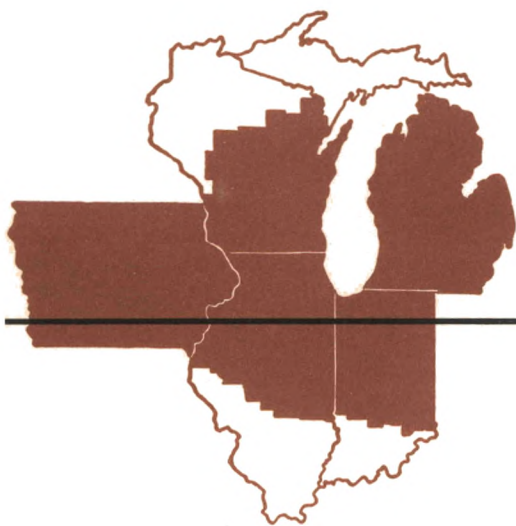


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1956 November



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THE Trend OF BUSINESS

In early fall, businessmen were displaying a general confidence in the near-term outlook. Production and new orders have been rising, and the continued uptrend in personal income is counted upon to keep consumer buying at a high level. Skeptics could point to recent evidence of a less than vigorous performance in some sectors, but these bearish notes were muted by the bullish chorus.

Of the purchasing agents who reported to their National Association in October, only 7 per cent expect poorer business in the fourth quarter; two-thirds look for improvement. Steel firms expect to operate at or near capacity in the final months of 1956, and there seems to be no early prospect for a significant easing in the market for plates, structurals and heavy pipe — items used principally in business expansion programs.

The automobile industry scheduled fourth-quarter output at 1.7 million cars, only 10 per cent below last year's record, compared with a 29 per cent decline in the first nine months. Moreover, industry spokesmen anticipate that 1957 passenger car output will climb 10-15 per cent over 1956.

Consumer demand vigorous

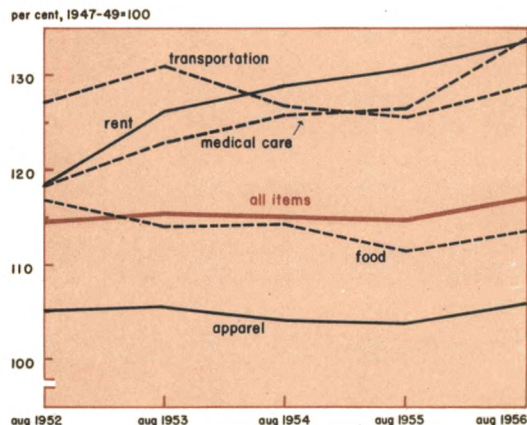
Retail sales declined about 2 per cent in September from the August level, mainly because of slower sales of automobiles during the model change-over period. But most merchants count on a move to higher levels of consumer buying in the fourth quarter. Personal income passed the 328 billion dollar rate in late summer, up 20 billion from last year.

Average hourly earnings in manufacturing cracked the \$2.00 mark in September for the first time, and average weekly earnings were at

a new high of \$81. Each new labor contract calls for generous additions to wages and supplementary benefits, and tight labor market conditions are bringing further increases in pay scales for white collar and supervisory employees. Dividends and interest earnings also continue to rise, and farm income promises to show further gains.

The wave of price increases, touched off by the boosts for steel products, has not yet run its course. Sellers apparently are confident that customers will be able and willing to pay the higher tabs. Appliance producers posted increases in recent months as did papermakers, clothing firms, distillers and a host of others. Moreover, virtually every nonfood category of the comprehensive consumer price index continues to show an upward tilt. New car models carried higher price tags as they were introduced in October. Suggested list prices will be

All major consumer price groups in moderate upswing



higher by 6 per cent on Chevrolets, 7 per cent on Lincolns and a smaller percentage on Fords.

Capital outlays remain strong

Perhaps the most heartening grist for the optimists' mill continues to come from the capital expenditure sector. Estimates call for an annual rate of 38 billion dollars in the fourth quarter, continuing the steady rise through the year. Machinery order backlogs continued to rise through August, and many firms have complained of slow delivery of new equipment. The job market in the metal-working trades remains very tight, and the types of steel used in capital goods continue in short supply. The picture has been strong enough for the head of the McGraw-Hill economics department to predict that investment in new facilities will be "substantially higher in 1957" than in the current year.

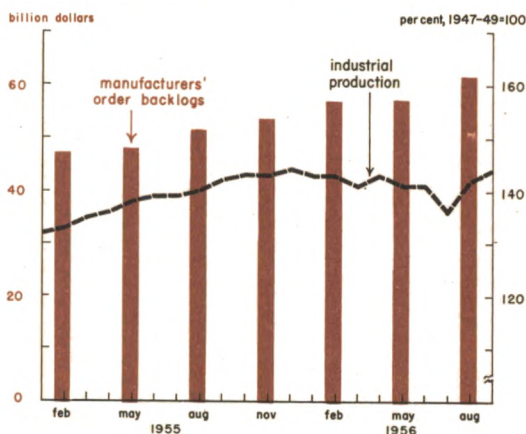
A new survey of the 1,000 largest manufacturing concerns reveals that the managements of these firms "approved" projects in the first half of 1956 involving 39 per cent more capital spending than in the same period of 1955 and that backlogs of ratified plans at midyear were one-fourth larger than six months earlier. The 1956 boom has been strongly supported by capital outlays which have accounted for one third of the rise in total output, and it appears that this sector will remain vigorous.

Physical measures lag?

But pessimists were not without evidence to support a less enthusiastic view of the trend of business. True, the gross national product was estimated to have reached 413 billion dollars in the third quarter, up 6 billion from the second. But the rise was traced almost entirely to higher prices. Some observers were disturbed at the failure of employment, average weekly hours of manufacturing workers and electric power consumption to rise in September, and others by the apparent dampening of the boom in Western Europe.

