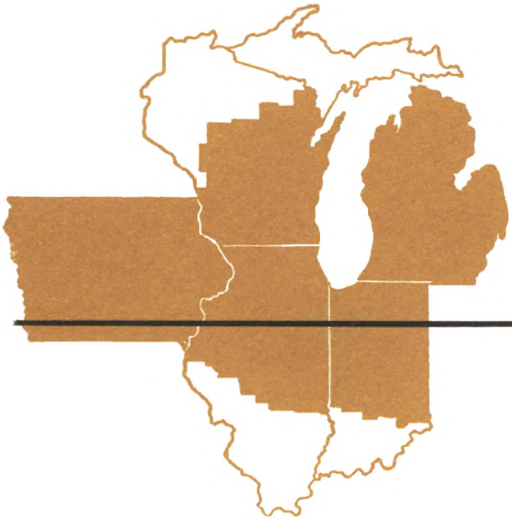
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1955 March

Contents

THE Trend OF BUSINESS

Optimistic forecasts of 1955 activity received support from retail sales in January. Preliminary reports indicate sales were 10 per cent above the low level of last year. This followed upon the heels of impressive gains chalked up in December and may signal a movement of consumer demand to new high ground.

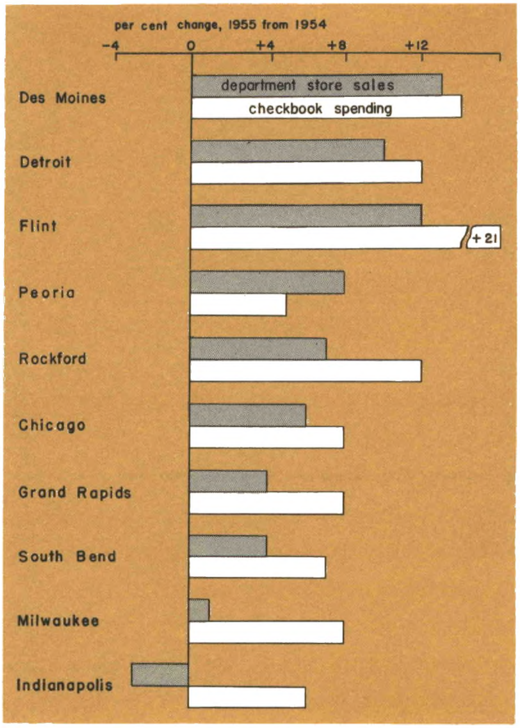
Department store sales in the Midwest about matched the national rise in total retail sales. This was made possible by booming Detroit which reported a 12 per cent gain in the early weeks of the year to offset results in Milwaukee and Indianapolis which merely equaled last year. Evidence of business strength is provided also by a strong upward movement in the volume of checks written on demand deposits in virtually all Midwest cities.

At the start of the year, total retail inventories were 3 per cent less than a year earlier, and Midwest department stores had about the same volume of goods in stock and on order as a year earlier. A continuance of retail sales at recent levels can be expected to induce some build-up of inventory and thereby contribute additional impetus to the upswing.

The gross national product increased to an annual rate of 362 billion dollars in the fourth quarter of 1954 for a gain of 6 billion from the third-quarter rate. Strength in autos, steel and construction and the near-cessation of inventory liquidation were largely responsible.

Amidst the widespread optimism of business and consumers, however, vital sectors of the economy continue to be watched closely for any evidence of weakening or additional strength. New home buying, for example, will have to exceed the year-ago rate by a substantial margin if residential construction is to be maintained at recent high levels. Similarly, spring sales of automobiles will be watched for evidence of a seasonal rise from the current high volume, and labor-management negotiations for indications of the probable number and duration of interruptions to production and wage income.

January sales and debits in Midwest



Passenger car output has provided the most spectacular production development of recent months. January accounted for 660,000 assemblies—200,000 more than a year earlier. In February, a record number of 170,000 units per week were being turned out. For December and January combined, retail deliveries are estimated at almost 1.1 million, far more than ever before in those months, which usually witness seasonal lows. As a result, dealer inventories had reached only 480,000 at the end of January.

Reported production schedules for the February-April period call for an output of over 2.1 million cars, so that by early May the industry will have passed the halfway point toward reaching the production goals set by the most optimistic forecast of 6 million for the calendar year.

