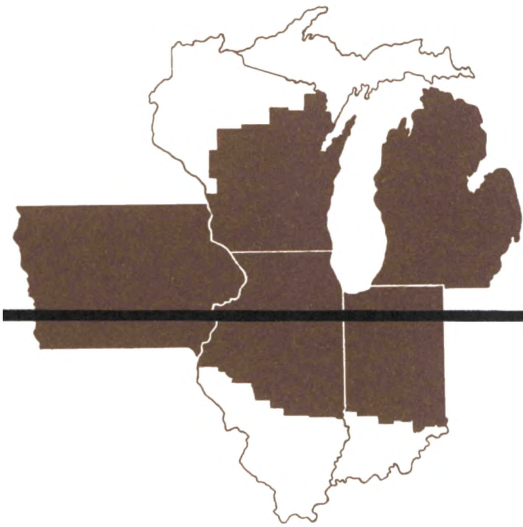
Business Conditions



1962 March

Contents

THE Trend OF BUSINESS

The rise in business activity which started a little over a year ago paused again in mid-winter. In the late summer of 1961 there had been a slackening of the rapid advance in some measures of economic activity but this was followed by a vigorous fourth quarter spurt in retail sales which dispelled most doubts as to the prospects for continued improvement in 1962. As information for January became available, it appeared that the complexion of the business scene had changed again, at least temporarily.

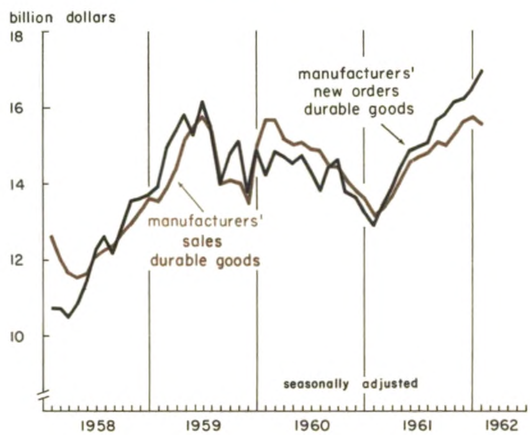
Retail sales, seasonally adjusted, declined somewhat in both December and January from the November peak. The Federal Reserve index of industrial production also dipped in January, employment showed no further rise and personal income declined slightly as the average weekly hours in automobile manufacturing, construction and some other activities declined. Auto assembly schedules were reduced somewhat as dealer inventories of new cars moved above the 900,000 level. Despite these developments personal income and retail sales remained 6 and 5 per cent, respectively, above the year-ago levels.

Midwest business executives continued to indicate confidence in the prospects for their firms during 1962 and reported further increases in new orders. Automobile manufacturers found encouragement in a Federal Reserve survey which indicated that in January consumers intending to buy new cars were appreciably more numerous than had been the case in previous years. The steel and petroleum industries reported plans to increase spending for new plant and equipment. New orders for some types of farm, construction and industrial machinery and transportation equipment were rising in late 1961 and in the new year. A Commerce Department survey of prospective plant and equipment spending, to be available about mid-March, will provide evidence on changes in business plans since last fall. At that time a private survey indicated that private capital outlays in 1962 would be about 4 per cent above the preceding year.

Steel and autos no longer lead

Between February and December of 1961 total manufacturing output rose by 14 per

Durable goods orders rise



cent. Production of the durable goods industries increased 17 per cent, with the motor vehicles and steel component rising 40 per cent. In January steel rose further, but auto output declined. These "prime movers" of the initial phase of the business expansion may now have made their major contributions toward lifting the economy to higher levels of activity.

In mid-February steel output reached an annual rate of 127 million tons—60 per cent above the year-ago rate but still 10 per cent below the record high set in early 1960 after a long strike. In the past two years the capacity of the industry has expanded further as new facilities have been added and new processes have been utilized.

Room for a further substantial increase in total steel output was still present in February, although finishing capacity for products such as hot-rolled, cold-rolled and galvanized sheet was being utilized fully. However, at an annual rate of 127 million tons, steel production was considerably above the current rate of consumption.