Although business inventories are not high relative to sales when compared with recent years and there is no anticipation of a general

Factory output resumes upward push, order backlog continues to build up



reduction in stocks, an easier supply situation was developing in some lines. Stocks of gasoline were over-ample, and demand pressures on items such as cement, lumber, scrap iron, copper, aluminum and other nonferrous metals were relaxed somewhat. Household appliance firms laid off workers "to balance inventories," and further cutbacks in production of farm machinery were reported as dry weather retarded sales in some areas and manufacturers' holdings appeared burdensome.

Home-building prospects weakened further in early fall. Housing starts declined in September to an annual rate of about one million, 21 per cent below last year. Reflecting the rise in value per unit, expenditures on housing remained at a level about 10 per cent below the year-ago rate.

Guaranteed FHA and VA loan applications were especially weak as the fixed rates on these mortgages became less attractive relative to the rising yields on alternative outlets for funds, particularly conventional loans and industrial bonds. VA appraisal requests were only 30 thousand in September, two-thirds the year-ago number. It has been announced that the current rates of 5 per cent on FHA and 4½ per cent on VA mortgages will be continued at least until Congress reassembles in January.

The Midwest holds its own

During the postwar decade the huge investment programs of American business firms have greatly enlarged factory production capacity. In the process the nation's industrial map has been altered significantly. New facilities have been located in areas best suited to promote efficient operation because of availability of man power, reduced transportation charges or other reasons. Moreover, some companies, principally textile firms, have closed factories in the North and moved South. How have these developments affected the distribution of manufacturing activity in recent years?

One of the basic "benchmarks" used for determining the size, make-up and location of the nation's industry is provided by the periodic Census of Manufactures. Prior to World War II, the Census of Manufactures was taken every two years. Since the war two surveys have been made covering the years 1947 and 1954. The seven-year interval, of course, was one of the most dynamic periods of industrial expansion in history. Although the 1954 Census is still being tabulated, a steady stream of information is being released. The new data give an opportunity to take stock of recent changes.

Manufacturing comprises the largest single segment of economic activity in all industrialized countries. In the United States, factory employment accounts for about one-fourth of total employment, and manufactured products contribute one-third of the value of the nation's total output of goods and services.

In 1954, value added by manufacturing, that is, total sales less the cost of purchased materials and services, amounted to 117 billion dollars, 57 per cent more than in 1947. Prices of manufactured goods had risen about 20 per cent in the interval, so the physical increase in activity was about 26 per cent — a figure which checks closely with the industrial production index of the Federal Reserve Board. In evaluating these levels of industrial output, however,

it is well to remember that the nation's factories were operating somewhat below capacity in 1954. Total manufacturing output was off 6.6 per cent from record 1953, and most metal-using industries had witnessed substantially greater declines. Nevertheless, factory production in 1954 exceeded all years prior to 1953.

Growth industries highlighted

In general, it was the durable goods industries, such as motor vehicles, primary metals, aircraft, building materials, machinery and electrical products, which expanded most between 1947 and 1954. But chemicals and paper products were also high on the list of "growth industries." Some of the largest gains in output in particular industries are shown below:

	Per cent increase 1947-54	
	Value added	Physical volume
Aircraft	+541	+439
Radio-TV	+168	+133
Metal-working machinery	+107	+39
Nonferrous metals	+110	+19
Iron and steel	+80	+7
Chemicals	+71	+53
Motor vehicles	+68	+15
Pulp and paper	+56	+35

In industries such as motor vehicles and primary metals it is apparent that the dollar increases were much more impressive than the rise in physical volume. The enormous growth in aircraft — from 1 billion dollars in 1947 to over 6 billion in 1954 — of course, stemmed largely from the rearmament program under way after Korea.

Among the smaller industries the greatest gains occurred in machine tools, computing machines and scientific instruments — all connected with the increased emphasis on automation and research. Some building materials lines, such as cement and structural metal parts, doubled their output to provide for the large increase in construction activity.

With the exception of textiles, virtually all segments of industry increased their dollar volume of output between 1947 and 1954. During the earlier year the textile firms were still outfitting millions of discharged servicemen, and other backlogs were being made up. In addition, supply and demand conditions in textiles were such that the intercensus years saw a significant decline in prices of these goods. As a result, textile output was 12 per cent lower in 1954.

Industry goes West

Value added by manufacturing output was greater in all major geographical subdivisions in 1954 than in 1947, but the rates of growth varied greatly from one area to another. The northeastern part of the country expanded activity much less than the nation; the Midwest and the South about matched the national pace; and the Southwest and the Pacific Coast did substantially better.

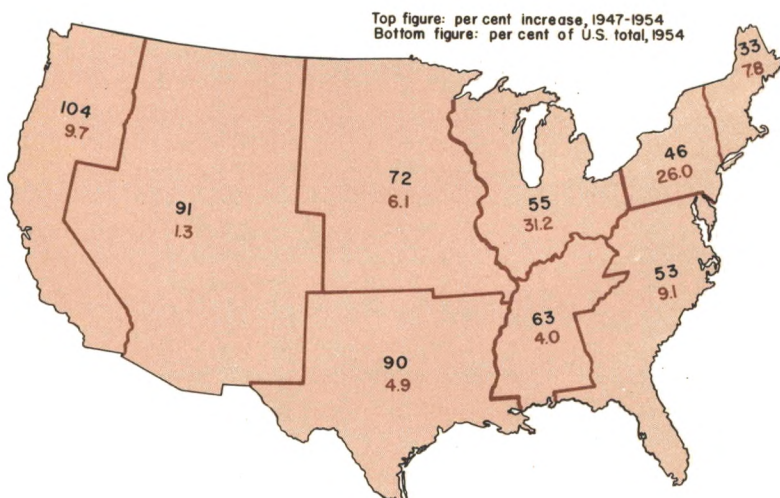
The over-all industry changes can be seen as a westward shift. Manufacturing output east of the Mississippi rose 50 per cent between 1947 and 1954, while activity west of the river

increased 90 per cent. Despite this trend, however, the bulk of American manufacturing still lies in the area east of the Mississippi and north of the Ohio. This region continues to account for almost two-thirds of the total.

