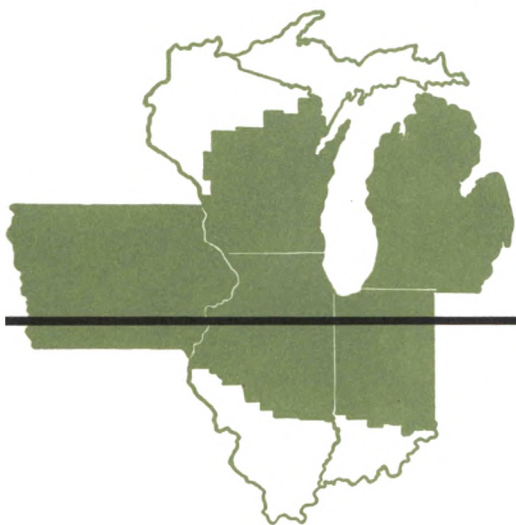


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1960 October

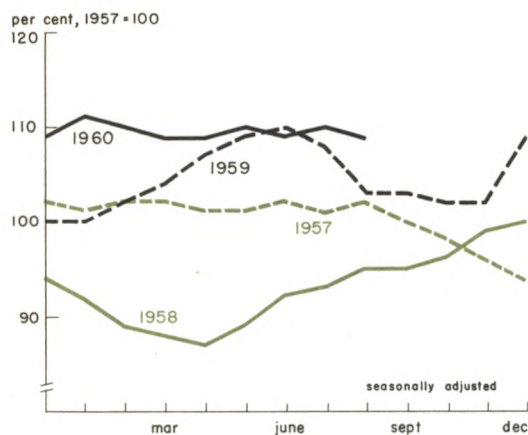


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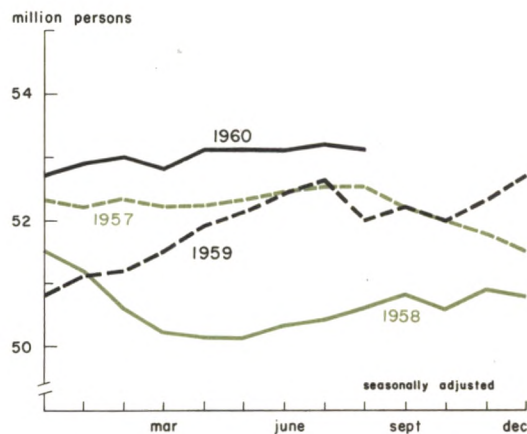
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THE Trend OF BUSINESS

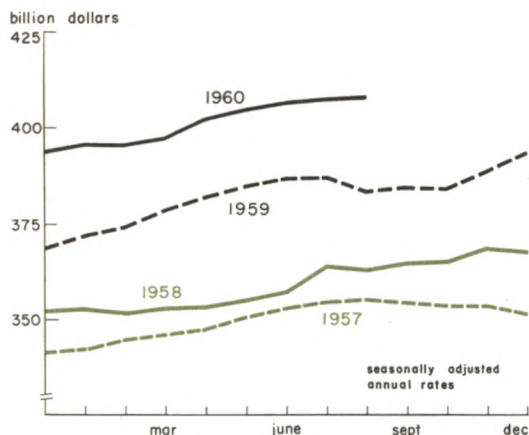
Business activity remained on a high plateau between the spring and early autumn of 1960. At the beginning of the year, there were expectations that the first half would witness a vigorous upsurge, to be followed, perhaps, by a leveling in the second half. Instead, it soon became evident that the demand for hard goods was not rising vigorously. In the spring, production was cut back in some durable goods lines, offsetting further gains in nondurables and services so that activity, over-all, remained relatively stable. As the economy continued on an even keel, and in the absence of a strong seasonal uptrend in the late summer and early fall, business expectations lost much of their optimism. Possibly the most important reason was the lethargy in retail sales. Recent trends of selected economic indicators are shown in the charts below, including comparisons with 1957, 1958 and 1959.



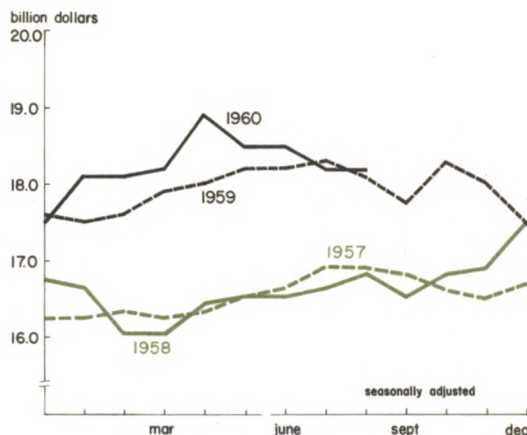
Industrial production during the first eight months of 1960 has remained on a high plateau, about 9 per cent above the 1957 level and equal to the peak reached prior to the steel strike in 1959. High levels of production of nondurables, gas and electricity have largely offset cutbacks in steel, farm machinery, motor vehicles and appliances.



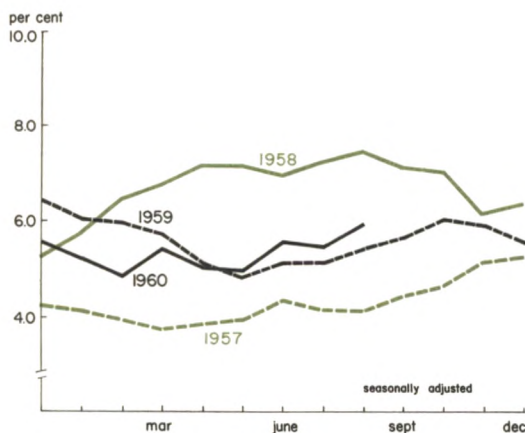
Employment of nonagricultural wage and salary workers has remained near the record high established last spring. The picture is mixed, with greater employment in trade, service and government offsetting a decline in durable goods manufacturing. In nondurable goods manufacturing, employment drifted down slightly from the record high in May.



