SEPTEMBER 1949

LIBRARY
OCT 3 1949

BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Devaluation of the British Pound—I

Background of the Dollar Crisis Reviewed

On September 18 the British Government announced a reduction in the exchange value of the pound sterling from $4.03 to $2.80, or 30.5 per cent. The devaluation followed the conferences of officials of England, Canada, and the United States and the annual meeting of the International Monetary Fund during which discussion centered around Britian's critical dollar position. Gold and dollar reserves of the United Kingdom and the sterling area were estimated to have fallen to 1.2 billion dollars at the end of August, compared with the two billion dollar level considered by the British Government to be a safe minimum operating balance.

This latest "dollar crisis" had its immediate cause in a marked deterioration in the balance of payments situation—reflecting chiefly a decline in exports—beginning in the second quarter of the year. It suggests forcibly that external aid, through loans and the Marshall Plan, has not so far brought Britain closer to the goal of being self-supporting at her present standard of living, and that more fundamental adjustments are necessary to restore national solvency even with continued assistance under the European Recovery Program.

The plight of Britain, which has received so much public attention in recent weeks, is an acute case of a condition which applies to a large part of the non-dollar world, particularly Western Europe—a chronic shortage of dollars. Basically, a "dollar shortage" means simply that a country is buying more than it is selling in the dollar area and cannot offset the deficit with earnings from other areas because of currency inconvertibility. The difference represents a drain on reserves of gold and dollars to the extent that it is not offset by grants, loans, or private dollar investments in deficit countries. In the early postwar era demands for American goods abroad were great, and the means of payment were small or nonexistent. Most of the international aid programs undertaken by the United States were designed to provide war-impoverished countries with the means of obtaining products necessary for subsistence and for the restoration and development of productive facilities which would enable them to earn dollars.

BRITAIN A SPECIAL PROBLEM

The strategic position of Great Britain as a world power and a great trading nation and the drastic changes wrought by the war on her international economic position made the British problem of special importance, and special measures were adopted to assist her in the interests of world trade and economic peace. Such a policy was, however, based on the assumption that such assistance would be needed for a temporary, transitional period until production and earning capacity could be restored. The first step in this process was the grant of a 3¾ billion dollar credit early in 1946. Exhaustion of this loan in 1947, far earlier than had been anticipated, threw the country into another emergency which was met by funds advanced by the Economic Cooperation Administration. Total aid from these two sources totaled approximately six billion dollars through June of this year. As a condition of this assistance, trade and currency restrictions were to be gradually eliminated.

Meanwhile, in the effort to earn and conserve dollars, the British Government asked its people to support a program of austerity and hard work and attempted to make it effective by controls over employment and wages, production targets, and import restrictions. For a time in 1948 and early 1949 it appeared that real progress was being made in holding down the deficit, but recent months have given rise to more and more restrictive practices such as the bilateral trade agreements with Argentina and Russia and stricter import quotas.

What is behind the failure of United States and British efforts to prevent the recurrence of another dollar crisis? Underlying the United Kingdom's entire balance of payments problem is, of course, the liquidation of foreign investments early in the war and with them one of her most valuable sources of foreign exchange. Interest on overseas investments provided her with one-quarter of the dollars spent for prewar imports. Earnings from shipping and other services were also curtailed as a result of the war. Since England is still heavily dependent on imports, not only for consumption but for raw materials used in her export industries, a basic readjustment was needed to expand exports sufficiently to make up for the loss in income from other sources. Achievement of this end is dependent, of course, on the ability and willingness of the dollar area to accept imports from Britain.

CHANGED MARKET CONDITIONS

The immediate responsibility for the recent export slump has been attributed largely to the effects of the American recession, both in lessening the demand for British goods and in the lowering of dollar prices paid for primary products purchased from the sterling area—principally wool, tin, rubber, and cocoa. Although prices paid for British imports also declined to some extent, long-term contracts and American farm supports held up the prices of many primary products. Accentuating the problem was undoubtedly the fact that rumors of coming sterling devaluation naturally induced consumers of British goods to postpone purchase in the hope of obtaining better terms of trade.

There is widespread belief among experts, and it is

(Continued on Inside Back Cover)

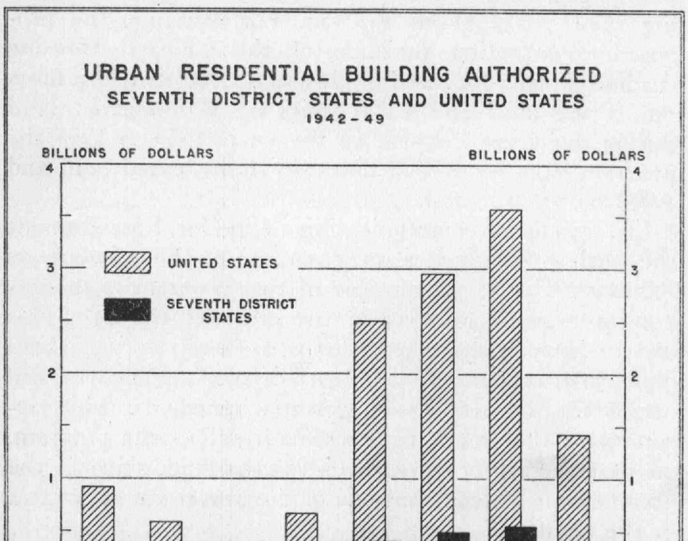
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Midwest Public Housing Plans

Gradual Effects of New Federal Legislation Foreseen

Despite a rush of Seventh District communities to qualify for newly-authorized Federal housing aid, public housing expenditures in the Midwest do not seem likely to have a very marked expansionary effect upon the construction industry or upon demands for building money during the coming year. Although more than 100,000 units of Federally-aided low-rent housing probably will be built in the Seventh Federal Reserve District during the next six years, extensive delays in getting so enormous a program started promise to limit the first year's results to a relatively few thousand completed dwelling units. Preliminary estimates indicate that the volume of public housing expenditures in Midwest cities will be insufficient to offset the decline in private urban homebuilding which currently is under way.

