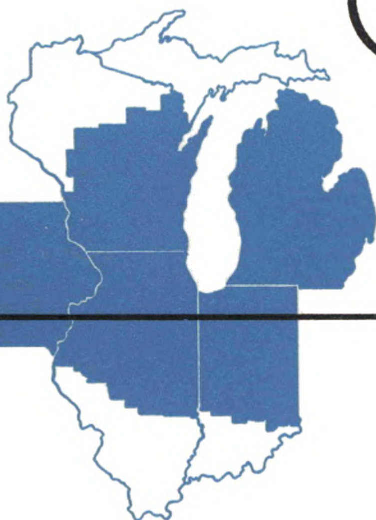
*A review by the* **Federal Reserve Bank of Chicago**

# Business Conditions



**1951 December**

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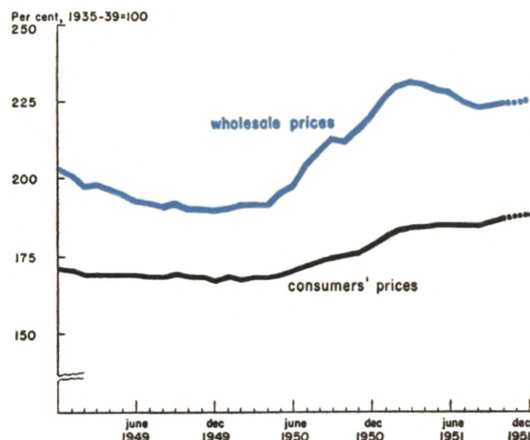
# Economic conditions—a review and outlook

With prospects pointing to a good Christmas season, 1951 seems sure to establish itself as a banner year from the standpoint of economic activity. Sparked by rapidly rising defense outlays, almost every measure of over-all business has reached new peacetime levels during the past 11 months. Industrial and farm production, business investment in plant and equipment, employment, personal income, and the dollar volume of retail sales have exceeded the levels of 1950 or any other peacetime year.

All this has occurred within a framework of continued international tension. Nevertheless, appreciable price inflation was avoided at both the wholesale and retail level after the first quarter of the year. Most business and Government forecasters of a year ago failed to foresee this condition of stability. Such statements as, "the real economic problem for 1951 is inflation," "I expect prices to rise from 5 to 10 per cent," "the most critical problem in 1951 is how to curb civilian consumption," were common in forecasts of last December and January.

The widespread belief that upward price pressure would be substantial and continuous during the year was based primarily upon the outlook for a rapidly rising volume of defense expenditures. Anticipations were that this would require significant cutbacks in the production of civilian goods, but that incomes would be maintained and probably increased as employment in defense industries rose and wage rates stiffened. It was generally believed that the resulting excess of income over the available supply of civilian goods could not fully be soaked up through higher taxes, increased saving, and reduced use of credit. Hence, the consensus was that further inflation was in prospect for 1951.

*Post-Korea price rise halted in the spring*




As the year progressed, however, price weakness developed in many lines, and inflation was brought to a halt. What were the factors which led to an approximate balancing of supply and demand? How strong are the influences which have held prices in check? These are important questions bearing upon expectations for the year ahead.

### The year in review

The dominant thought in the minds of con-



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sumers and businessmen as 1951 opened was the fear of general war. Chinese participation in Korea was now officially recognized and fears of shortages reasserted themselves. Seasonally adjusted retail sales soared to an all-time peak in January and February. Consumer purchases of durable goods were 20 per cent greater in the first quarter than they had been the year before. In addition, consumers bought many items of apparel and other soft goods in excess of their normal needs.

Largely in response to heavy consumer demand, business expectations soared and dealers stepped up their buying. Manufacturers' new orders reached an all-time peak in March, 53 per cent above the same month of 1950. Rising defense contracts and heavy capital spending by business contributed to this figure.

### Output and prices level off

Industrial production rose to 221 per cent of the 1935-39 base during January. Passenger automobiles were being turned out at the extremely high rate of more than six million per year. First-quarter production of television sets, refrigerators, washing machines, and most other durable goods was at near record rates.

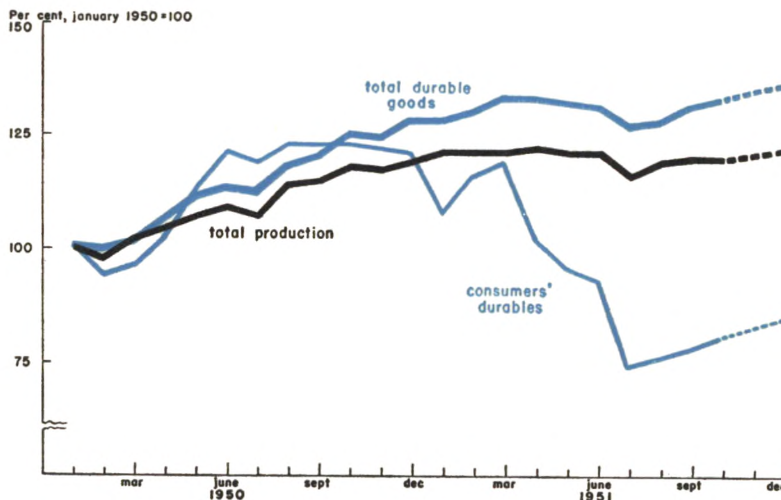
This tremendous production was soon to make itself felt. In spite of all the warnings that material allocations would reduce output, dealers and other retailers became convinced in the spring that the short-run problem was what to do about rapidly growing inventories. Storage space was at a premium. Most businessmen at first felt that large finished inventories were entirely safe because of promised reductions in output later in the year. Nevertheless, as stocks piled up, they came to realize that production schedules would have to be cut back. Among the first and hardest hit by this situation were manufacturers of television sets, and layoffs became common in these plants during April.

