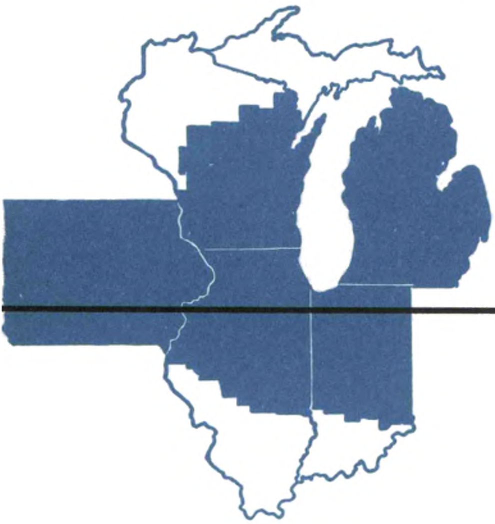
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1957 August

Contents

THE Trend OF BUSINESS

Business activity is now emerging from the July trough, created by vacations and other hot weather drags on production. Typically, industrial production runs 6 per cent below the year's average in July compared with only 1.5 per cent in the next slowest month. A seasonal upswing, therefore, is virtually certain in the months ahead. But will it exceed the usual seasonal rise? Recent evidence suggests that the preponderance of business opinion is shifting toward optimism, thus helping to place that intangible but vital factor, business sentiment, on the side of economic expansion.

It is extremely difficult to gauge business psychology objectively. A "satisfactory" level of activity is an individual matter and may range from a substantial gain over year ago to maintenance of existing conditions or even a lesser than expected decline in operations. But, increasingly, observers have been presenting their views in the concrete form of projections of widely used statistical measures of activity.

In the first half of 1957, the gross national product, total of all spending for goods and services, showed a moderate growth to an annual rate of over 433 billion dollars, up 7 billion from the fourth-quarter 1956 level. This rise was about the same as in the first half of last year but was far smaller than the 15 billion dollar gain in the second half of 1956. Moreover, the recent rise in dollar activity can be accounted for largely in terms of price increases. In real terms, the trend has been described as a "plateau." Now, a number of organizations have gone on record with predictions that the economy is in the process of shifting into higher gear.

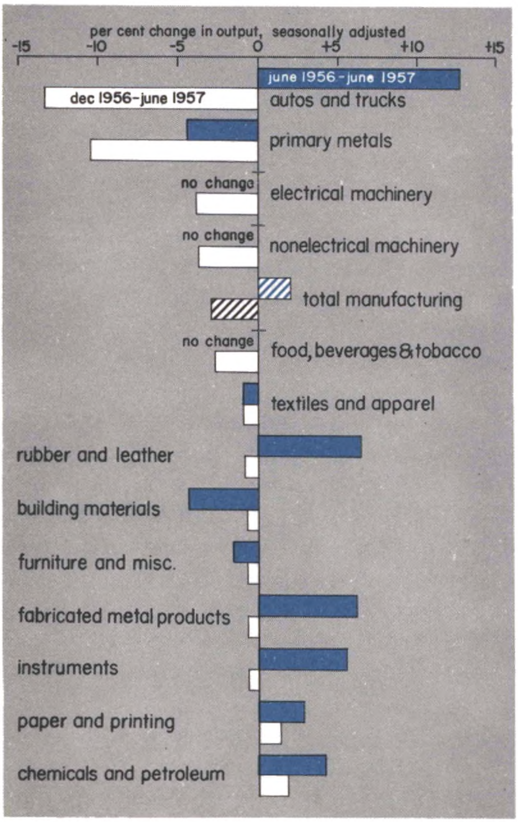
In past weeks, the economic staffs of a number of prominent financial journals have indicated their belief that the uptrend will begin to accelerate once again and that the nation will be turning out goods and services at an annual rate of 440 billion dollars or more in the fourth quarter of 1957. In most cases, this uptrend has been projected on into 1958 as well.

Confidence is reflected also in membership polls taken by the American Bankers Association, the National Industrial Conference Board and the National Association of Purchasing Agents. Moreover, almost without exception the economists from business and academic circles who testified before the Joint Economic Committee in June took the position that inflationary pressures were still strong and that tax cuts were not needed to stimulate business activity this year. Meanwhile, the strong uptrend in the stock market from February to early July has reflected a generally bouyant investor attitude toward sales and profits prospects.

Recent trend suggests caution

This resurgence of optimistic expectations is somewhat surprising in view of the less than vigorous showing made by most business indicators so far in 1957. Even with the price stimulus, retail trade did no more than maintain a plateau, seasonally adjusted, from December through May. Some general measures, unaffected by price, have actually tended downward. The index of industrial production declined slightly from a December high of 147 to 143 in April through June. Total wage and salary employment held stable during this period, after adjustment for usual seasonal influences, but manufacturing jobs declined somewhat, and the average work week shrank until May but showed a seasonal rise in June.

Slowdown since year end in most industries; sharpest declines have occurred in steel and autos



A striking factor in the downtrend in industrial production has been its universality. With a few exceptions, such as railroad equipment, leather goods and chemicals, which reported moderate gains, all major industrial groupings participated in the decline from December to May and June. Even nonelectrical machinery, mainstay of the boom in the Midwest, dropped back 4 per cent from the December high as a result of less than anticipated demand for construction machinery and some types of industrial equipment.