Steel production has been stimulated by the automotive ordering, but also through buying of other hard goods firms whose inventories had begun to appear inadequate. Production has hit 2.1 million tons in recent weeks and reached 88 per cent of capacity nationally in February. Even higher rates were reported by the strategically placed Chicago and Detroit-Cleveland areas. Markets for some types of steel, such as cold rolled sheets, galvanized sheets, tin plate and wide flange beams, have been tight. Nevertheless, there is little indication of speculative buying. Industry experts expect some letup of buying later in the second quarter, but there is a growing expectation of a 100 million ton year—up 13 per cent from 1954 but still below 1951 or 1953.

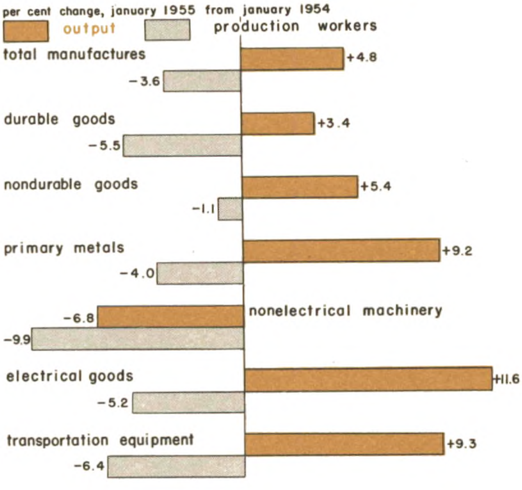
Electric power output is establishing new records by a substantial margin almost weekly, partly as a result of a strong long-term uptrend but also because of the renewed strength of industrial demand. Nationally, electric power sales have exceeded 1954 by 12 per cent compared with an 8 per cent gain in the previous 12 month period. Gains in the Chicago area have been about 7 per cent compared with a 1 per cent increase from 1953 to 1954. Detroit kilowatt use has been outrunning last year by 15 per cent, whereas January 1953 had merely equaled the previous year. Freight carloadings have also been passing last year's figures by about 3 per cent after the substantial reductions posted last year. Carloadings have remained 9 per cent below 1953, however.

Employment declined seasonally after the Christmas holidays, and unemployment reached an estimated 3.3 million in January compared with 3 million last year. February usually establishes the high for the year and doubtless will be above the January figure. New unemployment compensation claims have been fairly heavy but well below last year. All Midwestern states reported substantially fewer persons collecting unemployment compensation in January than last year, whereas in the nation the number was about the same.

Continued good business would melt the jobless total noticeably in the spring. However, it is noteworthy that employment gains have lagged the industrial revival. In January, manufacturing production worker employment was 4 per cent below the previous year while production activity was 5 per cent higher. The average work week, meanwhile, was about an hour longer.

Construction activity was 13 per cent greater in January than in the previous year. Meanwhile contract awards, according to F. W. Dodge, showed a gain of 30 per cent. The industry is thus well launched on what shows every indication of being another record year. In the Midwest, activity is likely to be especially strong. Construction awards in the Sev-

Employment down, output up



enth District exceeded last year by 50 per cent in January. As in the case of manufacturing, the rise in construction activity has not been fully reflected in employment. In early 1955 virtually the same number of construction workers were employed in the nation as in the previous year. In the Midwest, however, there were a somewhat larger number.

Most prices of goods continue to show considerable stability despite some persistent inflationary rumblings. Prices of certain raw materials have been boosted by heavy demand on the part of prosperous Europe as well as by domestic customers. Nonferrous metals are about 20 per cent higher than a year ago. Natural rubber was recently quoted at 37 cents per pound compared with 20 cents last year. Prices of tires and a variety of other rubber products have been advanced. Most of these items, however, are well below their postwar highs. Indirect price increases on some steel products, through elimination of discounts on sub-standard items offered by steel warehouses, have occurred, and increases have been posted in some other lines. Nevertheless, competition resulting from ample capacity continues to make most producers cautious of increasing finished goods prices even in cases where costs have risen. Despite the large volume of construction, bidding on most large projects is said to be heavy with low bids well under engineers' estimates in many cases.

Renewed interest in farm real estate

After declining for almost two years farm real estate values in the Midwest have turned upward. In the last half of 1954 land values chalked up a gain of about 2 per cent. This was in sharp contrast with the South and West where values continued their decline from the Korea-induced peak reached in 1952.

Corn Belt income maintained

During the winter and spring of 1953-54 receipts from farm marketings in the Corn Belt held near or slightly above the year-earlier level due largely to strong markets for hogs and soybeans. At the same time near-record production of agricultural commodities was general throughout most of the Corn Belt. More recently, a strong market for fed cattle has provided some support for farm income. As a result, all Midwest areas shared in the increase in land values except those where drouth cut sharply into incomes. In contrast, nationwide cash receipts from farm marketings continued the decline that started in 1952 and in the 1953-54 period ran 4 per cent below the year-ago level.

