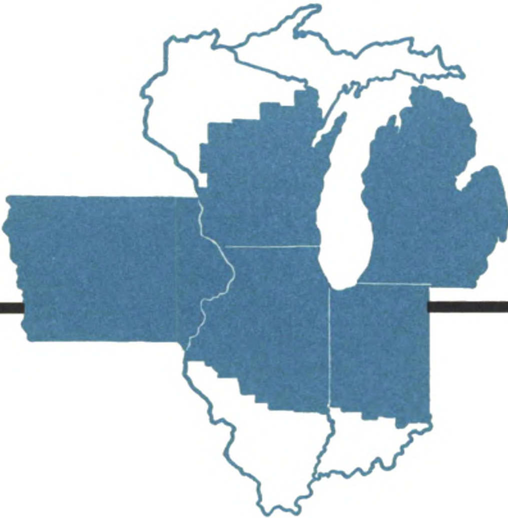
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1969 April

Contents

The trend of business
New surge in capital expenditures 2

Regulation Z—truth-in-lending 11

U. S. foreign trade surplus declines 16

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THE Trend OF BUSINESS

New surge in capital expenditures

Business expenditures on new plant and equipment are expected to total $73 billion in 1969—14 percent more than in 1968—according to a government survey released in March. With a prospective rate of increase about twice that seen in most forecasts for total spending on all goods and services, business investment is clearly stated as the most vigorous spending sector.

Since the Korean War, year-to-year increases in plant-and-equipment expenditures were as high as 14 percent only in 1956 and 1964-66. And the long-extended investment boom of the mid-1960s was unprecedented. There had been nothing like it before—even in the 1920s.

There was widespread belief last fall that these outlays would rise no more than 5 percent in 1969—possibly not at all if adjustments were made for price increases. Partly because of the rise in the stock of capital goods in recent years, it was thought that capital expenditures would increase slower than total spending on goods and services, probably for several years.

Estimates of manufacturers' operating rates relative to their plant capacities have indicated a widening margin of unused capacity since 1966. This, together with an expected slowing of demand for goods and services and reduced availability of credit, was expected to keep a damper on new investments. Much of the idle capacity, however, cannot produce goods and services of adequate quality at competitive prices. Significantly, manufacturers are expected to increase capital spending even more than other industry groups.

Plans for buying new plant and equipment are also being influenced by the rise in labor costs, the inadequate supply of trainable workers, confidence in long-term economic growth, and by expectations of still higher prices for construction and equipment.

Once started, an upsurge in spending on plant and equipment is not readily slowed. Many projects now underway have been in planning two years or more, and most are integral to overall corporate plans. Curtailed availability of funds and high interest rates may postpone some expenditures, but the large, well financed businesses that account for most of the capital outlays can tap a variety of sources for debt and equity.

In March 1966, the government survey indicated a rise of 16 percent in capital expenditures over 1965. Despite a period of reduced credit availability culminating in the famous "credit crunch," business investment actually increased 17 percent. Only once in more than 20 years, in 1960, has a March projection of a large increase in plant-and-equipment expenditures been too high.

Manufacturing leads

Manufacturers expect to increase their expenditures for plant and equipment 16 per-

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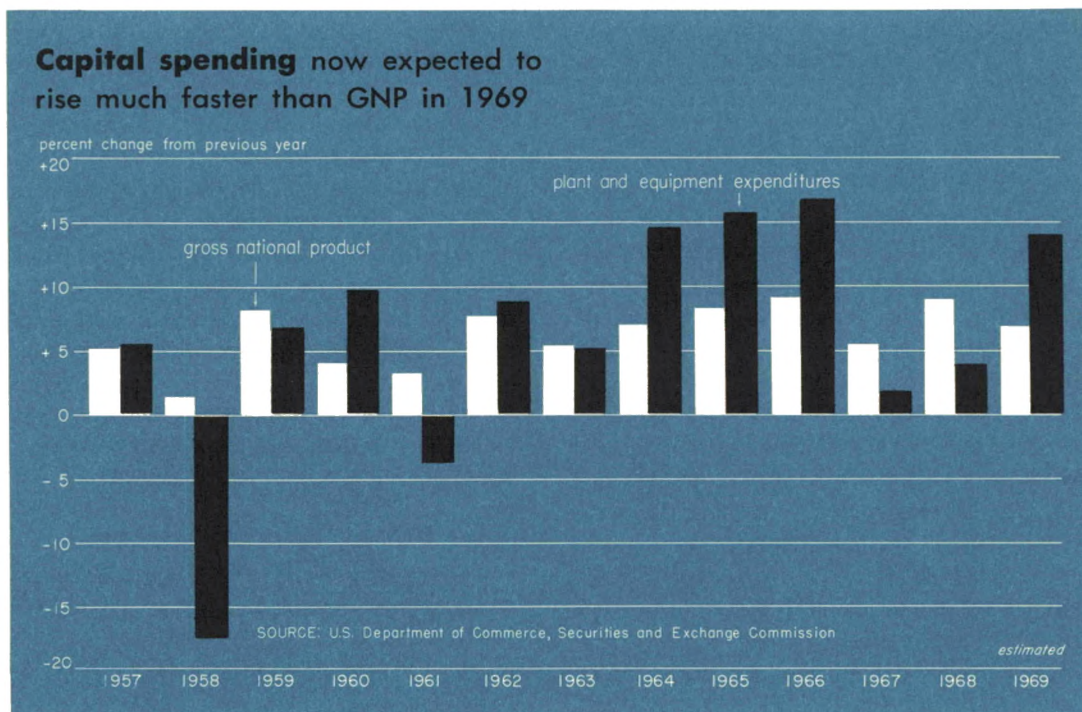

cent this year, pushing such outlays to a new high of almost $31 billion. The prospective increase is about equally divided between manufacturers of durable and nondurable goods. Except for steel, all major industries expect to share in the increase, but producers of motor vehicles, building materials, paper products, and textiles plan the largest increases.

The increase, if realized, will be in sharp contrast with manufacturers' capital outlays in 1967 and 1968. In both years, manufacturers' spending on plant and equipment declined 1 percent—and more if allowances are made for the rise in prices. The broadly based uptrend in expenditures reflects mostly programs of modernization and replacement rather than expansion of capacity.

