



DECEMBER, 1947

BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Loans to Farmers Surveyed

Short-Term Loans Summarized

A summary in the November 1947 issue of *Business Conditions* gave an analysis of farm real estate loans as reported by bankers in a special sample survey. There is presented below a summary of the data obtained from Federal Reserve member banks and FDIC nonmember banks in the Seventh Federal Reserve District covering loans to farmers other than real estate loans. On short-term loans the cooperating bankers supplied data on one out of each five of such loans as of June 20, 1947.

It can be said without exaggeration that no two farm loans are exactly alike, except by coincidence, in all their characteristics. But in spite of this, such characteristics as size, purpose, security, maturity, method of repayment, and interest rate give patterns of similarity to loans in relation to size and type of farm, tenure, and other characteristics of the borrower. The data from the sample thus permit the description of some of the current practices, patterns, and tendencies of borrowers and banks.

VARIATIONS IN SIZE OF LOAN

The short-term loans covered by the survey ranged widely in size from a few dollars to loans up to \$50,000, although the average size outstanding was only \$645. Nearly two-thirds of all loans were less than \$500 in amount, and 80 per cent were under \$1,000.

By type of farming practiced by borrowers the smallest average loan, less than \$500, was shown for part-time farms. Loans to general farmers and to dairy and poultry farmers averaged somewhat larger, nearly \$600. Loans to farmers classified as field crop producers (mostly cash grain farmers) and fruit producers averaged just under \$800. Loans to livestock farmers averaged over \$1,000 in size.

Some of these differences in average size are a reflection of the differences in amounts of capital required for different types of farm operation. But it should be borne in mind that a study as of one date, such as this one was, affords no measure of the seasonal variation in farm operations and credit needs. Since farmers borrow short-term credit largely to finance seasonal operations, it is obvious that some of these differences in average size of loan outstanding are due to the time at which the survey was made, catching loans for some types of farms when seasonal use of credit was at a peak, while for others the peak would come later.

Of the total number of loans outstanding, 55 per cent were to general farms, and 23 per cent to dairy and poultry farms, while only 10 per cent were reported as loans to livestock farms.

MOST LOANS ARE SMALL

Variations in size of loan in relation to size of farm are

about as one would expect and therefore of no special significance. Aside from small farms of under 10 acres where the average loan was just under \$500, the loan size average ranged from \$305 for farms of 10 to 29 acres and \$325 for farms of 30 to 69 acres on up to \$1,156 for 260-499 acres and \$3,091 for farms over 500 acres. More than half of the loans to farms under 140 acres were less than \$250, while more than one-third of the loans to farms above 260 acres in size were over \$1,000.

Three-fourths of all loans were to farms between 70 and 260 acres in size. According to the 1945 Census of Agriculture farms of these sizes were only 62 per cent of all farms in the Seventh Federal Reserve District. Offsetting this was the fact that less than four per cent of the loans were to farms under 30 acres, but such farms were 14 per cent of the Census total for the District. This suggests that either smaller farmers are not as commonly borrowers as are their somewhat larger neighbors, or that if they do, they apparently borrow from other than banks. It is also true that some bankers do not consider very small farmers within manageable limits as economical borrowers. It is probable that some substantial part of the credit used by smaller farmers comes from merchants and dealers.

LOANS FOR LIVING AND PRODUCTION IMPORTANT

Reports on the purposes for which credit was borrowed show that 40 per cent of the loans were to pay production and living expenses, for which the average size of loan was \$373. Another 43 per cent of the loans were for the purchase of livestock and/or machinery, with an average size of \$877. Only six per cent were to buy or improve land and buildings, but the average size of these loans was \$1,134. Another four per cent were to pay old debts, with a loan size average of \$588. Seven per cent of the loans were for purposes not known to the banker, and averaged \$347 in size.

Moderate differences in maturities of loans for different purposes were shown in the reports. Loans to pay production and living costs were due on the average in five and one-half months. The same average maturity was shown for loans where the purpose was not known. Loans to buy or improve land and buildings were due in a little over eight months, while loans to buy livestock or machinery were not due for nearly nine months. Loans to pay debts had an average maturity of seven months.

As to method of repayment, 90 per cent of all loans were to be paid in one payment, while eight per cent were to be repaid in regular instalments, and two per cent in irregular instalments. The average size of the single payment loans was just over \$600, but the average size of

(Continued on Page 7)

Consumer Instalment Financing by Small Loan Companies

Postwar Loan Volume Up Sharply in Spite of Increasing Competition

As a result of a post V-J Day rise of two-thirds, outstanding small loans are now at an all-time peak in the Seventh Federal Reserve District and the nation. Small loan company advances in the Seventh District states of Illinois, Indiana, Iowa, Michigan, and Wisconsin currently approximate 150 million dollars and comprise more than one-fifth of the national total. This total exceeds the 1941 prewar peak of 118 million dollars by over 25 per cent.

High-level business activity encourages borrowing by consumers and is the major factor underlying the sharp postwar growth in small loans which are commonly held to include loans of \$300 or less.¹ Although outstandings of small loan companies fell slightly in September, the first decline in two years, generally continued rises may be expected as long as the short-run outlook for business remains strong. The end of Regulation W on November 1 is providing some additional stimulant in the whole field of consumer instalment financing.

During periods of strong or rising consumer demand for their services, small loan companies obtain progressively increasing proportions of needed additional funds from commercial banks. For example, bank funds now probably account for almost one-third of the total assets of the two leading small loan companies having nation-wide operations.² This compares with corresponding figures of slightly under 20 per cent at the end of 1945 and two per cent at the low point of the wartime period of curtailed demand for small loans. There is a good deal of evidence that regional and local small loan companies are more dependent on bank loans at all levels of business activity than the national cash lending chains.