Future drags on certain lines of business also are indicated by reports that aircraft employment will be gradually reduced by 300 to 400 thousand as a result of a shift in defense procurement policy from aircraft to missiles. Also, the knowledge that capital outlays were leveling off and that the stimulus to exports from the Suez crisis has ebbed presumably would not be conducive to a resurgence of boom psychology. Other restraining developments of the second quarter include: the absence of a strong seasonal pickup in auto sales and a decline in manufacturers' order backlogs, including substantial drops in certain lines such as machine tools.

A reading of most barometers, then, indicates that the boom has topped out and the economy has been tilted slightly downward in recent months, a condition veiled partially by a slow rise in retail prices. Under these circumstances, why have so many forecasters moved out so far on an optimistic limb? Their projections do not merely extend an observed trend; rather, they are "calling a turn" in business activity.

The basis for bullishness

In part, a favorable view of the future can be supported in that the economy's natural bent is for growth. A common error in the postwar years has been to underestimate its underlying strength and resiliency. In addition, several specific arguments for the impending upturn are offered by those who project renewed growth.

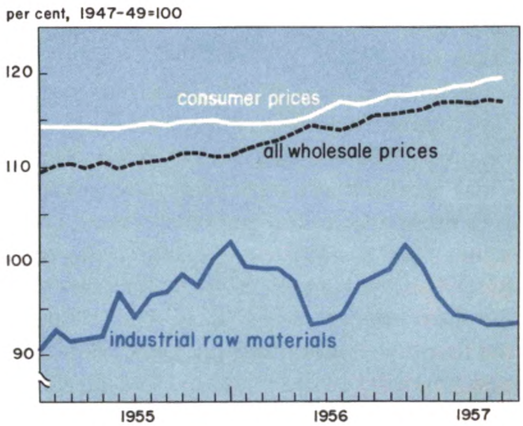
> An upsurge is due in the automotive sector as 1958 models are introduced and firms which accounted for a declining share of the market in 1957 attempt to regain their earlier positions; also, the working off of instalment loans contracted in the record 1955 sales year should give autos an assist;
>
> Housing starts may have passed bottom and be heading up once more;
>
> The persistent uptrend in personal income will spark a revival in retail sales;
>
> The current inventory adjustment should be completed by year end and accumulation renewed;
>
> The view that the nation's number one problem is, and will continue to be, price inflation has been reiterated so frequently in recent months that it is becoming a more important factor in business and consumer decisions.

Various information can be adduced to support the first three contentions. The evidence on inventory policies is contradictory. Purchasing agents continue to report a desire to make further downward adjustments while new orders in manufacturing as a whole increased somewhat in May. There is some indication that buyer interest has picked up for cold rolled sheet steel and building materials. Construction contract awards in May and June also indicated continued high-level activity in the building field.

The continued emphasis on "the inevitability of price inflation" is based largely on expectations. Actually, the spot commodity price index — usually considered a sensitive indicator of price trends — has been averaging 4 to 5 per cent below the high of last November mainly because of reductions in nonferrous metals and steel scrap. Moreover, the wholesale price index of nonfarm commodities has been very stable since early this year.

Consumer prices have continued to move up each month since last summer, but seasonally reduced food prices during August are expected to halt this trend, at least temporarily. One large mail order house has indicated that the average of prices in its fall catalog is slightly lower in contrast to a significant rise last year. Manufacturers of television sets and appliances have announced price increases for fall models, but there is some question as to how fully these boosts will be reflected at retail. Meanwhile, the suppliers of the great bulk of the goods supplied to consumers find themselves in a highly competitive market as to price, quality and speed of delivery.

Consumer prices continue rise; average wholesale prices level because of sag in raw materials



Credit demand remains strong

In the midst of the usual midsummer lull in the pace of business activity, the total demand for credit remains strong and financial markets continue to show evidence of tightness. The July rally in the bond market, like so many other less spectacular adjustments before it, gave rise to speculation that perhaps a turning point in the three-year upswing of interest rates had at last been reached. This seems to have been only a respite — in part a reaction to one of the steepest yield advances on record and in part a reflection of the lessening pressures of the summer season. The latest Treasury exchange offering, which included a 4 per cent coupon on a one-year issue, reflects the strong demand for short-term money. Market rates responded by moving upward again.

The real test of the situation will come with the fall credit demand. If this proves unusually large, it will signal that business plans to carry through, and possibly augment, its extensive expansion plans announced earlier. In addition, it may indicate a reversal of the inventory adjustments which have tended to hold down credit needs since the beginning of the year.

As in 1956, most of the additional demand for credit so far this year has been from business (see chart). The major forms of personal indebtedness have increased modestly with mortgages as the main component (consumer debt is normally reduced in the early part of each calendar year). At the same time the Government sector repaid borrowing as the first-half Federal surplus more than offset new financing by state and local units. Funds released through Federal debt operations, however, were considerably smaller than in the first half of last year.

Business use of credit in the first six months of 1957 closely approximated that of a year earlier. Although bank loans to business expanded by about half the record 1956 amount, the difference was largely balanced by a greater volume of funds acquired in the capital market.

