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

Business Conditions

1953 July

Contents

Interest rates boosted by strong demand for funds	2
More grain storage needed	5
Supplying credit to consumers	10
Department store sales brisk	16
The Trend of Business	**8-10**

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

Interest rates advance

As prices respond to changes in supply and demand for commodities, interest rates reflect the supply and demand for investible funds.

RECENT INCREASES in the cost of borrowing money have sparked widespread discussion as to "why the increase" and, more importantly, "what will be the effect on business." There is much speculation also as to "where will interest rates go from here?"

Interest rates are prices paid for the hire of money—or credit. As such they are determined by supply and demand considerations just as are other prices. Thus, when the demand for credit increases relative to the supply of funds seeking investment, interest rates rise. Conversely, when the supply increases relative to the demand, interest rates decline. In the past, rates usually have risen in periods of high business activity and declined in recessions.

In the first half of 1953 the demand for funds from businesses and consumers outstripped that of last year when expansion was the largest of any of the postwar years. Although the supply of funds seeking investment is large, lenders are hard-put to meet the demand. The resulting rise in interest costs has spread throughout the credit structure because lending is highly competitive and credit markets are nationwide in scope.

The demand for loanable funds

Changes in the demand for credit accompany changes in the level of expenditures and employment in the economy. When business expectations are for higher prices or for a continuation of good profits, most firms are receptive to proposals to expand their plant, purchase new equipment, try out new processes, and add to working capital and inventories. Our past experience indicates that expansion in business activity cannot proceed far before it becomes necessary for many firms to tap the supply of loanable funds.

Consumers respond to the outlook for price and income developments in about the same way. When the outlook is for rising or even steady income, they usually have sought to supplement current income with borrowed funds for purchases of durables and housing.

Efficiency of money use—One of the more spectacular and, paradoxically, one of the least noticed developments in the economy since the war has been the increasingly efficient use by businesses and consumers of their holdings of bank deposits and currency. Since 1945 the amount of "money work" per dollar has gone up by about 50 per cent. What makes the record so impressive is that a substantial part of the increase in efficiency has occurred since 1949—after it could have been expected that war-swollen idle money holdings had long since been put to use.

The connection between efficient money use and the demand for loanable funds is apparent. At any level of expenditures, the more efficiently consumers and businesses use available funds, the smaller will be their individual demands for credit. Thus, had consumers and businesses not effected major economies in their use of money after the war, credit and money would have had to expand much more than they did to achieve the same levels of employment and expenditures.

Dividend policy — Business management policy with reference to the disposition of earnings affects the demand for corporate borrowing and equity funds. To the extent that earnings are retained rather than parceled out in dividends, the demand for funds to expand plant

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

and working capital is reduced. In recent years the amount of funds plowed back into "the business" has been very large. For the seven years ending in 1952, annual average retained earnings and depreciation allowances have been almost 17 billion dollars.

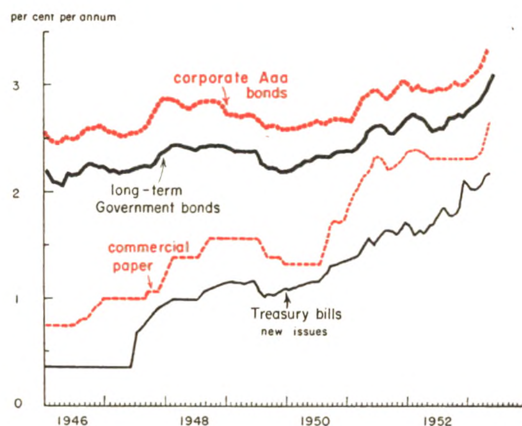
Despite the powerful dampening influence of greatly increased efficiency in the use of money and high levels of retained earnings and liquid assets, the demand for business and consumer credit to finance the postwar expansion in the nation's production and distribution of products has proceeded at record rates. By the end of 1952, consumer and business debt had approximately doubled the 1945 outstandings.

Some kinds of debt have recorded even more spectacular gains. Business loans at banks have about tripled; consumer instalment loans at banks alone rose from less than three-fourths of a billion dollars to almost 8 billion. Almost as impressive as the gain in consumer credit has been the growth in mortgage debt on urban houses—from 18.5 billion dollars in 1945 to 58.2 billion at the end of 1952.

In recent months continued growth in the nation's output has been accompanied by further substantial demands for credit in most sectors. In the first three months of the year *consumer instalment credit* outstandings increased by 650 million dollars. This contrasts with a drop of about 300 million dollars for the same period in 1952. *Bank loans to business,* which ordinarily decline somewhat in the first half of the year, have shown little reduction this year until recent weeks. *New corporate securities* issues so far this year are about 5 per cent above last year's record. Increases in *residential mortgages* thus far are running well above the comparable period for last year.

Government demand—This year, unlike other postwar years except 1952, the Federal Government will require substantial amounts of new money. Since large March and June tax payments result in a Treasury surplus in the first half of the year, the demand for new money comes in the second half. The precise

Interest rates respond to strong credit demands



amount required is not known, but it appears likely that it may be well above the 3.4 billion dollar figure absorbed in 1952.

The Government demand for new loanable funds is dictated by different considerations than is the demand from businesses and consumers. It is largely determined by legislative decisions as to the level of taxes and the volume of expenditures. In the main, the gap between receipts and expenditures has been wide in periods of national emergencies.

