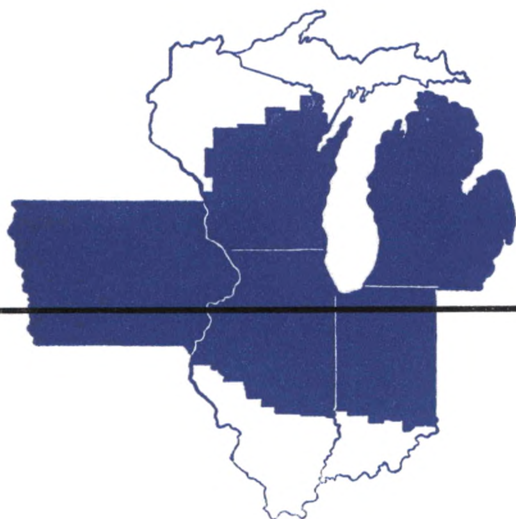
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1952 October

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The fall advance in business loans

Usual seasonal influences are pushing up loan totals, but the rise through year end promises to be less than last year.

FOR BANK LENDING OFFICERS, autumn is a time of peak activity. Between August and December, business customers borrow more money than at any other time of the year.

The ramifications of the fall bulge in borrowings are many. Individual banks must make necessary shifts in investment portfolios. The national total of expenditures swells because of the added bank deposits moving through business and consumer hands. This fall business loans are being watched particularly closely, for many observers regard them as the key to general credit conditions in the months ahead.

Gauging the dimensions of each autumnal growth in business loans, however, is as difficult as it is important. Traditional seasonal influences—carrying and processing the yields of harvest and stocking up for the holiday season, to mention two—are but part of the picture. Technical financial factors, the varying market conditions facing major industries, and the broad drift of business activity vary the pattern of each fall credit expansion. Prejudging the final product requires a close look at all the ingredients at hand.

The pattern of the past

The standard measure of business loans—commercial, industrial, and agricultural loans outstanding in the nation's weekly reporting member banks—stood at 21.2 billion on September 10. This was 400 million below the record end-of-1951 level, but 800 million higher than the 1952 "low" on June 4. How this position compares with that of previous periods is illustrated in the chart on the opposite page.

In looking at trends through the last half of the year, the record of the recent past, excluding 1950, can be deceptive. For 1947, 1948, and 1949 taken together, business loans climbed 13 per cent from July 30 through year end. Over the same five months in 1951, the percentage rise was exactly the same. But this 13 per cent is not a reliable rule of thumb estimate of prospective business loan expansion in the last five months of 1952.

The years for which it represents the "average" fall increase are few and diverse, ranging from boom through recession and back again. Furthermore except for 1949, substantial net loan expansion occurred over each year as a whole. When adjusted for this uptrend, the average "seasonal" rise for these years is about 10 per cent.

The results of such calculations, however, need careful interpretation. Any "seasonal" in business loans is the net reflection of seasonal shifts in bank credit needs among hundreds of American industries. These "industry seasonals" are spread unevenly over the year. Some are regular, others are highly susceptible to outside influences. Forces now at work promise to make some borrowing patterns this fall differ from either "the usual seasonal borrowing" or "the same as last year."

The position of manufacturers

One slant on the prospective rise in business loans through year end is provided by the weekly reports of some 200 of the nation's large banks. In these reports, larger loans made to business customers are broken down into 12 industrial groups. A review of this information reveals that important lines of business are moving into the fall period in sharply different financial positions.

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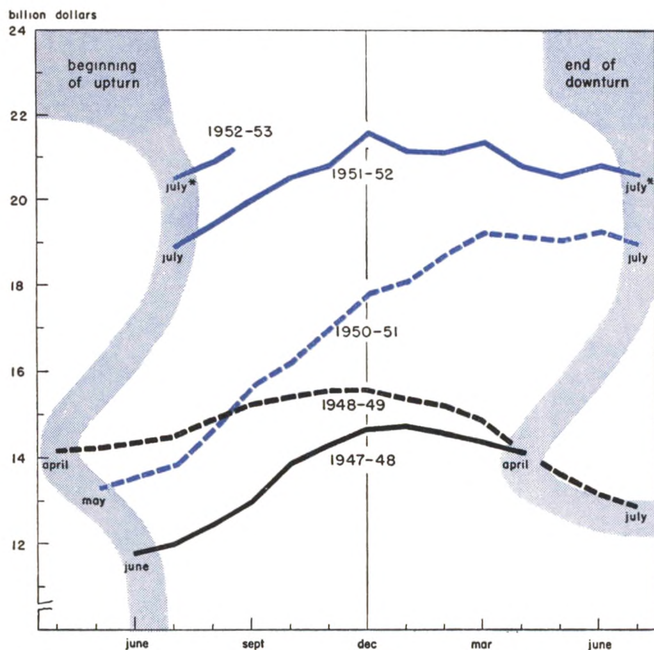
Among manufacturing industries, three lines which have been particularly significant in recent business loan movements are: food, liquor, and tobacco processors; makers of textiles, apparel, and leather goods; and metals and metal products manufacturers. The contrasts between production, inventories, and borrowings of these groups are illustrated in the charts which follow on pages 4 and 14.

Food, liquor, and tobacco. Firms engaged in the processing of food, liquor, and tobacco, of course, are prime examples of concerns subject to powerful seasonal influences. The concentration of raw material supplies in harvest months forces wide seasonal swings in output and inventories. These dominate all other industry influences and create a sharp fall bulge and spring contraction in financial requirements. In the 1951-1952 season, for example, inventory changes regularly trailed the large swings in output by about two months, with the trend of industry borrowings from large banks lagging an additional month behind changes in stocks. Mid-1952 marked the end of one annual cycle in output, stocks, and borrowings and since that time those measures have turned up in repetition of last year. Except for some mildly dampening effects from the C.C.C. support program referred to below, loans to food, liquor, and tobacco concerns at large banks will probably continue to follow closely last year's 930 million last-half expansion.