In conformity with the recently passed United States Housing Act of 1949 (see "Public Housing Boom Ahead," *Business Conditions,* August 1949), reservations for 43,950 dwelling units to be built during the first two years of the public housing program had been requested of the Public Housing Administration (PHA) by local housing authorities in the Seventh District as of September 1, 1949.[1] This building volume would require the expenditure of from 300 to 400 million dollars, an amount equal to approximately 30 per cent of all expenditures for new urban residential construction in the District during the past two years. However, a more realistic appraisal of the actual building prospects, taking into account the building schedules in the major cities rather than the "reservations" mentioned above, results in an estimate of about 25,000 units during the next two years, less than 10,000 of which are likely to be started during the year immediately ahead.



Early reactions to the public housing program on the part of private builders and mortgage lenders in the Seventh District seems to be one of general apprehension. The *manner* in which the public housing programs will proceed seems to be of most concern. Projects planned for open land in non-blighted neighborhoods appear likely to bring forth local opposition, both from private homebuilders and from adjoining property owners, whereas slum clearance low-rent projects promise to be applauded. Because of the exceedingly complex problems of relocating slum dwellers, purchasing slum land, demolishing the existing buildings, and replanning the area for new uses, timing of construction would be even slower than indicated above if the entire emphasis had to be laid upon slum clearance from the beginning.

PUBLIC HOUSING PLANS

The bulk of the low-rent housing to be built in this District during the next six years almost certainly will be in the major cities—Chicago, Detroit, Milwaukee, and perhaps also Indianapolis.[2] However, many hitherto inactive authorities in the smaller cities are planning programs of varying size. In most cases these smaller cities can present cases for low-rent housing needs which are equally as appealing as those in the larger centers. The fact that agitation for slum clearance and low-rent housing has been greater in big cities, however, has concentrated past public housing activities there, and seems likely to assure the greater part of the expansion in them.

Of 48 local housing authorities in the Seventh District, 20 actually have currently operating programs of Federally-aided low-rent housing. About 20,000 units are being operated in these cities, a number equal to 11 per cent of all such units in the nation. Roughly 12,500 of these units are in Chicago and Detroit. In addition to these low-rent projects, many housing authorities have participated in postwar programs providing temporary and in some cases permanent housing facilities for veterans of World War II. Milwaukee has made use of local government aid for the building of three permanent veterans' housing projects providing facilities at moderate rentals, and Chicago is now constructing a number of relocation projects using both state and local aid.

Recent activities of most of the local housing agencies have consisted primarily of surveys to determine the

[1] Local housing authorities are created under state law in general conformity with the United States Housing Act, and are empowered to build, own, and operate public housing projects. Among Seventh District states, Iowa law does not provide for local housing authorities, and Michigan law permits housing "commissions" which are merely city departments rather than "authorities."

[2] Indianapolis has, as yet, no local housing authority. Steps are being taken, however, to establish one so the city can qualify under the Federally-aided low-rent housing program.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

needs for low-rent public housing, and indications are that much of their work for the months immediately ahead will be of this nature. Among the lower income families of practically all cities in the District a serious housing shortage can be shown to exist. This is especially true when available rental housing is related to the incomes of doubled-up and other inadequately housed families.

Particularly critical situations exist in the District's two largest cities—Chicago and Detroit. The large migration of Negroes into each of these cities during the last decade has resulted in a major housing shortage when the income and race of the persons affected are considered. Unquestionably, the most difficult problem facing the housing authorities in these two cities will be the actual housing of the eligible families in this racial group including the relocation of those displaced by the slum clearance programs.

The over-all housing need in Chicago, as indicated by the Chicago Housing Authority, would require the building of 272,000 dwelling units. The Authority recommends that this need be satisfied in important part by 114,000 dwelling units to rent at less than $49 per month, 40,000 units of which are definitely scheduled in its six-year building program. The Housing Authority also recommends the construction of 50,000 privately financed homes for sale, about a half of which should be priced at less than $12,500 per dwelling unit. These recommendations result from a comprehensive study of the number, size, and income distribution of Chicago families, and the number and condition of existing houses. The Authority assumes as underlying policy that families should not pay more than 20 per cent of their income for rent, and that they should not purchase houses costing more than two and one-half times their annual income.

In Detroit the pressing housing need among low- and moderate-income families is set by the Detroit Housing Commission at 100,000 dwelling units. The Commission recommends that 30 per cent of this need be met by low-rent subsidized housing. About a third of the gross requirements should be satisfied through the building of rental units designed to rent for from $40 to $55 per month. The balance of the need would be taken care of by housing for sale, the bulk of which would be priced at less than $10,000.

The Milwaukee housing need is described by the local housing authority to require the building of 43,000 dwelling units. The authority proposes to meet part of this need through the building of 6,750 units of low-rent, Federally-aided houses, and suggests that the balance be met by privately financed dwellings at moderate rents or sale prices. In Milwaukee three projects for veterans' rental housing at moderate rents—$50 to $60 per month—already have been completed or are now under construction. Municipal aid made construction of these moderate rental dwellings possible.

In the District's smaller cities, studies needed to develop detailed housing needs and recommendations for meeting them generally are less advanced. These places commonly have critical housing needs for low-income families. Plans now in preliminary stages indicate that about 10,000-15,000 units are likely to be constructed in the 30 or more smaller communities which plan now to participate in the new Federally-aided program. The most common range for individual city projects is from 200 to 400 dwelling units.

