditures on a seasonally adjusted annual rate basis are expected to total 27.5 billion dollars in the first quarter of 1953, compared with 27.0 billion in the forth quarter of last year. A further rise to 28.1 billion is anticipated for the second quarter. Comparison of current seasonally adjusted rates of expenditure with the total anticipated for 1953 suggests some decline later in the year. In recent years, however, actual expenditures during the second half have generally exceeded anticipations.

Working capital requirements. Although financing of plant and equipment expenditures accounted for the greater part of corporate demand for long-term funds in 1952, working capital requirements were also an important factor. Of the 9 billion dollar total of corporate security offerings, nearly 2 billion—or about one-fifth—were to provide working capital.

The necessity for larger cash working balances and the desire to improve liquidity positions were probably the most important factors contributing to this long-term financing of corporate working capital requirements. As additional productive capacity is completed and brought into operation, companies find their need for working funds increased by larger payroll and inventory requirements and, since these are more or less permanent, they tend to finance through bond or stock issues rather than with short-term bank or trade credit.

Corporations generally are also finding that the shifting of a larger proportion of their Federal income tax payments into the first half of the year has raised somewhat the required level of liquid asset holdings. This shift in tax payments, which was provided for by the Mills Amendment to the Revenue Act of 1950, required most corporations to pay 70 per cent of their prior year's Federal income tax liability in the first half of 1952, as contrasted with 60 per cent in the first half of 1951. This year, with 80 per cent of total income tax payments falling due in the first half, the drain on corporate liquid assets is still greater.

The decline in liquidity position of business corporations in the aggregate—as measured by the ratio of cash and United States Government securities to total short-term indebtedness—that began in mid-1950 continued during 1952, though at a much more moderate rate. In an effort to check this decline, or to improve their liquidity positions, some companies took steps to fund existing short-term indebtedness and/or build up their liquid asset holdings with the proceeds of security issues.

Inventory accumulation, while contributing to the working capital requirements of some companies, was not nearly so important a factor in 1952 as it was in the preceding year. Largely as a result of the steel strike, corporate inventory holdings declined by 2 billion dollars in the second quarter of 1952. The reduction temporarily freed some funds for tax payments and other working capital purposes. While there was some addition to the book value of corporate inventory holdings during the second half, and particularly during the fourth quarter, the increase over the year 1952 as a whole amounted to only 0.1 billion dollars, as contrasted with 10 billion in 1951.

Growth in manufacturing and trade inventories during January and February suggests that corporate inventory holdings probably rose during the first quarter of 1953, though at a substantially slower rate than that of fourth quarter 1952. While additions to inventory are oftentimes financed with trade or bank credit, the desire to avoid further

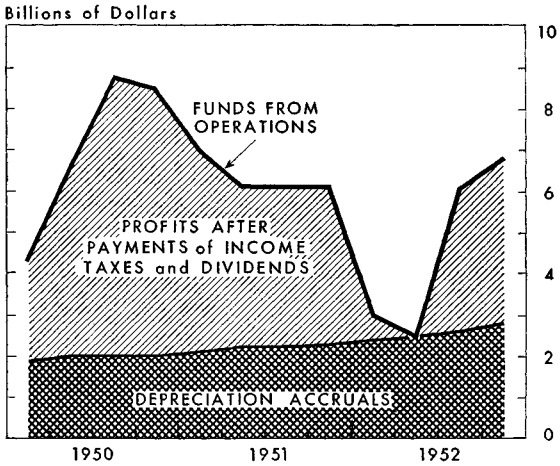
expansion of short-term indebtedness may have prompted some companies to seek longer term financing of their recent inventory accumulation.

Funds from operations. Corporate profits were adversely affected in 1952 by strikes in the petroleum and steel industries. From a seasonally adjusted annual rate of nearly 43 billion dollars in the first quarter, profits before taxes declined to an average of 37½ billion in the second and third quarters. Marked advances in production and sales resulted in a sharp increase in profits during the fourth quarter; nevertheless, the total for the year was roughly 3 billion dollars, or 7 per cent, less than in 1951.

Although corporate depreciation allowances in 1952 exceeded those of 1951 by roughly 1½ billion dollars, the volume of corporate funds from operations, shown in the chart, declined by about one-fourth from 1951 to 1952. This decline in funds from operations was almost entirely attributable to the lower level of profits before taxes and to the substantially larger volume of Federal income tax payments, since dividend disbursements were about the same in both years. Moreover, with approximately 70 per cent of 1952 income tax payments concentrated in the first half of the year, funds from operations averaged less than 3 billion dollars in the first and second quarters, as compared with 6½ billion for the comparable quarters of 1951 and the last half of 1952.

