

# BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

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JUNE 1949



# Money and Credit Trends in 1949

## Treasury Cash Balance Down in April and May

Money and credit conditions in the first four months of 1949 were characterized by a number of developments which contrasted noticeably with the experience of a year ago. A decline in bank loans was accompanied by renewed strength in the Government security market, while net cash receipts by the Treasury were considerably smaller than in the comparable period of 1948. Concurrently, important revisions in regulations were made by the Federal Reserve authorities, involving relaxation of member bank reserve requirements, margin requirements, and consumer credit controls.

In the first quarter of 1949 Treasury cash receipts from the public amounted to 13.1 billion dollars as compared with 15.0 billion in the first three months of 1948. Treasury cash expenditures, on the other hand, were 9.9 billion dollars, some 1.3 billion greater than in the first quarter of 1948. The resulting net cash operating income of 3.2 billion this year was thus half as large as in the same period of the previous year. Only 1.6 billion dollars was used for net cash repayment of borrowing, about 40 per cent of the amount so used in the comparable quarter of 1948. Because the proportion of net debt redemption to net cash income was smaller this year than in 1948, the Treasury was able to build up the General Fund balance by 1.6 billion dollars, only 700 million less than the increase last year.

In the month of April 1949 cash expenditures were more than double receipts, and as a result the Treasury cash balance was drawn down 1.8 billion dollars to a level of four billion. As indicated in Table 1, the net cash debt repayment was minor in April. Through May 24 there was a further decline in the Treasury's cash balance of over 600 million dollars, reflecting a continuing excess of cash expenditures over receipts. The diminished cash receipts in 1949 were caused largely by the decline in income tax collections which resulted from lower effective rates on personal incomes. The increase in expenditures is attributable to larger outlays for national defense, foreign aid, and Commodity Credit Corporation activities.

Public debt operations are only partially explained

by the cash retirements which were made during the period. The decline in total interest-bearing debt, including non-cash operations, amounted to 1.2 billion dollars. The following figures, in millions of dollars, summarize the changes that occurred in the major classes of direct interest-bearing debt:

	Dec. 31 1948	April 30 1949	Change
Marketable debt	157,482	155,450	-2,032
Nonmarketable debt	61,383	62,227	+844
Special issues	31,714	31,833	+119
Total	250,579	249,509	-1,170

It is apparent from these figures that net increases in the nonmarketable debt and special issues amounted to some 950 million dollars and thus offset in part the two billion dollar net decline in the marketable debt. In its refunding program the Treasury replaced four issues of certificates and one note issue—totaling 12.9 billion dollars and all bearing a 1½ per cent rate—with new 1¼ per cent certificates to the extent of 11.6 billion. These transactions, however, contributed to the net marketable debt reduction by only 1.3 billion dollars—the amount of maturing issues turned in for cash. Approximately 500 million dollars of this cash repayment and an additional 700 million of bills paid off were from the Federal Reserve portfolio, a much smaller proportion of total cash retirements than in the corresponding period of 1948. The net rise in nonmarketable debt consisted principally of an increase in savings bonds of almost one billion dollars, including non-cash interest accrual, less relatively small declines in other issues.

## BANKS PURCHASE BONDS

Beginning in late 1948 and continuing through the early part of 1949, commercial banks again became active bidders in the Government security market for medium and longer term eligible bonds. As a result of this demand, as well as of increased purchases of restricted issues by other institutional investors, the Federal Reserve System sold substantial amounts of bonds in accord with its policy of stabilizing the Government security

(Continued on Inside Back Cover)

**TABLE 1**  
**TREASURY CASH OPERATIONS**  
**JANUARY THROUGH APRIL, 1949**  
(In millions of dollars)

Item	January	February	March	April	Total
Cash receipts	3,684	3,893	5,555	1,500 <sup>1</sup>	14,632
Cash expenditures	2,834	3,252	3,845	3,200 <sup>1</sup>	13,131
Net cash receipts or expenditures (-)	849	641	1,710	-1,700 <sup>1</sup>	1,501
Net cash borrowing or repayment (-)	-399	-10	-1,234	-72 <sup>1</sup>	-1,715
Change in Treasury balance	+451	+631	+476	-1,772	-214
General Fund balance at end of period	4,659	5,291	5,767	3,995	3,995

<sup>1</sup>Estimated.

**TABLE 2**  
**FEDERAL RESERVE HOLDINGS OF**  
**GOVERNMENT SECURITIES**  
(In millions of dollars)

Item	December 31 1948	April 30 1949	Change
Treasury bills	5,487	4,866	-621
Certificates of indebtedness	6,078	6,941	+863
Treasury notes	791	385	-406
Treasury bonds	10,978	8,902	-2,076
Total holdings	23,333	21,094	-2,239

# Bank Lending to Business Declines

## *Principal Cause Shrinking Demand Rather Than Tightening Supply*

While other indicators of business activity have moved slowly but haltingly downward in recent months, business (i.e., commercial, industrial, and agricultural) loans of weekly reporting member banks have declined nationally for 21 consecutive weeks. This development reflects primarily an increasingly cautious financial policy among business managements, aimed at scaling down debt wherever possible, and especially short-maturity bank debt.

The drop since late last December has been about 14 per cent, or roughly two billion dollars for the weekly reporting member banks, and well over two billion dollars for all commercial banks in the nation. Seventh District reporting banks started to lose business loans last September, three months before the nation, and have experienced a greater proportionate drop, 17 per cent, involving a 300 million dollar reduction in their over-all business loan total. Quite recently some, perhaps temporary, leveling tendency has been evident in this District.

Analysis of the current situation and evaluation of the outlook for the balance of the year probably should focus more upon the factors influencing business needs for loans than upon the conditions of supply. This is be-

cause the decline to date has been largely attributable to lower levels of prices, inventories, capital expenditures, and general business activity, rather than to any over-all tightening of supply. The foregoing demand factors probably will continue to exert downward influences on loan portfolios, sufficient to obscure the seasonal upturn normally expected in the second half of the year.