Factory output reached a peak for the year in April. Nonagricultural employment and income continued to advance to new high levels. By early March, however, consumers had abandoned their buying spree and saving rates rose sharply in the second quarter. Retail inventories continued to increase as sales declined from their previous highs.

As a result of these developments, wholesale prices leveled in April and began a slow decline in May and June. Merchants stepped

*Industrial production*

held relatively stable in 1951, after significant gains during the last half of 1950. A sharp drop in the production of consumers' durable goods beginning in the early spring about offset gains in the output of military hard goods and producers' durables. Production of nondurable goods declined about five per cent during the year.



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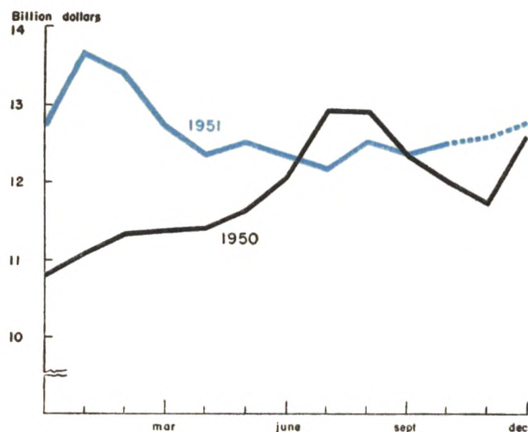
up their promotion plans and special sales became common. At the same time, merchants cut back their orders to manufacturers and in line after line civilian production was reduced. These reductions were most noticeable in consumer durables but also became evident in soft goods later in the spring.

The widely heralded manpower squeeze did not come, except in the case of certain highly skilled workers. Rising defense production and plant expansions absorbed about as many workers as were laid off, although not always in the same area, as Detroit could testify.

### Controls reappraised

The summer months brought a political review of the entire controls program, as the extension of the Defense Production Act was debated at length. By now it was clear to all that the expected inflation had not come, but it was difficult to make the case that direct price control had been the main reason. Consumer prices were practically level while wholesale prices had begun a gradual decline. Many basic commodity prices had declined sharply throughout the spring and summer months.

*Retail sales dropped off in the spring but have averaged higher than in 1950*




The conflict over price controls centered largely around beef prices. High and rising income had increased the demand for this most desired of all foods, but the supply was smaller during the spring and summer months than in earlier years. Pork slaughter increases offset this small decline, but in the minds of many consumers pork was an inadequate substitute for beef. The consumers' price rise had been largest in food—especially in beef—during the post-Korea period.

In view of the expectation of continued inflationary pressure to be exerted by the military spending program, the general body of price, wage, and credit controls were continued in the extension of the Defense Production Act. The modifications, however, bespoke the changed expectations. Price controls were weakened by the Capehart amendment, which permitted manufacturers to obtain price adjustments based upon cost increases between the Korean outbreak and July 26, 1951. Moreover, price controllers were denied authority to roll back agricultural prices below their May 19 levels, and previously existing livestock slaughter quotas were ruled out. In response to Congressional action, consumer credit restrictions were relaxed both in Regulation W (consumer instalment credit) and Regulation X (credit for new houses).

### Price stability achieved

The fourth quarter of 1951 opened with general economic stability in evidence. In fact, during the entire second half of the year both wholesale and consumer prices were remarkably steady.

Total industrial production also fluctuated very little, although the segments within it underwent important changes, partly because of material restrictions and partly because of shifts in demand. Numerous manufacturers are closing the year with unbalanced inventories of materials and parts, due to tighter curbs on the use of steel, copper, and aluminum.

Reflecting high over-all production, indus-



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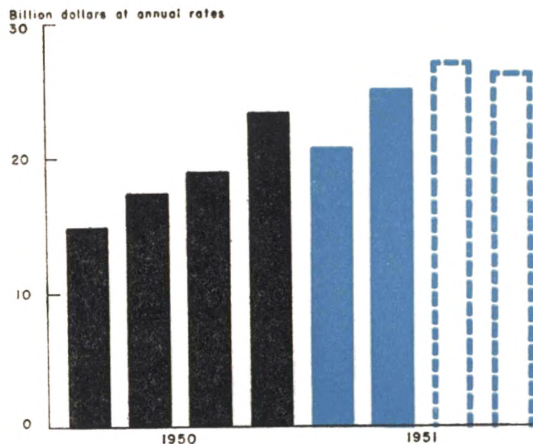
## *Business capital spending well above 1950 in each quarter this year*




trial employment and workers' earnings have stayed on a relatively even keel. Seasonally adjusted total employment rose gradually during the first two quarters of the year, and appears to have remained relatively stable since then.

As 1951 comes to a close it is apparent that business activity as measured in dollar terms has increased only moderately during the past 12 months. Government spending and business expenditures for plant and equipment are sharply higher, while personal income and prices have advanced by a lesser amount. Retail sales are slightly lower, and residential construction expenditures, corporate profits, and the rate of inventory accumulation have declined appreciably. Business as measured in non-dollar terms, such as industrial production and employment, shows little net change over the year, although the annual averages are well above 1950. Broadly speaking, 1950 was a year of rapid increase, while 1951 showed significant shifts in activity, but less over-all rise.

### What curbed inflation?

The high gear operation but relatively stable price performance of the nation's economic machine during 1951 resulted from the interaction of strong opposing factors. On the inflationary side were the rapid expansion in defense spending, the substantial increase in business outlays for plant and equipment, and a high and rising level of personal income. Taken by themselves, these forces undoubtedly were strong enough to result in at least as great an increase in prices as had been anticipated in many quarters at the beginning of the year.

Partly through good fortune and partly as a result of Government actions, however, a combination of developments was successful in counteracting these potent inflationary forces early last spring. These included: (1) a significant rise in production, (2) a sharp rise in personal saving, (3) increases in Government tax receipts which resulted in a record cash surplus, (4) actions to restrain credit expansion, and (5) imposition of direct controls over prices and wages. To a large extent, the effects of these forces were interrelated and their individual importance cannot be measured. Together, however, they halted inflation in the early spring and have held prices in check since then.