Approximately 40 per cent of all public low-rent houses in the District are planned for the city of Chicago alone. Somewhat more than a third will be in the two cities of Detroit and Milwaukee, with the remaining units distributed over the smaller cities in the District. Such a distribution conforms roughly with past history of low-rent public housing in that 65 per cent of all existing houses of this type in the District are now in the three larger centers. Thus, the total Seventh District public housing program of 100,000 units within the next six years can be seen to be largely a big city program.

SLOW START ANTICIPATED

The time-consuming tasks of demonstrating need, preparing site and building plans, and obtaining local government approval seem certain to delay actual letting of contracts for most local housing authorities until the spring of 1950 or later. Thus, in the short run, public housing activities are likely to have little direct effect upon building materials prices or building trades employment. For many months the chief activity of most housing authorities will involve planning and development work by economists, statisticians, architects, and engineers, as provided for through preliminary loans granted from PHA for such purposes.

These circumstances obviously project the new public housing program in the Midwest into 1950 and beyond in so far as direct economic implications are concerned. In fact, the housing authorities in the larger cities are planning programs which accelerate year by year, reaching their peaks about 1953-55. For example, the proposed construction schedule of the Chicago Housing Authority calls for the building of 11,000 dwelling units on vacant land and 2,000 units on slum-cleared land during the years 1949-52. In the years 1953 to 1955 the program calls for 23,000 units on slum-cleared land and 4,000 on vacant land.

In its official communication to the local government the Authority indicates its reasoning for this schedule as follows: "The prime purpose of this program is to contribute to the rebuilding of the slums of the city. This can be done in orderly fashion, however, only if there is housing available to take care of the families who will necessarily be displaced by slum clearance. This accounts for the emphasis, in the first half of the program, on construction of projects on vacant land, since at the present time Chicago has one of the lowest vacancy rates in the country."

A highly important—and frequently misunderstood—aspect of slum clearance in general is illustrated by the Chicago public housing schedule. A total of about 75 million dollars is now available to the Chicago Land

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Clearance Commission for the clearing of blighted areas in Chicago. This results from some 25 million dollars of local and state funds already voted for this purpose, plus twice that amount from Federal grants. However, the Commission's chief initial problem in actually clearing blighted areas is how to house the present slum area occupants during the period of demolition and rebuilding.

The solution to the problem of slum clearance which is offered by public housing authorities in the other District cities—as well as that previously indicated in detail for Chicago—is to build low-rent projects on open land during the early stages of the program. Then, as the shortage of rental units eases, making possible the relocation of present occupants of slums, the emphasis of the program will shift to slum clearance projects.

If this solution can avoid delays caused by local opposition, the volume of public housing constructed in the District during the last half of 1950 and the succeeding five years will equal, and perhaps exceed, the 100,000 units suggested earlier. If local opposition—whether because of the expected adverse effects upon existing property values, the racial issue, or other causes—should hamper the building of public housing on open land, there is little doubt but that slum clearance as such and public housing on slum-cleared land would be materially retarded.

SIGNIFICANCE OF TIMING

The gross volume of expenditures planned for public housing in the six years during which the newly adopted Federal program is to run could have either mere offsetting or expansionary consequences on the Midwest construction industry. In the event that other construction expenditures stay at or near their present high level the program would require an expansion of about 15-20 per cent in the dollar volume output of the District's industry at current prices. If a decline in total volume should occur, the public housing program would tend to offset at least part of it. Such a relationship however depends to a considerable extent upon the timing of the program. As already pointed out, the volume of actual public housing expenditure in the Midwest during the year immediately ahead will be small, but in subsequent years will become progressively larger. However, the President of the United States is empowered to vary the tempo of public housing, as he and the Council of Economic Advisors believe the best economic interests of the nation require.

In respect to types of materials used and kinds of contractor organizations employed, public housing will affect principally the heavy construction sector of the building industry. In contrast to trends in the nation, Midwest industrial, commercial, and public utility building authorizations in total are only slightly under last year, and these small declines have been more than offset by increased building of schools, churches, hospitals, and other community buildings. Consequently, no significant slack in activity as yet has taken place among the kind of construction firms which would normally bid for public housing work. Very recent reports, however, indicate that a more marked decline in Midwest industrial building may be in the offing. Hence this District's pattern of construction activity may conform more nearly to that of the nation by the time the public housing program attains sizable volume.

The relationship between the timing of public housing construction and other types of heavy building probably will be more significant with respect to labor requirements than in relation to contractor services or materials. This is because site labor as a rule must be available locally whereas contractors' services and materials can be procured on a national or at least regional market.

DEMANDS FOR FUNDS

A total program of 100,000 units of public housing over the next six years would require about one billion dollars of expenditure, provided prices remain reasonably stable. These funds will be obtained principally through the sale of local housing authority bonds to the public, or through direct loans from PHA, but in either event will effect District banking activity as they are expended in local communities.

Obviously, future trends in general business and construction activity will determine the impact of this overall prospective demand for public housing building money. The chief questions are: (1) will total construction expenditures (aside from public housing) continue for several more years at or near current levels with the result that public housing expenditures are a net increment, or (2) will the peak period for public housing expenditures coincide with a decline in general construction activity so that their principal effect is to offset a decline. Corollary questions concern the trend of *residential* building as distinct from general construction activity, and the effects upon demands for long maturity mortgage funds as distinct from building money.

During the first six months of 1949 both the number of dwelling units and the dollar volume of private home construction authorized in urban places in the Seventh District declined eight per cent from the level which prevailed during the comparable months of 1948. Recent reports from the major cities indicate that the downward trend probably has continued since midyear.