Last year from June through December, commercial, industrial, and agricultural loans of weekly reporting banks nationally rose 10 per cent as opposed to 25 per cent during the same period the year before. The comparable second-half gains in the Seventh District were 6 and 20 per cent, respectively, reflecting in 1948 a small increase from mid-year to a September peak, and a decline thereafter. Although a moderate second-half rise in business loans has been a long observed seasonal tendency, it is important to note that in years of generally declining business, e.g., 1938, the seasonal advance was more than canceled by the over-all drop in loan activity. Such may well be the case this year, if, as expected, the current slide-off continues.

### POSTWAR BUSINESS LOANS

#### NOTE ON WEEKLY REPORTING SERIES

Loan figures relied upon for most of this article necessarily are for the weekly reporting member banks because more comprehensive data are only available at infrequent "call" report dates. The weekly reporting bank series, published since 1919 and extensively revised in 1947, provides the only commercial bank data available on a week-to-week basis. Nationally, the series now includes 441 banks in 94 large cities and covers more than 96 per cent of all deposits in reserve and central reserve cities, as well as 17 per cent of all country bank deposits. These banks account for 60 per cent of total loans and 80 per cent of the commercial and industrial loans of all commercial banks in the United States. The figures check closely from one call date to another with complete data for all insured and all member banks, and are widely used as a helpful weekly indicator of business trends. Chief interest here lies in business loans, classified as "commercial, industrial, and agricultural."

Some difficulty is encountered in business analysis in using the weekly reporting bank data because of the inclusion of agricultural as well as commercial and industrial loans in the "business" loan category. Although farm borrowing represents only from two to five per cent of the business loan total, increases in farm loans over last year actually hide in the amount involved the full extent of the decline in commercial and industrial loans.

Some questions frequently are raised as to the dominance of New York and Chicago banks in the weekly reporting series and whether the trends are comparable outside these largest financial centers. New York and Chicago now account for 45 per cent of the business loans of all reporting banks, but these banks have been responsible for over 50 per cent of the decline this year, and more than 70 per cent of the drop in the comparable period of 1948. While the largest loan transactions obviously tend to occur in New York and Chicago, the over-all trend in business loans in the smaller centers in recent months has not been very different from that in the largest centers.

When the nation's business loans at reporting banks reached their all-time peak of over 15.6 billion dollars just before last Christmas, they were almost two and one-half times the amount outstanding on V-J Day, and more than three times the 1939 level. Most of the increase was achieved by the end of 1947 when indexes of business activity and prices were not far from the record highs of last year. The 14 per cent drop in business loans this year has been roughly comparable to the declines in prices and production which peaked out somewhat earlier.

This year's slide brought business loans for all reporting banks in the nation below the comparable 1948 level on April 27; whereas less-than-year-ago totals began in the Seventh District as early as the first week in 1949. The national rate of decline was accelerated in April, with that month accounting for 742 million dollars, or close to 40 per cent of the four-month drop. Three of the weekly declines in April were the largest on record. In the week ending April 6, the business loan total was off 277 million dollars. The District decline, while extending over a longer period, in general, has paralleled the national movement this year.

### REASONS FOR DECLINE

In the postwar years, business financing has been provided largely by internal sources, i.e., retained earnings and depreciation reserves. Additional funds have



been obtained on the outside from trade creditors, securities markets, insurance companies, and banks, with borrowings from the latter commonly serving as a residual source of funds for some, and especially the largest, firms.

The requirements of business for funds have been tremendous since V-J Day. Close to 60 billion dollars have been spent for plant and equipment, and over 25 billion used to rebuild and enlarge inventories. About 61 per cent of the funds needed by corporations for these purposes have come from internal sources, and only nine per cent from banks. The remaining sources were: new security issues, 16 per cent; trade debt, nine per cent; and other, five per cent. From the close of the war to the end of 1948 commercial and industrial loans of all commercial banks in the nation increased by over 11 billion dollars. Most of this expansion of bank credit was completed by the end of 1947 when upward price movements had begun to level and many "pipelines" were becoming filled. New bank loans declined proportionately as a means of current financing in each of the three complete postwar years, from 14 per cent in 1946 to three per cent in 1948. This year business loans actually may prove to be a negative source of funds, that is, net contraction of such loans may use money obtained in other ways.

It is apparent that business needs for bank credit depend on three general factors: (1) the total amount of money required; (2) the amount provided from non-bank sources; and (3) the attitude of business management toward a policy of bank borrowing. Changes in prices, inventories, and capital expenditures, for example, have direct effects on total demand for funds. Shifts in the proportions of total requirements supplied by retained earnings, security issues, or insurance companies obviously mean altered demands for bank loans.

The conservative attitude in business toward expenditures, arising from reduced confidence in sales and earnings prospects set against high break-even points, has been an important contributory factor in the recent decline in business borrowings. Most managements have adopted a policy of avoiding additional debt in general, and bank debt in particular. Debt maturity schedules have taken on new significance, particularly when there is some doubt that incomes will be sufficient to provide the liquidity needed to pay off the loans when due and meet other current expenses without difficulty.

An important cause of business conservatism now is the price picture. In each business decline at least since the first World War, a drop in wholesale prices has heralded the approach of financial troubles for many concerns. Typically bank loans have reached a peak a few months after the turning point in prices and then declined. In May 1920, wholesale prices began a 45 per cent break, while bank loans generally continued upward until October 1920, and thereafter fell off about 20 per cent. Later in the same decade, wholesale prices started to drop in July 1929, followed three months later by a slide in bank loans. In this instance the ultimate declines were 40 and 55 per cent, respectively, with a contraction in security loans highly instrumental in moving the loan

total downward. In 1937 wholesale prices began to subside in April and bank loans, in turn, in September, with the former dropping 15 per cent before leveling, and the latter 19 per cent. Since wholesale prices topped out in August 1948, the same lead-lag relationship among prices and loans is apparent, inasmuch as loans started to fall off in December.

