

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

Business Conditions

1953 May



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THE Trend OF BUSINESS

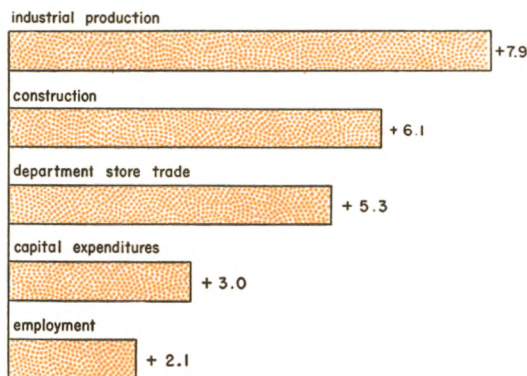
FOR MANY MONTHS pronouncements on the business outlook have been prefaced by the proviso—"no change in international tensions." Now, only a few short weeks after Georgi Malenkov grasped the reins of Soviet power, oil appears to be spreading over the turbulent waters separating East and West. Conference tables at Panmunjon are dusted off, Vishinsky smiles at fellow delegates, Pravda recalls World War II friendships, and business forecasts are subject to re-examination.

The possibility that peaceful Russian gestures are merely a prelude to a resumption of the diplomatic or military offensive at a more opportune time cannot be ignored. For the time being, however, it must be assumed that pressures to reduce the arms budget will be stepped-up and that many consumers, businessmen, and lenders will reconsider earlier plans to enter into new commitments. The more bearish attitude was reflected in the jolt suffered by the stock and commodity markets in early April.

Would peace in Korea bring an abrupt end to the unparalleled prosperity of recent years? Not necessarily. According to the staff of the Joint Committee on the Economic Report, the war accounts directly for 4 to 5 billion dollars per year, only about 10 per cent of all national security outlays. Moreover, most of this expenditure would continue long after a cease fire. More important, however, is the fact that the boom following last summer's steel strike has been almost entirely a civilian phenomenon.

The current rate of national security outlays of about 50 billion dollars per year is little changed from a year ago. Gradual elimination

First quarter activity gains



january - march percentage change from 1952

of wage, selective credit, and allocation controls during this period helped boost civilian purchases to new highs. According to tabulations of expectations made prior to the resumption of the truce talks, high-level activity might have been expected to continue through most of 1953. The final results of easier international relations will depend largely upon the degree to which the following expressions of bullish sentiment have been modified.

Construction of all types was expected by the government agencies to exceed last year by 4 per cent. Thus far, it appears that this forecast was modest. The 7 billion dollar outlay of the first quarter topped the like period of 1952 by 6 per cent, and contract awards have been still more impressive.

Business expenditures on new plant and equipment have been estimated by

the SEC at 27 billion dollars—a new record. These projections were higher than a similar survey made last fall.

Secretary of Commerce Weeks reported at the end of March that “every major industry expects higher sales volume in 1953 than in 1952.” Appliance makers look to a sales gain of 20 per cent, and automobile firms are planning for at least a 30 per cent boost.

The Federal Reserve Board’s Survey of Consumer Finances taken in January and February reveals that individuals consider themselves to be in better financial shape than last year and expect to buy more durable goods and houses.

Expectations, of course, are subject to change, but the available data on the performance of the economy in the recent past indicates a momentum which will not be dissipated suddenly. March, usually a dull month as a result of heavy tax payments, produced some eye-catching reports of the business tempo.

Industrial production rose for the eighth straight month to a level 9 per cent above the year-ago mark.

Steel output exceeded 10 million tons for the first time in history. Nevertheless, some users still seek supplies at premium prices.

Passenger cars were turned out at a rate 50 per cent above 1952, and still greater numbers were scheduled for following months.

Department store sales exceeded year-ago figures by 8 per cent after allowance for the different Easter date. The early weeks of April continued to show rather good results.

Countering the rosy glow of these data are a number of disquieting developments which, even in the absence of adverse psychology resulting from international developments, could cause some edging down in over-all activity in the coming months. Most of the following

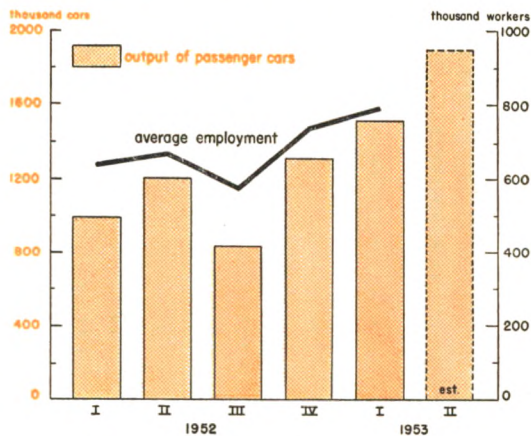
items are of particular interest to Midwesterners.

Cash farm income in 1953 is expected to be as much as 10 per cent below last year. In part, the farmer’s loss is the city dweller’s gain in lower food prices, but suppliers of farm machinery and fertilizer have found that their markets are showing again the seasonal ups and downs of prewar years.

Cutbacks in aircraft orders held by “second-source” contractors in Detroit, South Bend, and Chicago will tend to loosen currently tight labor markets. At the present time, workers released by affected firms could readily find employment elsewhere, but this situation might not prevail some months hence.