Effective voluntary continuation of the credit terms which prevailed under Regulation W would represent an important contribution to lessening of the current problem of combatting renewed inflationary pressures, particularly by reducing the upward pressure upon commercial and industrial loans of banks. Weakening of credit terms, readily apparent since November 1 in the fields of retail instalment selling and cash instalment lending, clearly accentuates the

already existing inflationary forces. In some instances, this relaxation has gone beyond the standard terms recommended to their memberships by the several consumer credit trade groups.

Although borrowings by small loan companies comprise only a minor fraction, certainly not much more than one³ per cent of total commercial and industrial loans of banks, like any other industry considered separately, they have an important marginal role. In the fight against inflation, restrained use of bank credit is imperative on all fronts.

The extent to which maturities can be weakened in the case of the small loan companies is limited by state regulations. Other consumer financing agencies and instalment sellers, however, are generally not subject to these particular legal restrictions.

COMPETITIVE POSITION

Small loan companies, industrial banks and loan companies, and credit unions pioneered instalment cash lending in the early decades of the present century. By 1929 such lending was a well established industry with loan outstandings of 652 million dollars. Of this amount small loan companies held 40 per cent, industrial banks and loan companies 34 per cent, and credit unions five per cent. The relatively few commercial banks then in the instalment financing field accounted for six per cent and miscellaneous lenders for the remaining 15 per cent.

During the 1930's commercial banks entered the field in large numbers and by 1939 had supplanted small loan companies as the leading instalment cash lenders. As a result of a post V-J Day advance of 165 per cent in outstanding instalment cash loans, commercial banks have further improved their prewar leadership. Excluding home repair and modernization credits, commercial banks account for 49 per cent of the more than 2.5 billion dollars in currently outstanding instalment cash loans.⁴ In part, the relative gains of banks in this field are attributable to a shift from the single payment to instalment method. Small loan companies now have 26 per cent of the over-all total small loan volume; industrial banks and loan companies, 11 per cent; and credit unions, 10 per cent. Outstandings of *all* instalment cash lending agencies are today at record dollar levels.

Except for legal limits not relevant to small loans, commercial banks, and industrial banks and loan companies are free to advance as much as they wish to any one

¹In a few states the statutory limit is higher, for example, \$500 in Illinois and Michigan.

²Cash and receivables comprise virtually all of the assets of small loan companies. The two national companies account for upwards of two-fifths of all outstanding small loans by licensed companies.

³Inclusion of sales finance company borrowings would raise this figure to three-five per cent.

⁴Inclusion of home repair and modernization credits would further widen the differential in favor of commercial banks.

**AVERAGE SIZE OF SMALL LOANS MADE IN ILLINOIS,
INDIANA, MICHIGAN, AND WISCONSIN
1939 and 1943-46**

Year	Illinois	Indiana	Michigan	Wisconsin
1939	\$133	\$124	\$142	\$151
1943	136	133	155	149
1944	142	143	164	156
1945	162	154	176	162
1946	169	N.A.	183	N.A.

N.A. Not available.

SOURCE: Annual reports of state agencies administering small loan laws.

borrower. Small loan companies, however, operate under a legal maximum, usually \$300.⁵ War and postwar rises in retail prices and consumer incomes have resulted in a marked upward trend in size of loan. Excluding Iowa, for which detailed data are not available, the average loan in the Seventh District states combined increased from \$134 in 1939 to more than \$170 in 1946 (see accompanying table for individual state trends). Scattered information indicates even greater corresponding absolute increases in the average size of personal instalment loans of commercial and industrial banks.

Small loan companies have been more and more anxious in the last few years to obtain effective higher maximum loan limits. The direct approach, i.e., changes in state small loan legislation, is being advocated, and has been successfully used to obtain \$500 limits in Illinois and Michigan. The industry is now engaged in revising the "Uniform Small Loan Law," a bill which has been drafted as a guide to state legislative policy. For the first time no specific loan maximum is being suggested, the upper loan limit being left to each state legislature to determine in light of local conditions.

Small loan companies have considerable inertia to overcome in their campaign to secure higher loan maximums. The \$300 limit has been one of the "symbols" attached to the industry for a number of years. Concern has been expressed in some quarters that small loan companies might tend to neglect the smaller loans, say, those under \$100, if they were given permission to make loans above \$300. In refutation, the industry: (1) points specifically to the satisfactory experience on this score in Ohio which for some time has permitted loans up to \$1,000 and (2) argues generally that the smaller loans are more a function of permissible rates to be charged than of maximum loan limits.

Pending direct legislative action, small loan companies have been able to make loans in excess of \$300 in at least 15 states by organizing and operating industrial loan companies. In Indiana and Wisconsin, the two District states in which this procedure is feasible, industrial loan companies have much higher loan maximums, five per cent of paid-in capital and surplus and \$2,000, respectively. Organizing dual corporate entities offers the usual disadvantages of roundabout methods and in some states, Indiana, for example, requires additional capital, ordinarily available only to the larger small loan companies.

Small loan companies are permitted to charge considerably higher maximum interest rates than other instalment cash lending agencies. They are, therefore, under no competitive handicap in this respect. The small loan industry, however, is openly concerned with the fact that differing methods of rate statement complicate the problem of comparing the rate levels of the several types of instalment cash lenders.

Small loan companies are required to state their interest charges as a monthly percentage of the unpaid balance on each outstanding loan. In Iowa, for example, the maximum permissible charge is three per cent per month on that part

⁵Historically, this maximum was developed to delimit an appropriate dollar range of lending, commensurate with the rates permitted.