Continuation of this rate of decline for two years would result in a total drop from the 1948 level about equal to the two-year plans for public housing construction—that is, 40,000 units. However, as pointed out above, there appears to be little likelihood that the full 40,000 dwelling units will be built during the next two years. Thus, on balance the total demand for construction funds resulting from a continuation of the current decline in private home building and the planned expansion in public housing in this District seems likely to be somewhat lower than the level of demand which has prevailed during the last two years. Trends in the *private* sector of the construction industry seem certain to continue to be the dominant factor in over-all demands for this type of funds.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Farm Income Reduced

District Decline Centers on Livestock Items

Farmers received about 16.2 billion dollars from sales of crops and livestock in the first eight months of 1949, 10 per cent less than a year earlier. A moderate increase in the volume of farm products marketed partially offset the effects of a 12 per cent lower average level of prices.

During the first quarter of the year, cash farm receipts were close to the year-ago level. In more recent months, however, receipts failed to make the usual large summer increase with the result that total August receipts were 17 per cent below receipts in August 1948 (see Chart 1) with indications that this relationship would continue at least through September.

The trend in Seventh District states differed somewhat from that for the U.S. The first-quarter *decline* in livestock receipts was more pronounced—12 per cent as against seven per cent for the U.S.—as was the *increase* in crops receipts—28 per cent as against three per cent—the net result being a decline of four per cent in total receipts from marketings relative to the first quarter of the preceding year. This first-quarter trend continued through July, the last month for which state data were available, but with some further decline relative to the preceding year in receipts from livestock items, bringing total receipts for the first seven months of the year to an average level 12 per cent below the corresponding period of 1948. District receipts from crops exceeded those in the first seven months of 1948 by 10 per cent, compared with a five per cent decline for the U.S. This increase occurred even though prices of all crops averaged 12 per cent lower during this period, with prices of feed grains—the most important crops in these states—down 42 per cent (Chart 2). Sales of livestock and livestock products in Seventh District states totaled 18 per cent less than in the preceding year, compared with a 12 per cent decline for the U.S.

LIVESTOCK INCOME DOMINATES DISTRICT TOTAL

Any evaluation of cash farm income in the Seventh District must give particular attention to livestock. Meat animals, dairy products, poultry, and eggs accounted for 74 per cent of the total value of farm marketings in these states in 1948, about the same proportion as in 1947 and the years immediately prior to the recent war, but a much larger proportion than the 56 per cent average for the U.S.

In Wisconsin, 87 per cent of total receipts from marketings in 1948 were from livestock and their products; followed by Iowa, 82 per cent; Indiana, 71 per cent; Michigan, 63 per cent; and Illinois, 61 per cent. Meat animals accounted for the major part of the livestock income in Iowa, Indiana, and Illinois while dairy products were of outstanding importance in Wisconsin and Michigan. Poultry and eggs, although of major importance in small areas within the District, were not of outstanding significance in any one state, ranging from 11 per cent of total receipts in Michigan and Indiana to seven per cent in Illinois. Other important sources of income were feed grains and oil-bearing crops, particularly in Illinois, Iowa, and Indiana, and fruits and vegetables in Michigan (see accompanying table).

The greatest percentage *decline* in receipts from marketings during the first seven months of 1949, compared to the corresponding period in 1948, occurred in Wisconsin, 19 per cent; followed by Michigan, 15; Indiana, 14; Iowa, 11; and Illinois, 7.

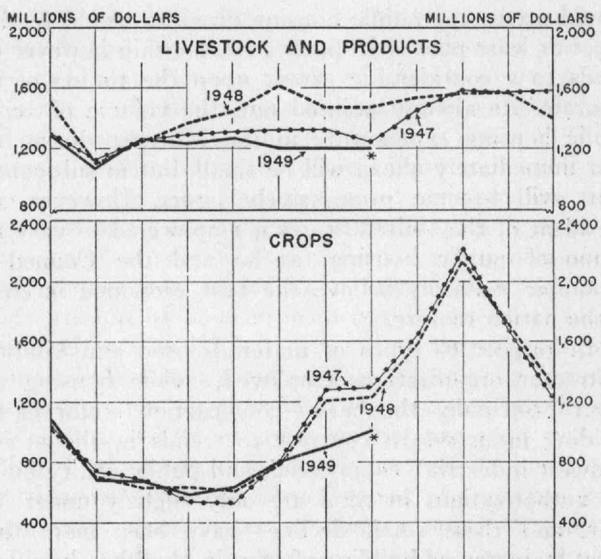
The declines resulted largely from decreased receipts from livestock items but with lower crops receipts also contributing for Wisconsin, Indiana, and Michigan. Dairy products, particularly important in Wisconsin and Michigan, averaged 18 per cent lower in price in the first seven months of 1949 than a year earlier, and in August were 20 per cent below the August 1948 level.

Receipts from livestock and products in Iowa declined 20 per cent but were offset to a substantial degree by an increase of 56 per cent in receipts from crops. Meat animal prices, particularly important to Iowa, Illinois, and Indiana, averaged 12 per cent lower in the first seven months of 1949 than a year earlier and for August were down 23 per cent. A decline of 16 per cent in livestock