Textiles, apparel, and leather. On the other hand, seasonal influences have had little to do with the marked shifts in the position of textile, apparel, and leather goods manufacturers. Such firms were important borrowers during the late 1950 loan boom, but spent the bulk of 1951 working down large stocks and credit lines in the face of slackened market demand. By cutting production drastically and selling out of inventory, these firms acquired sufficient cash reserves to reduce their loans outstanding at large banks by over 300 million



Seasonal pattern in business loans

Month-end totals of commercial, industrial, and agricultural loans at reporting banks are traced from each summer low through the midyear low in the next year.*

In these selected years, annual lows varied from as early as April to as late as July. More often than not September and October were the months of most rapid increase, with the rise usually reversed within a few days of year end. Underlying seasonal swings was the press of general business activity—strong in 1947, easing through 1949, strongest after early 1950, and now back to a less frantic pace.

* In 1952, the low is shown in July although an overhang of June tax borrowing kept July figures slightly above the early June level.

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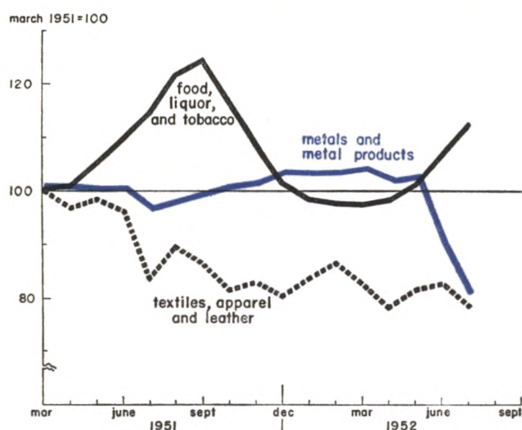
dollars during the last six months of 1951.

Beginning in early 1952, however, leather goods makers experienced some upturn in business and recent months have brought some recovery in demand for apparel and textiles. As a result, production and inventory figures in these lines are moving up and borrowings from large banks show signs of steady increase. Such firms are neither so willing nor so able as food processors to utilize large bank loans to support production and inventory increases. Nevertheless, a moderate volume of net borrowing at large banks will probably materialize between now and year end in direct contrast to the net repayments of a year ago.

Metals and metal products. Almost exactly opposite have been the movements in the metals and metal products lines, the area most directly associated with the swelling defense effort. Although not usually heavy peacetime applicants for bank loans, such concerns became the largest industrial borrowers from the banking system during 1951. Since March of that year, producers of metals and metal products have borrowed a net of over 2 billion dollars, largely in short-term credit, from the

—continued on page 13

Large shifts in manufacturing output help to shape credit needs



Cattle feeding prospects

Cheaper feeders, adequate feed, a strong demand for meat, and larger beef supplies dominate the cattle feeding situation.

"WILL CATTLE FEEDING BE PROFITABLE THIS YEAR?" In answering this question, Corn Belt farmers are being influenced by vivid memories of the generally unsatisfactory results of their 1951-52 ventures. Nevertheless, as they mentally weigh prices, costs, and profit prospects, they find the outlook to be more favorable than a year ago.

An increased supply of feeder cattle is available, large stocks of hay and small grains are on hand, and a good corn crop is ready to be cribbed. Furthermore, the relationship of feeder and slaughter cattle prices is favorable to feeding. A large number of cattle, therefore, is expected to be moved into Corn Belt feedlots this fall. These animals will be fed for periods ranging from about three months to a year or more before their journey to the slaughterhouse. As usual, the major uncertainty in the profit outlook is the price the cattle will bring at the close of the feeding period.

Plenty of feeder cattle

Over one-half of the annual feeder cattle shipments into the Corn Belt usually occur in the September-November period, October being the month of peak movement. Record herds of cattle in the range and pasture areas assure increased supplies of feeder stock this fall. Drought in some areas as well as the lifting of the embargo on importations of cattle from Mexico will also boost the supply.

These developments have already brought a

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sharp adjustment in feeder cattle prices. Reflecting the break in June and July, the average price at the big Kansas City market in August was about six dollars per hundred pounds below a year ago. This contrasts with only a two to three dollar decline for choice slaughter cattle. Nevertheless, there is no evidence of an avalanche of feeder marketings this fall. Rather, the bargaining between sellers and buyers promises to continue with neither getting firmly settled in the driver's seat.

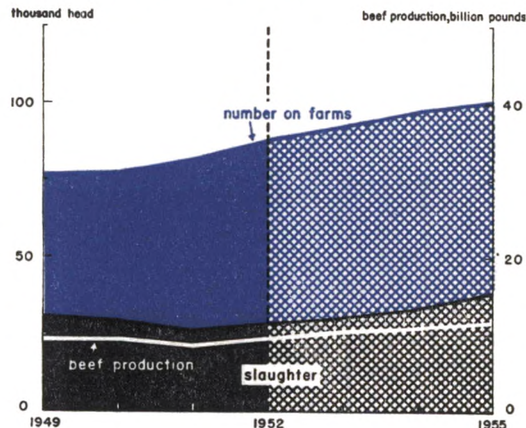
Range producers are resisting the lower prices and, where feed supplies permit, appear to be willing to increase herds further. Many Corn Belt farmers, on the other hand, flatly assert that they will not buy unless prices are seven to eight dollars below a year ago. Recognizing that they paid too much for feeder cattle last year, they are doing some shopping around and waiting. With a good quality corn crop at hand the pressure to "buy irrespective of price" is absent this year. But the net result of the pressure of feed shortages and growing numbers on range producers, and of large feed supplies and reasonable profit prospects on Midwest farmers, is likely to be a record or near-record volume of cattle feeding.