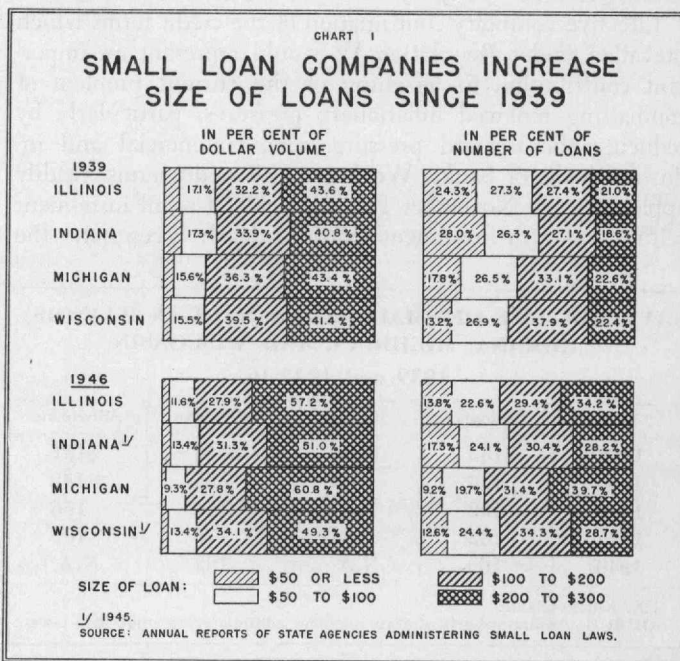
of the loan up to \$150 and two per cent per month on that part of the loan between \$150 and \$300. Under the small loan method the annual rate, of course, is 12 times the monthly rate.

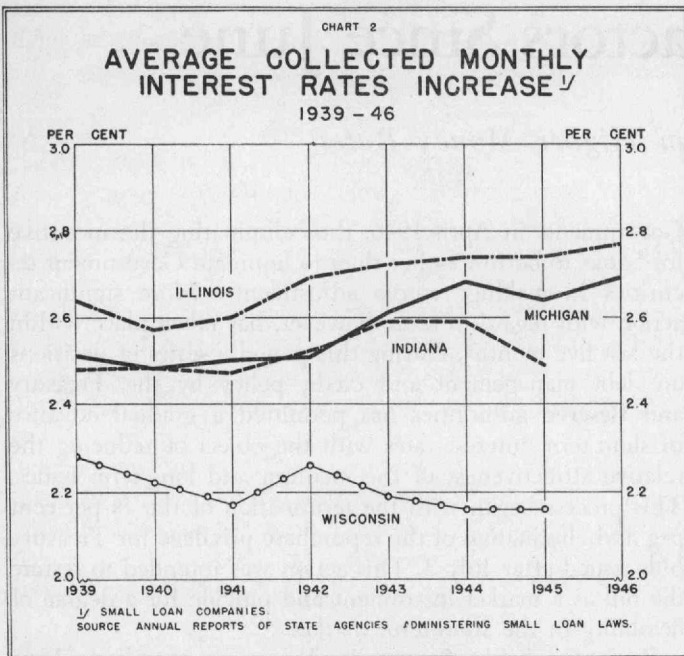
Commercial and industrial banks and industrial loan companies state their charges in terms of the annual dollar cost per \$100 borrowed. Under this discount method, as it is generally known, the borrower pays the charge at the time the loan is negotiated. The use of a percentage method by small loan companies and a dollar method by banks and industrial loan companies complicates direct comparison of their respective rates of charge. If the dollar charge method is cast into percentage terms, an added complication arises from the fact that on instalment loans only one-half of the amount borrowed is on the average in the borrower's hands during the course of the year. Consequently the effective rate is approximately double the rate which results from dividing the dollar charge by the amount loaned. For example, on a \$100 loan on which the charge is \$6 and which is repayable in 12 monthly instalments, the effective annual rate of interest is slightly under 12 per cent.

An influential segment of the small loan business was for some time actively engaged in supporting legislation to require all instalment cash lenders to use the monthly percentage method of rate statement. According to a recent announcement, this program has been dropped because bankers have raised objections on a number of grounds. Certain small loan companies believe that a better solution would be universal adoption of the discount method. For the immediate future, however, no change seems likely in either direction.

SMALL LOAN TRENDS

Rising incomes and prices have resulted in an upward trend in average size of small loans since 1939. A marked increase has occurred in the percentage of the *dollar volume*





of total loans between \$200 and \$300 each and decreases in the respective percentages covering the three smaller loan size classes, i.e., under \$50, \$50-100, and \$100-200, (see Chart 1). Loans under \$50 have suffered the greatest relative decline, the percentage being cut in half during the past eight years. Trends in the distribution of the number of loans in each loan size group have been similar in direction although less in extent. Since 1939 the average monthly interest rate collected has risen slightly in Illinois and Michigan, fallen a little in Wisconsin, and moved about a fixed level in Indiana (see Chart 2).

Because of their higher rate maximum, small loan companies are in a much better position to make the smaller loans, e.g., under \$100, than are commercial and industrial banks and industrial loan companies. As long as loan funds are plentiful, small loan companies have an incentive to expand loans of all sizes. Even if the smaller loans are not as profitable as the larger ones, nevertheless they add to total profits. Most states, including those in the Seventh Federal Reserve District, however, have tried to provide added incentive by establishing a graduated rate structure similar to that illustrated earlier in the article for the state of Iowa. As long as prices and incomes rise, it seems reasonable to expect that the smaller loans, those under \$100, will continue to account for falling percentages of the number and dollar volume of small loan company advances.

