FEDERAL RESERVE BULLETIN

VOLUME 41 | *June 1955* | NUMBER 6

BUSINESS FINANCING IN EARLY 1955

Expansion of business investment accompanied the upturn in economic activity in the latter part of 1954 and has accelerated in 1955. Larger earnings and increased borrowing have provided ample funds, and business liquidity has apparently increased.

While business outlays for new plant and equipment in the first quarter of 1955 were smaller than in the same period of 1954, expenditures in the second quarter are estimated to be 6 per cent larger than a year ago and a sharper rise is anticipated for the third quarter. There has been some accumulation of inventories since the end of 1954, especially by retailers, and probably an increase in financing of customers, both consumers and other businesses.

An increase in the volume of funds retained from current operations has facilitated the financing of outlays in 1955. Corporate profits before taxes have apparently been substantially larger than in the first half of 1954, and depreciation allowances have reached a new peak. Income tax payments, though high in the first half of the year for seasonal reasons, have been smaller than in early 1954, both in dollar volume and in relation to current income.

Business demands for both long- and short-term credit have also risen in recent months. Corporate security offerings for new capital were larger during the first three months of 1955 than in any previous first quarter, and the volume has also been large in the second quarter. Business borrowing at commercial banks, which usually declines in the first half of the year, has increased sharply during 1955. The expansion in external financing has reflected to a considerable extent the needs of those concerns, such as durable goods manufacturers and consumer finance companies, that have been most affected by the increased business and consumer demand for durable goods.

BUSINESS INVESTMENT

The increased business investment in 1955 has differed in several important respects from early 1954, when businesses were adjusting their outlays and financing to reduced levels of activity and sales. Plant and equipment outlays have expanded in the second quarter of 1955 in contrast to a downward movement a year ago. Inventories and accounts receivable of nonfinancial corporations have increased moderately this year, whereas together they declined nearly 4 billion dollars in the first half of 1954.

Plant and equipment. Business expenditures on new plant and equipment may total 7.3 billion dollars during the second quarter of 1955, according to estimates of the Department of Commerce and the Securities and Exchange Commission. In the second quarter of 1954, such expenditures amounted to 6.9 billion. Outlays of manufacturers as a group have been only slightly above their year-ago level, although expenditures in the

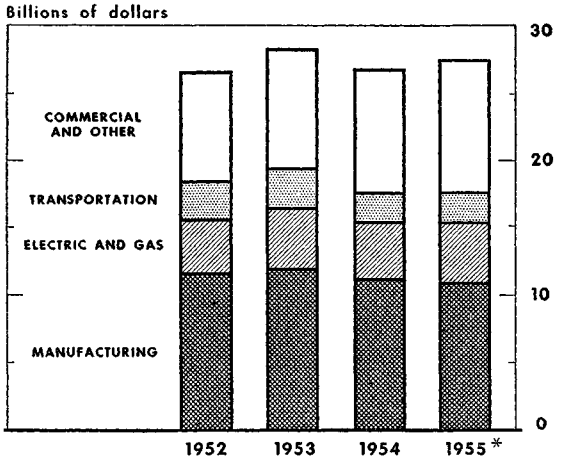
nonelectric machinery and petroleum industries have increased sharply. Outlays by concerns in the commercial and miscellaneous group—communications, trade, service, finance, and construction—have risen about 10 per cent.

The most recent Commerce-SEC survey of expenditure plans indicates that businesses as a group expect to spend 9 per cent more on new plant and equipment in the third quarter of 1955 than they spent in the same period last year. If these plans are realized, capital outlays will be at a seasonally adjusted annual rate of 28.8 billion dollars—equal to the record third quarter of 1953.

Another indication of an optimistic outlook toward investment in plant and equipment is the increase since mid-1954 in new orders received by manufacturers of durable goods. By March 1955 such orders were approaching the high levels reached soon after the Korean outbreak, and in April they remained close to the advanced March level.