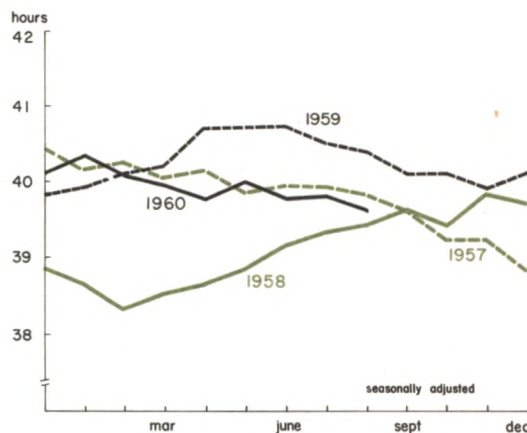
Personal income continued to rise through the summer but at a slowing rate and has been about 5 per cent above last year. Wage and salary payments to Federal Government employees were increased in July; income from other sources showed a relatively small change during July and August.



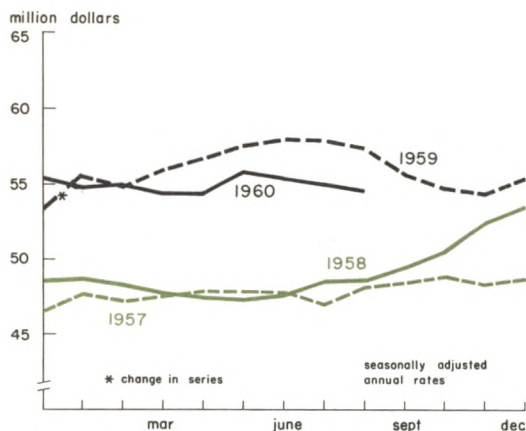
Retail sales have declined in recent months from the record high in the spring. Although personal income has risen, sales recently were about the same as a year earlier. Sales were depressed in the second half of 1959 as a result of the steel strike and layoffs in transportation and related lines.



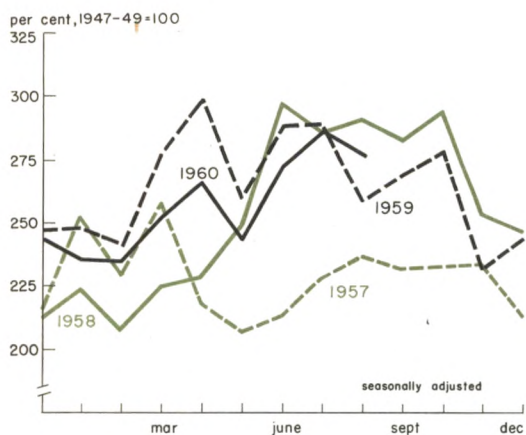
Unemployment is appreciably higher than in 1957, when the preceding boom topped out, but has remained well below 1958, a recession year. The total number at work has remained well above 1959 even though activity in durables slowed.



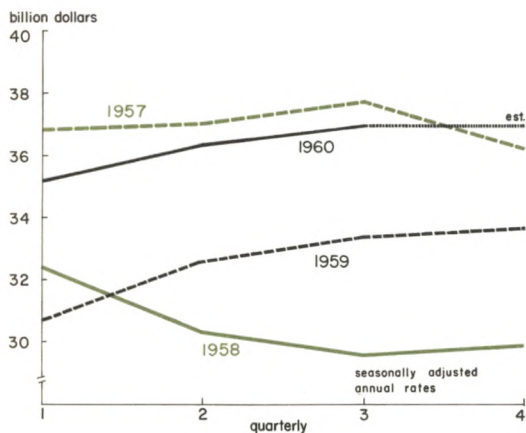
The work week in manufacturing declined further in August and was nearly one hour less than last year. The drop has been largely in the durable goods industries. Thus far, changes in length of work week have followed the pattern of 1957 closely.



New construction activity has been on a fairly even keel since the fourth quarter of last year at a level well above 1957 and 1958 but about 5 per cent below the record high in mid-1959. New home building has been about 15 per cent below the year-ago rate but nonresidential construction and public works have been increasing moderately and in August and September were both above the year-earlier levels. Total new construction rose in September, according to preliminary estimates.



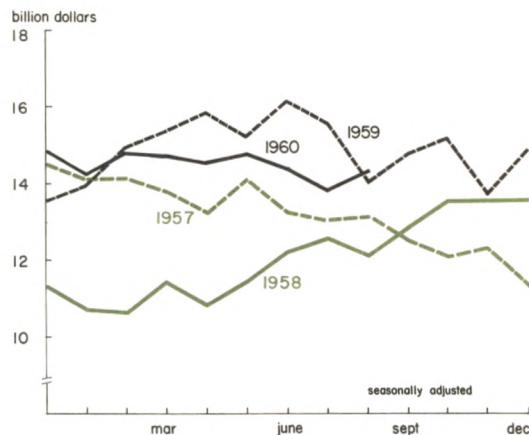
Construction contracts awarded in August exceeded the like 1959 period for the first time this year, largely because awards during the second half of last year were affected by the steel strike. During the first eight months, awards for nonresidential construction were 3 per cent above year earlier; residential awards were off 15 per cent.



