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BUSINESS CREDIT DEMAND IN A DEFENSE PERIOD

Business expenditures for new plant and equipment and for inventory reached a new record level in 1951—together, they exceeded the previous year's total of such investment by more than 20 per cent. Accompanied, as it was, by a marked decline in retained earnings, this increased investment necessitated a substantial amount of external financing in the form of bank loans and corporate security issues. The increase in bank and other short-term indebtedness, together with a substantial growth in Federal income tax liability, brought about a further decline in the liquidity position of business.

In the first quarter of 1952 plant and equipment expenditures and corporate security issues continued at record levels for that season of the year, but inventory accumulation and growth in customers' receivables were smaller than a year earlier and bank credit demands consequently slackened. As a result, total business investment and needs for external funds were less than in the first quarter of 1951.

The large volume of external financing of business in the past year coincided with some curtailment in the rate of expansion of other types of credit, notably that of consumers for the purchase of houses, automobiles, and other durable goods. Total credit demands were more nearly in balance with the current volume of saving, and after the early months of 1951 were provided for without further inflation, in contrast to the situation in 1950.

BUSINESS INVESTMENT

Plant and equipment expenditures rose appreciably during 1951 and in the first quarter of 1952 were about one-fourth larger than a year earlier. Growth in book value of business inventory holdings, however, declined sharply during the past year, first quarter 1952 additions amounting to only one-third those of first quarter 1951. Together, these two forms of business investment in early 1952, while smaller than a year ago, were nevertheless substantial relative to earlier periods.

Plant and equipment. From a total of 17.8 billion dollars in 1950, business expenditures on new plant and equipment rose to 23.3 billion in 1951. While manufacturing industries alone accounted for two-thirds of the increase, every major industry group for which figures are compiled by the Department of Commerce and the Securities and Exchange Commission shared in the advance.

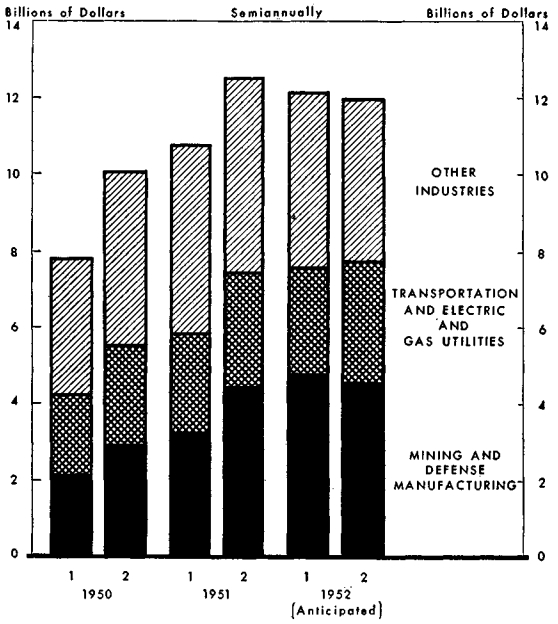
To a certain extent the record 1951 volume of business expenditure on new plant and equipment reflected efforts by the Government to assure increased output of such basic materials as iron and steel, chemicals, petroleum, and nonferrous metals, and the enlargement of essential transport and electric power facilities. The Defense Produc-

tion Act of 1950, in addition to setting forth objectives for expansion of basic productive capacity, authorized building restrictions, materials allocations, monetary and credit restraint measures, and incentives to private investment that would help to assure their accomplishment. Thus far, the primary incentive to private expansion of productive facilities has been accelerated amortization of the investment for tax purposes. As of April 17, 1952, such permission had been granted on proposed investment of 18.8 billion dollars.

On the whole, it appears that governmental policies have been more successful in stimulating essential expansion than in curtailing less essential and deferable investment in new plant and equipment. The investment covered by tax amortization certificates that was put in place by the end of 1951 amounted to about 5 billion dollars, compared with total business expenditures on new plant and equipment in that year of more than 23 billion. Though some expansion deemed essential to the defense effort was not covered by accelerated amortization, the difference of 18 billion dollars suggests that a significant part of the total expenditure undertaken on the initiative of private business represented projects which were postponable or deferable for the duration of the defense emergency.