The feed situation

Possibly the most important factor affecting the volume of cattle feeding is the amount of feed available in feeding areas. With a prospective corn crop totaling 3.1 billion bushels, adequate supplies of oats, and a large hay crop, there is enough feed on Midwest farms to support a large volume of cattle feeding in the year ahead. Also, with hog numbers reduced, competition from this source for available feed supplies will be less than a year ago.

Feed grains, of course, can be stored, marketed, or fed whichever appears most profitable. With empty cribs on most farms this fall, corn storage space is available. Furthermore, the level at which price support loans are made for the 1952 crop may exceed the market price at harvest time, thereby encouraging farm storage.

Beef production will rise as slaughter increases



Corn, however, is not the only consideration. The large amounts of hay, pasture, and other rough feeds which Corn Belt farmers typically have available usually must be utilized on the farm by cattle or sheep. Since most of the feed grains are fed along with the roughages, the price support and storage program probably will have only a nominal effect on the number of cattle fed this year.

The widespread interest each fall in the price relationships of feeder to slaughter cattle and of feed grain and hay to beef steers reflects primarily a concern about profit prospects. While some farmers decide each year whether or not to feed cattle, the more usual decision is in terms of, "shall I feed a few more or a few less than last year", "heavier or lighter cattle", "higher quality or more common stock".

Midwest agriculture is geared to the production of feed crops and the conversion of these into meat animals and dairy and poultry products. There is little possibility that farmers will lie down on the livestock feeding job when they have large harvests of feed crops at hand.

The demand for beef will have an important bearing upon the crucial factor of future slaugh-

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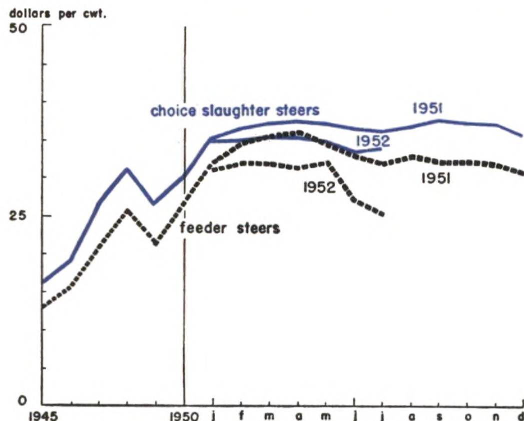
Feeder cattle prices have declined more than slaughter cattle



ter cattle prices. Consumers have been spending about 5.5 per cent of their income after taxes for meat, about one-half of this for beef. This percentage has been relatively stable indicating that any important change in consumer income or supply of beef affects beef and cattle prices correspondingly.

Strong demand for beef

Continued high level employment and a gradual rise in personal income are indicated at least until mid-1953. If realized, this would tend to increase the total volume of expenditures for beef. But this is only the demand side of the story.

The course of beef and cattle prices will be affected also by an increase in slaughter. In the first six months of 1952, cattle slaughter was about 5 per cent larger than in the corresponding period of the previous year. This fall and winter it is expected to show more than the usual seasonal rise, possibly averaging 7 to 8 per cent over the year-ago volume. This would result from the increase in cattle on feed in the Corn Belt states and from a step-up in marketings of grass-fat cattle this fall. The price depressing effect of the increased beef supply will be offset somewhat, however, by a drop in pork supply, indicated to extend through mid-1953. The over-all result is likely to be moderately lower prices for slaughter cattle, with the possible exception of the prime grade, as the current feeding period progresses.

Sources of feeding profits

Cattle feeding profits may be realized from any one or all of three sources. The first involves the addition of weight. To be profitable in itself, gains in weight of course must be attained at a cost per pound which is less than the selling price of the fattened animal. Contrary to the experience of the past three years, the selling price of fed cattle in the current season may be no higher than the cost of weight gains made in the feedlot. Although efficient operators probably will achieve gains at feed costs which will leave a profit margin, the over-all prospects in this respect are not encouraging this year except for the young lightweight cattle.

A second source of profit is tapped if the per hundredweight selling price is higher than the purchase price of the feeder animal. This "spread" or "margin" has been very favorable in most of the postwar years. Last year, however, it was negligible, especially for the higher grade and heavier weight animals.

At the start of the current feeding season the spread between feeder and fat cattle prices averaged about seven dollars, compared with about four dollars a year earlier. This development was general for all types and classes of feeders, but has become relatively more favorable for the lower grades of feeder cattle as the season progressed. Unless slaughter cattle prices decline sharply, profits obtained through margins this year will be appreciably larger than in 1951-52.

A third and not completely independent source of profit results from improving the quality of the animal while in the feedlot. In some instances, this is more important than the addition of weight. In the case of heavy steers

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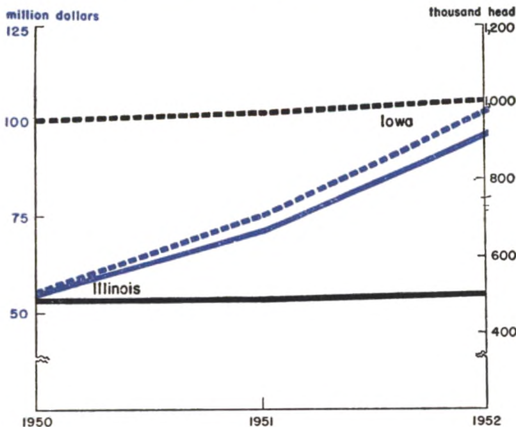
in particular, weight gains alone are generally not profitable. Consequently, farmers handling such cattle, especially on short-term feeding programs, commonly do so with the expectation of marketing a higher grade animal than was originally purchased and thereby widening their margin.