Among all nonmanufacturing industries, the largest proportional rise in capital spending is projected for railroads—an increase of 29 percent. Expenditures by railroads tend to be much more volatile than those of most industries. They declined substantially in 1967 and 1968. Even if the large increase expected in 1969 is realized, the total will fall short of the 1966 peak. Although most railroads are not pressed for capacity, improvements are needed to provide better, faster service. Most of the spending will be for larger, more modern locomotives and freight cars, with the rest going for improvements in trackage and other facilities.

All other types of transportation are expected to increase their spending about 12 percent. Airlines expect to reduce their ac-

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quisitions of new aircraft, which were very large in 1968. But with aircraft deliveries due to rise again when jumbo jets are delivered in volume in 1970, airlines are already making large expenditures for progress payments and construction of facilities to handle these outsized aircraft.

Trucking companies are increasing their expenditures on trucks and trailers, hoping to continue improving their competitive position relative to railroads and other modes of transportation. Installation of new pipelines will also increase sharply this year.

An increase of 14 percent is expected in the plant-and-equipment expenditures of gas and electric companies. The utilities have had the most consistent performance of any industry group. Hard put to keep up with demand for their services, they have increased their investment spending substantially every year since 1963.

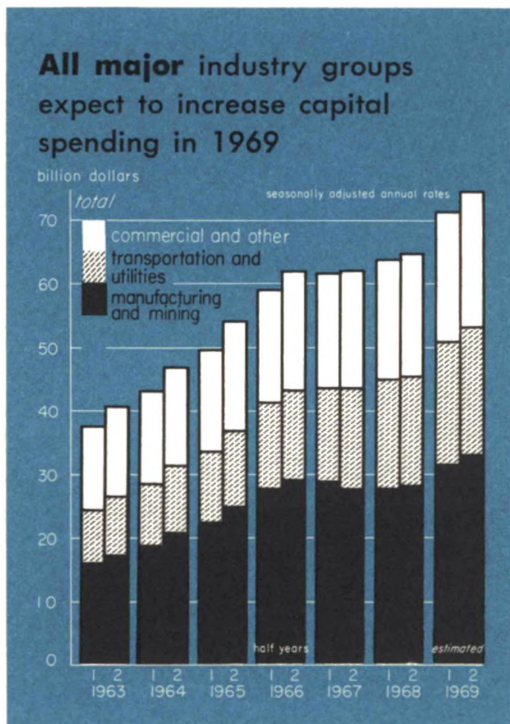
Mining companies plan to spend 13 percent more this year than last. Included in this total is part of the oil industry's outlay for production and exploration of crude oil. A large part of the expenditures for oil production and exploration is written off as current expenses, however, and therefore is not included in this total, which is limited to investments that are capitalized and depreciated.

The government report lumps commercial buildings and communications utilities together. Analysis of construction contracts, announcements of new projects, and statements of executives indicate that about 10 percent more in capital outlays will be spent in these two categories than in 1968.

Reports of this substantial increase in plans for business investment are important for several reasons. On the one hand, by making use of the latest practical scientific and technological innovations, these outlays will provide not only more and better goods and services but also additional leisure for workers. But on the other, spending for plant and equipment fluctuates more than total spending and, through the multiplier effect, plays a large part in shifting the economy from recession to prosperity and from prosperity to boom. With the economy already in a strong uptrend, a rapid rise in expenditures for plant and equipment will add still further inflationary pressures by diverting scarce labor and materials from channels supplying final demand. This will be true, even though the new facilities eventually dampen price increases by augmenting supplies of goods.

The plant and equipment survey

The Department of Commerce, in cooperation with the Securities and Exchange Com-



mission, has been surveying business plans for plant-and-equipment spending since World War II. Together, these agencies obtain reports from almost all corporations registered on the security exchanges and from a large sample of smaller companies. The companies are asked to report each quarter on their expenditures for new plant and equipment in the United States (exclusive of land) charged to fixed asset accounts. The reports include actual expenditures for the previous quarter, plus planned expenditures for the current and future quarters.

In compiling totals, the government makes adjustments to reported plans on the basis of consistent differences between planned and actual expenditures in the past. Survey results are first published in March. Subsequent quarterly surveys report changes in plans, and the final results are published in March of the following year.

Because of the intense interest in plant and equipment spending, several private organizations try to anticipate the government survey by releasing studies based primarily on reports of very large companies. These private surveys often provide useful advance information, especially for analysts needing only totals, rather than breakdowns by industry.

Last September, two private surveys reported total spending on plant and equipment would probably be 5 or 6 percent higher in 1969 than in 1968. This surprised many who had expected a leveling or declining trend. Later private surveys indicated successively larger increases in prospective capital expenditures. And, at least in some quarters, each survey was received with skepticism.

The government's March survey has not been off more than 4 percentage points since 1955. Several years, its projection has been "on the nose." The direction of change has been invariably correct, and errors have usually understated the extent of the change. That does not mean the survey will necessarily prove accurate in 1969. But the record suggests that only powerful forces can alter the current prospect.

Prices of capital goods

Changes in the prices of capital goods, like those of many consumer goods, are hard to measure—because of changes in the goods themselves. New buildings and equipment can be more efficient than existing models or designed to produce new types of goods or services. In constructing price indexes for equipment, the government tries to allow for such changes, but its efforts are seldom wholly satisfactory.

After several years of little change, plant-and-equipment prices have been increasing at an accelerating pace since 1963, following a pattern similar to that of the general price level. Official estimates show that plant-and-equipment prices rose 3.3 percent last year, compared with a 3.8-percent increase in the general price level. Average prices of new business structures increased about 5 percent. Equipment prices averaged about 3 percent higher, with all major categories of equipment showing some rise.

Taken alone, higher prices of capital goods would tend to discourage purchases. But the current widespread expectation that prices of plant and equipment, especially construction costs, will continue to increase rapidly in the future has caused executives to push ahead with new programs, even when the need for additional facilities has not been urgent.