Despite the record volume of expenditures for new plant and equipment during 1951, business concerns are currently expecting to invest even larger amounts in such facilities. Reports obtained from businesses during February and early March showed that in the aggregate they were anticipating expenditures of 24.1 billion dollars in 1952—roughly 4 per cent more than in the preceding year. Practically all of the anticipated increase from 1951 was accounted for by

BUSINESS PLANT AND EQUIPMENT EXPENDITURES



NOTE.—Department of Commerce and Securities and Exchange Commission data. Industries classified as "defense manufacturing" are: primary iron and steel, primary nonferrous metals, electrical and other machinery, motor vehicle and other transportation equipment, chemicals, and petroleum.

very large companies undertaking large-scale projects.

There have been scattered reports recently of cancellations and curtailments of plant expansion and improvement programs of individual companies, but those publicly announced to date have not been large in total amount, and some companies have actually revised their expenditure programs upward since the beginning of the year—in one case, at least, quite substantially. Though the seasonally adjusted rate of capital expenditure may decline somewhat during the latter part of the year—indicating that the peak of the current plant expansion program has been passed—over-all anticipations for 1952 seem likely to be realized.

Inventory accumulation. Book value of manufacturing and trade inventories increased by a record 9.5 billion dollars in 1951,

as compared with 9.3 billion in the preceding year. Thus, while the character of business inventory expansion was quite different in these two years, reflecting more largely growth in physical quantity during 1951 as contrasted with price increases in 1950, actual inventory financing requirements differed only slightly.

As a result of a transition during the year from inventory accumulation to liquidation on the part of many manufacturing and trade lines, practically all—9.4 billion dollars—of the 1951 increase in inventories occurred during the first 5 months. In the case of wholesale and retail trade, the reduction in inventory holdings during the latter part of 1951 exceeded 3½ billion dollars, as compared with an expansion of 8 billion from the outbreak of the Korean war through May 1951. Manufacturing inventories, on the other hand, continued to expand through 1951, as shown in the table, though the rate of accumulation declined after the middle of the year.

Business inventory accumulation during the first quarter of 1952 amounted to 2.2 billion dollars, as compared with 7.2 billion in the same quarter of 1951. This increase, which was largely seasonal in character, may be followed by some liquidation of inventories during the remainder of the year, as there are still a number of manufacturing and trade lines in which inventory holdings appear large relative to current sales. On the other hand, processing of purchased materials and component parts by manufacturers with defense contracts, together with the inventory requirements of plants completed during the year, may lead to some further expansion of manufacturing inventories.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES

[Book value, in billions of dollars]

Year and quarter	Total	Manufacturing		Trade	
		Durable	Nondurable	Wholesale	Retail
1950—1	+2.0	+0.1	−0.2	+0.3	+1.7
2	−0.2	+0.4	(1)	(1)	−0.6
3	+2.8	+0.1	+0.5	+0.6	+1.6
4	+4.8	+1.8	+1.8	+0.8	+0.4
1951—1	+7.2	+1.6	+1.1	+0.8	+3.7
2	+2.0	+2.0	+1.1	−0.1	−1.0
3	+0.8	+1.5	(1)	+0.1	−0.8
4	−0.4	+1.2	+0.2	−0.2	−1.6
1952—1	+2.2	+1.0	−0.3	+0.1	+1.4

[1] Change of less than 50 million dollars.

NOTE.—Department of Commerce data, without adjustment for seasonal variation or for inventory revaluation arising out of price changes.

FINANCING OF BUSINESS INVESTMENT

Nonfinancial business concerns obtained new credit—short- and long-term bank loans, real estate mortgage loans, and corporate bond and note issues—totaling 8.6 billion dollars in 1951, compared with 7.6 billion in 1950. The growing importance of plant and equipment expenditures relative to total business investment is reflected in the increasing importance of corporate security issues relative to total credit obtained, as shown in the table.

