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B. TRENDS IN BUSINESS AND CREDIT AS VIEWED IN THE THIRD DISTRICT

The business readjustment which began over a year ago appears to be largely completed. Gross national product and industrial production, after declining for about a year, have flattened out in recent months at levels only moderately below the peak of last year. Nonagricultural employment moved up in June and July, and unemployment, after declining slightly in the second quarter, has been stable at about 3.3 million despite the seasonal increase in the labor force. The downpull on industrial production exerted principally by the decline in defense spending and inventory liquidation has moderated substantially. Consumer and construction expenditures, supported by a high level of disposable income and easier credit, continue to be strong sustaining forces. For the next few months the prospects are for a stable or slightly higher level of production at an operating rate somewhat below full capacity. Economic slack should be sufficient to absorb a moderate amount of credit expansion without generating a general rise in prices.

There are some significant differences between the economy of the Third District and the national economy. Manufacturing and mining are somewhat more and agriculture somewhat less important in the district than nationally, measured in terms of the total number of gainfully employed. Thirty-five per cent of the workers in the district are in manufacturing as compared to 26 per cent for the United States, and 4.8 per cent of district workers are in agriculture as compared to 12.5 per cent nationally. District employment in manufacturing is also more evenly balanced between durables and nondurables than for the country as a whole -- it is fifty-fifty in the district in contrast tc 59 per cent in durables and 41 per cent in nondurables nationally. As to industries -- apparel, textiles, chemicals, tobacco, petroleum and coal products, leather, primary metals, and electrical machinery are somewhat more important in the Third District than nationally; food processing, lumber and furniture, and transportation equipment are less important.

Factory employment in the Third District in July was 10 per cent below a year ago. The decline in employment, payrolls, and working time from June to July was less than 1 per cent, reflecting largely vacation shutdowns in both durable and nondurable goods lines. The decrease in employment was about the usual seasonal decline, but the drop in payrolls and hours was the smallest for any similar period in recent years. Total employment in the Philadelphia area increased slightly during June and July, interrupting a continuous decline during the preceding eight months. The increase included both manufacturing and nonmanufacturing employment and reflected largely the resumption of operations in strike-bound plants and seasonal expansion in such industries as apparel, construction, and transportation and other service industries.

Unemployment rose somewhat, however, as the gain in employment was not sufficient to absorb all new entrants into the labor market. The trend in unemployment compensation claims has been generally downward in recent weeks. Although soft spots are still apparent in such lines as textiles, apparel, machinery and transportation equipment, the over-all situation shows signs of stabilizing. Unemployment is a chronic problem in some of the coal-mining regions.

Agricultural conditions in this district are less favorable than last year. Spring planting was delayed by cool, wet weather. A severe drought from late June until early August drastically reduced the yields of some field crops and early vegetables. Some damage also appears inevitable in the case of later-maturing crops. Substantial acreage of some crops has been abandoned. Pastures provided little or no grazing; consequently, feed costs for livestock have increased substantially.

In the early months of this year, receipts from marketings were running about 10 per cent below 1953, reflecting reductions both in physical volume and lower average prices for crops and livestock. Farm production costs, on the other hand, have declined very little from year-ago levels. The market for farm real estate is somewhat weaker than in the spring and the summer of 1953.

Construction activity in the Third District is at a high level, the value of contracts awarded running about one-fourth above the same period last year. Builders are optimistic yet cautious. The more cautious attitude of builders is evidenced by increasing use of "pilot operations" for testing out the local market. More builders in this area are putting up sample homes, continuing construction in the new development on the basis of orders taken. New houses are moving well but real-estate brokers report that old houses are becoming more difficult to sell. Our recent re-check among Philadelphia area manufacturers shows practically no change in their capital expenditure plans.

Department store sales in the Third District for the first seven months were 5 per cent below the same period last year. Sales have declined in all major reporting city areas of the district with the exception of Wilmington. Inventories adjusted for seasonal changes declined 1 per cent in July. The July reduction in inventories brought department store stocks 5 per cent below July 1953.