Interest costs and credit demand—Experts point to differing effects of changes in interest rates on the demand for credit. In many businesses interest rates are a relatively small segment of business costs. Favorable tax treatment of interest charges further reduce the cost element in high-tax years. On the other hand, heavy users of long-term funds operating on relatively small and stable profit margins, such as public utilities, are more sensitive to interest costs. So are purchasers of houses where the amount of the purchase price financed through mortgages usually is large and for long periods of time.[1]

[1] For a detailed discussion of the effects of changes in interest rates on liquidity in the economy and the demand for credit see *Federal Reserve Bulletin*, March 1953.

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

The supply of loanable funds

There are two sources of loanable funds—bank credit, which represents largely the lending of funds deposited with them, and savings. Thus, the volume of saving and bank credit in the months ahead will have an important effect on changes in interest rates.

Savings fluctuate — Historically, savings have been fairly closely related with the level of employment and income. More savings are accumulated at high levels of national income than at low levels. This should not be surprising. Individuals and businesses can hardly save what they don't receive. Moreover, although saving by itself is a withdrawal of funds from the spending stream, a necessary condition for high levels of economic activity is that these funds are returned to the spending stream by individuals and businesses in expanding their operations.

Despite the general coincidence of movements in savings and income, there have been wide swings in rates of saving. Thus in 1942-45 the rate was very high. In the five years ending with 1950, the rate was probably well below "normal." Beginning in 1951, however, the volume of saving, as well as the rate, increased sharply.

Why changes in savings rates—From the outbreak of World War II to the end of 1950, changes in the rate of saving have reflected mainly war developments and the aftermath of war. High savings during the war were largely involuntary—imposed by rationing, price controls, and high levels of income. In the period 1946-50 generally rates of saving were also of a residual nature as consumers spent heavily out of current income to "re-clothe," "re-house," and "put themselves on wheels." In 1950 the outbreak of the Korean war was an added stimulant to spending.

Can the more "normal" rates of savings recorded in 1951, 1952, and thus far in 1953 be expected to be continued indefinitely? The answer has an important bearing on the future behavior of interest rates.

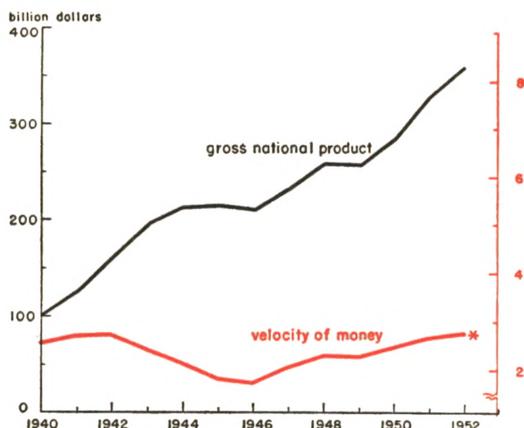
Savings are by contract—A sizable part of the nation's savings is fixed by contract, for example, amortized mortgage payments on a house. Such contractual payments have added importantly to the supply of loanable funds seeking reinvestment in recent years. More than half of the 6.6 billion dollars of mortgages closed at savings and loan associations last year, for example, were provided out of the flow of repayments. As the volume of outstandings in mortgages and consumer credit continues to mount, additions to the supply of loanable funds from repayments will grow.

Many individuals and businesses have savings programs which are near-equivalents to contracts. Life insurance programs, for example, are likely to be maintained so long as income permits. Despite such "contractual saving," however, there remains a significant portion of income which may be spent or saved at the initiative of its owners.

Expectations—The influence of prospective price changes on the rate of saving is strong. When consumers expect prices to increase, they

—continued on page 14

Money has been used more intensively in recent years



*gross national product divided by the money supply

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

More grain storage needed

As commodities accumulate under price support, farmers and Government find they have too little storage to handle the surplus stocks.

MIDWEST FARMERS are again confronted with a critical warehousing problem—another in a series of crises that extend back into the Thirties. The nation's grain storage capacity was clogged with surplus commodities in 1938-41, again in 1948-50, and is now overburdened once more.

To reap the full benefit of price support programs for corn, soybeans, wheat, and a number of other commodities, farmers must have storage space. A major part of the Government's price propping is provided through nonrecourse loans to producers. To obtain these loans, farmers must have their products in "acceptable storage." The crops may be stored on the farm or in rented or leased facilities. But as stocks accumulate, commercial storage becomes scarce and greater dependence on farm storage is necessary.

The storage problem is not limited to farmers alone, however. While they are responsible for the storage of the supported commodities during the first year following harvest, they may deliver these products to the Commodity Credit Corporation at the end of that year. The CCC must have storage space available to handle the volume of commodities farmers wish to deliver.

CCC promotes farm storage

Steps have already been taken to encourage farmers to hold their 1952 crops in farm storage for another year rather than deliver them to the CCC. Insofar as this can be accomplished, the CCC's problem will be minimized. Loans on both wheat and corn were extended from the current maturity dates for one full year.

To encourage farmers to "reseal" their commodities and retain them in farm storage, the CCC has offered a storage payment of 13 cents a bushel for 1952-crop corn and wheat. This would be paid at the end of the extended loan period if the commodity was delivered to the CCC to liquidate the loans. No storage payment would be made, however, to farmers who redeem their commodity by paying off the loan.

The construction of new storage is facilitated by the extension of low-cost building loans. The CCC makes direct loans to farmers and guarantees loans made by banks or other lenders up to 80 per cent of the cost of the storage structure. The loans are written for a four-year term and bear interest at the rate of 4 per cent. This program was recently extended for a year, to June 30, 1954. These loans will probably increase considerably in the months ahead as the magnitude of the storage problem becomes more widely recognized.