Since production and sales continued at advanced levels durings the first quarter of 1953, profits before taxes are believed to have been correspondingly large. With the completion of additional productive facilities, including those for which accelerated amortization has been approved, corporate depreciation allowances are continuing to increase. First quarter dividend payments, moreover, are customarily smaller than those of the fourth quarter, which frequently include substantial year-end extras. On the other hand, first quarter income tax payments were much larger this year than last, primarily as a result of the Mills provision which requires that 40 per cent of the 1952 tax liability be paid in the first quarter of 1953. Thus, despite continued advanced levels of profits before taxes and increased depreciation allowances, first quarter 1953 corporate funds from operations were probably substantially lower than those of the fourth quarter of 1952.

CORPORATE FUNDS FROM OPERATIONS



NOTE.—Quarterly rates without seasonal adjustment. Federal Reserve estimates based on Department of Commerce and other data.

Corporate Security Financing

Corporate security offerings for new capital totaled an estimated 9.0 billion dollars in 1952, compared with 7.1 billion the preceding year. During the first quarter of 1953, such issues amounted to 1.9 billion, roughly the same as for the first quarter of 1952. The 1952 total was an all-time record, if issues of investment companies are excluded from security offerings of the late twenties. It was accounted for in large part

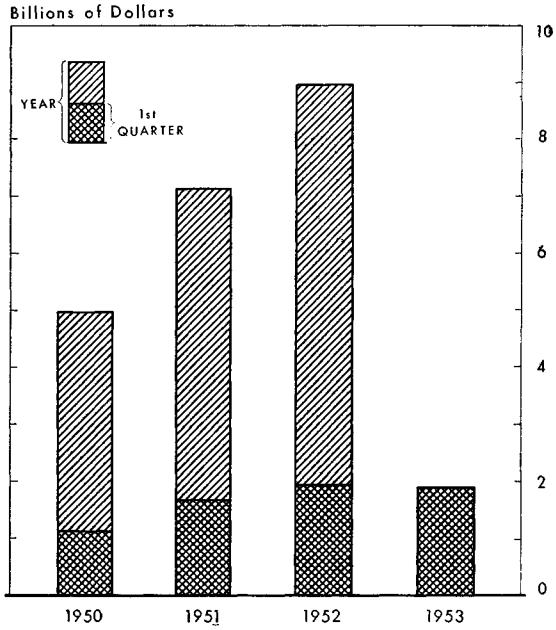
by manufacturing and utility corporations, and consisted largely of debt obligations.

Major issuers. Manufacturing industries, whose outlays of 12 billion dollars represented nearly half of corporate and noncorporate business expenditures for plant and equipment in 1952, accounted for over two-fifths of all corporate security issues for new capital during the year. Within manufacturing, the chemicals, machinery, and petroleum groups offered the largest volume of new issues, totaling 2.2 billion.

Second in importance as an issuer of securities during 1952 was the electric and gas utility industry. New capital offerings of this industry totaled 2.6 billion dollars, compared with plant and equipment expenditures of 3.8 billion. Following public utilities, in the order of their importance as issuers of securities, were the communication, transportation other than rail, and railroad industries. Included in the communications offerings was the 490 million dollar convertible debenture issue of the American Telephone and Telegraph Company—the largest single corporate offering on record. Oil pipeline financing was an extremely important factor in the other transportation group, whose security offerings during 1952 totaled 450 million dollars—over three times as much as in 1951.

First quarter 1953 security offerings by electric and gas utility companies were somewhat larger than those of first quarter 1952, while the volume of manufacturing corporation issues, including takedowns on private placements, was somewhat smaller. As yet, however, there is no clear-cut evidence of a shift in the relative importance of major industrial issuers, particularly if the Allied Chemical and Dye offering on April 1 of 200 million dollars of debentures—the largest recorded public offering of any manufacturing corporation—is taken into account.

CORPORATE SECURITY ISSUES FOR NEW CAPITAL



NOTE.—Securities and Exchange Commission data, with first quarter 1953 partly estimated by Federal Reserve.

Types of securities offered. Debt obligations, including bonds, notes, and debentures, accounted for four-fifths of all corporate security issues for new capital in 1952 and the first quarter of 1953. This was roughly the same proportion as in other recent years, with the exception of 1951 when, as a result of temporarily unsettled conditions in the bond market, debt obligations declined to slightly less than three-fourths of the total.

Under the impact of heavy over-all demand for long-term funds by corporations and others, yields on corporate bonds have been edging upward; those on common stocks have been declining since 1949. Despite this narrowing of the spread between bond and stock yields, there has been no clearly discernible trend toward increased reliance on external equity financing. The

differential cost of debt and equity funds still favors use of the former, especially since interest is treated as a deductible expense in computing taxable income, while dividends are not.