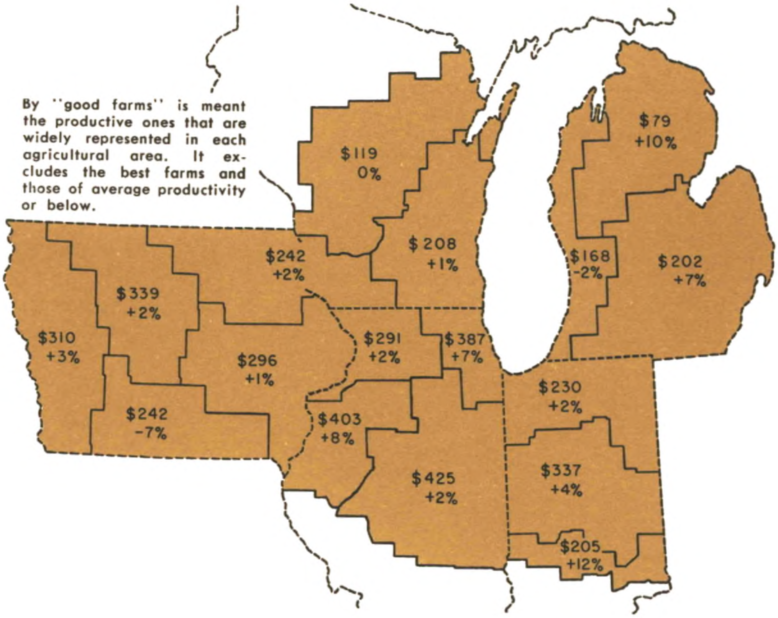
In many areas of the South and Southwest, land values have continued to decline as farm incomes shriveled due to persistent drouth and acreage cutbacks in cotton and wheat. In the grazing districts of the West, farm income has taken the biggest tumble as cattle prices shrank about 50 per cent during the past three years. In the same period land values have dropped about 15 per cent.

In the major dairy areas land values have continued to show a high degree of stability even though lower prices for dairy products have brought about sizable reductions in farmers' cash receipts.

Alternative investments, credit terms

Prices of farm real estate usually are thought to reflect primarily the expected long-term net income from the land. At times, however, short-term expectations take over, as in the year and a half following the outbreak of hostilities in Korea when farm land was widely purchased as an inflation hedge. In addition, changes in credit terms and current and expected rates of return from alternative investments affect land values. The lower interest rates since about mid-1953 and bidding up of prices on many types of stocks and bonds have reduced returns from those types of investments. As the yields from such investments declined, there has been some recapitalization of farm real estate values, particularly in the better agricultural regions and where "absentee ownership" is important.

Average per acre value of good farms, January 1, 1955, and change from July 1, 1954



The shading of interest rates also carried over to farm mortgage loans as lenders competed vigorously for loans on good lands. Along with lower rates down payments have been reduced, more liberal appraisals made and larger amounts loaned per acre. These changes in terms have permitted additional prospective buyers to enter the market, thereby strengthening the demand for farm land. Federal Land Banks and insurance companies have been the major lenders easing credit terms. Together they hold almost half of the farm mortgage debt in the Midwest—a higher proportion than in any other area.

The loosening of the strings on farm mortgage loans comes at a time when credit is playing an increasing role in sales of farm real estate. Just after World War II only two-fifths of the farms sold required credit. Since those years there has been a steady increase in the use of credit; last year about 70 per cent of the buyers employed some credit. Down payments show a similar trend; just after the War the average down payment amounted to about 50 per cent of the purchase price compared with 40 per cent today.

Farmer demand strong

The number of farms sold in the past two years was the smallest since the mid-Thirties. Most land owners have continued to realize favorable returns. In addition, most of them had acquired farms at a much lower price and, as with other capital assets, would be subject to a substantial tax on the capital gain if they were to sell.

A factor bolstering farmer purchases of real estate and thus strengthening land values has been the urge to increase size of farms. Even during the two postwar periods of substantial decline in net farm income—1947-50 and 1951-54—there was a continued brisk demand for "an additional forty." During 1953-54 about 30 per cent of the farm sales were estimated to have been for farm enlargement.