These results are not surprising except for the South (east of the Mississippi). Some impressive industrial development has occurred in that region, but it appears that over-all expansion there has been no faster than in the nation as a whole. In 1947, the entire region bounded by the Atlantic Ocean, the Mason-Dixon line, and the Ohio and Mississippi rivers accounted for 13.2 per cent of manufacturing production. In 1954, the proportion was almost exactly the same. Judging by employment data, this proportion remains unchanged in 1956.

Certain southern states, such as Florida and Tennessee, nevertheless show increases in manufacturing activity substantially in excess of the national trend. A major factor retarding other states in the region, particularly North and South Carolina, was the failure of the textile industry to expand between 1947 and 1954. Textile mills account for about half of all value added by manufacturing in the Carolinas.

Regions west of Mississippi show greatest output gains



It might also be mentioned that the new Atomic Energy Commission installations which have been located in the South are not included in the manufacturing census data.

Between the census years, California and Texas showed the most spectacular gains in manufacturing activity, about double the national rate. California leaped ahead of New Jersey and became the number six industrial state, ranking just behind Michigan. Texas climbed two rungs to the tenth spot, ahead of

The top twelve manufacturing states

Rank in 1954	Rank in 1947	Value added 1954	Increase over 1947
(million dollars)			
New York	1	14,149	+ 47
Ohio	4	10,154	+ 60
Pennsylvania	2	9,940	+ 44
Illinois	3	9,642	+ 44
Michigan	5	8,734	+ 68
California	7	8,670	+117
New Jersey	6	6,267	+ 50
Indiana	9	4,615	+ 55
Massachusetts	8	4,335	+ 29
Texas	12	3,508	+103
Wisconsin	10	3,314	+ 46
Connecticut	11	2,868	+ 51

Wisconsin. Among the largest manufacturing states, Ohio moved from number four to number two, behind New York and above Pennsylvania and Illinois.

California's rise was aided substantially by the much higher level of military aircraft procurement which was under way in 1954. Transportation equipment, heavily dominated by aircraft, quadrupled between 1947 and 1954 to account for one-fourth of the state's manufacturing volume in 1954. Texas also benefited from the aircraft program, but in that state the most spectacular development was in the chemical industry which tripled in size.

In the Midwest

Among Seventh District states, Iowa and Michigan exceeded the national increase in total manufacturing activity; Indiana was about the same; Illinois and Wisconsin lagged. For the five states as a whole the growth rate was very close to the national average.

Automotive industry expansion, of course, benefited Michigan particularly, but that state also saw important growth in food processing, chemicals and machinery. All of the District states reported gains in building materials and

in electrical machinery and equipment which includes most of the activity in the important television industry.

Other significant increases recorded in the various states include paper products in Wisconsin, construction machinery in Illinois and electrical apparatus in Indiana. Growth in Iowa was highly diversified. Output in some lines such as electrical goods and rubber products tripled in that state, but the resulting dollar volume remained small relative to other states in the area. In no case did the changes alter drastically the industrial mix in these states.

The accompanying chart depicts the value added by major manufacturing lines in the five District states for 1947 and 1954. Only those industries which produced 200 million dollars or more are included. A large portion of the rise between the two years, about half for most industries, can be attributed to higher prices.

In the Midwest, the largest centers such as Chicago, Detroit and Milwaukee witnessed manufacturing growth about in the same proportion as the states in which they are located. Indianapolis, however, enjoyed the sharpest gain of any Indiana city. Among the smaller centers, Des Moines, Springfield, Flint, Lansing, Saginaw and Madison all approximately doubled the value of their manufacturing output.

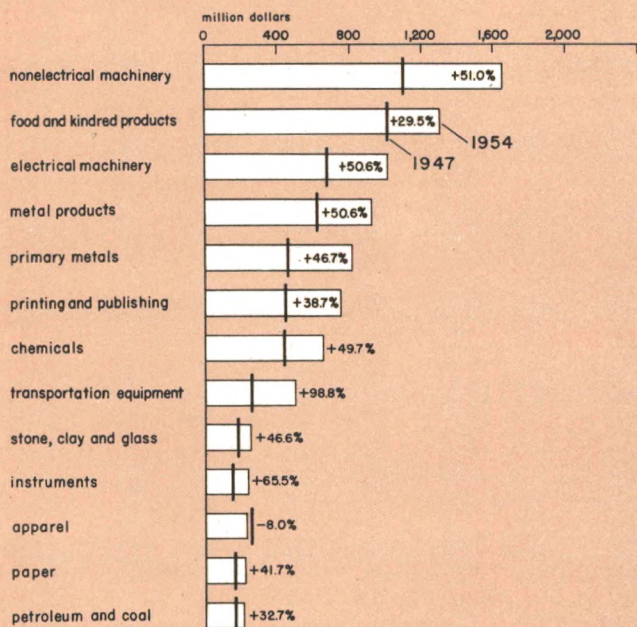
Employment totals rise less

The much higher levels of manufacturing output in 1954 compared with 1947 were made possible by an increase of less than 10 per cent in manufacturing employment. Some states actually had fewer factory workers. Only Iowa among the District states exceeded this gain, with a rise of 16 per cent. But Iowa was expanding from a relatively small base; manufacturing employment there was only 162,000 in 1954.