Buy and feed for widest margins

Seasonal patterns of cattle supplies and prices are useful guides to many farmers both in purchasing feeders and selling the finished animals. Highest margins in most postwar years have been obtained from feeding programs designed to put cattle on the market at the time of seasonally high prices. Nevertheless, it is important to recognize that such supply and price movements in any one year may differ widely from the averages.

The price of feeder cattle usually reaches a spring peak then declines until about October, the month of peak marketings. In postwar years, this decline has averaged less than 10 per cent, largely due to the heavy fall demand and limited supply of feeder cattle in several of these years.

Short-term farm loans at member banks boosted more by feeder cattle prices than by number fed



The usual periods of peak prices for fat cattle vary according to grade. The seasonal high price for low grade steers, for example, is commonly reached in the spring when marketings are small and a two-way demand—for slaughter and to put on pasture—exists. Prices of good and commercial grades tend to reach a peak in midsummer, top grades in the fall.

Cattle and credit

Although the amount of credit extended to finance the purchase of feeder cattle is not known, a large part of the short-term farm loans made in important District feeding areas is for this purpose. Outstandings of such loans at District member banks increased nearly 70 million dollars, over 30 per cent, in the last half of 1951. This reflected largely high prices for feeder cattle last year and the large number purchased by District farmers. In the important feeding state of Iowa the increase was 47 per cent.

With current feeder prices well below the year-ago level, Corn Belt farmers can lay in cattle for less money this fall. Most of them, nevertheless, will need some credit to finance their purchases. But the total volume of loans made for this purpose probably will be less than the high level of last year.

The large number of cattle on farms and ranches is a matter of some concern to both farmers and bankers. It portends a further decline in cattle prices as the volume of slaughter and beef production rises. Corn Belt cattle feeders, therefore, must plan to work against an underlying trend of declining prices. This suggests that wide margins between feeder and slaughter cattle prices at the beginning of feeding periods will be needed as protection from the effects of declining slaughter prices during the feeding period. The existing margins are such as to provide a substantial degree of protection. Prospects for the current season, therefore, point to reasonably profitable feeding operations, a more favorable outlook than prevailed a year ago.

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THE Trend OF BUSINESS

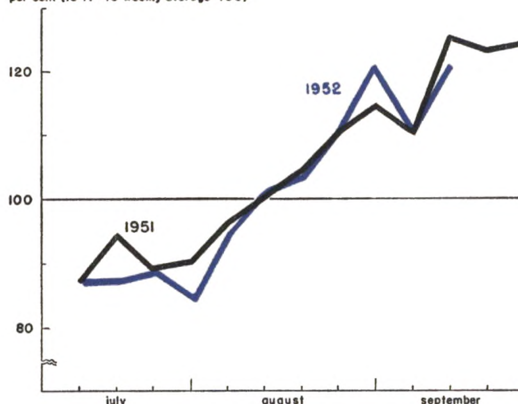
BUSINESS during August and early September has been marked by a rapid recovery in activity from the July low caused largely by the steel strike. Most firms which had been forced to curtail or halt production for lack of steel are now well on the road to resumption of full-scale operations.

Output of steel itself has climbed rapidly with mills operating at 101.5 per cent of rated capacity in mid-September. Automobile manufacturers turned out 133,200 cars and trucks in the week ended September 20 to establish a new high for this year. Over-all industrial production rose about 11 per cent from July to August and promises to approach earlier record rates this autumn.

Reflecting this pickup in activity, business sentiment generally appears more optimistic than in many months. Inventories of steel and of metal-using goods are being rebuilt. Retail sales have been relatively strong and have followed the usual fall uptrend in many lines. Textile manufacturers are enjoying a better volume of sales and orders as burdensome stocks have finally been worked off. According to the Purchasing Agents Association of Chicago, the number of member firms reporting increases in order backlogs during August was the largest since March 1951.

Recently there have been indications that defense outlays may not provide as much upward push for business in the months ahead as had previously been anticipated. The August Budget Review states that military spending in fiscal 1953 will be 6.3 billion dollars less than had been proposed earlier this year. Since then, there have been unofficial reports that schedules for future deliveries of tanks, ammunitions,

District department store sales rise seasonally, about equaling those of 1951



and other types of equipment are being cut back, partly due to steel shortages, and that the military demand for soft goods is on the wane. All this suggests that future increases in defense spending may be relatively moderate.

Such a development might prove desirable from the standpoint of economic stability. Business activity in the months immediately ahead will be supported by the necessity of recouping at least part of the production lost as a result of the steel strike, by continued heavy outlays for plant and equipment on the part of business, and by a strong seasonal upsurge in consumer buying. Under these circumstances, a sizable increase in Government spending might have brought some renewal of inflationary pressures.

Personal income rose appreciably in May and June after having remained remarkably

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stable for the preceding six months. Increases in labor, farm, and unincorporated business income accounted for an over-all gain of 1.6 per cent. Wages and salaries dropped moderately in July, reflecting steel-related layoffs, but probably more than recovered the earlier level in August.

Good rates of activity in most industries combined with somewhat higher average wage rates promise a continued rise in income at least through year end. It seems probable that this will mean stronger consumer demand for many lines than prevailed during the closing months of last year.

Sales at District department stores rose seasonally in August and September, but have not been stronger dollarwise than in the same weeks of 1951. Since price declines have occurred in the intervening period for many types of merchandise carried, however, the physical volume of buying has been considerably larger.