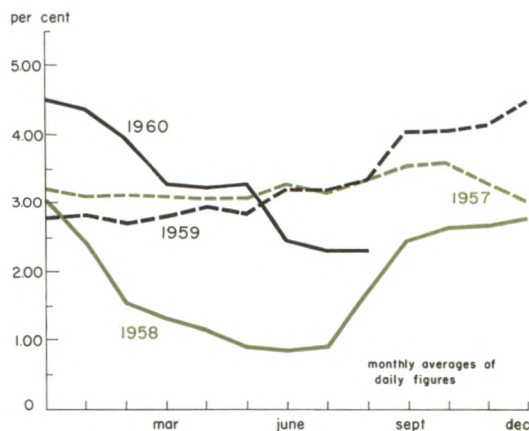
Business plant and equipment expenditures have been about 12 per cent above the year-ago pace. The most recent survey of business plans indicates that the total has now leveled off, slightly below the record high in the third quarter of 1957. Ample capacity in most lines and lower corporate profits appear to be limiting capital outlays. The current rate is somewhat lower than had been indicated earlier as a number of business firms have canceled or scaled down plans since last spring.

New orders of durable goods manufacturers

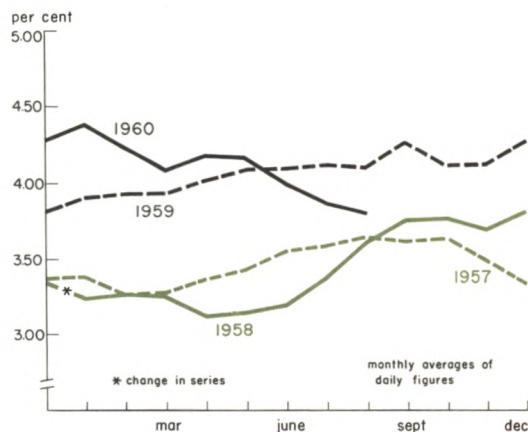
have been below expectations. With orders below last year, and below shipments, backlogs of unfilled orders have declined. The sluggish trend in new orders is related to the high level of unfilled orders at the beginning of the year, particularly for steel. In addition, rapid deliveries in virtually all lines during 1960 have permitted business firms to reduce order lead times.

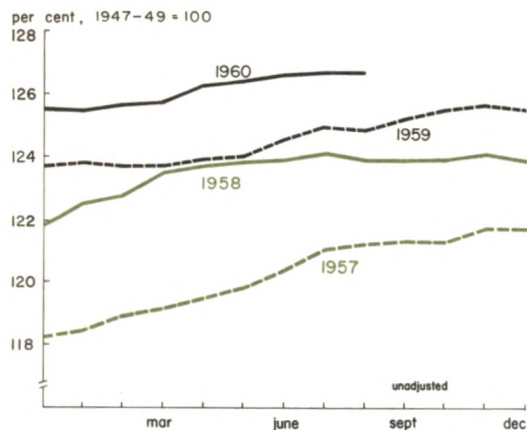


Interest rates have declined from the peaks reached early in the year. Yields on three-month Treasury bills dropped from about 4½ per cent to less than 2½ per cent. In recent months, bill rates have been well below those of last year or 1957 but have remained well above the low level in the spring of 1958. Other short-term rates such as prime commercial loans and commercial paper also have declined.

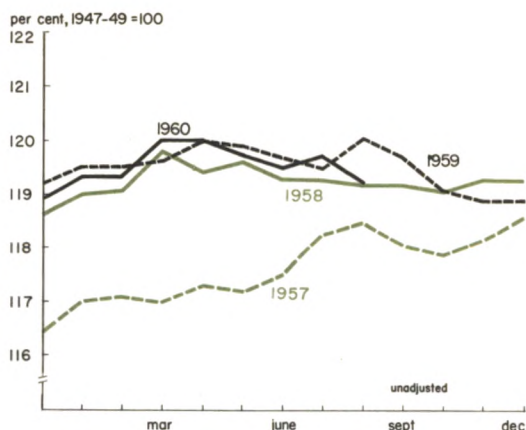


Long-term interest rates have moved down but much less than short-term rates. Yields on long-term Government bonds are now below last year and about equal to 1957 and 1958. Yields on municipal and corporate bonds also are lower than at the beginning of the year, and in recent months lower rates have been quoted on residential mortgages. The decline in interest rates reflects primarily reduced credit demands associated with the over-all stability of the economy.





Consumer prices have continued to creep higher, with prices of housing, medical care and personal care advancing steadily. Since last spring, food prices have risen above the year earlier level after declining between 1958 and 1959. Prices of new and used cars have been under downward pressure this year because of high inventories. The 1961 models are being introduced with only minor price changes.



Wholesale prices, on the other hand, have shown a high degree of stability since the fall of 1958, reflecting in part the effects of ample productive capacity in most industries. While prices of individual commodities show sizeable and divergent movements, in response to special supply and demand situations, the over-all picture shows primarily seasonal movements with no overriding tendency to rise or decline.

Business growth in the Midwest

Retail and service trade establishments in the major cities of the Seventh Federal Reserve District have grown in both employment and sales in recent years. Employment in manufacturing, however, has declined even though the value of output of manufacturing establishments has increased.

This is the broad picture shown by the

recently released Censuses of Business and Manufactures which permit comparisons of 1958 and 1954 in some detail. It must be borne in mind, of course, that censuses are essentially snapshots, not moving pictures. The comparisons, therefore, are of the two years and do not include the full swing of events during the intervening period. Both

1954 and 1958 were recession years, and the cyclically sensitive durable goods industries, important in the Midwest, possibly were somewhat more depressed in the latter than in the former year.

Sales of retail stores increased in all 34 of the District's standard metropolitan areas (each area includes one or more cities with a population of over 50,000) and were up 11 per cent, over-all. The sales of service establishments — such as hotels, motels, laundries, barber shops, advertising agencies, auto repair shops, dance halls and bowling alleys — rose 33 per cent.