The lag in bank lending activity reflects principally the needs for funds by business concerns at the time of delivery of goods ordered before prices started down. In general, loans tend to go up when prices are rising, but there is no consistent correlation. Loans, in fact, have risen in the face of increased business activity during a period when wholesale prices have been declining moderately, as during the middle twenties. From the standpoint of the current business financial situation, the downward movement in prices generally means lessened demands for funds to handle comparable volumes of sales. The reverse situation held so long as inflation persisted.

Spreading business conservatism usually manifests itself in a tendency toward hand-to-mouth buying and an attempt to run off inventories before they assume formidable proportions in relation to sales. Precisely these conditions have obtained in recent months.

Although roughly five per cent of business loans in this District are estimated to be secured by inventory collateral, the actual volume of inventory financing by banks is known to be much larger in view of varied banking practices in handling inventory loans on some other type of collateral or unsecured basis. At the end of 1948, both business inventories and non-farm business loans of banks were approximately double what they had been at the end of 1945. During the intervening years, however, it is difficult to relate month-to-month changes in inventories with loans. In the first quarter of 1949 total inventories rose 500 million dollars while bank loans to business declined steadily.

It would appear, therefore, that over-all inventory trends do not explain the general decline in business loans at banks in recent months. Some observers contend, however, that shrinking inventories to date have occurred in large part among the lines and firms which rely upon bank financing. This also does not seem to be the case to date, however. The November 1946 Federal Reserve survey of commercial and industrial bank borrowers found that manufacturers received nearly 50 per cent of total bank loans to business in this District, followed by 14 per cent by wholesalers, nine per cent by retailers and the remainder scattered among other types of businesses. If these bank borrower relationships still hold roughly, it would seem reasonable to expect that a substantial part of the recent decline in bank loans might be coming from repayments by manufacturers in view of their relatively great importance in total business loans by banks. In fact, manufacturers' inventories were two per cent higher in the first quarter of 1949 than the last quarter of 1948, and have declined only slightly since. Similarly, inventories at wholesale have remained steady this year. Only at retail have inventories fallen appreciably, about five per cent, since the final quarter of last



year. Moreover, in many cases where inventories have been reduced, receivables have been increased. Factors other than inventories, it can be seen, are playing an important role in influencing the course of current bank lending activities.

Although banks typically do not provide funds for capital improvements in business, in postwar years they have made numerous working capital loans which have replaced other financial resources used to modernize or expand plant and equipment facilities. Since capital expenditures for the first half of 1949 are estimated at somewhat less than 9.5 billion dollars, seven per cent down from 10.2 billion in the second half of last year, another reason for the loan decline becomes apparent. Total private construction put in place, moreover, has decreased about four per cent since a year ago, confirming the demand aspects of shrinking construction loans.

Not only have general business demands for funds tended to decrease in recent months, but some rather important shifts have occurred in the external sources of financing used by numerous large concerns. In the early postwar years large business organizations, particularly manufacturers, absorbed a disproportionately heavy share of bank loans, including term loans. Firms which did not possess sufficient liquid resources during the period when inventories and fixed assets were being greatly expanded, had to obtain funds quickly and conveniently. With a comparatively depressed stock market, commercial banks commonly offered the logical source. Late in 1946, business concerns with assets of five million dollars or more owed 55 per cent of the total dollar volume of business loans of banks, according to the Federal Reserve survey. In 1940 the National Bureau of Economic Research estimated that firms of the same size group accounted for only 20-30 per cent of the total.

Probably beginning sometime in 1947 the proportion of total bank borrowing and term loans of large establishments began to decline. As postwar operations became more profitable because of expanded sales and end of the excess profits tax, it became possible for many of these companies to repay large amounts of outstanding bank loans and to obtain further expansion funds from retained earnings and security issues, including many privately placed. Earnings retained by corporations after payments of taxes and dividends were 11.2 and 12.3 billion dollars in 1947 and 1948, respectively, in contrast to 7.2 billion in 1946, a year when commercial loans increased almost 50 per cent.

In several weeks since the decline in business loans set in, the drop has been in large part attributable to the repayment of one or more large business loans as a result of a shift of the obligations to debenture form placed largely with insurance companies and other institutional investors. Such repayments obviously have their greatest effect upon weekly reporting bank loan totals in New York and Chicago.

Loanable funds, like many commodities, are now in a buyers market, provided, of course, that the applicant has an acceptable credit standing. The recent cut in required reserves of member banks came at a time when

the banks were beginning to seek out borrowers. Competition for loans appears to be increasing, but with no clear-cut impact on interest rates. In some instances slightly lower terms are being offered to attract new borrowing; in others, higher rates reflect greater risks seen by bankers in generally declining business trends.

#### SOME SUPPLY TIGHTENING

Some portion of the decline in business loans can be traced to tightened credit. Bankers in this District to some extent have adopted more restrictive lending policies with respect to construction loans, primarily because of some recent defaults and expectations of further drops in building costs. Bankers also have shown marked selectivity toward loans to companies engaged in installment financing.

Some loans are being turned down for other reasons than the state of the industry in which the applicant operates. More prospective borrowers are turning out to be "problem" cases, i.e., applicants either seeking escape from acute financial stringency or desiring actual equity capital funds for novel or untried ideas.

#### FUTURE PROSPECTS

Although some seasonal business borrowing from banks is expected in the second half of the year, this is likely to be obscured in the aggregate loan figures by the continuing downward pressure of lower prices and sales, along with the possibly still greater conservatism in business toward expenditures for inventories and capital improvements. Business as a whole is in a relatively liquid position, and most firms seem able to meet commitments without large-scale use of bank loans.

If business activity recedes gradually, prices continue to fall, inventories are adjusted to lower sales, and capital expenditures are cut, the over-all financial requirements of business will be reduced. In turn, the need for funds from banks also should fall, at least correspondingly.