The expected expansion of plant and equipment expenditures this year compares with a moderate decline from 1953 to 1954, shown in the chart. Reflecting in part a lower level of expenditures on defense projects undertaken under certificates of necessity, capital outlays by manufacturing businesses were 7 per cent smaller in 1954 than in 1953, with the sharpest declines occurring in the primary metals groups. Outlays in most other manufacturing groups were moderately below 1953 levels but at or above those of 1952. Producers of transportation equipment, particularly of automobiles, increased their expenditures substantially. Large manufacturing corporations increased their capital outlays slightly, as noted in the article on pages 623-630 of this BULLETIN.

PLANT AND EQUIPMENT OUTLAYS



* Anticipated by business. Seasonally adjusted annual rate for first nine months.

NOTE.—Estimates of Department of Commerce and Securities and Exchange Commission for corporate and noncorporate business, excluding agriculture. Commercial and other includes mining, communications, trade, service, finance, and construction.

Outlays in the commercial and miscellaneous group increased slightly in 1954 to a new peak level. In most other major industrial groups, expenditures declined somewhat.

Inventories. The book value of manufacturing and trade inventories (unadjusted for seasonal) increased 2.8 billion dollars in the first quarter of 1955 compared with an increase of 1.2 billion in the first quarter of 1954, as shown in the table. Most of the expansion this year represented seasonal additions to retailers' stocks. After allowance for seasonal influences, accumulation was approximately 500 million dollars; holdings of retail automobile dealers rose by about the same amount. Inventories of manufacturers showed virtually no change, a marked shift relative to the first quarter of 1954 when such inventories declined roughly one billion dollars.

The total dollar value of manufacturing and trade inventories at the end of March 1955 was 1.7 billion dollars less than that a year earlier and slightly less than in March 1953, while the dollar volume of sales reached a new peak for the first quarter in 1955.

Inventories showed little change in April —declining less than seasonally—in contrast

CHANGES IN MANUFACTURING AND TRADE INVENTORIES

[Book value, in billions of dollars]

Industry and type of inventory	Increase, or decrease (−)					On hand, Mar. 31, 1955
	1954				1955	
	1st Q	2nd Q	3rd Q	4th Q	1st Q	
Total	1.2	−2.5	−0.9	−1.1	2.8	78.6
Manufacturing:						
Durable goods	−0.6	−1.0	−1.3	0.6	0.2	24.2
Nondurable goods	−0.4	(1)	−0.3	0.3	−0.2	19.3
Wholesale trade:						
Durable goods	0.4	−0.2	−0.2	−0.2	0.5	5.9
Nondurable goods	−0.2	−0.2	0.5	(1)	−0.4	5.7
Retail trade:						
Durable goods	1.0	−0.4	−0.6	−0.6	1.7	11.0
Nondurable goods	1.1	−0.8	1.0	−1.2	1.1	12.5

[1] Less than $50,000.

NOTE.—Department of Commerce data, without adjustment for seasonal variation or for inventory revaluation arising out of price changes. Details may not add to totals because of rounding.

to substantial liquidation in April, as well as May and June, of 1954. The ratio of inventories to sales was lower in March and April 1955 than at any time since early 1951.

Although investment in additional inventories appears to have been on a moderate scale in 1955, cessation of inventory liquidation in some lines and greater accumulation in others, relative to a year ago, has altered the character of business financial needs and increased the demand for credit.

Customer financing. Accounts receivable of nonfinancial corporations, which reflect financing by these businesses of their corporate and unincorporated business customers as well as credit granted to consumers by retail stores and consumer finance companies, probably expanded somewhat in early 1955. These accounts tend to level off in the first part of the year as consumers reduce their instalment and charge-account indebtedness, but the strength in the markets for consumer as well as industrial goods in early 1955 suggests an increase this year.