Yields at 25-year high

Added to a record volume of new issues by states and localities, the business demand for money has driven yields in all sectors to levels well above the 1953 highs and unexceeded since the early Thirties.

Corporate bond yields rose sharply in June. Moody's average of triple-A yields on seasoned issues reached the 4 per cent mark, but borrowing costs on new issues were recorded as high as 4.91 per cent during the month. Although the July average will probably show some decline from this peak, it will not necessarily indicate a change in trend.

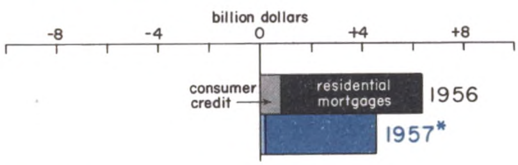
Yields on the tax-exempt issues have risen rapidly as states and municipalities sold securities to finance their highway and school programs. Standard and Poor's average of yields on municipalities is more than 50 basis points above its early-April level.

Long- and intermediate-term U.S. Government issues have also felt the pinch of large over-all credit demands. The 3's of 1995 hit a low of 86.75 to yield 3.63 per cent in mid-June. Meanwhile, the gap between high-grade corporates and long-term Treasuries which widened through most of last year has been maintained. Yields in the intermediate category have been above those on long-terms since the spring of 1956. Even the issues under one year in maturity have surpassed the longest bonds in yield.

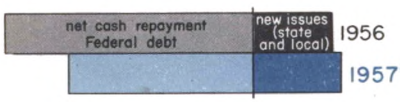
In the short-term area, Treasury financing operations have exerted the major influence on rates. The necessity for frequent borrowing, for cash as well as refunding, has caused the Treasury to avoid the bond market in competition with other borrowers of long-term money. Bill yields fluctuate from week to week with technical market influences, often reflecting temporary aberrations in reserve pressures at commercial banks or the short-term investment of funds raised in the capital market. A new high in the auction average of 3.40 per cent on the regular three-month bills was reached on June 17, but has varied down to 3.09 per cent more recently. Rates on both commercial and finance company paper have also been boosted by one-quarter per cent in the past six weeks.

During first half of 1957 . . .

major types of personal debt expanded more slowly than in 1956,



Federal debt repayment was a smaller offset to borrowing by state and local governments



and business drew more heavily on the capital market for its major credit needs

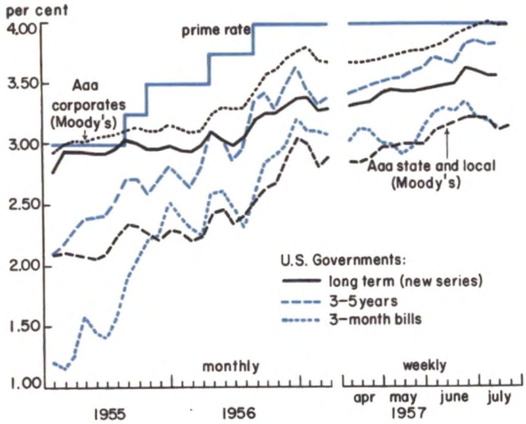
*1957 data partly estimated.
†Includes commercial mortgages and commercial and finance company paper.

In the autumn

What are the clues to the probable behavior of the credit markets when business emerges from its summer doldrums? Chances are that unless entrepreneurial optimism falters markedly, there will be little easing in credit conditions. True, rates cannot continue upward for long at the late-June, early-July pace before an equilibrium is reached, and the higher rates themselves will hasten this meeting point insofar as they influence both savings and borrowing.

Nevertheless, the scales seem to tip on the side of continued tightness. Not only is the period of seasonally heavy credit requirements approaching, but these may be augmented by capital-type financing needs which have gone unsatisfied in the long-term market. Estimates of expenditures for plant and equipment by manufacturing and commercial concerns are only slightly under the second-quarter rate while those by utilities are expected to increase. A large part of the funds to finance such expenditures has, of course, already been raised through the sale of securities. But there is a backlog of issues which have been withdrawn or postponed in retreat from an unreceptive market or rejected, on terms acceptable to the borrower, by increasingly cautious underwriters. Some of these companies may try to substitute bank credit to satisfy their needs temporarily. This would place additional strain on bank reserves and possibly result in some further liquidation of Governments, with its depressing effects on the Government market. Moreover, the Treasury, in addition to the just-

Yields reflect pressure of credit demands against a tight supply of funds



completed refunding of the August and October maturities, will be in the market for at least one cash offering to cover attrition and provide some new cash which is always needed in the last half of the calendar year.

The Federal Reserve, of course, can be expected to furnish the reserves needed to finance normal seasonal requirements. Roughly 600 million of reserves were provided in the last half of 1956. Business loans increased 2.6 billion in that period, of which 1.7 billion went to seasonal borrowers. Bank loans to business, though only part of the credit picture, are an important indicator of credit pressures. If the autumn rise is more than could be attributed to normal seasonal requirements, even some further tightening of credit could ensue.