**1. Production.** In the months immediately preceding the outbreak of the Korean war industrial production was running at a record peacetime rate. Employment was high, unemployment relatively low, most of our productive equipment was being utilized, and some industries were operating at a capacity requiring extra shifts of workers.

Nevertheless, in response to heavy anticipatory demand by both business and consumers, production climbed well above that "peak" rate in the months following Korea. By early 1951 total physical production was 14 per cent higher than in the second quarter of 1950. Output of durable goods—both consumer and producer—was more than 20 per cent greater, while nondurables had advanced nearly 10 per cent.

Production of many types of goods tended to outrun the immediate demand for them.



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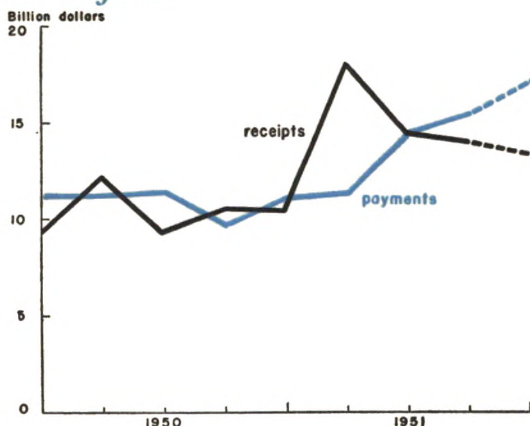
## *Federal cash income exceeded expenditures by a record margin in early 1951*




Despite two successive waves of heavy buying by consumers, the dollar value of total inventories rose by more than one-fifth between June 1950 and March 1951. Consequently, widely heralded shortages generally failed to appear, and retailers' shelves began to overflow with their wares. The effect of this flood of goods was to raise questions regarding the previously apparent wisdom of "scare" buying for most consumer and many business lines.

**2. Personal saving.** The short-run unpredictability of consumer spending made itself evident during the second quarter of the year. Despite rising levels of personal income, large holdings of liquid assets, and widespread expectations of future job security, consumers significantly reduced their rate of buying. Sales of television sets and other major appliances dropped off drastically, stocks of apparel and other soft goods became hard to move, and expected shortages of cars gave way to growing inventories instead.

During the spring and summer, personal saving advanced to a seasonally adjusted rate more than double that of the first quarter. What happened was that people repaid debts, built up savings accounts, and in other ways used a larger proportion of their record incomes for saving rather than spending.

Apparently consumers had decided that it was time to strengthen their financial positions. They had bought heavily during the preceding fall and winter, but expected shortages had not occurred. Moreover, all-out war had not materialized, the news from Korea was optimistic, and over-all price controls had been established early in the year. To cap it off, their tax bill had increased and take-home pay had not risen as much as gross wages.

Whatever the basic reasons, the significant point was that buying dropped off and remained at the lower level all through the summer and fall. This had not been anticipated by either manufacturers or retailers, and its effect was to make already high inventories seem ominously heavy.

**3. Government surplus.** Although defense outlays were expanding rapidly, the Federal Government experienced a record cash surplus in the first quarter of 1951. Cash receipts from the public exceeded expenditures by 6.9 billion dollars. The rise in receipts was partly seasonal. In addition, however, tax payments were swollen by higher incomes, the boost in tax rates which had been passed the previous fall, and a speed-up in the payment of corporate tax liability.

The increase in tax payments between the fourth quarter of 1950 and the first quarter of 1951 was about twice as large as the typical first-quarter rise during the postwar period, and absorbed an additional 7.7 billion dollars of private purchasing power. Total Federal cash outlays rose only 400 million dollars during this three-month period, and therefore, the expected inflationary push from the Government sector did not develop. Moreover, more than two-thirds of the increase in receipts came from personal taxes, and consumers probably met the higher tax payments only to a minor extent by drawing upon savings.

The unusually heavy personal tax drain was



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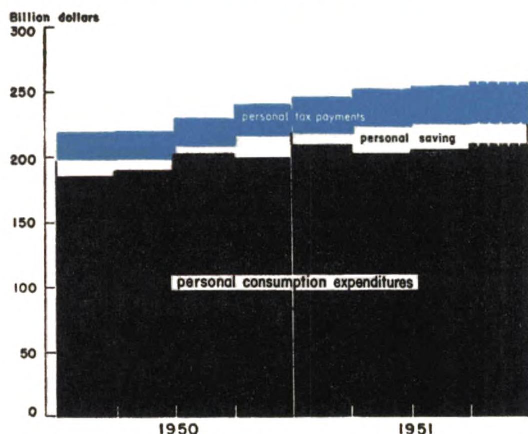
undoubtedly an important factor in reducing consumers' willingness and ability to continue spending at record rates. In addition, the effects of increasing defense outlays continued to be dampened in the second quarter of the year by high levels of tax collections which, although below the first quarter peak, resulted in an approximate balancing of Government receipts and expenditures.

**4. Credit restraint.** Although it is difficult to isolate specific causes, the wide range of actions taken by the Federal Reserve Board last fall and winter to curb credit expansion appears to have played a significant part in restraining inflationary pressures. Under powers granted by the Defense Production Act, restrictions upon instalment and mortgage credit terms were instituted in the fall of 1950.

Instalment debt declined nearly 500 million dollars between October 1950 and July 1951, the period in which controls over terms were most restrictive. A comparison with the same months of 1949-50, when instalment credit increased 2,430 million dollars, shows the extent to which this source of purchasing power was curtailed.

*Personal income has steady rise but taxes and saving take bigger bite*




Note: seasonally adjusted annual rates.