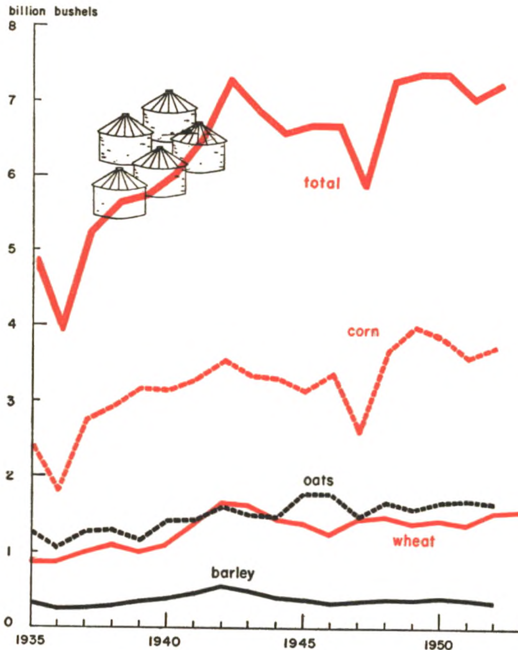
How much farm storage?

Many Midwest farmers are asking themselves, "Shall I invest in additional storage facilities?" Professional farm managers usually advise farmers to expand storage capacity on their farms if it is needed to achieve the benefits of price support programs or to do a good job of marketing and feeding the crops regularly produced on the farm. But they raise serious question as to the desirability of expanding storage space beyond these limits.

Many Midwest farms, of course, do not now have adequate storage to do a good job of handling their crops. And with commercial storage rapidly becoming clogged with large carry-overs of surplus stocks, their farm storage space will become even less adequate. On many farms, therefore, there should be an expansion of grain storage space.

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

A large corn harvest would boost the grain supply to a record level



When expanding storage space, consideration should be given to technological change as well as to CCC requirements. Recent studies of farm labor utilization indicate, for example, that mechanization of grain and feed handling can increase labor productivity on many farms. On some farms, the common practice of harvesting *ear* corn and storing it in this form until it dries sufficiently to be stored as *shelled* corn is becoming obsolete. A combination picker-sheller (which harvests only the grain) replaces the corn picker and ear corn cribs. Where this change is made, the storage bins should be designed to accommodate driers.

Further factors such as limiting damage from insects and rodents, owner- *vs.* tenant-operated farms, livestock *vs.* cash grain operations, temporary *vs.* permanent structures, and relative costs will affect farmers' decisions as to type, location, and amount of storage. All these considerations, however, distill down to the single question: will the additional investment in farm storage be profitable? It is on this basis that farmers' decisions should be made.

Commercial storage

Recent studies of grain storage costs in Indiana, North Dakota, and Oklahoma indicate that farm storage frequently is more expensive than storage in commercial facilities when all costs are included. If commercial storage is available to meet their needs, farmers may find it cheaper to use these facilities than to build new storage. The cost of storing grain in existing farm structures, however, is usually less than for commercial storage.

Because wheat moves primarily into human consumption, commercial structures located along the usual distribution channels may be most appropriate for it. Most corn, however, is fed to livestock on or near the farms where it is grown. So corn storage space should be located primarily on farms.

The corn situation

Loans on 1952-crop corn will mature July 31. As Corn Belt farmers face up to the corn storage problem, they will decide (1) to extend loans on 1952 corn and provide additional storage space for the new crop or (2) to deliver their current stocks to the CCC in satisfaction of present price support loans, thereby emptying their present cribs to make way for this year's harvest. For many of them, building new storage will involve credit. In this connection, country bankers may be called upon for counsel and service.

The problem is illustrated by the situation in Iowa. On the first of June, about 110 million bushels of corn from pre-1952 crops were held in CCC bins in that state. This was a large part of the total CCC inventory of about 250 million bushels.

Iowa farmers placed nearly 170 million bushels of 1952 corn under price support and have

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

the privilege of delivering this to the CCC next month. The Iowa PMA Committee states that, "present Government storage facilities are obviously inadequate for taking delivery of 1952 corn under loans and purchase agreements and consequently every possible effort must be made to encourage resealing."

After surveying the situation, the Committee estimates that farmers will be willing to reseal "at least 40 to 45 millions and that space will be available in present CCC bins and commercial elevators for around 80 millions, leaving 45 to 50 millions for which the Government must furnish additional facilities." If this appraisal of the corn storage situation in Iowa is indicative of the over-all picture, the CCC may need to provide about 90 million bushels of storage capacity to accommodate deliveries of 1952 corn this summer.

CCC officials, aware of the corn situation and an even more critical one with respect to wheat, have announced that they will buy more storage bins and conferred with bin manufacturers to survey the availability of materials for bin structures. Although expressing hope that farmers and private businessmen will provide most of the needed storage facilities, they apparently are convinced that the Government will be called upon to expand its activity in this field. The CCC now owns about 550 million bushels of bin capacity and will be adding to it through the year. Emergency storage will be used wherever it will ease the pressure. Ships, hangars, and similar facilities are being adapted to grain storage, and loans will be made for wheat temporarily piled on the ground in some areas.