Automobile dealers experienced severe competition in this district throughout the year and there has been a relatively large number of failures. Sales volume was disappointing during the winter, and seasonal improvement started later this year than usual. June sales were high but there was a sharp drop in July. Dealers report that cash discounts and excessively liberal trade-in allowances are common in most areas. Perhaps the brightest spot at present is the rise in used-car sales that developed in early August.

Credit trends in the Third District reflect both the business readjustment and the easier credit policy. In the year ended June 1954, member bank loans and investments increased over $300 million, or nearly 5 per cent -- twice as much as in the preceding year. Business loans, which had been a major factor in loan expansion, declined slightly, and the increase in consumer credit was markedly smaller. But real-estate loans were up substantially, and security and agricultural loans expanded -- the latter reflecting Commodity Credit Corporation paper. Seeking additional credit outlets, the banks added materially to their holdings of Federal Government and municipal securities. Reduced loan demand was more marked at reserve city banks, located in Philadelphia, than for country banks. Reserve city banks added considerably to security holdings and little to loan portfolios, while country banks expanded loans materially but reduced their investments somewhat.

For the two months following mid-year, banks in leading cities of the district increased their investments but there was no net change in loans. Real-estate loans and unclassified loans, which include consumer credit, continued to rise slowly, but security loans declined and business loans dropped off through early August. In the three weeks ended August 25, business loans increased by $21 million to $879 million -- nearly twice the increase for the same period last year and the largest for the period since 1950.

The effect of the easier money policy is most evident in the field of mortgage credit. Mortgage money is readily available, according to both lenders and builders, in practically all areas of the district. This represents quite a change from the tightness that still prevailed last fall. Lending terms on new construction have eased with respect to down payments and maturities, but the terms for mortgages on existing houses have not changed significantly.

VA loans account for a rapidly rising proportion of new-home mortgages, and FHA loans have become more popular also. One of the most significant changes has been the large increase in VA loans with no down payment. Some lenders estimate that the proportion of VA loans with no down payment may be as high as 50 per cent. They also report that about one-third of VA mortgages made in recent months run for 30 years. Six months ago the number of VA mortgages with no down payment was insignificant, and very few covered maturities beyond 25 years. Interest rates on conventional loans are somewhat lower, ranging from $4\frac{1}{2}$ to 4-3/4 where the down payment is substantial, as compared with 5 to $5\frac{1}{4}$ per cent six months ago.

Discounts on guaranteed and insured mortgages have practically disappeared. Discounts as low as 93 on VA mortgages and 95 on FHA mortgages were sometimes reported as recently as early last winter. Both VA and FHA mortgages are now readily salable at from $93\frac{1}{2}$ to par, depending on the size of the down payment. Lending institutions are now actively seeking mortgages, but we have had few reports of premiums being paid, even on prime-risk conventional paper.

Instalment credit has also eased somewhat this year. The tendency toward ease is more pronounced on automobiles than on appliances and other household goods, and on new cars than on used cars. Terms on automobile loans have eased in Philadelphia and the surrounding area but in some of the smaller cities of the district there are signs of tightening both as to down payment and maturity. Major appliance dealers generally have shown little tendency to alter terms of credit sales.

There has been some reduction in rates on wholesale financing to automobile dealers. One of the largest finance companies reduced its rate last spring from 5 to 4 per cent. There are unconfirmed reports of other finance companies charging even less for dealers' floor planning. Wholesale rates to appliance dealers have not changed significantly. Interest rates charged consumers on instalment loans remained at 6 per cent except for occasional "gilt-edge" applicants having the highest credit rating or a long-standing association with a particular lending institution.

Consumer credit standards are reported generally to be higher than six months ago. More lenders are insisting on full credit reports on applicants, and a significant number of loan applications are being rejected. Loan applications are being screened more carefully, with employment records and earnings prospects being given more weight. An increasing number of automobile and appliance dealers are doing their own preliminary screening before writing a loan application.

Collections on all types of instalment loans continue fairly prompt except in a few areas particularly hard hit by unemployment. Delinquencies are more frequent in the case of automobiles than appliances. Repossessions are not a serious problem anywhere.

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