The effects of restrictions on mortgage credit terms were delayed by the exemption of a large number of FHA and VA mortgage commitments which had been made prior to the new regulation. New housing starts during the second and third quarters of this year, however, were nearly 30 per cent below 1950.

In the area of general credit control three major actions were taken. Reserve requirements on member bank deposits were raised in January, reducing the amount of loanable funds available to banks by about two billion dollars. In March, the Federal Reserve suspended its program of supporting Government securities at fixed prices in favor of a more flexible open market policy. This operation had entailed substantial purchases of securities in earlier months, with the result that funds had been provided for expansion of lending activity by financial institutions. Average prices of long-term Government bonds dropped from 101.56 in January to a low of 97.62 in June. This meant that a substantial capital loss had to be taken by lenders who wished to shift from Governments to private obligations.

In addition, a program of voluntary credit restraint was instituted in March under Federal Reserve sponsorship. This program enlists the mutual cooperation of financial institutions in restricting the making of loans which are clearly inflationary in nature. Common standards of what constitutes an inflationary loan were developed, and there is consequently less pressure to make such loans to maintain competitive position.

The net effect of these actions has been to reduce the availability of credit to private borrowers. Total bank loans, which had increased nearly 10 billion dollars in the preceding nine months, rose only 400 million dollars from March through July. Seasonal and general business influences were important in holding down the loan rise, but credit restraints undoubtedly played a significant role. In addition, the sharp

*—continued on page 13*



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# Farm land values

*As an inflation hedge farm real estate has many attractions . . . but there are dangers here for the uninformed.*

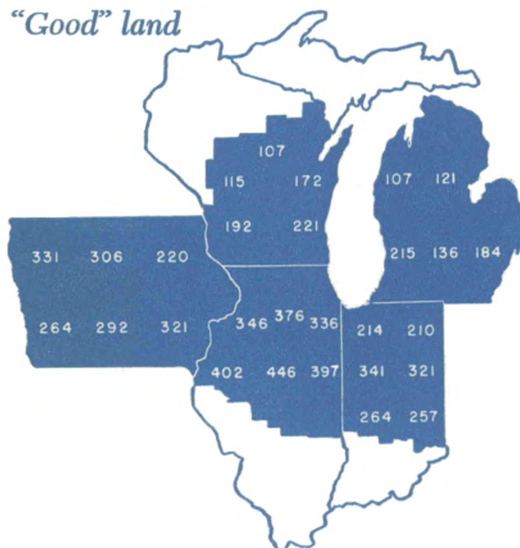
FARM REAL ESTATE VALUES continue the rapid rise which has been under way since the outbreak of hostilities in Korea last year. There are many ready buyers among both farmers and city investors but only a limited number of farms are offered for sale.

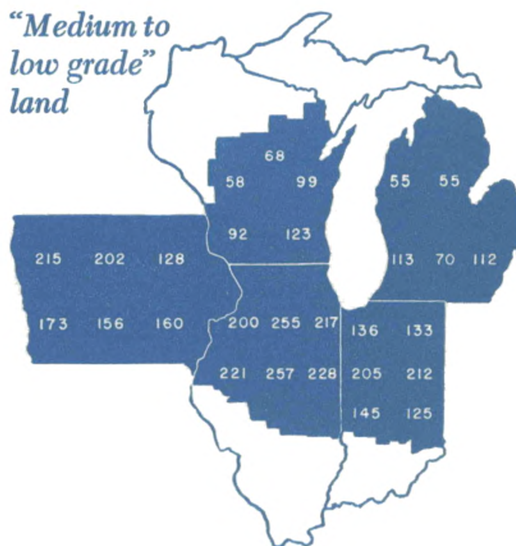
Values, of course, vary greatly. This is especially true in areas where soil type and topography change drastically within short distances. While it is a simple matter to evaluate such important factors as buildings, fences, topography, and location of a farm, the most important characteristic—the soil productivity—is not easily measured. It is this factor, consequently, which accounts for most "errors" in the purchase of farm land.

Many buyers, unfortunately, do not appreciate that the productivity of land within areas varies importantly. Furthermore, many are not aware that even small differences in productivity result in substantial differences in real worth of the land. This is because the cost per acre of producing a crop usually varies much less than the yield. In general, the variations of land values reflect the basic area differences in productivity. However, it is not a guide to differences between farms in an area. It is desirable, therefore, for inexperienced investors to obtain the advice of competent farm real estate appraisers familiar with the area in which land is being purchased.

The broad, general pattern of farm real estate values in the District is indicated in the accompanying illustrations. The values are those reported by over 400 country bankers in October and are based on typical sales prices of "good" and "medium to low grade" land in their areas. "Good" land is above average for the area but does not represent the few best farms which can be found in all communities. "Medium to low grade" land, similarly, is below average but not the poorest in the area.

*Average selling prices of farm real estate, dollars per acre*



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# Agricultural credit expands sharply

*Feeder loans pace rapid growth in short-term loans to farmers . . . correspondent banks provide backlog of funds.*

THE MOVEMENT OF FEEDER CATTLE to Corn Belt feed lots continues in near record volume even though prices this fall have been at an all-time high and profit prospects are less promising than in other recent years. Since many farmers have inadequate funds to finance their cattle, this has resulted in a tremendous demand for feeder loans throughout most of the District.

### No price increase in prospect

Observing the large number of cattle being fed, the high prices paid for them, and the narrow margins between feeder and slaughter cattle prices, some bankers have expressed concern that farmers may suffer financial losses on their feeding operations this year. Farmers, too, are aware of this possibility. Many of them have hesitated to assume the risks involved in purchasing and feeding cattle this fall, but with large feed supplies on hand, frequently including much hay and pasture and a crop of soft corn which can best be salvaged by use as feed, they turned to their bankers for funds and to range producers for cattle. Not unimportant in their decisions are the experiences in some recent years in which profit prospects were little better in the fall than they are this year. But in several of these years prices advanced during the feeding period, resulting in very favorable financial returns to farmers.