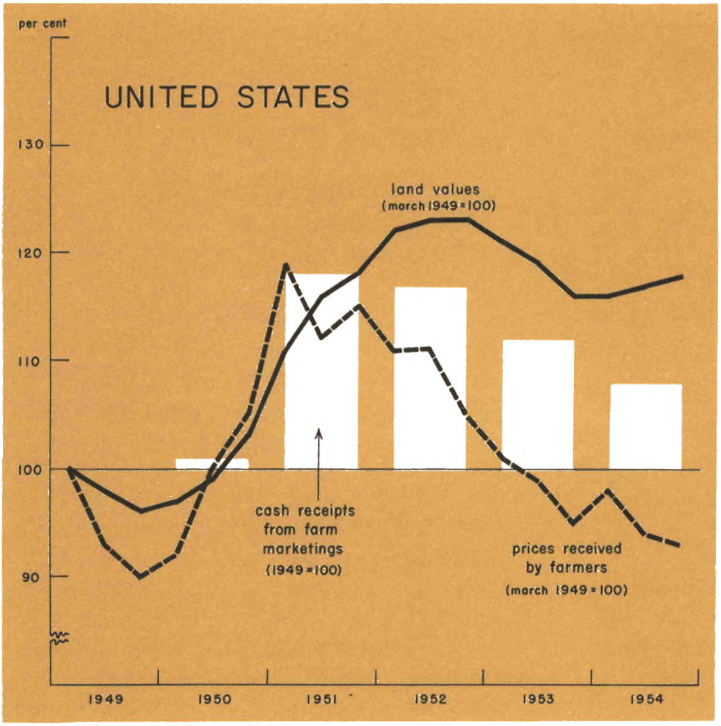
With large investments in machinery and

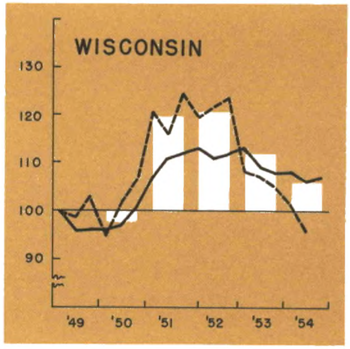
Farm land values respond to many forces

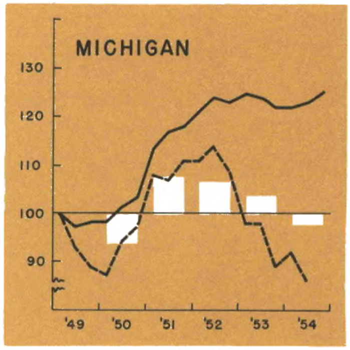
Current trends in commodity prices and farm income are usually the most important, but expectations as to future changes also play a part as do changes in yields on alternative investments.

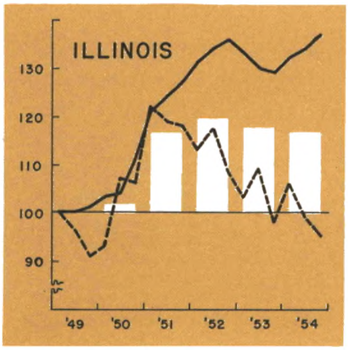
Recent land value increases are greatest in the Corn Belt states where farm income has held near year-earlier levels. Income in this area is somewhat insulated from the effects of reduced foreign demand which has been a major factor contributing to lower U. S. farm income and prices. Strong demand for livestock products which are almost exclusively consumed domestically has contributed to the relatively steady farm incomes in the Corn Belt.

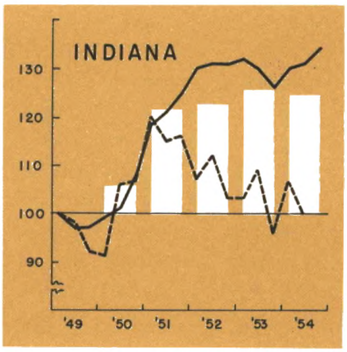
In the dairy states land values show their historical stability despite declining dairy product prices and income. Strength in Michigan values reflects a brisk demand for land for nonfarm uses.

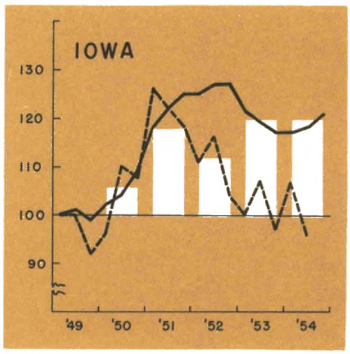












equipment many farmers find that they need additional land if they are to produce efficiently. Production costs per unit of output are reduced by handling enough land to fully utilize their machinery and labor. This situation has resulted in a real estate market which places about the same value on "bare" land as on that which is "improved" with a set of buildings.