With the higher labor costs contained in three-year contracts negotiated by building trades last year and the rising prices of building materials, construction costs are almost certain to increase further in the next two years.

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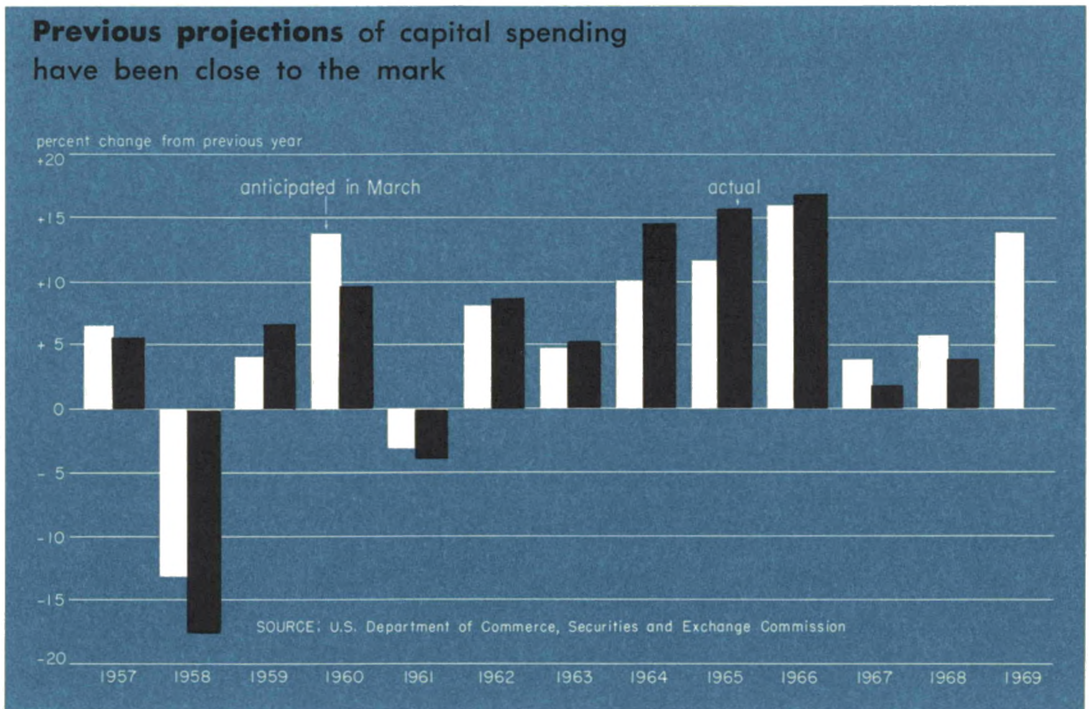
The uptrend in prices of machinery and equipment seems to have gathered strength in late 1968 and early 1969. Increases in the last year have been especially large for farm, construction, and metalworking machinery. Prices of electrical apparatus, which had declined in the early 1960s, have also increased in recent years, though not as fast as most other producer goods.

Pressure has been exerted on prices of machinery and equipment both by rising costs and stronger demand. Unfilled orders for machinery and equipment reached a new high in January after a steady uptrend beginning last May. So far, shipments of all types of machinery and equipment have increased about in step with unfilled orders. The result has been no clear tendency for the ratio of unfilled orders to shipments to increase. This ratio is actually lower than a year ago and much lower than in 1966 or 1967. But some producers of machinery and equipment parts and components have reported an accumulation of orders resulting in longer order lead times. If this trend becomes general, the increase in equipment prices could accelerate.

Productivity and labor costs

Almost all purchases of new plant and equipment help improve output per manhour. This has become increasingly important in the last three years with the rapid rise in wage rates and labor costs per unit of output.

Unit labor costs were relatively stable from 1958 through 1965, rising only slightly and actually declining most years in manufactur-



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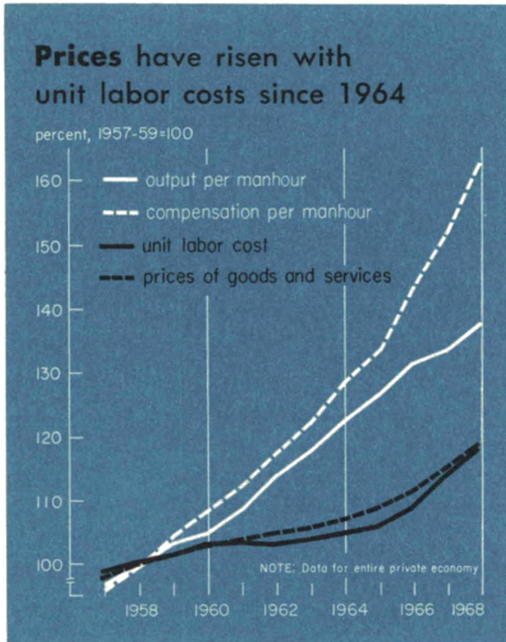

ing as output per manhour increased faster than hourly compensation. But worker compensation has been rising rapidly since 1966, exceeding gains in productivity. From 1966 through 1968, annual increases in output per manhour in the entire economy averaged less than 3 percent, while increases in hourly compensation averaged almost 7 percent. As a result, the average annual increase in unit labor costs was almost 4 percent. For manufacturing, the rise was slightly larger.

Executives see no prospects for near-term abatement in the rise in unit labor costs. Moreover, many companies, especially in large centers of the Midwest, have difficulty recruiting and maintaining adequate staffs. Recruitment of skilled workers and workers capable of undertaking intensive training programs has been particularly hard. Absenteeism and high quit rates reminiscent of World War II severely hamper efforts to increase productive efficiency.

Under these conditions, purchases of new labor saving plants or equipment are especially attractive. When the usable labor force is fully used, estimates of unused plant capacity—which assume an ample labor supply—have little significance.

Profits and capital outlays

More than 85 percent of the expenditures for plant and equipment are made by corporations. Increases in these expenditures are usually associated with increases in profits—actual and potential. On the one hand, prospects of higher profits increase corporate interest in new investment projects, while, on the other, undistributed profits provide a principal source of funds for corporate expansion and modification.