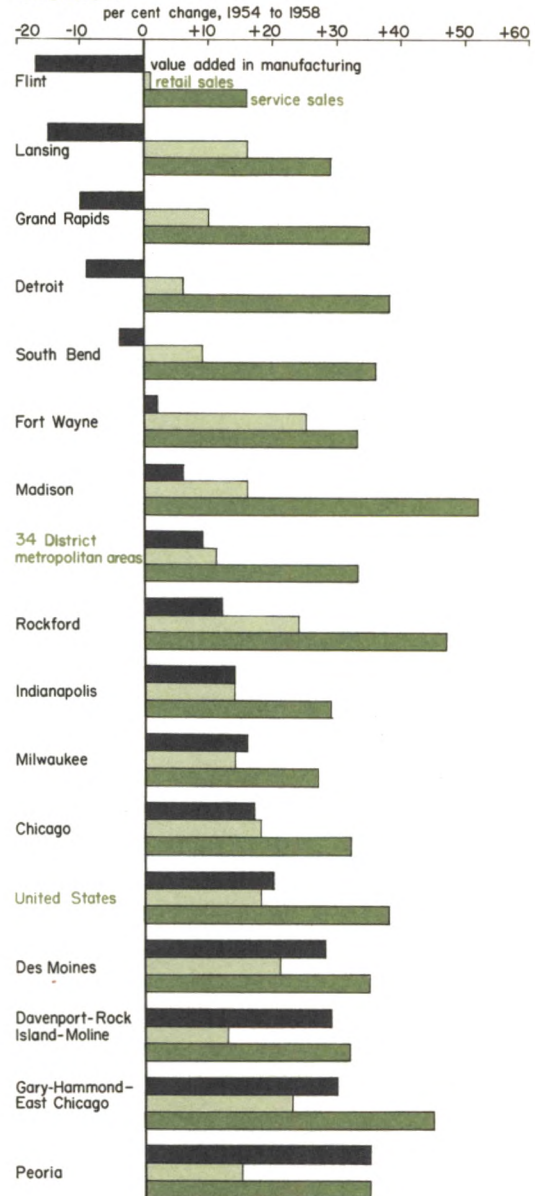
Although impressive, these sales gains in the retail and service trade sectors of Midwest business were smaller than the national increases of 18 and 38 per cent, respectively. Employment in these lines also showed smaller increases in the District than in the nation.

District manufacturing

A lower level of manufacturing employment in many Midwest areas in 1958 than 1954 is indicated by both the Census reports and data available from other sources. In those areas oriented largely to "heavy industry," the decreases exceeded the 3 per cent average decline for all manufacturing nationally. However, output of the District's manufacturing firms was larger in 1958 than in 1954, if measured in terms of the "value added" in the manufacturing process. The value added—the difference between sales and the cost of materials, parts, supplies and fuel—provides a measure of the contribution not only of employees but also of managers and capital to the output of manufacturing firms.

The changes in value added in manufacturing for the major population centers of the District show a somewhat different pat-

Retail and service trade sales in 1958 were above 1954 in the District's 15 largest population centers; "value added" in manufacturing declined



tern from that of employment. The value added in 1958 was greater than in 1954 for 27 of the 34 standard metropolitan areas. Among the District's larger areas, Des Moines, Davenport - Rock Island - Moline, Gary-Hammond-East Chicago and Peoria, had increases greater than the average gain for the nation. However, the District areas as a group, with a 9 per cent gain in value added, were far below the national average of 20 per cent.

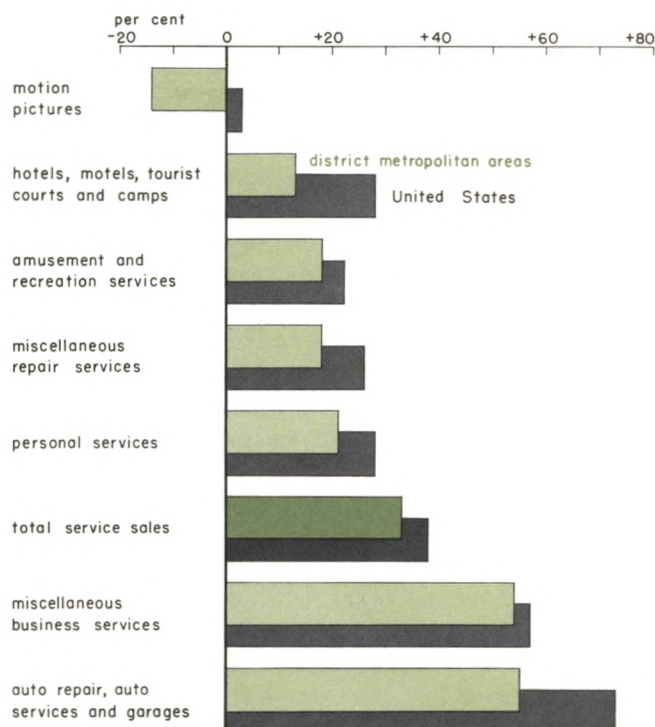
Declines in manufacturing employment may take place even though the value added increases. Changing manufacturing techniques and processes and large investments in new plant and equipment have made possible a larger production of goods with fewer workers. Moreover, any shift in the composition of manufacturing activity toward those industries which use large amounts of capital relative to labor will tend to result in increases in total value added even though manufacturing employment declines. Unfortunately, the data available from the Census of Manufactures do not permit an evaluation of the relative impacts of changes in techniques and composition of manufacturing activity on employment in the Seventh District metropolitan areas.

As noted above, one of the reasons for the relatively poor showing of manufacturing in the District was the greater severity of the slump in durable goods production in the 1958 recession than in the 1954 downturn. Especially hard hit were the District automobile centers of Bay City, Detroit, Flint, Lansing, Saginaw

and South Bend. Production of automobiles in 1958 was about 12 per cent below the 1954 output, and production of auto parts was off about 4 per cent in the nation as a whole.