The forces tending to increase size of farms probably will continue to have an important effect on the farm real estate market. But many other forces will be operative—farm income, interest rates and credit terms, yields on other investments, expected price trends—and their effects may differ materially for the various areas and grades of land.

Price support stocks accumulate

A quarter century of experience in direct Government support of agricultural commodity prices is now on record. Ever since the Federal Farm Board, starting in 1929, tackled the job of stabilizing grain and cotton prices, Government agencies have been laboring to achieve greater stability of prices for agricultural commodities, for the most part at levels above those which would prevail in the absence of the support programs.

Since the support programs usually have involved the withholding of supplies from the market, stocks have been accumulated and these, periodically, have assumed a magnitude that caused or threatened a breakdown of the programs. Except for the experience of the Federal Farm Board, however, strenuous efforts to control output, divert production to unsupported commodities and dispose of surplus stocks, while far from being fully successful, have succeeded in the past in keeping the stocks within manageable proportions until some unforeseen increase in demand permitted a substantial liquidation. On one occasion supply was restricted as a result of severe and widespread drouth and on two other occasions demand was boosted by the outbreak of war. With stocks now at a record level, the problem of burdensome stocks again rears its head.

The most recent build-up of stocks has its roots in 1948 and 1949 which were years of large harvests and of contraction in export demand as agricultural production recovered in war-torn areas abroad. At the close of the latter year the Commodity Credit Corporation had price support inventories and loans totaling 3.6 billion dollars. These were reduced as a result of the strong upsurge in demand touched off by the outbreak of hostilities in Korea, but at the end of 1951, CCC commitments still totaled about 2 billion dollars. Since that date, with continued high levels of output as well as a further reduction in foreign demand, the total has moved up year after year until it reached 7.2 billion dollars at the end of 1954.

The CCC is authorized to borrow up to 10 billion dollars to carry out its price support obligations. This provides adequate elbowroom for the 1954 crops—some of which can be placed under loan through May 1955—and probably for 1955 crops as well. Completely aside from the problem of financing the stocks, however, the task of providing physical storage capacity is becoming quite onerous. Moreover, the very rapidity with which stocks have been built up in the past two years compels attention to proposals to restrict production and alter the levels of support.

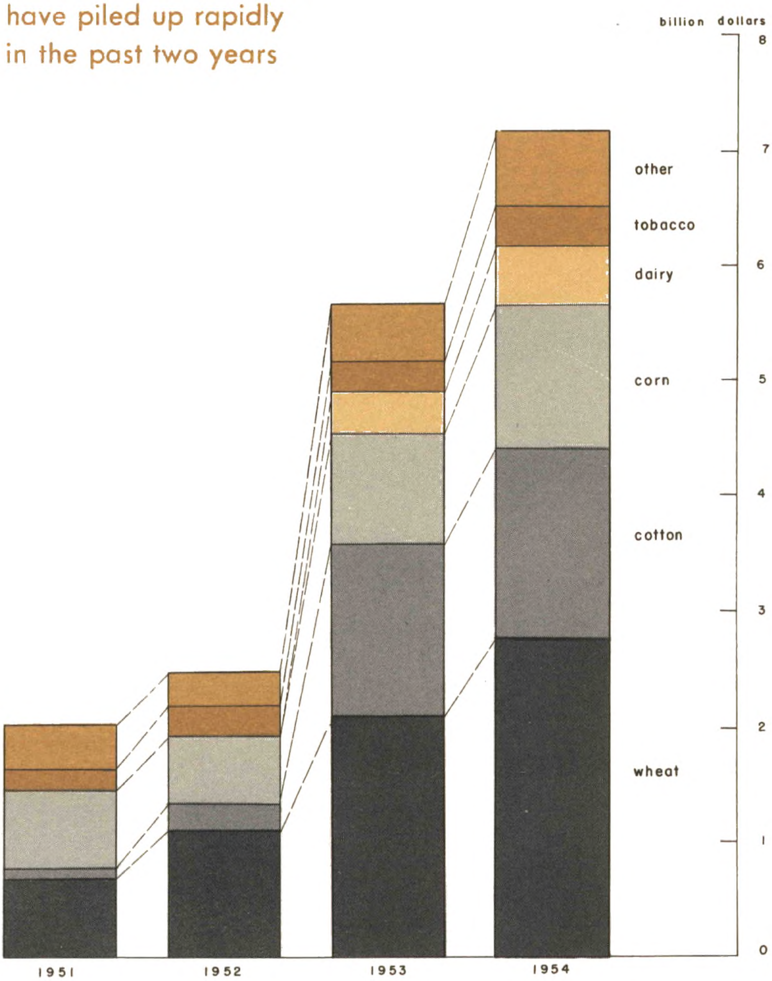
A beginning has been made in whittling down the rate of accumulation of stocks. Whereas CCC commitments increased a whopping 3.2 billion dollars in 1953, the increase in 1954 was about 1½ billion, considerably smaller but still a very substantial amount. The decline was due largely to a reduced volume of commitments on the CCC's three major customers—wheat, cotton and corn—and on dairy products.