Meanwhile, moves are being made to keep the storage problem within manageable limits. Production may be restricted by acreage allotments and marketing quotas, beginning with 1954 crops. The surplus problem is being tackled also from the other side. Both domestic and foreign outlets are being explored in efforts to move stocks into consumption. But there is little prospect of the storage bins being emptied in the near future unless output is reduced by bad weather or demand is boosted by some unforeseen incident.

Grain storage costs on Indiana farms and at elevators 1949-50 marketing year

Kind of grain	Storage period	Storage cost per bushel: On farms	Storage cost per bushel: At elevators	Farm storage costs as compared to elevator storage costs: More	Farm storage costs as compared to elevator storage costs: Less
		(Cents)		(Cents)	
Oats	1 year	9.6	16.8		7.2
	8 months[1]	9.0	11.2		2.2
	5 months[2]	8.5	7.0	1.5	
Soybeans	1 year	12.9	16.8		3.9
	8 months[1]	12.4	11.2	1.2	
	5 months[2]	11.4	7.0	4.4	
Wheat	1 year	16.0	16.8		0.8
	8 months[1]	15.5	11.2	4.3	
	5 months[2]	14.5	7.0	7.5	
Ear corn—Second year's storage[3]	1 year	12.9	16.8		3.9
	8 months[1]	12.4	11.2	1.2	
	5 months[2]	11.4	7.0	4.4	

[1]Average period farmers stored cash grain at home.
[2]Average period farmers stored cash grain in elevators.
[3]Applicable only to the storage of year old corn that started the storage year in the crib dry enough for elevator storage.

NOTE: Costs are for new double crib overhead granary building which has the lowest fixed cost of the three types studied; costs in separate wood granary with conveyor were 4.4 cents higher and in steel bins with conveyor were 2.9 cents higher.

Farm storage costs for small grain and soybeans are for 60 per cent utilization of granary capacity —the same as used by sample farmers. Ear corn is for full utilization of available crib capacity.

SOURCE: *Where and How Much Cash Grain Storage for Indiana Farmers*, Farm Credit Administration, Bulletin 68.

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

THE Trend OF BUSINESS

Underlying apprehension over the durability of the current prosperity has helped maintain the generally stable price level of the past nine months. Despite the upward surge in the nation's business after last summer's steel strike, the world supply situation for most basic commodities has eased. Stability during this period has owed much to the fact that the great inventory bulge anticipated in some quarters at the start of the year did not materialize.

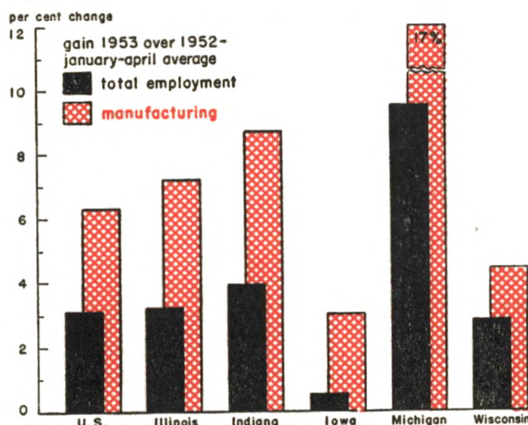
Until recently, price increases for manufactured goods following decontrol had been few and moderate—offset to a large extent by declines in other sectors. In mid-June some prices moved up as a result of strong product demand and the desire to recapture profit margins squeezed by higher costs. Following the steel wage agreement, the industry began to boost prices on various product lines. One producer indicated that prices would be raised an average of 5 to 10 dollars per ton. Even more newsworthy was the decision of many oil firms to boost buying prices for crude oil by almost 10 per cent. Basic prices for crude had been relatively stable for over five years.

Public utilities, railroads, and the post office also posted higher rates in June after favorable commission rulings. There is little evidence, except in the case of petroleum products, that higher wage and material costs will at once be reflected in finished product prices. Most of the recent increases have involved commodities or services which had lagged in previous periods of price inflation. Producers are showing a reluctance to increase finished goods prices in the face of expanded capacity and increasingly competitive markets.

The recent past, therefore, has lacked the earmarks of a speculative binge. Enthusiasm has been tempered by the belief that "the boom can't last." In fact, prophecies of an impending downturn have been increasingly prevalent. These statements are usually based upon one or more of the following:

1. the adverse effects, direct and psychological, of the international cooling-off period,
2. rising interest rates and the greater difficulty of obtaining borrowed funds,
3. declining backlogs of demand for machine tools, railroad equipment, and some other types of industrial equipment,
4. the weakness in farm prices, exports, and household appliance sales together with the expected lower output of automobiles and steel later this year, and
5. the apparent absence of new factors of strength.

Employment growth concentrated in manufacturing



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

"New factors of strength" may be hard to locate at the present time because most sectors of business have been doing so well. In any case, a bearish outlook depends upon *potential* developments of a depressing nature. The great bulk of recent evidence points to the strong momentum which continued to characterize the economy at midyear.

Business activity gains in the April-June quarter over March levels were meagre, principally because available man power limited further expansion. In recent months unemployment has been the lowest since World War II. The 1.3 million figure for May represented virtually an "irreducible minimum" set by labor immobility and unhurried selectivity on the part of those seeking work.

Civilian employment in the nation rose by only 150,000 between April and May—far less than the one million gain in the same period last year. In Midwestern centers, where the labor market has been especially tight, many large employers would have hired additional workers if they had been available.

