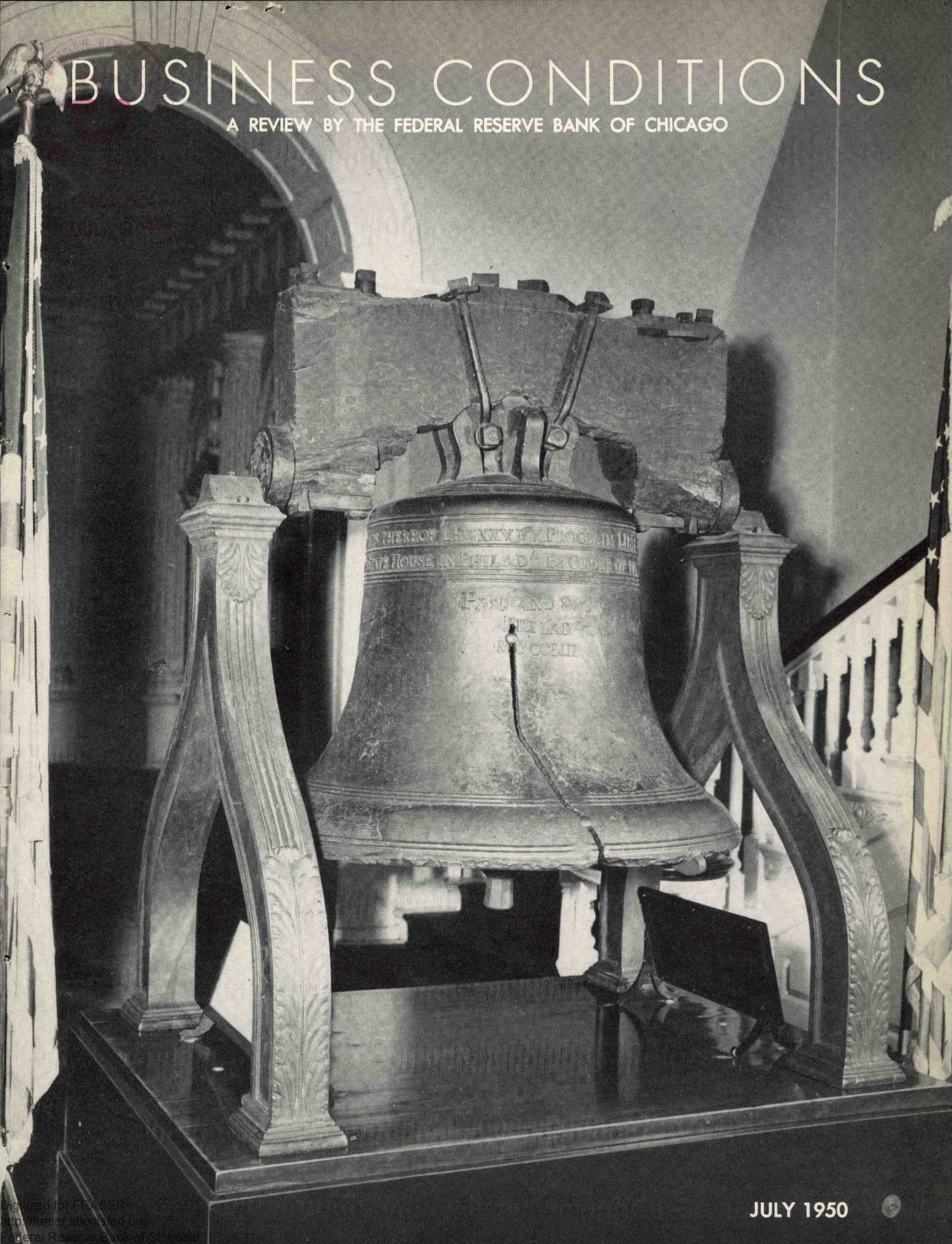
BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO



JULY 1950

Consumer Credit Reaches New Peak

Instalment Credit Paces Rise to New Record Highs

Consumer credit is playing an important part in the current business boom. Instalment credit has continued to increase rapidly, countering the seasonal decline in charge account balances, with the result that total outstandings were only slightly below the 1949 year-end level at the end of April and doubtless passed this previous peak during May. Moreover, the very high level of automobile sales, a reasserted demand for furniture and appliances, and the effects of generally eased credit terms promise a substantial further rise in consumer credit during the months immediately ahead.

Continuing the steep upward trend of previous postwar years, total consumer credit increased by nearly 2.5 billion dollars during 1949, despite a more than seasonal decline in the early months of the year. Furthermore, nearly all of the growth was concentrated in instalment credit and as such represented a substantial net addition to consumer resources for purchase of durable goods, including automobiles, home appliances, television sets, and furniture. For the postwar period as a whole, consumer credit has increased by more than 12 billion dollars, 70 per cent of which has been in instalment credit.

The rapid increase in consumer credit from 6.6 billion dollars at the end of 1945 to 18.8 billion dollars at the end of 1949 has caused concern in some quarters regarding its soundness and stability. Proponents of the argument that credit is becoming too high point to the fact that outstandings are 85 per cent above the prewar peak established in September 1941 and 144 per cent above the level attained in 1929. They believe that maintenance of payments on this amount of indebtedness will become a heavy burden if personal incomes fall off. Furthermore, they fear that eased credit terms are tending to attract marginal risks, which are likely to result in increased delinquencies and losses.

Other observers express belief that the level of consumer credit is not unduly high in relation to other measures of economic activity and consumer well-being. In their opinion, increased employment and greatly expanded personal incomes make possible a much greater volume of credit than could have been supported at any time in the past. Also, the large stock of liquid assets held by individuals constitutes an additional safeguard in assuring the soundness of a large amount of indebtedness. Regardless of the relative merits of these divergent views, it is clear that avoidance of any sharp decline in credit is important to business activity.

CONSUMER CREDIT AND BUSINESS ACTIVITY

The significance of consumer credit to the business community lies primarily in the direction and rate at which it changes, rather than in the amount outstanding at any particular time. Extension of new credit adds to the purchasing power of consumers, while repayment of indebtedness reduces the amount of current income available for spending. Since a change in the level of credit outstandings reflects the interaction of continuous flows of new credit extensions and repayments, an increase in indebtedness results in a net addition to purchasing power, while a decline in outstandings indicates a corresponding reduction in "free" income over what it otherwise would have been.

Therefore, a change in the total of credit outstandings has a dynamic effect on spending. If an increase in consumer purchasing power afforded by an expansion in credit is to be maintained, it is necessary that indebtedness continue to increase at about a constant rate. A leveling off in the total of consumer credit outstandings will result in a decline in purchasing power from this source, and a reduction in indebtedness will result, of course, in a greater decline.