Chattel mortgages are the security underlying almost four-fifths of the small loans made in Indiana, Michigan, and Wisconsin (see Chart 3). Because of a more satisfactory wage assignment law in Illinois, chattel loans comprise only about one-half of the total.

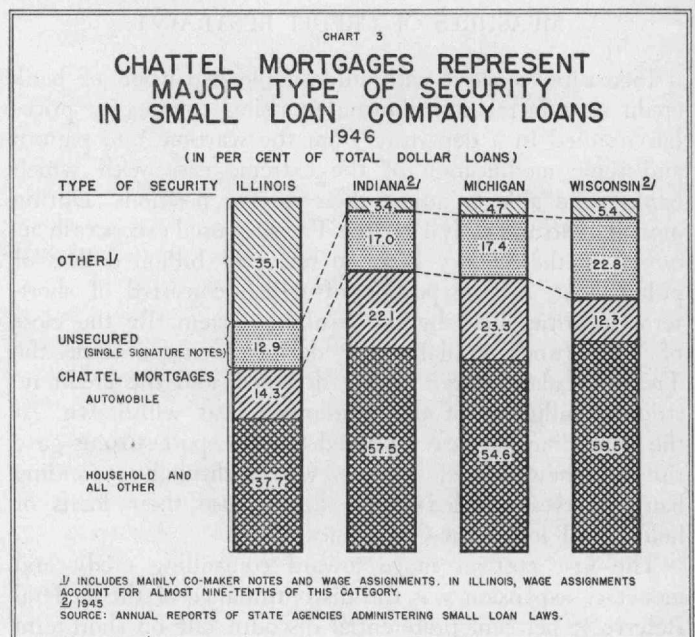
Many small loan companies stress one-signature loans in their advertising. These loans account for approximately one-sixth of total loans in the combined states of Illinois, Indiana, Michigan, and Wisconsin. Certain requirements, such as nature of occupation, permanency of residence, and level of income, result in the failure of many borrowers

to qualify for signature loans. Nevertheless, there has been a distinct trend toward such loans over the past decade. With increasing competition among instalment cash lenders, this trend will probably gain further momentum.

Losses on all types of small loans have always been modest and during the war dwindled virtually to nothing. Although now on the increase, losses are still far below prewar levels. Small loan companies in general keep losses low by prompt collection efforts. To some extent relatively heavy collection expenses take the place of debt losses. Raising loan limits may increase the loss potential.

Statistics on uses to which customers intend to devote their borrowed funds must be used with caution, particularly in recent years under varying regulatory provisions for different types of loans. Probably more important than knowing specific loan purposes is recognizing that the bulk of small loans are used to meet personal expenses, to purchase goods, and to refinance existing debt. In some cases borrowing is necessitated by unforeseen emergencies. Many families are innately conservative in their borrowing habits, increasing their demand for loans in good times and decreasing them in bad times. Lenders also tend to be more liberal during periods of prosperity. For these reasons the volume of outstanding small loans moves generally up and down with the business cycle. There is some lag, however, in the downward phase of the cycle largely because it takes a number of months to pay off loans contracted in the period near the previous business peak.

In summary, despite growing competitive pressure from banks, small loan companies today have a greater volume of business than at any time in their history. However, the industry is keenly aware of the fact that continuing future expansion requires not only extensive public relations and promotional campaigns but ultimately legislative permission to increase loan maximums above the prevailing limit of \$300. Many bankers oppose such extension on the grounds that banks are meeting the demand for loans above \$300 at a reasonable cost.



Money Market Factors Since June

Official Policy Reflected in Higher Money Rates

Recent trends in the loan and investment portfolios of member banks and the current weakness in the market for medium and long-term Government securities reflect a number of significant changes in the forces which have influenced the money market during the past five years. These changes may be grouped into two categories: (1) basic economic forces—particularly the increased demand for credit and capital by business generally, and (2) a series of official policy measures designed to curb additional credit expansion under current inflationary conditions.

Perhaps the most significant development resulting from these factors is the change in the interest rate pattern. Although short-term rates have firmed noticeably in the past few months, this development has occurred within the framework of a controlled market, and the Federal Reserve System is still committed to the maintenance of an orderly security market. The extent to which official action by the Treasury and the Reserve System has been able to influence credit expansion is conditioned by the requirements of managing the public debt as well as by the Government's current fiscal position. More than 50 billion dollars of marketable short-term issues will mature with the next year, and refunding requirements applying to the major portion of these short-terms will limit the possibility of material increases in rates. In addition to maturing short-term marketables, a similar volume of non-marketable Series E, F, and G Bonds is outstanding. The prevention of widespread redemption of these issues which might result from too sharp a drop in quotations on the marketable issues is another consideration.

MEASURES OF CREDIT RESTRAINT

Increasing concern with undesirable expansion of bank credit as a factor contributing to rising commodity prices has resulted in a departure from the wartime rate pattern and some modification of the extreme ease with which banks were able to adjust their reserve positions. During most of 1946 and early 1947 the Treasury used excess cash acquired in the Victory Loan to retire 31 billion dollars of public debt, a large portion of which consisted of short-term securities held by the banking system. By the close of June funds available for debt retirement from the Treasury balance were largely depleted, and the credit restricting influence of the retirements was withdrawn. At the same time the heavy United States export surplus gave rise to renewed gold imports, which through expanding bank reserves enabled banks to increase their loans or holdings of long-term Governments.