Consumer durable goods output probably cannot be maintained at current levels if involuntary inventory accumulations are to be avoided. Passenger cars are expected to be turned out at an annual rate of over 7.5 million in the second quarter; most optimistic estimates of sales prospects for the year as a whole are not much above 6 million.

Automobiles lead recent output upswing



Foreign markets important for many Midwest products

THE FOREIGN TRADE of the United States exceeds that of any other country. Yet, it is a small part of our domestic production, much smaller than in the case of other world powers. In 1952, United States exports totaled only about 5 per cent of our national income.

Nevertheless, export sales are of importance to the domestic economy. The Bureau of Labor Statistics has estimated that in 1949, excluding employment attributable to agricultural exports which comprise approximately one-quarter of our overseas shipments, about 1.7 million persons were employed in the production and distribution of goods and services destined for foreign markets. Since then, the volume of exports has increased by 14 per cent. Our total shipments abroad exceed outlays in some important segments of our economy. For example, in each postwar year except 1950, the value of U. S. exports has topped outlays for urban residential construction and has greatly exceeded retail sales of new automobiles.

Although the demand of the rest of the

world for U. S. products is a significant factor in the market outlook for many individual industries, it is usually given little attention in appraisals of over-all business prospects. Yet, any change in the volume of exports can have the same effect on domestic activity and employment as a change in domestic spending. Tractor workers in Peoria and Moline, auto workers in Detroit, and soybean farmers in Iowa represent a few of the persons in the Midwest whose employment and income result, in part, from our export trade.

Industrial Exports

A large share of the United States industrial exports are produced in Midwest plants and factories. According to recent estimates, Illinois, Indiana, Iowa, Michigan, and Wisconsin account for over 23 per cent of U. S. nonagricultural sales abroad, exclusive of military aid shipments.¹ In 1952 exports of industrial products reached a new high of 11.6 billion dollars—77 per cent of our total overseas business. Of these exports, 2 billion were military end-items shipped under mutual security grants to foreign countries.

On a per capita basis, Michigan, with exports of 139 dollars per person, stands far ahead of the other Midwest states. Over two-thirds of Michigan exports come from the motor vehicle and equipment industries. As a result of the large-scale steel production and petroleum refining in the Gary-Hammond area, Indiana ranks second with per capita exports of 95

A number of major industries serve large export market

Product line	Production 1950 (million dollars)	Exports as per cent of production	
		1950	1951
Household refrigerators..	1,100	5	14
Coal	4,500	5	11
Diesel engines	46	13	*
Machine tools	167	22	11
Primary copper	532	14	13
Tractors	158	21	21
Motor trucks and coaches	1,747	11	16

* Not available

¹Based on 1951 pattern of exports and 1947 pattern of employment in export industries. The estimates for the individual states have been derived by assuming that District states share in U. S. exports in proportion to their relative importance as employers in the various industries.

dollars. Illinois and Wisconsin follow with 70 and 66 dollars, respectively. Inasmuch as these figures do not include agricultural products, Iowa, predominantly a farming state, trails with exports of only 27 dollars per person.

The Midwest is the leading producer of much of the machinery, transportation equipment, and iron and steel products that make up a large part of U. S. exports. Last year, machinery and equipment accounted for over 28 per cent of our nonagricultural foreign sales, exclusive of military aid shipments, while automotive and iron and steel products added 10 and 8 per cent, respectively.

Major exporting industries

Close to three-fourths of all *motor vehicle* and equipment production in the United States is located in District states. Concentrated around the "Motor City" in Michigan, the automotive industries pay out over a third of the wages and salaries received by workers in that state. The Detroit area output of autos and

trucks, combined with that of Studebaker in Indiana, Nash in Wisconsin, Diamond T in Illinois, and the branch plants and parts manufacturers throughout the region, generates over 15 per cent of total nonagricultural income in the five-state area. The employment of nearly 30,000 motor vehicle and equipment workers in the District can be directly traced to 1952 automotive export sales.

Exports of passenger cars and trucks in 1952 were 30 per cent lower than in the preceding year. The main cause of this decline was import restrictions and quotas imposed by a number of countries to conserve dollars. It is generally agreed that, despite increased foreign competition, a large potential overseas market exists for U. S. cars and trucks.

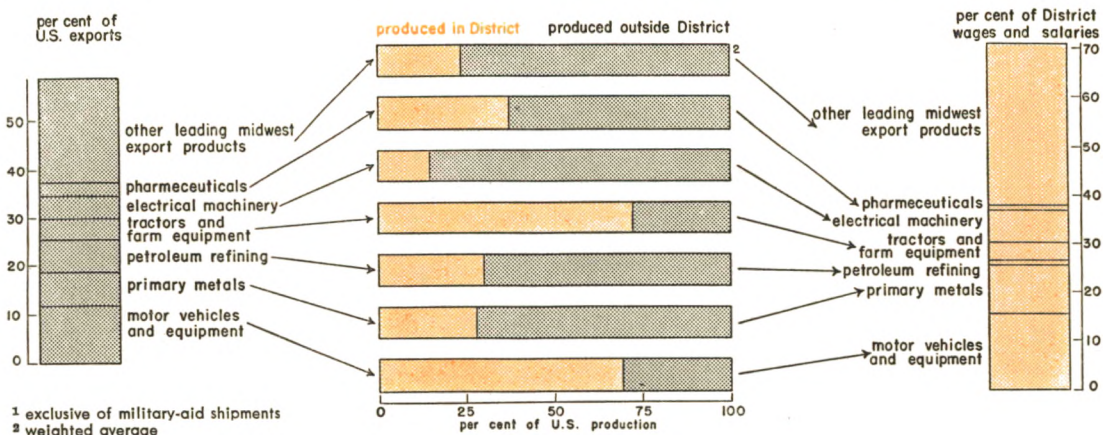
The *primary metals* group, the producers and primary fabricators of steel and other metals—second in size in this area only to the automotive industry—accounts for about 10 per cent of total wages and salaries received by workers in the Seventh District. Over one-