The major reason for the slower growth of manufacturing output in the District than in the nation is the structure of Midwest industry. The fastest growing sectors, in terms of value added—chemicals, electronics and aircraft—are less important here than in the nation as a whole. The steel, auto and machinery industries, relatively more important in the District than in the nation, have grown less rapidly.

Service trade sales in District metropolitan areas increased less than sales in the nation, 1954-58



Service stations lead

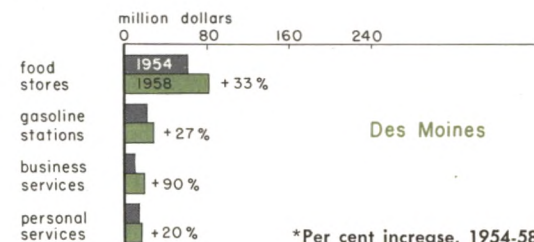
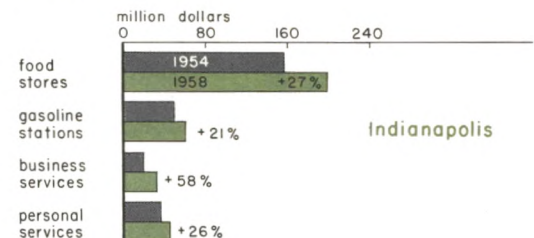
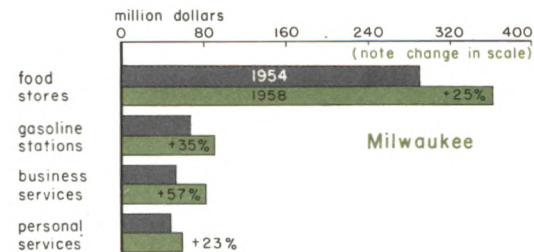
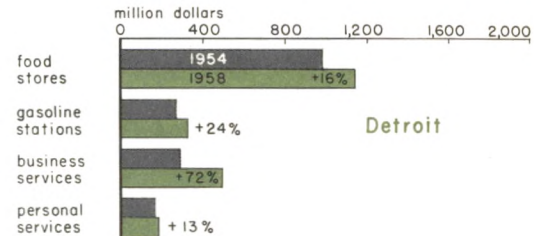
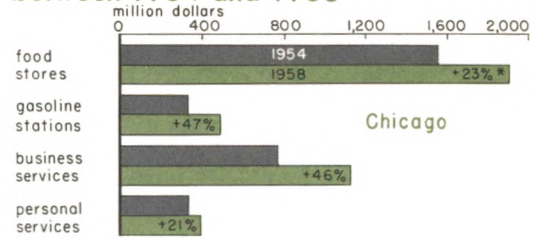
The growth in retail sales in Seventh District cities varied among the different types of establishments. The largest increase was in gasoline service stations—up 30 per cent in four years. Food, drug, furniture and general merchandise stores as well as a miscellaneous group, including gift, music, hobby and toy shops, all showed larger than average sales gains. Smaller-than-average increases were reported by eating and drinking establishments and apparel stores, with the lumber, farm equipment and automobile dealers showing the smallest sales rises. In dollar terms, the increase in food store sales was by far the largest in most centers, with gasoline service station and general merchandise sales falling next in line.

An interesting feature of the changing retail trade picture is the shift in number of establishments. The trend from corner grocery store to supermarket is well illustrated. Although sales of food stores rose 23 per cent, the number of stores declined 14 per cent. A similar trend is apparent for apparel stores; the number fell although sales rose 8 per cent. The decline in apparel stores probably reflects, in part, the increase in number and sales of general merchandise stores.

Serving business firms

Auto repair and business services reported the largest gains in sales in the service trades. With more automobiles in use and the cost of repairing them rising, the business of auto repair shops had increased 140 million dollars, or 55 per cent, in four years. Impressive also in the service trade sector was the rise in sales of establishments supplying services to business firms. Sales of advertising and employment agencies, window washing, sign

Firms supplying business services made large relative sales gains between 1954 and 1958



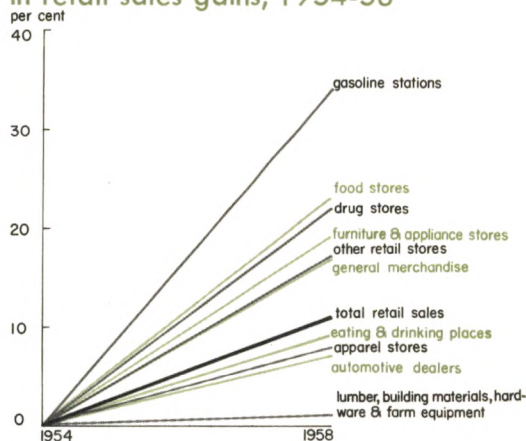
*Per cent increase, 1954-58

painting and telephone answering services rose 670 million dollars, or 54 per cent, during the same period.

Sales gains for personal services such as barber shops, laundries, shoe repair shops and cleaning establishments were relatively smaller than those in the business service and auto repair areas. In dollar volume, however, the increase in personal service sales exceeded that of the auto repair shops.

The only important kinds of services for which receipts declined were motion pictures and streetcar and railroad transportation. In the 21 areas for which data are available, receipts declined almost 14 per cent. However, other amusements rang up an 18 per cent sales increase in the same areas.