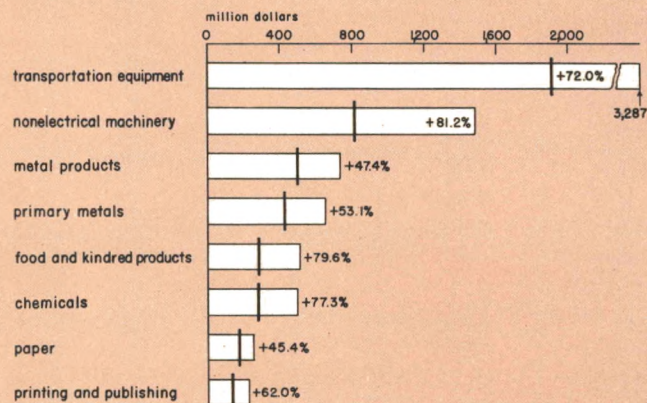
In 1955, employment in District states expanded considerably more than in the nation generally. But this relative gain was wiped out in 1956 mainly because of cutbacks in the automotive industry. Generally speaking, the industrial changes in the last two years appear

Major Midwest industrial lines advance, 1947-54 (value added by manufacturing)

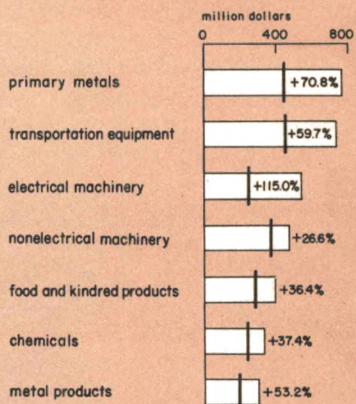
Illinois



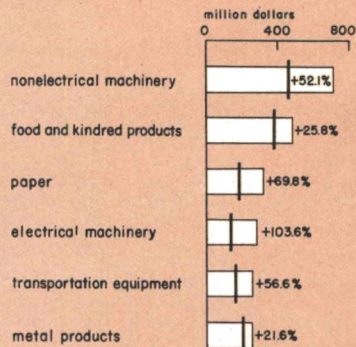
Michigan



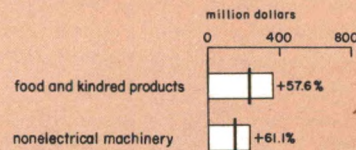
Indiana



Wisconsin



Iowa



to have continued the trend evident between 1947 and 1954. The West Coast and the Southwest have increased their proportion of total manufacturing somewhat further.

Regional pay differences persist

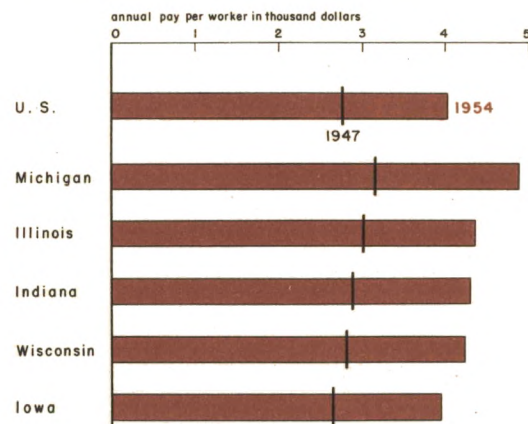
Factory pay scales have been rising everywhere year by year. But it is interesting that there has been little basic change in the relative rates among the nation's major regions.

Average annual earnings in the South were about 20 per cent below the national average in both 1954 and 1947. Midwest and Pacific Coast rates were about one-tenth higher in both years. These comparisons, of course, are influenced by the proportion of skilled workers in the labor force as well as the types of industry which are most important in the various areas.

In 1954, the average earnings of factory workers in Michigan were almost \$4,900 per year. This was higher than any other state and

21 per cent above the national average. Earnings in Wisconsin, Indiana and Illinois ranged between 5 and 8 per cent higher than the nation while Iowa was 5 per cent below the average.

Michigan leads in factory pay



Cheaper steak in the offing

October and November are a "time of decision" for Corn Belt farmers. In those two months 1½ to 2 billion dollars will be laid out by farmers in nine Corn Belt states for purchase of feeder cattle. The peak in activity usually occurs in October, and nearly 40 per cent of the year's total purchases are made in October and November combined.

With the arrival of November, the heavy push of fall work on Midwest farms has passed, the corn crop is made, and farmers' thoughts turn to methods of marketing corn which may augment their year's income. One way is by feeding the golden grain to cattle. Thus, many of the cattle shipped out of grazing regions as the pastures turn brown in the fall "take a turn" in Corn Belt feedlots before being con-

verted into packaged cuts available to consumers at their favorite meat counters.

The price at which the cattle are transferred from the range producer to the Corn Belt farmer is important, for it determines how the profits derived from supplying consumers their beef will be divided between these two important links in the production and marketing chain. To the rancher the sale price is the final factor determining the income for his year's work. To the Corn Belt farmer it represents the initial and usually the largest element of cost in a feeding program which enables him to market his corn as fat cattle rather than grain.

A dearth of rainfall over grazing areas, such as has occurred this year, weakens the bargain-

ing position of ranchers as they are forced to sell earlier or in larger numbers than usual. But the effects are largely offset this fall by the near-record harvest of corn which must be marketed or stored and the current good profit margins on fat cattle. These sharpen the appetite of Corn Belt farmers for feeder stock. The net result has been a marked degree of price stability for feeder cattle.

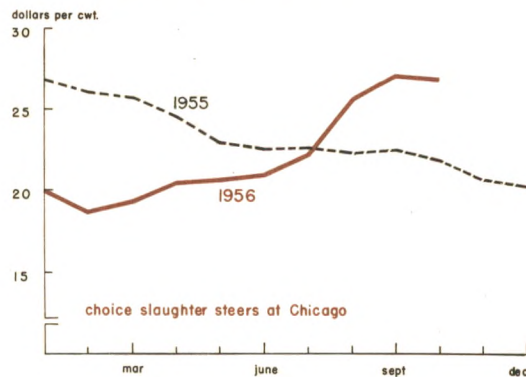
Fat cattle prices, on the other hand, staged a smart recovery beginning last July and pushed top quality slaughter steers to a level some \$8 to \$11 per hundred pounds above the cost of feeder stock bought seven months earlier. That makes for good profits to Corn Belt cattle feeders and for steaks over \$1 a pound at retail. But how long this favorable margin and current retail beef prices will continue is a \$64,000 question.

