an economic review by the Federal Reserve Bank of Chicago

Business Conditions

More on inflation

Banking developments

november 1973

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More on inflation

The October issue of *Business Conditions* described the nature of inflation, the measurement of price changes, the history of inflation, and some of the factors that have been responsible for upward price pressures in recent years. This article continues the story with an analysis of the nation's experience with price and wage controls, the impact of inflation on consumers, and a description of economic and social developments in the United States and the world that have made control of inflation more difficult.

Price and wage controls

Periods of rapid inflation usually bring demands for wage and price controls. Most people are aware of the "wage-price spiral," with rising prices bringing demands for higher wages which, in turn, place further upward pressures on prices. "Wages," which are taken as a proxy for total worker compensation, not only are the largest factor in business costs, but they also comprise the largest component of consumer buying power. Attempts to control either prices or wages alone, therefore, have generally been viewed as ineffective.

The federal government imposed price and wage controls in the two world wars and in the Korean War. In 1962, Administration economists proposed the wage-price "guideposts," more commonly called "guidelines." (The Council of Economic Advisers chose the term guideposts because people are supposed to be pleased by the concept of rallying around a *post*, but resent the idea of being dared to step over a *line*.)

Unions and managements were urged in 1962 to hold increases in worker compensation to 3.2 percent annually—the average annual rise in output per man-hour (productivity) for the previous five years in the private economy. Such increases, presumably, could be paid without raising prices, on average, because total labor costs per unit of output would be fairly stable. Some argue that adherence to the guidelines in basic industries kept inflation fairly well checked until late 1965 or 1966. Others believe that relative stability of labor costs per unit of output, and of prices, in the early 1960s mainly reflected the workings of competitive forces that would have been operative under existing conditions even if the guidelines had never been proposed. In any case, the guidelines broke down as the economy surged in the mid-1960s. This development accompanied the vast step-up of U. S. military involvement in Vietnam. Defense expenditures increased sharply, but there was no increase in tax rates until 1968.

As price inflation accelerated in the late 1960s, support for mandatory controls (sometimes called an "incomes policy") gathered strength, despite the indifferent success of such programs in Europe. In 1970, Congress passed the Economic Stabilization Act which gave the President broad powers to control prices and wages. The President accepted the control authority reluctantly. But when inflation continued in 1971, despite a sluggish economy, these powers were invoked. On Sunday evening, August 15, 1971, a 90-day wage-price freeze, known as "Phase I," was declared.

Phase I was followed by Phase II on November 14, 1971, which set a general wage increase guideline of 5.5 percent (6.2 percent for total compensation), required sellers to "justify" price increases, and lim-

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ited profit margins to the average for the best two fiscal years following August 15, 1968. Phase III, which was announced on January 11, 1973, liberalized the rules of Phase II and was blamed by some for the faster acceleration of inflation that followed. It is true that prices rose more rapidly in Phase III, but this development also was associated with the rapid disappearance of excess capacity. To slow the process of price inflation, the President declared a 60-day freeze on prices on June 13, 1973, but left wages free to rise subject to the guidelines. (The second freeze is sometimes called Phase 3½.) The announcement of Phase IV ended the price freeze on August 12. Phase IV rules were generally similar to those of Phase II.

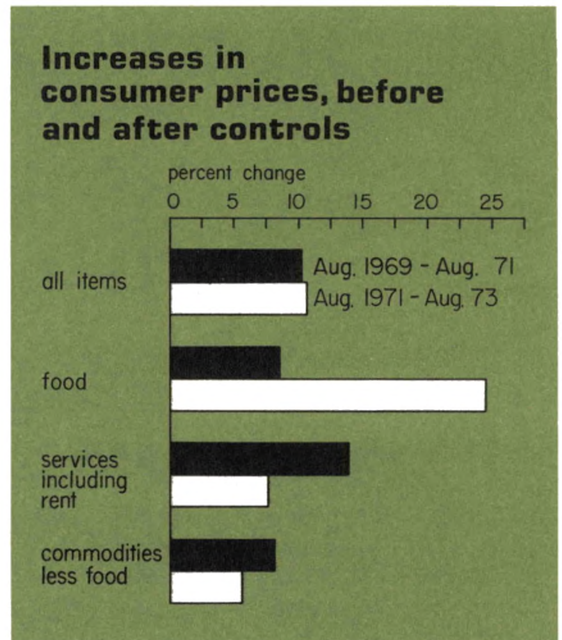
Reactions to the Administration's control program have ranged from qualified approval to outright hostility. No group appears to be fully satisfied, and some insist the controls have done more harm than good.