Smaller acreage allotments, together with marketing quotas, were in effect for wheat and cotton in 1954. The allotments in effect for corn probably were a minor factor in the smaller harvest and reduction in amount placed under price support loan. A lower level of price support for dairy products apparently had some retarding effect on milk production, caused a larger part of the output of these commodities to be consumed and reduced the amount as well as the per unit cost of supplies purchased by CCC. Furthermore, although severe drouth in many areas limited crop and livestock production in 1954, the year's total output was about as large as that of other recent years.

The amounts of 1953 and 1954 crops coming under price support by the end of the respective years, in millions of dollars, were:

	1953	1954
Wheat	932	778
Cotton, cottonseed, etc.	962	309
Corn	137	30
Dairy products	289	202
All commodities	2,733	1,888

Price support stocks
have piled up rapidly
in the past two years



Measures designed to further stem the build-up in CCC stocks in 1955 include additional acreage cutbacks on wheat, cotton and rice and lower levels of support scheduled for wheat, oats, barley, grain sorghums and rye. How effective these production controls and price adjustments will be remains to be seen. Not unimportant in the outcome, of course, will be the largess of "Dame Nature" in the 1955 growing season and the trend of general business activity and its effects on the demand for agricultural commodities both at home and abroad.

Export gains chalked up

An unexpected expansion in exports during 1954 is prompting many Midwest businesses to re-evaluate the importance of their foreign markets. The increased demand abroad for U. S. merchandise last year reversed a two-year decline that had set in after 1951.

Even more of an eye-opener is the fact that expanded foreign demand helped to sustain production and employment during a period of downward adjustment in the domestic economy. Moreover, with business activity in other countries showing every indication of continuing at the very high levels recorded in 1954, prospects are for a further increase in the export demand for American goods in 1955.

Dollar income and spending

Foreign spending and investing in the U. S. has averaged about 19.5 billion dollars a year in the postwar period. About 13 billion have been for purchases of goods. The remainder has gone for a variety of uses including the payment for transportation services, the purchase of securities and rebuilding bank balances in this country.

In order to spend and invest in the U. S., other countries must have dollars. In this respect trade between the U. S. and our trading partners is very much like trade between individuals within a country. First and foremost, dollars are earned by selling goods and renting or selling services. Dollars are obtained also from earnings on investments.

Current dollar earnings may be supplemented by borrowings, by the sale of capital assets, or by drawing down cash reserves. An additional supply of dollars comes from direct U. S. investments abroad.

Since the War, U. S. purchases of merchandise from other countries have averaged less than 9 billion dollars, compared with the nearly 13 billion of foreign purchases here. But beginning with 1948 other countries have earned more from our use of their services, such as transport facilities, insurance and expenditures of our tourists and military abroad, than they have spent for similar purposes in the U. S. In recent years the surplus on services has been roughly comparable to their dollar deficit on goods.

A large proportion of the income from services is extraordinary in the sense that it is accounted for by receipts from the expenditures of our soldiers, airmen, sailors and marines in other countries and U. S. purchases of equipment, food and other material for their upkeep. A part of these expenditures also result from purchases of goods abroad for transfer to our allies.

Foreign aid. In the whole postwar period U. S. Government grants for economic assistance have financed a considerable proportion of other countries' expenditures on goods and services in this country. Fortunately for the American taxpayer and the self-esteem of our allies, their dollar earning capacity increased sharply in 1950 and 1951 following several years of postwar reconstruction and a large volume of U. S. aid. The result has been much less reliance on American aid in subsequent years. The U. S. military expenditures referred to above as service earnings of foreign countries have a unique character but seem more properly classifiable as national defense expenditures than a continuation of economic aid.

