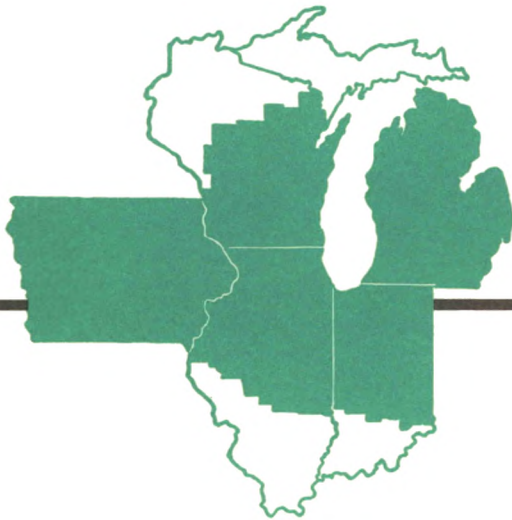


Business Conditions

1970 March



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THE Trend OF BUSINESS

The reversal of the business expansion is delineated clearly in the decline in manufacturing output—down more than 3 percent in physical units from July to February. Factory shipments, measured in dollars, reached a peak in October before starting to slide. New orders booked by manufacturers have declined with shipments but more rapidly.

Durable goods have accounted for virtually the entire decline in manufacturing output. Durables were off almost 6 percent in February, while output of **nondurables** remained near last year's highs. Durable goods always have been affected more than total activity in business slowdowns, but the dichotomy seldom has been so clear.

About a fourth of the decline in **manufacturing output** was a result of the General Electric strike that ended in early February.

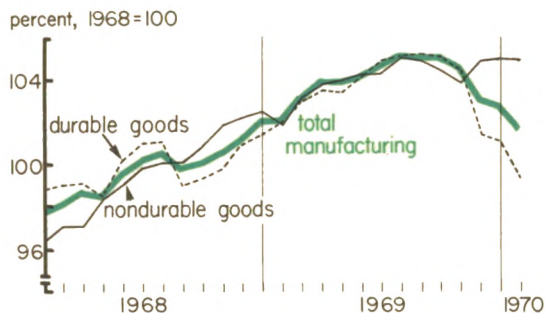
But the return to work did not prevent a further decline in manufacturing employment from mid-January to mid-February. Moreover, the average factory workweek slipped below 40 hours in February, compared to 40.7 hours last July.

From August to February, **manufacturing employment** dropped by more than

Orders for manufacturers' durable goods drop faster than shipments



Manufacturing output—durables decline, nondurables level off



500,000—almost 3 percent. During this period, non-manufacturing employment, led by government and the service industries, rose by almost 800,000, so there was a moderate increase in **total employment**. But the rise in total employment slowed quarter-by-quarter through 1969, and total employment failed to increase in February.

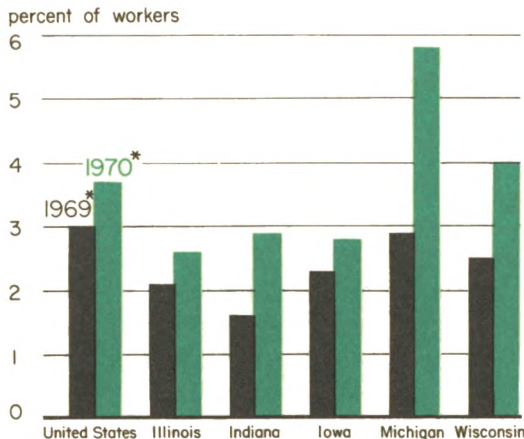
Continued growth in the labor force in the face of smaller employment gains has resulted

Manufacturing jobs drop, gains continue in other industries



*Estimated.

Proportion of workers receiving unemployment compensation up sharply

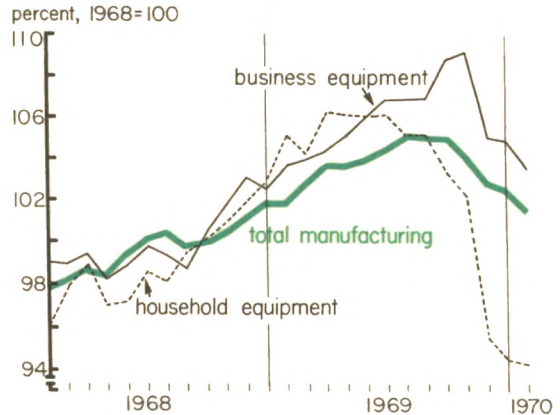


*Data as of February.

in higher unemployment. For the nation, unemployment was estimated at 4.2 percent of the labor force in February, still low by the standards of the early Sixties, but well above the 3.3 percent rate of a year earlier.