Exports from Midwest industries

Over one-half of U.S. nonagricultural exports¹ . . .

are produced by industries located largely in the Midwest . . .

and which provide about three-fourths of District wages and salaries.



quarter of total U. S. primary metal output is in this region, with production concentrated in the Chicago and Detroit metropolitan areas. In 1951 foreign sales of these industries totaled 648 million dollars, 7 per cent of U. S. industrial merchandise exports.

The bulk of all American-made *tractors* in use throughout the world were produced in the District states. About three-quarters of the tractor and farm equipment made in the U. S. is manufactured in this area—the proportion being even higher for tractors alone. The District includes the home office or major plants of International Harvester and Oliver in Chicago; Ford and Ferguson in Detroit; J. I. Case in Racine; Caterpillar, specializing in nonfarm tractors, in Peoria; Allis-Chalmers in Milwaukee; and in Moline both John Deere and one plant of Minneapolis-Moline. About 4 per cent of total wages and salaries in the District originate in tractor and farm machinery production. Over 16,000 jobs for Seventh District farm machinery workers are directly attributable to sales abroad.

In every postwar year foreign sales of tractors have been important relative to total sales. In 1951 exports of tractors reached 202 million dollars, over 19 per cent of the value of domestic tractor production.

Industrial exports from Midwest states

	Value of exports produced 1951*	Per cent of total U. S. nonagricul- tural exports**
	(million dollars)	
Illinois	619.3	6.3
Indiana	385.6	3.9
Iowa	72.5	0.7
Michigan	915.7	9.4
Wisconsin	232.1	2.4
Total	2,225.2	22.8

*Based on 22 major Midwest industries, which account for 59 per cent of U. S. nonagricultural exports. The products making up the remaining 41 per cent are produced almost exclusively outside the District.

**Exclusive of military aid shipments.

Exports of the *electrical equipment* industry reached 446 million in 1951 and about maintained this rate in the first three quarters of 1952. About 30 per cent of all workers engaged in manufacturing electrical machinery in the U. S. are employed in the five-state area, with half of the District output concentrated in and around Chicago. The major products include communication equipment, appliances, and industrial apparatus.

Another prime example of a prominent Midwest industry that serves foreign markets is that of *pharmaceuticals*. This District produces close to 40 per cent of all drugs and medicines manufactured in the U. S. Leading producers in the District include Parke, Davis and Company and Upjohn located in Michigan, Eli Lilly in Indianapolis, and Abbott Laboratories and Searle located in the Chicago area. During 1951 exports of pharmaceuticals reached a record 281 million dollars, compared with 22 million in 1939. Although the "dollar shortage" has held down the total of foreign sales somewhat, it has been less restrictive in the drug lines due to the fact that medicinals have usually received favored treatment at the hands of import licensors.

These are but a few of the more important industrial products of the Midwest which are exported in substantial volume. Also important are items such as diesel engines and turbines, railroad equipment, refrigeration machinery, photographic equipment, and a raft of fabricated metal products and industrial machinery, as well as a variety of smaller items such as fountain pens and safety razors.

Agricultural products

Recent events have pointed up the importance of agricultural exports to farm prosperity. Aside from cattle, much of the decline in prices and rapid accumulation of stocks under price support programs in the past year is traceable to a decline in foreign demand. Exports of agricultural products fell by 15 per

Exports vital to many farm products

Commodity	Cash farm receipts 1951 (million dollars)	Exports as per cent of production 1951
Whole dry milk.....	39	46
Raw cotton	2,475	42
Rice	192	36
Wheat	1,678	36
Grain sorghums	134	32
Soybeans	770	28
Tobacco	1,187	26
Lard	416*	24

*Wholesale value of production.

cent in 1952, from over 4 billion dollars in 1951 to 3.4 billion last year. Cotton and grains took the biggest drop—cotton exports declined by over 20 per cent. This downward trend in farm exports has continued into 1953, with January agricultural shipments off 29 per cent from those of the previous January.

About one-fifth of cash farm receipts originate in the production of cotton, wheat, tobacco, and soybeans—commodities which account for about two-thirds of our agricultural exports. Although small as a percentage of total output, corn exports reached 207 million dollars in 1951 to rank as the fifth largest farm commodity entering into export trade. Also, about half of all hogs are produced in the Midwest. In 1951 shipments of lard outside the U. S. exceeded 132 million dollars—24 per cent of the lard produced in that year.