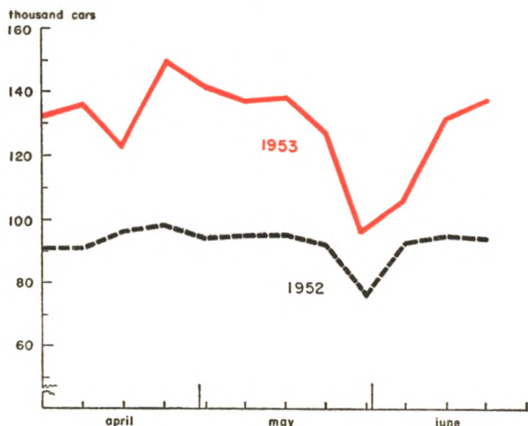
Personal income has been inching upward month-to-month, mainly as a result of continued gains in wage and salary payments. Moreover, employers in most major industries have shown a willingness to "go along" with further moderate wage rate increases. In April, total personal income was estimated to be 8 per cent above the same month of last year. All major categories were higher with the exception of farm profits.

New labor agreements have been negotiated by major automobile and steel firms so that serious interruptions in production as a result of work stoppages probably have been by-passed. Suppliers' strikes cut car output in May and June, with the result that the rapid growth in new car stocks was halted and some output was pushed into the second half. In mid-June passenger car production once again was building up toward the 150,000 per week rate reached in late April.

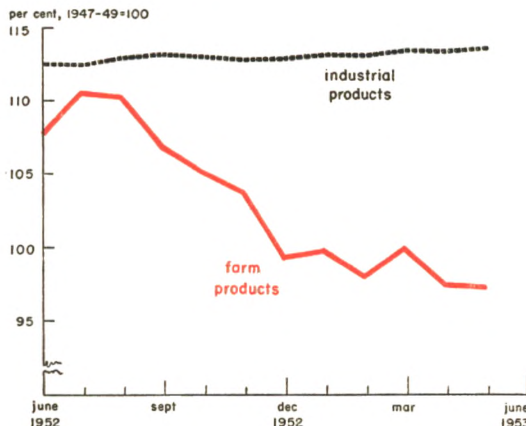
Building trades wages were boosted about 5 per cent on June 1 in the Chicago area, with the result that costs on an average size house rose about 300 dollars. New homes are reported to be moving better than last year at this time, and higher prices are not expected to have much immediate effect upon construction activity in this area.

Consumer spending has continued to keep

Weekly car output: high despite hampering strikes



Price declines confined largely to farm products



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

pace with income. Recently, weaknesses in sales of major appliances have been more than offset by substantial gains for clothing, furniture, air conditioning, gasoline, and other items.

Department store sales in the nation in the month of May were estimated to have been 7 per cent higher than in the same month a year ago, which had been the largest up to that time. Sales at District department stores, 6 per cent above last year-to-date, exceeded the national gain for May. Preliminary June data also indicate a new record high for that month.

Total business inventories, seasonally adjusted, rose by over 600 million dollars to a record 76 billion dollars at the end of April. The total, however, was less than 3 per cent greater than a year earlier, whereas sales were 9 per cent higher. Moreover, there is evidence that excellent retail sales in May, coupled with production cutbacks in lines in which stocks have been rising, prevented further growth.

Construction activity in the first five months of 1953 topped last year by 6 per cent. In addition, the most recent survey of business capital spending plans indicates a further rise to a record 28.7 billion dollar rate in the third quarter—8 per cent above the average for last year.

Pressure on the supply of loanable funds for private and public purposes has been intense. Some corporations and municipalities have encountered difficulty floating new debt issues, and residential builders have found that commitments for the future are increasingly hard to obtain. There is evidence that private demand for long-term funds will lessen later this year, but the Treasury expects to run a 9 billion dollar cash deficit in the second half as cash receipts decline seasonally. Part of this amount will be obtained from the sale of tax anticipation bills to corporations, which amounts to a prepayment of taxes. Nevertheless, the shift from Treasury surplus to net outgo in the second half, as usual, will be a supporting factor for general business activity in the nation.

Supplying credit to consumers

Commercial banks have played a major role in meeting the growing demand for instalment credit.

CONSUMER REQUIREMENTS for instalment financing have constituted one of the most dynamic sources of credit growth during the postwar period. Reflecting heavy demands for credit, instalment debt has expanded by 18 billion dollars since the end of 1945, rising rapidly in every year except 1951. Such debts now total nearly 21 billion dollars, more than three times the peak amount reached at any time before the war.

Thousands of lenders have been active in meeting this growing demand for credit on the part of consumers. These include most of the 14,000 commercial banks in the nation, many retail firms, sales finance companies, small loan companies, credit unions, and in lesser volume, several other types of financial institutions. Most operate on a local scale, but a few are regional or even national in scope. Some lenders specialize in extending particular types of instalment credit while others are more diversified in their activity. Despite a certain amount of specialization, however, supplying credit to consumers generally has been a vigorously competitive business.

Major shifts in the relative importance of the different types of lenders have taken place since prewar years. Most dramatic of these has been a marked increase in the share of total instalment credit supplied directly by commercial banks. Over 40 per cent of all consumer instalment paper is now held by banks, as compared with about one-fourth before the war. Most of this growth has been accomplished at the expense of retail firms, whose holdings of

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

instalment paper have declined steadily from 29 per cent of the total in 1940 to 17 per cent currently. Small loan companies and sales finance companies have also experienced moderate declines in relative importance, although the latter have recovered much of the business lost during the wartime period of curtailed automobile sales. On the other hand, the proportion of total instalment credit held by credit unions, although still relatively small, has increased 40 per cent since prewar, reflecting sharp gains in membership and resources.