There is little prospect this year, however, for a substantial advance in cattle prices during the feeding period as price ceilings are in effect and supplies of both pork and beef are expected to exceed those of a year ago. Nevertheless, farmers in District states purchased nearly 150,000 or 12 per cent more feeder cattle in July to October this year than in 1950. Considering the feed situation, and farmers' strong financial statements, country bankers generally were inclined to supply the necessary funds. Most of them followed their usual feeder loan practices although some required larger equities or additional collateral from borrowers. With few exceptions, however, experienced feeders with good financial statements and adequate feed on hand to finish cattle for market could borrow the full purchase price of feeder cattle.

### General increase in feeding

The increase in cattle feeding this year is not confined to the specialized areas which regularly carry on a large volume of feeding. Country bankers in all parts of the District, except south central Iowa and southwest Wisconsin, report more cattle on feed than a year ago. There is an especially active interest in some Michigan areas.

In addition to the effects of the higher prices paid for feeder cattle and the larger number being fed, credit requirements have been increased this fall as a result of about 10 per cent more farmers borrowing to finance their feeding operations. This has been the experience of bankers in all District areas except southern Indiana. About one-half of the country member banks in Illinois and Iowa made feeder loans to more farmers than last year, and about one-third of those in Indiana, Michigan, and Wisconsin. Some of these "additional" borrowers are beginners in the cattle feeding business. Most of them, however, are farmers who had been financing their own operations in recent years but with higher prices necessitating an increased investment per animal and an expanding scale of operations, they have had to turn to their banks for supplementary funds.



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### Loans rise from a high base

Country banks in important feeding areas reported cattle loan totals in early November which ranged up to as much as 200 per cent over a year ago. Increases of 50 per cent were common. As the demand for cattle money surpassed the capacity of some banks to supply it, they turned to correspondents for additional funds. The volume of cattle loans held by Chicago banks early in November, for example, was more than double the year-ago amount and was described as "the largest in twenty years." Banks in other large District cities, especially those near important feeding areas, have also experienced an active demand for funds to finance cattle. The volume of such loans outstanding at these banks is commonly reported to exceed a year ago by 60 to 100 per cent, occasionally more. The increase has resulted from three types of demand: (1) direct loans to farmers, (2) participation with small country banks in large feeder loans, and (3) outright purchase of cattle paper.

The sharp expansion in cattle loans is indicated also by the rise in short-term bank loans to farmers. For District member banks these increased nearly 50 million dollars or 22 per cent from June 30 to October 10, bringing the outstandings of such loans to a level 30 per cent above that of October 4, 1950. While this sharp June-October increase is very largely a reflection of the current cattle feeding situation and may be described as seasonal, it is appropriate to note that the substantial "seasonal" increases which have occurred in other recent years have merged into a continuous rapid rise in District member bank outstandings of this type of credit. The October 10 total of about 275 million dollars compares, for example, with less than 100 million in December 1946 and about 120 million in December 1947.

To a considerable degree this expansion in short-term loans to farmers is a reflection of rising prices and costs and the rapid mechanization of agriculture. As an increasing number of country bankers begin to think in terms of being "loaned up" they may resist more vigorously any further growth in agricultural loans.

### Will cattle prices hold?

In the immediate situation, the narrow margin between prices of feeder and slaughter cattle not only limits the profit possibilities in the current cattle feeding season but also exposes farmers to substantial losses if prices should decline before their cattle are marketed. Some market analysts have noted that short-fed cattle is marketed usually in large volume in January and February following harvests of soft corn and suggest that farmers probably should avoid selling in this period if they can. Others have recalled the weakness which prevailed in commodity markets in the first quarters of several recent years, commonly attributed to heavy income tax payments at that time, and suggested that this experience may be repeated in 1952. Generally, however, there is no expectation that cattle prices will decline materially within the next couple of months and remain at the reduced level. With these possibilities in mind, however, bankers and farmers are appropriately comparing livestock numbers and feed supplies so as to be sure they do not run out of feed and lose all flexibility as to time of marketing.

### *Short-term farm loan volume up sharply*[1]

| | Per cent increase | |
|---|---|---|
| | June 30, 1951 to October 10, 1951 | October 4, 1950 to October 10, 1951 |
| Illinois[2] | 31 | 39 |
| Indiana | 1 | 14 |
| Iowa | 29 | 36 |
| Michigan | 1 | 10 |
| Wisconsin | 3 | 1 |
| District | 22 | 30 |

[1]Loans other than on real estate or guaranteed by CCC.
[2]Excludes Chicago.



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# Exports important to farmers

*Foreign markets important outlets for farm products . . . production still exceeds domestic consumption even though population has increased rapidly.*

ONE OF EVERY 10 TO 12 DOLLARS of cash receipts from farm marketings in recent years has resulted from exports. Although this represents a small part of total farm production, exports of such important crops as wheat, cotton, tobacco, and soybeans range from 20 to 40 per cent of annual output. Foreign markets, therefore, continue to be important to American farmers even though our population is increasing rapidly.

Agricultural exports were valued at 3.4 billion dollars in the year ending June 30, 1951, nearly one-sixth more than in the preceding year, although the physical quantity actually declined about four per cent. The sharp value increase reflects primarily the world-wide impact of the Korean war on raw materials prices. A contributing factor was the increase of about one-fifth in the gold and dollar earnings available to foreign countries in 1950-51 over the previous year which made it possible for them to finance a larger share of our agricultural exports out of their own resources. Consequently, they were able to maintain the physical volume of agricultural imports from the U.S. even though the proportion financed with ECA and other assistance funds declined from two-thirds in 1949-50 to one-third in 1950-51.

### More exports in 1952

Following the outbreak of hostilities in World War II and the extensive efforts of the U.S. to avoid involvement, exports experienced a sharp although temporary decline to about one-fourth the predepression volume. Under the impact of war, lend lease, and the foreign aid programs of the postwar years, however, the volume of U.S. agricultural exports increased rapidly to approximately the predepression level. But this was generally considered a temporary development.