The Midwest is important in the production of a number of farm commodities exported in

	Per cent produced in District states
Soybeans	61
Dry whole milk	60
Lard	49
Corn	40
Wheat	19

large quantities. It is estimated that about one-

sixth of all agricultural shipments abroad come from Midwest farms. This proportion is somewhat lower than the share of U. S. farm commodities produced in this area because of the huge role of cotton and tobacco in the nation's export trade.

But the Midwest farmers' interest in export demand for U. S. farm products is still substantial. As foreign demand for cotton and wheat declines, some of the land and resources now devoted to the production of these commodities will be shifted into products that compete directly with Midwest farm output. So, any decline in exports of crops grown largely in other areas will increase the competition in domestic markets for agricultural commodities that are now produced mainly on Midwest farms.

Of interest to Midwest

Thus, even though exports make up only a small part of total U. S. production, they are important to many segments of our economy. They are of particular significance to a number of individual commodities and the areas in which these are produced. Seventh District states account for almost one-fourth of all U. S. industrial exports and one-sixth of total agricultural shipments abroad. Numerous Midwest centers are dependent on products for which foreign markets are important. Thus, developments affecting the course of U. S. foreign trade will have a definite impact on the Midwest economy.

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Farm loan demand shifts

FARMERS are adjusting their use of credit to changes in prices, market prospects, and their own financial position. This is indicated by the results of a recent opinion survey of Midwest country bankers. Although bankers in all District states expect more farmers to borrow this year than in 1952, the total amount of short-term farm loans probably will not exceed that of a year ago.

Less cattle credit

It is in livestock loans that the most general change is expected. More than two-thirds of the country bankers say that farmers will use less credit to buy livestock this year. Among the Iowa bankers, four out of five express this view.

Lower prices for both beef and dairy cattle are the major reason. With lower values, less credit is needed to finance the purchase of a given number of animals. A further factor is the "profitless feeding" which many Corn Belt farmers have experienced. This is tempering the use of credit to finance feeder cattle as both borrowers and lenders review their situations in the light of recent developments.

Income of Midwest cattle feeders was cut sharply in 1952, and the prospect for cattle now in feedlots is not encouraging in view of the more than 30 per cent decline in slaughter steer prices at Chicago in the first three months of this year. About one-half of the country bankers report that farmers expect to realize less than the market value from feed put into cattle now in feedlots. In the important cattle-feeding areas in Iowa and Illinois this expectation is even more widespread.

The current unfavorable outlook does not necessarily suggest a reduced volume of cattle feeding this fall and winter. But with lower

prices and some weeding out of marginal feeders, there probably will be less credit involved.

Less machinery credit

With farm income easing down it might appear that an increased amount of credit would be used to finance farm machinery purchases. But country bankers say this is not the case. Fully half of them estimate that farmers will use *less* credit to buy farm machinery this year than in 1952.

As with livestock, this view is most general in Iowa and Illinois where the growth in short-term farm loans has been very rapid in recent years. Considering the durable nature of farm machinery and the large volume of purchases since 1945, many farmers could postpone additional buying if they should feel a real squeeze on current income. Only one in six bankers expect farmers to use *more* credit to finance machinery purchases this year than in 1952.

More general operating credit

But Illinois, Indiana, and Iowa farmers will use a larger amount of credit this year for general operating purposes such as planting, fertilizing, and harvesting crops and covering other day-to-day farm operating and family living expenses, according to country bankers in these states. Michigan and Wisconsin bankers, on the other hand, expect little change in requirements for this type of credit.

What does this mean with regard to District banks' short-term lending to agriculture in 1953? Primarily, it reflects the effects of declining cattle prices on the demand for credit. Secondly, it suggests that any belt tightening that takes place in Midwest agriculture is likely to show up, at least in part, as a reduction in machinery purchases and credit extensions for this purpose. Finally, the indicated increase in use of credit to finance general farm operations reflects farmers' efforts to put "first things first" in the use of credit as declining prices reduce their profit margins.

Financing the family car

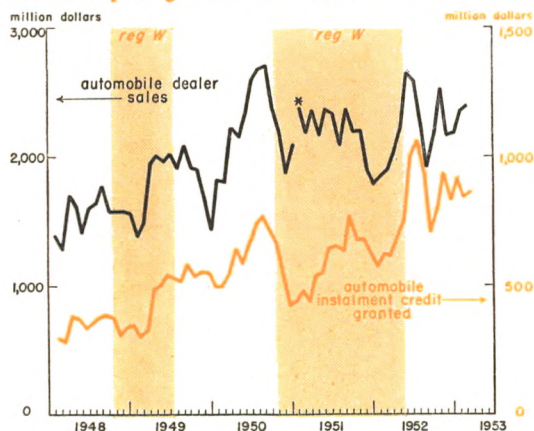
*Instalment credit of growing importance
in the demand for automobiles.*

SUPPLYING CREDIT for the purchase of cars on the instalment plan has become a big and highly competitive business in recent years. Credit extensions for this purpose amounted to a record 10 billion dollars last year. This was two-thirds more than the 1949 volume and three times that of 1941, the most active pre-war year.