The greater activity of commercial banks in the instalment credit field in recent years has meant that funds for consumer lending have generally been in ample supply. Although banks provide an important part of all consumer instalment credit, such credit absorbs only a small proportion of total bank resources as against a major share of the current assets of other lenders. Thus, funds could be shifted from other uses to consumer lending with relative ease, when this seemed desirable from the standpoint of bank policy. More importantly, the increased activity of banks in this field has led to greater access to bank credit expansion in meeting consumer needs.

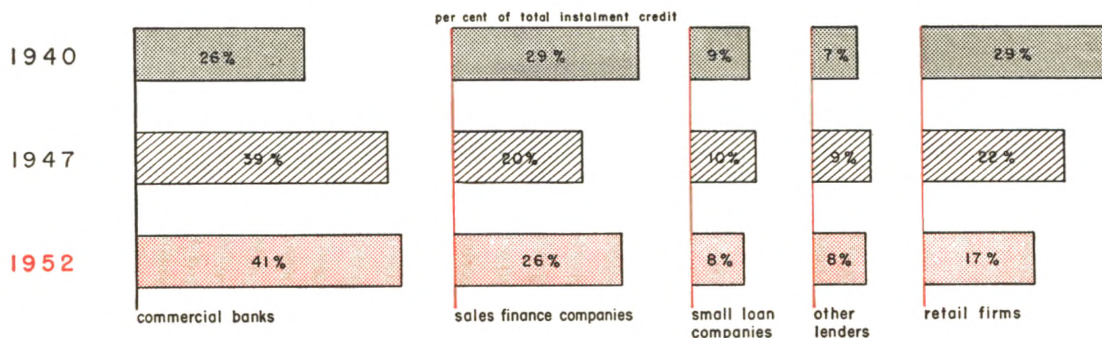
Characteristics of Consumer lenders

Wide differences as to sources of loanable funds and lending practices are evident among the major types of consumer lenders.

Sales finance companies, in terms of dollar volume, are second in importance only to commercial banks in the extension of instalment credit to consumers. Engaged primarily in the purchase of instalment paper originated by automobile and (to a lesser extent) other durable goods dealers, these companies now hold 5.5 billion dollars of consumer instalment debt. In purchasing retail paper, helping dealers to finance their inventories is normally an integral part of the business, so most companies also hold moderate amounts of wholesale receivables. In addition, many of them make personal loans and some extend business loans, often through the factoring of accounts receivable. Four large national companies hold about 65 per cent of the consumer instalment loans of all sales finance companies, but several hundred firms operate on a local or regional basis.

The larger sales finance companies typically maintain rather small equity capital positions in relation to their loan outstandings. The bulk of their loanable funds is obtained through the incurrence of three types of debt: (1) short-term borrowings from banks in larger centers, (2) the sale of open-market paper ranging in maturity from 3 to 9 months, mostly to banks, and (3) the issuance of long-term notes and debentures, largely to insurance companies. Sources from which funds had been obtained by

Importance of instalment credit holders has shifted since prewar



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

the four largest sales finance companies at the end of 1952 were as follows:

Bank loans	26%
Open-market paper	24
Long-term debt	22
Other liabilities	16
Equity capital	12
Total resources	100%

Although short-term borrowings are by far the most important source of funds for these large companies, long-term debt has shown the sharpest rise in recent years. At the end of 1940, it accounted for only 16 per cent of total resources. This movement into long-term securities has been accelerated since the turn of the year, reflecting the tightness of bank credit.

The financing of smaller sales finance companies differs in several important respects from the arrangements of the "big four." Because of more limited access to the long-term capital markets and greater difficulty in selling open-market paper, local and regional firms depend much less on these sources of funds. Instead, their equity capital is considerably greater, and more reliance is placed upon direct borrowing from banks. Thus, bank credit is important to both large and small firms, but the biggest companies have additional sources of funds which may be tapped when bank loans become more difficult to obtain.

Small loan companies specialize in the extension of instalment cash loans. They do not purchase instalment paper from retail dealers, and the maximum amount they may lend to any one customer is limited by law (except in California), most commonly to $300 or $500.

Most loans are unsecured and most are for personal purposes rather than the purchase of durable goods. At the end of 1952, four large companies—operating hundreds of offices—accounted for about half of the 1.5 billion dollars in consumer loans held by all small loan companies.

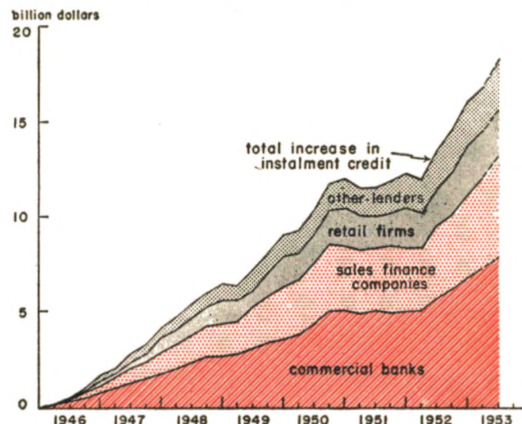
Like sales finance companies, these firms make important use of external financing. At the end of last year, the capital structure of the four largest companies was as follows:

Bank loans	25%
Other liabilities	7
Long-term debt	40
Equity capital	28
Total resources	100%

As is evident, equity capital and long-term debt are much more important sources of funds for these firms than for the large sales finance companies. Access to the capital market is largely restricted to the four big companies, however, owing to the small size and local nature of the firms doing the remaining 50 per cent of the small loan business. Consequently, these small companies must rely almost entirely on invested capital and local bank borrowing for loanable funds.