A large part of the consumer credit extended is of the instalment type, i.e., is repaid in regular instalments over a period of time. Most of the instalment credit extended is for purchase of consumers durable goods, such as automobiles, radio and television sets, home appliances, and furniture. It is this type of consumer credit which in the past has fluctuated most violently with the business cycle, primarily because of the postponable nature of most consumer durable goods purchases. Historically, instalment credit has increased rapidly during periods of high and rising economic activity. The additional purchasing power obtained through expanding credit has stimulated

(Continued on Page Eight)

TOTAL CONSUMER CREDIT OUTSTANDING BY MAJOR PARTS SELECTED DATES, 1941-50

(Dollar amounts in millions)

Type of Credit	Sept.[1] 1941	Dec. 1945	Dec. 1946	Dec. 1948	Dec. 1949	April 1950
Total instalment credit	6,215	2,364	4,000	8,600	10,890	11,321
Total sale credit	4,007	942	1,648	4,528	6,240	6,513
Automobile	2,216	227	544	1,961	3,144	3,478
Other	1,791	715	1,104	2,567	3,096	3,035
Cash loans	2,208	1,422	2,352	4,072	4,650	4,808
Total non-instalment credit	3,859	4,273	6,191	7,719	7,889	7,308
Charge accounts	1,712	1,981	3,054	3,854	3,909	3,241
Single payment loans	1,549	1,520	2,263	2,902	2,988	3,061
Service credit	598	772	874	963	992	1,006
Total consumer credit	10,074	6,637	10,191	16,319	18,779	18,629
	Per Cent of Total					
Instalment sale credit	39.8	14.2	16.2	27.7	33.2	35.0
Instalment cash loans	21.9	21.4	23.1	25.0	24.8	25.8
Total non-instalment credit	38.3	64.4	60.7	47.3	42.0	39.2

[1]Prewar peak.
SOURCE: Board of Governors of the Federal Reserve System.

A Review of the Savings Bond Program

Heavy Maturities Begin in 1952

A one-quarter trillion dollar Federal debt is one of the legacies of World War II. More than one-fourth of this public debt is in the form of nonmarketable securities held by millions of individuals and institutions. The major portion of this nonmarketable debt is comprised of United States Savings Bonds, approximately 57 billion dollars of which are now outstanding.

A concerted effort has been made to sell a maximum of savings bonds and to keep voluntary redemptions to a minimum during the war and postwar years. As a result of the success of this effort, the Treasury is now confronted with the new but inevitable problem of refinancing the large-scale maturities of savings bonds, which will begin in 1952 and will continue in heavy volume for several years thereafter. The decisions which will have to be made in meeting the maturity problem hinge to a great extent upon the nature of this type of security and its role both as an instrument of Government finance and as a savings medium.

After the end of war financing, Series E, F, and G Savings Bonds were retained as public debt instruments with slight modifications in terms. Special sales campaigns, such as the Opportunity Drive from May 16-June 30, 1949, and the Independence Drive, have been conducted from time to time. The Secretary of the Treasury has described the objectives of savings bond sales promotion in the postwar years as "maintenance of the widespread distribution of the debt, to encourage thrift," and as an "aid in combating the strong inflationary pressures which existed in the economy during a large part of the postwar period."

SAVINGS BONDS AS A SOURCE OF TREASURY CASH

Savings bonds, all series combined, have constituted a substantial net source of cash to the Treasury from their inception in 1935 through the first five months of 1950, as is indicated in Table 1. In terms of cash borrowing, the Treasury in the 15 years of the savings bond program has borrowed a total of approximately 88 billion dollars. Of this amount, it has had to repay to date—excluding accrued discount, which is here regarded as a regular budget cost[1]—about 34 billion dollars. Of the total repayments, an estimated 2.5 billion dollars have been for maturing issues.

During the first stage of the savings bond program, from 1935 through 1940, sales and redemptions were both relatively modest in amount. With the introduction of the new Series E, F, and G Savings Bonds in 1941, a sharp increase in sales appeared. Upon the entry of this country into the war and the inauguration of the war loan drives and the pay roll savings plan, annual bond sales almost immediately tripled. Even though redemptions also expanded substantially, net Treasury cash receipts in the war years rose to over 12 billion dollars in 1943 and to a peak of 12.7 billion in 1944.

There was widespread expectation that savings bond sales would contract and that redemptions would soar after the war. This in fact did happen, although not nearly to the extent anticipated. In 1945 bond sales dropped from the 16 billion dollar peak of the preceding year to a level of about 13 billion while redemptions increased to some 5.5 billion dollars, netting the Treasury cash receipts of not quite 7.5 billion. In 1946, the first full peacetime year, sales of savings bonds dropped 43 per cent below the amount sold in 1945. At the same time annual redemptions reached a peak of more than six billion dollars, with the result that net cash receipts declined to about a billion dollars. Since 1946 there has been a decline in the amount of annual redemptions in spite of the fact that the figures for these years are weighted by small but steadily progressively growing amounts of maturities as distinct from voluntary prematurity redemptions.

In the years since 1946 annual net cash receipts from savings bonds have ranged from one to 2.5 billion dollars, with the latter figure reflecting the special one billion dollar offering of F and G Bonds during 1948 without regard to annual limitation, and the added provision permitting commercial banks to acquire up to $100,000 of the bonds. Sales and redemption experience during 1949 yielded the smallest net cash receipts since the prewar era. Furthermore, net receipts from all bonds have been

TABLE 1

SALES AND REDEMPTIONS OF U.S. SAVINGS BONDS ALL SERIES, EXCLUDING ACCRUED DISCOUNT[1]

(In millions of dollars)

Calendar Year	Sales	Redemptions	Treasury Cash Receipts Net
1935-1940	3,449	369	3,080
1941	3,036	162	2,874
1942	9,157	343	8,814
1943	13,729	1,576	12,153
1944	16,044	3,321	12,723
1945	12,937	5,472	7,465
1946	7,427	6,243	1,184
1947	6,694	4,889	1,805
1948	7,295	4,840	2,455
1949	5,833	4,708	1,125
Jan.-May 1950	2,650	2,165	485
Total	88,251	34,088	54,163

[1]The figures shown in this table and in table 2 differ from the savings bond figures carried in the public debt statement in that all accrued interest on Series A to F Bonds (Series G Bonds carry no accrual) still outstanding, as well as interest actually paid on bonds redeemed, has been excluded. This has been done in order to obtain net *cash* receipts resulting from the savings bond program. Accrued discount actually paid is treated here as a Budget expenditure, that is, a cost of the savings bond program rather than a public debt expenditure, similar to the way interest on other debt items is handled.
SOURCE: *Treasury Bulletin.*

[1] See footnote to Table 1.

about 300 million dollars below 1949 during the first five months of this year, reflecting both smaller sales and increasing redemptions and maturities. Although the rate of growth in the amount of savings bonds outstanding has slackened markedly since 1944, these issues, together with other nonmarketable debt, produced the only net debt receipts in most of the postwar years. Savings bonds provided an important part of the funds used for the retirement of bank-held public debt.

COST OF SAVINGS BOND PROGRAM

Carrying an annual yield, if held to maturity, of 2.9 per cent for Series E Bonds, 2.53 per cent for F Bonds, and 2.50 per cent for G Bonds, savings bonds represent the most expensive current form of publicly-held Federal debt. Since the E and F Series are "appreciation-type" bonds, interest accrual represents a non-cash expenditure to the Treasury until the bonds are actually redeemed or matured. Because all three series of savings bonds carry reduced yields if redeemed prior to maturity, however, the actual annual cost of these issues so far has been considerably less than the above rates indicate.