The physical volume of farm exports in fiscal 1951-52 is expected to be 5 to 10 per cent larger than in the preceding year, while lower prices for some items may result in a smaller increase in value of exports. The major volume increase is expected to be in cotton for which the current large crop will permit an easing or removal of export controls. Smaller increases are expected for tobacco and wheat. These probably will more than offset reductions in exports of feed grains and dairy and poultry products. Export requirements of soybeans are likely to continue at about the same level as in the past year but may encounter more competition from soybeans produced in other areas as well as from other kinds of fats and oils.

### Policy problems raised

Recognizing that exports are an important outlet for American farm products, the U.S. Department of Agriculture has established a Foreign Agricultural Trade Policy Committee to advise the Department in matters involving foreign agricultural trade and policies. The Committee includes representatives of farm organizations, land-grant colleges, the agricultural press, and industry. Following a recent meeting, a statement was released endorsing Government efforts to promote greater freedom of trade between countries. However, recognizing that a country usually must import if it is to export, it recommended that restrictions and limitations incorporated in recent extensions of the Reciprocal Trade Agreements program and the Defense Production Act be



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reconsidered. The Committee apparently was referring to certain rigid import restrictions incorporated in recent legislation at the insistence of domestic commodity interests. As a result, imports of many fats and oils are currently prohibited and imports of most dairy products are sharply restricted. International commodity agreements were viewed as still being experimental, and, although further work in this field was encouraged, the Committee expressed hope that it would be done with an earnest effort to preserve individual and private trade rather than to expand state trading.

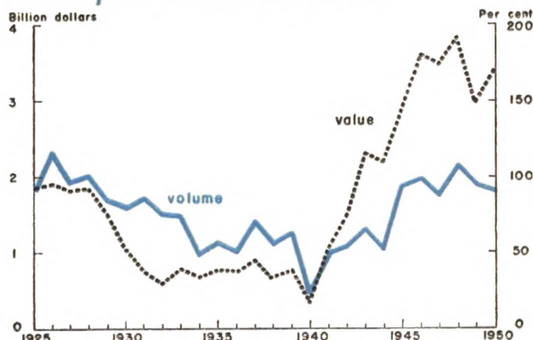
The Committee urged that domestic programs such as those of price support be appraised carefully in terms of their international effects and that they be modified when they endanger our international aims. The maintenance of reserve stocks of farm products for unforeseen circumstances and to assure an even flow of trade were considered worthy of careful consideration, but tying such programs directly to domestic price support measures was questioned on the basis that it probably would reduce their effectiveness.

### Wheat under international agreement

An International Wheat Agreement has now been in force for two full years. It is of special interest since it may set a pattern for international trade programs for other commodities, should they be developed at some future time. The present pact has two more years to run but steps for renewal have already been taken.

To date, wheat-importing nations have been primary beneficiaries of the wheat program, as the maximum price authorized in the agreement is lower than would have prevailed in its absence. Subsidies on the more than 400 million bushels of agreement wheat exported from the U.S. have cost about 250 million dollars. Supporters of the program suggest, however, that the wheat would have been exported in any event and that alternative programs would have been equally costly. Other benefits claimed are highly stable wheat trade and prices, and a

*Farm production increased steadily but export volume is erratic*




cessation of importing nations' attempts to become self-sufficient in regard to wheat supply. The agreement now applies to most of the wheat moving in world trade.

Exporters can be expected to propose higher maximum prices in any new agreement, or some means of adjusting the price scale during periods of sharp inflation or deflation. This may be especially important at any time the price of free wheat falls below the minimum required of importing countries, considering the escape clauses now provided.

Some critics of the present program insist that a definite schedule of prices is not a necessary component of a commodity agreement. Furthermore, they fear that the measures necessary to implement a predetermined price, whether in domestic or international programs, will inevitably lead to state trading and that this is likely to have adverse rather than beneficial effects on our relations with other countries.

### Exports affect all areas

Farmers in predominantly livestock-producing areas have frequently shown little positive interest in international trade since only a small volume of the products they produce are either exported or imported. Such a position probably is not justified for two important reasons. First, and most important, is the essential role of agricultural exports and imports in our in-



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ternational diplomacy since World War II. If, as a nation, we are really serious about deepening and widening the channels of international commerce and using this as an entree to a peaceful world, we must be willing to consider foreign producers' needs for markets for their products as well as outlets for our surplus production. Secondly, most of our domestic agricultural resources can be adapted to several alternative uses. If cotton and wheat exports are curtailed sharply, for example, much of the land and labor now engaged in their production probably will be shifted, possibly with the aid of Federal subsidies, to the production of products for which there is a domestic market—mostly livestock products. So long as the total production capacity of agriculture exceeds domestic requirements, interregional competition within the country may have as important effects on individual products and areas as competition with producers in areas outside the borders of the United States.

**BUSINESS TRENDS** *continued from page 7*

drop in new commitments for fixed rate mortgage loans reduced private credit extensions by other institutions as well as commercial banks. This was a direct result of the fall in Government bond prices.

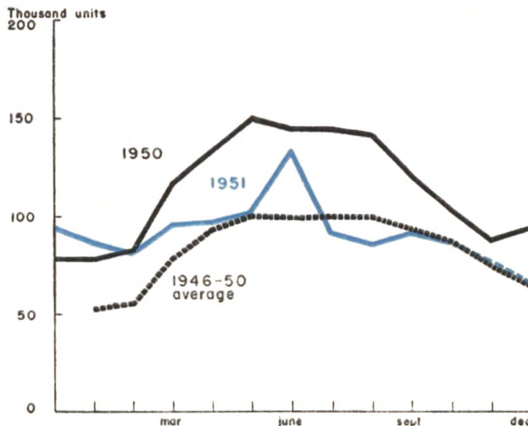
**5. Direct controls.** A comprehensive freeze over most wages and prices was imposed late in January, under authority of the Defense Production Act. The primary function of these controls was, of course, to halt the rise in prices caused by underlying inflationary pressures. They did so in two ways. First, by definition, the controls stopped many price rises insofar as they were obeyed. Second, their effects were partly psychological; to the extent that business and consumers believed that controls would slow down or stop price rises, the urgency of their buying plans was reduced.