Some clues as to the strength of the commercial and industrial demand for bank credit emerge from the unexpectedly high borrowing by business over the June tax period. Business loans of leading banks in major cities rose more in the two weeks ending June 19 than in any similar period on record, despite the fact that a smaller portion of corporate tax liabilities were due in June this year than a year ago and that there had been a much slower growth of business loans prior to June in the current year than in 1956. This suggests that an unusually large portion of these funds were borrowed for purposes other than tax payments, and there has been speculation that some firms were already borrowing in anticipation of fall seasonal needs.

The industry breakdown of loans, reported by the largest banks, indicates that the total of loans made to the seasonal businesses — food, liquor and tobacco processors, textile and apparel manufacturers, trade establishments and commodity dealers — did rise considerably more in the tax period than a year earlier, but this was due chiefly to an unusually large repayment of trade indebtedness in the 1956 period.

Nevertheless, the tax period loan totals were undoubtedly swollen by an enlarged nontax demand for funds. This arose from the apparent unwillingness of firms seeking funds for expansion to meet the stiff requirements of the capital market which was most unreceptive to new issues around mid-June. The public utility and transportation group, which has had a heavy calendar of security offerings, borrowed substantial amounts in the tax period, and in the week following, but made heavy repayments in the week of July 3 when the capital market showed a marked improvement.

Metals firms, which provided the largest impetus to business loans last year and were the largest June borrowers, used much less bank credit in the most recent tax period, probably reflecting important changes in inventory positions.

The total expansion in business loans by all commercial banks through the first half of

1957 is estimated at 1.7 billion, about 40 per cent less than the 2.9 billion growth in the comparable period of 1956. By ordinary standards, however, this still represents an active demand for credit for, at least prior to 1955, it was customary to expect a first-half seasonal decline in business borrowing. The seasonal industries do show first-half net repayments, of course, but other industries in the last three years have borrowed more than enough to offset such reductions.

At present a prime driving force behind the business demand for bank credit is the need for capital-type funds and the use of bank loans to finance them in periods when the long-term market weakens. If such temporary financing is added to the regular seasonal demand this fall, pressures on banks will be likely to increase. However, there is at least some indication that at the rates reached recently for new issues there will be sufficient investor interest in long-term offerings to provide a substantial volume of long-term funds.

The boom in exports

American merchandise is in increasing evidence in foreign lands, whether the country be as close as Canada or Mexico or as distant as Japan or Vietnam. Last year U. S. exports topped the 1955 level by 20 per cent, reaching a record 17 billion dollars.

Several factors lie behind this phenomenal growth in exports. Rising industrial production in Europe and Japan, the creation of vast markets in rapidly developing areas, attempts to whittle down our huge stocks of surplus farm commodities, and the temporary economic distortions and shortages resulting from the Suez crisis have all stimulated sales.

The transitory boost given U. S. exports by the Suez episode merely accentuated a movement that has been under way over the past three years. From 1953 to 1956, merchandise exports rose by 3 billion dollars or 40 per cent while, within the U. S., domestic purchases of goods and services by consumers, business firms and government grew by 12 per cent.

The boom in exports has continued into early 1957. For the first quarter, foreign purchases of U. S. merchandise were at a seasonally adjusted annual rate in excess of 20 billion dollars.

Capital equipment to Canada

Increased sales abroad of industrial machinery accounted for one-sixth of the 1956 rise in U. S. exports. The 500 million dollar increase last year pushed such shipments 30 per cent above the 1955 level.

The large-scale development of natural resources in Canada and Latin America is responsible for most of the bulge in machinery sales. Much of the equipment needed to exploit the rich iron ore and petroleum deposits in Canada and Venezuela is American made. In fact, a good deal of the development work has been undertaken by U. S. owned firms.

Capital equipment constitutes more than a third of Canadian purchases in this country. Producers' supplies and materials make up another 40 per cent. Last year exports to our northern neighbors of metals and metal products rose from 400 million to 600 million dollars and constituted a third of such U. S. shipments abroad.

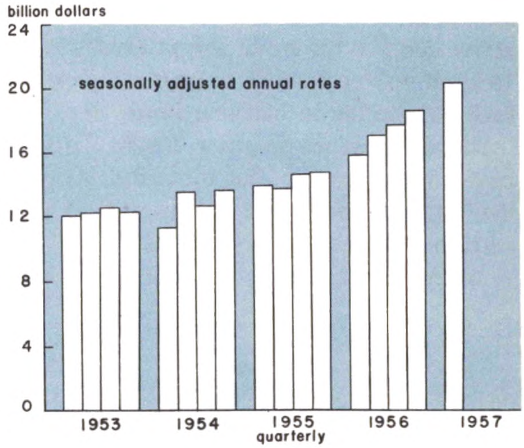
While industrial machinery and supplies make up the predominant share of Canadian purchases in this country, expanding incomes and a rising standard of living in Canada have increased the demand for U. S. produced consumer goods. A substantial share of our exports of autos and auto parts, TV sets and radios, refrigerators and other appliances are destined for Canadian households. Throughout the postwar period Canada has been our most important foreign customer. About a fourth of all U. S. merchandise exported last year represented sales to Canada. This was more than four times our sales to the United Kingdom, the United States' second largest foreign customer in 1956.