According to figures released by the Treasury, of all the Series E Bonds issued since the beginning of 1942, an average of approximately 19 per cent have been redeemed by the end of the first year after purchase and have thus earned no interest at all. Another 10 per cent have been redeemed by the end of the second year and have thus entailed a cost of approximately nine-tenths of one per cent. By the end of the fifth year another 16 per cent have been redeemed, costing an average of 1.5 per cent per annum.

The average annual interest cost of postwar savings issues considered alone is even lower because of the accelerated redemption of Series E Bonds after the end of the war. Of the series sold in 1945, 28 per cent were redeemed by the end of the first year and thus carried no interest charge. Since that time there has been some decline in the redemption rate, and of the series sold in 1948, approximately 20 per cent were redeemed in 1949. Hence, for the substantial dollar volume of Series E Bonds which have been redeemed in the early years after sale, the actual interest rate paid has been considerably less than that for comparable marketable issues.

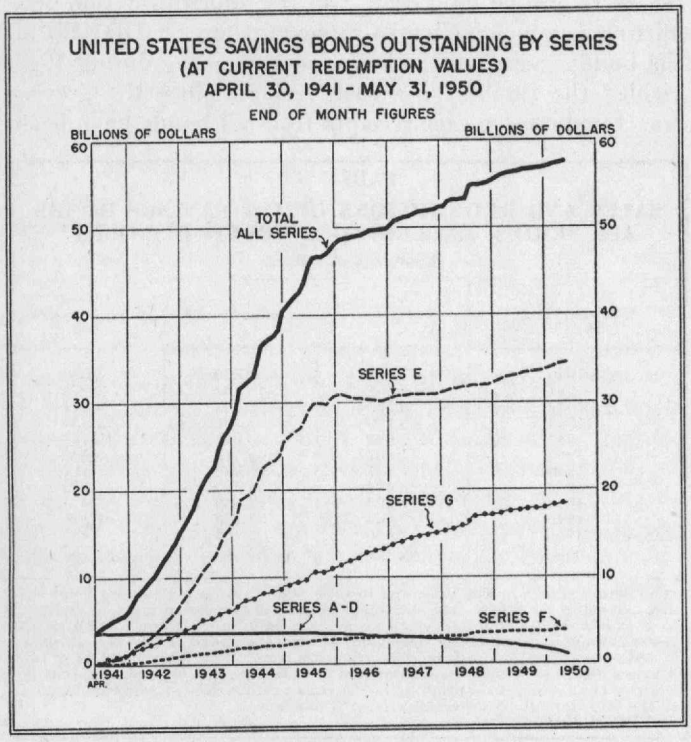
Series F and G Bond redemptions have not only been much smaller but have proceeded at a much slower pace through the age of the bond. For the "typical" F or G issue, only two per cent of the total is redeemed by the end of the first year and another 13 per cent by the end of the fifth. Therefore, the effective interest rate on these series tends to be much closer to their nominal rate than in the case of Series E Bonds. The total interest cost of the savings bond program (other than Series G Bonds) is indicated by the following data, which show in millions of dollars the interest accrued annually to date on savings bonds, compared with the amount actually paid on redeemed or matured issues:

Calendar Year	Total Accrued Discount	Accrued Discount Paid on Redeemed Issues
1935-1942	303	22
1943	169	9
1944	295	20
1945	484	86
1946	640	185
1947	742	237
1948	872	303
1949	981	394
Jan.-May 1950	428	238
Total	4,914	1,494

TABLE 2
COMPARISON OF SALES AND REDEMPTIONS OF SAVINGS BONDS, BY SERIES[1], CALENDAR YEARS 1945 - MARCH 31, 1950
(In millions of dollars)

Item	1945	1946	1947	1948	1949	1st Quarter 1950
Sales:						
Series A-D..	*	*	*	*	*	*
Series E....	9,822	4,466	4,085	4,224	4,208	1,127
Series F....	595	325	342	498	233	96
Series G....	2,520	2,637	2,267	2,573	1,392	590
Total.....	12,937	7,427	6,694	7 295	5,833	1,812
Redemptions:						
Series A-D..	179	302	367	436	631	359p
Series E....	4,925	5,330	3,813	3,575	3,274	810p
Series F....	104	185	196	211	189	47p
Series G....	264	426	512	618	613	158
Total.....	5,472	6,243	4,889	4,840	4,708	1,373
Net Sales:						
Series A-D..	−179	−302	−367	−436	−631	−359
Series E....	4,897	−864	272	649	934	317
Series F....	491	140	146	287	44	49
Series G....	2,256	2,211	1,755	1,955	779	432
Total.....	7,465	1,184	1,805	2,455	1,125	439

[1]See footnote 1 to Table 1.
pPreliminary.
*Less than $500,000.
SOURCE: *Treasury Bulletin.*



Thus, on all savings bonds other than Series G sold through May 1950, interest in the amount of 4.9 billion dollars has accrued, and of this amount approximately 1.5 billion has been paid off on redeemed issues. This leaves approximately 3.4 billion of unpaid interest accrued on issues now outstanding. As these issues approach maturity, the rate and amount of accrual will continue to grow until the large amounts of bonds sold in the peak war years mature and are repaid.

Interest on Series G Bonds is paid semiannually and has constituted a major part of the cash interest payments on total savings bonds to date. Payments on this account amounted to approximately 400 million dollars in fiscal year 1949.

Finally, added to the cost of interest must be the considerable expense involved in processing sales and redemptions of savings bonds, which are in registered form and number over one billion pieces. In terms of volume of work the savings bond program represents the largest administrative problem of the Bureau of the Public Debt. Expenses must also include payments to the thousands of paying agents.

SAVINGS BONDS AS A SAVINGS OUTLET

Looked at from the point of view of the lenders—the American public—as distinguished from the borrower—the U.S. Treasury—, the savings bond program has had a profound effect upon flow of individual savings. As a result of the E Bond program, a great many people in the lower and medium income brackets have become owners of securities for the first time. In consequence, the Government finds itself in debt to a group of creditors whose future reactions are singularly difficult to foresee.

The appeal to the smaller investor to lend his money to the Government has been confined during and since the war period largely to Series E Savings Bonds. This was done in a positive way by concentrating the mass sales appeal on these bonds and in a negative way by confining the denominations of marketable securities to a minimum of $500. Probably the most significant "discovery" made by the Treasury in the war finance years was the pay roll deduction plan, through which almost one-half of total E Bond sales in 1944—the peak year in E Bonds—was made. It has been estimated that there were from 25 to 28 million people participating in the pay roll savings plan in 1944, with automatic monthly salary deductions amounting to almost 500 million dollars. A measure of the wartime success of the bond program in absorbing excess consumer purchasing power is indicated by the fact that in the five years, fiscal 1941 to 1945, about 4.5 per cent of disposable personal income was absorbed by net sales of E Bonds.