Inventory buying by wholesalers and retailers will provide some upward impetus to business loans in the fall, but the amount probably will be less than last year. Loans for facilitating capital improvements cannot be counted upon this year as a strong boost for business loans. Such expenditures are anticipated to be less than 8.9 billion in the second half, off 14 per cent from last year.

On the supply side, banks are able to meet any over-all credit needs of business, assuming willingness to lend is not unduly restrained by sharpness of a business downturn. In light of the passing of inflationary dangers, Federal Reserve policy is to supply banks with ample reserve funds, as evidenced by the recent reduction in reserve requirements. Although restraint on loans as an anti-inflation measure will be absent, increasing attention is being directed to the soundness of loans in the banking community. Moves by banks and supervisory authorities to retard the decline in loans have been largely ineffective historically. Final results will depend more upon decisions of borrowers.



# Farm Leases—II

## A Good Lease For Every Need

Two important requirements of a good farm lease—security of tenure and adapted type of farming—were discussed in a previous article in the May issue of *Business Conditions*. A third requirement—equitable division of returns—is discussed in this article, along with the major types of farm leases in common use in Seventh District agriculture.

### DISTRIBUTION OF RETURNS

Provisions determining the distribution between landlord and tenant of the returns from the farm are an important part of any lease agreement. Actually, rentals in any particular area usually are determined largely by custom but modified somewhat by the number of tenants seeking farms relative to the number of farms to rent. The competition of tenants for land, or of land for tenants, varies in response to many factors but with alternative job opportunities probably being of major importance.

In general, it is considered equitable for the landlord and tenant to share the returns from the farm in proportion to the value of their contributions to the joint farming operation. To determine whether or not the provisions of a lease are reasonable, as measured against this standard, the values of the contributions by landlord and tenant to the farm business may be calculated and compared with the division of the returns. If the value of the contributions of the two parties are approximately equal, a 50-50 division of receipts is indicated. The following hypothetical example illustrates this situation:

<u>Item Contributed</u>	<u>Value of Owner's Contribution</u>	<u>Value of Tenant's Contribution</u>
Land and improvements (4 per cent of value) ..	\$1,600	
Machinery, power, and livestock (5 per cent of value) ..		\$ 500
Depreciation and upkeep on improvements .....	510	
Depreciation on machinery and equipment .....		300
Joint operating expenses ...	330	330
Operating expenses, tenant .		100
Real estate tax .....	410	
Personal property tax .....		150
Labor .....		1,500
	<u>\$2,850</u>	<u>\$2,880</u>

In many instances the proportions of total contributions furnished by the landlord and the tenant will be quite different and the distribution of the returns should be adjusted accordingly.

A fair rental for a farm is not easily determined. The principle illustrated above is considered by many qualified persons to be a good guide. In applying it to a particular case, however, estimates must be made of the value of such contributions as the land and improvements furnished by the landlord and the labor and operating capital furnished by the tenant. The values placed on these contributions may vary appreciably, even by disinterested persons. The estimates should use current market values insofar as possible. The rate of interest charge on capital items may be the usual rate for that type of credit in the area or the return that could be obtained from a similar alternative investment.

For cash leases, the procedure illustrated here is less applicable since the returns from the farming operation must be estimated, as well as the value of the contributions, if the dollar amount of rent is to be determined at the time the lease is drawn. Also, allowance should be made for the tenant assuming the full burden of risk for variations in crop yields and prices.

### BASIC LEASE TYPES

Several basic types of farm leases have developed to meet the particular needs of different groups of landowners and tenants. The different leasing plans provide a variety of arrangements for the supplying of land, labor, capital, and management to the joint farming enterprise. The sharing of expenses, risk, and income varies, of course, not only with the different types of leases but for individual leases of the same general type.

Cash leases provide that the tenant pay the owner a specified dollar amount per acre or in total for the use of the farm. They are adapted to the owners who view farms largely as investments to yield financial returns. Such owners usually prefer not to participate in the management of the farm or to assume risks of farming resulting from fluctuations of yields and prices.

Tenants who have sufficient operating capital to finance crop and livestock operations and who consider themselves good managers frequently prefer cash leases. They are willing to assume all risks of farming, desire to make their own crop and livestock decisions, and do not want to share the benefits of their superior management and labor efforts with the farm owner. Such tenants should have sufficient financial reserves to withstand temporary reverses.

Cash leases usually are simple. There is little chance of misunderstanding during the year. The tenant has great freedom in operating the farm and the owner assumes no responsibility for making management decisions relative to production and marketing. The necessity to



renegotiate the amount of the rent, usually each year, tends to restrict cash leases to short terms and to encourage "short-run" farming without sufficient attention being devoted to the long-run needs of the farm. Cash grain farming is encouraged as a result of both the "short-run" planning and the need for cash to meet rental payments. The rent tends to be set at a level reflecting the trend in farm incomes in several prior years and is not adjusted quickly to changed economic conditions.

Cash leases could be improved in many instances by providing for a variation in rental based upon levels of production and prices for the major products of the farm. This would make practical the inclusion in the lease of provisions providing for greater security of tenure and improved farming. Even without these provisions, many cash leases could encourage improved farming practices by providing for the maintenance and rotation on the farm of minimum acreages of adapted soil building crops.

The *crop share* lease is the most common type in the Seventh District states. It is readily adapted to a wide variety of conditions. Included, for purposes of the present discussion, is the *crop share-cash* lease where a cash payment is made for land used for such purposes as pasture, meadow, farmstead, and the like, from which the produce either is not readily marketable or easily measured and divided. This type of lease is well adapted to farm owners who in addition to viewing a farm as an investment are interested in actual farm operations and want to participate in some of the major management decisions relative to crop rotation and marketing. Their farms usually are well adapted to grain production and they are willing to assume some of the risks of varying yields and prices. Return to the owner usually is larger than for a straight cash lease but varies more from year to year.