Raw materials to Europe

One of the most significant developments in U. S. foreign trade in recent years has been the increased reliance of European manufacturers on this country as a supplier of raw materials. The vigorous upsurge in European production that continued through most of 1956 was mainly responsible for a 25 per cent increase in United States exports to that area. Industrial production in Western Europe has increased 30 per cent since 1952, compared with 15 per cent in the U. S. during the same period. U. S. exports to Western Europe in 1956 were over 75 per cent above the level just three years earlier and since 1953 have accounted for nearly half of the total gains in our overseas shipments.

In the initial stages of the upsurge in European production, the basic resources of these countries were adequate to meet their

Exports in first quarter show further sharp gains



raw material requirements. As the boost in industrial output gained momentum, however, manufacturers were forced to rely upon imports to satisfy their expanding needs. Coal, steel scrap and chemicals were among the major items in short supply.

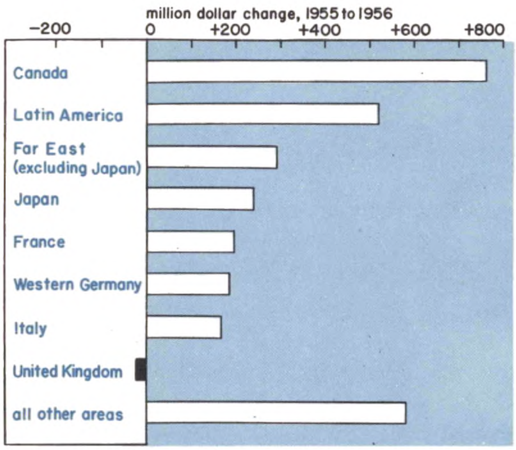
The value of U. S. exports of coal to Western Europe increased from 260 million in 1955 to 440 million dollars last year. While to a minor extent this reflected a substitution of coal for oil during the Suez stoppage, it mainly was due to a continuation of the rise in demand that had boosted our coal shipments to Europe from only 76 million in 1953. The importance of the United States as a supplier of basic raw materials is pointed up by the fact that more than half of our exports to Western Europe consist of such products.

Farm exports up

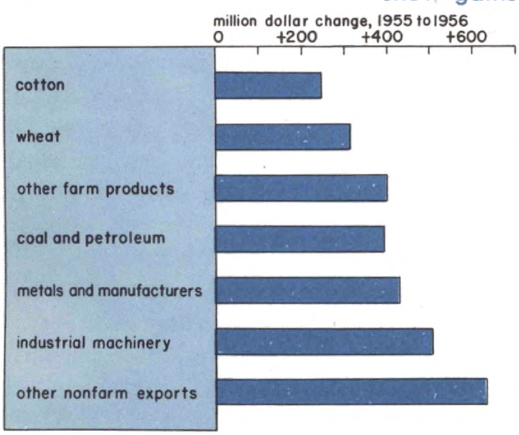
As a result of poor growing conditions in Western Europe last year, combined with sharp advances in personal income in most countries in that area, exports of U. S. farm products to Europe also increased in 1956. U. S. shipments of grains and fats and oils to Western Europe increased by about 250 million dollars, a gain of more than a third above the 1955 sales. Several Asian countries also increased their imports of U. S. "surplus" grains. Much of these exports of agricultural commodities were sales financed with foreign currencies, under barter arrangements, by Government loans and, in some cases, were outright gifts.

The 1956 export boom . . .

Where—
Canadian purchases register biggest rise



What—
both farm and industrial products show gains



Exports of farm products were given a strong boost by a new policy of selling surplus cotton abroad at prices competitive with those in the world market. Cotton exports increased from 420 million dollars in 1955 to 730 million last year, a 75 per cent gain. European buyers accounted for half of the increased shipments abroad.

Prop to business

U. S. export business plays an important role in influencing the pace of business activity. The 17 billion dollars in merchandise shipped abroad compares with the 15 billion that domestic consumers spent on autos and auto parts last year or the 15 billion of residential construction outlays. Over 8 per cent of all movable goods production is sold "overseas."

The rising demand for U. S. merchandise has done much to heighten domestic business activity. Attention has been focused primarily on business plant and equipment expenditures as the reason for the economy's buoyancy. Certainly the 6 billion rise in such spending has been the major reason for the continued rise in income and activity over the past year and a half. But the 3 billion dollar boost in foreign purchases, except for the sale of surplus farm stocks, was a significant factor in the rise in domestic output and income. In fact, the gain in exports more than offset the much-publicized drop in consumers' expenditures on automotive products during 1956.

Although sales abroad have continued to mount through April of this year, it is unlikely that the recent rate of growth will be maintained. First, with shipping again moving through the Suez Canal, the demand for U. S. fuels has receded somewhat. Second, the program of disposal of surplus farm commodities cannot be looked to for much in the way of further gains; in fact, agricultural exports may decline. Except in unusual supply situations, an additional boost in sales would probably disrupt the "normal" trade channels more than the U. S. disposal policy contemplates. Moreover, stocks of grains and cotton are building up overseas.

U. S. exports may also be affected by a slackening in the rate of growth of investments abroad. A sizable share of the 3 billion in overseas investments in 1956 represented direct investment in foreign subsidiaries or branches and entailed the export of a substantial amount of capital equipment. The private investment in overseas enterprises last year was more than double the 1955 rate.

