MONTHLY

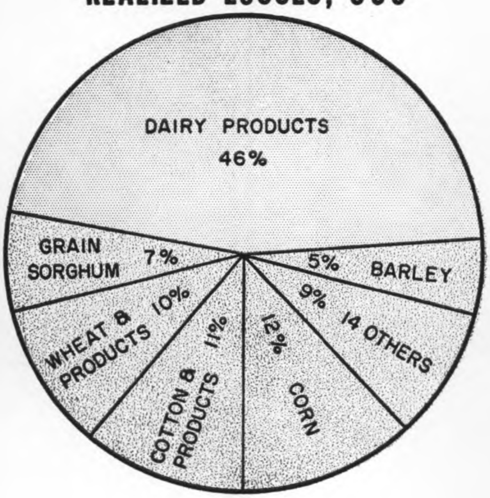
Business Review

FEDERAL RESERVE BANK of CLEVELAND

October 1956

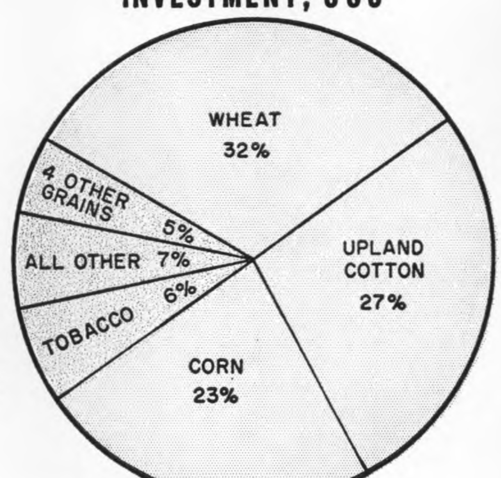
IN THIS ISSUE

REALIZED LOSSES, CCC



Substantial disposal of surplus stocks held by the Commodity Credit Corporation occurred during the fiscal year just ended. Losses on investment necessarily accompanied disposals. DAIRY PRODUCTS accounted for the largest realized losses.

INVESTMENT, CCC



Total stocks of farm products held by the CCC at the end of the fiscal year, however, were larger than ever, with the biggest investments applying to WHEAT, COTTON and CORN.

Additional copies of the MONTHLY BUSINESS REVIEW may be obtained from the Research Department, Federal Reserve Bank of Cleveland, Cleveland 1, Ohio. Permission is granted to reproduce any material in this publication.

Government Stocks of Surplus Farm Products

ACCUMULATION of farm surpluses in the hands of the Federal government is still a troublesome reality, in spite of very great efforts and some progress realized recently in the disposal of the excess. Facts about the dimensions of the surplus stocks and the particular commodities of which they are composed are important for any objective appraisal of the current status of "the farm problem." That is the case both in time of vigorous political controversy and in quieter periods.

The information presented below is based, for the most part, upon a rearrangement and simplification of the accounting data published in the Commodity Credit Corporation Report of Financial Condition and Operations as of June 30, 1956. First, however, a brief description of the disposal operations which were undertaken during the 1956 fiscal year is in order.

Disposal Operations

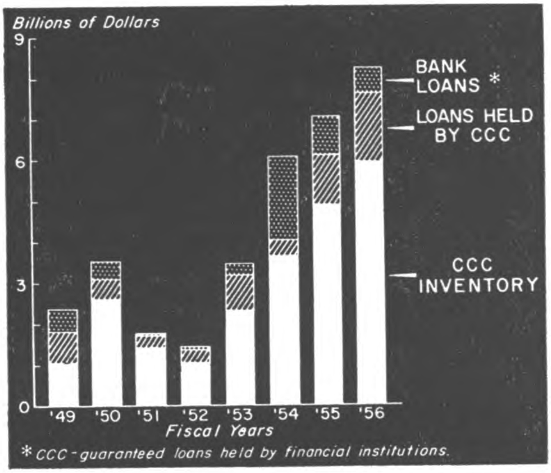
Intensive efforts at surplus disposal were undertaken over a broad front during the 1956 fiscal year. Commodities such as soybeans, the price of which increased far above the support price, were sold on normal markets. Where permitted by statute, many commodities were sold at market prices even though lower than the cost to the CCC. Some commodities were bartered to foreign countries in exchange for strategic materials. In other instances, surplus products were exchanged for foreign currency. Further large amounts were donated outright through domestic and foreign outlets. The School Lunch Program and special drought and disaster aid may be included among the many facets of surplus disposal.