Corporate profits have increased continuously since early 1967. The increase in the fourth quarter of 1968 was by far the largest quarter-to-quarter gain in the two-year period. Before-tax profits reached a record annual rate of almost $96 billion—$10 billion more than in the fourth quarter of 1967. Mainly because of the 10-percent surtax on corporate earnings for the whole of 1968, after-tax earnings were only $3 billion dollars higher than the year before. But at an annual rate of $53 billion, they still set a record.

Undistributed profits increased at an annual rate of $28 billion in the fourth quarter. Because of an increase in dividends, this was not a record. Nevertheless, undistributed profits rose in each of the last three quarters of 1968.

Total internally generated funds—including undistributed profits and capital-consumption allowances—reached a rate of $76 billion in the fourth quarter. Capital-consumption allowances have increased substan-

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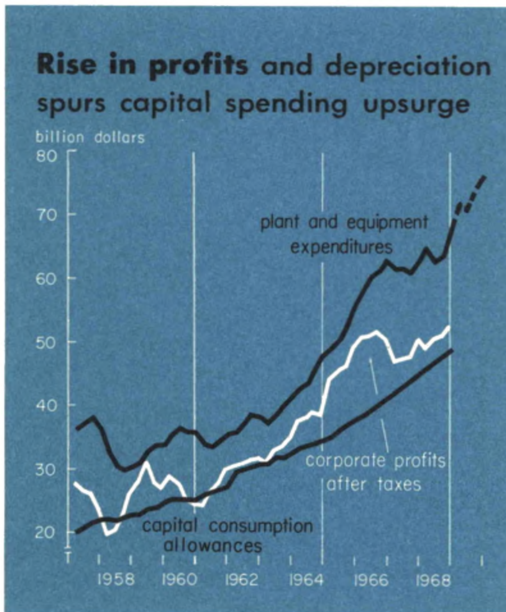
tially every year since World War II and are now almost twice as large as undistributed profits. Until 1966, internally generated funds accounted for about two-thirds of all funds available to nonfinancial corporations.

Expenditures for plant and equipment are the most important use of funds for nonfinancial corporations, accounting typically for three-fifths or more of their total investments in fixed assets and working capital. On the supply side, funds generated internally through undistributed profits and depreciation are still by far the most important source of funds. For the past three years, they have accounted for about three-fifths of the funds used by corporations.

Debts rise faster

The rise in expenditures for plant and equipment is accompanied by increased needs for funds to finance receivables and inventories. Despite higher profits and depreciation, many companies are relying even more on borrowings to finance these needs. So far this year, corporate security issues for new capital have been running ahead of the high 1968 level, and demands on banks and the commercial-paper market have been extremely heavy.



The net increase in outstanding securities of nonfinancial companies reached almost $13 billion last year—less than the $17 billion increase in 1967 but more than any other year. Loans, including term loans at commercial banks, increased more than $13 billion, which was substantially more than in 1967. Together, net loans and security issues provided these corporations with $26 billion last year—only $2 billion less than the year before and much more than in any previous year.

Pressures on the supply of loanable funds have pushed interest rates to unprecedented heights in 1969. This has been partly because of some institutional investors, especially pension funds, emphasizing investments in stocks and real estate and virtually ceasing purchases of bonds.

Issuers of high-grade corporate bonds have had to offer yields of 7.5 percent and more, together with call protection for purchasers. As recently as 1965, such issues would have sold easily with yields of 4.5 percent. In mid-March, major banks raised their prime rate on loans to top borrowers to 7.5 percent. Because of the compensating balances most borrowers are expected to carry, this increase implies an effective rate of as much as 9 percent. Four years ago the prime rate was 4.5 percent.

For the first time since 1966, some banks have begun rationing business loans. Some major bond issues have been postponed or reduced because markets were not receptive, even at record yields.

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Business borrowers have become accustomed in recent years to heavier debt structures and successively higher interest costs. Interest costs, of course, are tax deductible. Because the current effective corporate tax rate is more than 50 percent, corporate treasurers usually think of borrowed funds as having an after-tax cost of only half the stated rate.

Most corporations, unwilling to dilute equity interests—especially in view of the tax advantages of debt issues—have not sold issues of common stock for the past decade. Realization of present investment plans, however, may require that equity financing be reconsidered, perhaps through bond issues with attractive conversion rights.

The investment tax credit

A current debate concerns the desirability of abolishing or suspending the 7-percent investment-tax credit enacted in 1962 to encourage equipment expenditures. At that time, capital outlays were low, unemployment fairly high, and the general economy sluggish.

The tax credit was suspended in October 1966 in an attempt to dampen inflationary pressures in the economy generally, and particularly in the capital-goods sector, where capacity to produce both buildings and equipment was strained. Partly because of the suspension of the credit but also because of a slowing in total sales, capital spending peaked in the fourth quarter of 1966 and new orders for machinery and equipment declined sharply. Some movements, such as the level trend in orders for equipment components, suggest the capital expenditures boom would have tapered off in late 1966 and early 1967 even if the credit had not been suspended.

When pressures on resources subsided in the spring of 1967, the tax credit was restored in a more liberal form than before. The maximum credit a company could take in any one year was set at 50 percent of its tax liability, compared with 25 percent in 1962-66.

The suspension and restoration of the investment-tax credit in 1966-67 was widely criticized because of the "arbitrary" impact on company planning. Other criticism has been directed at the concept of the credit since its inception. The credit subsidizes only a certain type of expenditure (equipment with a useful life of at least four years and intended for use in the United States) and a certain type of purchaser (companies with enough earnings to use the credit for equipment purchases).

The investment tax credit was originally enacted to stimulate the economy at a time when its growth rate appeared inadequate. Stimulation of the economy through a general reduction in corporate and personal income tax rates was recommended by some but was not acceptable to the Administration or Congress in 1962 or to Congress in 1963, when the Administration first proposed such legislation. Lower tax rates would have encouraged capital spending, both by accelerating final sales and by increasing current and potential profits.

The investment-tax credit is one of a complex of factors now contributing to the excessive demands on resources. But experience indicates that temporary suspension of the tax credit has a destabilizing influence on business planning and the economy. Rather than a stop gap, therefore, any proposed change in the tax credit should be evaluated with a view to its long-term impact.