Starting in November, **unemployment claims** increased substantially, especially in the motor vehicle industry. The proportion of covered workers receiving unemployment compensation in mid-February in Midwest states ranged from 2.6 percent in Illinois to

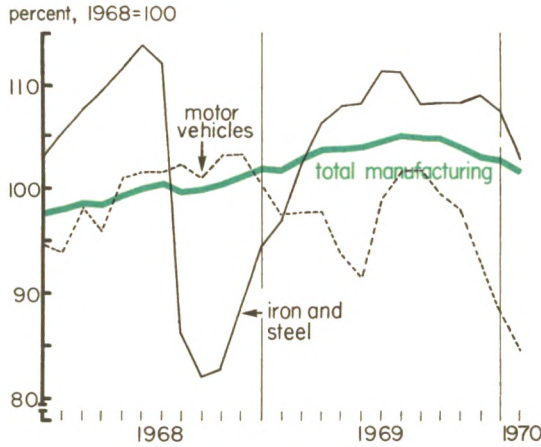
Production decline greater for household goods than for business equipment



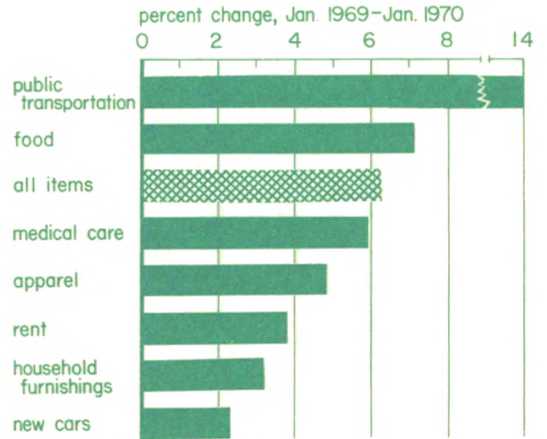
almost 6 percent in Michigan. The U. S. average was 3.7 percent. A year ago average unemployment of covered workers was below the national average in all Midwest states.

Output of **consumer equipment**, both household goods and passenger cars, has been reduced sharply. Defense procurement also has been reduced substantially, and output of some types of **business equipment** has dropped. But the general picture for business equipment spending remains favorable.

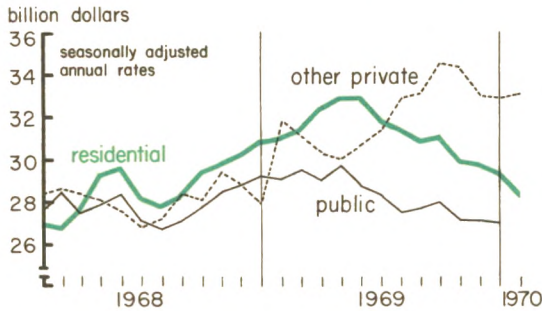
Motor vehicle output skids, steel output also lower



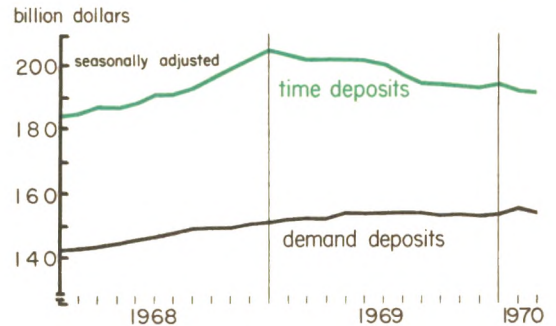
Prices higher for all types of consumer goods and services



Weakness in residential sector dominates construction picture



Time deposits decline further, demand deposits relatively stable



Steel output in early 1970 was below last year's record rate, but demand from most domestic customers, other than the motor vehicle industry, has been fairly well maintained, and exports to Europe have increased significantly.

The dollar value of new **construction** has declined gradually since last spring, despite

sharply rising costs. Housing starts, especially single-family homes, have plummeted since early last year. Construction contracts for residential work and new permits granted indicate the bottom has not yet been reached. The Seventh Federal Reserve District, with the Chicago area particularly weak, has experienced greater declines in new residential

construction activity than the nation.

Much **public construction**, especially federal work, has been postponed. **Commercial and manufacturing construction** has been maintained near last year's level, and the **utilities** are pushing ahead with needed installations. New construction contracts for nonresidential projects continue high.

Average **prices paid by consumers** in January were 6 percent higher than a year earlier. Price increases have been largest for public transportation, food, and medical care. Preliminary indications from the wholesale markets suggest a slowing in the rate of price

advance in February and early March.

Demand deposits at commercial banks were virtually stable from April through February, except for a temporary bulge in January. Prior to April 1969, demand deposits had been growing at an annual rate of about 7 percent for more than a year. **Time deposits** at commercial banks increased rapidly in 1968 and reached a record high in December of that year. Since then most months have seen declines in time deposits, especially in large negotiable certificates of deposit. In February, time deposits were down 5 percent from last April, and 7 percent from the peak.

Housing, production, and finance

Statement by Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System, before the House Committee on Banking and Currency

As a national resource, housing ranks high on both economic and social grounds. The construction of new homes and apartments absorbs the efforts of a major industry. The fortunes of this industry influence the course of production and employment in many other branches of the economy.