The first postwar move toward controlling credit and monetary expansion was the discontinuance of the Federal Reserve $\frac{1}{2}$ per cent preferential discount rate on short-term

Governments in April 1946, thus eliminating the incentive for banks to borrow rather than to liquidate Government securities in making reserve adjustments. More significant action with regard to rates, however, has taken place within the last five months. During this period a series of decisions on debt management and credit policy by the Treasury and Reserve authorities has permitted a gradual advance in short-term interest rates with the object of reducing the relative attractiveness of the medium and long-term issues. This process began with the termination of the $\frac{3}{8}$ per cent peg and elimination of the repurchase privilege for Treasury bills issued after July 3. This action was intended to restore the bill as a market instrument and provide for a degree of flexibility in the short-term market.

Beginning with August 1, Treasury refundings have been managed in such a way as to gradually increase the interest rate on short-term debt to levels less dependent on Federal Reserve support. In consequence, the yield on one-year money has risen from $\frac{7}{8}$ to slightly more than one per cent. While August and September certificates were refunded at $\frac{7}{8}$ per cent, it was with 11- and 10-month maturities, respectively. The September 15 $1\frac{1}{4}$ and $1\frac{1}{2}$ per cent notes were refunded into one per cent $12\frac{1}{2}$ -month notes. The replacement of $\frac{7}{8}$ per cent October certificates by one-year certificates at one per cent was followed by another step toward higher rates with an exchange of 11-month one per cent certificates for the November 1 maturity. Finally, on November 14 the Treasury announced that 13-month $1\frac{1}{8}$ per cent notes would be offered in exchange for both the December 1 certificates and the two per cent Treasury bonds maturing December 15. These refundings also had the effect of reducing the number of maturities by consolidating the new issues at quarterly dates.

To absorb accumulated investment funds and relieve the pressure on the market for the long-term marketable issues from this source, the Treasury announced late in September an offering of 18-year $2\frac{1}{2}$ per cent non-marketable bonds dated October 1, with subscriptions restricted to institutional investors and commercial banks holding savings deposits. Total sales of this issue amount to 970 million dollars, 870 million of which represented absorption of private investment funds—the remaining 100 million being purchased for the account of the Federal Deposit Insurance Corporation.

An additional restrictive influence on bank credit expansion was the cash redemption on November 1 of the 203 million dollars of Federal Reserve holdings of maturing certificates. In the three weeks ended November 26 the Treasury also paid off in cash 300 million of maturing bills which are still heavily concentrated in the Reserve Banks. The funds used for these pay-offs were obtained through war loan calls and thus exerted further tightening effects on bank reserve positions.

In addition to the successive steps already mentioned, sales of long-term Governments in the market from Treasury investment accounts were sizable for the period as a whole. Net sales from these accounts during the three months ended September 30 amounted to more than one billion dollars, tending to remove some of the pressure on publicly-held restricted securities.

YIELD SPREAD NARROWED

Reaction in the market for Government securities to the monetary and debt management decisions has been gradual and, prior to October 1, relatively inconspicuous. Since Treasury bills were unpegged the average rate of discount on new issues offered has risen from 0.375 per cent to 0.931 per cent on the issue date November 20, while the range in the rate on accepted bids has narrowed from 0.376 points on the July 10 bills to 0.095 points on the latest issue to date.

Despite the rise in bill rates, the proportion of total bills held outside the Reserve Banks has risen only moderately. From July 2 through November 19 Reserve Bank holdings declined roughly 1,200 million dollars, while 200 million of maturing bills were redeemed for cash during the period. Moreover, the total of unpegged bills held by investors outside the Reserve System rose in amounts which were less than proportionate to the increase in the amount of these bills outstanding. For the most part, banks which had Treasury bills tended to retain the "old" bills bearing the repurchase option and to use them in adjusting their reserve positions in preference to the unpegged higher-yield issues. Holdings of these bills, of course, gradually diminished until the last issue matured on October 2, and the option accounts of the Reserve Banks were closed out.

Along with refunding arrangements the unpegging action had the effect of creating uncertainty in the market as to prospects for short-term interest rates. Consequently, there was a tendency for banks, dealers, and other investors to sell longer-term certificates and invest the proceeds in shorter-term issues in order to place themselves in a better position to take advantage of any higher rates which might be offered later. In line with the changes in the Government market, a number of the leading New York banks raised their rates on dealer loans secured by short-term Governments from $\frac{7}{8}$ to one per cent in August. Rates on bankers acceptances were also advanced from $\frac{7}{8}$ to one per cent on short-term bills and up to $1\frac{1}{4}$ per cent for the longer dated bills. The open market rate on prime commercial paper rose from one per cent to $1\frac{1}{8}$ per cent in September.

The increase in short-term rates and generally greater flexibility in the management of the short end of the rate pattern was aimed in part at inducing banks to retain their short-terms and discourage additional pressure on the long-term market. Response to these restraining measures in the long-term market, however, was slow in developing. Even heavy sales of Governments from Treasury investment accounts failed to depress the market. The sale of the $2\frac{1}{2}$ per cent investment series tended to curb the demand for the ineligible issues somewhat, but not until after the announce-

ment of the November refundings, when it became apparent that the yield on one-year money was likely to advance beyond one per cent, was there any appreciable decline in the demand for long-term Governments as reflected in lower prices and higher yields. Since September 30 the yield to call date of the restricted $2\frac{1}{2}$ per cent bonds of December 1967-72 rose from 2.32 per cent to 2.44 per cent as of the middle of November. The effect on bank eligibles was smaller—the September 1967-72's declining in price from 105.28 to 104.12 in the same period with a corresponding increase in yield from 2.13 per cent to 2.22 per cent.