Food donations during the 1956 period were nearly double those of a year ago in tonnage. Over a million tons were given away, about 40 percent of which went to persons in this country. Donations to schools were up 36 percent from a year ago; institutions received 39 percent more; needy individuals received 96 percent more. Foreign donations increased 125 percent with distributions now being made in 84 countries through 25 private United States welfare agencies. Over the course of the fiscal year, domestic recipients of surplus food included about 12 million school children, over a million needy persons in charitable institutions and more than 3 million needy persons in family units.

Progress in surplus disposal is exemplified by the dramatic 89 percent reduction in CCC-held butter stocks which occurred in the two years 1954 to 1956. Such a decline in butter holdings brought to a close the inventory glut associated with the "butter dilemma" so widely publicized in 1954.

Despite the many-faceted attack upon the bulging granary of the CCC, however, surpluses continued to mount. The dollar total of investment of the CCC, in the form of inventory holdings and unredeemed loans, has accordingly risen. That has come about because commodities for which the investment declined were more than offset by others

Despite important accomplishments in the disposal of farm surpluses, another record has been established in the volume of loans and inventory representing the Commodity Credit Corporation investment.



which showed an increased investment. The reasons for the increases in investment are associated with the continued tendency toward excessive supply situations, — not assignable to any one specific set of factors. Rather they are outgrowths of a complex of changes in demand, production and carryover for specific commodities, — all taken against a background of large supplies of farm products and a government program of action which is also the subject of frequent modifications.

Those responsible for the formulation and administration of the price-support program are hopeful that continued surplus disposal operations, in conjunction with the newly legislated "Soil Bank" program and the flexible system of establishing support prices, will combine to reduce the surplus accumulation in years ahead.

Price Support Losses

Net losses realized in disposing of price-supported commodities in fiscal 1956 neared $1 billion, or 22 percent greater than the record level set the year previous. A further yardstick of the magnitude of this loss is the fact that it was nearly equivalent to the combined net loss for the first 17 years (1933-51) of CCC operations; higher average prices would account for only a part of the increase. Loss is taken here as the difference between the cost and selling price of products handled by the CCC.[1]

Six products or related groups of products accounted for over 90 percent of the losses realized in 1956. *Dairy products* alone accounted for 46 percent of the loss. For an individual product, more money was lost on butter than any other item. Other dairy products, especially dried milk and cheese, were also high on the list as loss items. Losses on butter exceeded the actual dollar reduction in butter inventory over the course of the year, insofar as newly acquired stocks were also disposed of. (Butter, being more perishable, cannot be stored for extensive periods like grains or cotton.) Presumably, were it not for intensive and costly disposal efforts, the butter inventory situation may have worsened during 1956.

Second to dairy products, as a loss item, was *corn* followed closely by *cotton* and cotton products accounting for about 12 percent and 11 percent, respectively, of the total losses. *Wheat* and wheat products added another 10 percent to the loss figure. Proportions of the total amounting to 7 percent for grain sorghum and 5 percent for barley complete the listing of six major commodities or commodity groups charged with more than 90 percent of the 1956 losses. The remaining losses were distributed among more than 14 products.