Also limiting the growth in U. S. exports is the fact that many countries are still anxious to husband their gold and dollar reserves. During recent months, such reserves in some nations have been declining sharply. The sterling area holdings of gold and dollars are still vulnerable to speculative activity, as was indicated during the Suez crisis. France and India, moreover, have had to institute import restrictions in an attempt to restore balance to their trade position. All of these factors, together with a moderation in the pace of expansion in Western Europe industrial activity, point to a leveling in U. S. export sales.

Debt and consumer spending

Consumer credit outstanding has nearly doubled since 1950 and now exceeds 40 billion dollars. This rapid expansion has contributed to a large and rising volume of consumer purchases. By using credit, consumers with little or no accumulated savings have been able to accelerate their purchases of automobiles and household durables, and other consumers with substantial resources have been able to buy without drawing down past savings.

A growing number of consumers have some portion of their current income committed to the repayment of instalment indebtedness. Early this year 47 per cent of all spending units owed instalment debt, compared with 38 per cent in early 1952.

The annual repayment obligation has increased also. Last year, repayments on instalment debt alone totaled 37 billion dollars, double the 1950 amount. Over the same period, personal disposable income increased about 40 per cent.

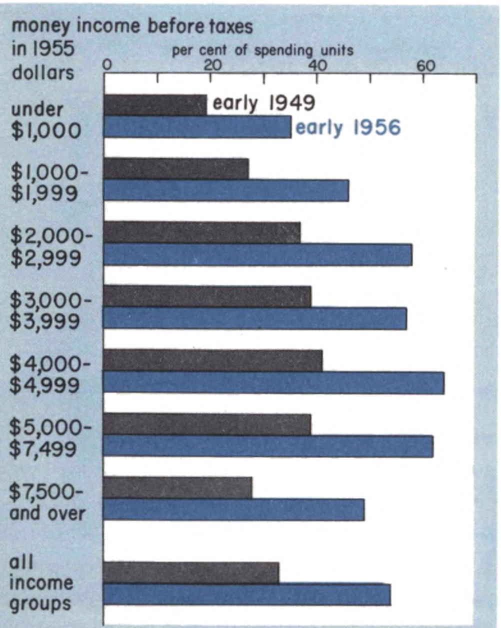
As the volume of repayment obligations has risen, manufacturers and purveyors of consumer durables, as well as business analysts, have raised questions concerning the relation of debt, and its repayment, to consumer spending behavior. Do those in debt reduce savings or expenditures for goods and services while their debt is being repaid? Do they become prospects for additional purchases on credit as soon as their debt has been reduced somewhat, only after their debt has been retired completely, or do they tend to use consumer instalment credit only once or a few times and thereafter become cash buyers?

Who are the instalment debtors?

Income and family status appear to be the most influential factors associated with the use of instalment credit. The most frequent users are the young married couples with small children — families with large "needs" but limited assets. These families, in the process of furnishing and equipping recently formed and expanding households, are big purchasers of household durables and automobiles. And they are also the spending units with relatively small holdings of bank deposits, savings accounts and Government bonds. Last year, among the young married families included in the Survey of Consumer Finances, one-third reported having no liquid assets other than currency; two-fifths reported liquid assets of less than 500 dollars.

However, when the spending units owing instalment debt are arrayed by income, 45 per cent are found in the middle and upper middle income bracket — $4,000 to 7,500. Families in the lowest income brackets do not constitute an important part of the market for consumer durables for which instalment debt is utilized, and those in the high income brackets often pay cash or, if they use credit, make larger down payments and repay the balance in a shorter interval.

In all income groups the proportion of families with some personal debt has increased



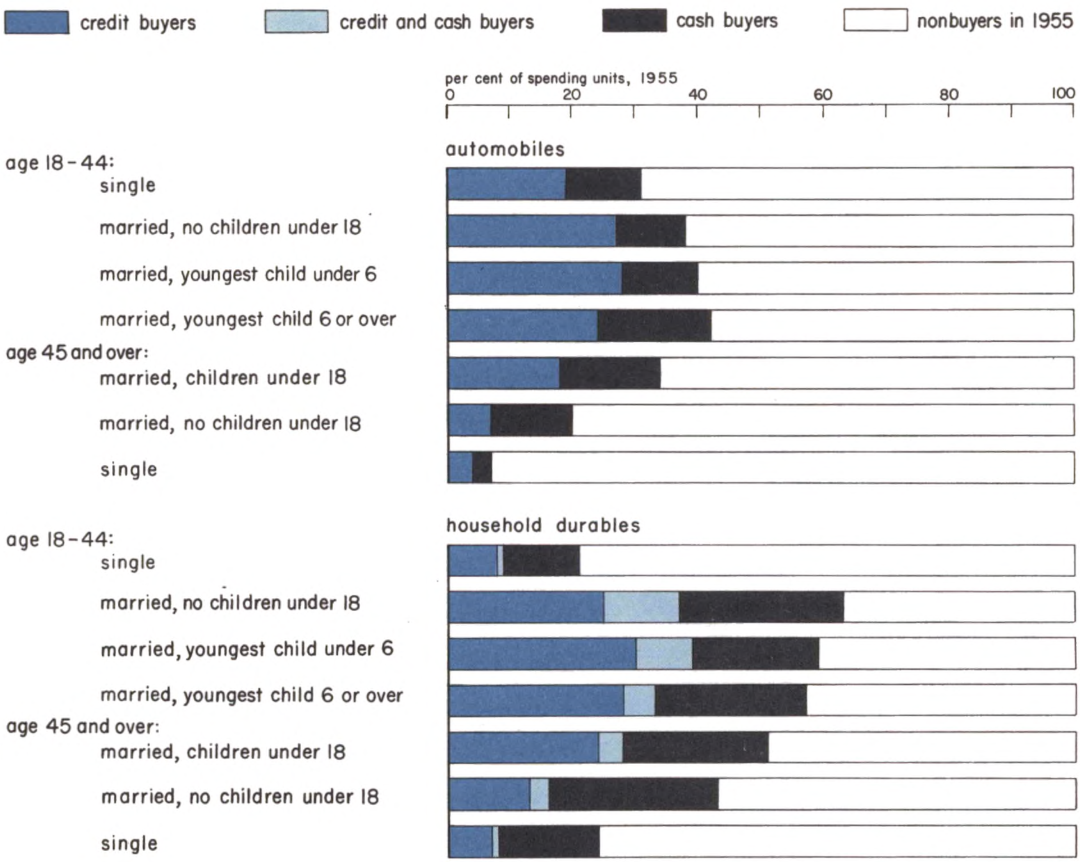
Note: Includes instalment and noninstalment debt, except charge accounts. Excludes mortgage and business debt.