Even more importantly, the provision of decent housing for all families is among our most pressing needs, as Congress recognized in laying down a decennial goal for the production of new and rehabilitated housing. Besides the volume of housing production, the price and quality of available shelter are of vital significance. Prices of homes and rents have of late been rising rapidly, reflecting not only higher financing costs but also inflated prices of labor, land, and materials.

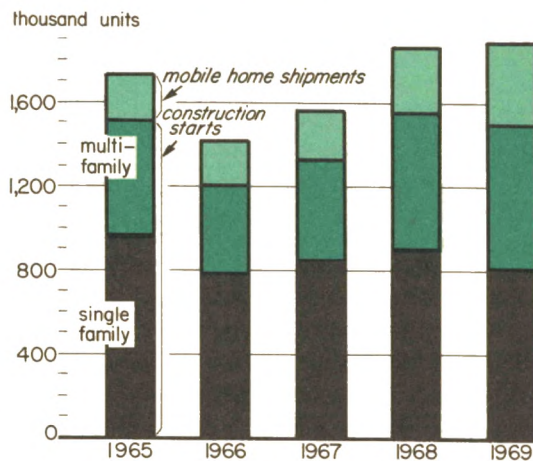
If these costs are not brought under control, the quality of all housing will be bound to suffer.

I assure you that the Federal Reserve Board is deeply concerned about the recent decline in production of housing and the further rise in costs of buying, financing, and operating new and existing dwellings. Housing starts have been declining for three consecutive calendar quarters now. By last December, the seasonally adjusted annual rate of 1,245,000 private housing starts was the lowest in two and one-half years. The downtrend has come at a time when demand for both new and existing accommodations has generally remained strong. As a result, the vacancy rate for dwellings available for sale or rent has become disconcertingly low.

At the same time, I think it is well to note that the performance of the housing industry over the past year has surpassed the expectations of many experts. Adherence to a policy of monetary restraint, which has been a necessary part of our national effort to bring inflationary pressures under control, has led to very tight credit market conditions and has clearly constrained homebuilding. Nevertheless, private housing starts in 1969 as a whole came within 3 percent of the total in 1968. If we include new public housing starts as well as shipments of new mobile homes, last year's combined output of about 1,890,000 units actually exceeded the preceding year's total. Measured in these terms, the gross addition to our total stock of shelter in 1969 was, by a slim margin, the largest in 19 years. The net flow of funds into residential mortgages also reached a new record of nearly \$20 billion, 5 percent above the 1968 level.

The totals that I have cited for last year conceal, however, the movement within the year. We need to recognize that the month-to-month trend of total housing starts over the past year, even including mobile homes, has been distinctly downward, and I fear that the totals may go still lower in the months immediately ahead. Despite everything that has been done to bolster the flow of funds into housing, reduced credit flows through mortgage lending institutions and lender's preferences for other types of investment have sharply curtailed the amount of money available for housing. The environment affecting savings flows to these institutions has been particularly adverse in recent weeks, and many of these institutions are no longer in a position to make large commitments of funds for future deliveries of mortgages. Moreover, reflecting the curtailed availability of funds, the terms of mortgage credit—that is, interest rates, downpayments, and credit standards—

Apartments and mobile homes account for growing share of new housing



have tightened, thereby excluding otherwise willing buyers from the market.

Of course, housing is not the only economic sector in which spending is being restrained by tight credit conditions. As is well known, many state and local government units have had difficulty in selling bonds to finance their capital outlays. Funds for commercial construction have become increasingly hard to come by, and many projects have been delayed because their promoters were unable or unwilling to obtain financing at prevailing terms. Many business firms—small firms in particular—also have been unable to obtain all the credit they desired, especially as the ability of banks to lend has come under increasing constraint. Even some very large corporations have announced cancellations or stretchouts of capital spending programs, at least partly because of the difficulty and cost of financing. It is the very essence of monetary restraint that many eco-

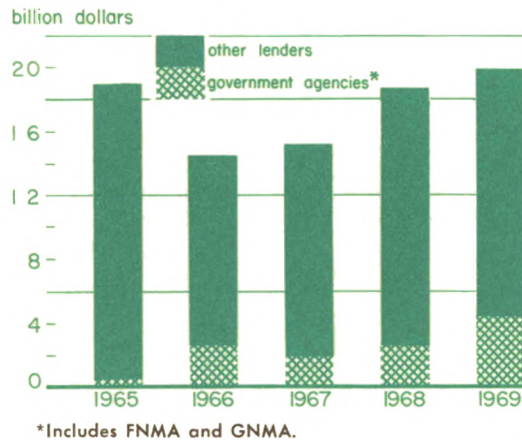
conomic units find it difficult or impossible to carry through all of their spending plans. This is the way that total spending is curbed and an overheated economy cooled down to a manageable condition.