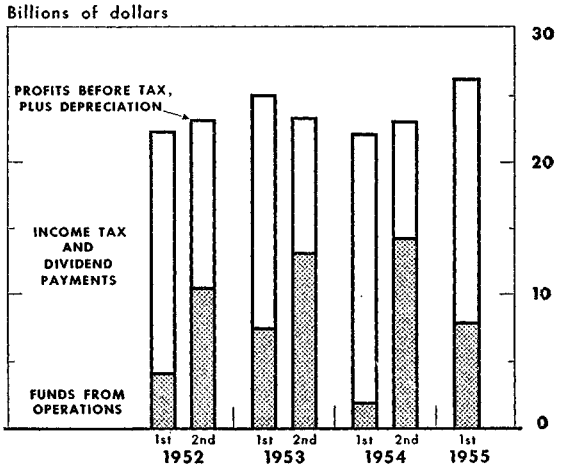
During the first half of 1954 curtailment of purchases by customers was accompanied by a 1.8 billion dollar reduction in corporate receivables. In the second half of the year notes and accounts receivable increased 3.0 billion dollars, reflecting in part the usual seasonal expansion in such accounts and in part an improvement in sales to other businesses and to consumers.

FINANCING FROM INTERNAL SOURCES

Funds available from current operations have continued to represent the major source of business financing. For nonfinancial corporations these funds—that is, profits after income tax and dividend payments, plus depreciation allowances—are currently slightly larger than they were in the first half of 1953 and are well above the level of early 1954, as may be seen from the chart. Depreciation allowances have continued to grow, and profits before taxes have increased sharply; although dividend payments have been somewhat larger, income tax payments have been smaller than a year ago.

Funds from asset liquidation—another source of internal financing—have been relatively unimportant thus far in 1955 for cor-

FUNDS FROM OPERATIONS



NOTE.—Semiannual totals based on data from Department of Commerce and Treasury Department. Figures for banks and insurance companies, partly estimated by Federal Reserve, are excluded. All figures shown for first half of 1955 include Federal Reserve estimates for second quarter based largely on data for first quarter.

porations in the aggregate. Such liquidation appears to have been confined to liquid assets, which have shown an unusually small decline for this time of year.

Corporate profits. A major determinant of the volume of funds from operations is corporate profits before taxes. These are estimated to have been at a seasonally adjusted annual rate of 40.0 billion dollars in the first quarter of 1955, as compared with 34.5 billion a year earlier. Profits of large manufacturing companies, as shown by Federal Reserve tabulations, were 40 per cent above those of the first three months of last year. Earnings of the larger railroads were substantially above the low levels of a year earlier, and those of other public utilities reached new highs. Business developments suggest that aggregate corporate profits have continued to rise in the second quarter.

The recent improvement in earnings began in the fourth quarter of 1954. Despite their increase near the year-end, corporate profits before taxes for 1954 as a whole were lower than in any other year since 1949 and were 11 per cent below the 1953 level, according to Department of Commerce estimates. Public utilities other than railroads appear to have been the only major industrial group to show a significant increase in profits from 1953 to 1954.

Manufacturing industries as a group experienced a decline of 14 per cent in profits before taxes from 1953 to 1954, according to the *Quarterly Financial Report, United States Manufacturing Corporations* published jointly by the Federal Trade Commission and the Securities and Exchange Commission. Profits declined in every industrial category shown in this report, with the sharpest declines being concentrated in durable goods groups. In most nondurable goods groups—including food, tobacco, paper, printing, chemicals, petroleum refining, and leather—declines did not exceed 5 per cent. Recovery in manufacturing profits in the fourth quarter of the year was general and for this period all but three of the 23 groups listed separately showed year-to-year increases in profits before taxes.

Liquidation of assets. In recent years some reduction in corporate holdings of cash and United States Government securities has normally taken place in the first part of the year. This has reflected the large cash drain on corporate funds resulting from the concentration of Federal income tax payments in the first half of the year.