The six products accounting for the bulk of the loss during fiscal 1956 also accounted for 86 percent of the investment at the close of the period. While this serves as some indicator of losses in the year ahead, it is significant that dairy products, which accounted

(1) Areas of operation such as the supply, commodity export and storage facility programs have the net effect of increasing the loss somewhat further. Likewise administrative costs are not included in net realized losses. Nor are many disposal losses for which the CCC is reimbursed in full by Congressional appropriations. Authorizations for Pakistan wheat, famine relief and Titles I and II of the Agricultural Trade Development and Assistance Act are examples of specific Congressional Acts authorizing full reimbursement.

for nearly half of the losses in 1956, were a relatively minor item in the year-end investment. Also the cotton and cotton products group which looms large in the over-all investment is historically a profit item for the CCC. Profits from the cotton group are not so consistent as to be a normal expectation; losses were realized in 1954-55 and in 1955-56 when the investment was much lower than at the July 1 start of the present fiscal period.

Corn and wheat, charged with over half the June 30, 1956 investment, are consistent money losers. Over the 23-year history of the Commodity Credit Corporation, corn and wheat have been responsible for $220 of every $1,000 lost on price support operations. Aside from potatoes and eggs, which are now generally excluded from price supports, corn and wheat along with dairy products total to nearly three-fourths of the CCC losses from 1933 to date.

Of the thirty specific items for which profits and losses were reported for 1956, only wheat flour, naval stores, dry edible peas and strategic materials registered a profit. For these four items a total profit of about $1 million proved of negligible effect in offsetting total losses of $976 million on the other items.

Composition of Investment

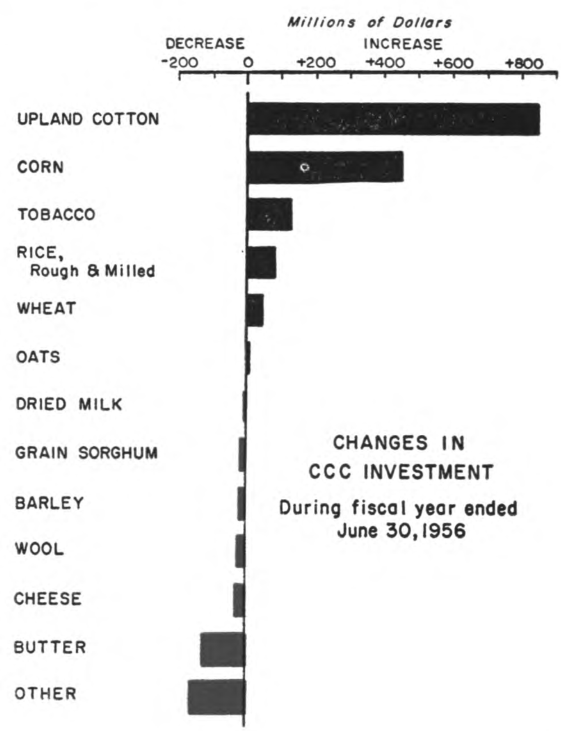
Money invested in supported farm commodities was larger than ever before, for a mid-year date, at the June 30 close of the 1956 fiscal year. This investment totaled nearly $8.3 billion dollars, consisting of $6.0 billion in inventories owned outright by the CCC and $2.3 billion in loans outstanding. The inventory accumulation during the year was somewhat less than in the previous year but the total investment, including loans, increased slightly more in fiscal 1956 than in the fiscal year 1955. The increase in fiscal 1956, however, was about one-half that of fiscal 1954.

Wheat, cotton and corn together account for 82 percent of investment in price-supported commodities, as of June 30, 1956. Tobacco accounts for an additional 6 percent. The remaining 12 percent is distributed among more than twenty different commodities. (See cover chart.)

The largest single item in the surplus commodity "portfolio" is *wheat,* with an investment amounting to more than $2.6 billion. Most of this excess wheat is owned outright by the Commodity Credit Corporation. Holdings of wheat by the government increased by less than 2 percent in dollar volume during the year ended June 30.

In terms of bushels, holdings of old wheat (exclusive of 1956 crop acquisitions) would be more than enough to supply normal foreign and domestic demand for a year. Aside from the carry-over, the estimated 1956 wheat harvest would be adequate to meet anticipated current needs. Accordingly, any

The net increase in the investment total of the Commodity Credit Corporation has been a result of substantial gains in some commodities, more than offsetting reductions in others.



significant reduction in over-all wheat stocks during the coming year would have to be a result of additional success in disposal operations.