Since the end of the war savings bond sales as well as total personal savings have continued at comparatively high levels in spite of considerable declines from their wartime peaks. It was expected that liquid savings would drop from the wartime high as an increasing supply of goods became available, and in 1946 a sharp contraction in bond sales and total new savings took place as consumers increased spending to satisfy their deferred demands. The character of total individual savings also shifted, a smaller proportion going into the liquid or near-money category and more into home construction and other durable goods. Savings made a slight recovery in 1947 and have continued at about the same level since that year. Savings bond sales, on the other hand, continued downward until 1948 when a slight rise occurred largely as a result of the special "Opportunity" Drive.

TABLE 3
PERCENTAGE DISTRIBUTION OF SALES OF SAVINGS BONDS BY DENOMINATION*
FISCAL YEARS 1945-1949

Fiscal Year	Denomination at Maturity Value			
	$10 and $25	$50 and $100	$200 to $10,000	Total
1945	26.9	28.5	44.6	100.0
1946	22.5	21.6	55.9	100.0
1947	12.2	14.4	73.4	100.0
1948	10.9	15.9	73.2	100.0
1949	10.4	15.4	74.2	100.0

*Figures based on dollar amounts at issue price.
SOURCE: *1949 Annual Report of the Secretary of Treasury.*

POSTWAR SHIFTS IN HOLDINGS

Recent years have brought a significant change in the concentration of ownership of savings bonds. During the war years a large proportion of savings bond purchases was made by wage earners in industrial areas, who enjoyed sizable increases in income at a time when the supply of consumer goods was limited. There is evidence that the postwar experience with the savings bond program, particularly E Bonds, largely reflected a reduction in holdings by the smaller investor. Apparently, the E Bond is being purchased to an increasing extent by middle and upper income groups. Recent developments in the pay roll savings plan support this conclusion. Estimated participation in 1948 was approximately 7.5 million persons as contrasted with a wartime peak of over 25 million. Monthly pay roll deductions declined from about 500 million dollars in 1944 to an estimated 150 million dollars in 1948.

Another source of evidence can be found in an analysis of denomination of bonds sold and redeemed, since a fairly reliable correlation exists between smaller denomination bonds and lower income investors. In fiscal 1945, as Table 3 shows, bonds of the $10[2] and $25 denominations, which presumably are most frequently purchased by individuals in the lower income brackets, accounted for almost 27 per cent of total savings bonds sold. This proportion declined steadily until 1949 when these smallest denomination bonds represented about 10 per cent of total sales. Conversely, annual sales of the largest savings bond denominations of all three series grew from less than half of the total in 1945 to almost three-fourths

[2] The $10 denomination was offered only to members of the armed forces and has recently been discontinued.

in fiscal year 1949.

On the redemption side Series E Bond redemptions in the first year following sale, which have always been heavy, increased considerably during the late war and early postwar years. This development reflected, among other things, the temporary nature of the desires of individuals to buy bonds and the increased alternative uses for cash which appeared after the war.

Since 1946, redemptions of small denomination bonds have exceeded sales each year. Series E Bond redemptions in the first year after sales, in the case of the $25 denomination, have risen from 33 per cent for the series sold in 1944 to 47 per cent in 1948, although the total volume of redemptions has declined in line with the drop in total sales. In the case of $100 E Bonds, first-year redemptions rose to 20 per cent in 1945 and have since remained at that level. For the largest denomination of E Bonds—$1,000—first-year redemptions have been at 10 or 11 per cent since 1945, while for the larger denomination F and G Bonds—$500 to $10,000—redemptions at the end of one year have been around 3 per cent since the end of the war, although rising gradually. Of all the E Bonds sold, approximately 43 per cent have been redeemed, compared with 15 per cent for F and G Bonds.

It appears that many purchasers of small denomination savings bonds have had to redeem bonds to meet emergencies or are still drawing upon their wartime accumulation of liquid assets in this form to supplement current income. The decline in outstandings of small denomination bonds has also probably reflected the leveling off of income and increased unemployment, the preference for other types of savings, and, of course, the increasing availability of consumer and durable goods.

COMPARISON WITH OTHER SAVINGS MEDIA

The *1949 Annual Report of the Secretary of the Treasury* pointed out that, despite the expansion in the popularity of savings bonds as a savings medium, "the sale of savings bonds has not been at the expense of other types of savings." The Secretary stated that "individuals increased their holdings of Series E bonds by 9% from the end of 1945 through October 1949, but in this same period, individuals increased their shareholdings in savings and loan associations by over 60 per cent; their life insurance by 30 per cent; their deposits in mutual savings banks by 25 per cent; their savings accounts in commercial banks by 15 per cent; their checking accounts by about 10 per cent" and that, of the various forms of liquid savings, "only currency holdings in the hands of individuals declined."

Surveys of consumer finances, conducted periodically by the Federal Reserve System, have shown that, while United States Savings Bonds have been the most popular form of liquid assets in the past three years, the margin of preference for this form of savings has declined during the period. According to the *1949 Survey of Consumer Finances,* 44 per cent of all "consumer spending units"[3] held some savings bonds at the beginning of 1949, as contrasted with 56 per cent two years earlier. The proportion of units holding bonds ranged from 20 per cent of those earning less than $1,000 per year to 78 per cent with income of $7,500 and over, with the largest decline shown by units in the $2,000-$3,000 income class.

MEETING THE MATURITIES PROBLEM

The problem of managing the savings bond program in the years ahead promises to be much more complex than any which has confronted the Treasury thus far in the postwar period, largely because of the forthcoming maturities of the heavily sold wartime issues. As of May 31, 1950, there were 57.5 billion dollars of savings bonds outstanding at current redemption value—35.4 billion dollars in Series D and E Bonds, 3.7 billion in Series F, and 18.4 billion in G Bonds. Although still relatively small in amount, maturities will spurt to an estimated four billion dollars in 1952 and will reach a peak of nine billion in 1954, continuing for several years thereafter in declining but substantial amounts.

In addition, fears have been expressed that the problem of these forthcoming maturities could be complicated, in the event of the resumption of inflationary pressures, by large-scale pre-maturity redemptions. In three years of postwar inflation, however, the public made a net addition to its savings bond holdings. This would suggest that in the absence of extreme inflation these fears are likely to prove groundless. On the other hand, the large-scale pre-maturity liquidation of bonds, which could be expected to occur in the wake of a depression despite complications in Treasury financing, would serve as a useful cushion for the economy.

Whether funds paid out at maturity will be reinvested will have an important impact on the cash position of the Treasury. Because of continued Government expenditures in excess of receipts, there is little doubt but that the Treasury will want to continue the savings bond program. The degree to which the lenders to the Government on this type of security—the nonbank public—will continue to provide the Treasury with funds through the savings bond program will depend to a large extent upon such economic factors as employment and income levels, the desire for and availability of consumer durable goods, and the relative attractiveness of other investment and savings outlets. Considering recent sales and redemption trends, it appears that a relatively large proportion of the maturing bonds may be redeemed for cash.