CHART 1

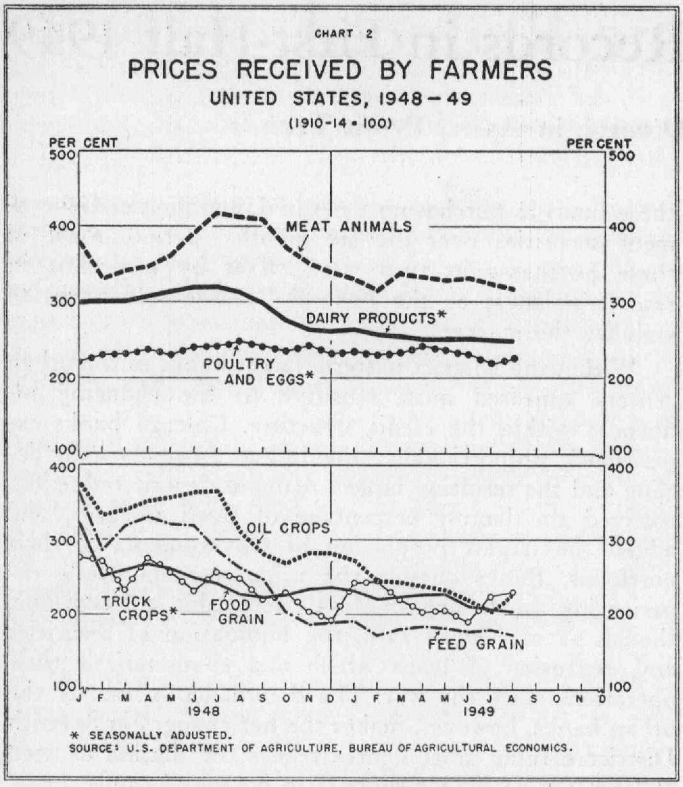
CASH RECEIPTS FROM FARM MARKETINGS

UNITED STATES, 1947-49



* PRELIMINARY.
SOURCE: U.S. DEPARTMENT OF AGRICULTURE.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



receipts in Illinois was partly offset by an increase of 10 per cent in crops receipts.

Michigan farmers experienced declines of 12 and seven per cent respectively in livestock and crops receipts, the situation being heavily influenced by dairy product prices.

PROSPECTIVE INCOME TRENDS

In general, it appears that some further downward pressure will be experienced on most farm product prices. Large supplies of most grains were carried over from 1948, and total agricultural production in 1949 will be a near record. In addition to the effects of abundant supplies, however, the price trend will be influenced, among other things, by price support programs. The level of price supports, although generally determined for 1949 crops, is not yet definitely established for 1950 and thereafter. Furthermore, the price support measures may well continue to be less than fully effective.

Even if fully effective, the necessary curtailment of production of some commodities, in order to bring supply into line with outlets available at the support level, would result in reduced farm income. It appears, therefore, that further declines in farm income are imminent, although the amount will be limited to some extent by agricultural programs yet to be designed and implemented.

Any price support program to receive serious consideration in the near future is likely to be based on some version of "parity" and, therefore, probably will attempt to support grain prices at levels more nearly approximating current market prices than would be true for livestock. As of mid-August, prices received by farmers for wheat averaged 83 per cent of parity; corn, 76 per cent; oats, 60 per cent; and barley, 65 per cent. These prices were generally below the official support levels. For the major livestock commodities the picture was different. Prices received for hogs averaged 110 per cent of parity; beef cattle, 147 per cent; veal calves, 135 per cent; lambs, 159 per cent; butterfat, 100 per cent; milk, 102 per cent; chickens, 91 per cent; and eggs, 93 per cent. In general, livestock prices could decline appreciably before reaching levels at which they are likely to be supported.

For Iowa, Indiana, and Illinois—states in which sales of meat animals are very important contributors to farm income—some further substantial decline in income appears likely, even though an increased volume of marketings of meat animals is in prospect. Price declines are likely to more than offset the effects on cash receipts of the increased volume.

For Wisconsin, where dairy products are the major single source of farm income, some further downward pressure on prices also appears to be in the picture. The volume of production may expand somewhat but probably will be more stable than for other commodities. Price support operations may be of considerable significance for dairy products but probably will not effectively stabilize the income of dairy farmers at current levels. Even if price support programs were fully effective for individual dairy products they probably would not stabilize use patterns of milk, and returns would decline as more of it is diverted to the lower value uses.

No single source of income dominates Michigan agriculture, but 30 per cent of total marketing receipts in this state are from dairy products with meat animals, vegetables, poultry, and fruit all making significant contributions. Price and income changes in this state probably will be similar to the other states in the District but may be expected to show somewhat smaller declines, due in part to the proximity to consumer markets.

PERCENTAGE DISTRIBUTION BY COMMODITIES OF RECEIPTS FROM FARM MARKETINGS, 1948

Item	Illinois	Indiana	Iowa	Michigan	Wisconsin
Livestock and products	*61*	*71*	*82*	*63*	*87*
Hogs	24	32	40	7	12
Cattle and calves	18	14	23	13	14
Sheep and lambs	1	1	1	1	*
Dairy products	10	14	9	30	50
Eggs	4	6	6	7	7
Chickens	2	3	2	3	2
Turkeys	*	1	1	1	*
Other	*	*	*	1	*
Crops	*39*	*29*	*18*	*37*	*13*
Corn	16	8	8	1	1
Wheat	4	5	1	7	*
Oats	3	1	2	1	1
Hay	1	*	*	1	1
Soybeans	10	7	4	*	*
Tobacco	*	1	*	*	1
Truck crops	2	3	*	6	3
Potatoes	*	*	*	2	1
Fruits	1	1	*	7	1
Other	2	3	1	11	4

*Less than one-half of one per cent.
SOURCE: Bureau of Agricultural Economics, U.S. Department of Agriculture.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

District Banking Sets New Records in First-Half 1949

Metropolitan and Rural Banks Diverge in Asset, Profit Trends

Amid the mixed "disinflation" of 1949, Seventh District member banks as a whole reported record first-half earnings on a shifting base of earning assets. A slump in income which hit central reserve city banks in the current recession was more than offset by the increased earnings of the outlying smaller banks in the District. Over this period, the large Chicago banks lost loans and bought U.S. Government securities, while the smaller banks for the most part did exactly the opposite.