Despite the decline in prices, moderate dollar sales gains have been made by furniture and some kinds of apparel. Sales of household appliances have been moderately, and radio and television sets substantially, below last year during the past month, partly because of a shift in consumer buying to the specialty outlets for these products. Indianapolis department stores have consistently done better in terms of total sales than stores in the other large District centers, reflecting the large volume of defense work in progress in that city.

Savings account holdings of the public have continued to rise steadily during the summer months. Additions to holdings of commercial and mutual savings bank time deposits, savings and loan association share accounts, and Series E and H savings bonds totaled 2,550 million dollars from April through July, 45 per cent more than in the same months last year. The depressing effect of this high rate of saving on sales was offset, however, by an increase in instalment debt of 1,575 million dollars from April through July as contrasted with a small decline during the comparable period in 1951.

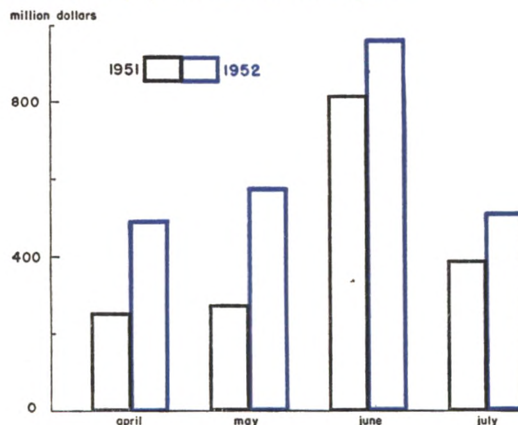
Residential building in the District has varied widely from city-to-city this year. Per cent changes in the number of building permits issued for the year to date as compared with the same months of 1951 are as follows:

Indianapolis	+35
Chicago area	+2
Milwaukee	−4
Des Moines	−21
Detroit area	−31
Grand Rapids	−59

These compare with an increase of 1 per cent from 1951 to 1952 in the number of housing units started privately in the nation from January through July.

Suspension of credit controls over new construction on September 16 is likely to stimulate home-building activity moderately, especially in the price range above 15,000 dollars. Many lenders, however, seem unwilling to extend conventional mortgage credit on terms substantially easier than those required by the Regulation. Down payment requirements for VA mortgages have been greatly relaxed, but the limited availability of 4 per cent loan money is likely to hold house demand from this source in check.

Increases in savings account holdings nationally far above last year*



*Includes commercial and mutual savings bank time deposits, savings and loan association share accounts, and Series E and H savings bonds.

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Deficit without inflation

Expected second-half Federal deficit of nearly 8 billion dollars unlikely to produce new inflationary outburst.

THE FEDERAL GOVERNMENT'S CASH OUTLAYS during the second half of this year will exceed its receipts by almost 8 billion dollars. A deficit of this size at any time may exert powerful upward pressures on the economy. It probably won't this year because the methods used to finance the Federal deficit will cause considerably less monetary expansion than resulted from comparable deficits in the past. Moreover, the deficit occurs in an environment of ample supplies of most goods.

The sizable deficit is a product of the highly seasonal pattern of Federal tax collections and the continued increase in defense outlays. Tax collections will be down sharply in the third and fourth quarters, reflecting the concentration of income tax payments earlier in the year, particularly corporate income tax payments. During most of the postwar period, well over half of Federal taxes have been collected in the first two quarters of the calendar year. This seasonal pattern is becoming more pronounced each year as the Mills Plan requires increasing proportions of the corporate tax liability to be paid in the first half. By 1955, the entire corporate tax bill will be due in the first half.

On August 19, the President estimated that the fiscal year which began in July would show a 6.8 billion dollar cash deficit. This compares with a 55 million dollar cash surplus in the fiscal year which ended this past June. Although tax collections are expected to be higher than ever next spring, the margin over expenditures in the first half of next year will be smaller than in the same periods of 1951 and 1952.

Financing the deficit

The Treasury has already raised much of the cash needed to cover the large second-half deficit. At the end of June, the General Fund balance amounted to nearly 7 billion dollars. This balance was augmented by the 4.2 billion dollars in proceeds from the 2 3/8 six-year bond issue sold at the turn of the fiscal year. In addition, corporations are expected to invest substantial portions of their income tax accruals in tax anticipation bills to be used for tax payments next March and June. The Council of Economic Advisers estimated that this investment will amount to at least 3 billion dollars.

These sources can provide the Treasury at least 10 billion dollars, enough to cover the cash deficit and take care of some net liquidation of other publicly held debt.

Somewhat similar means were used to finance the 5.5 billion dollar cash deficit in the second half of 1951. The General Fund balance was drawn down and substantial sales of tax anticipation bills occurred. In addition, cash was obtained by an increase in the size of the regular Treasury bill issue. The 7.5 billion dollars thus accumulated was used to finance both the deficit and some net liquidation of savings bonds and other securities.

The monetary impact

The monetary consequences of budget deficits will vary depending on the methods used to finance them. If increases in bank deposits and bank reserves are minimized, the potential inflationary impact of budget deficits will be held down. This is because increased deposits by themselves permit higher levels of spending, while increased reserves may support expansion of bank credit. If lenders and borrowers take advantage of this easier credit, private spending will rise. Obviously then, what happens to deposits and reserves is the key to the inflation