Credit unions are the most numerous of any type of consumer lender. There are more than 11,000 now in operation, but because their average size is quite small, they hold only 900 million dollars of consumer loans. These institutions are cooperatives. Membership is re-

Banks account for nearly half of the 18 billion dollar increase in consumer instalment loans since 1945



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

stricted to groups having a community of interest, such as a common employer. Funds are obtained solely through the purchase of investment shares by members and the accumulation of reserves. Earning assets are limited to loans to members and investment in U. S. Government and sometimes state securities.

The consumer lending activity of credit unions is diversified, including "emergency" cash loans, loans for home improvement, and loans for the purchase of durable goods, but does not include the purchase of instalment paper from dealers. Nevertheless, credit union loans to consumers have risen more sharply than total instalment credit since 1940, primarily reflecting a rapid postwar growth in membership and resources.

Retailers originate a large share of instalment credit, but much of this is then sold to financial institutions. Some retailers, however, continue to hold all or a portion of the credit they extend. The amounts of such holdings are small in the automobile field, where channels for selling the paper are well established. In the case of other types of retailers, however, a large proportion of the paper originated apparently is held rather than sold.

This historical difference in financing practices probably reflects the small average size of instalment credits originated by retailers and the limited resale value of much of the collateral. In addition, some retailers doubtless prefer that credit customers make payments to the store in the hope of stimulating repeat business, and others may not want customers to know that their instalment accounts have been sold. Finally, holding instalment receivables often makes possible a greater degree of flexibility in credit merchandising—such as the purchase of soft goods and multiple purchases on the instalment plan—which is especially significant for diversified retailers like department stores and mail order houses.

In the past decade, however, there has been a strong movement by merchants generally to sell a larger proportion of their instalment paper. Instalment holdings of retail firms have dropped from 80 per cent in 1940 to 50 per cent currently as a proportion of total instalment debt incurred for the purchase of consumers' goods other than cars. In large part, introduction of new and relatively expensive durable goods is responsible for this change. Such items as television sets, automatic washers and driers, and electric ranges involve credit contracts of a size which lenders are more willing to purchase. At the same time, the necessity of carrying *both* the larger inventories and larger instalment receivables required by these products would seriously strain the financial resources of many retail firms. Nevertheless, retailers as a group still hold 3 billion dollars of instalment credit and thus are the third most important type of consumer lender.

Commercial banks, however, are by far the most important instalment lenders. Currently they hold about 8.5 billion dollars of instalment debt and as a group are active in all types of consumer lending. Moreover, their share of the instalment credit business has increased by 60 per cent from prewar and now accounts for more than two-fifths of the total.

This growth in relative importance has taken place in all types of consumer lending (see chart). In automobile financing, the largest item of consumer credit, banks now serve 40 per cent of the market, a gain of one-third in relative holdings from prewar. The increase in the importance of banks is even more spectacular in the financing of other consumer goods purchases. The share of all such credit held by banks has grown from 13 per cent in 1940 to 35 per cent at the end of 1952. In the home modernization field, banks now hold more than four-fifths of all instalment loans, as against less than half before the war. Only in the extension of personal loans has the proportion of the business done by banks not increased appreciably. This probably results from the rapid growth of credit unions, as well as the slower expansion of this type of credit in recent years.

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

Dependence upon banks

Not only are banks the largest holders of instalment credit, but they also extend important amounts of credit to all other types of consumer lenders except credit unions. Sales finance companies have obtained over half of their resources from bank borrowings and the sale of open-market paper. Bank loans account for perhaps a third of the resources of small loan companies. Retail firms who hold instalment paper are generally less extensive users of bank credit but on the average probably owe such debts in an amount equal to 15-20 per cent of their current assets.

Altogether, perhaps 60 per cent of total instalment debt is now financed directly and indirectly by banks. This would mean that such loans accounted for about 18 per cent of total bank loan portfolios at the end of 1952 and over one-fourth of the expansion which has occurred in the postwar period. Clearly, consumer instalment credit must now be regarded as an important factor influencing movements in bank loans and thus indirectly in the nation's money supply.

Commercial banks have greatly increased their share of most types of instalment debt

Interest rates *continued from page 4*

have typically preferred goods to savings. Similarly if they expect further price declines, once prices have fallen, they will tend to reduce spending to take advantage of still lower prices. Peoples' expectations as to prices are an important element in forecasting the amount of savings which the economy will effect at high levels of employment.

Interest rates and saving—It is difficult to anticipate the effects on the volume of savings of increases in interest rates. For those who have definite objectives as to their future need for funds—say savings for educational purposes—higher rates may mean that less saving is necessary to meet the objective—lower rates, that more saving is necessary. There would seem to be little doubt, on the other hand, that rates do affect the decisions of some marginal savers, with saving being more attractive to them at higher rates.