Rise and fall in feedlot activity

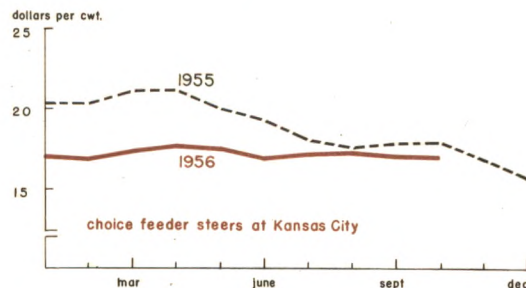
Corn Belt farmers purchased 12 per cent fewer feeder cattle in the first five months of 1956 than in the year-earlier period. This was in response to the severely depressed prices of fat cattle in that period and the inability of many farmers to break even on cattle they had purchased in prior months for feeding. Reflecting this cutback in procurement and the continued large volume of marketings of fat cattle, the number on feed in the spring and summer was reduced below the year-ago level and, with a cutback in pork production imminent, the stage was set for the mid-July price recovery in fat cattle. Gains of \$5 to \$7 per hundredweight were chalked up in a matter of weeks, and most of the advance has been maintained through early fall.

But attractive prices for fed cattle and an abundance of "raw materials"—corn and feeder animals—will change the picture. Farmers began promptly to step up their cattle-feeding operations. By early summer their purchases of feeder cattle once again exceeded year-earlier numbers by substantial margins. In June and July the increase was on the order of one-third; in August the number shipped into nine Midwest states was more than double

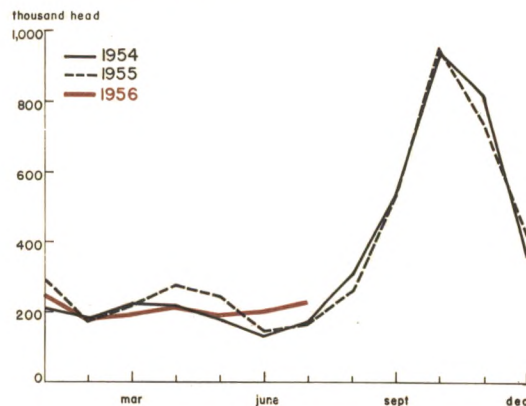
Prices of fed cattle rose sharply at midyear . . .



while feeder stock has shown little change since last fall



Shipment of cattle into Corn Belt states has exceeded the year-ago number since June



the year-earlier figure; and procurement continued at a high rate in September and early October.

Not all of these cattle were placed on fattening rations immediately. Thus, despite record inshipments the 2.6 million reported on feed in the Corn Belt in October was still 3 per cent less than the July figure and was 4 per cent below the year-ago number. However, four western states with nearly 1 million cattle on feed reported an increase of 17 per cent. Overall, the number on feed was slightly above a year ago.

The make-up of the herds on feed in October, as to weight, sex and time elapsed since being started on fattening rations, indicates that the supply ready for market in the next month or two will be below year-ago even though the total number on feed is somewhat larger. But with the rapid build-up of cattle in feedlots during the third quarter of the year and indications that cattle are continuing to move into the Corn Belt in near-record volume, it is likely that by year-end the number will at least equal the rather burdensome number being fed last year-end. Thus, the stage is set for a substantial increase in the supply of fat cattle for slaughter. However, there is an important difference. This year, farmers will likely market their cattle at lighter weights. How soon the larger supply will reach the markets cannot be foretold, but it clearly is on the way. Prices of \$26 to \$28 per hundred pounds for choice fed cattle probably cannot continue indefinitely.

Cheaper beef

Consumers may recall, with considerable satisfaction, the bargains in beef last winter and spring. In major cities across the nation rib roast at an average price of 65 cents a pound

Most feeder cattle loans are at 5 per cent; rates range higher on small loans, lower on large loans

Interest rate	Under \$1,000	Size of loan \$1,000-2,499	\$2,500-4,999	\$5,000 and over	All sizes
(per cent)			(per cent of loans)		
4	*	1	1	4	2
4½	1	6	15	21	13
5	32	60	69	67	61
5½	3	2	3	2	2
6	57	26	10	5	19
7	7	5	2	*	3

* Less than 0.5 per cent.

Data for feeder cattle loans made in July and August in major feeding areas of Iowa and Illinois.

proved very attractive. Less desired cuts and the universally popular ground beef were even cheaper. Since midyear, however, prices have moved up. Rib roast averaged 71 cents in August, and higher prices were indicated for September and October. Other cuts showed similar advances.

However, farmers are not likely to repeat the mistakes of last fall and winter. Then, with feedlots loaded with fat cattle, the anticipated "usual" seasonal price rise did not materialize. And as marketings were delayed in anticipation of higher prices, the cattle got fatter and heavier and finally were marketed at prices which provided bargains to consumers through the first half of 1956 but were a severe disappointment to Corn Belt farmers. In the months ahead, fewer farmers will likely risk their capital in carrying cattle to the prime grade. The emphasis this fall is on "fast turns" in the feedlot. Profits to cattle feeders are expected to be better than the unfavorable results of a year ago but not so large as in recent months. Consumers, meanwhile, can look forward to cheaper beef, but not so cheap as in the first half of this year.

The banker and the beef supply

Credit plays a big role in Midwest cattle feeding. Relatively few farmers finance the purchase of feeder cattle entirely from their

own resources. A common practice in the Midwest is to borrow from banks or other commercial lenders the full purchase price of the cattle and to provide from the farmer's own resources the feed, labor and facilities to handle the cattle. To do this, the farmer must be well established and have a record of successful cattle feeding as cattle feeding is inherently a high risk activity.