It should be kept in mind, also, that the problems of the housing industry are not related solely to tight credit. Unusually large wage settlements have been contributing powerfully to a further advance in the total cost of constructive dwellings. New labor contracts negotiated last year called for an average first-year wage increase of as much as 14 percent, according to Bureau of Labor Statistics figures on settlements affecting 1,000 workers or more, whether employed in residential or other construction. According to one widely-cited privately compiled index, the average cost of constructing a new dwelling rose by more than 8 percent in 1969, the largest annual increase since 1948. Land values also continued their long-term upward trend as did typical operating costs for both houses and apartments.

Measures taken to aid housing in the past year

A number of measures have been taken within the past year to bolster the supply of resources available for housing and to shift some of the burden of credit restraint away from this sector. Paramount among these actions has been the Administration's program to bring Federal finances under strict control, as indicated in the austere budget presented to the Congress earlier this week. A budget surplus is essential in achieving a proper mix of fiscal and monetary policies for restoring conditions that favor sustainable economic growth. There can be no doubt whatever that the single most important contribution toward improving housing market conditions would be success in the present

Federal agency share in residential financing much larger in 1969 than in 1966



struggle to check inflationary trends and expectations. This, of course, has been the principal objective of the monetary policy of the Federal Reserve System over the past year. Nonetheless, it must be recognized that it takes time to overcome an inflationary momentum that has gathered headway over a span of years dating all the way back to 1964.

As credit and fiscal measures were adapted last year to our overriding need to cool down the nation's highly inflationary condition, special steps were simultaneously taken to lessen the impact of tight credit on housing. The principal Federal agencies supporting housing provided an unprecedented amount of assistance to the mortgage market. The combined net purchases of home and multi-family mortgages by the Federal National Mortgage Association (FNMA) and the Government National Mortgage Association (GNMA) totaled a record \$4.3 billion. That accounted for more than a fifth of the total net expansion in outstanding residential mortgage debt. In addition, the Federal Home

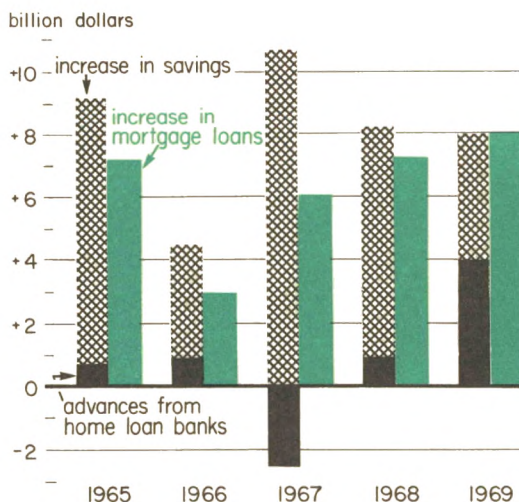
Loan Banks during 1969 extended a record \$4 billion in net advances to savings and loan associations (S&LS). This assistance was equivalent to 45 percent of the total expansion in mortgage portfolios at all savings and loan associations.

The capacity of the savings and loan associations to advance funds to the mortgage market was also sustained as the Federal Home Loan Bank Board reduced S&L minimum liquidity requirements. The reductions, of one-half percentage point each in June and November 1969, altogether released approximately \$1.3 billion for additional mortgage investment.

The record amount of funds funneled into the mortgage market by these Federal agencies partly counterbalanced the reduction in net savings inflows to savings and loan associations and mutual savings banks that occurred last year. It should be pointed out, too, that the relationship among maximum ceiling rates on time and savings accounts that could be offered by financial institutions was such that the commercial banks suffered the largest decline in the share of total credit flows. Thus, mutual savings banks and savings and loan associations, which are major sources of funds for housing finance, were protected from inter-institutional competition by the structure of ceiling rates on time and savings accounts—a notable departure from the 1966 experience.

As 1969 progressed, however, and as market interest rates continued to rise further above ceiling rates on time and savings accounts, all types of financial institutions came under increasingly severe pressure. It was no longer a question of one type of institution gaining at the expense of another but of all losing savings funds heavily to the securities markets. Under the circumstances, the Federal Reserve Board felt that a general upward

Home Loan Bank advances more than half of new funds of S&Ls in 1969



adjustment in ceiling rates could no longer be delayed and, after consultation with the other regulatory agencies, an increase in the ceilings for member banks was announced late last month. The Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board adopted similar measures. As a result, all institutions now have somewhat higher rate ceilings, including the ability to offer new one- and two-year time instruments at premium rates. Maximum permissible rates on large CDs (\$100,000 and over) were also raised appreciably, and the savings and loan associations were permitted to offer such instruments at higher rates for the first time. The higher ceilings generally are intended to help preserve, and eventually to enhance, the flow of savings to the private financial institutions, and thereby to give support to the flow of housing credit.

Also in January, contract interest rates on FHA-insured and VA-guaranteed mortgages were raised for the first time in 12 months. The increase brought returns on such investments closer in line with yields available on other types of capital market instruments and should help to make such mortgages more acceptable to lenders in competition with other investments. Unfortunately, the one percentage point rise in contract rates on these Government-underwritten mortgages failed to match fully the increase that had taken place over the previous year in bond market yields.