The reduction in liquid assets in 1955 has probably been small relative to earlier years. In the first half of 1954, on the other hand, when income tax payments were the largest on record and pretax current earnings were the lowest since the first half of 1950, nonfinancial corporations reduced their holdings of liquid assets by nearly 6.5 billion dollars. The 1954 reduction—the largest for any first-half-year period since adoption of the Mills Plan for accelerating corporate income tax payments—is the more striking since it occurred at a time when corporations were also obtaining a substantial volume of funds from liquidation of inventories and reduction of customer financing.

In the last half of 1954, with income tax payments seasonally low, profits beginning to rise, and short-term debt expanding, corporations added substantially to their liquid assets.

External Financing

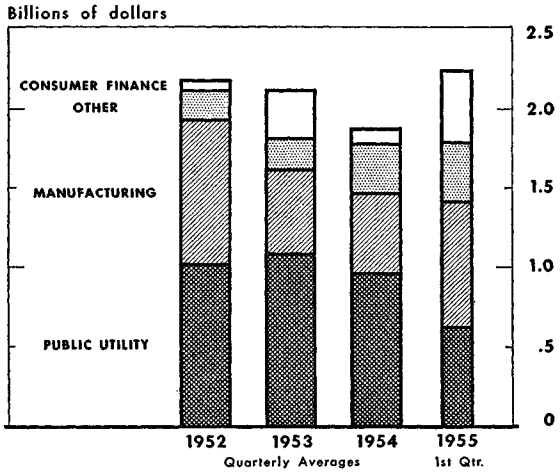
For many businesses, financing needs associated with increased capital outlays, inventory accumulation, or the expansion in customer financing—largely related to the increase in consumer credit—have been too large in 1955 to be met with internal funds.

As a result, business demands for long- and short-term credit have been heavy despite the marked increase in aggregate funds retained from operations.

These developments differ greatly from those during the first half of 1954, when corporations floated the smallest volume of security issues since the first half of 1950 and also repaid more than 4.5 billion dollars of short-term debt, including bank loans and debt owed to suppliers. A large part of this repayment was undoubtedly associated with the voluntary liquidation of manufacturers' inventories during the period. Corporate notes and accounts payable increased moderately in the closing months of 1954, but new capital issues remained below the fourth quarter level of the three preceding years.

Security issues. Corporate security offerings for new capital in the first quarter of 1955 were almost 40 per cent larger than in the corresponding period of 1954 and about 15 per cent above the previous January-March peak reached in 1952. Offerings by sales finance and personal loan companies were larger than in any quarter on record with the exception of April-June 1953.

CORPORATE NEW CAPITAL ISSUES



NOTE.—Securities and Exchange Commission estimates of net proceeds from public offerings and private placements of all issues except those for retirement of securities. Public utility comprises electric and gas, railroad and other transportation, and communication. Consumer finance figures, compiled by Federal Reserve, include sales finance and personal loan companies.

Manufacturing companies as a group also offered an unusually large volume of security issues for new capital in the first three months of 1955. About two-fifths of the total represented the 325 million dollar common stock issue of General Motors Corporation. Trade, service, and construction companies as a group sold a substantially larger volume of securities than in the corresponding period of the two previous years, but offerings by electric, gas, and water utilities were appreciably smaller.