The consumer price index (CPI) rose 10.7 percent in the two years following the Phase I freeze, slightly more than the 10.3 percent rise in the two years preceding the freeze. Prices on nonfood commodities and services rose at a significantly slower pace in the latter two-year period than in the earlier one. Food prices, however, rose three times as fast in the last two years. The rapid uptrend in food prices in 1973 reflects various factors, including poor crops and strong domestic and foreign demand for grains and meat. But price controls, which generally exempted raw foods, may have actually caused some food prices to rise more, overall, than otherwise would be the case. Because nonfood prices were more strictly controlled, people had more money to spend on food. Limits on cost pass-throughs caused cuts in output of pork, beef, poultry, milk, and some processed foods.

Those who support controls maintain that, without this restraint, prices would have risen even more (which is certainly true of many particular goods), and that controls should have been more stringent and more strictly enforced. Opponents of controls reply that rising prices perform a vital function in attracting resources to the areas where they are most needed. Also, they contend that stricter enforcement of controls would have forced more goods off the market, encouraged black markets, and would have stimulated exports even further than was the case under existing programs. They also suggest that the price indexes have understated the rise in the price level in the past two years because of various devices used to evade or avoid controls.

Problems of control

In World War II, price and wage controls were part of a "harness" that included comprehensive programs of rationing, allocations, and priorities for both materials and manpower. Many items, especially consumer goods deemed nonessential, were not produced at all. Conversely, certain manu-



facturing industries were told what they *should* produce. Either ration tickets or priorities were required along with money or credit to obtain certain scarce resources. This greatly simplified the problems of controlling prices but did not completely eliminate black markets.

The Cost of Living Council (CLC), currently the principal Administration agency responsible for price stabilization, has enforcement powers, but it has relied very largely on voluntary cooperation. Without this cooperation, economic controls would require a huge organization, itself a major user of trained personnel, to police the myriad transactions that take place each day. The Administration has attempted to aid the price control machinery by temporary restrictions on agricultural exports, especially oilseeds. Recently, strict allocations have been ordered for petroleum products. Existing deficiencies in fuel supplies have been seriously worsened by the Arab oil embargo. But there has been no attempt, as yet, to control the entire system of distribution of goods.

Certain products have been exempted from price controls because controls were deemed impractical or counter-productive. Exempted products include raw agricultural products, new manufactured products, exports and imports, and many services. In October, the fertilizer industry was exempted. Small firms have not been required to file reports, in effect exempting them from controls.

Exemptions from controls have helped to maintain flexibility of the market system. To the extent that price controls have been effective in the nonexempt sectors, they have tended to "freeze in" existing channels of distribution and have slowed adjustments to changing conditions that normally occur in the processes of progress and growth.

A popular theory, dating back long before August 1971, was that effective controls on prices of the large basic industries, such as steel and automobiles, would be sufficient to control the general price level. Experience since 1971 has been that large firms have not raised prices nearly as much as the general price level has advanced. In fact, the CLC has stated that many large firms have not fully used their authorizations to raise prices. Partly, this reflects CLC rules that relate price increases to profit margins.

Devaluation of the dollar relative to foreign currencies since August 1971, and worldwide prosperity, have increased the ability of foreign buyers to bid scarce products away from U. S. markets. Examples include various chemicals, fibers, metal scrap, fertilizer, and lumber. In addition, there have been reports of meat animals and lumber sent to Canada or other countries for processing to be returned as exempt imports—obviously an inefficient arrangement.

Price controls have caused producers to revive avoidance techniques used in earlier periods of market stringency. Some firms have dropped items with low profit margins, with the result that some buyers have had to purchase higher grades than they desired. Some manufacturers have raised the minimum sizes of the orders they will accept, with the result that some customers have been forced to buy in larger quantities than usual and, therefore, have become involuntary hoarders.

In order to increase profits without raising prices, some firms have required that a purchaser of a scarce item also purchase an item in more plentiful supply—the "tie in" sale. Purchasing managers complain of products "redesigned" to be new and, therefore, exempt products, even though changes are insignificant; elimination of customary discounts and free services; emphasis on "reciprocity" (you sell to me and I'll sell to you); cutbacks of sales to nonaffiliated customers; curtailment of sales to customers whose overall business is relatively less profitable; and receipts of shipments

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with many inferior items on a "take-it-or-leave-it" basis. Many of these devices are not illegal, but they reflect the types of "gray" markets that develop in times of pressures on resources.

Aside from the possibility of evasion or avoidance of price controls, there is a more subtle aspect. Price is only one of the dimensions of a sale. Others are quality, time of availability, and, perhaps, services to customers long after purchases are made. These factors are quite as important as price and are much more difficult for regulators to control. In the case of components that represent a small proportion of total cost, above-ceiling prices do not deter purchases and buyers are not likely to report violations.

Dynamic forces

The momentum of the uptrend in worker compensation—up 7 percent annually since 1967—greatly complicates the problem of containing inflation, either through restrictive monetary and fiscal policies or through direct controls. Even before labor shortages became widespread in mid-1973, militant unions were able to obtain increases in compensation well in excess of the guidelines by strikes or threats of strikes. Employers have been reluctant to "take a strike," particularly when they believe their competitors will soon have to meet similar demands. In 1973, pervasive shortages and bottlenecks have made manufacturers increasingly vulnerable to work stoppages. Union militancy has become common in recent years in fire and police departments, school systems, and the Postal Service—sectors that were once immune to union pressures.