It must be recognized, however, that the expectation of controls probably caused additional inflating of prices in the period immediately preceding their imposition. Anticipatory increases of wage rates and of prices for at least the less profitable lines were undoubtedly widespread.

With the passage of time the importance of direct controls in limiting price advances appears to have diminished. Weakness in demand had forced a reduction in prices of many goods below their ceilings, with the result that controls were inoperative. Other products remained at the O.P.S. ceilings, although the current demand-supply relationship may have warranted reductions. Finally, the freeze gradually was replaced by more flexible controls, which generally meant that key prices and wage rates were allowed to advance.

Certain basic difficulties in administering direct economic controls have been encountered in the past several months. First, the job of intelligently setting prices so as to yield a reasonable profit is difficult, time consuming, and controversial. Second, the task of policing and enforcing controls for all but the larger companies and labor groups is nearly impos-

*New housing starts well below last year but near postwar average*



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sible without widespread public support. Third, the political pressures from business, labor, and agriculture to which controls are constantly exposed tend to limit their longer-run effectiveness. Finally, direct controls do not significantly reduce the basic excess of demand relative to the supply of goods.

On balance, the economic effect of the present system of direct price and wage controls appears to be more to delay general increases than to stop them altogether. Their usefulness is in proportion to the strength of underlying inflationary forces. Delaying tactics provide time for shifts in productive resources to take place, and for the more basic methods of combatting inflation to be introduced and to become operative. Thus, in periods of unusual stress, direct controls may play an important part in limiting the rise in prices and wages.

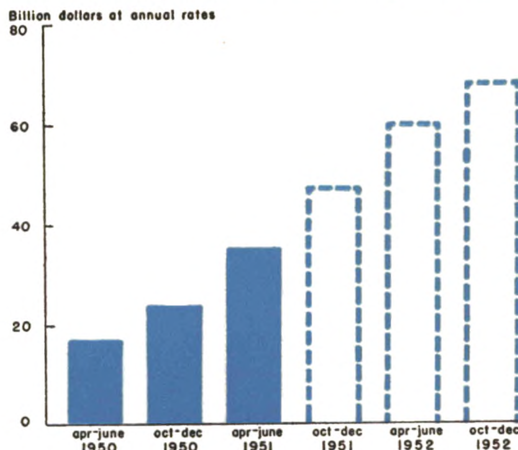
### What about next year?

The current high level stability probably will continue into early 1952. As the year proceeds, however, inflationary forces seem likely to reassert themselves. Present indications are that Government price and wage controls will gradually give ground under these pressures and that at least some cost inspired price rises will take place.

International developments will continue to have a highly important influence on business in 1952. An obvious easing of tensions probably would bring political pressures to slow up the increase in defense expenditures and to increase materials allocations to the civilian economy. A dramatic new crisis in military activity, however, would entail a still greater expansion in defense spending, and might bring another civilian buying splurge.

Military and foreign aid spending is scheduled to keep on rising at about the same rate as this year. This would mean that by the end of 1952 it will have reached an annual rate of over 65 billion dollars compared with 47 billion at the end of this year. The continued (and

*Defense spending scheduled to continue rapid growth through 1952*




cumulative) inflationary effect of such spending should not be underestimated.

Revenues also will be higher. In fact, a seasonal rise in tax payments is expected to produce a cash surplus of about six billion dollars in the first quarter of the year. In subsequent quarters, spending should exceed revenues by substantial amounts. This means that the increase in Government spending will not fully be offset by tax drains upon civilian purchasing power, as has been the case during most of 1951.

### Business spending high

Outlays of private business for new plant and equipment will total about 25 billion dollars in 1951, far more than ever before. The figure would have been even larger were it not for Government restrictions. Delays in the present programs help assure that next year's total of business spending on plant and equipment—now related in large part to the rearmament program—will be close to the figure for this year. Rising construction and machinery costs may carry it even higher.

One factor, however, might bring about a reduction in business outlays. Toward the end



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of 1951 many financial managers were confronted with continuing deterioration in their firm's working capital position. Taxes were the main cause. By the end of June the Federal income tax liability of corporations topped 17 billion dollars compared with 10 billion the year before. This rise did not reflect the higher taxes, retroactive to April 1, which were voted in October. Moreover, the corporate tax speed-up requires that 70 per cent of this year's tax bill be paid in the first six months of 1952. Thus, liquidating the tax liability on 1951 income will place some firms in a tight cash position next year.

The long rise in total business inventories was halted in August 1951. This was due to a working off of stocks at the retail level. With material restrictions cutting deeply into the output of consumer durable goods, there will be downward pressure on retail inventories well into 1952. Manufacturers' inventories are likely to stay high, however, in response to expanding defense production.

Although Regulation X terms were eased last summer, residential construction has declined gradually during 1951. The drop would have been even greater but for the large volume of pre-Regulation X commitments carried over from 1950. Housing starts up to mid-1952 will be well below the comparable months of 1951, as VA and FHA mortgage funds continue in short supply and material restrictions tighten.

## Consumers hold the key

The key to prospects for business in 1952 lies with the consumer. If his rate of spending increases significantly from presently reduced levels, important inflationary pressures almost certainly will result. If saving is maintained at the high rate of recent months, however, serious inflation during 1952 may be averted, despite growing defense expenditures.