The recent sharp decline in the market for Treasury bonds is attributable in part to the fact that short-term rates have reached a more attractive level and to the depressing effects of the sale of the long-term investment series. Equally important, however, are the increasing availability of other suitable long-term investments for insurance companies and savings banks, particularly high grade corporate bonds and mortgages, and the rising demand for business loans.

While yields on long-term Governments have moved upward, the strong demand for business capital has forced corporate rates up even more sharply so that there has been a widening gap in the yields between Governments and high-grade corporate issues. Moody's average yield of Aaa corporates rose from 2.56 per cent at the end of June to a basis of about 2.77 per cent by the second week of November, while the advance in the Baa group was even more marked. Indications that the volume of corporate financing will continue large during the first part of 1948 may mean that this spread has not yet reached its maximum.

In response to the slackening demand for Governments, net sales of securities from Treasury investment accounts were a negligible 14 million dollars during the month of October.

LOAN EXPANSION ACCELERATED

Despite efforts by authorities to halt bank credit expansion, total earning assets of the weekly reporting member banks have shown continued growth, with the increase attributable to an expansion in loans, particularly commercial, industrial, and agricultural loans as shown in the accompanying chart. Total loans of reporting banks in leading cities rose more than $2\frac{1}{2}$ billion dollars from July 2 through November 12, of which 2.3 billion were in the commercial, industrial, and agricultural category. This compares with an increase in the first half of 1947 amounting to slightly more than one billion dollars. Loans of these banks now constitute 35 per cent of earning assets compared with 30 per cent as of the beginning of the year. Real estate and other loans, principally consumer loans, of these banks have also increased approximately 370 million and 270 million, respectively.

Total holdings of Government securities by the reporting banks have declined somewhat more than one billion dollars. A major part of this decline has occurred in certificates and notes, most of which were absorbed by the Reserve Banks. Changes in holding of these issues reflect the increasing tendency to shift the longer-term certificates and

notes to the Reserve Banks instead of bills to obtain reserves, particularly since the first of October. Except for a reduction of bond holdings of 350 million dollars in connection with the cash redemption of the 759 million of 4¼ per cent bonds redeemed October 15, bond portfolios continued a slow but steady upward trend for the entire period. Estimates of ownership indicate that the aggregate of Governments held by the banking system as a whole has undergone relatively little change since the end of the Treasury's large-scale debt retirement program this spring.

The ability of the banks to continue to expand their loans and add to their Government bond holdings in face of the successive attempts to tighten money conditions has been facilitated by continued Federal Reserve support of the market. So long as banks have short-terms which can be sold directly or indirectly to the Reserve Banks to obtain reserves, the effects of retirements from the Reserve System and other restrictive measures are temporary. Following a rapid decline during the early part of the year, total Federal Reserve Bank credit has been gradually expanding since the end of June, the increase from July 2 through November 12 amounting to almost 900 million dollars. The reduction of 1.2 billion in Reserve Bank holdings of bills in this period was more than offset by net acquisitions of 800 million of certificates, almost 950 million of notes, and 60 million of bonds. Most of the sharp increase in Treasury note holdings has occurred during the past few weeks.

In addition to the reserve gains through frequent and substantial use of Reserve Bank credit, member banks have acquired reserves steadily through the sharp increase in monetary gold stock and through disbursements to the market from foreign accounts in payment for the heavy U. S. export surplus. The increase in gold stock for 1947 to date, net of the 700 million dollars transferred to the International Monetary Fund, exceeds two billion dollars, of which approximately 1.2 billion occurred during the second half of the year. This inflow was the largest single factor influencing member bank reserves, and gains from this source constituted an important offset to other factors tending to tighten reserve positions and limit loan expansion.

Changes in money in circulation, on the other hand, have had a negligible influence over bank reserves in recent months. Except for seasonal variations and other temporary influences, the demand for currency has remained fairly stable throughout 1947. During the week ended September 3 an unusual currency outflow of 447 million dollars was a result of the combined influence of the pre-holiday demand and the preparation by banks for the cashing of veterans' terminal leave bonds.

With the exception of the last two weeks of October, when banks bought bills heavily and permitted excess reserves to fall, there appears to have developed a tendency for banks to retain somewhat higher excess reserves than was customary while bills bearing the repurchase option were outstanding in large volume. This failure to convert surplus funds into earning assets may reflect uncertainty in view of current developments in the short-term rate structure as to their ability to liquidate temporary investments without loss when funds are needed.

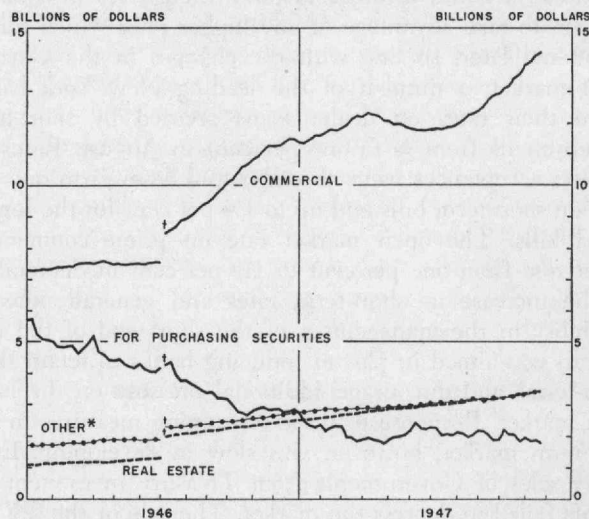
Both demand deposits adjusted and time deposits have increased in the last half of 1947 but at a rate much below the expansion in earning assets. Time deposits of the weekly reporting banks showed a slackened rate of growth compared with the first six months of the year, while demand adjusted showed a considerably greater rise than previously, reflecting the accelerated expansion in loans. Reporting banks in New York City, at variance with the country in this respect, showed a net decline in demand adjusted for the period as a whole, but there were wide variations within the period which indicated that the general trend is in an upward direction. Required reserves, which rose approximately 700 million dollars for the period July through November, reflected not only the growth in private accounts but also the higher level of Government deposits at the end of the period.