Union contracts, which often set the pace for non-union compensation, have included a growing variety of nonwage benefits. New contracts call for larger pensions, earlier retirement, additional supplementary unemployment compensation, broader health insurance, longer vacations, more holidays, less actual working time per day, and a variety of other benefits. The full costs of these nonwage benefits are often difficult to calculate in advance. Generally not taxable, they now account for more than 25 percent of total benefits in major industries and in government.

Increasingly, worker compensation and other costs have become flexible only in an upward direction. Attempts to halt price and wage increases run the risk of causing halts in production that are, in themselves, inflationary because supplies of goods are curtailed.

Strong pressures exist to increase the minimum wage, set at $1.60 per hour since 1968, to $2.20 per hour or more, and to broaden its coverage. Higher minimum wages would not only boost the earnings of those who now receive less than the new minimum, but it would also tend to push up the wages of those in brackets just above the new minimum. These changes, while welcome to wage earners, increase costs of employers. Moreover, some analysts believe that higher minimum wages would cause some marginal businesses to reduce output or shut down.

The construction industry is perhaps most afflicted by continued upward pressures on costs. In the past five years, 1968-73, construction costs increased more than 40 percent, while the general price level rose about 25 percent. In this five-year period, average hourly earnings have increased 48 percent in construction, compared to 35 percent in manufacturing. In addition to wage increases, construction costs have been boosted by sharply rising prices of lumber and other materials and higher interest rates. In most desirable urban areas, land prices have increased

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faster than costs of labor and materials. Many construction projects were slowed in 1973 because of short supplies of steel, bricks, cement, and plumbing components. Such delays further increase costs.

Rising real income

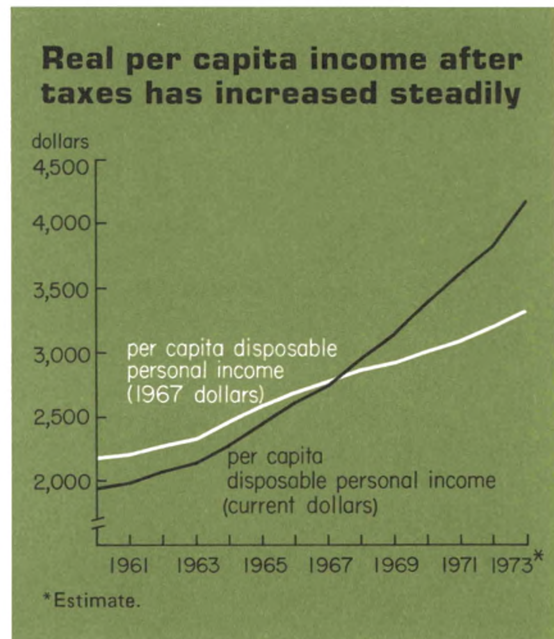
In August 1973, the chairman of the Council of Economic Advisers attempted to explain why a large and apparently growing share of U. S. families believe they are worse off economically year by year, while statistical data indicate that consumer buying power has increased substantially and steadily over the years, even after allowance for inflation and tax payments. He pointed out that increases in income come only at infrequent intervals for most people, usually once a year, while purchases of food, the cost of which increased dramatically in 1973, typically are made each week. He also suggested that income increases are regarded as "barely sufficient to keep pace with the recipient's just deserts, whereas price increases tend to be regarded as extortions."

Per capita after-tax income, adjusted for price changes, has increased each year since 1958. In the ten years 1962 through 1972, real per capita disposable income increased 40 percent, about 3.5 percent per year. In the third quarter of 1973, when food prices increased most rapidly, this measure was up 4.5 percent from the same period a year earlier. In the previous ten-year period, 1952-62, real per capita income increased only 17 percent. The past decade, doubtless, has seen one of the fastest increases in living standards in U. S. history.

Not everyone has participated in the rise in buying power in the past year, even in the past ten years. In fact, some people will earn less this year than last in current dollars, even without consideration of price inflation. But these are exceptions. Data on real per capita disposable income indicate that the great bulk of families have enjoyed an improvement in their status again this year. The fact that many people deny this to be true partly reflects the larger share of their compensation that represents health insurance, more leisure, and provision for retirement rather than increased take-home pay. Another factor is the tendency to consider purchases of many goods and services, once regarded as luxuries, as normal and necessary.

It was once contended that certain broad groups were hurt by inflation because their incomes either were stable or did not rise as fast as prices. These "fixed income" groups were believed to include pensioners, government employees, and private white-collar workers.