Will plans be realized?

A year ago, manufacturers surveyed by the government expected their sales to increase 10 percent over 1967. This expectation was realized for manufacturers as a group, al-

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though some companies missed their sales projections by wide margins. Expectations of trade companies and public utilities were slightly exceeded. This year, manufacturers and trade firms expect an 8-percent increase in sales over 1968, and utilities expect sales to rise almost as much. Presumably, plans for increased plant-and-equipment expenditures are related to these expectations.

If sales continue to advance, and equal or exceed expected results, the surge in capital spending will probably retain its momentum. The record shows that when expansion and modernization plans near their implementation stage, they are usually carried through if orders and shipments are at expected levels. But if, as restrictive monetary and fiscal policies take hold, sales of goods and services begin to lag behind projected levels, starts on some new capital projects doubtless will be delayed and projects underway may be pushed ahead less vigorously.

Limitations on resources of men and materials will delay some capital spending. The large increase in such spending indicated for the year implies a rise in backlogs of orders and a stretchout in lead times from those of early 1969. There will also be a question of sufficient funds being available to finance the expenditures.

Businesses, especially large corporations, have great flexibility in obtaining funds. They can obtain funds from banks and nonbank financial institutions, from short-term money markets, and from capital markets and in a variety of forms and instruments not available to other private and municipal borrowers. Typically, businesses are not limited by usury ceilings, debt limitations, or government regulations on the quantity of funds raised or the channels employed. But in view of soaring interest costs, limited supplies of loanable funds, and the need to finance larger inventories, receivables, and other requirements, some managements are probably re-evaluating their plans for capital spending.

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Regulation Z — truth-in-lending

"Truth-in-lending" becomes law July 1, 1969, when the Consumer Credit Protection Act adopted by Congress last May goes into effect. Every firm and individual regularly extending credit to consumers will be affected.

Just what the impact will be on credit sales is uncertain, but it could be sizable in some areas and for some kinds of transactions. By and large, it is doubtful whether the new law will have any substantial impact on either the volume of merchandise sold on credit, the amount of consumer credit outstanding, or the terms of such credit. It will, however, let additional light into some heretofore dimly illuminated areas of credit selling and lending to consumers.

To provide this illumination, the act requires extenders of consumer credit to provide detailed information on the dollar amounts and annual percentage rates of finance charges. The law does not set maximum interest rates or other credit charges but relates only to what information must be disclosed to borrowers and in what way.

Nine federal agencies are charged with responsibilities for enforcing the law. The Federal Reserve System, however, was singled out to specify the rules creditors must follow in carrying out the provisions of the act. These rules have been formulated and issued as Federal Reserve Regulation Z.

Eight years in passing

Former Senator Paul Douglas of Illinois is generally considered the "father" of truth-in-lending legislation. He introduced a bill in the Senate in 1960 and every succeeding session until his retirement in 1966. The drive for passage of the bill was then taken over by Wisconsin's Senator William Proxmire and Missouri's Representative Leonor Sullivan.

Consumer credit has grown rapidly since World War II, presenting a continuing source of concern to those who believe consumers use too much credit and spend too much for it. When Senator Douglas first introduced his bill, consumer credit outstanding amounted to around $50 billion. It has since risen to about $113 billion. A widely held view is represented by Senator Douglas' statement, "No one really knows the proper level of consumer debt. But when it has reached the unprecedented size which it has . . . we should do all we can to insure the wise use of credit." Congress reasoned that consumers can make more intelligent use of credit if they have specific information on its cost.

It is likely that many supporters of truth-in-lending are hopeful that the new law will reduce the cost of consumer credit by stimulating competition among financial institutions and other firms extending credit. Yet a chief reason for Congress not enacting truth-in-lending legislation earlier was the concern in some quarters that disclosures of true charges would discourage credit buying and thereby reduce production and employment. There was also strong opposition to the measure on grounds that true annual rates of interest would be hard to compute, particularly on revolving credit accounts at department stores.

The truth-in-lending measure was passed in 1968 after it was demonstrated that such a law could be administered. Massachusetts had passed a state truth-in-lending law the

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previous year, and the Department of Defense had issued a directive in 1966 requiring disclosure of finance charges on credit to military personnel. In addition, there has been increasing agitation for consumer-protection legislation on a fairly broad front. A truth-in-packaging law had been passed two years before, requiring clear, conspicuous labeling of the net contents of packages. Legislative attention had also been turned to other areas of consumer interest, including drugs and auto safety.

Shopping in credit markets

Even the most sophisticated buyers and borrowers have been hard put to understand differences in finance charges. On a revolving credit account, a stated interest rate of 1.5 percent a month, for example, can result in wide variations in actual charges, depending on (1) variations in the interval allowed from date of purchase to the time when credit charges begin and (2) whether the service charge is computed on the basis of the previous month's closing balance, with or without deductions for payments during the month, or credits for merchandise returned, or both.

The new law, therefore, may encourage some comparison shopping for favorable credit terms. More detailed disclosure of credit charges will at least make such comparisons possible. Banks should fare fairly well in such comparisons. They have traditionally drawn their customers from relatively "sound" credit risks by offering shorter maturities with larger downpayments than some other lenders. Consequently, they have been able to offer lower credit charges.

Individuals tend to gravitate to lenders and retailers with the best credit terms they can afford. With disclosure of rates, this tendency to confine poor credit risks to creditors with higher charges will probably sharpen. It could well cause risk classes served by particular firms to become even more homogeneous. On the other hand, it could encourage some lenders to offer a range of rates to accommodate differences in borrowers' creditworthiness and collateral.

Finance charges will probably still be determined largely by local influences with consumers continuing to confine their borrowing and credit buying to conveniently located stores and institutions. Local lenders in many localities compete with national finance companies and chain stores in extending credit. But the rates these national lenders charge vary somewhat with the locality.