BUDGET PROSPECTS AND CREDIT CONTROL

Current expectations are that a substantial cash surplus will be available for retirement of the marketable debt in the first quarter of the calendar year 1948. Such cash retirements would exert considerable pressure on the money market. To the extent that Federal Reserve holdings are reduced through retirements, commercial bank reserves and deposits decline.

Although debt retirement operations would initially absorb bank reserves, whether they can permanently limit loan expansion depends on the extent to which offsets are provided through liquidation by the banks of short-term Government holdings. In view of the exigencies of debt management, whatever possibility there may be of curbing credit expansion through an additional decline in the bond market is limited. Meanwhile alternative proposals for tightening the money market are receiving an increasing amount of attention.

LOANS OF REPORTING BANKS IN LEADING CITIES
(WEDNESDAY FIGURES)



† REVISED SERIES JULY 3, 1946
* EXCLUDES LOANS TO BANKS

LOANS TO FARMERS SURVEYED

(Continued from Inside Front Cover)

multiple payment loans was \$825.

MOST LOANS UNSECURED

Half of all the loans outstanding were reported as unsecured and not endorsed. This is common practice among country banks where the reputation and ability of the borrower is known to bank lending officers, especially where such knowledge is supplemented, as is quite commonly the case, by financial statements of the borrowers. Another 10 per cent of the loans were endorsed but otherwise unsecured.

Livestock was the security for 12 per cent of the loans, and machinery secured 10 per cent. Loans secured by a combination of livestock, crops, or machinery were 13 per cent of the total. G.I. guarantee was the security for less than one per cent of the outstanding loans. Three per cent were secured by "other security" not listed in the returns.

Loans not secured tended to be smallest, averaging under \$500. Loans secured by machinery were \$600 in average size, while livestock-secured notes averaged \$875. G.I. guarantee loans were on the average nearly \$1,700 in size, and loans secured by the combination of crops, livestock, or machinery averaged \$1,175.

There was considerable variation in the security backing the short-term loans in relation to the reported purpose for which the credit was borrowed. While, as reported above, half of all loans were unsecured and unendorsed, nearly three-fourths of the loans to pay production and living costs were unendorsed and unsecured. For loans to buy machinery and livestock only 28 per cent of the total number were without security or endorsement. As previously mentioned, loans for the latter purpose are more than twice the size of the loans for the payment of production and living expenses.

SECURITY NOT MUCH RELATED TO SIZE

While it might seem that the larger loans would be more apt to be secured, this alone does not appear to explain satisfactorily the difference in proportions unsecured and unendorsed between purposes. The average size of the unsecured and unendorsed loans to pay production and living costs was \$338, while the average size of unsecured and unendorsed loans to buy machinery and livestock was \$757.

Of loans to buy or improve land or buildings, 72 per cent were unsecured, although 13 per cent were endorsed. Of the loans to buy machinery or livestock 20 per cent were secured by only livestock and another 20 per cent by machinery alone.

CONSIDERABLE VARIATION IN INTEREST RATES

Interest rates on short-term loans vary in relation to several factors, and it is impossible to draw final and complete conclusions from this study on all the various influences affecting the interest charged on these loans. Interest charges are presumed to cover among other things

the two chief elements of costs of extending and administering loans and a certain amount of risk of loss, or what might be regarded as an insurance premium. The latter element is of negligible importance throughout most of the Seventh Federal Reserve District, and especially at the present time when farm incomes are relatively high, and prices appear to be still mostly on the rise.

Bearing in mind that there are certain irreducible handling costs for any loan, regardless of its size,—such items as accounting, filing, and sometimes investigation,—it is to be expected that, in terms of interest rates charged, smaller loans cost more per dollar loaned than larger loans, since the amounts are larger over which minimum costs can be spread. The average rate charged for all loans outstanding in this survey was 5.7 per cent. The rates ranged from 6.5 per cent for the smallest loans, those under \$250, on down to 4.9 per cent for loans over \$5,000. Again it must be emphasized that these are averages for size groups of loans. Variations of substantial amounts were shown within given size groups. For example, for loans under \$250 rates ranged from a low of 4.5 per cent for some to as high as 8.5 per cent in a very few cases.

INTEREST RATES BY TYPE OF FARM

Interest rates on loans by type of farm would be expected not to vary in any clear-cut relationship unless the type of farming practiced by the borrower affects the terms of credit, particularly interest costs. Analysis of interest rates by type of farm shows some fairly clear-cut differences between different types of farms. The average for field crop farms was the lowest, averaging 5.2 per cent. The average rate for loans to livestock farms was 5.4 per cent. Dairy and poultry farms and fruit farms each showed an average of 5.6 per cent. Highest rates were shown for general farms and for part-time farms, 5.9 per cent.

Again, these differences in rates bear some relationship to average size of loan, since, for example, field crop farms and livestock having low average interest rates are also the types of farms having large average size loans. Similarly, the loans on types of farms having relatively higher interest rates, for example part-time and general type farms, are also those types on which loans were relatively smaller in size. But in spite of these relationships there appear to be some differences in rates on loans to different types of farms not due to the differences in average size of loan. This is brought out by comparing the interest rates for the same size of loan to each type of farm. On this basis loans to field crop farms were, for example, lowest or near the lowest for each of the various size classes of loan. Similarly, loans to part-time and general farms were not only highest as to average rates for all loans, but were highest or near the highest for all types of farms in each of the comparable size-of-loan classification.