BUSINESS FUNDS FROM SELECTED EXTERNAL SOURCES

[In billions of dollars]

Year or quarter	Business debt				Corporate equity issues[2]
	Total	Bank loans[1]	Corporate bonds and notes[2]	Real estate mortgages[1]	
1950	7.6	4.9	2.0	0.7	1.7
1951	8.6	4.0	3.6	1.0	2.8
1950—1	0.5	0.0	0.5	0.1	0.5
2	0.5	−0.2	0.7	0.1	0.7
3	2.9	2.5	0.2	0.2	0.2
4	3.5	2.5	0.7	0.3	0.4
1951—1	3.1	1.9	0.9	0.3	0.5
2	1.4	−0.1	1.2	0.3	0.8
3	1.5	0.8	0.6	0.2	0.6
4	2.6	1.4	1.0	0.1	0.9
1952—1	0.9	−0.1	0.9	0.1	0.7

[1] Change in outstanding indebtedness.
[2] New security issues, less securities retired for cash or through refunding.

Source.—Federal Reserve, Securities and Exchange Commission, Home Loan Bank Board.

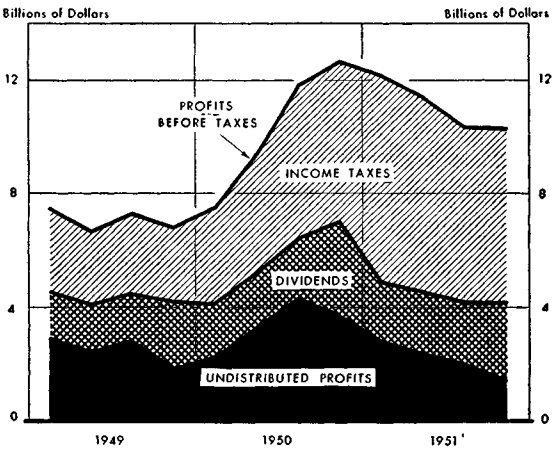
This trend has continued into 1952. During the first three months of this year, new corporate funds from debt and equity security issues reached a first quarter record of 1.6 billion dollars, while outstanding bank loans declined slightly. A further shift during 1951 and thus far in 1952, not revealed by the table, has been the increase in relative importance of financing in defense and defense-supporting industries, partly as a result of credit and monetary policies directed toward channeling available credit into such activities while restricting over-all credit expansion.

Funds retained from operations. The increase in business external financing from 1950 to 1951 reflected an appreciable rise in investment expenditures and a decline in the volume of earnings available for investment. Income data for all nonfinancial businesses are not available, but for corporations alone it is estimated that funds retained from operations (depreciation allowances plus profits after taxes and dividends) in 1951 were less than in 1950 by 3 billion dollars, or 15 per cent.

While depreciation accruals increased steadily last year, undistributed profits declined sharply, as shown in the chart, from an all-time record of 4.3 billion dollars in the third quarter of 1950 to 2.2 billion in the third quarter of 1951 and 1.5 billion in the fourth quarter, when large year-end dividends customarily reduce the level of retained earnings. The declining level of retained earnings in 1951 reflected a combination of factors, the most important of which were the shift during the year from inventory profits to inventory losses and an increase in Federal income and excess profits tax rates.

Thus far in 1952, corporate retained earnings have probably been well below the average for 1951, although moderately larger

CORPORATE PROFITS



NOTE.—Quarterly Department of Commerce figures, without adjustment for seasonal variation.

than in the last two quarters of that year. Even if sales rise moderately from recent levels, prospects of further increases in operating costs, the full impact of the higher Federal income tax rates imposed by the Revenue Act of 1951, and continuation of relatively large dividend payments would mean a 1952 level of retained earnings little if any above that of 1951.

Security issues. Corporate security issues for new capital, exclusive of refundings, increased substantially in 1951. Despite some increase in the relative importance of equity issues, debt obligations accounted for the major share of the total. The continued predominance of debt financing reflects a number of factors, among the more important being the significant role of private placements with life insurance companies, largely on the basis of prior commitments. Another is that, despite the decline in common stock yields and rise in corporate bond yields during the past year, the after-tax cost of borrowed capital is still lower than that of external equity capital. Moreover, in some instances, the allowances for interest payments and borrowed capital permitted under the Excess Profits Tax Law of 1950 result in