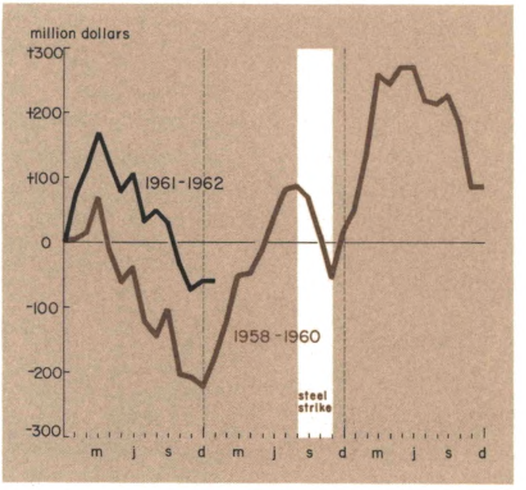
During December auto assemblies averaged 31,400 per working day, or about 8 million on a yearly rate basis. The rate dropped to about 7.3 million in January but this was equal to the most optimistic forecasts of output for the year as a whole.

Other durables rising

From February 1961 through January 1962 new orders of durable goods manufacturers exceeded shipments each month. As a result, order backlogs rose moderately but steadily by 4 billion dollars, or 10 per cent.

Despite this rise, order backlogs of durable goods manufacturers represented 3 months' sales on February 1, somewhat less than a year earlier. Compared with current shipments, order backlogs in recent months have been at

Bank loans to manufacturing firms



Note: Figures plotted are cumulative changes from the end of 1957 at large Midwest banks. Excludes food and tobacco processors.

or near the postwar low. At the peak of the 1954-57 upswing, backlogs equaled 4.5 months' sales and even higher ratios had prevailed in prior years.

The relatively low level of orders on hand compared to the recent level of shipments reflects the margins of capacity and rapid delivery schedules found in most industries. This situation has aided the maintenance of price stability for these products. However, it should be noted that sharp increases in backlogs generally occur in the later stages of business expansions. This has been the case in all postwar upswings except that of 1958-60.

Unfilled orders of durable goods manufacturers totaled 46.7 billion dollars at the end of January. In 1957, these backlogs had reached 61 billion dollars and in 1952, during the Korean war, a record high of 75 billion.

The much higher levels of unfilled orders of several years ago were based primarily upon heavy demands for long lead time capital goods and military "hardware." Both of these groups of products have been playing a lesser role in the current uptrend than in the Korean war or the 1954-57 boom in private capital investment. A further moderate rise in military procurement contracts is anticipated. The extent of the current upswing in private investment in capital goods is still highly uncertain.

Demand for bank loans

Although the current expansion in business has been under way for over a year, bank loans to manufacturing firms declined through most of this period. Between mid-1960 and late 1961 loans to manufacturing establishments, as reported by banks that make a large part of the loans to commercial and industrial firms in the Seventh Federal Reserve District, declined approximately 300 million dollars. (This figure excludes loans to food processors which rise sharply every fall as farm commodities are marketed.) Although bank loans to manufacturing firms in 1961 were at a higher level than in 1958, month-to-month changes were quite similar to the experience of 1958 when the economy was also expanding after a moderate recession.

In January 1962, these loans showed little change compared to the sharp upward trend that began early in 1959. In February and March, loans to industry normally rise.

Part of the rapid bank loan expansion in the early months of 1959 reflected the build-up of steel inventories in anticipation of the strike that began in the third quarter. So far this year there is no evidence of strong demand for bank credit for a similar purpose.

Exports important to Midwest

Last year United States exports were just over 20 billion dollars, up 6.7 billion from the average in 1951-55. Imports too have risen, but much less than exports. Therefore, in 1961 receipts from exports were about 5.5 billion more than payments for imports—a sizable balance in any set of accounts. In addition, the United States had net earnings from loans and investments abroad and other nonmilitary services. But these receipts were insufficient to cover our overseas military and economic aid commitments, long-term private investments abroad and outflows of short-term capital.

All told, in 1961 Americans spent and invested abroad about 2.4 billion dollars more than foreigners spent and invested here. As a result, our international balance of payments showed a deficit for the fourth consecutive year. While some observers found encouragement in the fact that the deficit was smaller than the 3.7 billion dollar annual average in the three preceding years, others emphasized that in the fourth quarter the deficit was at a much higher rate than the average for the year.

A number of steps of varying degrees of significance have been taken to reduce and eventually eliminate the deficit in the United States balance of international payments, with major attention being focused on moves to increase exports. As a major exporter of manufactured goods and farm products, the Midwest has an important stake in the outcome of this effort.

The trade expansion program

The Administration has proposed that the Trade Agreements Act—which has been the cornerstone of our foreign trade policy for 28 years—be replaced by new and enlarged authority.