Less spending or less saving

The commitment of future income for instalment payments necessarily alters the allocation of the family's income over the repayment period. A number of adjustments are possible; the particular action taken will reflect the financial position, previous saving-spending pattern and current preferences of individual families.

Households making regular payments on instalment debt can maintain their expenditures for current consumption by reducing the proportion of income saved (aside from that used to retire debt) if they had been adding to their liquid assets prior to making the instalment purchase. Data from household budget studies indicate that most families are inclined to make this type of adjustment. One alternative would be to reduce spending for current consumption. This adjustment is likely in a limited number of situations where the family has a strong desire to add to its liquid savings although

Credit buyers are most frequently young married couples with youngest child under six



making debt repayments, and in that substantial number of families which had not been using a part of their income to accumulate liquid assets prior to making the instalment purchase. In a recent survey three-fourths of the consumers owing instalment debt reported that they did not save during the year.

However, the fact that a big majority of the instalment debtors are "nonsavers" does not lead to the conclusion that instalment debt always retards saving. It is evident from the statistics on liquid asset holdings that some of the families not saving while repaying instalment indebtedness also had not saved when they were without debt.

Another alternative, and one which no doubt is utilized very frequently, is to curtail current outlays for "postponable" purchases (semidurables and non-credit financed durables) and allow the family's inventory of such items to decline during the period of instalment debt repayment.

Buyers again?

One-third of the families owing instalment debt have payment obligations which are but a small fraction of their disposable income. The instalment debt payments of another third are between 10 and 20 per cent of their income after taxes. But the remaining households, mostly of relatively low income, have scheduled repayments amounting to 20 per cent or more of their disposable income. However, these ratios of scheduled repayments to income do not indicate how soon families will complete payments on current contracts. Since most contracts are written with level payments, it would seem that the declining debt balance would not have much effect on consumer willingness to buy until the time the last payment is made or is near at hand.

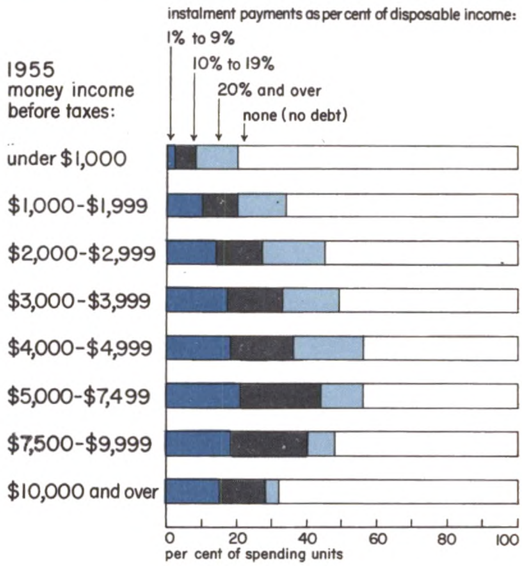
Nevertheless, many consumers will take on new debt while repaying old debt, if they *want* to buy and can *qualify* for additional credit. Early this year, according to data from the Survey of Consumer Finances, 40 per cent of instalment debtors were servicing debt on two or more purchases. Furthermore, among new car buyers in 1954-55, 30 per cent of those purchasing on credit still had debt outstanding on the car they traded in.

The capacity of instalment debtors to borrow in order to purchase durables is in large measure dependent upon their income prospects and the proportion of income not already allocated to relatively fixed outlays, such as instalment and mortgage payments, rent, life insurance premiums and pension fund contributions. In the aggregate, this proportion has held close to one-fourth of disposable personal income since 1954 and about the same proportion as in 1939.

Most lenders do not require applicants to have any minimum amount of liquid assets to qualify for loans. Even when the loan is for a large amount, it is rather rare for liquid asset holdings to be a significant factor. In early 1956, 60 per cent of the consumers owing instalment debt reported no liquid assets other than currency. Also, in instalment lending, additional collateral — liens on property other than the item being financed — is not commonly used.