Sales finance companies, the traditional source of automobile credit, are supplemented by the growing number of banks which have entered the instalment credit field during the past decade. In most communities this means that there are several sources of credit available to finance sales of new and used cars. As a result, funds for such financing have been in generally ample supply, despite the rapidly rising needs of borrowers.

Ready availability of instalment credit is

*Instalment credit extensions
for purchase of cars have risen
more rapidly than dealers' sales*



*revised series

essential to automobile dealers. A large proportion of car purchases are financed in part through the use of credit, and this proportion has increased substantially over the postwar period. Credit extensions last year accounted for 38 per cent of the retail dollar volume of automobile dealers, as compared with 28 per cent in 1951 and 22 per cent in 1948. Moreover, these figures understate the role played by credit in automobile financing, since a sizable portion of dealers' sales volume consists of repair work and sales of parts and accessories.

The announced intention of the automobile industry is to increase the output of cars from 4.3 million units in 1952 to over 5.5 million this year. So far this estimate has been backed up by production at an annual rate of 6.1 million units in the first three months of the year. If this rate of output is continued and inventory accumulation is to be avoided, dealers' sales will have to expand by about one-third this year. Obviously, this higher volume of sales would require a very substantial increase in the amount of instalment credit extended, even if the proportion of credit buying does not increase further. In these circumstances, the question of whether lenders will supply even larger amounts of funds at the liberal credit terms currently prevailing becomes an important factor in the sales prospects for new and used automobiles.

Credit buying bulks large

New passenger car sales last year totaled 4.2 million, a decline of about one-sixth from the 5.1 million sold in 1951. Although no total figure on used car sales is available, new car dealers sold 7 million used cars in 1951 and

6.9 million in 1952, including those which were wholesaled to used car dealers. Taking into consideration privately arranged sales and direct purchases and resales by used car dealers, a reasonable estimate of the total number of used cars sold in each year might be in excess of 8 million units.

Most of these cars were financed in part through the use of instalment credit. According to the *Survey of Consumer Finances*, 55 per cent of all consumers who purchased automobiles in 1951 utilized credit (including single payment loans). It seems clear that this proportion rose much further last year, perhaps to 65-70 per cent. The increased importance of credit buying is evidenced by the fact that the volume of instalment credit extended on automobiles increased by one-third from 1951 to 1952, while the number of cars sold declined 5-10 per cent.

The *Survey* revealed a significant difference between the frequency with which credit was used in 1951 for new and used car purchases. Fewer than half of the new car buyers required instalment credit to finance their purchase, as compared with 6 out of 10 used car buyers. The reasons for this can be found in the differing financial positions of new vs. used car buyers. First, 4 out of 5 new car buyers already had an automobile which they traded in or sold privately, as against 3 out of 5 of those who bought used cars. This narrowed considerably the difference in the average net outlays of the two groups (see table). Second, over half of the new car buyers earned an income of \$5,000 or more, as compared with only one-fifth of those who purchased used cars. More than three-fifths of the used car buyers were in the \$2,000-\$5,000 income class.

All *Survey* findings point to persons of moderate income as the most frequent users of credit in financing car purchases. Buyers with large incomes often have the resources to purchase without resorting to the use of instalment credit. On the other hand, most of those with low and irregular incomes are unable to

Car buying in 1951

	New cars	Used cars
Average purchase price.....	\$2,390	\$790
Buyers making trade-ins.....	81%	59%
Average net outlays.....	\$1,440	\$570
Buyers using credit.....	47%	60%

obtain credit, both because of their financial situation and the fact that they usually purchase the older used cars which are considered to be less desirable collateral. Moreover, the average user of credit has only limited holdings of liquid assets. In 1951, 6 out of every 10 car buyers who held less than \$500 in liquid assets early in the year borrowed, while only 1 in 10 of those holding liquid assets of \$2000 or more utilized credit in making their purchase.

These characteristics emphasize the importance of credit terms in bringing credit buyers into the automobile market. Smaller down payments and a moderate reduction in the required monthly payment are of considerable importance, not only in attracting additional buyers, but also in making it possible for credit users generally to buy more expensive cars.

Prior to the ending of Regulation W last spring, borrowers were required to pay one-third down and the balance in 18 months. Since then credit terms have been markedly liberalized. Although terms vary from one lender to another and among localities, new cars commonly are being financed at one-fourth down and 24 to 30 months to pay. Used car terms have continued somewhat more restrictive, with one-third down and 18 to 24 months to pay usually required. The relaxation in terms which has taken place undoubtedly was the major factor leading to the sharp rise in the number of cars bought on credit last year.

Competition among lenders

Instalment credit is extended to car buyers

in one of two ways. Most commonly, financing is arranged through the dealer, who subsequently sells the credit contract to an institutional holder. A second and growing method of financing involves direct negotiation between the borrower and a lending institution for a loan secured by and for the purpose of purchasing a car.

A variety of lenders extend automobile instalment credit. These include industrial banks and loan companies, credit unions, and automobile dealers themselves, who may hold and service some or all of the credit paper they originate. The lion's share of the business, however, is done by sales finance companies and commercial banks. At the end of 1952 sales finance companies held about half and commercial banks 44 per cent of the 6.8 billion dollars in automobile instalment credit outstanding.