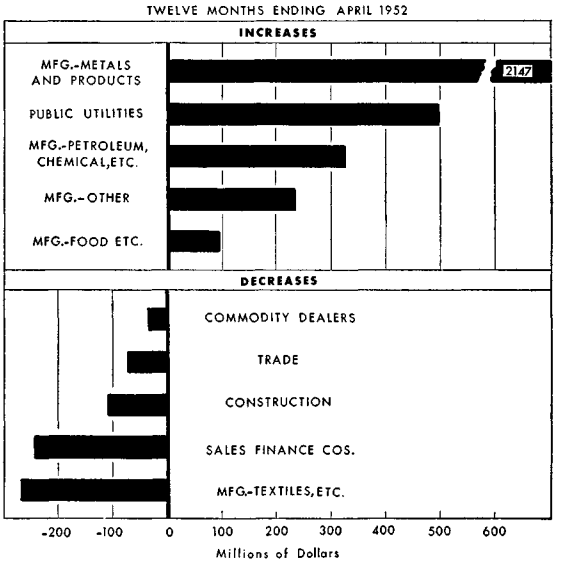
nominal or even negative effective interest cost.

New capital security issues of railroads, public utilities, and defense and defense-supporting manufacturing companies together increased very sharply after mid-1951 relative to the same period a year earlier—much more sharply than issues of companies that might be classed as nondefense. So far as purpose of financing was concerned, over 70 per cent of all corporate security issues for new capital in 1951 were for plant and equipment, as compared with about 60 per cent in 1950 and 1948.

During the first three months of 1952, corporate security offerings for new capital reached an estimated first quarter record total of 2.0 billion dollars, of which nearly 75 per cent was for plant and equipment financing and about 50 per cent represented issues of manufacturing companies. Private placements of new corporate securities amounted to 810 million dollars in the first quarter. As of the end of March, outstanding commitments of major life insurance companies to acquire business securities totaled 3.1 billion dollars, of which 1.3 billion was expected to be taken down during the second and third quarters. A large volume of public utility financing is also in prospect, most of which will be publicly offered.

Other credit. Business borrowing from commercial banks increased sharply in the last half of 1950 and first quarter of 1951, reflecting in large part the financing of inventory accumulation in nearly all areas. Since mid-1951, however, growth in bank loans has tended to represent normal seasonal requirements for short-term funds and, to an increasing extent, borrowing by defense and defense-supporting businesses. In the twelve months ending April 1952, for example, outstanding loans by more than 200 of the largest weekly reporting member banks to manufacturers in the metals, metal products, petroleum, coal, chemical, and rubber industries increased by 2.5 billion dollars, while loans to other manufacturing and mining industries rose only 60 million. The latter group had increased in accordance with seasonal influences in the latter part of 1951, and decreased in the first quarter of this year.

CHANGE IN BANK LOANS TO BUSINESS, BY INDUSTRY



NOTE.—Data reported by over 200 of the largest weekly reporting member banks. Changes are for period April 25, 1951 – April 23, 1952.

A substantial volume of business funds was provided in 1951 through the regular deferral of payment of Federal income and excess profits taxes. In the case of manufacturing corporations, for example, joint estimates of the Federal Trade Commission and the Securities and Exchange Commission indicate that accruals of such taxes, for payment the following year, were over 4 billion dollars larger in 1951 than in 1950. Those companies which used these funds to finance expansion of inventories, receivables, or plant and equipment may face special financing

problems during the current year when tax liabilities on 1951 income must be paid.

During 1951, and thus far in 1952, financing of defense contractors by the Federal Government, through direct loans or progress payments, has been relatively less important than more indirect financial aids such as the V-loan guarantee program. As for direct loans of the types authorized by the Defense Production Act, latest available data show that the Reconstruction Finance Corporation, through the end of 1951, had participated to the extent of 190 million dollars in 600 loans for defense purposes, and that the Defense Production Administration and the Defense Materials Procurement Agency, through March 1, 1952, had certified 145 applications under Section 302 for direct loans totaling 181 million. As for Regulation V loans, banks had obtained, through the end of March, procurement agency guarantees of 971 loans in authorized amount of 1.7 billion dollars, of which 837 million was outstanding.