Down payment and contract maturities are important factors influencing the number of families that can qualify for instalment credit. It has been noted, for example, that the liberalization of auto terms in 1955 was largely responsible for a surge in credit sales. In addition to attracting a larger number of credit buyers, smaller down payments and longer payment periods enable some debtors to purchase additional durables and others to make more expensive purchases than could otherwise be financed.

Instalment debtors are most numerous in middle income groups



The available evidence indicates that many additional *consumers* could qualify for instalment credit and finance a step-up in their purchases if they desired to do so; also, that a considerable number of *instalment debtors* could qualify for additional credit. However, most instalment debtors probably re-enter the market for credit-financed purchases after current contracts are paid out, or nearly so.

Credit forever, or credit to cash?

Do users of instalment credit acquire a *habit* of borrowing to purchase consumer durables, or do they shift to cash purchases at the earliest opportunity? Available evidence suggests that much shifting takes place in both directions.

Surveys of cross sections of the population reveal age and income patterns which suggest a definite progression of credit buyers to cash buyers. The older the purchaser, the less likely it is that he will use credit. Among purchasers of new cars in 1954-55, for example, the proportion in each age class using credit falls steadily from 88 per cent for the 18-24 age class to 62 per cent for the 35-44 class and down to 21 per cent for buyers 65 and over. Although these ratios may increase in the future, as the number of older buyers with instalment debt experience grows, the downward trend in the use of credit over the life-cycle will probably remain.

Also, the relationship of credit buying to income indicates that many credit buyers will climb into positions of smaller credit use. However, this probably isn't a one-step transition (and it isn't always in the same direction). A household, for example, may now pay cash for items such as refrigerators though still use credit to buy a new car. Furthermore, there apparently are short-term shifts in attitudes relative to the use of instalment credit. Fear that paychecks may be less steady, for example, will curtail the credit buying of spending units, especially of units who consider themselves to be well stocked in "basic" durables. In a recent survey of middle income buyers of durable goods, in two out of three cases, consumers expecting to be worse off paid cash for durables purchased during the year. Credit purchasers usually were consumers expecting income increases and business prosperity.

However, the number of consumers who have shifted from credit to cash buying of durables is small compared with the steadily rising number of families using instalment credit to purchase at least one kind of durable. For every cash buyer of a new car in 1954-55 who had used credit to purchase the car traded in, there were four former cash buyers who shifted to credit. The spreading acceptance of consumer credit by both borrowers and lenders and, along with this, the development of easier terms have made this type of credit available to larger numbers.

The relatively low level of family formation indicated for the years immediately ahead will tend to slow the growth in number of families using instalment debt, but this may be offset by a continued high rate of births and the trends to individual home ownership, suburban living and other forces which boost pressures for individual ownership of a lengthening list of consumer durables at an early stage in life cycles. Within the past six years credit-financed sales of new automobiles rose from 46 to 63 per cent of total sales. But even in the case of some of the household durables where instalment credit sales have been a decreasing segment of the consumer market — furniture and refrigerators — the use of instalment credit today is still more widespread, and in larger amounts, than in the years immediately following the end of the war.

Furthermore, with the growth in nonliquid types of financial saving (home ownership, life insurance, retirement programs) resources become less accessible and a larger share of current income is "committed," so that borrowing to buy big-ticket items may become more general in the higher income brackets. Finally, there are indications that attractive merchandise and credit terms can entice a large number of families to utilize credit.

Credit purchasers of automobiles and other selected durables, 1953-1955

Type of purchase	Percentage of purchasers using credit 1956	1955	1954	1953	1950	1947
New automobile	63	60	61	59	46	29
Used automobile	58	60	61	61	57	36
Furniture and major household appliances[1]	48	52	54	56	49	43
Furniture	46	45	50	50	47	
Television set	49	56	57	55	44	
Refrigerator	40	51	58	63	54	
Washing machine	46	55	55	58	42	

[1]Includes items listed and other major appliances. Purchasers of two similar items, one for credit and one for cash, were classified as credit purchasers. Charge-account purchasers are excluded.

Credit prospects re retail sales

Is consumer credit likely to play a key role in any change in consumer buying in the near-term future? This review of attitudes and practices affecting the use of instalment credit does not provide a clear answer. It indicates that a very large number of consumers are in a position to qualify for the use of larger amounts of credit if they should desire to do so; not all credit buyers await retirement of current debt before buying again; and attractive merchandise and liberal credit terms apparently can attract additional numbers of consumers into the credit market.

Some observers expect the 1958 model automobiles to be very "attractive merchandise." Furthermore, a substantial portion of the four million consumers who purchased cars on credit in the peak year of sales, 1955, have recently or will shortly complete their payments on the typically 30-month auto instalment plans. These factors could provide a strong stimulus to credit sales of autos and possibly other durables. However, consumers' use of credit is sensitive also to their expectations relative to personal income and business conditions. And, finally, in view of the strong demand for credit from other sectors, consumer instalment terms are not likely to ease again as in 1955. As in the past, the consumer will continue to play a key role, but his probable turn of mind is not clearly evident in advance.

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