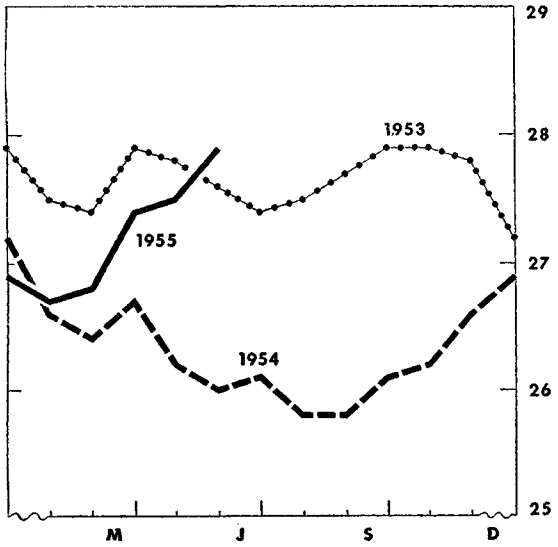
The volume of corporate securities issued for refunding purposes in the first quarter of 1955, while much larger than in the first quarter of last year, was only half as large as in each of the final two quarters of 1954. With bond yields lower than in 1953 and with corporate needs for new funds lessened, refinancing increased sharply in 1954 and for the year was the largest since 1946.

The proportion of total security issues represented by preferred and common stocks increased slightly in 1954 and rather sharply in 1955, reflecting in part the higher price levels prevailing on the stock market. Despite this increase, external equity financing is still relatively small, and debt issues accounted for two-thirds of total security offerings in the first quarter. The proportion of debt issues that are convertible into stock was small in the early months of 1955 but has increased sharply in the second quarter.

Bank loans. Business loans at commercial banks increased about one billion dollars in the first five months of 1955. Some borrowers, mainly food processors and commodity dealers, made large seasonal repayments during this period, but other industries increased their bank loans. Sales finance companies were particularly heavy borrowers.

BUSINESS LOANS AT COMMERCIAL BANKS

Billions of dollars



NOTE.—Figures for June 30 and December 31 are reported; other figures are for last Wednesday in month and are partly estimated. Latest figure shown is for May.

The increase in outstanding business loans in 1955, shown in the chart, contrasts sharply with the first five months of 1954, when businesses repaid on balance 1.2 billion dollars of their indebtedness to banks. Heavy borrowing, associated largely with seasonal credit demands of trade concerns, food processors, and commodity dealers, was resumed late in 1954, but business loans showed a moderate decline for the year. This reflected to a large extent very heavy repayments of bank debt by metals and metal products manufacturers. Sales finance companies and public utilities also repaid more bank debt than they incurred.

FINANCIAL POSITION

The over-all financial position of business, which has been relatively strong throughout the postwar period, appears to have continued to strengthen in 1955. Corporate holdings of cash and United States Government securities have declined somewhat from their level at the end of 1954, but the reduction has been small both in relation to the decline in the first half of other recent years and in relation to the substantial decline in accrued tax liabilities. Even though some other types of short-term corporate debt have increased, the ratio of liquid assets to current liabilities appears to have risen somewhat. The ratio of net worth to total corporate debt has probably also risen this year, reflecting primarily the high level of earnings.

SELECTED FINANCIAL RATIOS OF BUSINESS CORPORATIONS [1]

[End of year]

Ratio	1950	1952	1953	1954
Current assets to current liabilities	2.02	1.94	1.95	2.05
Liquid assets to current liabilities	.60	.53	.54	.56
Liquid assets to current assets	.30	.27	.27	.27
Equity to debt [2]	1.41	1.19	1.21	1.27

[1] Excludes banks and insurance companies.
[2] Ratio of capital stock and surplus to long- and short-term debt.

NOTE.—Based primarily on data from the Treasury Department, the Securities and Exchange Commission, and the Department of Commerce.

The financial position of corporations had improved slightly during 1954, as may be seen from the table. Outstanding debt was reduced on balance, and the equity-to-debt ratio increased for nonfinancial corporations as a group, and especially for manufacturing companies. Liquid assets at the end of the year were still somewhat smaller relative to total current assets and to short-term debt than they had been in the postwar period through 1950. In the past few years corporate holdings of both cash and United States Government securities have fluctuated within a narrow range except for seasonal changes associated with income tax payments. Most of the increase in current assets since 1950 has reflected additions to inventories and expansion of customer financing.