While the proportion of equity to debt security offerings has remained relatively constant over the past few years, financing through bonds convertible at the option of the holder into common stock has grown appreciably. From negligible amounts in 1948-50, the total of such convertible bond issues rose to about 490 million dollars in 1951 and to more than 940 million in 1952.

From the standpoint of the issuing corporation, convertible bonds offer the distinct advantage of relatively low cost financing during the period of installation and initial operation of productive facilities, and at the same time facilitate eventual repayment of the debt through conversion into equity shares. Moreover, since convertible bonds offer the investor opportunities for capital gains and profit-sharing comparable in many respects with those of equity ownership—along with greater assurance of income and protection against capital loss—they may be offered at somewhat lower rates of interest than would be required to market ordinary bonds or debentures.

Sources of Long-term Funds

During the past several years long-term corporate financing from external sources has been facilitated by large savings of individuals. Personal saving, as computed in the national income accounts, totaled 18 billion dollars in 1952—up one billion from 1951 and nearly 7 billion larger than in 1950. Such saving is still being maintained at a high level.

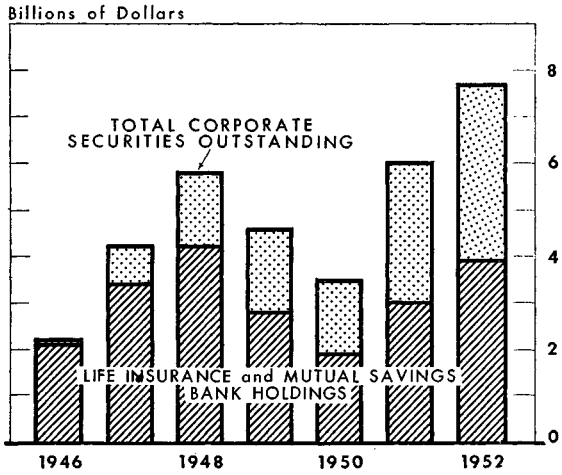
While direct investment by individuals in corporate bonds and stocks has provided corporations with part of their long-term funds, a larger proportion has been supplied through such financial intermediaries as pension and trust funds, life insurance companies, and savings institutions, which accept individuals' savings and channel them into various types of investments. The inflow of savings into life insurance companies and mutual savings banks—two of the principal institutional suppliers of business funds—was nearly one-third greater during 1952 than in 1951, and in the first quarter of 1953 was somewhat larger than in the first quarter of last year.

Role of private placements. The importance of financial intermediaries as suppliers of long-term corporate funds is indicated in part by the volume of corporate securities privately placed with such institutions. In 1952 private placements totaled a record 4.1 billion dollars, compared with the previous peak of 3.4 billion in 1951. The proportion of debt obligations that was privately placed was smaller in 1952 than in 1951. The 1951 ratio, however, was unusually high and undoubtedly reflected efforts by a number of companies to avoid bond market uncertainties of that year by placing their securities and loans directly with institutional lenders.

Institutional financing. Life insurance companies and mutual savings banks together increased their holdings of corporate securities by 3.9 billion dollars in 1952. This was the largest increase of any postwar year except 1948, when they added 4.2 billion, as the chart shows. During the first quarter of 1953 their additions about equaled those of first quarter 1952.

It should be noted, however, that relative to the net increase in outstanding corporate securities, additions to life insurance company and mutual savings bank holdings of such investments were smaller in 1952 than

GROWTH IN CORPORATE SECURITIES AND IN SELECTED INSTITUTIONAL HOLDINGS



NOTE.—Increases in outstanding corporate securities, which exclude those of investment companies and foreign corporations and reflect cash transactions only, are compiled by the Securities and Exchange Commission. Data on increases in institutional holdings of corporate securities are from Institute of Life Insurance and Federal Reserve.

in any previous postwar year except 1951. During 1952, both life insurance companies and mutual savings banks restricted their new loans and investments more closely to the supply of funds available from premium receipts or deposits, repayments on outstanding loans and investments, and net investment income. Investment funds obtained through reduction of their combined holdings of Governments amounted to about one billion dollars; in 1951 the reduction totaled nearly 3½ billion and was necessitated in part by the large volume of commitments outstanding at the beginning of the year.

Increases in corporate security holdings of life insurance companies and mutual savings banks relative to changes in outstanding corporate securities have been progressively smaller each year since 1946. This smaller increase reflects in part the emergence of other sources of long-term investment funds, including larger purchases by individuals; in part the relatively larger proportion of debt obligations, which are subject to amortization, in the portfolios of these institutions.

A continued inflow of individuals' savings at relatively high levels, and an increasing volume of funds from amortization payments, will provide financial intermediaries with a large volume of funds during 1953. Thus, they should be in a position to meet a substantial proportion of corporate demands for long-term funds.