Tenants who own farm machinery and equipment but do not wish to assume full risk for variations in crop yields and prices, prefer the crop share lease to the cash lease. They prefer to give a share of the product for the use of the land to committing themselves for a specified cash rent. Many tenants like the added interest the landlord has in the farm when operated under a crop share lease. There may be a tendency, however, for the interest of both the landlord and the tenant to concentrate unduly on the production of grain for market and to slight other phases of the farm business. The emphasis on cash grain frequently results in a large part of the crops being removed from the farm with comparatively little manure and crop residue returned to the fields.

The annual negotiation of the cash payment for pasture and hay land frequently is an unsettling influence in this type of lease. There is a decided tendency for the shares of crops going to landlord and tenant to remain fixed and for changes in the financial arrangements to be limited to the amount of the cash payment for hay and pasture land and the share of certain production expenses to be borne by each party.

The *livestock share* lease is an arrangement under which the landlord and tenant usually jointly own the productive livestock and share the receipts from it. The

usual arrangement is for the landlord to provide the land and improvements and the tenant to furnish machinery, power, and labor. The operating expenses may be shared between landlord and tenant in a variety of ways, depending upon local circumstances and customs.

This type of lease frequently is advantageous to tenants with limited capital or experience who do not want to assume the full risks of operating a livestock farm. Landlords who have had farm experience and possess the knowledge, desire, and time to exercise considerable supervision over the farm planning and operations may desire the livestock share lease. They must be willing to assume a substantial share of the risks in farming. This type of lease will usually provide owners the highest possible return from their farms and at the same time aid in the maintenance of soil fertility and physical condition of farm improvements.

The arrangement requires agreement between landlord and tenant on many production and marketing decisions and may lead to frequent misunderstandings unless both parties have the ability and desire to work well together. It permits the tenant with limited capital resources to operate a larger business and makes possible better kept and more improvements due to the landlord's direct interest in the operation of the business. It is designed to be a long-term lease which will facilitate the development of stable livestock operations well adapted to the farm resources.

Tenants who have a few debts and adequate livestock and machinery to handle a family-size farm will usually prefer the crop share or cash lease. With this type of lease they do not have to share with the landlord any benefits resulting from their livestock skills or unusual efforts.

Farm leases should be revised frequently to keep them up to date. The technology of farming changes rapidly and must be accompanied by appropriate adjustments in leases if the most efficient production methods are to be adopted promptly and arrangements between farm owner and tenant are to be kept equitable. Such developments as increased use of commercial fertilizer, chemical weed control, combine harvesting of grains, greater use of conservation practices and mechanical power, and the development of new crops illustrate the types of changes which have occurred in recent years and which frequently should be accompanied by changes in lease terms.

The importance of the best possible farm leasing arrangements in any area where there is a substantial number of tenant farm operators should not be minimized. It is an essential preliminary step to achieving the maximum contribution from agriculture to the economic activity of an area. The perennial problem of adequately financing agriculture would be simplified and facilitated by such a development. The goal, of course, is the provision of the land, labor, capital, and management in the best combination and under terms and circumstances so each can make the optimum contribution to the production of farm products. Leases which are based on an understanding of the basic problems involved can aid materially.



# Farm Prices Readjust

## But Some Disparities Continue

In a period of declining prices, such as the present, it is generally believed that a re-establishment of normal relationships in the economy, supposedly thrown out of line by inflationary conditions is in process of formation. It is often suggested that these price relationships must return to a more normal basis before the downward trend can be halted or reversed. While this is not always necessarily true, there is an important element of truth in the suggestion, important enough to warrant the raising of questions as to how far out of line some prices may have gone, what progress has been made toward restoring normal relationships, and at what patterns of price behavior a more normal situation might be said to prevail.

The following discussion is emphatically not intended to be a prediction or forecast of further changes to come. It is at best only a speculative examination of some relationships that have prevailed among prices, and it attempts to evaluate, in a very tentative way only, the possibilities of further farm price adjustments. Most of the discussion will be in terms of patterns and relationships ignoring the various Governmental activities that have been or may be introduced to affect either the general price level or farm product prices specifically. It attempts only to suggest roughly the magnitudes of change that would be reasonable to expect on the basis of past experience with the "structure" of prices. Those not caring for the yeast and ferment that this kind of speculation represents may well stop here.

### IS THERE A NORMAL?

Starting with the general proposition that the war-time and postwar inflationary period has distorted prices from their usual relationships, an attempt is here made to see to what extent prices have been "distorted," how

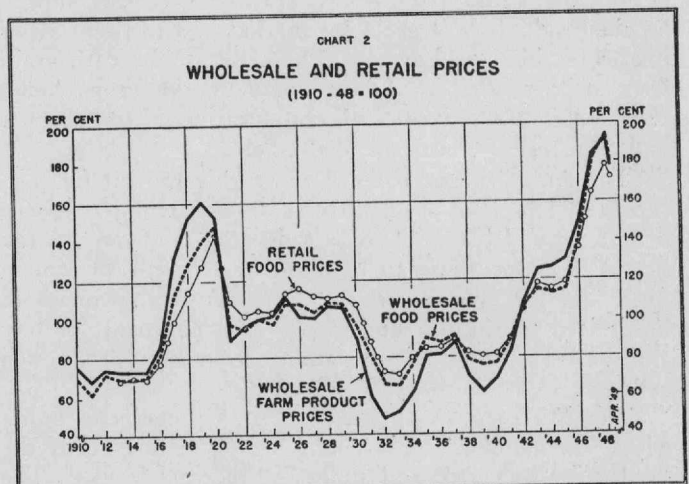
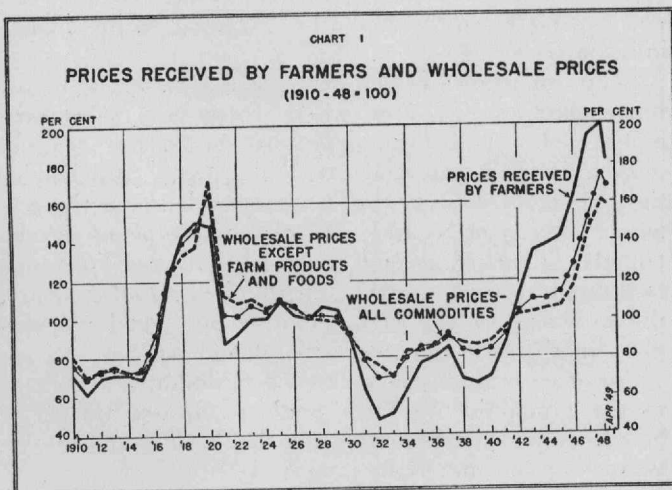
far they have returned toward "normal," and how much more readjustment may be in order before a reasonably "normal" situation prevails. Almost every economist or other student of prices will immediately protest loudly that in a dynamic economy there is no such a condition as normal.