Several possible moves which the Treasury might take to assure or encourage reinvestment of funds from maturing issues have been suggested in recent months. To date, only one step in this direction has been taken. Individual holders of Series A, Series C—1938, Series D—1939, and Series D—1940 bonds have been permitted to reinvest the proceeds of the maturing bonds in Series E Savings Bonds currently on sale, without regard to the $10,000 annual limitation (maturity value) on purchases of E Bonds.

[3] A consumer spending unit is defined as all persons living in the same dwelling and related by blood, marriage, or adoption who pool more than half of their incomes for their major items of expense.

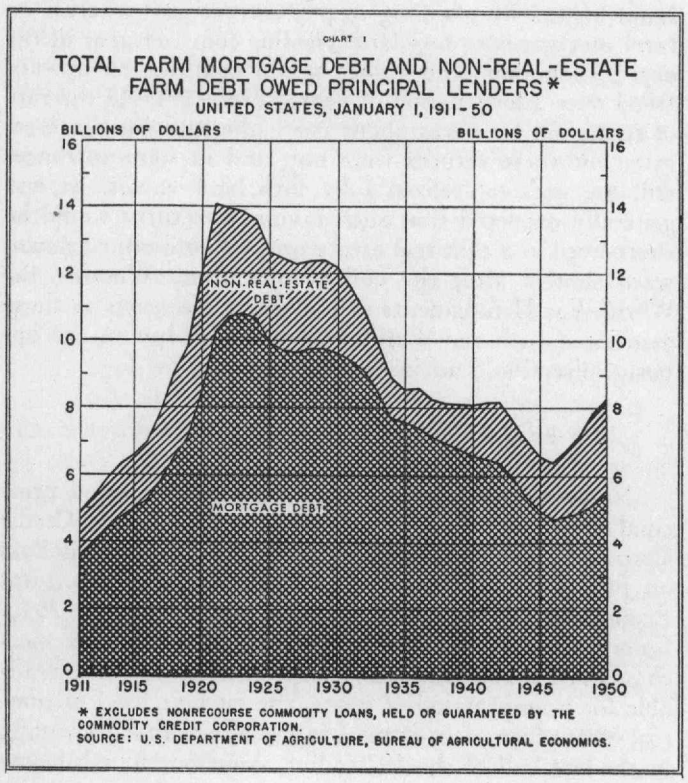
Farm Debt Rise Continues

Total Still Low Relative to Assets

Farm debts continue the rise which started in 1946, reaching a total on January 1, 1950, of about 10.8 billion dollars, 3.2 billion or 42 per cent more than at the low point reached in 1946[1]. Increases have occurred in both farm mortgage and non-real-estate debt but with the latter showing by far the largest rise in both absolute and relative terms. Even with this large increase over the past four years, however, the current level of farm indebtedness is only about 12 per cent above that in 1940 and is far below the post-World War I peak reached in 1921. Meanwhile the value of farm assets is more than double prewar and net farm income is about two and one-half times the prewar level.

Farm debts, therefore, generally are at moderate levels. This is emphasized particularly when compared with developments during and following World War I. In this period debts nearly tripled with farm mortgage debt and non-real-estate debts owed to principal lending agencies reaching a peak in excess of 14 billion dollars in 1921 (see Chart 1). Estimates of non-real-estate debts owed other lenders such as merchants and individuals are not available for this period, but it appears that they also increased sharply as there was a strong demand for such credit and it was generally available.

[1] Including farm mortgage debt and non-real-estate debts owed principal institutions, merchants, and others.



MORTGAGE DEBT REACHES 5.4 BILLION DOLLARS

Farm mortgage debt, as estimated by the Bureau of Agricultural Economics, reached 5.4 billion dollars on January 1, 1950, following an advance of about one-sixth from the low point in 1946. This increase occurred though the number of farm transfers has declined.

Voluntary sales of farms for the year ending in March 1950 were 36 per cent below the peak volume reached in 1946 and 1947, and current reports indicate that the number of transfers continues to decline. This trend is not expected to be reversed soon, unless land values should increase significantly.

Mortgage recordings declined moderately in 1949 to a total of 1.4 billion dollars. This was about two per cent less than the large 1947 volume, which exceeded the 1929 level as well as that of any subsequent year except 1934 when refinancing was at an exceptionally high level. In the fourth quarter of 1949, however, mortgage recordings exceeded the year-earlier level. Thus, the debt rise, which to date has reflected primarily a slow-down in repayments, may now be augmented by a step-up in volume of new mortgages written. Repayment rates declined first in response to heavy expenditures for machinery and improvements and to higher living costs, followed in 1949 and 1950 by the effects of lower net farm income.

The lesser decline in mortgage recordings than in number of farm transfers indicates that farm mortgage credit is being used for purposes other than the purchase of farm real estate. Major capital investments such as buildings, extensive soil improvements, and the like may be financed in this way. Also, in those instances where short-term debts have become burdensome they may be refinanced over a longer period, using a mortgage on the farm real estate as security for the loan. Appearance generally of this type of short-term debt funding would indicate financial stringency in agriculture. Although major lenders report a noticeable increase during recent months in requests for farm mortgage credit of this type, the total number still is small.

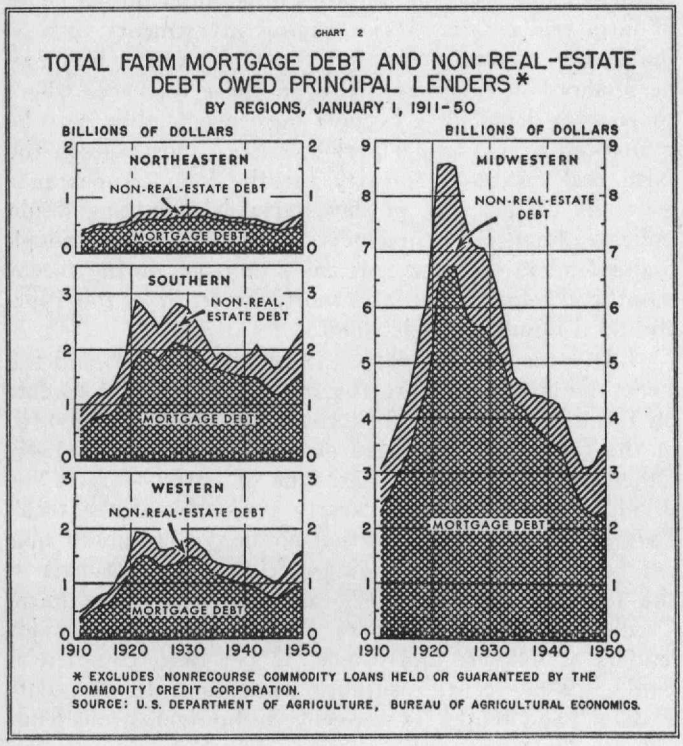
Life insurance companies, commercial banks, and the Federal Land Banks are the major institutional lenders on farm real estate, each accounting for about one-fifth of the total farm mortgage debt as of January 1, 1949. Other major sources of this type of credit—largely individuals—accounted for nearly two-fifths of the total. Farmers Home Administration holdings were about four per cent of total outstandings. Mortgage recordings in the fourth quarter of 1949, as reported by the Farm Credit Administration, were divided among the major lenders as follows: individuals, 32 per cent; commercial banks, 29 per cent; insurance companies, 18 per cent; Federal Land Banks, 14 per cent; and miscellaneous lend-