Employment will continue high. Strong pressures will be exerted to increase wage rates as union contracts come up for negotiation and workers attempt to improve their position. At the same time, employment in defense industries will rise, putting still greater pressure on skilled manpower. Conversion unemployment should diminish during the year. Under these conditions personal income—at least the wage and salary component of it—should rise moderately. Disposable income, however, will rise less because of higher personal tax payments.

Goods to buy, in general, will be readily available in the coming year. This is particularly true for apparel and other soft goods lines, where production is currently below capacity and important material restrictions are not likely. Food supplies also are ample, and meat production is expected to increase moderately. Output of automobiles, appliances, and other durables, however, will continue to be restricted by material allocations, a fact which will become increasingly important as current high inventories are worked down.

Personal saving was at a rate of 9.5 per cent of disposable income during the second and third quarters of 1951. This compares with a 1946-50 average of 4.8 per cent. This exceptionally high rate of saving does not seem likely to continue through 1952. The financial position of consumers has improved during the past year. At the same time, consumer inventories have been reduced somewhat through lessened purchases, and the fruits of last year's forward buying have been digested. Actual need plus indications of developing shortages should stimulate increased buying activity.

Thus the main economic problem in the year ahead seems to be that of keeping upward forces in check.

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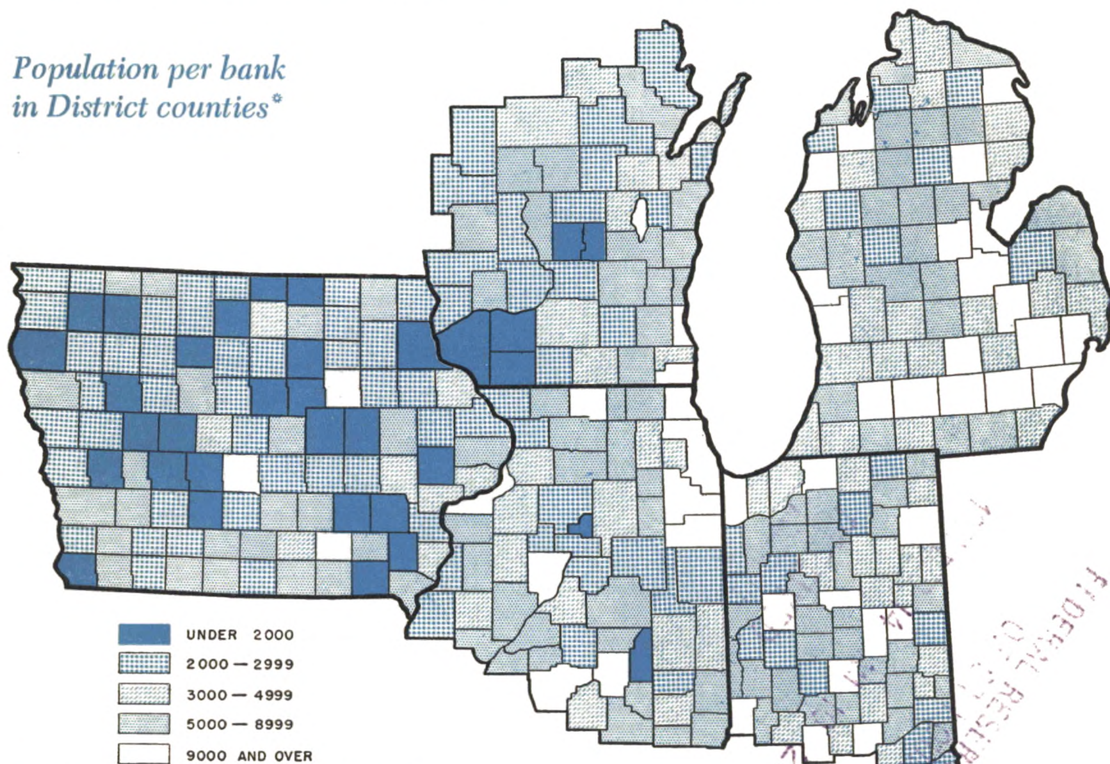
# Bank facilities

- The District's 2,500 commercial banks and over 600 branches are widely scattered throughout the area.
- Every county has at least one commercial bank or branch, all but six have two or more.
- There is a banking office for every 7,000 District residents, compared with one for every 8,000 in the nation as a whole.
- The number of persons per bank is larger in the densely populated industrial areas and smaller in rural areas which comprise about four-fifths of the District counties. Iowa, for example, has a commercial bank office for every 3,200 persons. This reflects, in part, the more widespread use of bank facilities by farmers.
- More than 80 per cent of the District towns with over 500 population have a commercial bank office; over 90 per cent of the District's town population live in bank towns and 75 per cent live in towns having two or more banks.
- Twenty District cities of more than 5,000 population do not have a bank but these are suburbs of large cities which have extensive banking facilities.
- There is a bank within the sphere of the day-to-day activities of almost every District resident suggesting that banking facilities are adequate for those persons and businesses normally having need for them.

*Population per bank in District counties**




*includes all commercial banks and branches.

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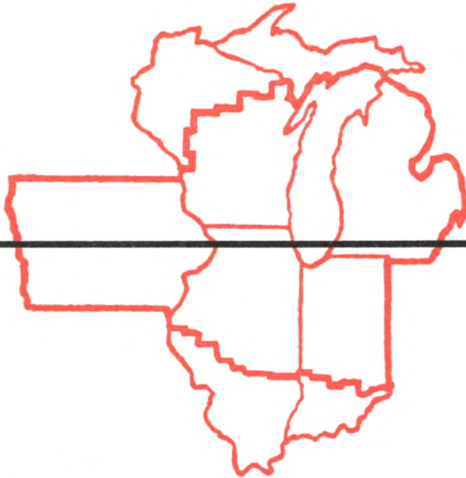

# Business Conditions

*a review by the Federal Reserve Bank of Chicago*

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