Cotton, ranking second only to wheat in the CCC investment, was the principal contributor to the *increase* in investment during the 1956 fiscal period. A 61 percent increase occurred over the year in the volume of CCC money invested in cotton. Inventories increased from 1.7 million bales to 6.8 million bales. Cotton still under loan added another 6 million bales to the investment. Total holdings on June 30 at 12.8 million bales were far greater than expected domestic and foreign demand for the entire 1955-56 season. (Reduced exports were a prominent factor in the increased CCC investment in cotton.) Surplus cotton sales have been stepped up very substantially at "cut-rate" prices since the June 30 close of the CCC fiscal year; this, along with a smaller crop, provides some hope of reduced holdings in 1956-57.

Corn, dislodged from second place by cotton in the investment portfolio, counts as third in amount of investment. Corn under support on June 30, 1956 was 30 percent greater in dollar volume than the year previous. Corn was exceeded only by cotton as a factor responsible for the over-all increase in the price support investment during the fiscal period. When related to the rate of use, however, corn in CCC hands was equivalent to about 4½ months' supply, or decidedly less than that of either cotton or wheat. Corn production this year is expected to exceed 1956-57 utilization — the fifth consecutive year of imbalance between output and demand.

An especially significant development in the status of the price support program during fiscal 1956 has been the continued decline in the volume of *dairy products* held in inventory. On June 30, 1954, dairy items had accounted for about 9 percent of the total CCC investment. But, in 1955 the proportion declined to about 5 percent; and by the close of the 1956 fiscal period, dairy products represented only 2 percent of the total. In dollar terms this represents a reduction from $544 million to $173 million in two years.

Of the many other items included in the current CCC price support investment, *tobacco* looms the largest; a 31 percent increase in stocks brought holdings up to about 6½ percent of the dollar total. Inventories of *rice* increased 64 percent in dollar volume to account for 2½ percent of the over-all investment. No other single commodity bulked as large as 2 percent in the holdings.

Strategic materials acquired by the CCC in exchange for surplus commodities were nearly triple the previous year's figure on June 30, but still accounted for slightly less than 2 percent of the investment.

Borrowing Authority

Price support operations are financed primarily by borrowings of the Commodity Credit Corporation. Through most of the 1956 fiscal year, the agency was authorized by statute to draw funds as needed up to a limit of $12.0 billion. At the end of June, $11.8 billion of the authorized amount was in use. About $11.2 billion was in actual borrowings and $0.6 billion in obligations to purchase loans financed by lending agencies. Among the loans financed by lending agencies are certificates of interest, individual loans, and storage facility and equipment loans.

With nearly all of the authorized borrowing authority in use, and in light of the prospect of further needs in the 1957 period, Congress on August 1 approved an increase to $14.5 billion in the amount the CCC can use. Previous increases were from $8.5 billion to $10.0 in August 1954 and to $12.0 billion in August 1955.

At the present time, it is too early to appraise the effectiveness of the Soil Bank and flexible supports in reducing the surplus accumulation. By harvest time in 1957, it will be evident whether existing borrowing authority will be in excess of needs or whether additional increases in borrowing authority will be necessary.

Mortgage Warehousing in Retrospect

During 1956, the Federal Reserve System conducted three surveys of warehousing of real estate mortgages by weekly reporting member banks, the most recent of which was conducted on August 8.[1] Although the total amount of warehousing loans for the nation or the Fourth District has increased since August 10, 1955, the rate of increase has declined markedly. At the same time, unused commitments to warehouse future mortgages have been reduced more than loans have been expanded.

Background

About a year ago, scattered reports in the financial pages and from other sources directed attention to the growing practice of commercial banks of extending credit to the real estate market indirectly through short-term loans to real estate lenders. From all indications, an unusually large amount of such loans, commonly and somewhat loosely referred to as "warehousing loans," had been made by commercial banks during the first half of 1955. The practice was criticized in some quarters as an unwarranted use of bank funds in a period when the demand for bank loans was already swollen by increased activity in other areas.