In the past year, for example, a farmer feeding out 100 yearling steers would have invested about \$12,000 in the feeder stock and an additional \$9,000 in feed and transportation expense. On top of this he would provide the labor to care for the cattle over about a seven-month feeding period and the use of buildings, feedyard and other facilities. In addition, the farmer and the banker are exposed to the risks of loss from a market decline while on feed. Market prices can and often do change significantly before the fattening period is completed. A market advance spells large profits; a decline can spell disaster for anyone caught overextended.

A recent survey of member banks in Illinois, Indiana and Iowa indicates that the volume of feeder cattle loans outstanding on October 1 was up 7 per cent from a year ago, due to the larger number of cattle purchased this fall. And a number of bankers reported they were

prepared to finance expected further increases in purchases.

Banks in the major cattle-feeding areas are making feeder cattle loans on about the same terms as in other recent years. As usual, more than half of the cattle loans are unsecured in the sense that no specific property is pledged to assure payment. Loan maturities, reflecting marketing plans and usual feeding practices, range from as short as 30 days to a year, occasionally even longer, but with the bulk of the loans being for six months. Extensions of an additional 30 to 60 days are frequently provided if farmers desire to continue feeding longer than originally planned, due either to the condition of the cattle or an adverse market. The pattern of interest rates reported on feeder cattle loans is nearly identical to that reported in the same areas in other recent years.

The availability and cost of credit in Midwest cattle-feeding areas, therefore, appear to be having little effect on the number of cattle placed on feed this fall. The key factor is the sum total of the decisions of individual farmers as they attempt to appraise their prospects for earning profits in providing quality beef to American consumers. And the current prospect, as farmers respond to attractive prices for fed cattle, is that consumers will soon have larger supplies of choice beef at attractive prices.

The squeeze on corporate liquidity

During the past year the financial managers of American business firms have been subjected to their severest test of the postwar period. Business expenditures on new plant and equipment have been rising sharply. At the same time more money has been needed to finance higher inventories and receivables and to make larger payments of taxes and dividends. Result: business liquidity positions have been eroded

substantially in 1956 and the money and capital markets have been called upon to supply an unprecedented volume of funds to business.

A decade of declining ratios

American corporations, like individuals and financial institutions, emerged from World War II more liquid than ever before. Their holdings of cash and Government securities totaled

about 43 billion dollars at the end of 1945 and virtually equaled outstanding short-term corporate indebtedness.

Since then, business firms have retreated from that position of high liquidity. Over-all, this has not occurred in absolute terms — cash and Government holdings are about one-fourth greater now than they were on V-J Day. But in a relative sense, that is, when these assets are compared with the growth of short-term indebtedness or the expanding volume of business, it is evident that a substantial decline has occurred.

At midyear, the liquidity ratio — cash and Governments to current liabilities — was 48 per cent for all nonfinancial corporations. In other words debts payable in one year or less were more than twice the means of payment on hand. This compared with 54 per cent at the start of the year, a ratio which had been maintained with little variation for five years.

Meaning of the ratios

Ratios of various groups of business assets to liabilities have long played a part in financial statement analysis by lenders, investors and business managers. Most widely used, perhaps, is the “current ratio,” the relation of all current

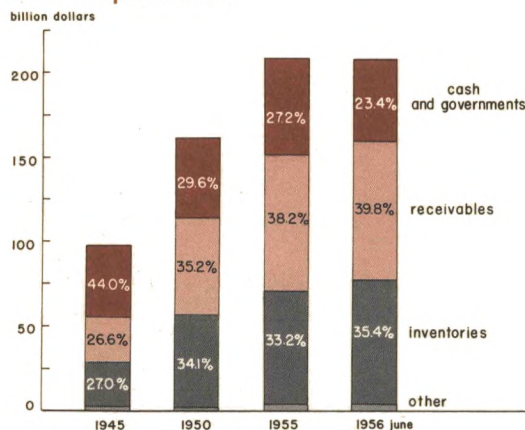
assets, consisting mainly of cash, securities, receivables and inventories, to all current liabilities, including notes and accounts payable, accrued taxes and other items due in a year or less.

The rule of thumb for a healthy current ratio for an individual business in recent decades has been 2 to 1 for most lines of activity. But a total which includes inventories, of course, is of questionable value in determining the ability of a firm to safely expand its commitments. Conversion of inventories to cash requires sales to customers which are never assured. Moreover, deliberate liquidations of inventories to obtain cash would ordinarily occur only in desperate situations because of the need to maintain an adequate level of stock for efficient operation. The failings of the current ratio as a measure of liquidity are shown by the fact that all corporations had current assets equal to 2.05 times their current liabilities at midyear, a figure somewhat larger than in other recent years.

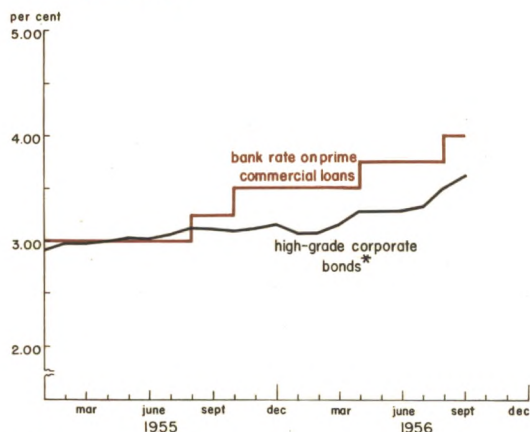
Another measure of the current position is the so-called “acid test” which compares cash, securities and receivables with current liabilities. In this case, a one-to-one rule has been employed. By this standard, too, American business has been in a highly liquid position. All corporations had an acid test ratio of 1.3 to 1 at the end of June. But, although receivables can be pledged for credit, they do not comprise a means of payment in themselves and cannot be considered liquidity for business as a whole. As in the case of inventories, the level of receivables depends mainly on business volume. In fact, one of the main reasons for the tighter financial positions of large firms in 1956 has been the slowing in collections from customers.