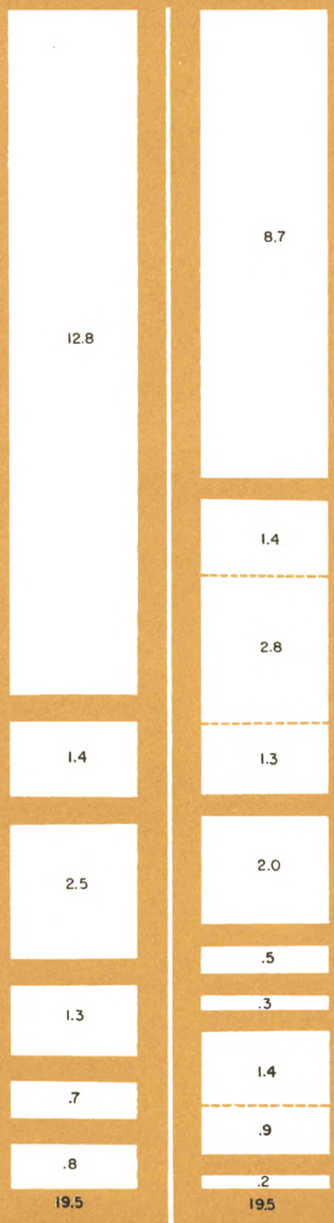
Investments and reserves

Since World War I, the U. S. has been a creditor nation and an exporter of relatively large amounts of capital. Typically such funds have been used by the receiving country to develop local industries and to exploit their natural resources, and they have usually led to purchases of equipment and services from the U. S.

The anatomy of U.S. foreign trade
1946-54 annual average

Other countries spent or invested 19.5 billion dollars annually in the United States for the following purposes:

They obtained the dollars from the following sources:



purchases of goods produced in this country . . .

military supplies and services (financed by U.S. grant) . . .

use of our services, such as transport, insurance and travel . .

payments (interest, earnings, redemption of principal) on U.S. investments abroad . . .

and for investment and building up bank balances in this country.

The residue was made up of unrecorded transactions (probably dollar accumulation).

sales of goods in the U.S. . . .

grants received from U.S. Government to pay for military supplies and services,

other governmental aid (grants and pensions)

and through U.S. military expenditures abroad . . .

services provided American businesses and tourists . . .

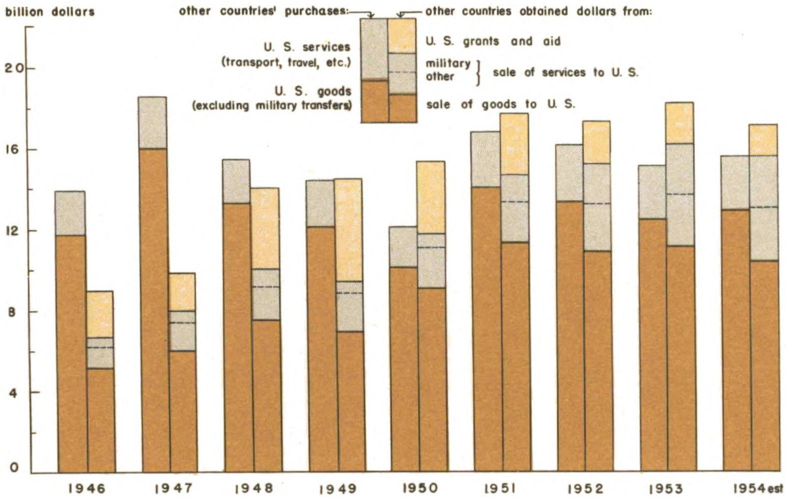
private remittances from the U.S. . . .

as income from their investments here . . .

U.S. Government loans

and investments and loans of private U.S. citizens and corporations . . .

and finally, gold purchases by the U.S.



The surplus of U. S. exports over imports has been reduced, but a gap persists. Economic aid financed a large part of our exports in the middle postwar years; in more recent years "extraordinary" service expenditures have been important.

In the early post-World War II years, American capital was exported in large part through Government loans and economic aid. Both of these items have been sharply reduced in recent years. To date private investment by American businesses and individuals has been comparatively small. In fact, since 1949, U. S. dollar receipts from interest and dividends and repayment of principal from past investment abroad have actually exceeded the flow of new investment dollars to other countries from private and Government sources in this country. The return of investment funds to the U. S. would have been much larger had not our manufacturers invested substantial amounts of retained earnings abroad.