Social security pensions have increased much faster than prices in recent years, and adjustments also are made periodically in many private pensions. Increases in salaries of federal, state, and local government workers in recent years have generally kept pace with increases in compensation for comparable private jobs, sometimes under union pressure. In the



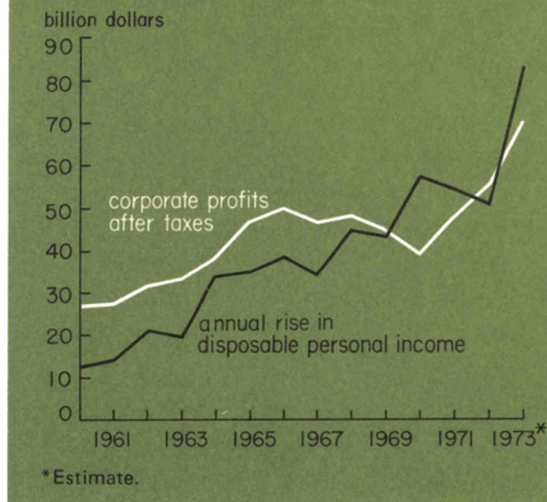
past five years, the average pay of federal workers has increased about 8 percent annually, including a 15 percent boost in 1969. Military pay scales have increased even faster than federal civilian salaries, mainly to encourage voluntary enlistments. Many private white-collar workers, even when they are not unionized, now receive increases in wages and benefits similar to those obtained by union negotiators. This is partly because employers may wish to avoid unionization of their employees, but also because they must pay going market rates to maintain a quality labor force.

Developments of the past ten or 20 years have substantially reduced the number of people who can be assigned to the "fixed income" category. The effects of this development on inflationary pressures have been twofold. First, white-collar workers and pensioners now contribute more fully to the spending stream. Second, the political base required for really effective anti-inflation policies has been eroded.

Corporate profits

Corporate profits after taxes are expected to rise at least 25 percent in 1973, and exceed $70 billion. This increase will follow substantial gains in each of the two previous years. Profits usually rise rapidly in times of business expansion. Conversely, profits, which are on the whip end of any business fluctuation, may decline if the expansion slows down, even if a recession does not develop. Nevertheless, there is a widespread popular view that rising corporate profits have been a major factor behind the acceleration of general price inflation in recent years.

Although corporate profits have risen rapidly since 1970, they are still not nearly as large relative to GNP or other appropriate measures of activity as they were in the middle 1960s. In 1965 and 1966, corporate profits after taxes were almost 10 percent as large as disposable personal in-



come (DPI). In 1970, this ratio dropped to 5.7 percent, the lowest since World War II. In 1973, corporate profits probably will be equal to about 8 percent of disposable personal income. Most analysts expect profits to be about the same in 1974 as in 1973, or to decline somewhat, while personal incomes continue to rise at a fairly rapid pace. If so, the ratio of after-tax profits to DPI would drop significantly.

In the five years 1968-72, corporate profits after taxes averaged $47 billion per year. The average annual *rise* in disposable personal income in these years was $50 billion. Therefore, if all corporate profits in any given year were distributed among the population, the rise in disposable personal income would merely equal about one year's increase in disposable personal income. Despite the sharp increase in after-tax profits expected for 1973, these profits, totaling about $70 billion, will be significantly less than the rise in disposable income, which will probably exceed $80 billion.

Consumers would not be suddenly placed on easy street if all corporate profits

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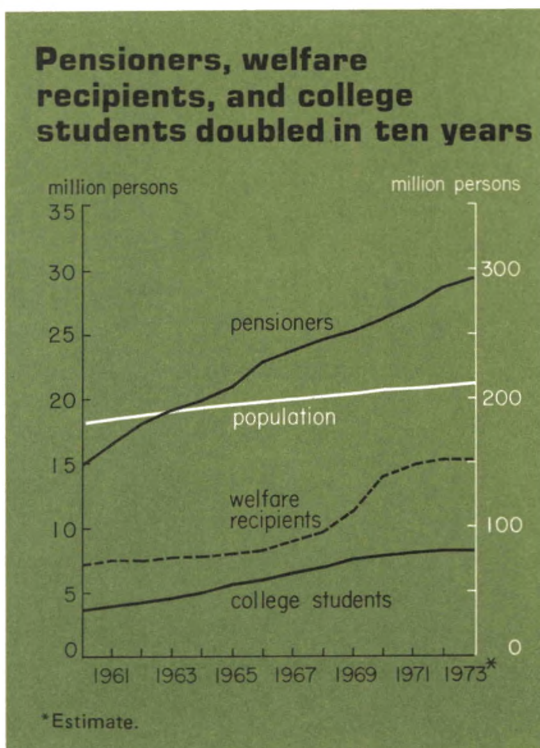
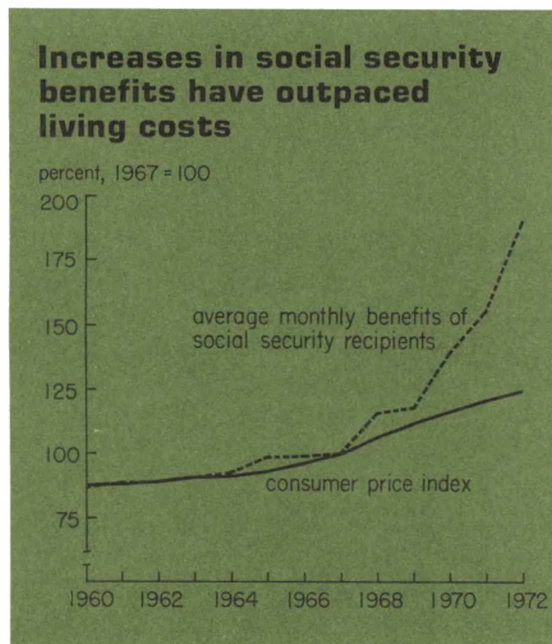
were divided among them. Such a suggestion is absurd in any case. About 60 percent of this year's after-tax profits will be reinvested in inventories, plant, and other assets to carry on corporate business, in order to supply the public with goods and services. Moreover, a reasonable return to shareholders is necessary if private enterprise is to continue to attract investors' funds in the future.