Attention, therefore, has been directed, increasingly, to cash and short-term investments, mainly Governments, as a useful measure of the liquidity of business. True, Government securities are not a medium of exchange, but the short maturities are steadily coming due, they can be sold readily, and one form, tax-anticipation certificates, can be used to pay income taxes. Moreover, short-term securities,

Cash and securities shrink as proportion of current assets, U.S. corporations



Short- and long-term interest rates rise as business borrows for expansion



*Standard and Poor's A1+.

unlike inventories and receivables, are intended to provide cash when it is needed.

Higher cash needs in 1956

Evaporating liquidity in the first half of 1956 resulted from a number of pressures. Corporate investment was rising rapidly. Spending on new plant and equipment exceeded 1955 by about 3 billion dollars or 27 per cent in the first half, and inventories rose by almost 5 billion dollars compared with a half billion increase a year earlier. Funds tied up in receivables also increased. In addition, Federal income taxes drained off 2.7 billion dollars more than the previous year, and larger dividends put a further burden on cash.

This greater need for funds continues in the second half of 1956. Although larger sums are available from retained earnings and depreciation reserves, these amounts are falling far short of increased needs. As a result, record demands have been made upon the securities markets and the commercial banks. Since the supply of funds is limited, interest rates have moved up sharply on both short- and long-term obligations.

Tightness in the capital and money markets,

however, does not spring from a reduced supply of loanable funds. In fact, security issues for new capital totaled a record 4.9 billion dollars in the first half — 15 per cent greater than last year. Business loans of large banks rose by 2.3 billion dollars during the same period, 47 per cent more than the year-ago expansion. It should be noted, moreover, that in most past years business loans have *declined* in the December-June period.

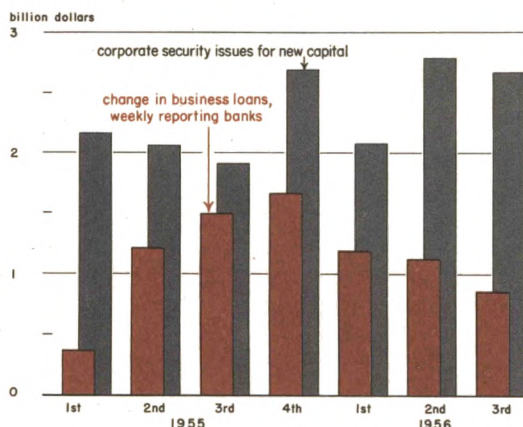
New responsibilities for moneymen

When spending plans are considered in a corporation's councils today, the treasurer, financial vice president or other official responsible for the firm's fund raising is re-assuming a stature he relinquished after the era of high finance in the Twenties. Production and sales, of course, are still the vital functions, but the wheels of industry require lubrication by ready cash or credit.

Under present conditions, the query "where's the money coming from" no longer refers merely to the type of financing to be used, but rather to the problem of the basic feasibility of a venture. Until quite recently many firms were in such a strong position that current retentions of earnings and depreciation funds, coupled perhaps with a dip into the surplus liquidity pool, would handle any requirements. Retained earnings and depreciation continue to be by far the most important source of funds for business as a whole, but, increasingly, outside help is required to finance planned expansion.

Higher prices and wages, the need to build inventories and the rise in receivables in 1956 put a greater than anticipated strain on financial resources. As a result, some blue-chip concerns have been forced to offer their securities at interest costs which were considered excessive by management. Many issues, moreover, were postponed only to be brought back to market at still higher yields. In addition, numerous firms possessing "good names" have turned to the commercial banks for the first time in many years. Often these concerns had to surrender a long-standing opposition to borrowing of any sort.

Bank loans to business show slower growth in 1956 while new security issues remain at record level



Although liquidity problems have plagued most business firms in the past year, larger firms have continued to be the more successful in maintaining a sufficiently liquid position.

The larger the firm, ordinarily, the more flexible its financial alternatives. Large concerns are usually better able to sell stocks and bonds and negotiate term loans. Sales of equity obligations and the use of long-term debt like the retention of earnings provide funds "below the line." That is, the ratio of noncurrent liabilities to those due within a year is raised and liquidity improved.

Large firms also have a more dependable source of internal funds. Their profits tend to be larger and more stable, and most of them are in lines which have a high proportion of depreciable assets.

In general, these tendencies all work toward providing greater liquidity to large firms. A group of 295 leading companies analyzed by the Federal Reserve Board had a liquidity ratio of 79 per cent at the end of 1955, compared with 46 per cent for all other nonfinancial corporations. The 295 had actually improved their position somewhat during the year, mainly because of security issues placed before year-end which provided a temporary boost to cash

and short-term investments. For all other firms there was a decline from 50 to 46 per cent in the liquidity ratio during 1955.

The greater liquidity of large firms can be explained in part by the fact that they more often acquire cash or short-term investments to "fund" their higher tax liability. Even after deducting the tax liability from both current assets and current liabilities, however, large firms still show the stronger liquidity position.

Another reason for the more favorable liquidity position of large firms is the fact that the "big" include the automobile producers and most of the railroads and utilities which have relatively small amounts of receivables and payables. Also not all of these organizations compromised their anti-debt prejudices.

Getting the most out of cash

One aspect of the tightening liquidity picture has been a more efficient use of cash balances. Holding currency and deposits in excess of minimum working needs plus a safety margin is usually a wasteful use of resources. This is particularly true when appreciable yields can be earned by investing idle cash in short-term obligations of governments or business firms. Careful projections of cash inflows and outflows and the construction of cash budgets have permitted a relative reduction in the cash cushion. In other words, corporations are making their cash work harder.