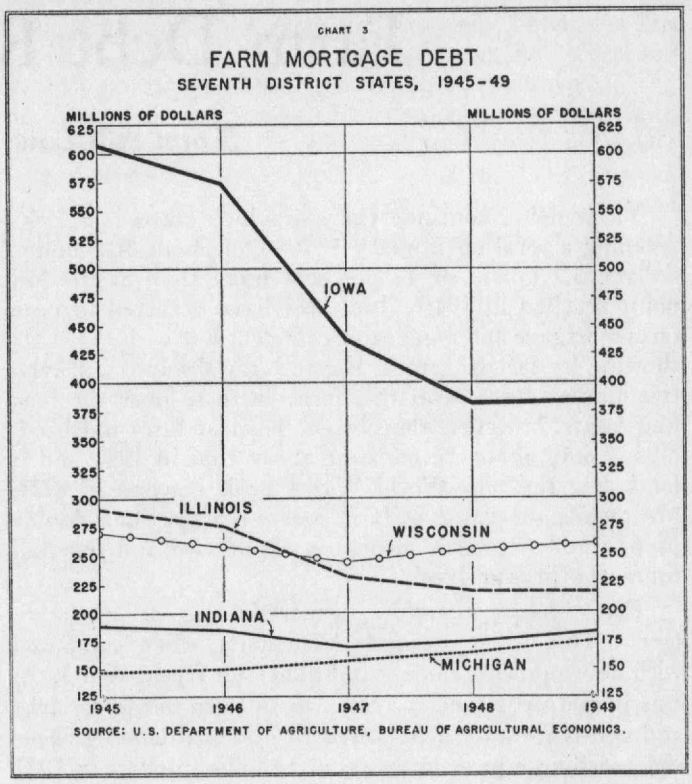
ing agencies, 7 per cent. Insurance companies and the Federal Land Banks appear to be acquiring an increasing proportion of the new mortgages written, while a diminishing proportion is accounted for by individuals and commercial banks.

The relatively low level of total farm mortgage debt is revealed when it is compared with the current value of farm real estate. At the beginning of the year such debt accounted for only about nine per cent of the total value of farms, compared with about 20 per cent in 1940. Rising debt and reduced farm real estate values have increased the debt-value ratio, but it still must rise substantially before it approaches the prewar relationship.

This modest level of over-all farm mortgage debt does not indicate, of course, that all mortgaged farms can carry their present real estate debt load without difficulty. The debt total is low largely because of the increased proportion of farms now owned completely free of mortgage debt. Whereas 39 per cent of United States farms were mortgaged in 1940, only 29 per cent were mortgaged in 1945, and the proportion may have declined since.

The rise in farm mortgage debt has been relatively much greater in the Western and Southern states than in the Northeastern and Midwestern states (see Chart 2). It is interesting to note also that the absolute level of mortgage debt in the Midwestern states is lower currently, relative to previous years, than for other areas. The Midwest, of course, was the heart of the World-War-I-born inflation of farm real estate values. Memory of the distasteful aftereffects of this experience, no doubt, has been an important factor in the moderation shown in this area in recent years. Both farm owners and agencies extending farm mortgage credit have generally followed relatively conservative credit policies in recent years. This is very true of Illinois and Iowa, among the





Seventh Federal Reserve District states (see Chart 3).

The great difference in experience to date during the inflationary periods associated with the two World Wars is due largely to differences in expectations which prevailed in these periods. In the World War I period net land returns averaged about four per cent of land values compared with a mortgage rate of more than six per cent. Land buyers were willing to pay six per cent interest on farm mortgages to buy land yielding four per cent in the expectation that land values would continue an upward trend over a long period of years. From 1943-48 the rate of return on land was about twice the mortgage interest rate, but these returns were not, and in some instances still are not, capitalized fully into land values. It was generally expected that such favorable returns would be short-lived and that real estate prices would adjust downward shortly after the end of hostilities. Whether the World War II judgments will prove as erroneous as those associated with the World War I period, but in the opposite direction, remains to be seen.

NON-REAL-ESTATE DEBT DOUBLED SINCE 1946

Non-real-estate farm debt, including that owed principal lenders and others but excluding Commodity Credit Corporation price support loans, totaled 5.3 billion dollars on January 1, 1950, according to Bureau of Agricultural Economics estimates, 76 per cent more than in 1940. Ignoring the debts owed "other" lenders such as merchants and individuals, for which estimates are not available for a long period of years, the current level of non-real-estate farm debt is moderately above that prevailing in the last half of the 1920's but about one-fourth below

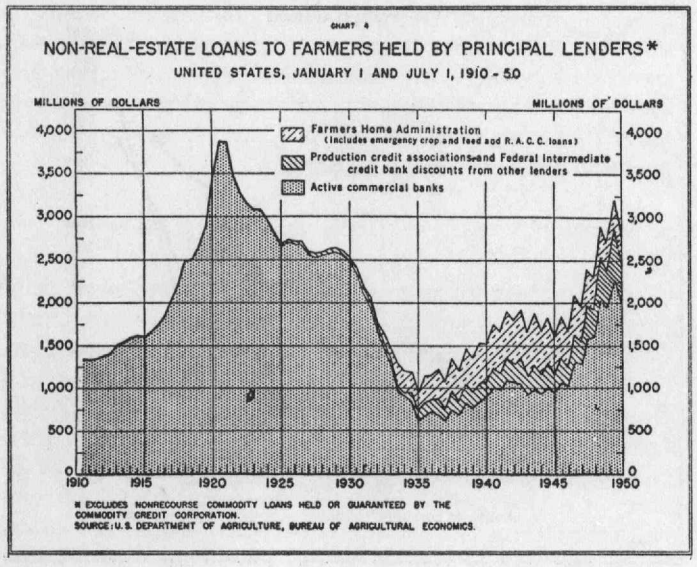
the peak level of the early 1920's. Although the trend still is upward, the rapid rise experienced in recent years has leveled off (see Chart 4).