There have been a number of other steps taken in recent months to aid housing. Last September, the Administration ordered a reduction of 75 percent on new contracts for Federal construction projects until conditions ease. This step was followed by a vigorous effort, which has proved moderately successful, to persuade state governments to carry out similar postponements of construction work under their jurisdiction. All this was done with a view to releasing resources, wherever possible, for homebuilding.

Finally, in 1969, nearly a dozen states raised their usury ceilings applicable chiefly to conventional home mortgages. The increases brought these limits to more realistic levels that allowed buyers of residential properties who are dependent on this predominant type of mortgage financing to compete on more equal terms with other users for the scarce supply of credit funds.

What more can be done?

These recent measures have contributed significantly to the surprising performance of housing under the very stringent credit conditions of 1969. However, as the continuing problems in the housing market clearly indicate, more remains to be done, particularly

if we are to enhance the potential for achieving the long-run housing objectives of the nation.

In the immediate future, it will be vital to preserve the taut fiscal position outlined in the Administration's budget. Keeping a tight rein on Government expenditures will, of course, require discipline on the part of both the Executive and Legislative branches of Government. Such a fiscal policy is an essential element in bringing inflationary pressures under control and in laying a basis for moderation in overall credit conditions. When this happens, the cost of credit for housing transactions will, obviously, move down.

But as long as credit remains in rather short supply, the financing of new housing is likely to be restricted. Housing is a sector highly sensitive to the cost and availability of credit. In part this is because housing expenditures involve relatively large amounts of long-term credit with fixed interest charges that are large relative to other and more variable costs over the life of the dwelling. And in part it is because the depository institutions, which accommodate the lion's share of total mortgage demands, are unable to compete for funds on the same high interest terms that borrowers in the open market are prepared to pay.

For this reason, the Federal Reserve Board supports the continued large-scale extension of credit by specialized housing finance agencies, such as FNMA and the Federal Home Loan Banks, under current conditions. The Board also supports the principle of aiding disadvantaged families by subsidizing their mortgage debt burden by means of appropriated funds. We do not favor, however, tapping Federal Reserve credit for the support of a restructuring of credit flows, no matter how worthwhile the immediate objective may be. Special-purpose lending by the Federal

Reserve for housing would be likely to lead to demands for other types of special lending as well. Taking such assets into Federal Reserve portfolios would require us to make correspondingly heavy offsetting sales of Treasury securities in order to keep control of the reserve base, and that would lead to a weakened market position for Treasury securities. I assume, of course, that no one is suggesting that the credit needs of housing or other special sectors, however worthy, should be monetized by superimposing them on the money and credit totals that would otherwise be appropriate for the nation as a whole. To compel the Federal Reserve to follow such a policy could lead to a disastrous inflation.

In addition to providing for a continuing substantial flow of Government-assisted funds into housing—while making certain that it is financed through the housing agencies rather than with newly created Federal Reserve credit—we also believe that everything possible should be done to enhance the attractiveness of mortgages to private investors. In this connection, there is considerable room for improving the characteristics of the mortgage instrument and the institutional practices associated with issuing, holding, and retiring mortgages. For example, greater standardization of laws and customs is needed with respect to the origination of conventional mortgages and with respect to the foreclosure of all types of mortgages. We also support the provision of facilities—such as that envisioned by GNMA-guaranteed securities—that would package mortgages in sufficiently large lots to be attractive to pension funds and other institutional investors. It would also be desirable if the states, as well as the Federal Government, would continue to weed out restrictions that unnecessarily limit mortgage lending by size of structure, location of prop-

erty, or terms of credit.

Of course, nothing will help very much in stimulating private investment in mortgages, unless the yield available on such investments can be as attractive as that on alternative outlets for funds. Some 21 states and the District of Columbia still impose ceilings of 8 percent or less on home mortgages, particularly on conventional loans which are the principal form of this type of credit. Although these limitations were originally designed to protect borrowers, we should recognize that economic conditions change and that interest rate ceilings that are below the market operate in practice to discriminate against borrowers by denying them access to sources of credit available at going market rates. We think that artificial barriers to competitive rates on mortgages should be lifted, or at the very least, administered flexibly.

To give an added incentive to member banks in meeting the public's needs for long-term mortgages as well as other types of credit, the Board of Governors again wishes to recommend that the Congress permit member banks of the Federal Reserve System to borrow from the Federal Reserve banks on the security of mortgages or any other sound asset at the regular discount rate. Mortgages are only an example of the kinds of collateral involved. The adoption of this recommendation would not, of course, solve all the problems of the mortgage market by any means, but we believe that this step—which should be taken in the interests of efficiency in any event—could prove to be of some benefit in stimulating mortgage lending by member banks.