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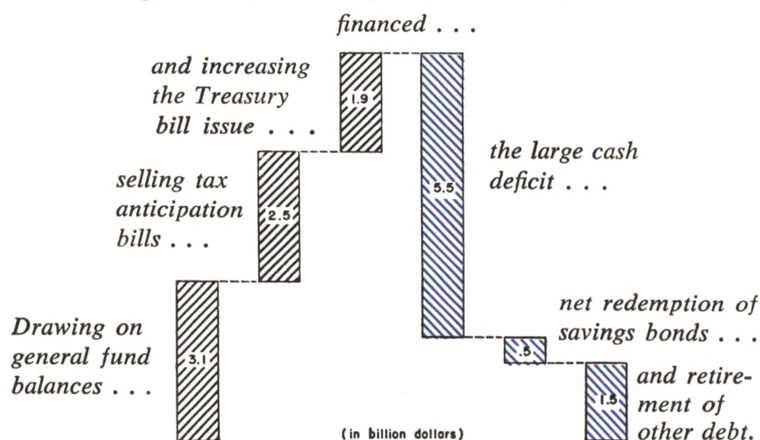
potential when the Government is spending more than it receives in taxes. As illustrated on page 12, under one possible method of financing both deposits and reserves may be unchanged. Another possibility is that deposits may increase without increases in reserves available to support further credit expansion. A third alternative will result in increases in both deposits and excess reserves.

When the Treasury covers a cash deficit by selling Government securities such as savings bonds and tax anticipation bills to nonbank investors, no monetary expansion occurs. Consumers and businessmen exchange bank deposits for Government securities. To the extent that they hold on to their Governments, funds which might have contributed to an expansion of private demand are at the disposal of the Treasury and the immediate monetary effect is not too different from increased taxation.

On the other hand, when the Treasury raises funds by selling securities to banks, there is an increase in total deposits rather than a transfer of existing deposits from private accounts to Government accounts. This is because banks generally buy the securities by crediting the Treasury's accounts at their institutions. If the Treasury's borrowing is not accompanied by Federal Reserve open-market purchases of Governments, no new reserves are created in the process. In fact, banks use up excess reserves otherwise available to support expansion of loans to private borrowers when they create new Government deposits.

However, if Treasury borrowing from the banking system is accompanied by open-market purchases, reserves as well as deposits are increased. Reserves expand because the Federal Reserve Banks pay for the Governments they buy in the market by crediting the reserve accounts of member banks.

This year's second-half deficit is being financed by the first two of these three methods, that is, by sale of securities to nonbank investors and to banks without Federal Reserve reserve-creating purchases. Corporations are expected to purchase most of this year's issue of tax anticipation bills. This transfers existing deposits to the Government instead of creating new deposits. Although the bulk of the original allotments of the 2 3/8 intermediate-term bonds was outside the banking system, a large proportion of these bonds has since been resold to banks. Thus, this aspect of the current deficit financing program on balance has added to total bank deposits. Since Federal Reserve open-market operations have not supplied banks with sufficient reserves to finance their purchases of 2 3/8 bonds as well as to meet the usual seasonal demands for bank credit, member banks have been forced to maintain their borrowing from the Federal Reserve Banks at a high level. However, since banks are reluctant to use this method of acquiring reserves on a large scale for protracted periods,



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The initial results of deficit financing

Method of financing[1]	Impact on: bank deposits	Impact on: bank reserves
Sale of Government securities to nonbank investors	Transfers ownership from individuals and businesses to the Treasury	No change
Sale of securities to banks without accompanying Federal Reserve open-market purchases	Increase in Treasury deposits with no reduction of private deposits	Excess reserves reduced by amounts needed to support new Treasury deposits unless member banks acquire reserves by borrowing from the Federal Reserve Banks
Sale of securities to banks accompanied by Federal Reserve open-market purchases from banks	Increase in Treasury deposits with no reduction of private deposits	Excess reserves increased by amount of Federal Reserve purchases less reserves needed to support new Treasury deposits

[1]Assumes Treasury receives proceeds through tax and loan accounts at commercial banks

the net effect of bank purchases of the 2 3/8 bonds has been to make them also reluctant to increase credit to non-Government borrowers. To some extent this tightness was offset by banks selling other Governments to make room in their portfolios for the 2 3/8.

The spending potential

The reservoir of funds available for private spending is affected both by the fact of Government spending in excess of revenues and by the methods used to finance the deficit. Deficit spending itself increases business and consumer incomes since the Government spending adds more to the private income stream than taxes remove. The financing methods can either offset or aggravate this impact on the private spending potential through their effects on the other two sources of funds for private spending: holdings of liquid assets and available credit. When the deficit is financed through nonbank investors, the increase in potential non-Government demand due to higher incomes is to some extent offset. Privately-owned bank deposits are exchanged for Governments and, if investors hold on to these, their liquidity is reduced.

In the case of a bank-financed deficit with the Federal Reserve playing a neutral role, credit availability is somewhat reduced since excess reserves are reduced as a result of the bank purchases of Governments. On the other hand, there is no offset to increases in current incomes when a portion of the deficit is in effect financed by the Federal Reserve System through open-market purchases. While liquid savings are not directly affected, the increase in excess reserves will make credit more available.

On the whole, the current round of deficit spending and its financing will increase the private spending potential. This is because of the increase in personal and business incomes as Federal spending continues to rise while Fed-

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eral tax collections drop sharply. The sale of tax anticipation bills to corporations will tend to offset this since funds otherwise available to businesses as working capital will flow into the Treasury. Bank purchases of the 2 3/8 bonds are also creating an offset since the resulting tight reserve positions are tending to reduce the availability of bank credit for private borrowers. Financing the deficit via drawing down the General Fund balance simply adds to current income with no offsetting influences.

Potential vs. actual spending

Whether an increase in the private spending potential actually will produce an increase in private spending is another question. Recent years have shown that people will not necessarily spend as freely as increased incomes, easy credit, and high savings will permit. Conversely, people may increase their expenditures without the stimulus of higher income.