Specifically, the President has requested authority to negotiate reductions in existing United States tariffs by 50 per cent and to reduce or eliminate all tariffs on those groups of goods where this country and the Common Market together account for over 80 per cent of world trade. The proposed reductions would take place gradually over the next five years or more and would apply to broad categories of goods, not individual commodities. Recent international tariff negotiations have shown that bargaining on an item-by-item basis is exceedingly cumbersome and time consuming and is looked upon as undesirable by leaders of the Common Market. All reductions in tariffs and other trade restraints would be extended to other countries under the "most favored nation" principle to which this country has long adhered.

It is proposed also that we reduce or eliminate all restrictions on imports of tropical agricultural products supplied by underdeveloped countries and not produced in the United States "in any significant quantity." The Common Market would be expected to take similar action. This would assure underdeveloped countries "as large a market as possible" for their exports and enable them to finance more of their development needs themselves.

In addition to utilizing the traditional safeguards such as "escape clause" relief and "peril point" procedures, it is proposed that assistance be provided to companies, workers and farmers who suffer injury as a result of any increased imports resulting from the tariff reductions. Workers would receive readjustment allowances, vocational training to learn new skills and financial assistance to help them relocate in areas where jobs are available. Business firms and farmers would receive technical assistance, loans and various tax benefits.

The principal objective of the proposed trade expansion program, therefore, is the establishment of a "nondiscriminatory trade partnership" among all nations of the Western community. This would help to make possible greater economic specialization among nations, broader markets, a lowering of production costs and, it is hoped, faster economic growth both here and abroad.

Significance for Midwest

Although far removed from both oceans, export markets always have been important to the industries and farms of the Midwest. Now world markets have been brought closer to the Midwest, as a result of the opening of the Great Lakes-St. Lawrence Seaway in 1959 and its accompanying effects upon rates and service of all rail, truck and ship carriers serving the different export gateways. In recent years United States merchandise exports have averaged just under 20 billion dollars annually—about three-fourths manufactured goods and the remainder industrial raw materials and agricultural products. The five states of the Seventh Federal Reserve District contribute to exports about in proportion to their share of total United States production.

The District produces little or none of the cotton and tobacco and only 10 per cent of the wheat which are the nation's three most important agricultural exports. However, the three Corn Belt states—Illinois, Iowa and Indiana—account for about half of the nation's entire production of corn and soybeans. About 25 per cent of the soybeans and 15 per cent of the corn sold by American farmers are exported annually. In 1960 such shipments amounted to more than 600 million dollars.

Animal products that are large export earners include tallow, lard and hides of which 40, 20 and 30 per cent, respectively, are sent abroad. Among foods processed in large quantities in the Midwest, 16 per cent of the pork, 13 per cent of the condensed milk and 10 per cent of the margarine are exported.

Until recently there had been no accurate information on the contribution of the various states to total exports of manufactured goods. This gap has been filled by a Government survey released in late January.

United States exports of manufactured goods, including processed foods, totaled 15.5 billion dollars in 1960. It is estimated that almost 1.3 million workers, 8 per cent of the nation's total manufacturing work force, were directly or indirectly engaged in producing these goods. In addition, many other workers

District states provide nearly one-fourth of U. S. exports of manufactured goods in 1960*

	Illinois	Indiana	Iowa	Michigan	Wisconsin	Total	Per cent of U. S.
			(million dollars)				
Food and kindred products	184	45	74	43	39	385	24.2
Machinery, except electrical	653	89	96	180	201	1,219	41.5
Electrical machinery	124	73	44	32	40	313	30.9
Transportation equipment	131	120	1	399	46	697	26.3
Chemicals and allied products	55	50	4	93	8	210	11.7
Petroleum, coal, rubber and plastic products	34	10	3	12	4	63	7.4
Primary metal industries	42	39	3	46	6	136	12.5
Fabricated metal products	51	30	7	23	16	127	25.2
Instruments and related products	38	4	3	9	12	66	15.4
Other manufactured products	96	23	8	62	39	228	8.8
Total	1,408	483	243	899	411	3,445	22.3
Per cent of U. S.	9.1	3.1	1.6	5.8	2.7	22.3	

* Exports are f.o.b. producing plant.

SOURCE: U. S. Department of Commerce

were employed in the transportation, warehousing, finance and other phases of the export trade.

In general, the contribution of individual states to the export of manufactured goods is closely related to the total amount of manufacturing within their borders. The seven largest manufacturing states—New York, Pennsylvania, California, Ohio, Illinois, Michigan and New Jersey—are also the seven largest exporters. Moreover, except for Illinois, the rank of these states in total manufacturing activity and exports of manufactured goods is identical. Illinois, the fifth most important manufacturing state over-all, closely challenges New York as the leading exporter.