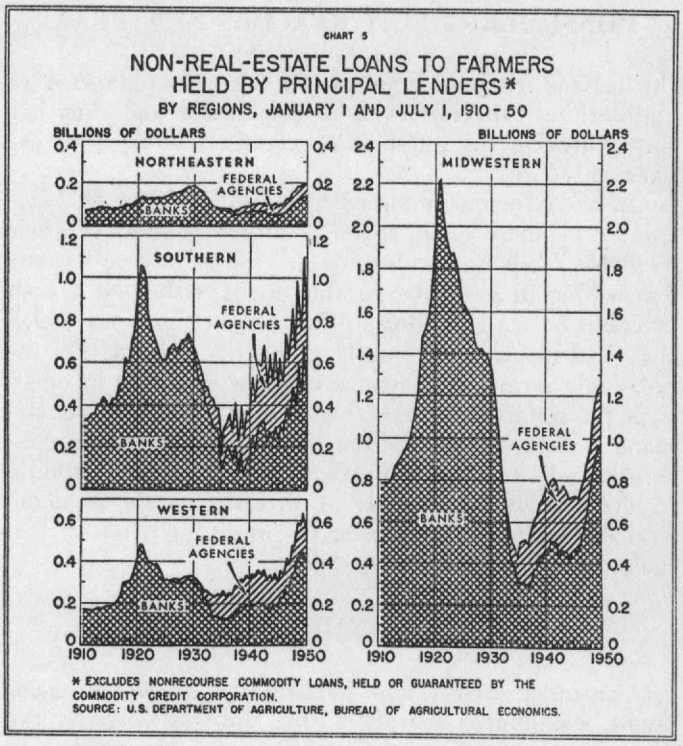
All operating banks in the United States reported a total outstanding of non-real-estate loans to farmers on December 31, 1949, of 2,048 million dollars, an increase of five per cent from a year earlier. Seventh District banks, however, reported an increase of 10 per cent to a total of 418 million dollars. A survey of country bankers in the Seventh District early this spring indicated that they expect a moderate rise in this type of loan in 1950.

As with farm real estate loans, over-all non-real-estate farm debt is at a modest level, equaling about one-fifth the value of livestock, machinery, and motor vehicles on farms at the beginning of the current year, compared with 37 per cent in 1940. If measured against farmer holdings of bank deposits, currency, and United States Savings Bonds, the comparable percentage figures are 28 in 1950, 72 in 1940.

The increase in non-real-estate farm debts since 1946 has been similar in all major areas (see Chart 5). There are large differences, however, in the current volume of such debts as compared with previous years. For all areas except the Midwestern states the peaks reached following World War I have been recently exceeded. In the Midwestern area the current volume is only slightly more than one-half the 1921 level.

The above-noted increase in non-real-estate farm debt resulted largely from greatly increased expenditures for livestock, machinery, motor trucks, automobiles, farm improvements, and additional land as well as for current production expenses and living costs. The future trend in volume of this type of debt probably will be determined largely by the trend in farmer expenditures for capital purposes. These expenditures, in turn, are likely to reflect the level of farm income. If income declines further, the volume of farm expenditures for capital purposes and of credit associated therewith is likely to decline. Also, more of the non-real-estate debt would be converted into long-term obligations in order to extend repayment periods. Both types of adjustment were important in the decline of the 1920's and early 1930's.





Although only limited information is available on this point, it appears that most of the increase in volume of non-real-estate debt in recent years resulted from increased debts per borrower rather than increased number of borrowers. If farm product prices and net farm income decline further in the years immediately ahead, as now appears probable, this situation may change. Certainly the credit requirements of some present borrowers will be reduced, thereby tending to reduce over-all short-term credit to farmers. Other farmers, however, who presently operate without resort to borrowed funds, are likely to need credit to finance the acquisition of livestock and machinery. In these circumstances the total volume of non-real-estate farm debt probably would decline but with the decline limited to modest proportions as lenders accommodate the larger number of potential borrowers.

DEBTS LIKELY TO RISE FURTHER

The future trend in dollar volume of farm debts probably will be determined largely by the general level of economic activity and prices. If relatively high levels of employment, industrial production, and prices prevail for the next several years, further price and income declines in agriculture are likely to be quite moderate. In this general economic setting total farm debts probably would increase further. This development appears particularly likely for farm mortgage debt.

There are profitable opportunities on many farms in most areas for the investment of additional capital to increase the productivity of both labor and land. The extent to which both farmers and lenders recognize the opportunities for such investments may determine whether non-real-estate loans rise or fall in the years ahead.

CONSUMER CREDIT REACHES NEW PEAK

(Continued from Inside Front Cover)

the demand for durable goods at a time when plants were approaching capacity levels of production and thus has contributed to the inflationary pressures of such an expansion.

In a retrenchment forced by declining incomes, however, consumers must spend a larger portion of their available funds on nondurable necessities and so become less willing to purchase durable goods, either on a cash or credit basis. In addition, the credit obligations which they had incurred previously constitute a burden of increasingly serious proportions on their declining incomes, with the result that spendable income and consumer demand is reduced even further. Thus, fluctuations in consumer credit tend to reinforce the business cycle, adding to demand during periods of prosperity and reducing available consumer purchasing power during periods when unused productive capacity exists.

POSTWAR CREDIT TRENDS

Consumer credit, and particularly instalment sales credit, was limited sharply during the war years by the general unavailability of consumers durable goods. As production was diverted to the war effort, many products became virtually unobtainable, except on a special allocation or rationing basis. In addition, the Federal Reserve System was granted the power during this period to regulate the terms on which instalment credit could be extended. Relatively high down payments and short contract maturities were specified in an effort to curb the use of credit and thus restrain inflationary pressures resulting from a demand for goods far in excess of available supply.

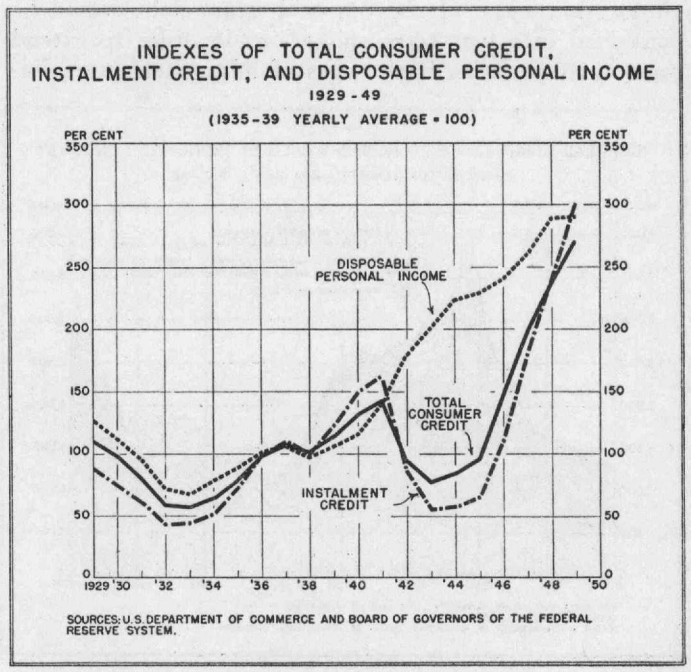
Credit outstandings began to increase gradually in 1944, but at the end of the war were still one-third lower than at the prewar peak in 1941. Moreover, since nondurable goods and services remained in better supply than durables and because the effects of Regulation W fell primarily on the extension of instalment credit, the pattern of outstandings by types of credit was altered substantially (see accompanying table). Non-instalment credit, including charge accounts, single payment loans, and service credit, actually increased moderately between 1941 and 1945, while total instalment indebtedness declined by three-fifths and instalment sale credit dropped to less than one-quarter of its 1941 level. As a result, non-instalment indebtedness constituted a much larger part of total consumer credit at the end of 1945 as compared with 1941.