Another helpful step would be to liberalize the authority of national banks to make real estate loans. For conventional mortgage loans, the loan-to-value limit should be raised from 80 to 90 percent, and the maximum

maturity from 25 to 30 years; for loans on large construction projects, the maximum maturity should be extended from three years to five years. You will recall that the Commission on Mortgage Interest Rates recommended these amendments in its report filed last year, and your Committee included provisions to carry out this recommendation in H. R. 15091, as reported to the House. These provisions were retained in the bill passed by the House, but were dropped by the Senate-House conference committee.

Taking a still longer perspective, further measures will be required to release the full potential of private enterprise to respond to our nation's shelter requirements. Substantial additions to the supply of skilled construction labor, for example, will be forthcoming under the expanded and redirected manpower training programs of the Federal Government. Another promising attack on the housing problem is HUD's "Operation Breakthrough," which aims to cut construction costs by relying on mass production and factory technologies as well as by modernizing building codes and labor practices. These and other approaches should help to dampen rising construction costs, which in part have reflected, but also have been a major source of, inflationary pressures.

The Board also recommends that further detailed study be given to establishing a broad secondary market for conventional residential mortgages, recognizing the technical problems involved. Such a market for conventional mortgages would depend in part on the

standardization of the instrument, including more uniform procedures involving property inspection and loan origination. In the interim, to gain experience with a two-way market, the Board suggests that the FNMA experiment with operating a trading desk for outstanding Government-underwritten loans. By facilitating portfolio adjustments, FNMA's trading desk could enhance the appeal of this type of mortgage issued under standardized terms and conditions that conform to broad public policy.

In summary, improvements over recent years in Government-sponsored financing of housing and in laws and regulations surrounding the private financing of housing have contributed to a significantly better maintenance of housing starts in 1969 than in the previous tight money period of 1966. I have no doubt that further improvements in the structure of the mortgage market are possible and practicable, and that these will enhance the performance of the housing industry in the future.

The Board is studying ways and means to lighten the burden of monetary restraint on the mortgage market without impairing the use of monetary policy in achieving national economic objectives. There is great need to focus, as we hope many will, on seeking out ways to increase the attractiveness of mortgage instruments to private investors, to shift the flow of credit towards the housing market, and to lessen the cyclical impact of alternating tight and easy credit conditions on housing production and finance.

Farm finance in a period of high interest rates

Strong demand for credit caused interest rates to rise to historic highs in late 1969 and early 1970, despite continued growth in total credit outstanding. The advance in interest rates was a continuation and acceleration of a persistent uptrend that started soon after World War II. All classes of rates have been affected—long- and short-term, public and private, business and consumer, farm and nonfarm.

Interest rates, like other prices, are influenced by many forces that affect supply and demand. Although changes in expectations can strongly influence interest rate trends in the short run, the trend of rates in the long run reflects changes in basic factors such as commodity prices, business profits, government expenditures, private investments, consumer savings, actions of the monetary authorities, and international flows of goods and capital.

Interest rate movements usually are especially large in times of rapid change in total spending. Just as rising prices indicate that the demand for goods and services exceeds supply at existing prices, rising interest rates indicate an imbalance between the demand for and supply of loanable funds. Increased supplies of goods and services can check a rise in prices. But a more rapid expansion of credit, not matched by higher savings, may not dampen a rise in interest rates. If upward pressures on prices are expected to continue, farmers and other borrowers are willing to pay even higher rates to obtain credit, while lenders demand still higher rates to

compensate for declines in the purchasing power of the money on loan.

For a quarter-century, policies intended to minimize unemployment and maximize economic growth have been largely responsible for higher prices and higher interest rates. Continuance of these policies in the past five years of limited war has produced deep-seated expectations of continued price inflation. The momentum of the price inflation until recently was probably as great as at any time since 1920, during the peak of the speculative boom that followed World War I. Expectations then changed only after the onset of a sharp, painful recession. Current monetary and fiscal policies are designed to bring about a change in expectations in a much less painful fashion, but such moderate policies require time to have their effects.

A number of developments suggest the uptrends of prices and interest rates are due to abate. Curtailment of defense expenditures, continued reduction of the U. S. involvement in Vietnam, efforts to maintain a balanced budget, and a reduced growth of money and credit are serving to slow the rise in total spending and reduce pressure on productive resources. In early 1970, some market interest rates declined, but unless the rise of prices levels off, this could be temporary.

In view of unfilled demands for goods and structures, public and private, a sustained downtrend in interest rates to levels prevailing in the early 1960s does not appear likely. Continued relatively high, but reasonably stable, interest rates are probably the most

reasonable prospect. This assumes, of course, that economic policies, public and private, are more consistent with price stability in future years than in the years just past.