The most striking development which has occurred in automobile instalment financing during the past two decades has been the growth in commercial bank activity in this field. In 1939 bank holdings of car loans amounted to only 44 per cent of the holdings of sales finance companies. By 1941 this proportion had increased to 55 per cent, and in the postwar period automobile instalment loans of banks have been roughly equal to those of sales finance companies.

The greater importance of banks in the automobile instalment loan field since the war reflects both the growing number of banks which engage in this type of lending as well as efforts on the part of some to increase their volume of business. Most banks now do some instalment lending, and many have set up personal loan departments and aggressively compete to purchase instalment paper from automobile dealers. There are several reasons for the increased interest of bankers in the instalment credit business. First, it serves as an additional outlet for funds in the bank's own community. Second, when run as a specialized operation and on a volume basis, automobile instalment lending

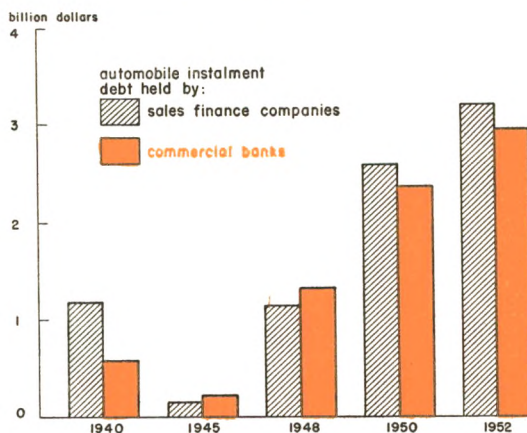
has proved more profitable than many other types of bank loans and investments.

Finance company financing

Sales finance companies have been specialists in automobile instalment financing for many years. The bulk of the business is done by several very large national companies, but hundreds of smaller firms operate successfully on a regional or local basis. In recent years the losses experienced on instalment credit have been relatively low, and sales finance companies have realized very favorable profits. In 1951, for example, a sample of companies reporting to the First National Bank of Chicago showed net profits after taxes averaging 15 per cent of net worth and net losses equal to less than one-half per cent of the instalment credits fully paid down or otherwise liquidated during the year.

The funds with which sales finance companies operate come from several sources and are relatively flexible in amount. Long-term capital is supplied through investments of stockholders, including retained earnings, and also through the sale of junior debenture bonds, principally

Automobile loans at commercial banks and sales finance companies up sharply



to insurance companies. The major portion of sales finance company funds, however, are obtained on a short-term basis, in the form of borrowings from banks and also from the sale of three-to-nine month commercial paper in the open market. As of mid-1952, the sources from which investible funds had been obtained by companies in the First National Bank sample were as follows:

Bank loans	56%
Commercial paper	10
Unearned income and loss reserves	7
Long-term debt	11
Net worth	16
Total resources	100

Operating so heavily on the basis of short-term borrowings, the possibility that sales finance companies might not be able to obtain sufficient funds to meet the potential demands of automobile credit buyers cannot be overlooked. No serious difficulties appear to have been experienced in providing for the rapid rise in instalment borrowing to date, however, and there would seem to be little reason for expecting sales finance companies to come into disfavor with lenders so long as currently high credit ratings are maintained.

One result of the competition among commercial banks and sales finance companies in making automobile instalment loans has been a general decline in interest rates charged. Whereas a 6 per cent rate per year on the original amount borrowed appears to have been customary before the war, loans at 4½ and 5 per cent are now generally available. In some areas, where competition has been especially vigorous, interest rates have fallen as low as 3½ per cent.

Prospects are for continued growth

The volume of automobile instalment credit extended, of course, is closely related to total sales of automobiles. Since dealers' sales are

currently running well above a year ago and manufacturers plan to better last year's output by about a third, the demand for instalment credit is certain to continue high in the months ahead. Moreover, it seems likely that dealers, hard-pressed to sell the large volume of new cars produced and used cars traded in, will exert strong pressure on lenders to ease credit terms further.

There seems little doubt that the funds needed to finance those credit buyers who meet reasonable risk standards will be forthcoming. Commercial banks can shift a somewhat larger proportion of their resources into this growing field of credit if they so desire, and at least the larger sales finance companies clearly have not exhausted their ability to borrow.

But whether credit terms will be allowed to ease further is another matter. Lenders are subjected to two opposing forces in this respect. On the side of more liberal terms is the desire to meet competition and maintain or increase the share of available business obtained. On the side of greater caution is the possibility that delinquencies and repossessions will rise, which would both cut down on profits and tend to engender customer ill will.

Delinquencies have been relatively low in the postwar years of good business, high income, and full employment. Moreover, there appears to have been little increase in delinquencies in the face of the rise in borrowing during the past year. Banks reporting monthly to the American Bankers Association indicate that delinquencies of 30 days or more at the end of February were only slightly higher than in early 1952 and fully a third lower than at the beginning of 1950. At the same time, however, lenders generally are aware that they are vulnerable to any downturn in business activity and employment which might develop. Therefore, it seems probable that most lenders will exercise caution in their selection of risks and will generally hold the line on credit terms, particularly since the demands for instalment credit will be large in any event.

Farm financial structure adjusting

Debt situation still healthy, but its complexion may be blemished by lower farm income.