The District generally experienced a 4.6 per cent drop in gross deposits. Most banks, however, were able to hold their total earning assets fairly stable, as a one-half billion reduction in reserve balances, cash holdings, and collection items offset the deposit decline. At the same time, within these aggregate figures, District bank holdings of time deposits, consumer loans, real estate loans, and non-Government securities reached their all-time highs.

AGGREGATE TRENDS

Of overriding importance to Seventh District banking were three related factors growing out of the business recession which characterized the first six months of this year: (1) the appreciable downturn in bank lending, traceable largely to a falling off of commercial loans in the larger banks in larger urban centers; (2) a considerable decline in demand deposits, due to the net repayment of business loans, and a moderate rise in time deposits; and (3) a reduction in member bank reserve requirements by the Board of Governors early in May, primarily because of the above two deflationary credit trends. The decline in loans, together with the drop in reserve requirements, freed a substantial volume of bank reserves. Accordingly, District member banks employed these funds in purchasing a net of 258 million of Government securities over the six months' period. Most of these purchases in turn were offset by a decline in reserve balances as the Federal Reserve sold issues to stabilize the market.

Within the District pattern, larger banks in the urban centers appeared most sensitive to the changing influences within the credit structure. Chicago banks experienced, proportionally, the largest business loan decline and the resulting largest demand deposit reduction, received the largest percentage of freed reserves, and added the largest proportion of Governments to their portfolios. Banks outside the urban centers, while experiencing some deposit loss, were able to continue, though at a reduced rate, the liquidation of securities and expansion of loans which had characterized their operations since the war. The dominance in size of the urban banks, however, makes the net changes in Seventh District earning asset figures reflect the decline in need of large businesses for short-term borrowed funds.

LOAN OPERATIONS

Commercial Loans—Cyclically the most volatile type of bank asset, District commercial loans dropped 309 million dollars in the first six months of this year. This represents a 14 per cent decline from December 1948 levels for the District as a whole and includes a 16 per cent decline for Chicago banks. The percentage drop in business loans within the various banking areas was directly correlated with the proportion of the loan portfolio which commercial loans constituted. Chicago, with two-thirds of its loans made to business, suffered the largest drop, and the rural and smaller city banks, with one-fifth of their loans made to business, experienced the

TABLE 1

AGGREGATE TRENDS IN EARNING ASSETS AND DEPOSITS OF SEVENTH DISTRICT MEMBER BANKS FROM JUNE 30, 1948, AND DECEMBER 31, 1948, TO JUNE 30, 1949

(In millions of dollars)

Area	Total Loans			Total Investments			Gross Demand Deposits			Time Deposits		
	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948
All District Member banks......	*4,332*	*−225*	*−23*	*10,649*	*+298*	*+135*	*12,808*	*−621*	*−108*	*5,632*	*+98*	*+134*
Chicago...............	1,796	−243	−171	4,229	+292	+278	5,788	−308	−54	1,748	+54	+111
Other four centers*.....	869	−44	−20	2,472	+77	+22	2,918	−127	−14	1,281	+34	+14
Rest of District........	1,667	+62	+168	3,948	−71	−165	4,102	−186	−40	2,603	+10	+9

*Des Moines, Detroit, Indianapolis, and Milwaukee.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

smallest decline. This pattern of commercial lending was analyzed in detail in the June issue of *Business Conditions*.

Agricultural Loans—The 250 million dollars of Seventh District non-real-estate loans to farmers outstanding on June 30, 1949, were held almost entirely by banks outside the five major financial centers.[1] For these banks, non-real-estate agricultural loans on June 30 represented over 14 per cent of their loan portfolio, after increasing almost 100 per cent in volume over the past year. During the last half of 1948, the 56 million increase in District agricultural loans was evenly divided between loans on crops guaranteed by the Commodity Credit Corporation, and "business" loans to farmers to finance livestock operations and the harvesting, transportation and storage costs in connection with the new crops. During the first half of 1949, however, "business" and other non-real-estate loans to farmers declined 10 million, largely as a result of the usual seasonal repayments of fall credit; while crop loans guaranteed by the CCC jumped 71 million (trebling the amount outstanding), as farmers, particularly just before the CCC June 30 corn loan deadline, placed their carry-over crops under seal.

The relatively large and rapid increase in agricultural loans over the past year has been the primary sustaining factor in the continued rural bank credit expansion. As such, therefore, the loan expansion unique with rural banks during the first half of the year is in large measure the result of the operations of the Government parity program during a time of nationwide transition from agricultural shortage to surplus.

Real Estate Loans— Seventh District member bank loans on real estate underwent a further substantial slowing of their upward advance in the first half of 1949. From a half-yearly rate of expansion of about seven per cent in 1948 real estate loans slackened to a 1.5 per cent rate of increase during the first six months of this year. In Chicago banks, where real estate loans are relatively unimportant, loans on business properties remained fairly stable, while loans on residential properties declined slightly. A small expansion in real estate loans in the other four major centers[2] in the District was accounted for largely by increased loans on commercial properties. The remainder of the member banks in the District, which hold two-thirds of the District's real estate loans, effected a net two per cent expansion in this type of credit. Loans on farm real estate remained fairly stable, but loans on business and residential property increased moderately in these rural areas.

The various causes of the slow-up in real estate lending were discussed in *Business Conditions* for March 1949. As noted there, the current economic uncertainty, the easing housing shortage, and wide expectations for declines in housing costs are the most important factors behind the recent decline both in the supply of and the demand for mortgage credit.

Consumer Loans—Movements in consumer credit paralleled the changes in real estate credit over the first six months of 1949. For Seventh District member banks as a whole, loans for consumption purposes increased two per cent in the first half of 1949, compared with a nine per cent increase in the preceding half year, and an even higher rate in the earlier postwar years.