Welfare and social security

The 1960s witnessed a sharp increase in the rise in the number of indigent persons receiving public assistance payments (not social security) despite vigorous economic expansion. At the end of 1972, over 15 million people were receiving welfare payments, including about 11 million members of families with dependent children. The number of welfare recipients almost doubled from 1964 to 1972, and cash payments almost tripled. While attempts are being made to "crack down" on people who are improperly receiving welfare payments, and the number of recipients has declined slightly in 1973, there are also strong pressures to substantially increase monthly payments. There is little hope for any general reduction in the cost of social welfare programs in the years ahead.





Another economic fact of life is the rise in the proportion of retired persons who continue as consumers but who are no longer producing goods and services. Almost 29 million people were receiving federal old age or disability payments at the end of 1972. This number almost doubled since 1960, while the labor force increased about 25 percent.

It is often said that people on social security are on "fixed incomes." This is true at any given time, but average social security payments have increased almost every year in the 1960s and 1970s. From 1960 through 1967, average social security payments rose 16 percent, while the consumer price index rose 13 percent. From 1967 through 1972, social security benefits increased 91 percent, while the CPI rose 25

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percent. Incomes of social security recipients may be far short of an "adequate" level, but they certainly are not on fixed incomes.

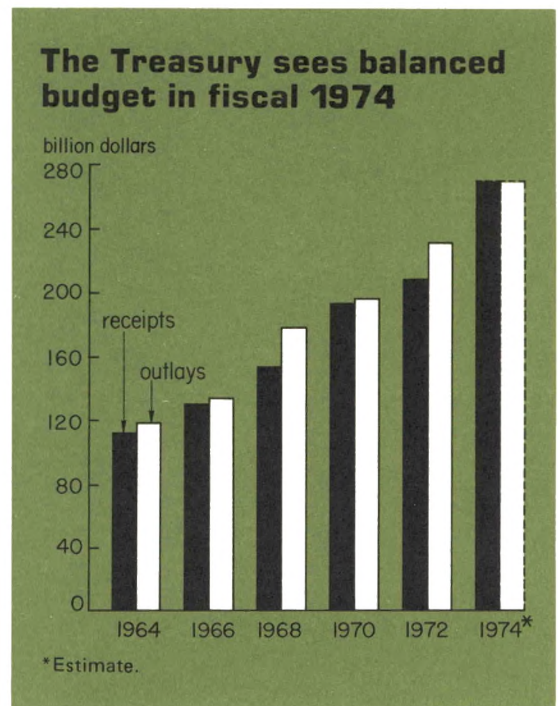
The budget's impact

In the fiscal year 1974, which ends July 1, 1974, it is currently estimated that federal unified budget outlays will total around $270 billion, up $24 billion from fiscal 1973 and about two and one-fourth times as much as in fiscal 1964. Outlays on "health and income security" are expected to reach $106 billion, almost four times the total of ten years earlier, and well in excess of the $78 billion military budget. Federal outlays, currently, are over 20 percent of GNP, about the same as ten years earlier.

The unified federal budget is expected to be almost in balance in fiscal 1974, compared with substantial deficits in each of the past three years. A balanced budget despite higher outlays reflects higher receipts resulting mainly from rapidly rising collections of personal and corporate income taxes. In the past 20 years, the federal budget has been in surplus in only four fiscal years, the last in 1969. A return to a balanced budget in fiscal 1974 would reduce the inflationary impact of rising government expenditures.

Increased federal spending and deficits under the New Deal in the 1930s were feared in some quarters for their inflationary potential. But price inflation was not a problem until 1941, the year of Pearl Harbor. The deficits of the 1930s were very small by recent standards, and until participation in World War II, the nation had large unused resources of facilities and manpower.