FARM PRODUCT PRICES declined 9 per cent over the past year. In view of the possibility of some further decline by year-end, a look at the farm debt situation may not be amiss.

Asset-debt ratio favorable

On the surface, at least, the situation looks highly encouraging. Estimates for January 1 show the value of all agricultural assets to be 12 times the total farm debt (excluding CCC loans). But is this a pertinent comparison? The current value of farm land, livestock, machinery, etc. still reflects to some extent the recent exceptionally favorable history of farm earnings.

If valued at 1940 prices, total farm assets—physical plus financial—amount to $5\frac{1}{2}$ times total farm debt. This is exactly the same ratio as existed in 1940. Thus, even at a much lower level of prices, the over-all debt situation still looks encouraging if judged in relation to the value of farm assets.

More liquid assets

The internal structure of agricultural assets and debts has changed significantly. Non-real estate assets have increased in relative importance. Even after eliminating the effects of price changes, livestock, machinery, stored crops, and household furnishings increased 50 per cent during the past 13 years. Financial assets increased 500 per cent.

On the debt side, real estate indebtedness now is practically the same as in 1940. But non-real estate debt has increased about 300 per cent.

Consequently, the present balance sheet shows more liquid assets and more short-term debt. Aside from the cushion of liquid assets,

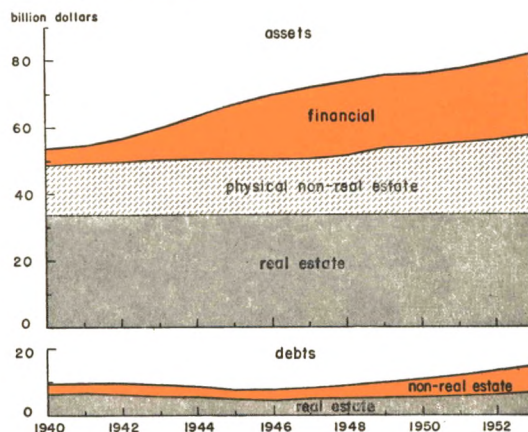
some of the short-term debt can be converted into longer-term real estate debt if the need arises, so there seems to be no cause for alarm in these changes. Interest charges might be a source of concern, but they constituted only 3 per cent of total production expenses last year.

Real estate debt to increase

If the farmer's "terms of trade" deteriorate further—if his products exchange in the market place for less nonfarm products—will agriculture's present asset-debt structure be maintained? The currently favorable debt picture was made possible by the favorable farm income situation that has existed since 1942. Real estate debt was held down—in spite of the

Farm assets much larger than debts

Real estate is valued at its 1940 figure; other physical assets at their 1940 prices. On the debt side, CCC loans are excluded as they are non-recourse loans.



increase in the price of land—because owners were able to quickly repay real estate loans out of current net income.

But with lower farm product prices it is expected that this year (barring intensified military activity) cash farm receipts will be down possibly 10 per cent from 1952 and net income will drop to its 1944 level. In the next few years, if net income continues its decline, we must expect less prompt repayment of debt acquired in land transfers. This would mean a rise in real estate debt. Conversion of some short-term debt to real estate debt would reinforce this trend. In addition, farm mortgage loans will probably come into greater use for the provision of operating and improvement capital. Thus, real estate debt is expected to return to a “more normal” relationship to land values.

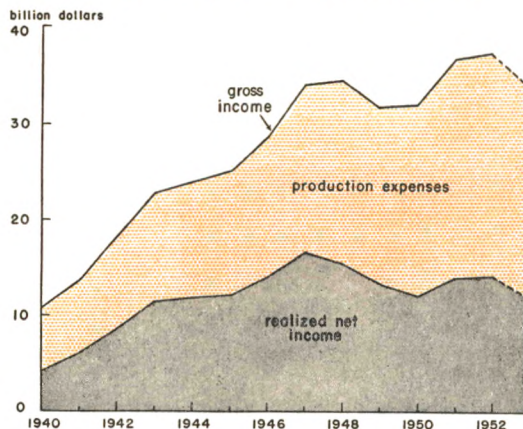
Short-term debt

What is the outlook for short-term agricultural debt? Exclusive of CCC loans, it has risen from 3 billion dollars in 1940 to an estimated 8 billion this year. But none of the increase occurred until 1946 when prices shot upward following decontrol and farm machinery and consumer durable goods supplies increased. Since that time the uptrend has been maintained, with the largest increases occurring in 1950 and 1951 as prices spurted following the outbreak of Korean hostilities.

However, prices rose from 1940 to 1946, whereas short-term debt did not. Production expenses doubled during this period; but net income tripled, and there was much internal financing of production expenditures. Since 1947 net farm income has been trending downward, while production expenses have continued to rise. Hence, more external financing has been necessary. Thus the volume of non-real estate debt also seems to be associated with the size of net income compared with production expenses.

Production expenditures in 1952 were $3\frac{1}{2}$ times their 1940 amount. Of course, this rise

Net income declines from 1947 peak; production expenses continue rise



is a compound of increases in both prices and quantities of purchased goods and services. During this period, prices paid by farmers rose $2\frac{1}{3}$ times, so most of the increase in expenses is traceable to higher prices. But it appears that the annual quantity of productive inputs bought by farmers increased by about 50 per cent from 1940 to 1952. This development has helped increase the efficiency of agriculture, but it also has sharply increased farm capital requirements. Furthermore, the higher the production expenses, the more the farmer stands to lose in case of crop failure or sharp decline in the price of his output.