(1) For Fourth District figures on November 16, 1955, see page 6-7 of the February 1956 issue of this *Review*. The latest revised national figures appeared on page 936 of the *Federal Reserve Bulletin*, September 1956.

It was considered at that time that any marked expansion of warehousing by commercial banks would run counter to the direction of certain actions taken by Federal Government agencies to restrain the expansion of real estate credit. For example, on July 30, 1955, the maximum maturity on Government guaranteed and insured mortgages had been reduced from 30 to 25 years and the minimum downpayment had been increased by 2 percentage points. In September, the Home Loan Bank Board had taken steps to reduce the volume of outstanding advances to Federal savings and loan associations by advising member associations that mortgage lending should be limited to the inflow of funds from savings shares and repayments. On a broader front, Federal Reserve policy had moved gradually from ease to restraint in 1955.

Ordinarily available information on credit extensions by commercial banks provide no data on indirect extensions to the mortgage market. Regular reports of condition from insured banks and weekly reports of condition from large banks in leading cities provide data on loans made directly by banks to mortgagors and purchases of mortgages from real estate lenders, with and without repurchase agreements, but the direct loans are not classified separately from the indirect, or warehousing loans. Loans made by commercial banks to real estate lenders, when the real estate lender retains ownership of the mortgage, are classified on reports of condition as business loans, loans to banks, or in a miscellaneous category, depending on the real estate lender's major business function. This classification prevails whether or not the loan is secured by a mortgage on real estate. Thus, the usual reported figures on real estate loans include only a portion of mortgages warehoused.

Types of Warehousing Loans

The most common type of mortgage warehouse lending, practiced by commercial banks for many years, takes the form of loans made to real estate lenders and secured by mortgages being processed — completing of legal and administrative details — before they can be sold to the permanent holder. The short-term nature of the loans is assured by a commitment on the part of the permanent holder to accept delivery of the mortgages, once its terms and specifications have been met.

In more recent years, the advent of a middleman in the mortgage market — the mortgage company — has led to the development of a type of warehousing loan that is similar to the above but lacks a commitment by a permanent holder. To some extent, this type of loan adds stability to the mortgage market by making it possible for the middleman to maintain continuous operations and to finance mortgages for which he has not yet found a permanent holder. On the other hand, when the credit is continuously rolled over, it becomes a permanent addition of commercial bank credit in the mortgage market.

A third type of warehousing loan involves an extension of credit to a permanent holder. The demand for such loans occurs when the permanent holder is committed to purchase mortgages in excess of current and near-term supply of available funds. Such loans may be made for as long as twelve or eighteen months, depending upon the time required by the permanent lender to reduce his commitments to a volume compatible with available funds.

While the first two types of warehousing techniques are short-term loans designed to finance the processing and sale of mortgages, in a way similar to inventory and other working capital loans, the latter type adds to the resources of the permanent lender and, if the term is extended, it is more akin to an intermediate-term capital loan.

The First Survey

In order to ascertain the amounts of all types of credit extended to real estate lenders, the Federal Reserve System has conducted five special surveys of weekly reporting member banks, the first of which was conducted on August 10, 1955. (These banks held about two-thirds of total loans of all commercial banks.) The results of the survey indicated that warehousing had, indeed, increased substantially over the previous year.[2] On a national scale, such credit extensions increased from $608 million on August 11, 1954, to $1,408 million on August 10, 1955. In the Fourth District, the increase was from $22 million in 1954 to $87 million in 1955. Data on unused commitments to make such loans were not obtained for August 11, 1954, but on August 10, 1955, District reporting banks had outstanding commitments of $51 million, and for the nation, the comparable figure was $1,295 million.