The discussion and charts to follow are, however, based on the tentative assumption that the *average* relationship between different prices and price series or indexes during the period from 1910 through 1948 may be useful indicators in the sense that the average is a statement of central tendency of price relationships. The deviations from "normal," in the sense of average price relationships of previous years, can thus be examined in the light of history and recent changes. The year 1910 marks the beginning of fairly well-rounded and reasonably complete recording of farm prices in this country. And thirty-nine years of price relationships ought to tell us a little something of what to expect, even though subject to a wide range of important qualifications.

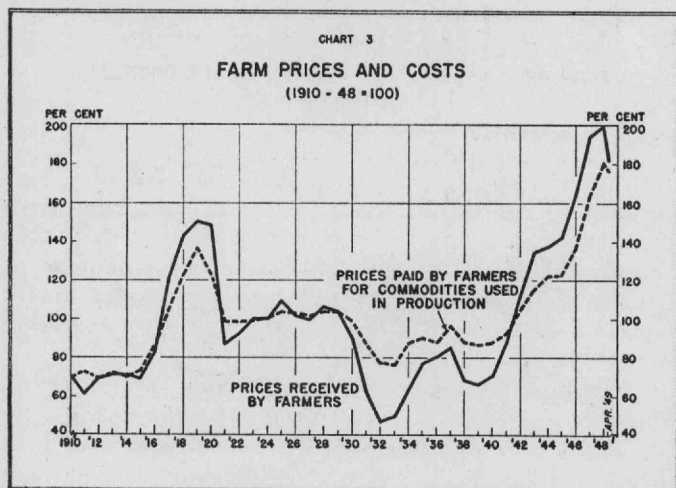
While advancing technology and shifting tastes and demands are bound to have altered to some extent these price relationships, it is, nevertheless, probably accurate to say that given free choice and scope of operation various prices will tend strongly to express an over-all or collective evaluation which society places on goods and services in the economy, and that this evaluation or scale of values is, within limits, a relatively stable one. In this sense the use of 1910-48 historical average relationships as indicators of "normal" may be defensible.

### FARM PRICES FLUCTUATE MOST

In Chart 1 three aspects of the wholesale price level are presented. With some relatively minor exceptions the







index of prices received by farmers adhered rather closely to the index of wholesale prices of "all commodities" from 1910 through 1930. During the "depression" years 1931-34 rather wide disparities developed and continued for some time, with farm prices falling considerably below the index for all commodities and below the price index for all commodities excluding wholesale prices of farm products and foods. A temporary realignment occurred for the three years 1935-37, reflecting largely the drought period which temporarily relieved the relative surplus position of farm products, and to a lesser extent some improvement in demand. The chart does show clearly the great relative rise in farm product prices after 1940, especially in relationship to wholesale prices other than farm products and foods.

During most of the rest of this discussion this index of prices other than farm products and foods will be used as a basis for measuring roughly the normal level of price relationships. Ordinarily the index of wholesale prices of *all commodities* is used to indicate the general price level, but in this discussion about the relationship of farm and food prices to other prices it is desirable to treat the price level exclusive of farm products and foods as a guide to what is "normal," since the index of all commodities is heavily weighted with farm product and food prices and thus includes the prices of these two classes on both sides of the comparison. Since it is the disparity between farm prices and other prices in the economy and the progress toward ending the disparity that we are attempting to approximate, it is necessary to separate out the influence of farm product and food prices on the wholesale price level.

In Chart 2 the index of the wholesale prices of farm products, of foods, and the index of retail food prices are compared. Treating the average relationship of the 1910-48 period as normal, it appears that in spite of the mild readjustments that had occurred to April of this year it would require a further decline of three or four per cent in the wholesale prices of farm products and of foods relative to retail food prices to bring the three series into "normal" relationship. Some lag in price adjustments at this level is a usual characteristic of price behavior. If over and above this we consider the

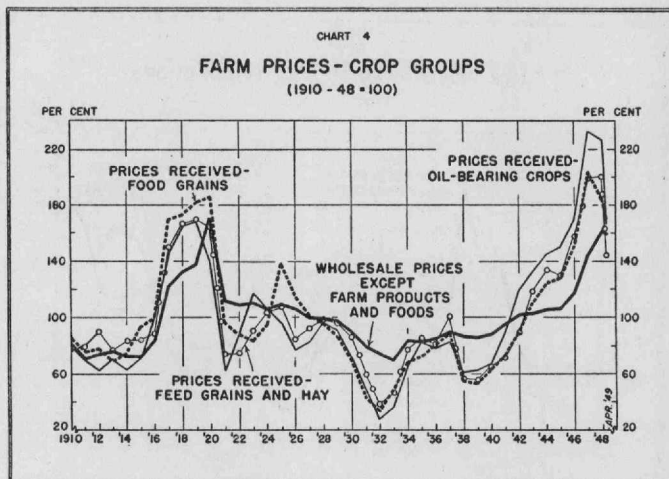
level of wholesale prices excluding farm products and foods as the indicator of normal a further decline of 11 per cent in retail food prices and of about 15 per cent in farm product and wholesale food prices would be in order.