With the economy operating close to full capacity in most of the past decade, federal programs have absorbed resources that otherwise would have been available for other purposes, and this continues to be true even if the budget is balanced. Advocates of particular federal outlays often proclaim that their programs can be implemented because "we're a rich country." We are a rich country, but not in the sense that substantial idle resources are available.



It had been hoped by some that the winding down of the Vietnam War would create a "peace dividend" that could be used for other programs. Military outlays did decline somewhat from fiscal 1969 through fiscal 1973, but fiscal 1974 will see another rise to an all-time high. Part of the increase reflects the costs of conversion to an all-volunteer army with higher pay and enlistment bonuses. Additional military outlays apparently also will be required because of the Middle East war.

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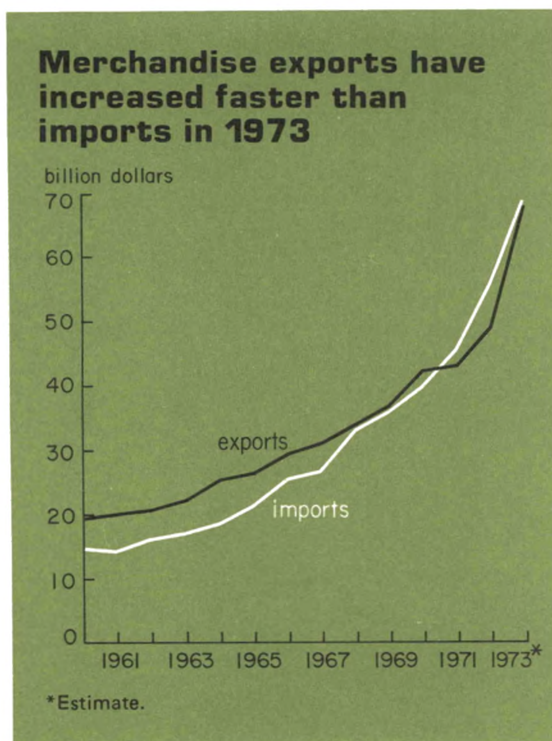
Foreign trade

In 1964, merchandise exports of the United States exceeded imports by almost $7 billion. In the following years, imports rose relative to exports until, in 1972, merchandise imports exceeded exports by $6.9 billion. Although the relationships are complex, it would appear that this shift to foreign suppliers tended to hold down price inflation in the United States because relatively more goods were available in domestic markets.

Because of a combination of factors, including more rapid inflation in other countries, new trade agreements, worldwide shortages of food and materials, major devaluations of the dollar relative to foreign currencies, and U. S. price controls, the U. S. trade balance shifted into the black in the third quarter of 1973 when U. S. exports exceeded imports. An adjustment in the large adverse balance of trade was clearly necessary, but one effect has been to exert upward pressure on domestic prices. The move back to a trade surplus has reversed the experience of recent years, because relatively less goods have been available for U. S. purchasers.



Foreign demand for U. S. products has played a major role in boosting U. S. prices of farm products, fertilizer, and metal scrap. Because of strong demand in their home markets, foreign producers of steel, castings, and metal fasteners have reversed their efforts to supply U. S. markets. Many U. S. manufacturers who had become dependent on foreign suppliers have encountered difficulties in reestablishing domestic lines of supply. Pressure on world fuel supplies has caused some nations to curtail shipments of petroleum and other products to the United States. These developments preceded the Arab embargoes of October 1973.

Living costs—here and abroad

A tabulation published recently by the First National City Bank of New York shows that the rise in the general price level in the United States in 1973 has been significantly less than in any other industrialized nation and less than in all but a few "less-developed" countries. Moreover, the U. S. record compares favorably with that of most countries over the past ten years. Data on consumer prices published recently by the Organization for Economic Cooperation and Development (OECD) show similar results.

In mid-1973, the U. S. CPI was 44 percent above the level of ten years earlier. This was the same as the rise reported for Canada and West Germany. Japan, the Netherlands, and the United Kingdom reported increases in consumer prices of over 70 percent from 1963 to 1973; France and

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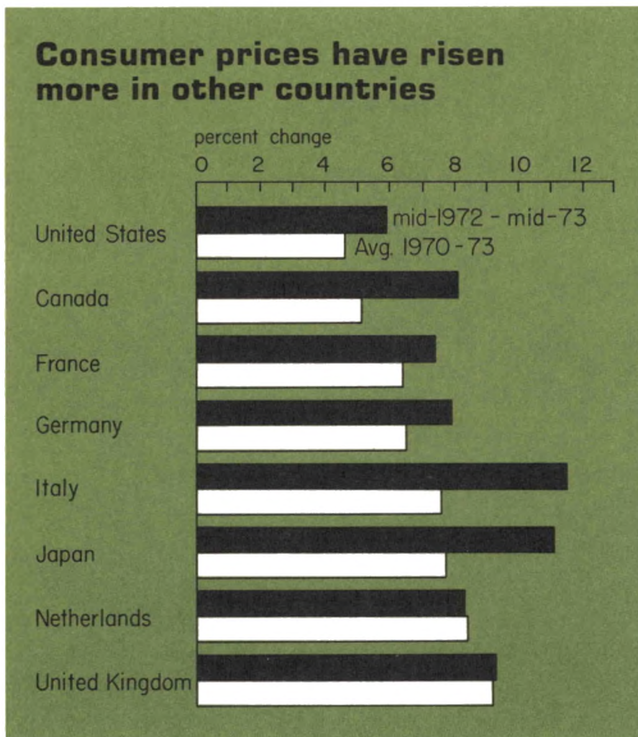

Italy reported increases of about 60 percent.