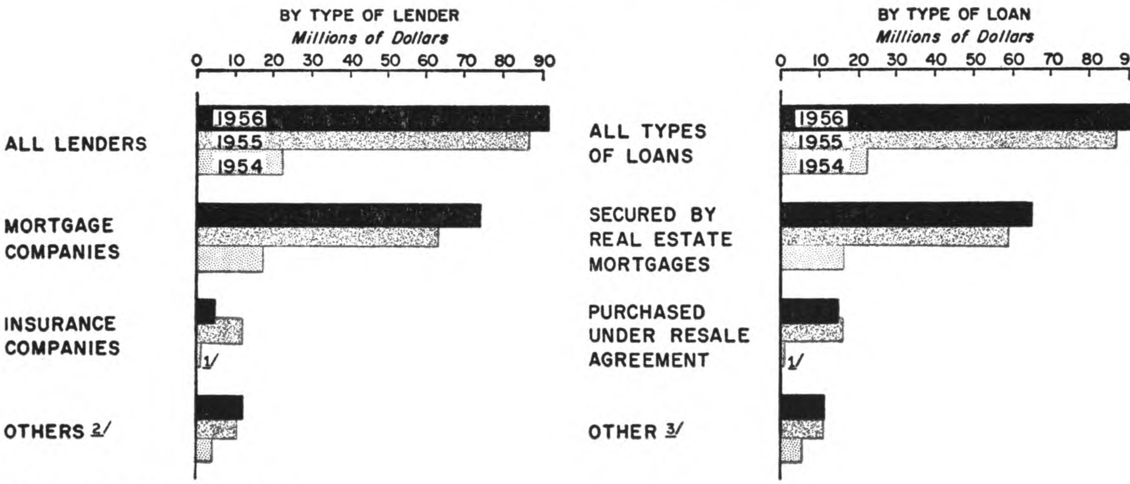
What was occurring at that time was apparently as follows. Having been stimulated during 1954 by credit ease, relaxation of mortgage terms, and a more favorable rate position on Government guaranteed and insured mortgages, many investors went into 1955 with large forward commitments to purchase mortgages. In 1955, they found themselves overcommitted. Savings had fallen below the anticipated volume, the demand for credit in general had increased considerably more than expected, and liquidation of

(2) For a discussion of Fourth District figures see pages 9-11 of the November 1955 *Review*. National figures, subsequently revised, appeared on page 980 of the *Federal Reserve Bulletin* of September 1955.

LOANS TO REAL ESTATE MORTGAGE LENDERS

Fourth District Weekly Reporting Member Banks

August 8, 1956, August 10, 1955, and August 11, 1954



(1) Less than $200,000 in 1954

(2) Consists mainly of savings and loan associations

(3) Unsecured, or secured other than by real estate mortgages

Treasury securities had become a less desirable means of obtaining funds. The availability of commercial bank resources in the mortgage market after the Spring of 1955 in the form of "warehousing loans," probably helped to stabilize the market and prevent widespread disturbances of the type that has occurred in the past when real estate lenders found that they had overshot the mark in making forward commitments. On the other hand, the use of bank loans by overcommitted lenders, while adjusting their commitments to the inflow of available funds from savings and mortgage repayments, indicates longer-term extensions of credit than needed for processing purposes.

Recent Survey

As indicated in the accompanying table, warehousing loans to real estate mortgage lenders at 17 weekly reporting member banks of the Fourth Federal Reserve District amounted to $92 million on August 8, 1956. That represents an increase of nearly 4 percent since May 16, 1956 and nearly 6 percent since August 10, 1955. Unused firm commitments to make such loans at a future date were $35 million on August 8, about 25 percent below the May figure and 32 percent below that of August a year ago.

Mortgage companies continued to be the largest borrowers in this type of transaction. (See the accompanying chart.) Loans to mortgage companies accounted for more than two-thirds of the $3 million increase in warehousing loans to all borrowers between May 16 and August 8. Loans to insurance companies declined 6 percent from May 16, but they dropped about 56 percent from August 10, 1955. Borrowing by other real estate mortgage lenders, predominantly savings and loan associations, accounted for the remaining third of the increase between May 16 and August 8.