SIZE OF FARM ALSO AFFECTS INTEREST RATE

A similar situation was shown by the study for the relationship between size of farm and interest rates. The

average rate for all loans to farms under 10 acres was 5.5 per cent, but for larger farms the rate declined as size of farm increased, ranging from 6.2 per cent for farms of from 10 to 69 acres down to 5.0 per cent for farms above 500 acres in size. But, as shown above, size of loan varied proportionally with size of farm, and since the evidence cited above shows that size of loan is a major fact in the effective interest rate charged, it is obvious that indirectly therefore interest rates would vary somewhat inversely with size of farm, being lower for the larger farms with larger average loans. But again this relationship does not explain all the variations in the inverse relationship between interest rates and size of farm. Even when given size classes of loans are compared as between different sizes of farms, the inverse relationships between rates and farm size hold. For example, loans between \$250 and \$499 had an average interest rate pattern as follows: 10-69 acres, 6.5 per cent; 70-139 acres, 140-259 acres, and 260-499 acres, each 6.3 per cent; and 500 acres and over, 6.2 per cent. The relationship is even clearer for loans between \$500 and \$1,000: 10-69 acres, 6.4 per cent; 70-139 acres, 6.2 per cent; 140-259 acres, 6.0 per cent; and 260-499 acres and 500 acres and over, each 5.8 per cent. Similar trends were shown for other size-of-loan groups.

INTEREST RATES VARY WITH PURPOSE

Interest rates also varied according to the purpose for which the loan was made. Average rates were: to pay production and living costs, 6.0 per cent; to buy or improve land or buildings, 5.2 per cent; to buy machinery or livestock, 5.6 per cent; to repay debts, 5.6 per cent; and those loans where purpose was not known, 5.9 per cent. Once again size of the loan is of primary importance in explaining these differences in rates, for it was shown above that production and living cost loans were smallest in size and loans for purchase or improvement of land and buildings were largest in average size.

Yet over and above this influence of size of loan, rates did vary with purpose of the loan. For example, taking the size-of-loan classes individually, the loans to pay production and living expenses carried higher interest rates than any other purpose in all but one of seven size-of-loan classes. Similarly loans to buy or improve land or buildings carried lower interest rates than any other purpose in all but one of eight size-of-loan classes. The evidence thus appears to be clear that the purpose of loan reflects differences in costs of extending and handling loans that are reflected in interest rates charged.

Differences in interest rates as related to maturity of loans are also largely a reflection of the size of loan. They ranged from 6.1 per cent for loans due up to three higher than other types of repayment in interest cost.

INTEREST RATE BY TYPE OF SECURITY

When the influence of average size of loan is eliminated the relationship between type of security for the loan and the average interest rate was found to be that lowest rates

tended to be charged for unsecured notes and for loans secured by a general combination of crops, livestock, and machinery. Highest rates tended to be shown for loans with crops in storage as security and for notes secured by machinery. Intermediate were the rates charged for loans secured by livestock. For example, on loans under \$250 the reported average interest rates by type of security were as follows: combination of crops, livestock, and machinery, and unsecured loans, 6.5 per cent; livestock, 6.6 per cent; machinery only, 6.7 per cent; growing crops, 6.8 per cent; and crops in storage, 6.9 per cent.

The reports included for each loan a statement of the year in which the loan was made. Although seven-eighths of all the loans reported had been made in 1947, a few 1945 loans and several 1946 loans were also reported. Taking the two major purposes for which credit was borrowed, the study showed that the average interest rate for loans to pay production and living costs was 5.0 per cent for the loans made in 1945, 5.7 per cent for the 1946 notes, and 6.0 per cent for loans made this year for this purpose. For loans to buy livestock and machinery the average rates were 5.1 per cent for 1945 loans, 5.5 per cent for 1946 notes, and 5.7 per cent for the current year's loans. These differences appear largely to be reflections of the relationship of interest rate to length of maturity discussed above. Some slight firming of rates may also account for a very small part of these differences.

INTEREST RATES A COMPLEX PATTERN

Finally, the interest patterns arising from the relationships between purpose and the security for the loan are of some interest. Generally the rates for loans where security was not reported by the bankers tended to be larger than for loans where security was stated, almost regardless of the purpose of the loan. On loans to pay living and production expenses those secured by machinery averaged 6.4 per cent compared with 6.0 per cent for those secured by livestock and for those loans reported as unsecured. The rate for notes for this purpose secured by combination of crops, livestock, and machinery was 5.9 per cent. For loans to buy livestock and machinery the average rate for those secured by machinery was 6.2 per cent, while unsecured notes averaged 5.8 per cent, the combination-security loans averaged 5.6 per cent, and loans for this purpose secured by livestock were reported as calling for an interest rate averaging 5.4 per cent.

In general it appears that the patterns of interest rates are subject to a very complex set of influences. Probably most of these are expressions of habits and customs on the part of individual banks and bankers. It is likely that many of these practices are too recondite and subtle to lend themselves to easy and clear explanation and exposition on the part of any individual banker. These patterns thus appear to be subconscious expressions of various slight variations of shades of individual practice, weaving themselves together into rather rough, over-all patterns which in general make sense in terms of cost, convenience, and accepted practices.

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SEVENTH FEDERAL



RESERVE DISTRICT