Disclosure requirements apply to advertising as well as credit contracts. Advertising mentioning credit terms must disclose all the terms of the credit offered. Statements such as *no money down, take 36 months to pay* or, *only $5 per month* will not serve as adequate descriptions of the credit terms offered. This feature of the law may strengthen any present tendencies toward uniformity of charges in particular localities—insofar at least as finance charges are still advertised.

It is expected that once the disclosure requirements are understood, lenders and merchants will generally comply with them. Enforcement will be aided by consumers who become sensitive to credit costs and by penalties provided in the law. A customer can collect from a creditor adjudged by the courts to have not complied with the disclosure requirements. The law allows customers to collect twice the finance charge, but not less than $100 or more than $1,000, plus reasonable attorney fees and court costs. Congress expected self-policing of the act to be strong enough to lessen the need for administrative machinery to investigate compliance, which, of course, would have involved additional expenditures.

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Agencies responsible for truth-in-lending

Type of creditor	Enforcement agency
National banks	**Comptroller of the Currency** Washington, D. C. 20220
State member banks	**Federal Reserve Bank of Chicago** Chicago, Illinois 60690
Nonmember insured banks	**Federal Deposit Insurance Corp.**
Illinois and Indiana	Chicago, Illinois 60604
Iowa	Kansas City, Missouri 64106
Michigan and Wisconsin	Madison, Wisconsin 53703
Savings institutions (insured by FSLIC and members of FHLB system, except for savings banks insured by FDIC)	**Federal Home Loan Bank**
Illinois and Wisconsin	Chicago, Illinois 60601
Indiana and Michigan	Indianapolis, Indiana 46204
Iowa	Des Moines, Iowa 50309
Federal Credit Unions	**Bureau of Federal Credit Unions**
Illinois, Indiana, Michigan, and Wisconsin	Chicago, Illinois 60607
Iowa	Austin, Texas 78701
Air carriers supervised by **Civil Aeronautics Board**	**Civil Aeronautics Board** Washington, D. C. 20428
Trucks, buses and other carriers supervised by **Interstate Commerce Commission**	**Interstate Commerce Commission** Chicago, Illinois 60604
Creditors subject to **Packers and Stockyards Act**	**Packers and Stockyards Administration**
Illinois and Wisconsin	Chicago, Illinois 60609
Indiana and Michigan	Indianapolis, Indiana 46221
Iowa	Omaha, Nebraska 68107
All other creditors, such as retail stores, professional people	**Federal Trade Commission** Washington, D. C. 20580

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Implementation by the Fed

To assist in arriving at the rules creditors must follow in complying with the law, the Federal Reserve was required to appoint an advisory committee of 20 people active in consumer affairs and consumer lending. A proposed Regulation Z was reviewed by other supervisory agencies and many consumer lenders before being revised and issued.

The regulation covers nearly all credit extended to individuals involving a finance charge or repayable in more than four instalments. Also included is practically all credit to farmers, even if the credit is for agricultural purposes. Credit to nonfarm business and government units is exempt, as is nonreal-estate credit of more than $25,000 to individuals and credit to cover purchases of stocks, bonds, and other securities extended by brokers and dealers registered with the Securities and Exchange Commission.

Computation of charge

To give consumers complete information on the cost of credit, lenders and credit sellers must include in their stated finance charges—in percentage and dollar terms—the interest charges and any other charges that would not be required if the purchaser had paid in cash—such as the cost of credit life insurance if required by the creditor.

The annual percentage rate is determined by dividing the total finance charge by the total amount financed. For example, an add-on charge of $6 for $100 of credit repaid in 12 monthly instalments would have to be disclosed to the borrower as 11 percent. For a discount charge, where the amount available is $94, the rate disclosed would be 11.5 percent. This is because interest is charged on the whole amount of credit extended while the credit outstanding (at the disposal of the borrower) is constantly declining throughout the life of the contract. The average amount of credit outstanding over the life of the loan is actually only about half the original amount.

Information in dollar terms is required so that direct comparisons can be made in the charges on small transactions and so that the price of credit can be compared with prices of other goods and services. But the percentage rate is also required, because it summarizes features of the credit sale or loan contract other than monthly payments.

In order that all creditors use a uniform method in computing the rate on loans, the regulation specifies that the rate must be calculated by the actuarial method or, in some instances, by the "United States rule," which gives essentially the same results when the payments are at regular intervals. This means that payments are applied first to interest and then to principal, with the interest for each period a stated percentage of the unpaid balance.

The rate must be figured to the nearest fourth of a percent. But to make the task of disclosure easier and more practical, two booklets of tables are available for calculation of rates: one for regular payments and one for irregular payments, or multiple advances. The booklets, which cost $1 each or 85 cents in lots of 10 or more, can be ordered from the Federal Reserve Board in Washington or from any Federal Reserve bank.

Conspicuous disclosure

To ensure that the information is readily available to the borrower and not lost in "fine print," both the finance charge and annual percentage rate must be printed on the contract more conspicuously than anything else, in numerals no smaller than 10-point type (the size of the subheadings of this article), 0.075-inch computer type, or elite-size type-

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writer characters, or must be legibly handwritten.

Other specific disclosures pointing up the charge for credit must also be made, depending on the type of credit advanced. Bank credit-card and check-credit plans are governed by the same rules as those for revolving credit at stores and other open-end accounts. The periodic percentage rate must be disclosed as well as the effective rate—the rate based on actual charges reflecting the difference arising from the "free-time" allowance and other adjustments.

Slightly different rules apply to instalment and similar credit plans. The usual items—number of payments, their amounts and due dates—must be disclosed. In addition the contract must show the sum of these payments and the amount of any charges for late payments. There is one exception: since mortgage loans extend over many years and allowance should be made for the time values of money, the total dollar-amounts of finance charges in the sale of dwellings do not have to be disclosed. But the annual percentage rate is required.

Borrowers offering their homes as collateral have the right to cancel a contract within three business days after it is negotiated. (The exception is a first mortgage made for the purpose of buying a residence). The rule also applies to mechanics' liens. Under emergency circumstances, the right of cancellation can be waived.

Other consumer aids

In addition to truth-in-lending, the Consumer Credit Protection Act sets criminal penalties on extortionate credit transactions, provides limitations on garnishment of wages and establishes a National Commission on Consumer Finance to propose further legislation in this field.