Although the effect of increased rates on the volume of savings may be largely indeterminate, changes in rates may have an important influence on whether savings are made available to borrowers. Since financial intermediaries, such as life insurance companies, banks, and savings and loan associations tend to remain fully invested, savings channeled through these institutions are immediately available to borrowers. A sizable proportion of total savings, however, is accomplished by individuals and businesses who make their own investment decisions. These noninstitutional investors may and frequently do keep their savings for some time in the form of idle bank deposits awaiting more favorable opportunities for investment. The funds involved are not small, as indicated by the fact that last year individuals bought more than 4 billion dollars of securities alone—mainly corporate and state and local government.

Interest rates "channel" funds

Interest rates play an important role in channeling funds to the most urgent demands.

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

Personal saving fluctuates—
has averaged nearly 8 per cent
of income in the past two years

Thus the extraordinary demand for residential mortgage credit has been met (1) because the rate differential between mortgages and other investment outlets has been very substantial and (2) institutional investors primarily serving the mortgage market have been able to attract more than a proportionate share of current savings. Since 1945 the more favorable rates paid by savings and loan associations are reflected in the unprecedented growth in shares. In the past seven years, they have expanded by approximately 2½ times as contrasted with a 50 per cent increase in deposits at mutual savings banks and a 33 per cent increase in commercial bank time deposits.

Federal Reserve and supply of funds

By purchasing Government securities, reducing member bank reserve requirements, and lending to banks, the Federal Reserve increases member bank excess reserves and the potential supply of loanable funds by a multiple of the additional reserves.

For example, when the Federal Reserve buys a million dollars worth of Government securities from an insurance company, it pays for it with a check. When the bank where the insurance company deposits the check forwards it to the Federal Reserve for collection, it receives a million dollar credit to its reserve account. If reserve requirements are set at 20 per cent of deposits, the bank will have $800,000 of excess reserves which it may lend or invest. When the borrower of the funds spends them, the money finds its way to other banks which as a result find that they have excess reserves which they may lend. This process continues until the original million dollars is absorbed into required reserves.

At this point the original purchase of 1 million dollars of Government securities has permitted the supply of loanable funds to be expanded by 5 million dollars (1 million dollars for the insurance company and 4 million dollars at banks). In addition and equally important, the supply of bank deposits has been increased by 5 million dollars.

In periods when inflationary pressures predominate, the System endeavors to avoid adding to bank reserves and the supply of loanable funds in amounts larger than is required for a growing economy and for seasonal requirements. This, in essence, has been System policy for most of the two years since the Treasury-Federal Reserve Accord. Increases in rates over the period reflect the interaction of the supplies of funds seeking investment and the demand for them with only such additions to bank reserves as seemed to be required by the nation's economic growth.

Business Conditions *is published monthly by the* FEDERAL RESERVE BANK OF CHICAGO. *Subscriptions are available to the public without charge. For information concerning bulk mailings to banks, business organizations, and educational institutions, write: Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago 90, Illinois. Articles may be reprinted provided source is credited.*

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

Sales brisk

Durables off some at department stores but moving in good volume.

ALL FOUR of the District's major cities reported better department store sales in the first five months of 1953 than in the corresponding 1952 period. The year-to-year changes were these:

Chicago	+ 1%
Detroit	+10
Indianapolis	+ 5
Milwaukee	+ 1

Sizable increases in recent weeks give evidence that, on the threshold of summer, consumers were continuing to act much as they might be expected to in a period of record production and full employment. In each of the District's four leading centers May sales, with allowance for the number of trading days, were higher than ever before registered for that month.

Trouble ahead for durables?

On the face of it, the recent experience in sales of durables might give some cause for concern. Sales during May in the important furniture, floor coverings, appliances, and radio-television categories this year accounted for only 10.8 per cent of total sales in Chicago department stores, as against 11½ per cent a year before. In Milwaukee the percentage dropped to 9.8 from 10.9. Detroit's stores, on the other hand, turned up a sizable gain, the percentage rising to 11.9 from 10.7 in May 1952. It will be recalled, however, that Detroit results for this period a year ago were affected by the rather severe business dislocation that plagued eastern Michigan during the first half of the year, while recently that area has been experiencing a boom of record proportions.

The apparent setback for durables departments in the Chicago and Milwaukee area stores in large part reflects no more than the relatively high level of sales a year ago.

The May record for the four durables departments combined obscures divergence in tendencies characterizing individual categories. Furniture department sales for this May and the same month in each of the preceding three years were these proportions of store totals in the District's three largest centers:

	1953	1952	1951	1950
Chicago	5.7%	5.6%	5.7%	5.5%
Detroit	6.7	5.4	6.9	5.7
Milwaukee	4.6	4.4	4.1	4.5

The floor coverings, appliances, and radio-television departments have been spotty. In the Chicago and Milwaukee stores, each category in May this year accounted for a smaller fraction of total business than in 1952. In Detroit, sales in the radio-television and floor coverings departments held their 1952 fractions of total store business, while major household appliances dipped slightly.

Since there is evidence that in the past few seasons department stores have lost some of their durables business to specialized appliance and radio-television outlets, the evident weakness in these departments probably is not to be taken seriously as an indication of a change in consumer buying habits. Moreover, comparison of this year's results with those registered in all three of the immediately preceding years is complicated by two conspicuous waves of scare buying and by the imposition and subsequent suspension of consumer credit restrictions.

These circumstances, coupled with the changing competitive situation confronting the department stores, thus vitiate comparisons of 1953 with the earlier years and make interpretation difficult. That it would be premature at this time to read as a danger signal the apparent weakness of certain of the hard goods lines—appliances and television conspicuously—is suggested by the record current volume of total store sales, as well as by the evident strength of the important furniture category.

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