Reserve city and country banks dominate this general lending field; in almost every type of consumer credit, they account for more than 80 per cent of the District volume. Instalment loans to finance retail automobile sales continued to expand rapidly, rising 29 millions, or 17 per cent, in the first six months of this year. Repair and modernization instalment loans increased six per cent over the period, but nonautomotive retail instalment paper and cash loans underwent moderate declines. On balance, the big Chicago banks experienced a net 20 million contraction in consumer loans; while the remaining member banks increased their consumer credit by a net of 34 million. Thirty million of this increase came in connection with automobile sales financing, which in this half year appears as the critical factor sustaining the volume of bank loans to consumers.

INVESTMENT OPERATIONS

The pattern of asset changes in the Seventh District since the beginning of 1949 is an excellent illustration

[1] Chicago, Des Moines, Detroit, Indianapolis, and Milwaukee.
[2] Des Moines, Detroit, Indianapolis, and Milwaukee.

TABLE 2

TRENDS IN SELECTED TYPES OF SEVENTH DISTRICT MEMBER BANK LOANS FROM JUNE 30, 1948, AND DECEMBER 31, 1948, TO JUNE 30, 1949

(In millions of dollars)

Area	Commercial and Industrial			Agricultural (Non-Real-Estate)			Real Estate			Consumer		
	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948	Total June 30 1949	Change Since Dec. 31 1948	Change Since June 30 1948
All District Member banks	*1,973.0*	*−308.7*	*−261.7*	*249.7*	*+60.8*	*+117.0*	*1,163.2*	*+17.4*	*+77.5*	*726.1*	*+14.1*	*+70.9*
Chicago	1,266.1	−238.1	−189.1	5.7	+1.6	+4.0	138.7	−1.3	+8.4	230.4	−13.5	+12.6
Other four centers*	378.0	−44.1	−42.0	5.2	+3.6	+4.7	285.9	+3.0	+14.2	163.6	+6.4	+13.8
Rest of District	328.8	−26.6	−30.6	238.8	+55.6	+108.4	738.5	+15.7	+54.8	332.1	+21.3	+44.4

*Des Moines, Detroit, Indianapolis, and Milwaukee.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the degree to which Government obligations have come to supplant reserve balances as the residual item in member bank balance sheets. The changes in loans, for each bank individually and for the various collective groups, are closely counterbalanced by inverse changes in Government holdings.[8] As their commercial loans (the backbone of their loan portfolios) fell off sharply, the banks in Chicago and other four major centers quickly transferred freed funds into Governments. Within the country banks, where the upswing in aggregate loan volume was sustained by crop loans to farmers and instalment loans on automobiles, Governments were liquidated regularly to provide the funds for private lending. When the reserve requirement reduction of early May added 183 million to member bank excess reserves, most banks used these funds almost immediately in the purchase of Governments. In this altered environment, the changes in Government holdings are explained easily—Governments have been traded merely to bridge the gap between the moves in private borrowings and in reserve requirements.

Seventh District member bank holdings in non-Government securities increased three per cent during the first six months of 1949, accompanying the increase in holdings of Governments. Acquisitions by banks in Detroit and Chicago, and by Wisconsin banks outside Milwaukee, more than offset the moderate reductions in holdings by the remainder of the banks throughout the District. The desire to balance somewhat larger holdings of Governments and to subscribe to local issues on the one hand, and supervisory authority recommendations and uncertainty as to future economic prospects on the other, appear to be the most common factors influencing recent changes in these holdings.

BANK PROFITABILITY

Seventh District member banks turned in a collective midyear income statement which is probably the best in their history. In each aggregate operating figure—gross earnings, total expenses, and net current earnings—District banks collectively hit an all-time half-year peak. A reduction in losses and charge-offs to 50 per cent below last year's average enabled banks to show a nonoperating profit also, with the result that net profits after taxes increased 34.6 per cent over the last half of 1948.

The District's total, however, concealed important divergent movements in the earnings picture between large city banks and the remainder of the District. A sharp falling off in loan income and a four per cent rise in expenses reduced net current earnings for District central reserve city banks 1.9 million below the level of the previous half year. Most of the remaining member banks in the District, meanwhile, were receiving increased income both from loans and from Governments, and experiencing a slight drop in expenses. As a result, net current earnings for these banks rose by nearly three million dollars over the preceding half year. Changes in nonoperating income accounts served to more than redress this imbalance, as Chicago banks cut their tax-allowed bad debt allocations twice as sharply as did the rest of the District, while enjoying an unusual increase in recoveries. The bookkeeping nature of most of these changes in the nonoperating accounts, however, suggests the use of a more realistic comparison of profit positions, on the basis of net current earnings. The changes noted above for this category amount to an 8.1 per cent decrease for central reserve city banks from last-half 1948 levels, in contrast with a 6.4 per cent increase for the remainder of the banks in the District.

These divergent net earnings trends are primarily the passive result of the basic difference between rural and metropolitan banking in the current period of transition. Large urban banks, highly sensitive to the first changes in economic conditions and the credit structure, have slid off their postwar peaks of prosperity in parallel with the current course of business. The more insulated rural banks, serving less variable segments of the economy, have thus far experienced only a slowing of their postwar rise in prosperity; and their weight in the District earnings picture has served to carry the aggregate income figures to new highs.

[8] Excess reserves freed by action of the Board of Governors account for most of the excess of Government securities acquisitions over loan contractions.