The 1968 Consumer Credit Protection Act, therefore, may well be broadened. Congress has begun, for example, to look into procedures for correcting inaccurate information in files of credit bureaus and of protecting individual privacy in the development and use of such files. And some Congressmen are reported to feel that a "cooling-off" period should apply not only to real-estate contracts but also to other transactions, especially those negotiated with door-to-door salesmen. Interest is also growing in a bill which would establish a new executive department specializing in consumer affairs and centralizing in one agency the administration of consumer legislation now performed by several agencies. If this bill is passed, the truth-in-lending law may well have even further reaching effects.

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U. S. foreign trade surplus declines

The United States ended 1968 with the lowest foreign-trade surplus in more than 30 years. Until last year, when exports exceeded imports by only $726 million, the annual trade surplus had ranged between $4 billion and $6 billion and, since the start of the 1960s, provided a bright spot in an otherwise bleak balance-of-payments picture. The decline in the trade surplus last year was all the more disappointing since projections made early in the year had indicated another trade balance strong enough to help offset deficits in other sectors of the balance of international payments. But imports rose far faster than exports, and as imports surged—reflecting strong domestic demand, strengthening domestic inflationary pressures, and interruptions of production by strikes—the trade surplus was nearly wiped out.

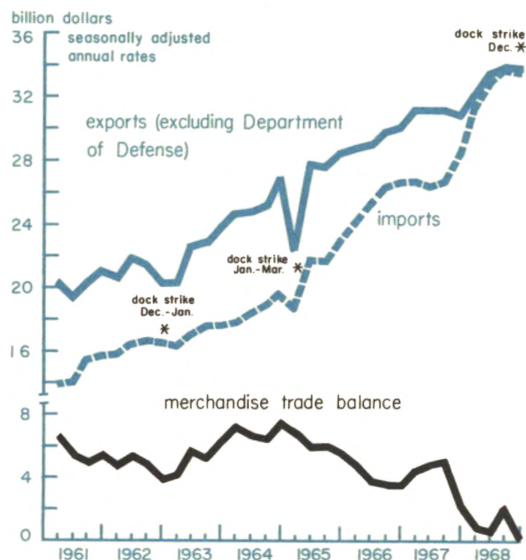
The impact on the overall balance of payments was less than might have been expected, however, since large amounts of foreign capital poured into the United States, allowing the U. S. balance of payments to show, on the liquidity basis, a small surplus. But the capital inflow was largely in response to financial and political uncertainties abroad and to high interest rates and the stock-market boom in this country. Such a situation is clearly not stable. It is generally agreed that if the United States is to improve its balance of payments over the long term, a sizable trade surplus must be reestablished.

Causes of the deterioration

From 1961 to 1964, when the economy was functioning below capacity, exports increased at an annual average rate of 7.5 percent while imports increased at a rate of 6 percent—a difference that allowed the trade surplus to increase from $5.5 billion in 1961 to $6.8 billion in 1964. But with the economy rising to a level of "full employment," a new pattern began to emerge in late 1965. Exports continued to rise through 1967 at about the same rate as before, but imports increased at the rapid yearly rate of 15 percent. Last year, imports increased 23 percent while exports increased only 9 percent—a difference that reduced the trade surplus to near-zero.

Several factors contributed to the decline. Most important was the rise in U. S. prices associated with the high level of economic

Merchandise trade balance declined after 1964



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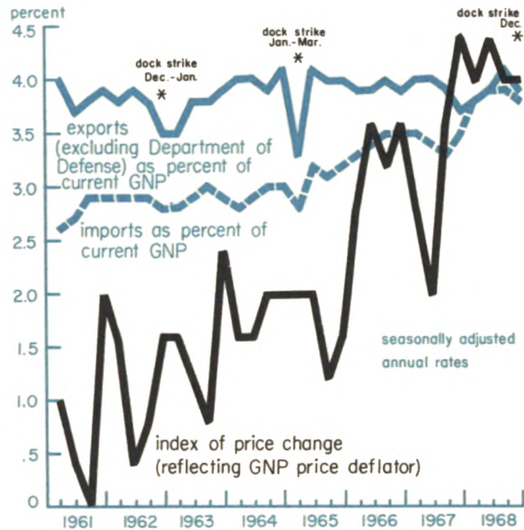
activity and the strong domestic demand for goods and services. But also important were strikes and threats of strikes affecting imports, especially in the first half of the year, and exports as well as imports in the second half. The year began with work in the copper industry already stopped by a strike. This boosted copper imports and curtailed copper exports in the first half. Steel imports increased sharply in the first half as users built up inventories as a hedge against a steel strike expected after midyear.

During the second half, exports and imports were increased as hedges against a strike by East and Gulf coast longshoremen. Although the strike was postponed under a Taft-Hartley injunction from the initial October deadline until after mid-December, there was a considerable upswing in shipping in September, before the initial strike deadline, and again in November, before the actual strike. Hedging was much heavier in exports than imports, with the result that the trade balance, on a seasonally adjusted annual rate basis, rose to $2 billion in the third quarter, compared with a rate of $650 million for the first and second quarters. Trade in the fourth quarter varied with month-to-month changes in labor conditions and, on balance, showed a small surplus.

Trade and GNP

Exports remained fairly stable as a percentage of total domestic purchases (GNP, or gross national product) in the early 1960s, fluctuating between 3.5 and 4 percent. Imports were also fairly stable relative to GNP until 1965, averaging slightly less than 3 percent. But beginning that year, with the marked increase in domestic inflationary pressures, imports began rising faster than total purchases. In 1968, imports reached nearly 4 percent of GNP.

Imports increase as percentage of GNP



The rate of increase in imports has been sensitive to increases in both GNP and prices. A Department of Commerce study suggests that when GNP increased faster than 5 or 6 percent a year, imports tended to increase even faster. Conversely, when GNP grew slower than that, imports tended to grow slower than GNP. Part of the growth in GNP is, of course, a result of price changes. Both GNP and prices have increased far faster since 1965. Between 1961 and 1964, prices increased at the average annual rate of 1.3 percent. But they increased 1.9 percent in 1965 and 3.8 percent in 1968 (as measured by the implicit price deflator for GNP, a broadly based measure of price changes).