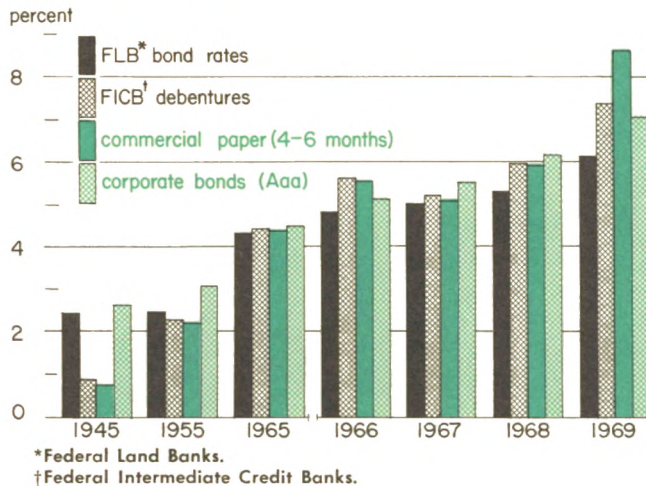
Interest rates in agriculture

Credit markets in rural areas tend to respond sluggishly to changes in the central money and capital markets. Farmers and small businesses in many rural areas, therefore, have not faced the full heat of the upward surge in rates. Therefore, rates in rural areas could rise further, even though rates elsewhere declined somewhat.

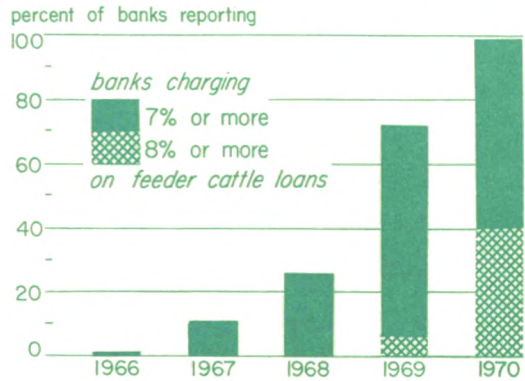
In agriculture, as in other business, interest is one of the costs of acquiring and using resources. Rapid increases in interest rates, coupled with a substantial rise in outstanding debt, have resulted in some increase in the proportion of gross farm income allocated to interest payments and in the proportion of total expense represented by interest.

Total farm debt outstanding rose at an

Interest rates at historically high levels



Rural banks boost lending rates*



*Based on surveys on rural banks in Seventh Federal Reserve District.

annual rate of almost 10 percent from 1965-1969, while interest payments by farmers rose at an average annual rate of about 11 percent. Interest payments rose from 5 percent of realized gross farm income in 1965 to 6 percent in 1969. As a proportion of total production expenses, interest payments rose from 7 percent in 1965 to 8 percent in 1969.

Increases in farm debt on the order of 8 or 9 percent annually have been projected by some analysts for the 1970s. If so, total farm debt would rise to \$120-130 billion by the end of the decade, compared with about \$56 billion now.

Credit and land prices

The upward thrust of farm real estate prices may be restrained by high interest rates and reduced availability of long-term credit, especially in areas where the potential use of the land is exclu-

sively agricultural. With mortgage interest rates at 8 percent or more and farm income relatively stable, ownership of farmland is less attractive than when rates were lower.

The rise in land prices slowed in 1968 and 1969, according to surveys of country banks in the Seventh Federal Reserve District. In the second half of 1969, in fact, prices showed no further rise on average, and declines were noted in some areas.

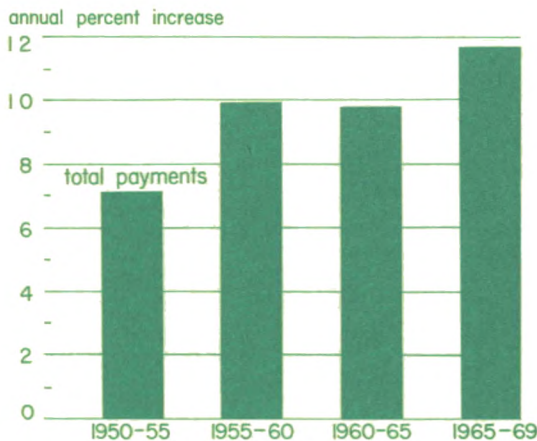
Farmland prices are affected by many factors other than interest rates and credit availability. Prospects for agricultural commodity prices, changes in government programs, and yields on alternative investments all play a part. Prices of farmland leveled off on three previous occasions since World War II, in 1949, 1952-53, and 1960. Mortgage interest rates do not appear to have been a major factor in those earlier developments, but rates were relatively low. In the current

setting, if prospective buyers and sellers of farmland conclude that refinancing at lower interest rates is not likely for a number of years, downward pressures on land prices may intensify.

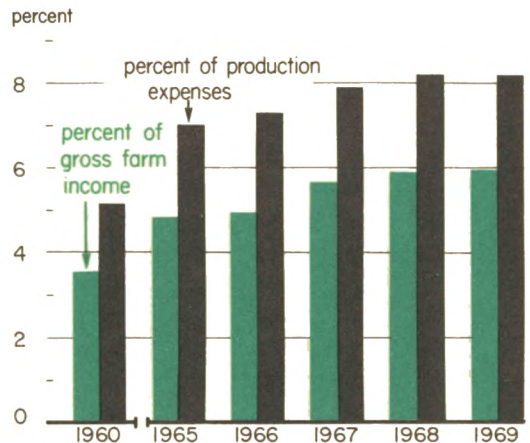
Over a period of time the value of agricultural assets, especially real estate, tends to move to levels that equalize returns on agricultural resources with returns available on other investments. In order for the adjustment process to function efficiently, however, resource markets must be relatively free.