Of particular interest to farmers is the return of normal relationships between prices received and the level of production costs. In Chart 3 are presented the indexes of prices received by farmers and of the costs of goods and services used in production. It is evident from the chart that "normal" relationships between these two series have been the exception. The indexes coincided approximately from 1910 through 1916 and again from 1923 through 1929. But during World War I and the 1942-48 period farm product prices were relatively out of line with production item prices. During the 1930-41 period they were also far out of line on the low side. In view of the readjustments in farm product prices that had occurred to April of this year it would take a further drop of only about three per cent to bring them in line with the index of prices paid for production items.

It might be pointed out that with the existing capacity of American agriculture and putting aside Government programs to bolster farm prices, a sharp drop in demand could produce another period like 1920-21 for agriculture. Farmers then could expect by 1950 a further drop in farm product prices of 15 per cent from April levels if there are no changes in the level of the costs of production. A drop of 35 per cent from present levels might be involved if there were to occur also by 1950 a drop of as much as 25 per cent in production costs. This assumes a "normal" relationship between farm prices and prices of production items. One need not go very far with these speculative illustrations of "normal" price relationships to realize why there is so much expected from Government in the way of measures to support prices.

#### SOME CROP PRICES NEAR "NORMAL"

In Chart 4 are presented the indexes of the prices of certain crop groups. It appears that prices received by farmers for feed grains had by April fallen below normal

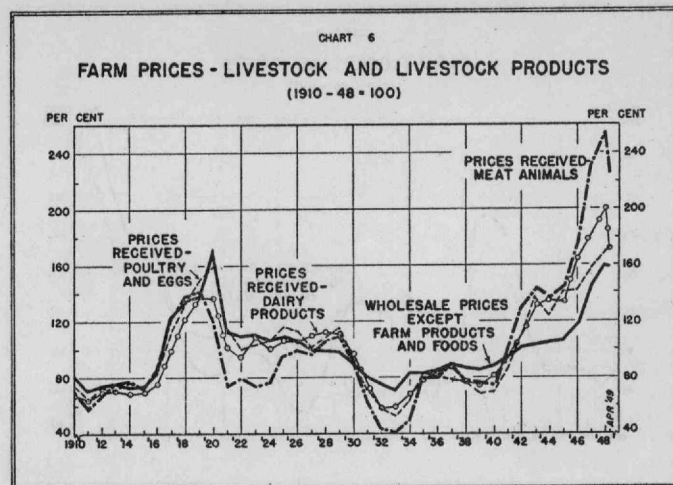
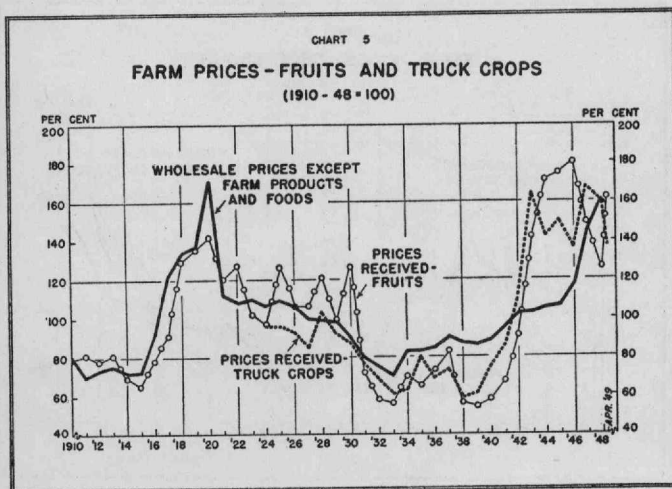




levels as measured by the level of wholesale prices other than farm products and foods. Prices of food grains and fats and oils have also declined to near normal levels. If, however, the experience of 1921-23 were to be repeated during the next two or three years it would seem likely that even without a further decline in wholesale prices, other than farm products and foods, further drops from present levels of prices of food grains and fats and oils of at least 15 per cent might be expected, while feed grain prices at present levels would be in line with the earlier relationship. Such additional declines for the food grains and fats and oils groups would, of course, be in the nature of a recessionary reaction, with such prices *below* normal. Perhaps it should here be emphasized that such drops as suggested completely ignore any relative differences between the two periods in the supply situation for the respective groups and in the character of who holds the surpluses, as well as probable price support programs.

In Chart 5 similar comparisons as to the normal levels for fruit prices and truck crop prices are presented. These two groups are subject to a considerable amount of price irregularity. But truck crops appear currently to be below the normal relationship, while fruit prices appear at the current time (April prices) to be about in line with normal after having been materially below normal in 1948. Demand for both groups of products has increased considerably since the depression of the 1920's, but even without this added strength it would appear that in the absence of excessive supplies the prices for both groups should suffer no greater drop in the next several months than would be proportional to any possible decline in wholesale prices excluding farm products and foods.

Meat animal prices dropped early during the 1920-21 recession and it was not until 1926 that they recovered to a level near normal in relation to the wholesale indicator we are using. In terms of normal they are today farthest out of line from normal of any of the major price groups. It would take a drop of about 30 per cent in meat animal prices to bring them down to normal as measured by wholesale prices excluding farm products and foods.



Dairy product prices and poultry and egg price levels are now about five per cent above normal relationship to other prices.

#### SUMMARY

The discussions above, it was emphasized at the outset, are highly tentative and speculative, and most certainly should not be taken as suggesting predictions or forecasts. The measures are subject to important limitations. They largely ignore changes in supply and demand and treat the components of the price structure in terms of long-time averages on the supposition that there is a balance or relationship between prices, including farm prices, that tends to re-establish itself. This may be a very unrealistic assumption, but it is quite evident that there are strong forces in the economy tending to induce a restoration of previous relationships, especially after periods of unusual developments such as the economy has been through the past several years.