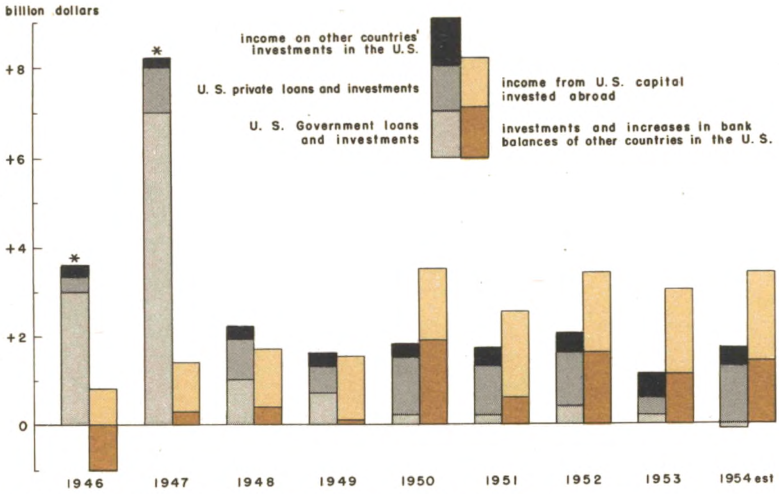
Additions to reserves. Economic recovery abroad, which resulted in greater dollar earning capacity, combined with the dollars made available through various U. S. Government aid programs, have enabled other countries to add substantially to their reserves of gold and dollars. These additions have averaged about 2 billion dollars a year since 1950. With approximately 24-25 billion dollars now in their reserves, losses suffered during the War and postwar years have been more than replaced. This is all to the good since the accumulation of adequate reserves to meet temporary emergencies is a necessary preliminary to the removal of trade barriers which many countries imposed after the War.

More trade?

Since 1951 the dollar earnings of foreign countries from merchandise exports to the U. S. have tended to decline moderately. The decline in 1954 was aggravated to some extent at least by the interruption of growth in the U. S. economy in that period. This falling off in dollar earnings has become a matter of some concern to American exporters since further growth in our export trade depends to a considerable degree upon the availability of dollars to countries where there still exists a sizable unsatisfied demand for U. S. goods.

Substantial increases in our purchases of goods from abroad are expected in the next two decades. The Materials Policy Commission has estimated that a progressively larger proportion of our raw materials requirements such as copper and petroleum will be imported if the American economy continues to expand. The near-term outlook for imports is less certain. With the recovery in business activity in the domestic economy, however, some strengthening in the demand for foreign goods, particularly raw materials and semimanufactured goods, may be expected.

Foreign dollar earnings from our use of their



*Includes 3.4 billion U. S. contribution to International Monetary Fund and the International Bank for Reconstruction.

Large U. S. Government loans helped to fill the deficit on goods account in early postwar years. Since 1950 U. S. receipts from past investments abroad plus dollars received for investment or to build up bank balances here have exceeded dollar payments from the U. S. for these purposes.

services other than "extraordinary" expenditures have shown increases each year in the postwar period. These increases are associated in the main with the rebuilding of foreign shipping facilities and the rehabilitation of facilities for handling the traditionally large U. S. tourist trade. The latter is now approaching the billion dollar mark.

The main question involved in the future of dollar earnings from services is in connection with the "extraordinary" expenditures of our military abroad. Although there is no terminal date for withdrawal of our troops from abroad, there is an understandable hesitation to regard these expenditures as permanent sources of dollar earnings.

U. S. investments and credits. A variety of methods have been adopted in recent months to stimulate loans to and investments in other countries. Congress raised the lending authority of the Export-Import Bank in the last session and urged that the funds be used to the limit. Proposals to set up an international lending authority and to provide favorable tax treatment of income from new investments abroad are being considered.

There is no dearth of investment opportunities abroad, especially in the underdeveloped countries. The principal deterrent has been political instability which often carries with it the threat of expropriation and the exposure to blocked income and fluctuating local currencies. In some countries local laws prohibit or limit American ownership or subject earnings of foreign investors to discriminatory taxes.

Dollars made available through loans and investments in other countries tend to boost U. S. exports at the time the funds are invested, but unless they are made in increasing amounts, they must give rise to increased imports. Only by selling a larger volume of goods in U. S. markets or providing additional services for the U. S. can other countries earn the dollars required to pay interest on loans or remit earnings on U. S. investment abroad.

Adequate reserves. In the future smaller additions to foreign reserves may release a considerable volume of dollars for purchasing U. S. goods and services. Reserves have been accumulated since 1950 at an annual rate of approximately 2 billion dollars. At some level additions to reserves will be less attractive, and the goods which these accumulations could buy more attractive. In fact, the relaxation in the past year of other countries' barriers to importation of U. S. goods, the increase in U. S. exports and the somewhat smaller additions to their reserves may indicate a widespread feeling that reserves are approaching "adequate" levels.