High interest rates probably have the greatest effect on the trend of land values in areas where ownership by non-farmers is important. Landlords may be more sensitive than owner-operators to yields on alternative investments. If prospects for capital gains on investments in land were to become less attractive, more land would be offered for sale. This would exert some downward pressures

Interest payments on farm debt...



... account for larger share of expenses and income



on prices but make it easier for those seeking to expand their farms to acquire land.

High and rapidly rising interest rates cause shifts in sources of credit and usually are associated with shortening of maturities. In agriculture, this is illustrated by the trend to seller-financing. Seller-financing, always an important factor in the farm real estate market, has grown rapidly in recent years. General price inflation, inflated land prices, credit restraint, and features of the federal income tax all have encouraged this trend. Seller-financing is estimated by the U. S. Department of Agriculture to account for more than half of all credit extended on farm real estate.

About four-fifths of the seller-financed credit is extended through instalment land contracts. Interest rates on land contracts are reported to average somewhat lower than rates charged by commercial lenders, while maturities are relatively short, ranging between ten and 15 years. If conditions in the farm real estate and credit markets were to be relatively unfavorable when these relatively short-term contracts mature, refinancing could present a problem.

Production loans

Merchant credit extended to farmers appears to have been increasing as a proportion of total non-real estate credit. The finance subsidiaries of a number of the major manufacturers of farm equipment are reported to have greatly increased their loans outstanding on sales of farm machinery in recent years. At the same time, supplier financing of fertilizer, petroleum products, and feeds has continued to rise. Lender experience with such financing has varied greatly, largely reflecting differences in competitive conditions in individual supply markets in which credit terms are used as merchandising aids. The availability and terms of merchant credit,

therefore, have not been related closely to general credit conditions.

Various studies suggest that sales of farm machinery are influenced somewhat by interest rates but that other factors are much more important. Farmers' purchases of current operating supplies, such as fertilizers and seeds, probably are affected even less by interest rates than are purchasers of equipment. Returns from current operating inputs are realized in a shorter time and interest costs on funds invested are smaller than for long-term investments.

With agriculture continuing under pressure to make adjustments, the distortions of credit flows associated with the rapid increases in interest rates are of great interest. Are the trends to larger farm size, rapid technological change, greater specialization, and greater mechanization hindered? The answers are not yet in. But the distortions of credit flows probably are temporary and will gradually disappear as individuals, institutions, and regulatory authorities adjust to the new higher level of rates. Adjustment processes, of course, will be facilitated by a period of relative stability of rates, whatever the level. In these circumstances, there should be reasonably adequate and dependable flows of agricultural credit. The younger farmers operating the larger farms are a dynamic factor working for change in U. S. agriculture. Many of these young farmers are strongly motivated to expand holdings and make maximum use of credit. They have been acquiring control of an increasing proportion of the total agricultural resources.

If limited credit availability and associated high interest rates restrict borrowings of expansion-oriented farmers, the resource adjustment processes probably would be retarded. But these farmers appear to be strong contenders for the available credit. Further-

more, substitution of leased resources and purchased services for borrowed and owned capital is increasingly common.

Developing trends

The need to assemble large amounts of resources under the control of one management in order to utilize advances in technology is being achieved in a number of ways. Corporate farming, leasing of land from a number of owners, arrangements where some land is owned and some is leased, and the combination of land ownership and hiring of custom service for major operations are all increasingly important. Arrangements vary with individual circumstances. Availability of credit is one of many factors affecting individual decisions.

Farmers who minimize ownership of land may have the greatest capability for growth and adaptation. If so, the role of farm supply industries in providing farm credit and management services probably would be strengthened further. Supply industries would then become even more important conduits of credit from capital markets to farmers. But this development would not appear to be either accelerated or retarded by the level of interest rates.

Credit markets in agriculture, as in other sectors, can function as well at a high level of rates as at a low level of rates, once expectations, plans, institutions, and regulations have had time to adjust. In any period of rapid change, gaps in the credit fabric may appear. It is important, therefore, that credit institutions and credit practices have the flexibility to adapt to changing conditions. The credit institutions now in existence have demonstrated a strong capability to accommodate new needs in the farm, the farm supply, and the farm marketing sectors.

Although the overall structure of credit institutions appears generally adequate, greater flexibility of interest rates in local markets for both loans and savings and closer links between credit markets are needed. Progress along these lines would be expedited by elimination of usury laws on agricultural loans, rate adjustment clauses in long-term credit contracts, and more effective relationships between country banks and the urban money markets. Better facilities for leasing land and equipment and improved channels for equity investments in agriculture may also be needed to serve future needs of agriculture, and the agricultural supply and marketing industries.

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