Loans secured by a pledge of real estate mortgages that remain the property of the real estate lender continue to be the predominant type of warehousing loan. Such loans

LOANS TO REAL ESTATE MORTGAGE LENDERS
Fourth District Weekly Reporting Member Banks

Type of Loan By Major Classes of Borrower	Thousands of Dollars Outstanding on				Percentage Change	
	Aug. 8, 1956	May 16, 1956	Aug. 10, 1955	Aug. 11, 1954 (1)	May 1956 to Aug. 1956	Aug. 1955 to Aug. 1956
Mortgages Purchased Under Resale Agreement:						
Insurance Companies	4,758	5,061	10,879	0	— 6.0	—56.3
Mortgage Companies	9,362	12,574	5,159	0	—25.6	+81.5
Others (2)	959	520	191	110	+84.4	(3)
Total	15,079	18,155	16,229	110	—17.0	— 7.1
Secured by Real Estate Mortgages:						
Insurance Companies	202	202	1,322	173	0.0	—84.7
Mortgage Companies	64,652	58,913	57,671	16,104	+ 9.7	+12.1
Others (2)	165	175	5	20	— 5.7	(3)
Total	65,019	59,290	58,998	16,297	+ 9.7	+10.2
Unsecured, or Secured Other Than by Real Estate Mortgages:						
Insurance Companies	0	0	0	0	0.0	0.0
Mortgage Companies	707	947	870	1,402	—25.4	—18.7
Others (2)	10,863	9,968	10,659	4,517	+ 9.0	+ 1.9
Total	11,570	10,915	11,529	5,919	+ 6.0	+ 0.4
Unused Firm Commitments to Extend Credit of Above Types:						
Insurance Companies	15,700	16,188	20,377	(4)	— 3.0	—23.0
Mortgage Companies	18,367	29,382	26,606	(4)	—37.5	—31.0
Others (2)	854	1,100	4,465	(4)	—22.4	—80.9
Total	34,921	46,670	51,448	(4)	—25.2	—32.1

(1) Reporting banks estimated 1954 figures.

(2) Savings and loan associations, mutual savings banks, builders and other organizations (other than banks) that make or hold substantial amounts of real estate loans.

(3) Manyfold increase.

(4) Not requested.

increased $6 million between May 16 and August 8, 1956. Loans secured by non-real estate assets or unsecured loans rose less than $1 million. On the other hand, the technique of purchasing mortgages from the real estate lender under resale agreement declined $3 million from May to August 1956.

It is evident from the 1956 information that the volume of new warehousing loans at commercial banks has slowed considerably since 1955. Warehousing loans outstanding at Fourth District reporting banks increased 6 percent between August 1955 and August 1956 in contrast to an increase during the previous twelve months that amounted to a tripling of the outstanding volume of such loans. One important factor of reduction in 1956, a 56 percent decline in loans to insurance companies, probably resulted from working down a substantial loan, participated in by a number of the nation's banks, to one insurance company. A lower demand for mortgage credit was also a factor in the slower rate of growth in outstanding warehousing loans.

Although the rate of increase declined, the volume of outstanding warehousing loans did increase about $5 million during 1956. However, unused commitments to finance such loans declined about $16 million between August 1955 and August 1956, indicating expiration and curtailment of commitments of a year ago by means other than fulfillment. It seems evident, therefore, that permanent mortgage holders have managed to move their forward commitment volume into a more appropriate relation with the current demand for, and supply of, mortgage funds and that the demand for warehousing loans in the foreseeable future will be substantially below the rate suggested by the net increase in outstandings during 1955.

NOTE

There has long been a need for a reasonably short, but clear and accurate, statement of the actual workings of the "open-market operations" of the Federal Reserve System. Just how, and by whom, are these operations conducted? What are the mechanics of the Trading Desk? How do the dealers fit into the picture? What is the nature of today's "money market" within which these strategic activities are carried on?

The need is now met by a new 108-page booklet entitled:

"FEDERAL RESERVE OPERATIONS IN THE MONEY AND GOVERNMENT SECURITIES MARKETS"

by Robert V. Roosa

Federal Reserve Bank of New York

Copies may be obtained by letter request to the Research Department of this bank or to the Federal Reserve Bank of New York.

FOURTH FEDERAL RESERVE DISTRICT