There are many factors that continue to act in the direction of preventing return to "normal," including the changes that have developed and are occurring in demand and supply. There are still prospects of heavy export demand for some farm products, especially food grains and fats and oils. Even if a "normal" relationship is based upon well established patterns in capital building and consumption tastes and preferences which have a stability and tenacity often overlooked in economic "planning," this discussion has necessarily omitted actions of many kinds that have been and probably will continue to be undertaken by Government to prevent some of these "normal" relationships from asserting themselves.

It would appear from this speculative examination of price relationships that if past experience is useful as a guide, further declines in farm prices could be expected. It also seems clear that if the adjustments suggested above are to be avoided they probably can be warded off in part only by Government price support activities, the success of which depends not only on the ability of administrative agencies to give effective implementation to such policies, but also upon the public's willingness to expend the sums needed.



# MONEY AND CREDIT TRENDS IN 1949

(Continued from Inside Front Cover)

market. Table 2 indicates that in the four months after the end of 1948 the bond portfolio of the System Open Market Account was decreased by some two billion dollars. Bond prices, particularly for bank-eligible issues, tended to rise during the period. The following price quotations (decimals in 32nd's) show this rise for three representative issues:

	Nov. 30 1948	Dec. 31 1948	May 18 1949
2¾'s 1960-65 (partially tax-exempt)	109.00	109.20	111.19
2½'s Sept. 1967-72 (taxable, eligible)	101.18	101.29	103.09
2½'s Dec. 1967-72 (taxable, restricted)	100.08	100.15	100.29

An important contributing factor to the revival of commercial bank investment in Government bonds was the steady decline which has taken place in recent months in business and agricultural loans by commercial banks. This decline, which is discussed in detail elsewhere in this issue, induced banks to turn to Governments as a source of income. The announcement by the Treasury of the terms of the June refunding—replacement of maturing two per cent bonds and 1½ per cent certificates with 1¼ per cent certificates—stemmed the upward price trend and the corresponding yield declines on these maturing issues. The demand for these particular issues had been caused by some expectation that the Treasury would offer a higher-rate issue in the refunding.

Reporting bank figures presented in Table 3 suggest the extent to which banks made net acquisitions of Governments in excess of holdings retired for cash, as well as the net loan contraction. The table also shows that demand deposits adjusted were reduced, reflecting not only the loan shrinkage but also heavy withdrawals for tax remittance during the period.

## RESERVE REQUIREMENTS REDUCED

Excess reserves of all member banks on April 27 were 480 million dollars, more than 700 million below the level at the end of 1948. In the two following weeks lowered reserve requirements, announced by the Board of Governors of the Federal Reserve System on April 29, were put into effect. The change in regulations re-

**TABLE 3**  
**CHANGES IN REPORTING MEMBER BANK**  
**SELECTED ASSETS AND DEPOSITS**  
**DECEMBER 29, 1948 TO MAY 4, 1949**  
(In millions of dollars)

Item	New York	Chicago	Other Leading Cities	Total Reporting Banks
Loans:				
Commercial and agricultural	-592	-205	-804	-1,601
All other	+82	-16	+31	+97
Government securities:				
Treasury bonds	+148	+84	+891	+1,123
All other	-51	+23	-819	-847
Deposits:				
Demand adjusted	-583	-202	-1,187	-1,972
Time	-27	+38	+209	+220

**TABLE 4**  
**SELECTED FACTORS AFFECTING MEMBER BANK**  
**EXCESS RESERVES**  
**CHANGES FROM DECEMBER 31, 1948 TO MAY 11, 1949**  
(In millions of dollars)

Item	Dec. 31, 1948 to April 27, 1949	April 27 to May 11, 1949	Dec. 31, 1948 to May 11, 1949
(Signs indicate effect on excess reserves)			
Decrease in Federal Reserve holdings of Government securities—total	-2,125	-1,078	-3,203
Net market sales	-955	-1,078	-2,033
Retirement by Treasury	-1,170		-1,170
Increase in gold stock	+85	+6	+91
Decrease (+) or increase (-) in money in circulation	+868	-96	+772
Decrease (+) or increase (-) in Treasury deposits with Reserve Banks	-23	+233	+210
Decrease in required reserves	+737	+1,236	+1,973
Other factors—net	-264	+79	-185
Decrease in excess reserves	-722	+380	-342

duced requirements against net demand deposits by two percentage points for central reserve city banks and by one percentage point for all other member banks, and against time deposits by one-half point for all member banks. The new requirements, effective May 1 for country banks and May 5 for other banks, are as follows:

	Demand Deposits	Time Deposits
Central reserve city banks	24%	7%
Reserve city banks	21	7
Country banks	15	7

The change in regulations reduced required reserves by approximately 1.2 billion dollars. Some 350 million of the amount was at country banks, another 350 million at reserve city banks, and about 500 million at central reserve city banks. About one-third of the reserves released by the lowering of requirements went into excess reserves. The remainder was apparently used to a large degree to acquire additional Governments.

For the entire period December 31, 1948, to May 11, 1949, member bank excess reserves declined approximately 340 million dollars despite the increase following the reduction in reserve requirements. The relative importance of other forces influencing the reserve position of member banks is revealed in Table 4. Banks received funds from a net return flow of currency which was partly seasonal in nature. The reduction in the Treasury's account with the Reserve Banks and continued but much slackened imports of gold also increased bank reserves. Because of the large decline in Federal Reserve credit, the effect of these factors was more than offset.

Prior to the downward revision in reserve requirements, the Reserve Board modified its controls on two other phases of the economy. First, effective March 7, Regulation W was amended to lengthen the maximum maturity on extensions of consumer instalment credit from a 15 to 18 month range to a uniform 21 months. The amendment also reduced the minimum downpayments required for controlled items other than automobiles from 20 to 15 per cent. On March 30, margin requirements for purchasing registered securities were reduced from 75 to 50 per cent. These measures were taken in response to the diminished need for restraints following the cessation of credit expansion.



**SEVENTH FEDERAL**



**RESERVE DISTRICT**