Between June 1972 and June 1973, the U. S. consumer price index rose 6 percent. In this period, consumer price increases for the other seven countries in the OECD tabulation ranged from 7.4 percent for France to 11.5 percent for Italy. The recent U. S. experience was even more favorable relative to the other nations when the indexes for "all items less food" are compared. In the United States, prices of nonfood items have been restrained more by controls than have prices of foods.

Families in other countries spend a much larger proportion of their incomes on food than do U. S. families, and rising food prices, therefore, are more significant elsewhere. Food accounts for 22 percent of the U. S. consumer price index. In the Canadian index, food has a weight of 33 percent. In Western European and Japanese indexes, food has a weight of about 40 percent.

For all U. S. consumers, food expenditures are less important than in the CPI, which reflects the budgets of moderate-income urban families surveyed in 1960-61. In the third quarter of 1973, despite sharply higher food prices, consumer expenditures for food (exclusive of alcoholic beverages) equaled 16 percent of after-tax income. This proportion was about the same in 1971 and 1972, but it has tended to decline over the years as living standards have improved. Ten years ago, 19 percent of U. S. personal disposable income went for food; 20 years ago, the share was 22 percent.

The decline in the proportion of income spent for food is an indirect measure of the ability of consumers to satisfy their wants for other goods and services—e.g., finer clothing, better housing, motor vehicles, higher education, health care, alcoholic beverages, and recreation. The steady rise in aspirations for the "good things of life" is closely related to demands for higher incomes. With incomes rising faster than output of goods and services, and with consumers increasingly able and willing to incur debt, upward pressures on prices are all but inevitable.

Inflation to continue

Achievement of reasonable price stability, a continuing national goal, seems increasingly elusive. The two-year experience with price and wage controls has disillusioned many who thought inflation could be ended by administrative fiat.

Inflationary developments of recent years include the steps being taken to

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correct health and safety hazards and reduce air and water pollution. These programs require expensive equipment and have caused utilities and manufacturers to shift to higher-priced fuels and materials. Farmers and lumberman have had to forego use of certain pesticides which protect against damage to crops and timber. Motor vehicles are consuming more gasoline.

Programs to aid the handicapped and to require employers to lower hiring standards to increase hirings of disadvantaged people all have their economic costs. The fact that about 50 percent of all high school graduates move on to higher education has reduced the supply of trainable young workers. The potential labor force also has been reduced by the larger number of retired people on pensions.

Continued deterioration of the purchasing power of national monetary units has been a fact of life as far back as analysis is possible from historical records. Several hundred years ago, the English penny was a coin of substantial value. The *Wall Street Journal* has recounted the decline in the value of the denarius of the Roman Empire, and the futile attempt of Emperor Diocletian to control prices and wages early in the fourth century.

The current inflation seems more firmly rooted than any previous inflation in U. S. history. Upward pressures on prices retain strong momentum, both here and abroad. The growing pessimism concerning achievement of price stability is indicated by recently publicized forecasts that the price level will rise at least 5 percent annually for several years to come. Inflation tends to feed on expectations. Interest rates, especially long-term rates, are kept high by inflationary expectations. Lenders demand, and borrowers are ready to pay, interest rates that include an allowance for the expected decline in the purchasing power of the dollar.

National governments and monetary authorities are under great pressure to restrict growth in income and borrowing power, but they do not wish to take actions to slow spending abruptly. The record indicates that such actions may cause economic hardship without a commensurate slowdown in the rise in prices.

Although the portion of our population on fixed incomes is less than a generation ago, inflation still causes widespread inequities—disproportionate gains and losses as price/income relationships change. But the desire to keep inflation from continuing to accelerate involves other serious considerations. The experience of all modern nations has been that inflation of a limited degree promotes prosperity by reducing the risks of investment and productive activity. Beyond a certain point, however, diminishing returns are noted. Excessive demands on resources result in lowered productivity.

A true "flight from the dollar," a widespread attempt to rapidly convert money into goods, has been foreign to this nation's experience. National policies aimed at maximizing production while restraining excessive increases in purchasing power will prevent such an occurrence in the future.

George W. Cloos

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Banking developments

Loan portfolio composition

Total loans at all commercial banks in the Seventh District increased by more than 75 percent in the past five years. Data from the mid-1973 official condition statements of district commercial banks indicate that while the composition of these loan portfolios still varies markedly by bank size and location, there has been some tendency for those differences to be reduced.