TABLE 3
COMPARATIVE INCOME STATEMENT FOR SEVENTH DISTRICT BANKS FIRST HALF, 1949, IN RELATION TO FIRST AND SECOND HALVES, 1948
(In millions of dollars)

Item	All District Member Banks			Central Reserve City Banks			District Excluding Central Reserve City Banks		
	First Half 1949	Change from Second Half 1948	Change from First Half 1948	First Half 1949	Change from Second Half 1948	Change from First Half 1948	First Half 1949	Change from Second Half 1948	Change from First Half 1948
Interest on U. S. Government securities	74.0	+1.6	−.2	21.7	+.3	−.7	52.3	+1.2	+.6
Interest on loans	83.7	0.0	+8.4	22.6	−1.3	+1.3	61.1	+1.3	+7.1
Total earnings	204.3	+1.9	+10.3	60.4	−.5	+.9	143.9	+2.3	+9.4
Total expenses	134.4	+.8	+7.8	38.9	+1.4	+1.3	95.5	−.6	+6.5
Net current earnings	69.9	+1.0	+2.5	21.5	−1.9	−.4	48.4	+2.9	+2.9
Losses and charge-offs (−)	16.0	−13.9	−23.2	4.1	−8.8	−13.2	12.0	−5.1	−10.0
Recoveries and profits (+)	17.9	+2.8	−6.5	13.9	+4.4	−2.2	3.9	−1.6	−4.3
Net profits after taxes	55.6	+14.3	+18.1	26.1	+10.9	+11.2	29.5	+3.4	+6.9

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

DEVALUATION OF THE BRITISH POUND—I

(Continued from Inside Front Cover)

even implicit in Sir Stafford Cripps' message to the House of Commons, that a basic difficulty is Britain's inability to adjust to the changing economic atmosphere of the world. Recent months have witnessed a marked shift to a buyers' market, and Britain is ill-equipped to sell in a competitive market because of the rigidities which characterize both her domestic production and her present trading methods. It is widely recognized that if England is to maintain markets under current conditions, her export prices must come down, and the hampering effects of bilateral and discriminatory trade practices must be reduced.

Fundamental to the solution of the dollar problem is a revision in Britain's internal economic policy. Her postwar program has been planned in such a way as to result inevitably in inflation, high expenditures for social welfare, and a misdirection of productive resources from the standpoint of balancing dollar earnings against requirements. A reduction in production costs, i.e., increased efficiency, is essential to enable Britain to meet the competition of goods more cheaply produced abroad. Many factors have contributed to England's high-cost economy—among them technological backwardness, the high taxes required for the maintenance of expanded social services, high wages, cheap money, and the suppressed inflation which is both a result of the high-cost economy and a deterrent to increased efficiency and production incentives. The kind of program needed is one which will provide incentives to both business and labor to work harder and cut costs of production. It must also encourage a redistribution of production into lines which will increase goods exportable for dollars or provide substitutes for imports payable in dollars. Finally, through adequate fiscal or other controls, it should prevent unessential expenditures for goods which could be exported or which are imported for dollars.

Another impediment to prospects for improvement in the British dollar position is the network of trade and exchange controls which, though adopted for the purpose of holding down the deficit, make it increasingly difficult for exporters to obtain supplies and have unfavorable repercussions on other nations' willingness to hold sterling. Bilateral pacts lose some of their attractiveness under circumstances where purchasers can buy more cheaply in a competitive market. So does payment for sales in a currency which can be spent only in the high-cost sterling area. The "temporary" suspension of sterling convertibility has helped to prevent heavy drains on Britain's reserves from this source, but there is evidence to indicate that some capital flight has taken place despite restrictions. In addition, dollar payments have been made to third countries in fulfillment of clearing agreements which require compensation in gold or dollars above stated maxima of sterling holdings.

PROPOSED REMEDIES

Granted that the basic problem is largely a matter of improved production and more realistic fiscal policies, a significant degree of progress toward these aims will take time. Meanwhile stopgap measures have been taken or are being considered to check the drain on Britain's reserves. Early in July it was announced that a "standstill" on all but essential purchases from the dollar area would be enforced for the time being. For the fiscal year 1949-50 cutbacks in purchases are expected to amount to about 700 million dollars. A request for 1.5 billion dollars of Marshall Plan aid—600 million over the amount originally applied for—was answered by a tentative allotment of 850 million, as set by the Organization for European Economic Cooperation. There were also emphatic denials that another dollar loan by the United States will be granted to tide Britain over the current emergency, or that the United States price of gold will be raised, or that United States gold will be sent to Britain to support the convertibility of sterling.

One of the most discussed measures for narrowing the dollar deficit is devaluation of the pound, now an established fact. Adjustments in exchange rates are permissible under the Articles of Agreement of the International Monetary Fund "to correct a fundamental disequilibrium" in the balance of payments. The theory behind this provision is that if a nation suffers a sustained deficit on international account its currency is overvalued, and that a downward adjustment in the rate of exchange will correct the deficit by compensating for price-cost differences between the countries involved. The chief advantage of pound devaluation is to make British goods cheaper in terms of dollars and in this respect improve their competitive position in the export market. Whether such a step will better England's overall dollar position, however, depends on its effects on the volume of her exports and imports, on internal prices, and on the extent to which other countries follow her leadership in depreciating their currencies.

In addition to the decision to reduce the exchange value of the pound, other constructive steps were taken toward relieving the pressure on Britain's dollar position at the September meetings in Washington. These conferences resulted in the formulation of a ten-point program of action, involving chiefly adjustments in United States trade policies and practices and in E.C.A. requirements. A more detailed account of the September meetings and the effects of the devaluation will appear in a forthcoming issue of *Business Conditions*.

These measures are expected to relieve the acute strain on Britain's reserves, but they are not alone sufficient to assure long-run stability. Even proponents of exchange rate adjustment do not offer it as an all-inclusive or permanent solution. Improvement in internal policies with respect to production and fiscal operations is still necessary. It is a truism that international accounts will be balanced. The only question is by what means. In the absence of expanded and sustained financial assistance from abroad, the long-run alternative to Britain's progress in production and the restoration of national wealth is a reduction in her already low standard of living.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

SEVENTH FEDERAL

RESERVE DISTRICT

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis