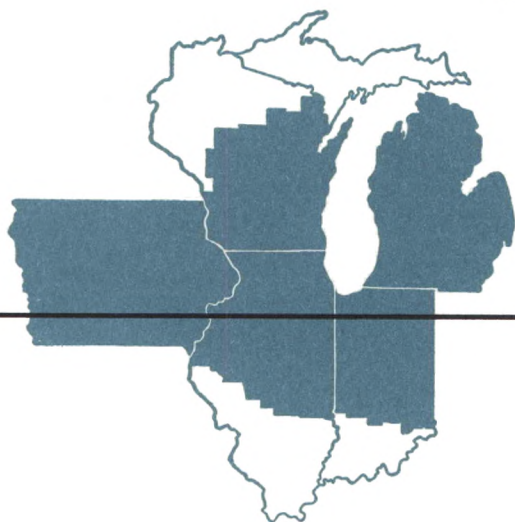


*A review by the* **Federal Reserve Bank of Chicago**

# Business Conditions

**1954 April**



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# Dairy farm income to decline

*Shrinking demand for milk-fat at the bottom of the dairy problem.*

**M**any dairy farmers will have less money to spend this year. On the average their net cash incomes are likely to be 10 to 15 per cent below last year. This would result from an expected moderate decline in gross farm income from the sale of dairy products, accompanied by a small dip in production costs.

The reduction in gross income will be due to an anticipated 10 per cent drop in the average price received by farmers for milk, but this will be partly offset by a prospective increase in the volume of milk produced and marketed. With lower cash receipts from marketings, it is expected that farmers will exert every effort to reduce costs with the result that total production expenses will be cut somewhat despite the increased output.

The drop in price received by farmers for milk has its roots in a persistent decline in the demand for milk fat, which is the principal constituent in butter. In the decade prior to 1952, milk production per capita declined in proportion to the decreasing demand. However, in 1952 production turned upward while demand continued its downward course. This led to the accumulation of surplus stocks which pressed hard upon the support price maintained by the Government.

## **Price support**

On the first of this month the price support for dairy products was reduced from 90 per cent of parity to 75 per cent. Under current legislation, each spring the Secretary of Agriculture is required to set the dairy support level for the following twelve months within the range of 75 to 90 per cent of parity.

A year ago when the Secretary of Agriculture faced the problem, he seemed inclined to reduce supports because supplies were already accumulating in Government hands at that time. But the dairy industry asked for a year's

extension of 90 per cent in order to provide time to solve the problem itself—or at least make some headway on it. So we have had 90 per cent support during the past twelve months.

In that time the Government purchased more than 260 million pounds of butter, 240 million pounds of cheese, and 480 million pounds of nonfat dry milk in its effort to maintain prices near the support goal. These purchases were equivalent to about 7½ per cent of the milk produced during the period.

## **Consumer and producer prices**

Reduction of the support level will have an important effect on prices paid by consumers and prices received by milk producers. It is estimated that the retail price of butter will drop about 8 cents per pound, cheddar cheese will come down about 5 cents, and dry milk about 1 cent. Bottled milk may dip 1 cent per quart in some markets; but in others there may be no price decline, because in some cities fluid milk prices are not tied to prices of manufactured dairy products.

All in all, the lower dairy support will result in an average reduction of perhaps 5 per cent in the retail prices of dairy products in the aggregate. If the past relationship between the price and consumption of dairy products continues to hold, a 5 per cent reduction in retail prices might be expected to produce a 2 per cent increase in the quantity consumed. However, if the Government initiates "bargain basement sales" to dispose of previously accumulated dairy stocks, retail prices probably would drop more and consumption would be given an additional boost above what could be expected solely from the drop in support prices.

The lower dairy supports will mean a drop in prices received by milk producers. For manufacturing milk—that is, milk utilized in



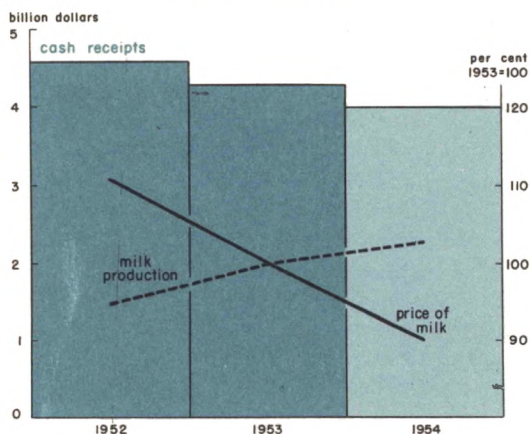
making evaporated milk, ice cream, cheese, butter, and powder—the support price will be reduced from \$3.74 per hundredweight to \$3.14, a drop of 16 per cent. Market prices can be expected to show about the same decline. For milk utilized in fluid form by consumers, however, the percentage drop in price will be much less. All in all, it is expected that the average price received by farmers for milk will drop at least 10 per cent.

### Incomes of dairy farmers

This price decline will not necessarily mean a 10 per cent reduction in farmers' cash receipts from sales of milk and cream, because the volume of marketings this year is indicated to be some 2½ per cent larger than in 1953, despite the announced lower level of support. Consequently, cash receipts from dairy marketings may be only about 7 per cent lower in 1954 than they were in 1953. Coincidentally, the decline from 1952 to 1953 also amounted to 7 per cent.

However, the percentage reduction in net income from dairy farming will be larger than the decrease in cash receipts, because production costs are relatively inflexible. This is illustrated in the following figures which apply the

### Farmers' cash receipts from sale of milk expected to continue moderate decline



national dairy outlook for 1954 to a typical farm in western Wisconsin.

	1952 <sup>1</sup>	1953 <sup>1</sup>	1954 <sup>2</sup>
Gross farm income.....	\$7,415	\$6,790	\$6,280
Total farm expenses.....	3,490	3,466	3,360
Net farm income.....	3,925	3,324	2,920

<sup>1</sup> Data from the Agricultural Research Service, USDA.  
<sup>2</sup> Tentative indication.

These data suggest a drop in net income of about 12 per cent between 1953 and 1954. This is less than the 16 per cent drop from 1952 to 1953, but during that period the prices of cull cows and calves went down sharply, in addition to the decline in milk prices. Cattle prices are expected to be more stable this year. Also, it is expected that production expenses will be reduced more in 1954 than they were in 1953.

### Government support purchases

Previously it was noted that the decline in retail prices of dairy products might be expected to produce a 2 per cent increase in the quantity consumed this year. In addition, our population is larger now than it was a year ago, but this is partly offset by a persistent decline in the per capita consumption of milk products. On balance, we can expect about a 1 per cent increase in consumption as a result of population growth. Thus, lower support prices and a larger population may result in a 3 per cent increase in consumption this year compared with last. But, as we noted earlier, milk production probably will be about 2½ per cent larger.

Consequently, the quantity of dairy products bought by the Government to support prices may be almost as large this year as in 1953. Because of the lower level of support, however, the expenditure of the Commodity Credit Corporation will be smaller.

### The basic problem

It was noted above that there has been a persistent decline in the per capita consumption of dairy products. This is the nub of the problem. If per capita consumption were to be as high this year as the near record in 1942,

it would be equivalent to 132½ billion pounds of milk. This compares with an estimated production this year of 124 billion pounds and an estimated consumption of only 118 billion.

Almost all of the decline in per capita consumption of dairy products in the past 15 years can be traced to butter. In 1953 butter consumption was only 8.6 pounds per capita, exactly one-half the rate of 15 years earlier. During the same period, margarine consumption increased. Last year it reached 8.2 pounds per capita, 3½ times the prewar rate.

The reason for this development is the simple fact that edible fats can be obtained at a lower price from vegetable sources than from milk. Where the products appear to be quite similar to consumers, many of them choose the lower-priced product. Consequently, butter consumption has declined.

Just how far butter prices would have to fall to displace a substantial amount of margarine is an open question. Some observers think that, if margarine retails for 30 cents per pound (its average last year), butter would have to sell as low as 50 cents in order to develop much of a comeback. But such a price would mean a very low income for the farmer who specialized in the production of milk for manufacture into butter.

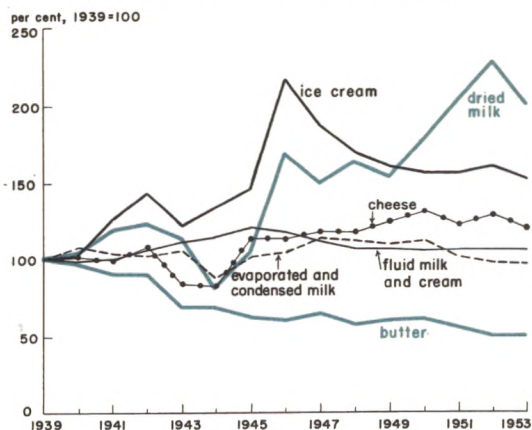
### Supply

From 1945 to 1952, milk production per capita declined almost 15 per cent. This exceeded the decline in per capita consumption of dairy products during this period. But in 1953 consumption kept on declining whereas production turned back up.

This pattern of milk production is associated with the gyrations of beef cattle prices and dairy prices. From 1945 to 1951, beef cattle prices averaged 145 per cent of parity whereas milk prices averaged only 103 per cent. In this situation it was profitable to cull herds closely and feed young animals for disposition as beef stock rather than to utilize them in the dairy.

However, from 1951 to 1953 beef cattle prices dropped from 146 per cent of parity to 80 per cent. In the same period milk prices

## Per capita consumption of butter shows persistent downward trend



dipped only from 97 per cent of parity to 94 per cent. So dairying had improved its position relative to the raising of beef animals.

There was an immediate response in the number of cows kept for milk. It increased 3 per cent during 1952 and another 3 per cent during 1953. Milk production per cow also rose. In 1952 milk production totaled 115 billion pounds or 734 pounds per capita; in 1953 production hit 121 billion, 759 pounds per capita; this year production is expected to reach 124 billion, which is about 770 pounds per capita.

### Adjustments

Under these circumstances, it would seem reasonable to advise the farmer whose primary product is butterfat to shift to some other line of production. Dairy products which utilize all the milk—or at least emphasize the milk protein and minerals as well as the milk fat—would seem to have a brighter future.

But these other products (like cheese and dried milk) are already in surplus supply. The per capita consumption of every major class of dairy product either held steady or declined last year compared with 1952. None advanced. To shift production from butter to other dairy products would merely shift the milk surplus



to these other products. And the CCC already has an oversupply of cheese and dried milk.

From a long-run standpoint, milk for fluid consumption is probably in the best competitive position of any dairy product. But even here it is the milk solids, rather than the fat, which provide the competitive strength. A dairy farmer selling to a city fluid milk market probably will be able to do reasonably well in the years ahead if (1) he has a large enough herd for economical operation, (2) he has cows of high quality, and (3) he utilizes recommended cropping and feeding practices. With regard to the third point, some dairy farmers could cut costs by substituting roughages for grain to some extent in their cattle feed. But even on farms producing milk for fluid consumption, the outlook does not seem to call for large additional capital investment unless it is for items that will reduce costs per hundredweight of milk produced—usually by stepping up output.

For milk utilized in manufactured dairy products, the outlook is less favorable. This is especially true of those products (like butter) which have milk fat as a principal constituent. The hard economic fact is that we are now producing more milk than is required to satisfy the present demand for these products at current prices, hence the accumulation of stocks.

### Shift, but where?

In some areas dairying is practically the only type of farming permitted by the weather, soil, and topography which can come anywhere near maintaining present values of invested capital and land. For such farms there seem to be three alternatives: (1) accept a lesser income, (2) move on to a different type of farm, or (3) sweat out an interval in which others are making these adjustments and over-all demand is growing.

For dairy farmers who can switch to other types of farming the outlook is better but still cloudy. Surpluses dot the whole agricultural landscape. From a technical standpoint, raising beef cattle is a possible substitute for dairying. But this is a much more extensive type of farm-

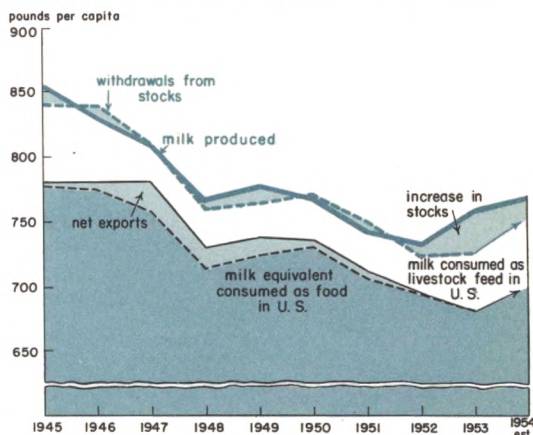
ing and requires a larger farm and more capital to provide full employment for a farm family. In areas where the soil will accommodate a crop program including a large amount of grain, especially corn, hogs can be substituted for dairy cattle. At present, the supply of hogs is short; but this situation is likely to change next fall.

Another possible shift is to leave agriculture and go into industry. The attractiveness of this alternative, of course, is limited at any one time or place by the availability of industrial employment. An optimum use of the nation's labor force, however, indicates a need for a continued transfer of workers from agriculture to other lines of activity.

### Demand

On the demand side, there have been a number of efforts and proposals. Now under way is an advertising program on a much larger scale than had been attempted previously. Among the proposals, the one presently drawing most attention involves subsidizing the consumption of dairy products among low income groups. The Food Stamp Plan is an example. As the real scope of the dairy problem becomes more clear, plans to subsidize consumption may draw additional support.

### Milk production trended downward in line with consumption until 1952





## Corporations turn to internal funds as borrowing needs shrink

So far in 1954 corporations have enjoyed a sellers' market for their bonds and notes to a degree unknown in recent years. New bond issues, almost invariably, are meeting with an excellent reception despite lower coupon interest rates. Bank rates on good short-term loans also are being shaved; in March big city banks announced a reduction in the prime commercial rate from  $3\frac{1}{4}$  to 3 per cent. These developments reflect the reduced dependence of business upon outside financing at a time when a huge volume of savings continues to flow into financial institutions.

In 1954, for the first time since 1949, internal sources of funds—retained earnings, depreciation reserves, and liquidation of inventories—will supply virtually all the money needed by business. On the basis of existing evidence, it appears that the money and capital markets will be of minor importance on a net basis. For business in the aggregate a reduction in bank loans during the year may largely offset new money acquired by sales of securities of all types.

The corporate financing picture has been redrawn completely since the second quarter of 1953 when interest rates were bounding upward in response to heavy demand for borrowed funds on the part of business, consumers, and governmental bodies. At that time some pending bond issues were taken off the market—temporarily in most cases—because of a reluctance to pay the high rates required for successful flotation. Demand for short-term funds also was strong. Some firms borrowed from banks so as to avoid issuing long-term securities at rates believed to be temporarily high. Other businessmen apparently arranged short-term credits because of a concern that the money market would continue to tighten

and that money would be less available later in the year.

### Inventory cutback will supply cash

Plant and equipment expenditures of corporations are expected to fall a billion dollars or so from the 24 billion record of 1953 on the basis of recent surveys—not enough to reduce appreciably the amounts of funds needed for this purpose. The big change in business needs is “above the line” in the working capital section of the balance sheet.

About 3.5 billion dollars of corporate funds were invested in inventory in 1953. This year a considerable amount of money may be supplied to corporations as stocks are drawn down. At the end of January, inventories of manufacturing firms were reduced hardly at all from December's all-time high, despite the fact that sales had slipped 10 per cent and order backlogs had declined 28 per cent from their 1953 peaks.

Accounts receivable may continue to rise in 1954 as business firms extend additional book credit to customers, but the gain probably will not equal last year's growth.

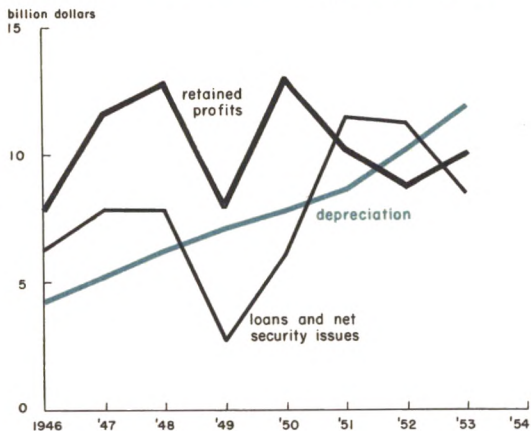
### Internal generation of cash

A continued large volume of retained earnings and depreciation allowances supplemented by inventory liquidation will provide the bulk of corporate cash needs in 1954. These three categories ordinarily constitute the “internal sources” of funds available to business under the conditions likely to prevail in this year.

Funds are generated internally by business firms as they are able to hold back some of the money received for sales of goods and services. Cash over and above the amount needed to pay expenses and taxes is available for dividends, repayment of debt, or investment in physical assets. In addition, larger amounts of cash may be held to improve liquidity and thus increase the flexibility of financial management.

Many corporations depend primarily upon internal funds, and tap the capital and money

## Depreciation allowances becoming dominant source of corporate funds



markets only for residual amounts. It is through the little-publicized internal route that American business has created the great bulk of its investment over the years. When needs are very heavy temporarily, as in an inflationary period, it is often necessary to obtain larger amounts of money on the "outside." When prices level or begin to fall, when inventories stabilize or decline, and when outlays for plant and equipment are reduced, the need for outside financing is lessened and the process of debt expansion may be reversed.

Retained earnings and funds made available through depreciation reserves have covered about two-thirds of all corporate needs through the postwar years. In the eight-year period 1946-53, corporations invested over 150 billion dollars in plant and equipment alone. During these years retained earnings and depreciation amounted to about 144 billion, almost as much as the expenditure on fixed assets and more than three times the volume of net security issues of all types—debt and equity.

The fourth quarter of 1953 already had witnessed a considerable earnings decline from the earlier portion of the year. Corporate profits are very likely to be significantly lower in 1954. Normally it might be expected that profits would fluctuate very abruptly in the face of

changing sales volume. However, many firms will benefit by elimination of overtime pay and premium-priced raw materials, the withdrawal of inefficient facilities, and other efforts to lower costs. After-tax earnings, moreover, will be bolstered by elimination of the excess profits tax.

Dividend payments constitute a highly stable outlay for most large corporations. There is a reluctance on the part of financial management to increase dividends rapidly in a boom, because the funds are needed for expansion of physical assets and because of a desire to hold payments at a level which can be maintained in less profitable years. Dividends in 1954 are likely to remain at the 9 billion dollar plus level of the past four years and probably will exceed retained earnings for the first time in the post-war period.

### Write-offs now largest money source

Although earnings retentions are expected to slip, depreciation allowances will continue to mount rapidly, with the result that earnings and depreciation combined may be equal to last year's record total. Depreciation will reach or approach 14 billion dollars in 1954, twice the amount of five years ago. This would far exceed the volume of retained earnings.

Growth in depreciation allowances is the natural result of continuous additions to plant and equipment at post-World War II prices. It is further enhanced by the use of accelerated depreciation under certificates granted by the Government for defense-related facilities since 1950.

Congress is now considering changes in the tax law which would permit shorter depreciation periods at the option of all business regardless of the use to which the facilities are put. This would, of course, further increase the flow of funds from depreciation. The program might also increase the volume of capital expenditures since many business firms apparently relate such spending to the amounts taken as depreciation. Of course, depreciation money does not become "available" to the extent that a

—continued on page 11



# THE Trend OF BUSINESS

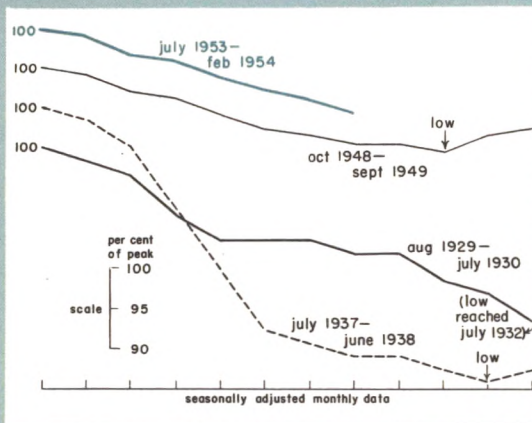
**B**usiness activity has continued to move downward in recent weeks, but there is some indication that the rate of decline is slowing, at least temporarily. Industrial output eased slightly further in February, but construction activity continued at a record pace. Nonfarm employment declined by another 300,000 during the month, but the trend in new claims in unemployment compensation has come closer to the usual seasonal pattern in the past few weeks. New car sales are reported to have picked up sharply from the reduced January level in February and early March, while other retail sales generally have held steady somewhat below last summer's record level. Despite these signs, however, no upturn in over-all activity is yet in sight.

Although the business downturn to date has been moderate and gradual, the accumulated

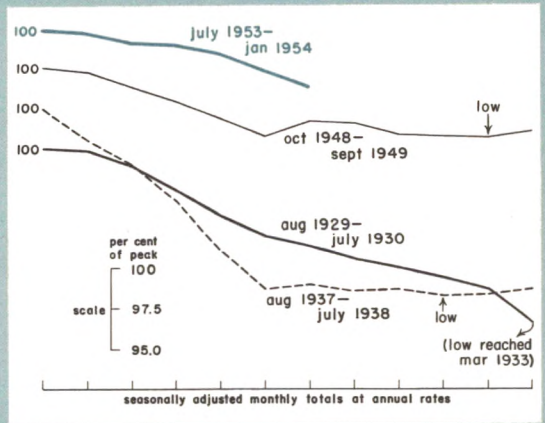
effects of this trend have resulted in substantial reductions from last summer's peaks in many broad measures of activity. In fact, the magnitude of some of these declines already rivals those experienced during the mild 1948-49 recession. The 10 per cent decline in industrial production since last July, for example, about equals that which occurred between August 1948 and May 1949. Wage and salary receipts also have followed a similar pattern, declining about 3½ per cent in the first six months of both periods.

Significant differences in the character of the two downturns are also apparent, however. Wholesale prices have been steady and the stock market rising in recent months, apparently indicating a high degree of business and investor confidence that the current recession will be mild and of short duration. On the other

**Industrial output** decline so far about equals that of 1948-49 . . .



wage and salary receipts also have moved gradually downward . . .





hand, rising Federal outlays and a continued strong demand for consumer durable goods were major sources of strength in the business picture during the 1948-49 period; declines in such expenditures have been prominent in the current business downturn.

**Manufacturers' new orders** dropped to 20.2 billion dollars on a seasonally adjusted basis in January, the lowest dollar volume since May 1950. Thus far the decline from last spring's peak has amounted to 22 per cent, considerably more than that which occurred in 1948-49. Sales volume has consistently exceeded new orders since last May, with the result that order backlogs have been reduced by more than one-fourth in the past year. Nevertheless, at 56 billion dollars, the cushion of unfilled orders is still far larger than at any time in 1948-49, even considering the higher level of prices and increased operating rates in most industries.

Manufacturers' sales in January were 10 per cent below the peak reached last July, after seasonal adjustment. This compares with a 5 per cent decline during the first six months of the 1948-49 downturn and 14 per cent from the peak to the low. Most of the decline has been in durable goods, which are off 15 per

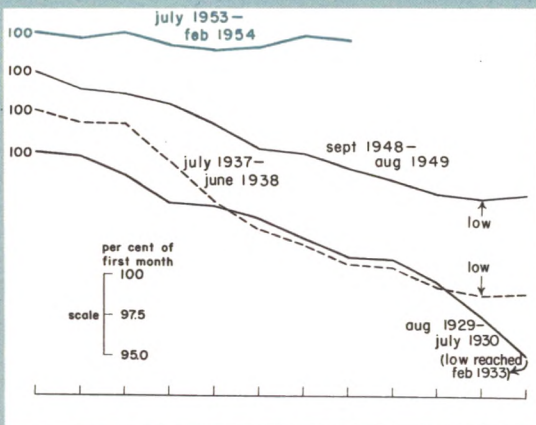
cent, but manufacturers' sales of nondurables have also dropped 5 per cent.

**Employment** in nonfarm firms dropped 300,000 from mid-January to mid-February, according to the Bureau of Labor Statistics. Although this drop was partly seasonal, the total number of employees was 900,000 less than a year earlier and 1.3 million below last summer's peak (after adjustment for seasonal changes). This compares with a decline of 1.7 million from the peak in October 1948 to the low in July 1949. There is some evidence that the decline in employment is slowing. New claims for unemployment compensation, 94 per cent higher than a year earlier in the latter part of January, had eased off to a 75 per cent year-to-year gain in the latter part of February.

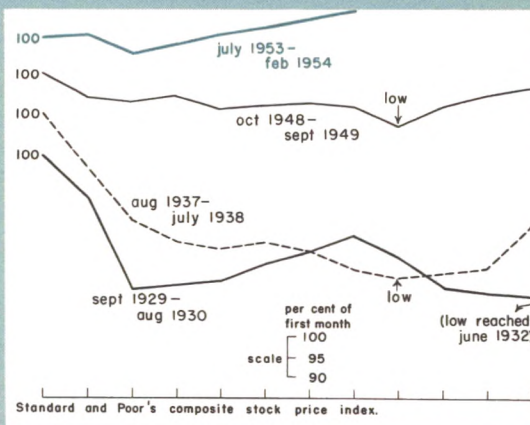
Reflecting the decline in employment and shorter work weeks in manufacturing, wage and salary receipts have dropped steadily since last July. Through January the decline had amounted to 3½ per cent, equaling that which occurred in the first seven months of the 1948-49 recession. Increased social security tax withholdings partly accounted for the January drop, however.

**Business inventories**, seasonally adjusted, were reduced moderately in January for the

but wholesale prices, unlike other periods, have held firm . . .



and common stock prices have actually risen



fourth consecutive month, and all evidence points to a continued liquidation since then. As in the 1948-49 recession, the shift from large additions to stocks immediately preceding and during the initial months of the downturn to one of liquidation as the business slide progressed has been a major influence in the decline in production, employment, and manufacturers' sales. Following an inventory growth averaging more than 600 million dollars per month in the second and third quarter of last year, stocks have been reduced at a monthly rate of about 300 million since September.

Reductions to date have not made much of a dent in the 80 billion dollar inventory total, however, although stocks of some individual products, such as steel and television sets, appear to have been reduced substantially. At the end of January, total inventories were 3.6 billion dollars higher than a year earlier and only 1.3 billion lower than at the peak in October. In fact, business sales have dropped off more rapidly than inventories, with the result that the stock-sales ratio has advanced to the highest point since early in 1950.

**Declining outlays** of the Federal Government have also contributed to the fall in business activity, unlike the 1948-49 experience. In the earlier period, such expenditures increased steadily throughout 1948 and the first half of 1949. The current decline in Federal outlays is entirely accounted for by a cutback in national security expenditures, which in January and February were running at a monthly rate of about 3.5 billion dollars, 20 per cent less than in the third quarter last year.

**New construction** continues as one of the strongest spots in the economy. Private expenditures in January and February were 5 per cent higher than a year ago and at a record level for these months, while public outlays were running only 4 per cent behind 1953. Moreover, private contract awards as reported by F. W. Dodge are holding well above last year. Private housing starts in January and February were moderately below those of early 1953 but at an annual rate about equal to the total number of units started last year.

**Wholesale prices** have remained remarkably steady in the face of declining output and sales. In February, the index of prices for all commodities was virtually the same as in July, the peak month for most business measures. This is in sharp contrast with earlier periods of business decline, when the level of prices responded vigorously to reductions in demand. In part, the much greater current strength in over-all prices is accounted for by the leveling out in farm prices which already had declined substantially prior to mid-1953. Prices of industrial goods have also held steady, however, and at a point close to the all-time high.

	Farm products	Industrial goods
July 1953-February 1954	0%	0%
September 1948-April 1949	-13	-3
July 1937-February 1938	-22	-3
August 1929-March 1930	-12	-3

Indexes of wholesale prices are probably less reliable indicators of trends in actual transaction prices during periods of declining business than normally. Various types of informal price concessions—discounts from list, special sales, absorption of delivery and other costs—have undoubtedly become much more common in recent months in wholesale as well as in consumer markets. There is no evidence, however, that such concessions are now more prevalent than in earlier downturns, and the translation of such concessions into lower formal prices generally has been resisted successfully so far.

Reluctance of sellers to cut prices has both favorable and unfavorable connotations. On the unfavorable side, this means that price

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paring generally has not yet fully assumed its traditional role in stimulating demand. On the other hand, the firmness of prices has probably made the task of reducing inventories less pressing, since book losses have not become an important consideration as yet. Moreover, resistance to formal price cuts suggests that many businessmen feel that the current downturn will be temporary and moderate in character. That investors also tend to share this view is indicated by the rise in security prices in recent months. This continued confidence in future prospects is perhaps the most promising aspect of the business situation today.

### Business finance *continued from page 7*

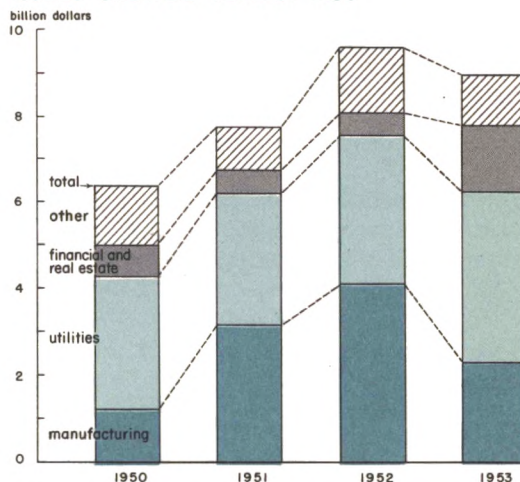
firm suffers losses. It is simply a "non-cash" expense which is represented by assets only when it is earned.

#### Utility offerings remain large

In the first quarter of 1954, listings of new issues of corporate securities were heavily dominated by utilities, particularly electric power companies. The special issue of notes totaling 250 million dollars placed by Chrysler with an insurance company stood alone as a large recent or prospective borrowing by a manufacturer. Securities sold by manufacturing concerns declined over 40 per cent between 1952 and 1953, from 4.1 to 2.3 billion dollars, and fell well below the volume issued by utilities. A further decline in manufacturing flotations is expected in 1954 whereas gas and electric utility issues may be maintained at about 3 billion dollars.

Total security issues for new money, that is, exclusive of retirement of bonds or preferred stocks, were very close to 1952's record 8.2 billion dollar total in 1953. However, 1953 offerings were boosted by a huge increase in sales finance company issues. These firms sold one and a quarter billion dollars of securities, mainly debentures, in 1953 in contrast to one-fifth that amount in the previous year. Finance

### Security sales of manufacturing firms declined in 1953; utility issues showed further rise



SOURCE: Securities and Exchange Commission

companies will not experience a similar need in 1954.

Railroads also will require a substantially smaller amount of equipment financing, and the Bell Telephone System, which sold a massive 600 million dollar issue in December of 1953, is not likely to equal this record in 1954. In the aggregate American business will obtain considerably less new money from the capital markets in 1954 than in 1953.

#### Borrowing rates down sharply

The reduced supply of new corporate issues coupled with the continued heavy flow of savings has brought coupon rates well below the levels of last spring which in turn were the highest in almost two decades. In March, high-grade corporate bonds were quoted to yield about 2.8 per cent compared with 3.4 per cent last spring, and further yield declines were expected.

When the Treasury issued 3¼ per cent 30-year bonds last spring, these securities soon declined below par indicating that the market rate was even higher. Currently these bonds

are selling at over 109 to yield about 2.7 per cent. During the month every outstanding Government bond was quoted at par or higher for the first time since the Treasury—Federal Reserve “accord” in March of 1951. Future movements in long-term rates will hinge largely upon the types of securities which the Treasury employs to fill its needs. Should a large long-term Treasury issue be announced, it would, of course, tend to brake a further decline in the yields of corporates.

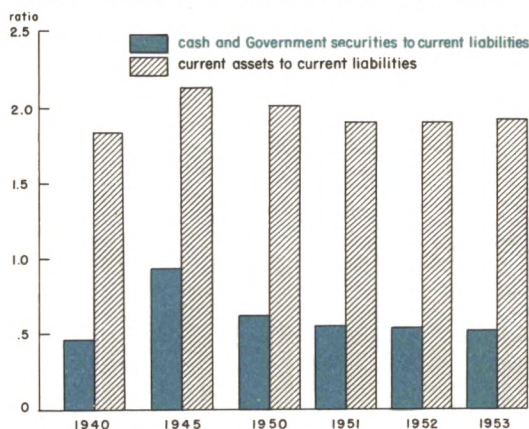
If the supply of long-term funds continues to rise relative to demand, it is probable that a large volume of new refunding issues will be offered to replace securities sold in the past two years. Last year, the dollar amount of refunding issues was the lowest since the Thirties. Recently, new issues of comparable quality have been yielding  $\frac{1}{2}$  to 1 per cent less than was the case a year ago. As a result many bonds are selling at or above the prices at which they may be called for redemption by issuers.

The continued flow of savings to insurance companies, savings and loan associations, mutual savings banks, commercial bank time deposits, pension funds, and similar investment outlets in 1954 may approximate the record 15 billion dollar level of 1953. A reduced supply of corporates will increase the volume of funds seeking investment in mortgages and help improve construction prospects. Most municipalities also will find a ready market for their obligations. Finally, it is possible that some institutional funds may be invested in Governments on a net basis for the first time since 1946.

### Bank loans being paid off

Although many corporations prefer to be out of debt to banks except for purely seasonal needs, this aversion to short-term borrowing is commonly overcome when circumstances dictate such a course. A sharp rise in prices and activity such as occurred in the years 1946-47 and again in 1950-52 tends to bring to the banks borrowers who ordinarily make no use of short-term loans. Usually these firms

## Working capital ratios have dropped since 1945, but remain above prewar



Note: 1953 based on third-quarter figures; 1940-52 on year-end data.

are excellent risks, and their wants are satisfied readily. However, as internally generated funds become available and as securities are sold to satisfy needs which appear relatively permanent, dependence upon bank loans lessens and many firms are in a position to repay previous borrowings.

Two such cycles have been traced in the postwar period. From 1946 through 1948, the net expansion of corporate bank loans and mortgages slowed, and a net reduction occurred in 1949. In 1951 these loans provided 5.2 billion dollars to business—a record for the postwar period. In 1953 this amount had shrunk to about 1 billion, and 1954 is likely to see a sizable net reduction. The magnitude of the decline will depend largely upon the level of profits, inventory trends, and the course of prices.

So far in 1954, metal processing firms have reduced bank loans sharply. Seasonal borrowers such as sales finance firms, food processors, and commodity dealers have paid off loans at a rate much faster than that observed last year. The commercial, industrial, and agricultural loans category of the tabulation of the weekly reporting banks declined over 1 billion dollars or about 5 per cent between the December



peak and early March, far more than in the same period of 1949. Moreover, this reduction was moderated by important acquisitions of certificates of interest issued by the Commodity Credit Corporation.

Not all firms have short-term bank loans to repay. In these cases, accumulations of cash may be held idle or used for the purchase of securities. The net result of all of these developments should be a rise in the ratio of current assets to liabilities and in liquidity as measured by holdings of cash and Governments relative to current liabilities. Except for 1949, the past eight years have witnessed an almost continuous decline in these comparisons from the extremely liquid position attained during World War II.

It is paradoxical that a decline in business activity should bring an improvement in the financial position of business. But this tendency will not be the case for many individual enterprises and perhaps not for a majority of all corporations. The above analysis is based upon aggregates which are dominated by large, stable, well-financed corporations, many of which have been paying excess profits taxes.

A lower level of sales may eat into the profit margins of less favorably situated firms so sharply as to increase rather than lessen dependence upon lenders. Evidence to support this view is offered by the fact that outstanding loans of smaller banks do not follow closely the pattern set by the big city banks. It is these larger banks which make up the weekly reporting series and which account for a very large proportion of all bank loans to business.

### Tax liability declining

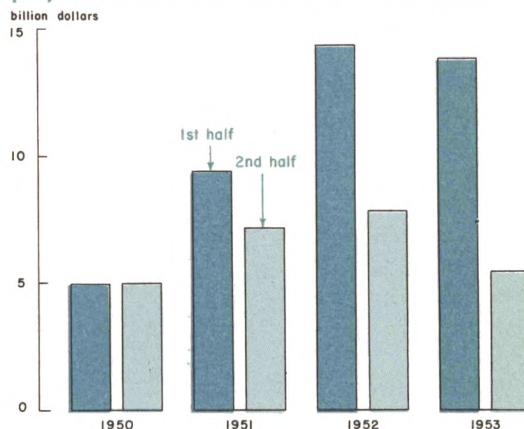
Another vital element in the sources and uses of funds picture is the liability for taxes payable to the Federal Government. When the tax liability is growing in years of rising profits, corporations have the temporary use of funds which eventually must be paid to the Government when profits decline. At the end of 1953, nonfinancial corporations showed a tax liability of about 19 billion dollars, double the amount on the books at the end of 1949.

The Mills plan, under which corporate tax payments due on the prior year's liability have been moved gradually into the first half of the year, has affected the use of tax reserves as a source of funds. In 1954, 90 per cent of the tax liability shown on the books at the end of 1953 will be paid in the first half of the year. In 1955 the transition will be complete, and 100 per cent will be due in two quarterly instalments in the first half.

The necessity of meeting these payments in March and June has caused many corporations to carry larger average balances of cash and Government securities. Some even prefer to immobilize tax funds as they are earned by investing them in suitable Government securities or commercial paper which can be used to meet the obligations as they come due. Such a course prevents the utilization of tax payables as a source of operating funds. Other firms avoid funding the tax liability and rely upon temporary borrowing, liquidation of inventories or receivables, or a temporary depletion of cash balances to satisfy the tax collector.

Congress is now considering a new plan to further accelerate corporate tax payments to a modified pay-as-you-earn basis similar to the method by which individual income tax payments are made. Under this program larger

### Acceleration of corporate tax payments swells first-half collections





corporations would be required to pay 10 per cent of their 1955 tax liability in that year. The payment on the current year's estimated liability would be increased until 1959, when the remaining half of the 1958 liability would be paid in the first half of 1959 and one-half of the 1959 liability would be paid in the year in which it was incurred.

The new plan eventually would eliminate some of the unstabilizing effects of the Mills plan, but it would reduce the accumulation of the tax liability in times of rising profits and thus prevent corporations from financing themselves through tax reserves to the extent possible in the past. During the transition period the new plan would put a burden upon corporate finances because corporations would be paying 110 per cent of a year's taxes in a single year, assuming stable profits and tax rates.

#### **Financial decisions more flexible**

Easy money in both the long- and short-term markets, coupled with the reduction in needs for funds and the growth in funds available from internal sources, will help corporations solve their financial problems in 1954 in the manner they believe to be most advantageous. Many firms wishing to reduce outstanding debt will be able to do so. Almost all corporations will be better able to substitute one type of financing for another—long-term bonds for short-term debt or lower coupon rates on re-funding issues for long-term debt undertaken in the recent past.

Financial flexibility will not necessarily extend to new issues of common stock which are likely to remain a rather minor source of funds for most major groups of corporations. A large portion of the common stock sold in recent years has been offered by electric utilities which must keep equity accounts in a reasonable relationship to debt and are able to retain only a relatively small fraction of their profits.

The history of many large firms which have not sold common stock since their origin indicates that such financing is not necessary for business growth. Only a small portion of the equity proclaimed on corporate balance sheets

was obtained initially through sales of common stock for cash. Rather, capital and surplus accounts have been built up by reinvestment of earnings. Continuance of business growth and financial stability will depend as in the past upon the ability to sell products in sufficient volume at prices which adequately cover costs and taxes.

New debt will play a relatively minor role in business finance during 1954. Nevertheless, lenders will be well supplied with loanable funds, and the financial climate has remained favorable enough to suggest that by and large business will be able to borrow in cases where such a policy is desired. It is sometimes said that, in the past, money has been tight (that is interest rates were high) but available in prosperous times and easy but unavailable in periods of declining business. This latter condition is not likely to prevail in 1954. The eyes of businessmen and lenders are not trained upon the extent of the dip which has occurred or the course of events immediately ahead to the exclusion of the longer-run future.

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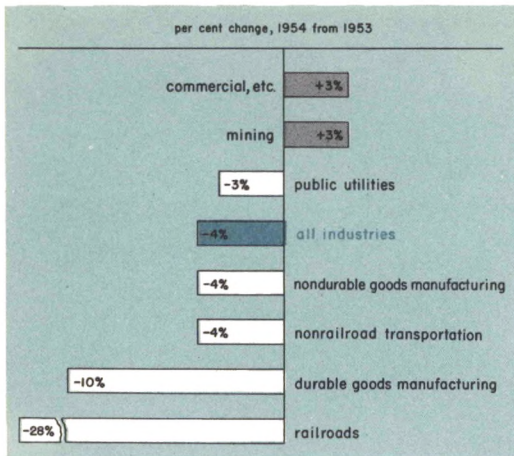
#### **Defense plant expansion slows, commercial construction continues at high level.**

**B**usiness expenditures on new plant and equipment are being scheduled in an amount of 27.2 billion dollars this year, according to a recent survey made by the U. S. Department of Commerce and the Securities and Exchange Commission. This is about 4 per cent less than actual outlays for this purpose last year. Although all major industrial groups other than mining and commercial firms plan to spend somewhat less than in 1953, the largest declines are for railroads and durable goods manufacturing.

A substantial part of the very large business outlays for expansion and modernization of plant and equipment since Korea was sparked



## New plant and equipment expenditures expected to decline in 1954



by the Government-fostered program to enlarge capacity in the nation's basic industries. Although the proportion of total capital expenditures related directly to the defense effort dropped in 1953, the existence of a backlog of about 10 billion dollars in the program at the end of 1953 remains as a significant factor in the outlook for capital expenditures on new plant and equipment in 1954.

The program for increasing capacity in the nation's basic industries, launched shortly after Korea, was aimed at providing capacity to produce such basic materials as iron ore, steel, petroleum products, and aluminum in volume sufficient to support a long-run mobilization effort without interfering unduly with high standards of civilian consumption. The incentives for industry to invest in expanded capacity in these selected lines, quickly and beyond normal requirements, were the much-coveted certificates of fast tax amortization. These certificates permitted businesses to depreciate new facilities over a five-year period rather than the much longer time usually required by the Bureau of Internal Revenue. Additional incentives present in the situation then prevailing were expectations of continued high profits and indications that the Government would

undertake the expansion job if business did not.

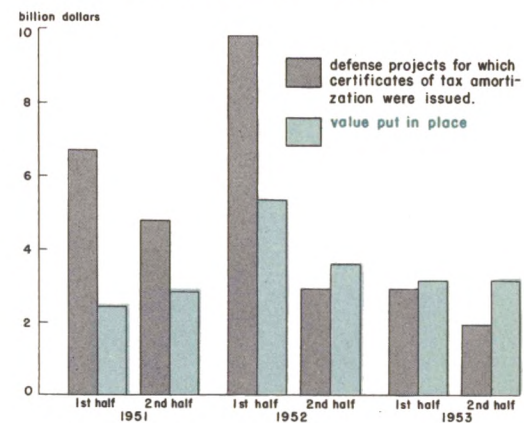
A number of the goals called for very sharp expansion in capacity.

	Goal		
	1950 capacity	1954 capacity	per cent increase
Railroad freight cars (million) . . . . .	1.6	1.9	16
Steel (million tons) . . . . .	100.0	124.0	24
Oil refining (million barrels, daily) . . . . .	6.7	8.7	30
Gas (billion feet, annual). . . . .	6.1	8.1	33
Electricity (million of K.W.H.) . . . . .	63.0	116.0	84
Aluminum (million tons) . . . . .	.7	1.7	162

Particularly noteworthy is the planned capacity for aluminum—more than double that available in 1950. Steel capacity, already up 10 per cent from the 91 million tons at the end of World War II, was scheduled for a further increase of 24 million tons.

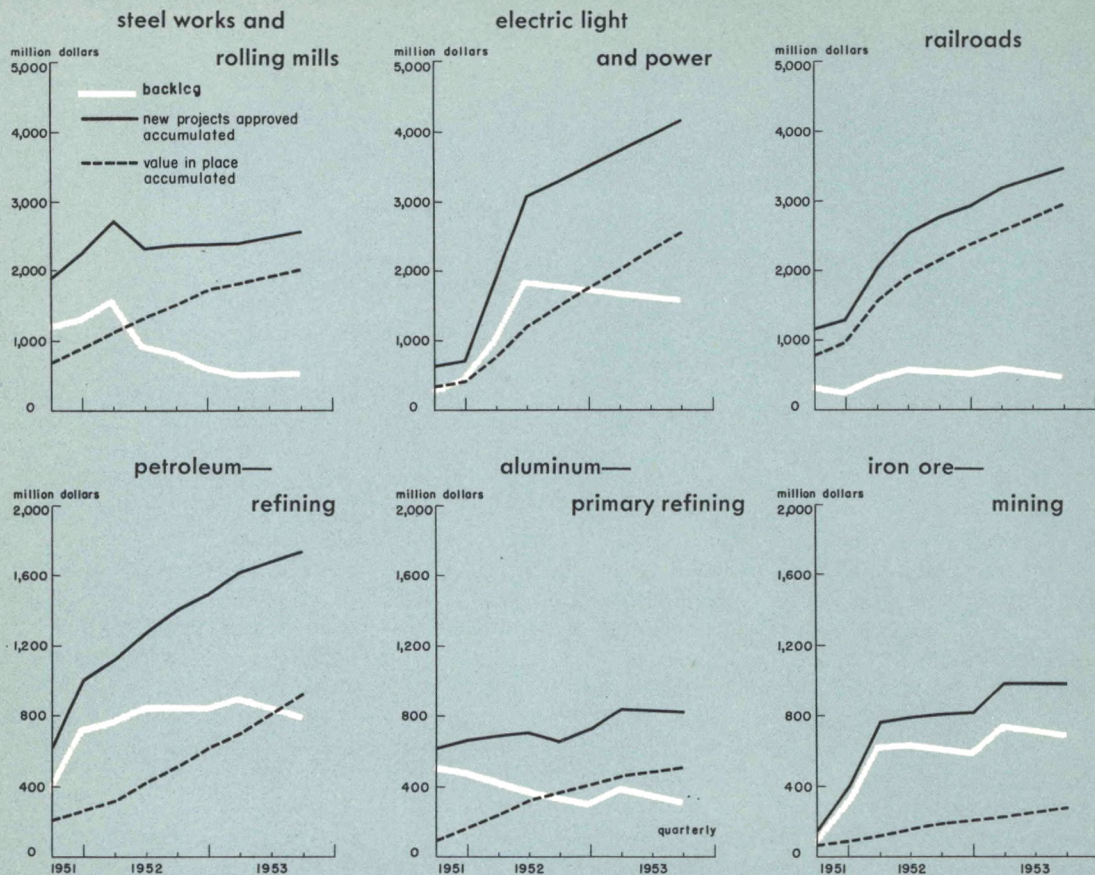
Tax amortization certificates have been issued in the amount of about 30 billion dollars to cover projected business outlays on defense-related projects. The great bulk of these expenditures was to be made by the end of 1954. The most recent estimates of the Office of Defense Mobilization show that about 20 billion

## Business outlays on defense projects have been declining since the first half of 1952





## Progress in major areas of defense plant expansion



dollars have been spent on certified projects to the end of 1953.

The slowing of expenditures on covered programs since 1951, the expiration last January of the excess profits tax which had helped make fast amortization attractive, and the appearance of excess capacity in many industries raises the possibility that much of the backlog may not be fulfilled on schedule. Additional incentives may be needed to push the program to completion.

Whatever may be the fate of the remainder of the program, very large additions to the nation's capacity to produce in basic industries

have already occurred. The planned dieselization of the railroads, for example, has been virtually completed. Expenditures remaining in this program are largely planned for additional freight cars. Steel ingot capacity has nearly reached the target figure. Aluminum capacity, estimated at more than 1.5 million tons, is more than double the 1950 figure. Electric power generating capacity, at 90 million K.W.H., has been boosted by about 50 per cent. Of the six major industries charted below, which accounted for about half of total planned expenditures, only iron ore mining would appear to be seriously lagging.