With the end of the war and reconversion of plant capacities to peacetime production, consumers goods reached the market in increasing volume, and consumer credit began to expand rapidly. Initially, the major part of the expansion was in types of credit related in larger degree to expenditures on nondurable goods and services than on consumers durables. Charge account balances increased by more than a billion dollars and instalment cash loans by 930 million dollars in 1946, while instalment sale credit outstanding expanded 700 million dollars. Despite the relatively moderate expansion in instalment sale credit, however, consumer indebtedness had passed its prewar peak by the end of 1946.

As durable goods became more plentiful, instalment sale credit expanded rapidly. Between the end of 1946 and 1948, automobile sale credit outstanding rose from 544 million dollars to 1,961 million dollars, a growth of 260 per cent in two years. Likewise, sale credit on other durable goods lines increased substantially, from 1,104 million dollars to 2,567 million dollars. The rate of growth in other types of credit slackened significantly during this period, however, reflecting satisfaction of the most urgent of postwar demands for nondurable goods. Charge account balances increased by 560 million dollars in 1947, but by only 240 million dollars in 1948. Instalment cash loans, which include direct loans granted for purchases of automobiles and other durables as well as for more general purposes, increased by a billion dollars in 1947 and by 725 million dollars in 1946.

Consumer credit declined in the early part of 1949, in part because of seasonal factors but still more because consumers generally demonstrated increased buying caution, particularly in the home appliance, housefurnishings, and apparel lines. In response to eased credit terms, somewhat lower prices, and more aggressive merchandising by retailers, however, indebtedness resumed its previous upward movement during the last half of the year. By the end of the year outstandings had increased by nearly 2.5 billion dollars, of which 93 per cent was in the instalment credit category. Consumer indebtedness reached a total of 18,779 million dollars, 86 per cent higher than at the prewar peak in September 1941 and nearly triple the 1945 year-end figure.

The distribution of oustandings by types of credit has trended steadily back toward the 1941 relationship since the end of the war (see table). The major difference in



the current distribution is that instalment cash loans have expanded relative to instalment sales credit, primarily as a result of increased lending to consumers for purchase of automobiles and other durable goods by commercial banks. The upward trend in instalment credit is continuing at a rapid pace, however, and it appears that this category will soon exceed the high 1941 proportion of total consumer credit.

IS CONSUMER CREDIT TOO HIGH?

The primary test of the ability of consumers to incur and repay indebtedness is the level and trend of personal incomes. It seems likely that a rise in personal income can support at least a proportionate increase in the volume of credit. Furthermore, it is apparent that consumers can incur new indebtedness with greater safety when income is expanding.

Although the postwar rise in consumer credit has been very rapid, it appears that the relationship between outstandings and disposable personal income (income of individuals after payment of taxes) is not out of line. Income trended steeply upward during and after the war, with the result that consumer indebtedness has not yet reached its 1935-39 proportion of disposable income (see chart). Credit outstandings were in fact considerably higher relative to consumer income in the immediate prewar years, 1939-41. The upward trend in credit has been much steeper than that of income since the end of the war, however, and with instalment credit continuing to expand rapidly and personal income tending to level off, the prewar average ratio soon may be exceeded.

A second important factor affecting the ability of consumers to carry a high debt load is the trend of prices relative to income. If incomes increase more rapidly than prices, the portion of total income needed to meet basic living costs will decline, and a larger proportion of current income will be available for purchase of luxuries and durable goods, for allocation to saving, and for servicing and repayment of debt. This has been the case during the past decade. Consumers' prices have advanced 67 per cent from the 1935-39 average, while disposable personal income has increased by 190 per cent. Even allowing for an expanded population, it appears that provision for basic living needs requires a smaller proportion of personal income currently than before the war. Thus, the current level of outstanding credit appears considerably more moderate when compared to *available* income not required to meet basic living expenses rather than to total personal income.

The amount of savings held by individuals also must be considered when evaluating the soundness of the present level of consumer credit. Liquid assets of individuals have increased markedly during the past decade. The Board of Governors of the Federal Reserve System has estimated that these holdings (including currency, demand and savings deposits of banks, share accounts of savings and loan associations, and U.S. Government securities) increased from 49.6 billion dollars at the end of 1939 to 174.8 billion dollars at the end of 1948, and the additional gain during 1949 amounted to at least two billion dollars.

It is apparent that this expansion of 256 per cent in the liquid savings of individuals has added substantially to the financial capacity of consumers in the aggregate to carry debt. In many cases it is probable that consumers hold liquid assets equal to or greater than the amount of credit they have obtained. Furthermore, the existence of a large and gradually increasing store of liquid assets undoubtedly affects favorably the willingness of lenders to lend and consumers to borrow.

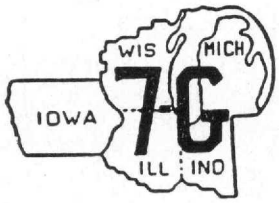
Finally, the terms on which consumer credit is extended obviously affect the soundness and stability of the aggregate of outstandings. Lowered down payments and extended repayment periods tend to result in a rising level of outstandings through stimulation of the use of credit and because the proportion of purchase price financed is larger and the amount of the monthly repayment is smaller. On the other hand, the rise in credit will tend to be checked after most of the outstanding contracts are on liberalized terms and the initial stimulus to credit buying given by lowered requirements has passed.

Furthermore, easier credit terms are likely to attract persons who could not meet the higher payment requirements. To the extent that these poorer risks are not eliminated in the credit investigation, outstanding indebtedness will rest upon a weaker base. In the event of a moderate downturn in employment and income, higher delinquencies and losses probably will occur, and lenders may become less willing to extend new credit.

Both down payment requirements and repayment periods have eased gradually during most of the postwar period and apparently weakened significantly further after final expiration of Regulation W on June 30, 1949. Since the latter part of 1948, minimum down payment requirements on most new model automobiles appear to have dropped from 33-1/3 per cent to about 25 per cent of purchase price, and maximum repayment periods apparently have lengthened from 18 to 30 and even 36 months. Instalment credit terms on other durable goods also have been eased significantly, judging by current advertising of retail dealers. Of course, terms vary substantially from one area to another and from dealer to dealer, but the easing in credit terms unquestionably has been widespread.

In conclusion, it is apparent that the rising level of consumer credit is becoming gradually more vulnerable from the standpoint of a downturn in income and employment. Credit currently does not appear to be inordinately high relative to the over-all financial position of consumers, but the diversity between the trend of credit and such measures as income has been widening steadily. Furthermore, the continuing upward movement in credit outstandings is based primarily upon the more volatile instalment credit, granted on liberal down payment and maturity terms. Although it does not seem likely that consumer credit will turn downward in the near future, the importance of consumers durable goods in the current boom makes consumer credit developments an important factor in appraising the business situation.

SEVENTH FEDERAL



RESERVE DISTRICT