Population growth and more autos in use in District cities are reflected in retail sales gains, 1954-58



Midwest industries adjust to shifting world trade patterns

One of the more significant developments of the postwar period has been the vigorous overseas expansion by United States business firms. The Department of Commerce reports that since 1950 direct private investment abroad has increased from 11.8 billion dollars to over 30 billion or nearly three-fold. The trend shows no sign of slackening. According to a recent McGraw-Hill survey, American companies plan to invest a total of 2.4 billion dollars abroad in 1960 and 2.5 billion in 1961, compared with 2.1 billion actually spent in 1959.¹

Although the international oil companies

have accounted for the lion's share of this country's overseas investment, expansion by a wide range of manufacturing firms is rising rapidly in importance. In 1959, their outlays surpassed those of the petroleum industry for the first time in the postwar period. According to the McGraw-Hill survey, the manufacturing companies which it covered intend by 1961 to raise their foreign capital spending to 1.3 billion dollars from the 1.1 billion level projected for 1960, while oil

¹The McGraw-Hill series accounts for 75 per cent of all foreign capital spending by U.S. manufacturing and petroleum companies.

companies plan to reduce their outlays. Roughly half the capital expenditures planned by manufacturing firms will be concentrated in Europe, reflecting efforts of chemical, machinery and transportation equipment companies to strengthen positions inside the Common Market.

This sustained overseas investment expansion has laid the base for a vigorous sales growth. In the past decade, sales of foreign-based U.S. manufacturing establishments have risen much faster than exports from domestic plants, to an estimated present annual rate of more than 21 billion dollars. This mushrooming of overseas sales reflects not only the growing demand for capital goods and consumer wares in foreign countries but also steadily rising shipments of manufactured goods to the United States from abroad.

These developments emphasize a decided tendency among U.S. firms to strengthen their respective competitive positions in world trade by expanding production and distribution facilities abroad. Major Midwest industries, including the auto, tractor and farm equipment, construction equipment and drug producers, have figured importantly in this overseas investment expansion. Are the forces that caused them to initiate or accelerate foreign investments continuing to gain momentum? Will these investment trends have significant effects on employment and economic growth in the Midwest?

Exports important to Midwest

Seven industries rank large in the Midwest economy as well as in U.S. exports of finished manufactured goods. In addition to such obvious examples as the automobile and tractor and farm equipment industries, the list includes electrical machinery, machine tools, construction and mining equipment,

heavy engines and turbines and drugs. During 1953-58, five of these industries shipped at least 8 per cent of their total annual output to foreign markets. In comparison, total merchandise exports for the United States averaged during this period about 4 per cent of Gross National Product.

According to latest available information, the seven industries account for 34 per cent of the manufacturing employment in the states of the Seventh Federal Reserve District and 69 per cent of the industrial production. In 1959, their pro rata contribution to U.S. exports totaled 1.9 billion dollars.

Owing chiefly to the heavy concentration of the automobile industry in the Detroit area, Michigan leads the District states in exports of finished manufactured goods. In 1959, United States overseas shipments of autos, trucks and parts totaled 1.1 billion dollars, with Michigan contributing about 0.5 billion.

Illinois is second in exports, reflecting its broad industrial base. Leading producers of tractors, farm machinery and construction equipment such as Allis-Chalmers, International Harvester, Deere and Caterpillar have major plants in the state. Nearly half of the District output of electrical machinery and equipment and 45 per cent of the machine tools are produced in Illinois, most of them in the Chicago area.

In Wisconsin, the tractor and farm implement, and construction and mining equipment industries and producers of heavy engines and turbines make important contributions to exports, while in Indiana exports are largely from the automobile, drug and electrical machinery industries.

Total net exports of the seven manufacturing industries important to the Midwest climbed steadily, from 2.9 billion dollars in 1953 to 3.6 billion in 1957, and then drop-

ped sharply to 2.4 billion in 1959. This deterioration reflected the combined effects of a business recession in Europe and a decline in capital investment expansion in mining and oil ventures in Canada and Latin America, plus vigorous competitive inroads made by Western European and Japanese goods in overseas markets as well as in this country.

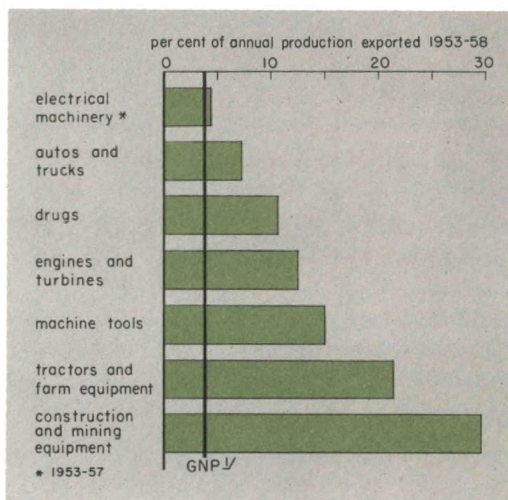
Since the second half of 1959, however, total net exports of the seven industries have rebounded strongly, largely in response to heavy demands generated by the European business boom. Only the drug industry's net exports have continued to drift downward. Further improvement in the Midwest export picture in the months ahead will, of course, depend heavily on whether business activity overseas is maintained at a high level. An examination of basic trends in these industries follows.

Midwest industries go abroad

Shifting world trade patterns have had a most dramatic impact on the American *auto* industry. Owing to a rapid rise in imports of foreign cars and a decline in exports of domestically built units, the industry's net exports dropped from nearly 1 billion dollars in 1957 to 0.3 billion in 1959. Cars produced in overseas plants of the major Detroit firms figured importantly in these imports. In 1959, for example, domestic sales of General Motors' cars built in Britain and Germany accounted for nearly 10 per cent of total U.S. foreign car registrations.

The industry has also moved aggressively at home in response to the American public's growing preference for "economy" cars; in the 1960 model year, every major firm toolled up to produce its own line of domestic compact cars. The compact cars were an immediate success. Accounting for more than 25

Overseas markets important to major Midwest industries



¹Gross National Product is the total output of all goods and services.

per cent of new car registrations in the first half of 1960, the compacts not only made inroads on the sales of standard domestic models and European imports but also helped to boost the industry's export sales. During the first eight months of 1960, the industry exported 87,000 passenger cars, with compacts representing nearly 47 per cent of the total, while in the same period last year exports came to only 73,000 units.