In a high-income economy like ours, there is enough of a margin over basic "necessities" to permit postponement or speeding up of many items of spending in response to a variety of stimuli such as fears of shortages, expectations of price changes, and the like. Thus, when incomes rise, as they do under the pressure of Government deficits, private spending may or may not change.

At present, indications are that consumers and businessmen will not respond to moderate increases in incomes with an outburst of buying. Private demand should move up moderately through the end of the year. Offsetting this, supplies of most goods are ample and capacity in many lines is sufficient to support considerably higher levels of output. Existing inventories — producer, distributor, and consumer—current output, and available capacity should be sufficient not only to handle expected Government and private demand, but also to dampen fears of shortages. Thus, with relatively mild monetary expansion and a good supply situation, the inflationary push from this year's second-half deficit should not be serious.

Business loans *continued from page 4*

nation's large banks. A glance at the accompanying chart indicates the most obvious reason. While some bank credit was drawn down to finance plant expansion and conversion, more borrowings were associated with the nearly 6 billion dollar or 40 per cent rise in inventories over the past 16 months.

The causes for such a rapid build-up of stocks, of course, are centered primarily in the nature of defense procurement. Large stocks had to be accumulated to enable quantity production of military "hard goods" and inventories of many items multiplied as a result of the inevitable reschedulings, revisions of specifications, cancellations or suspensions of contracts, and lack of coordination among suppliers. Nondefense inventory accumulation also played some part in the first-half 1951 rise, for consumer durable goods sales dropped below expectations after the first two months of that year. But most such civilian stocks have long since been worked down; with few exceptions they are no longer an important part of the net inventory accumulation.

The recent steel strike naturally produced a sharp drop in metals inventories and a corresponding but milder reduction in bank borrowings as well. Even before that time, however, there were indications that the heaviest stocking and borrowing by metals firms was over. The process of closing the gaps left by the prolonged stoppage of steel production will undoubtedly entail some further net borrowing by concerns in these industries. With stocks already high and Government payments for deliveries under contracts growing, however, it is probable that borrowings by metals firms in the last half of 1952 will make a far smaller contribution to over-all business loan expansion than was true a year ago.

Loans to carry commodities

Governmental policies may also affect the figures on business loans this fall. The operations of the farm price support program may

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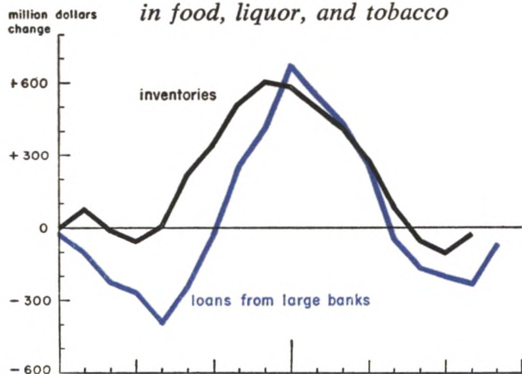
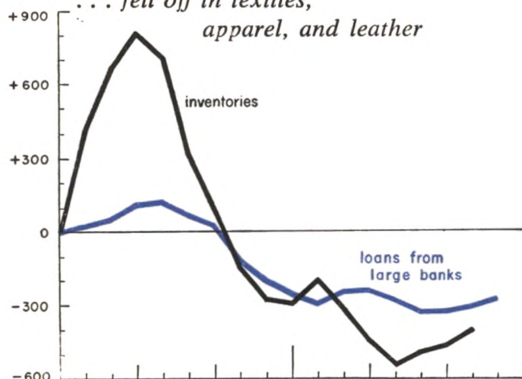
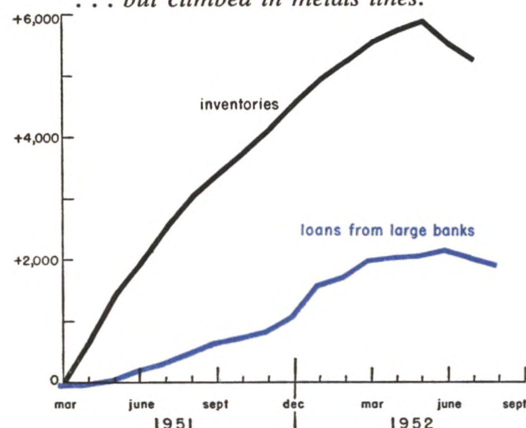
After March 1951, loans and inventories:







serve to place a sizable volume of loans outside the large reporting banks.

Among the businesses which borrow most heavily from banks each fall are the dealers in agricultural commodities. During the last half of 1951, such firms accounted for over 700 million or one-fourth of the total increase in larger business loans granted by the nation's large banks. This year, however, the market price of wheat and corn—and less certainly, cotton—may be significantly lower than the "loan support" prices set by the Commodity Credit Corporation. Under these circumstances, many farmers will choose to store such crops under C.C.C. loan arrangements rather than market them immediately through normal channels.

Bank credit will be employed in the process, but instead of being granted by banks in large centers to private dealers and processors it will stem from smaller rural banks in the form of C.C.C.-guaranteed loans to farmers on "sealed" crops. Only a part of the total crop will be financed on this basis, and a number of rural banks will find it necessary to pass on some of these loans to their larger city correspondents. Nonetheless, the effect of these operations should shrink the seasonal rise in business loans to carry commodities made by the nation's large reporting member banks.

The question of tax accruals

Another potential Government influence on the course of business loans stems from the revised corporate tax payments schedule. Under the terms of the Mills Plan, corporate tax payments are being compressed into the first half of the year following incurrence of liability. As a result, some corporate cash which would formerly have been siphoned off to pay taxes in September and December is now available as working capital until March and June. Conceivably such "unpaid tax money" could serve as a substitute for seasonal bank borrowing during the fall.