In the case of manufacturing firms, sales in the fourth quarter of last year were 14 per cent greater than in the final quarter of 1953. Cash on hand and on deposit was only 4 per cent greater. Firms under the 100 million asset size were doing 10 per cent more business with about the same amount of cash as two years earlier.

Corporate treasurers with extra cash to invest on a temporary basis increasingly are using outlets other than 91-day Treasury bills. Tax-anticipation certificates and other Governments with suitable maturities play a larger part than a few years ago. In addition, some big firms are loaning funds to security dealers on Governments through "repurchase agreements." The

date on which the security dealer agrees to buy back the security can be tailored to the cash need pattern of the particular business. Moreover, some firms make significant purchases of commercial paper. At the end of last year, according to a survey by *Fortune*, 276 large corporations held 444 million dollars in commercial paper, one-third more than a year earlier.

Corporate pay-as-you-go

Without question, the decision to accelerate corporate tax payments under the so-called Mills plan has been one of the most significant developments affecting business finance in the postwar decade. Prior to 1951 most corporations paid their taxes in four equal instalments in the twelve months following the fiscal year in which the liability was incurred. The 1950 revenue act required a gradual speed-up of these payments so that the entire obligation eventually would be satisfied in two quarterly instalments in the first half of the following year.

By 1955 that transition was complete, but legislation enacted in 1954 provided that a further acceleration should occur. The new Mills plan requires corporations earning \$100,000 or more to adopt a pay-as-you-earn basis somewhat similar to that required for individuals.

In the second half of 1955 corporations were required to pay 10 per cent of their estimated tax liability incurred in that year. When the acceleration is complete in 1960, corporations will pay 50 per cent of the current year's tax in the second half of the same year and the re-

mainder in the first half of the succeeding year. Then the disruptive effect of the speed-up of tax payments on financial planning will be smoothed out once more. In addition, the end of the speed-up will ease business financial problems somewhat because a firm with stable profits will be paying 110 per cent of its "true" tax bill each year until 1960.

But the relative impact of the corporate tax in the first half of each year is already being moderated by the new plan. Corporate profits before taxes rose by 29 per cent between 1954 and 1955, but payments were only 19 per cent more in the first half. If profits had been unchanged in the two years, tax payments in the first half would have been 10 per cent less than last year.

Pressure on bank loans

Rising prices and enhanced needs for funds for expanding business usually bring a sharp rise in bank loans. For many firms, use of commercial bank credit is a temporary expedient pending the accumulation of retained earnings, the negotiation of more permanent financing or a possible later reduction in the need for working capital. But once it is thrown into the cash hopper, a bank loan dollar may do the work of a bond or profit dollar.

The accelerated tax payment schedule for corporations, coming atop a cyclical bulge in inventories and receivables, and rising need for funds for longer-run expansion, have played havoc with the traditional seasonal pattern for total business loans in recent years. When movements in outstanding bank loans to business were more dominated by seasonal business needs for operating capital, the characteristic annual trend was a decline in loans in the first half and a rise in the second. Loans to such seasonal borrowers as commodity dealers and trade firms continue to follow the traditional seasonal pattern, but loans to firms in lines such as metal products have altered the picture for the aggregate.

In March and June in 1955 — the two big tax months — the increases in business loans were .6 and .9 billion, respectively. This year,

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March borrowings were 1.5 billion and in June, 1.1 billion.

In the second quarter it was widely expected that the demand for outside funds by business firms would slacken in the second half. Reduced tax payments and the prospective end of inventory accumulation in excess of seasonal needs were counted upon to ease requirements.

Corporate bond yields did stabilize and even decline in some cases in May and June. But in July new downward pressures were felt on bond prices which continued through September. Security issues for new capital hit 2.7 billion

dollars in the third quarter — 40 per cent above last year — and the fourth-quarter calendar appears to be heavy. Commercial banks also are being forced to ration available credit carefully.

Perhaps most important in the continuing large demands for funds has been the new wave of price increases which followed the end of the steel strike. But capital expenditures are still rising, and in view of the continued high level of retail sales, there is little likelihood of a general move to liquidate inventories from now to year-end.

"Federal Reserve Operations in the Money and Government Securities Markets"

The current period of exceptionally strong demand for credit has focused renewed interest on the ways in which the Federal Reserve System helps create money and credit conditions conducive to sustainable economic growth at stable prices. Of the System's three major instruments of monetary policy — adjustments in the level of reserves required of commercial banks, changes in the rates the Reserve Banks charge on loans to member banks and open market operations — the latter is by far the most frequently used. In fact, open market operations are carried on continually. Yet, few persons outside those involved in the operation itself have become familiar with the mechanics by which open market policy is carried out.

Now, however, it is possible for everyone to "spend a day at the trading desk" by way of a 108-page booklet recently published by the Federal Reserve Bank of New York. The book contains a detailed description of Federal Reserve operations in the money and Government securities markets. Written by Robert V. Roosa, one of the bank's officers assigned to the "trading desk," the book describes at the outset the setting within which the Federal Reserve must

operate, the role of the national money market and the market's major instruments and institutions.

The second half of the book describes in detail the procedures by which the broad policy directives of the Open Market Committee are translated into specific actions at the trading desk at the Federal Reserve Bank of New York. Gaining the "feel" of the market, making projections of factors that affect bank reserves and utilizing the variety of signals coming from the market itself all play a part in the decisions required daily of the New York-based Manager of the Open Market Account and are described in the book.

Much of the information in this booklet is not readily available elsewhere. Teachers, businessmen and, indeed, readers of the daily press may find in it much that will be helpful to them in understanding the monetary mechanism and the role which the Federal Reserve plays.

Single copies may be obtained without charge either from the Federal Reserve Bank of New York or the Federal Reserve Bank of Chicago. Bulk copies are available for educational and classroom use.