Despite the steady decline in overseas shipments of autos between 1955 and 1959, foreign markets have gained steadily in importance for the Detroit firms. Throughout the postwar period, exports of American cars and trucks to foreign countries have been seriously restricted. Exports to Europe, which one company views as a potential market rivaling the United States, are hampered by

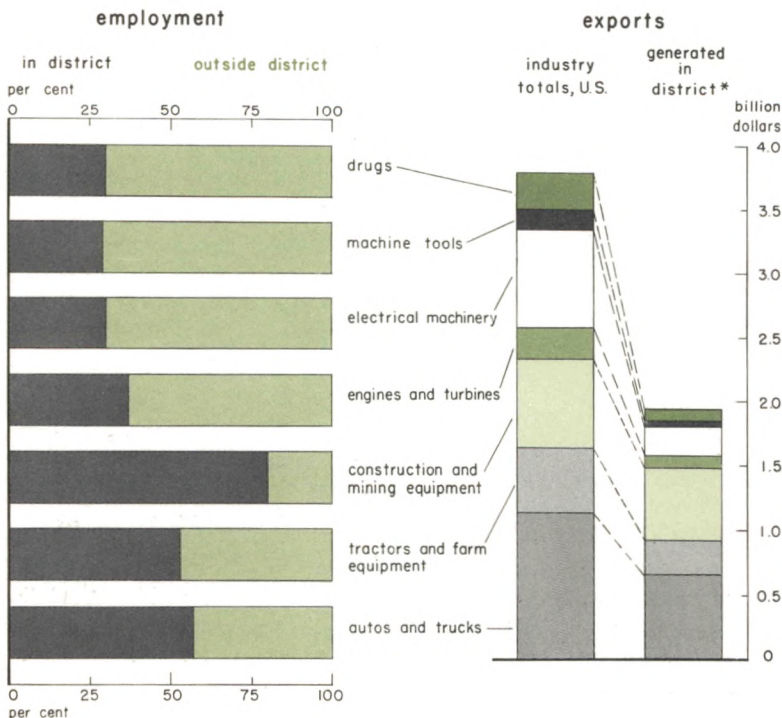
high tariffs. Important Latin American countries, like Argentina and Brazil, require local manufacture of cars and trucks to provide employment and conserve meager foreign exchange reserves.

Because of these restrictions, the Detroit auto firms aggressively expanded overseas production capacity by building new manufacturing and assembly plants, modernizing existing facilities and acquiring part ownership in going concerns. As an illustration, General Motors during 1953-59 more

than quadrupled its net investments outside the United States and Canada. In 1959, sales of cars and trucks manufactured in GM overseas plants totaled 711,000 units, accounting for 19 per cent of the company's total unit sales that year. In 1953, only 7 per cent of GM's unit sales were produced abroad. Ford's performance has been quite similar. On the basis of planned expansion programs described in recent company reports, overseas operations unquestionably will continue to assume increased significance. GM, alone,

intends to spend more than 200 million dollars to expand its overseas manufacturing facilities.

District shares of U. S. employment and exports for important Midwest industries, 1959



*Based on the assumption that the District states contribute to U.S. exports in proportion to their relative importance as employers in the industry. To illustrate, the District states generate approximately 80 per cent of our exports of construction and mining equipment.

The United States is the principal world supplier of *construction and mining equipment*, with exports accounting for about 30 per cent of the industry's annual production. Foreign competition has been negligible. Our exports were hard hit in 1958 and 1959 by a curtailment of new private investment in mining and oil ventures in Canada and Latin America. Overseas shipments were probably further depressed by a stretch-out in basic economic development programs in Latin America and other underdeveloped countries, owing to mounting balance of

payments problems associated in part with the weakening of prices of basic commodities exported from those areas.

Despite these developments, the long-term outlook for United States exports of construction and mining equipment remains favorable. Construction of roads, airports, dams and irrigation projects and clearance of land for farming are important features of the basic economic development programs planned in many areas of the free world. These projects should generate a heavy demand for bulldozers, power shovels, graders, concrete mixers and other related equipment. The demand for mining equipment should be sustained by the efforts of the world's principal industrial nations to develop additional mineral reserves in Canada, Latin America and Africa. With a significant portion of the construction and mining equipment industry located in the Midwest, the District states should benefit materially from these potential markets.

Competition from foreign sources will probably increase, however, partly reflecting overseas expansion of major American firms. Caterpillar Tractor, for example, is expanding facilities in Britain to produce scrapers and bulldozers and will soon begin manufacturing similar equipment in a new plant in Brazil.

Despite a decline in exports during 1958 and 1959, overseas markets have assumed increased significance for *U.S. machine tool builders*. This stems from the fact that foreign demand declined less rapidly than domestic demand; exports of metal-cutting and metal-forming machine tools averaged 27 per cent of industry shipments during the period, compared with 12 per cent in 1953 and 1954. In the first half of 1960, overseas shipments of machine tools and parts rose briskly, helping to offset lagging domestic

demand. These exports reflect, in part, orders from European automobile firms for high-speed, special-purpose machine tools as well as orders for general-purpose tools that European tool builders cannot deliver promptly because of heavy backlogs and shortages of skilled labor. In some instances, deliveries by European firms are lagging as much as two years behind orders. Informed sources have estimated this overflow demand from Europe may continue to bolster American exports for several years.

The long-term outlook for American machine tool exports is clouded, however, by the rapid expansion of machine tool building facilities abroad, in which American firms have played a major part. At first, this participation generally involved licensing arrangements with European producers. In many instances, the tool builders later acquired an equity interest in the European licensee or bought their own manufacturing facilities. According to the National Machine Tool Builders' Association, some 75 to 80 American machine tool builders now have plants or production arrangements abroad, about twice the number six years ago. In their published annual reports, many of the major firms in the industry clearly express the view that these steps were necessary to retain export markets formerly supplied by domestic plants.