But there is another side to the coin. The Mills Plan reduces tax payments in the last

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half of the year by increasing them in the spring. Thus, firms whose annual peak in fund needs does not always disappear until after the heavy March 15 tax payment date may not be able to regard their "unpaid tax money" as a dependable source of temporary working capital. Officials of such concerns may feel that the prudent course is to continue to rely upon bank loans to carry the seasonal load.

Such decisions will be encouraged by two other aspects of Treasury finance. One is the forthcoming offering of several billion dollars of Treasury "tax anticipation" securities specifically designed for purchase by corporations to balance tax liabilities. The other is the legal provision that 75 per cent of average borrowings by corporations can be used as a capital credit in computing excess profits tax liability. Accordingly, many corporations will find it both convenient and profitable to invest "unpaid tax money" in Treasury "tax anticipation" securities while at the same time obtaining temporary working capital funds through bank loans. As a result, it is not likely that this latest wrinkle in corporate taxation will produce more than small-scale reductions in seasonal borrowings from banks during the last half of 1952.

The over-all picture

The manufacturing interests and commodity dealers discussed above generally have set the tone in business loan growth in recent years. In the current half year few other businesses will produce such significant changes in borrowings. Most likely remaining candidates for important shifts in borrowing needs are the sales finance companies. While Regulation W was in effect, such companies made net repayments of loans from large banks during 1951. Since the suspension of Regulation W in May 1952, however, consumer instalment credit has been rising at a fairly rapid rate. If this trend continues, sales finance companies may originate sizable net demands for bank loans before the year is out.

At times in the past, a simple run down of the potential loan demands of business has been enough to delineate prospective business loan expansion. This fall, however, the availability of credit may play an important part in setting the dimensions of loan growth.

In most banks, loans now account for the largest proportion of total assets in more than a decade. "Loaned up" is a phrase which is becoming increasingly common in banker-borrower conversations. This does not portend refusals of necessitous requests for credit by good customers, but it does suggest that bankers will be more reluctant to accommodate loan applications not rooted in certain business needs. Such bank reluctance is abetted by the tight reserve positions of larger banks. Despite a temporary mid-September surplus of funds, experience suggests that reserve tightness will predominate from now until Christmas.

The net result of all these diverse influences is obviously difficult to estimate. In good part it depends upon the subjective reactions of bankers and businessmen to the pressures at hand. In mid-September, business loans at reporting member banks had risen 670 million above the first-of-July level, 20 million less than the rise in the comparable period last year. In total, the 1951 last-half rise amounted to 2.4 billion dollars. All things considered, a substantially smaller rise appears in order for 1952. The current margin of 1.4 billion over year-ago levels of business loans is susceptible to shrinkage between now and year end.

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Debt cost

THE INTEREST CHARGE to the world's largest borrower, the U.S. Government, passed another milestone recently when the computed annual cost on the total Federal debt went over the 6 billion dollar mark. This is 350 million above a year ago—the largest annual increase since the end of the war.

Although interest payments and accruals have been mounting steadily for two decades, the "burden" of this cost relative to the national income has swung both up and down. In 1941 the interest charge was 1.3 per cent of the national income, in 1946 3.0 per cent, today 2.1 per cent.

The factors involved

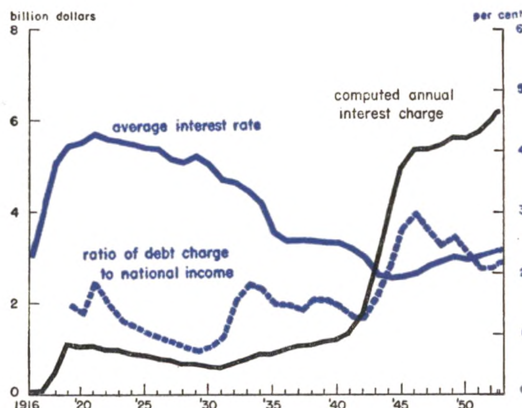
Debt cost reflects the size of the interest-bearing debt, its composition, and the rates on the various securities. The change in debt-size depends upon the difference between tax receipts and the level of expenditures determined by Congress. If there is no change in the amount of debt outstanding, the cost will be influenced only as securities are refunded or as interest rates change.

Since the war, issuance of relatively high rate nonmarketable and special securities pushed up the average interest rate on the debt. As an offset, however, the Treasury refunded most of the maturing debt into short-term issues carrying lower rates. But since Korea, short-term rates have risen sharply in relation to long terms. The new 14-month note at 2⅛ per cent tops the rate on 10-year money borrowed during the war. The cost reduction from refunding into short terms, therefore, is now less significant. The desirability of short-term refundings is further reduced by the disadvantage of frequent roll-overs of a larger and larger proportion of the debt.

In the last year or so, the rising debt cost reflected about 8 billion dollars of additional net borrowing as well as a boost in interest rates. The steady rise in rates stems from the return of relatively free market conditions in the supply and demand for funds, accompanying the withdrawal of Federal Reserve support of Government securities. It reflects, therefore, the heavy competition confronting the Treasury by private borrowers.

In the Government security market that now exists, rate movements reflect over-all credit demands. The Treasury has to meet the competition for funds required to finance private investment for plant and equipment expansion, for residential building, and for state and local construction. Current and prospective economic conditions can thus sharply affect future debt costs. If private investment spending recedes from its current record level, if the housing boom abates, and if state and local borrowing slackens, the Treasury's borrowing cost, along with that of other borrowers, will tend to decline. But if credit demands from these sectors remain strong, the Treasury will continue to pay high rates for new funds and refundings. In short, the future debt cost under present monetary policy will depend very largely upon changes in investment needs and the general economic environment.

Federal debt cost and debt "burden" over the years



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