Historically, when cash farm receipts drop, production expenses have dropped by a much smaller proportion. This happens because non-farm prices tend to be much less flexible than farm product prices and agriculture maintains its rate of output even in the face of falling cash receipts. Therefore net income drops, and the ratio of production expenses to net income rises.

Of course, agriculture does buy some things from itself: for example, in recent years livestock, feed, and seed have accounted for about one-third of total farm production expenses.

In this respect, Midwest farmers are fortunate. With our livestock-feeding economy, our purchases from agriculture are a higher proportion of total production expenses than is the case for specialized cash crop areas where purchases are more heavily loaded with industrial products. Hence, production expenses are more flexible in the Midwest than elsewhere.

In any case, we can expect production expenses to remain high in relation to cash farm receipts. If net income drops, production expenditures will be financed less from income and more from credit. This will tend to increase the volume of short-term farm debt. The cattle-feeding area may provide an exception because of the sharp decline in the price of feeder cattle during the past year and the importance of feeder cattle purchases in total cash outlays of these farmers.

Asset values to decline

What would be the effect of declining farm income on the values of agricultural assets? Obviously, asset values would drop. The values of physical assets depend directly on farm product prices and net income from farming, so physical assets would decline in value. Also, lower net incomes would hinder the accumulation of financial assets.

Assuming that the farmer's "terms of trade" deteriorate further, the outlook for agriculture's asset-debt structure looks like this: the value of assets will decline, real estate debt will rise, non-real estate debt also may rise, and owners' equities will drop. But widespread debt distress is not in the picture. Although continued adjustments are in store for agriculture, its financial structure would crumble only with a general business recession that sharply shrank consumer incomes and the domestic market for farm products.

Long-term factors

Will agricultural net income fall in the coming years? Part of the answer—possibly only a minor portion—depends on the relation

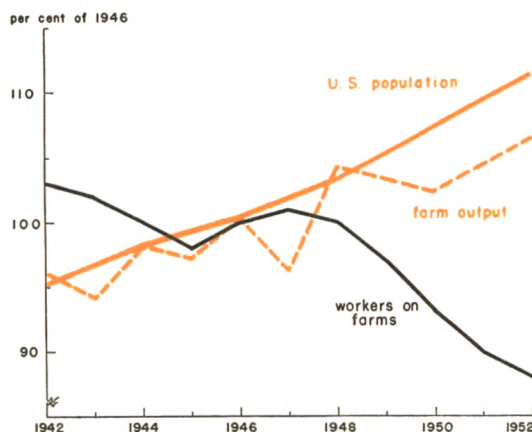
between growth in population and farm output.

Partially as a result of the decline in the number of workers in agriculture, farm output increased an average of only 1 per cent per year from 1942 to 1952. On the other hand, the average population increase was $1\frac{2}{3}$ per cent per year during this period.

Agricultural prosperity during the past decade was founded primarily on high-level domestic economic activity and large exports. Nevertheless, the increase in population relative to farm output was a contributing factor. If it continues in the years ahead, it will tend to mitigate any worsening of the farmer's "terms of trade." However, too much support should not be expected from this source. During the past several years the growth in farm output slipped below the population increase, but that did not prevent the present agricultural recession. Last year's decline in farm exports more than offset the gap.

In any case the Malthusian Devil—the pressure of the population on the land—is no threat in this country. If necessary, farm output can be continually expanded to accommodate a population increase even greater than our present rate.

Farm output up less than population; farm workers decline



More business—more checks

SINCE MORE THAN 90 PER CENT of all monetary transactions are made by check, the total dollar amount of checks drawn against deposit accounts—bank debits—reflects changes in overall business activity. Most checks are used to pay for goods or current services. Debits are not a perfect index of *current* business activity, however, since some checks are drawn in order to transfer funds or for capital transactions, such as buying securities. On the other hand, debits have the advantage of being promptly available and are the only comprehensive measure of business for small areas.

Business activity, as measured by bank debits, in almost all of the 32 major urban areas in the District was at a higher level during the first quarter of this year than in the same period a year ago. The performance in Michigan centers was especially noteworthy. The 10 urban areas in that state ranked among the first 16 in the District. Michigan, therefore, contributed heavily to the increase of 11 per cent for all areas combined.

The major reason for the large increases in Michigan areas is the record peacetime employment now prevailing there in contrast to the "allocation" unemployment of a year ago. Moreover, with prices relatively stable, the rise in debits indicates an increase in the physical volume of business. In contrast, the drop in Sioux City stemmed largely from a decline in the price of cattle received in that market.

The revised monthly debits series inaugurated in March by the Federal Reserve Bank of Chicago is a much-improved indicator of business trends. Debits to time and Federal Government deposits are now excluded as they are not related to current local activity. Separate series are compiled for each of the urban areas shown in the chart. These series, which are available from the Bank on request, include integrated outlying communities as well as the central city itself.

Urban areas in Michigan spark first quarter advances from year-ago levels