With the rapid increase in prices, imports accelerated. Except for a brief retarding of the increase in prices during the economic slowdown in early 1967, when imports actu-

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ally declined, prices and imports have been rising rapidly since 1965.

Imports rose sharply

While exports increased during the first three quarters of 1968, imports increased even more, reflecting both higher domestic prices and a shift in demand for foreign goods since the same (but less inflationary) period a year before. Industrial supplies, which account for more than 40 percent of imports, increased 21 percent over imports in the first three quarters of 1967. With the increased price competition from foreign producers and the buildup of steel inventories, imports of iron and steel increased 52 percent. Increases in imports of copper, resulting largely from the copper strike, were enough in the first six months to push the nine-month rise to a 65-percent gain over 1967.

With the rapid expansion in investment in new plant and equipment, imports of capital goods increased 16 percent. Foreign manufacturers have continued to gain expertise in the production of electrical and electronic equipment, computers, and business aircraft, providing U. S. business with alternatives to domestic products at competitive prices.

But the biggest increase was in consumer goods. Imports of these goods, excluding automobiles, increased 25 percent, reflecting rises in both domestic prices and consumer demand for foreign goods. Automobile imports increased nearly 60 percent, almost half the increase being attributable to Canada.

Exports continued strong in 1968

The advance in exports continued strong in 1968. During the first nine months of the year, exports of capital goods, which account for nearly a third of all U. S. exports, rose $900 million—a gain of 11 percent over the

Exports of consumer goods rise . . .

	January-September 1967	1968	Percent change
	(millions of dollars)		
Selected consumer goods—total	$1,595	$1,764	11%
Textiles	157	171	9
Durables	609	663	9
Printed materials	209	223	7
Medical preparations	277	309	12
Automotive—total	2,100	2,485	18
To Canada	1,308	1,677	28
Elsewhere	792	808	2
Selected foods, feeds, beverages—total	3,740	3,621	—3
Grains	2,200	2,156	—2
Soybeans	603	594	—1
Dairy products	98	106	8
Meat and meat animals	119	116	—3

SOURCE: U. S. Department of Commerce.

. . . but imports rise much faster

	January-September 1967	1968	Percent change
	(millions of dollars)		
Selected consumer goods—total	$3,115	$3,911	25%
Textiles	522	662	27
Electrical appliances (T.V., etc.)	441	567	29
Toys and sporting goods	158	215	36
Gem diamonds	283	349	23
Automotive—total	1,918	3,055	59
From Canada	1,177	1,813	54
Elsewhere	741	1,242	68
Selected foods, feeds, beverages—total	3,434	3,989	16
Green coffee	726	882	21
Cane sugar	445	479	8
Meat and poultry	483	570	18
Alcoholic beverages	344	456	33

SOURCE: U. S. Department of Commerce.

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same period in 1967. Although shipments of farm machinery declined 10 percent, shipments of civilian aircraft advanced 52 percent.

Industrial supplies account for another third of exports. Included are several raw and semiprocessed materials, such as iron and steel, fuels, and cotton, all of which registered declines. But other products, including nonferrous metals, processed steel, lumber and nonmetal building materials, and chemicals, gained enough to show an overall rise of 9 percent for industrial supplies.

Automotive exports continued strong, as they have been since the automotive trade agreement with Canada was reached in 1965 (*Business Conditions*, November 1968). Shipments to Canada increased 28 percent during the first nine months of 1968, accounting for $369 million of the $385-million increase. By contrast, shipments to the rest of the world increased 2 percent.

Exports of other consumer goods increased substantially, but they were only a small part of total exports. Even with an 11-percent gain, these exports increased only $169 million. Although exports of some foods, feeds, and beverages increased during those nine months—dairy products, for example—most commodity groups slipped below levels of the year before. Exports of grains declined 2 percent, apparently as a result of increased production abroad and fewer shipments under the Food for Peace program. Exports of soybeans slipped 1 percent.

Inflation and imports

Concern over the competitive position of the United States was intensified last year as the merchandise trade balance fell below the $1-billion level. There was some consolation in the continued vigorous growth of exports, which has averaged more than 7

Exports of industrial inputs up . . .

	January-September		Percent
	1967	1968	change
	(millions of dollars)		
Selected capital goods—total	$7,456	$8,347	11%
Electrical machinery	1,073	1,170	9
Construction machinery	1,083	1,134	5
Agricultural machinery	343	307	—10
Business machines and computers	622	673	8
Civilian aircraft and parts	1,152	1,753	52
Selected industrial supplies—total	7,546	8,190	9
Fuels and lubricants	841	810	— 4
Iron and steel products	551	530	— 4
Other metals	849	954	12
Chemicals	1,735	2,084	2

SOURCE: U. S. Department of Commerce.

. . . but imports increase faster

	January-September		Percent
	1967	1968	change
	(millions of dollars)		
Selected industrial supplies—total	$8,667	$10,498	21%
Fuels and lubricants	1,734	1,824	5
Iron and steel products	1,028	1,562	52
Copper	371	613	65
Lumber	310	400	29
Chemicals	441	517	17
Selected capital goods—total	1,788	2,073	16
Business machines and computers	139	167	20
Machine tools	173	180	4
Agricultural machinery	280	266	—5
Civilian aircraft and parts	95	130	37
Electrical and electronic machinery	399	508	27

SOURCE: U. S. Department of Commerce.

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percent since 1961 and, although probably inflated by shipments in the second half of the year as a hedge against the dock strike, increased 9 percent last year.

But the increase in imports has been leaving an ever deepening mark on the merchandise trade balance since 1965. Higher incomes and increasing price differentials between foreign and domestic goods, especially since inflationary pressures began to strengthen in 1965, have boosted demand for imports.

Expected reductions in inflationary pressures favor prospects for a larger trade surplus in 1969. But the improvement will probably be only moderate at best, falling well below the $4.1 billion surplus of 1967. Substantial improvements in the trade balance do not appear likely without substantial slowing of domestic price inflation.

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