The kinds of loans a bank makes reflect the credit demands of its customers, legal restrictions that affect its access to markets, the importance of other financial institutions in the area, and its own lending and marketing policies. As would be expected, large city banks tend to have a large proportion of business loans, particularly in areas where the prohibition of branches limits large banks in their access to the home mortgage and personal loan markets. Chicago is the outstanding case in point.

Loans to commercial and industrial firms (business loans) comprised one-third of all bank loans in the district (excluding overnight federal funds loans from one bank to another) at midyear. This reflects the high concentration of this type of loan at the district's biggest banks, which account for a large percentage of all loans. More than half of the dollar volume of all loans is in Chicago and Detroit, and more than half of all district business loans are in Chicago.

In Detroit, and in most areas outside the major cities, real estate loans are the largest component of bank portfolios. (See table.) Real estate loans include loans on commercial properties and farm or business loans secured by real estate as well as residential mortgages. Michigan banks typically have relatively large mortgage portfolios due to branch operations that give them access to home buyers, and have strengthened their competitive position vis-a-vis thrift institutions over the years.

Loan portfolios differ widely among district areas

Bank location	Percent of total loans, commercial banks, June 30, 1973				
	Mortgage	Business	Consumer	Farm	Other
Major SMSAs					
Chicago	15	47	13	1	24
Indianapolis	26	30	28	2	15
Des Moines	25	36	24	4	11
Detroit	43	26	17	*	13
Milwaukee	30	37	19	1	14
Other SMSAs					
Illinois	31	27	32	6	4
Indiana	39	25	30	2	5
Iowa	27	28	27	14	5
Michigan	44	21	29	2	5
Wisconsin	46	27	21	3	4
Outside SMSAs					
Illinois	30	19	28	21	2
Indiana	39	18	31	10	2
Iowa	23	17	18	39	2
Michigan	47	15	29	6	3
Wisconsin	48	20	19	11	4
District	29	33	20	5	14

Note: Loans exclude federal funds sold.
*Less than 1 percent.

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Consumer loans (loans to individuals) rank third as a use of loanable funds. These loans appear to be a bit more important in the smaller metropolitan areas of the district than in either the big city or small rural banks.

Agricultural loans (excluding those secured by real estate) are concentrated outside metropolitan areas and are especially important at Iowa banks. Even at the rural banks, however, farm loans declined as a proportion of portfolios over the last five years—a trend that has persisted over the past decade. Since 1961, at banks outside SMSAs, farm loans have declined from 33 to 21 percent of all loans in Illinois and from 43 to 39 percent in Iowa. Offsetting gains have been about equally divided between the business and consumer loans.

Despite the dominance of business loans at the large Chicago banks and their rapid expansion in 1973, business loans accounted for a smaller share of total loans at midyear than five years earlier (47 to 50 percent). This is explained by an even faster growth in the residual "other" loan category. Much of this residual consists of loans on securities and loans to financial institutions—types of credit that tend to be concentrated at major city banks. ■

Most smaller member banks now over 60 percent in loans/deposits

	Banks with deposits less than $100 million				
	Illinois	Indiana	Iowa	Michigan	Wisconsin
	(percent of banks)				
Loans as a percent of deposits on 9/26/73					
80 and over	3	5	6	13	16
75 – 79	7	6	10	19	12
70 – 74	7	13	12	27	22
65 – 69	11	11	18	22	17
60 – 64	15	21	12	9	10
55 – 59	15	19	12	6	9
50 – 54	13	6	11	2	8
45 – 49	9	4	8	2	2
Under 45	19	15	10	2	4
Average of individual bank ratios	(percent)				
9/26/73	56	60	61	71	69
9/27/72	53	57	59	68	66

Ratio of loans to deposits

Loans rose faster than deposits over the past year at both large and small district banks. For the 55 large weekly reporting banks in major cities, the average ratio of total loans to total deposits was 77 percent in early November—up from 70 percent a year earlier. Less than one-fourth of these banks still had ratios below 70 percent and more than one-fifth were 90 percent or above.

Smaller banks typically have a smaller proportion of their deposits in loans, partly because they have more limited access to nondeposit sources of funds and less liquidity in their loan portfolios. For Seventh District member banks with deposits less than $100 million, the average loan-to-deposit ratio was 62 percent at the end of the third quarter—up from 59 percent a year earlier.

The proportion of these small- and medium-sized banks having a ratio of 60 percent or over rose to more than 60 percent, compared with 52 percent in September 1972 and only 49 percent in mid-1970.

The district average of individual bank ratios is heavily weighted by Illinois, where nearly two-fifths of these smaller banks are located. Illinois banks' ratios are lower than those in the other four states (see table). In Michigan, where there is a smaller number of larger banks, almost 60 percent of bank ratios are 70 percent or higher. ■

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