Labor and material costs have been cited as compelling reasons for expanding abroad. The industry trade association has estimated a machine tool costing \$10,000 in America could be built for nearly 40 per cent less in Germany because of the wage differential between the two countries.

In light of these relative price considerations, American machine tool builders appear to have taken significant steps to supply foreign demand for machine tools from over-

seas plants. They may possibly export tools to this country, too. These developments would cut into overseas business presently supplied from United States plants as well as encroach upon domestic markets.

With the exception of the Canadian market, American export markets for *tractors and farm equipment* have been squeezed by keen competition from European suppliers offering lower-priced equipment and liberal, long-term financing arrangements. Import restrictions, generally reflecting balance of payments problems, handicap our exports to major agricultural countries such as Argentina, Brazil and India.

Imports to the United States, on the other hand, have more than doubled since 1957,

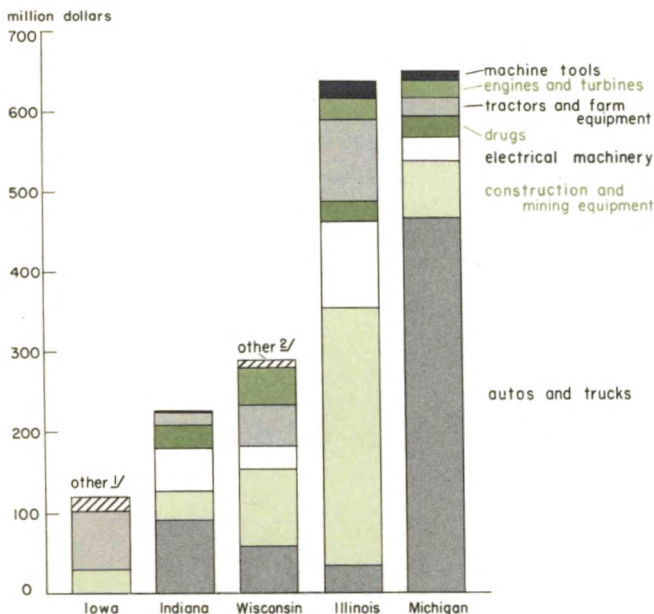
reflecting large shipments of harvesting equipment from Canada and tractors and tractor parts produced in Great Britain.

Like the auto industry, the scissors effect of rising imports and static exports, in large measure, probably arises from the overseas expansion of major United States producers of tractors and farm equipment. Led by International Harvester, these companies now have manufacturing and assembly plants in principal European countries which not only supply local demand but also export to other markets including the United States. International Harvester's British subsidiary, for example, in 1959 began exporting light-weight, diesel-powered wheel tractors to this country to compete with a Ford model also made in Britain. John Deere and J. I. Case have substantially expanded capacity in major Latin American countries to avoid being shut out of these markets by the import restrictions.

These trends may affect our position as the world's major supplier of heavy crawler tractors vital to land clearing, road building, dam construction and other basic development projects. During 1957-59, United States exports of heavy crawler tractors in excess of 100 h.p. totaled nearly 240 million dollars or 23 per cent of total tractor exports for the period. By the end of 1959, however, the three major American producers of crawlers, International Harvester, Caterpillar Tractor and Allis-Chalmers, were building these tractors in European plants to supply foreign markets.

In recent years, the United States *drug* industry has moved

Michigan leads District states in exports, 1959



¹Other for Iowa includes \$2 million, autos and trucks; \$11 million, electrical machinery; \$3 million, drugs; and \$1 million, machine tools.

²Other for Wisconsin includes \$2 million, drugs, and \$8 million, machine tools.

steadily in the the direction of supplying foreign markets from overseas facilities. In 1959, foreign operations accounted for more than 25 per cent of the industry's total sales. The rising importance of foreign business coupled with a fall in overseas shipments of penicillin and polio vaccine probably explain why industry exports have leveled off during the last two years after rising rapidly between 1953 and 1957.

The advantages gained by expanding operations abroad are said to be lower costs of labor and raw materials, reduced transportation costs and circumvention of import and exchange restrictions. Moreover, the capital investment required to manufacture drugs abroad is modest compared with other ventures such as the production and refining of petroleum and mining operations.

Major Midwest drug companies have participated fully in the industry's expansion of overseas operations. Eli Lilly, for example, has organized 11 overseas subsidiaries to manufacture and market pharmaceuticals, while Parke-Davis has built 18 overseas manufacturing plants in the last decade. G. D. Searle has expanded the manufacturing capacity of its British subsidiary so that it now supplies nearly all the Searle drugs sold in the sterling area.

Implications for Midwest

On the basis of the foregoing, there appears to be an unmistakable tendency among major Midwest industries to supply foreign markets by expanding production and distribution facilities abroad. The following are cited as key factors in this movement: cheaper labor and overhead costs available overseas and trade restrictions, including high tariffs, quotas and exchange controls. To avoid being shut out of rapidly growing foreign markets by such barriers, Midwest

firms, in many instances, have resorted to overseas production.

On balance, the sustained overseas investment expansion by Midwest firms will probably result in some diminution of a heretofore important stimulus to the area's economic growth—foreign demand for such items as machine tools, tractors, farm equipment, automobiles and drugs. In the future, expansion of output and employment in the Midwest durable goods industries may be geared more closely to the over-all growth of the United States economy and less to growth in export demand.

It should be noted, however, that changes in relative prices among leading industrial nations, reflecting economic policies pursued by businesses, labor and government, could modify this situation. If prices and wages in Western European countries continue to show larger percentage increases than in the United States, the margin of attractiveness of doing business abroad will diminish, and goods produced in Midwest plants will become more competitive in foreign trade. A faster pace of technological advance in this country would have a similar effect, as would any further relaxation of restrictions against the import of United States merchandise.

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