Michigan, Indiana and Wisconsin account for a somewhat smaller proportion of exports than of total manufacturing. On the other hand, Iowa, like Illinois, has a relatively higher share of the nation's exports. In total, the five District states accounted for 22 per cent of all exports of manufactured goods in 1960, slightly more than their proportion of total manufacturing. It is probable that close to 300,000 production jobs in the five-state area are dependent upon the export market.

A wide variety of goods manufactured by Midwest plants are exported. However, more than three-fourths of exports from the District states fall into four broad categories—processed foods, electrical machinery, nonelectrical machinery and transportation equipment. These are industries which have long played a vital role in Midwest manufacturing.

In three of these industries the proportion of total exports accounted for by the District states is close to their proportion of total United States production. In the case of nonelectrical machinery, however, the five states account for about 42 per cent of the exports but only 30 per cent of total production. This type of equipment is the largest export earner for Illinois, Wisconsin and Iowa, largely because of the pre-eminence of these states in the production of construction machinery for which foreign demand remains relatively strong. When domestic shipments have lagged in recent years, export demand has continued to grow. About 28 per cent of the annual output of the construction machinery industry is exported.

Among other important Midwest industries, the agricultural machinery manufacturers ship about 9 per cent of their annual production abroad. The corresponding percentages for various other machinery industries are: metal-cutting machine tools, 22 per cent; metal-working machinery, 26 per cent; diesel engines, 16 per cent; pumps and compressors, 15 per cent; and office machines, 10 per cent.

Exports of transportation equipment exceed those of machinery in Michigan and Indiana. For the most part these consist of passenger cars, trucks, buses, trailers and replacement parts for these vehicles. About 15 per cent of all trucks and 3 per cent of all passenger cars, domestically produced, are exported. Although the proportion of passenger cars exported is much smaller than for trucks, the value is almost as great. In addition, a large volume of parts and accessories are sent abroad each year.

Illinois is also an important exporter of transportation equipment, mainly diesel-powered railroad locomotives. A large share of American railroad locomotive production is located in the Chicago area. In recent years over 60 per cent of the industry's production has been for export.

In one important industrial category, primary metals, the export share of Midwest firms is much smaller than their proportion of total domestic production. The District states account for 26 per cent of the nation's output of primary ferrous and nonferrous metals, but only 13 per cent of the nation's exports of these semifinished manufactures. This is largely because this area until recently produced less steel than was consumed in the Midwest, and, of course, Midwest mills are less favorably located than seaboard mills for supplying export markets.

Illinois leads District states in agricultural exports

	Fiscal year ended June 30, 1961 (million dollars)
United States	4,940
Illinois	286
Indiana	159
Iowa	207
Michigan	92
Wisconsin	56
District total	800
Per cent of U. S.	16

U. S. dependence on foreign trade

Since the United States is a large and diversified country it produces a great variety of goods at low cost. Trade with other countries, therefore, is relatively less important than in many smaller and more specialized countries. Merchandise exports, over-all, account for only about 4 per cent of total United States production of goods and services while imports account for about 3 per cent. In comparison, 1960 exports equaled approximately 17 per cent of total production in West Germany, 14 per cent in the United Kingdom, 12 per cent in France and 15 per cent in Italy.

An estimated 60 per cent of United States imports are products which do not compete directly with domestic production. Most of these are minerals or agricultural raw materials such as natural rubber, coffee and bananas. We are dependent upon imports for a number of essential materials and requirements of many of these items probably will increase as population and income rise. Of 40 minerals "vital to United States industry" all or part of 31 are supplied from abroad. About 40 per cent of imports consist of items which could be supplied by domestic producers but only at substantially higher prices.

The growing dependence of American industry on essential foreign supplies, together with other factors such as the development of the Common Market and the need to maintain our military and foreign aid commitments, focuses attention on the need to expand exports further from present high levels. Alternative policies which would involve substantial curtailment of military expenditures and economic aid, restrictions on the freedom of Americans to import goods or travel and invest abroad or prohibitions against foreigners to utilize dollars to make payments abroad would be inconsistent with our long-term objectives. The United States has a long-standing policy of permitting international transactions on a voluntary basis, and other nations have been encouraged to follow this practice.

It is expected that the proposed new authority to negotiate further reductions in trade barriers would enable the United States to gain greater access to foreign markets for the products of our farms and factories. If achieved, this would permit us to expand production of those things in which we are most efficient, with the benefits accruing proportionately to Midwest producers and consumers.