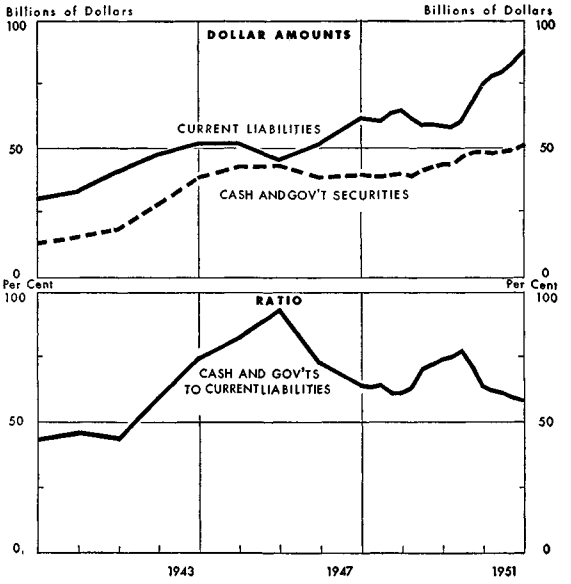
Decline in Business Liquidity

Over-all business liquidity has declined appreciably from the relatively high level that prevailed in mid-1950. In the case of nonfinancial corporations, this reduction in liquidity is reflected in the decline of total current assets and of liquid assets relative to short-term liabilities, in the rise in the proportion of current working assets represented by inventories and receivables, and in slower inventory turnover and receivables collections.

Coinciding with the acceleration of Federal income tax payments provided for by the Mills amendment to the Revenue Act of 1950, the reduction in liquidity following the outbreak of Korean hostilities has accentuated the short-term financing problems of many enterprises. During the first half of 1952, for example, corporations will have to pay 70 per cent of the Federal income tax liability accrued during 1951—an amount estimated in the neighborhood of 15 billion dollars. While their holdings of cash and United States Government securities have increased more than 4 billion dollars since Korea and totaled an estimated 51 billion at the beginning of 1952, or roughly three to four times the amount of their first-half tax payments, a substantial part of these liquid assets is required for general working purposes. The current position of corporations is definitely tighter than it was at the beginning of 1949, the previous postwar low point in business liquidity, when they held 39 billion dollars of cash and Governments against first-half tax payments of slightly more than 5 billion.

While the over-all business liquidity picture during the past 18 months is one of gradual impairment and, at the present time, of some financial tightness, the situation does differ

CORPORATE LIQUIDITY



NOTE.—Securities and Exchange Commission data; end of year, 1939-47, end of quarter 1948-51.

markedly among different industries and concerns of different size. Within manufacturing there are some industries, like textiles and apparel and other transportation equipment, that have been confronted with a combination of declining liquidity positions and smaller profit margins, while others have experienced some decline in liquidity but find their sales and profits margins well maintained.

Judging from data available for manufacturing corporations, the post-Korean shift in liquidity position has been more pronounced among large than among small companies. In the case of manufacturing corporations with total assets of 100 million dollars and over, for example, holdings of cash and United States Government securities declined from $1.22 per dollar of current liabilities on June 30, 1950, to $.76 at the end of 1951. For companies with total assets of less than $250,000, on the other hand, the reported ratio declined much less during this period—from $.58 to $.48. Such disparity in financial experience is not surprising in view of the fact that it has for the most part been the larger companies that have undertaken the major additions to plant and equipment and have accumulated substantial inventories for use in fulfilling defense contracts.

Conclusion

During the first quarter of 1952 long-term debt and equity securities, which were issued in record volume, represented the principal business funds from external sources. With large expenditures for new plant and equipment expected during the remainder of the year, substantial long-term financing continues to be in prospect. Though some part of such requirements for funds has probably already been met, the post-Korean decline in business liquidity could lead to some refunding of existing short-term indebtedness and to some more-or-less-permanent additions to working capital, both of which would involve long-term financing.

There was, on balance, some reduction of commercial bank loans to business during the first four months of 1952. The decline appears, however, to have been somewhat less than usual for this time of the year because of increased lending to defense contractors as well as some lending for tax payments. During the second half of the year the usual borrowing to move crops may coincide with further borrowing by defense contractors. At the same time, some business concerns, faced with a decline in liquidity, may endeavor to reduce their inventory holdings and to curtail expenditures in order to repay bank and trade creditors.