

MONTHLY *Business Review*

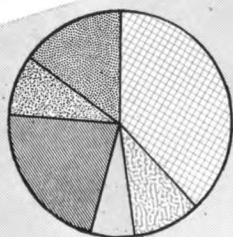
FEDERAL RESERVE BANK of CLEVELAND

May 1963

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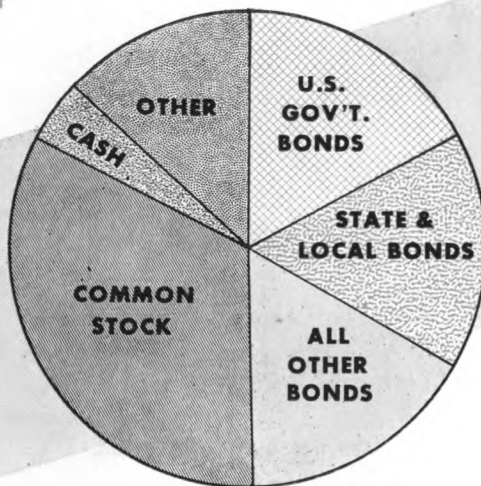
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In addition to more than doubling in size from 1951 through 1961, the holdings of securities by fire and casualty insurance companies showed a marked redistribution among the various investment media. The most predominant shift was away from fixed-income securities and cash into common stock.



1951

\$14.5 billion



1961

\$33.3 billion

Source of data: Best's Fire And Casualty Aggregate And Averages

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Investment Patterns of Fire and Casualty Insurance Companies

INSURANCE COMPANIES serve as an important supplier of funds in capital markets. Life insurance companies as a group are in fact one of the largest investors in corporate bonds and in real estate mortgages. Fire and casualty insurance companies are not widely acknowledged as an important supplier of capital. This reflects the fact that their role is quite different from that of life insurance companies due to the short-term and unpredictable nature of the fire and casualty insurance company liabilities.

Factors Influencing Investment Behavior

The usual practice among insurance companies in general is to require a payment of premium for insurance coverage at the time the contract is written. The premiums represent compensation for providing protection against financial losses occurring from various circumstances. The amounts and timing of the claims of policyholders are uncertain and cannot be determined with complete accuracy in advance. Since the premiums are paid in advance, however, insurance companies may have sizeable amounts of funds available to be invested. Not only are they available for investment but must be invested to provide income.

In the case of life insurance companies, actuarial science has made it possible to estimate closely, for any given period of time, the amounts of funds to be paid out in benefits. Their underwriting experience has a long established stability, and the timing and amounts of aggregate benefits to be paid out are predictable within a very small margin of error.

To their clients, life insurance companies represent a savings medium as well as a source of protection. Because of the nature of their commitments and because much of the

funds paid in are viewed as savings on which earnings are expected by the policyholder, investment income of life insurance companies plays a major role, while liquidity of investments plays a relatively minor role, in the management of their funds. The amount of their assets which must be held in the form of cash or a near cash form is fairly predictable.

Because of the nature of their liabilities, fire and casualty insurance companies take on special characteristics as investors in capital markets.

In the fire and casualty business the roles of investment income and liquidity are essentially reversed in terms of importance. The contingent liabilities of these companies are of much shorter duration and fluctuate to a greater degree than do those of life insurance companies. Consequently, fire and casualty companies are forced to cope with constantly changing calculations of expected losses and expenses.

The task of management in fire and casualty insurance is further complicated by the fact that the losses are not always independent of each other. For example, if severe storms occur in an area, it is likely that a company will be required to meet a substantial number of claims within a short period of time. If surpluses set aside for such unexpected crises and liquid assets are not sufficient to meet all the claims, a part of the long-term investments may have to be liquidated. In order to avoid capital losses on such investments, fire and casualty firms maintain relatively large portfolios of liquid assets.

In addition, fire and casualty companies experience seasonal patterns in claims. For example, automobile accidents and resultant insurance claims occur more frequently during

the winter season. In addition to seasonal patterns in automobile insurance claims, there have been longer cycles of high or low rates of accident claims which can not be readily explained. Recent years, for example, have marked a period of very high loss ratios as a result.

Thus, the investment decisions of fire and casualty insurance companies must be based not only on actuarial expectations of demands for cash, but also on up-to-date information concerning current trends in underwriting and claims.

Growth of Assets

Although underwriting in fire and casualty insurance preceded that in life insurance, the former is currently much smaller in dollar volume. At the end of 1961, life insurance companies held assets of nearly \$127 billion, while fire and casualty insurance companies held assets amounting to only \$33 billion. A large part of the size of life insurance assets is attributable to the fact that it is considered as a form of savings. A part of the premiums paid in represent cash value to the insured. His savings will be returned to him with dividends when the policy matures or will be paid to his beneficiary if the insured dies before the policy matures. In non-life insurance, however, there is no element of saving. Payments are only received in those cases where the policy holder experiences a loss covered by the insurance policy.

During the decade from 1951 through 1961, the assets of fire and casualty insurance companies grew at an average annual rate of nearly 9 percent as compared with a 6 percent average annual rate of growth for life insurance companies. Although assets advanced during each year of the decade, the rate of growth fluctuated somewhat with business conditions. The highest growth rate (14 percent) was experienced in 1954 and the lowest (1.4 percent) in 1957.

Changing Investment Patterns

An analysis of the distribution of assets reveals some changing trends in investment

patterns of fire and casualty insurance companies during the 1951-1961 decade. The principal change in asset distribution was a shift away from fixed-income obligations into common stock. In 1951, bonds of all types represented 54 percent of the total assets of fire and casualty insurance companies. By the end of 1961 they had dropped to less than 50 percent of the total. In the same period common stock holdings advanced from 22 percent to 33 percent of total assets. The general trend was broken, however, during 1953, 1957, and 1960, when bonds increased and common stocks declined as a proportion of total assets.

At the end of 1961 fire and casualty insurance companies held 33 percent of their assets in the form of common stock. This constituted a much higher proportion than that held by life insurance companies. This is accounted for, in part, by legal restrictions. Under most state laws, life insurance companies are permitted to hold only a maximum of 5 percent of their assets in the form of common stock.

On the other hand, life insurance companies invest a larger proportion of their assets in real estate mortgages than do fire and casualty companies. Life insurance companies held more than a third of their assets in mortgages at the end of 1961 in accord with their need for high-yield, long-term investments. Fire and casualty companies, in contrast, held only 0.5 percent in this form because of the short-term nature of their commitments and because of their need for a higher degree of liquidity.

Among the various types of bonds, the most significant decline in relative importance in the portfolios of fire and casualty insurance companies occurred in U. S. Government bonds. Treasury issues declined from 38 percent to 17 percent of total assets between 1951 and 1961. On the other hand, holdings of state and local government bonds contrast with the general trend in bonds, representing 16 percent of total assets at the close of 1961, as compared with 10 percent a decade earlier.

The increased emphasis on state and local government securities is largely attributable to the fact that interest paid on them is exempt from Federal income taxes. Consequently, the yield on a municipal bond, although it may be the same stated rate of return as that on a U. S. Government bond, provides a larger net return because the interest earned on a municipal is not subject to Federal taxation.

The share of total assets held in the form of cash amounted to only 4 percent at the end of 1961, less than half the 9 percent held in that form at the beginning of the decade. This decline, in conjunction with the proportionate decline in holdings of U. S. Government securities presents an appearance of diminishing liquidity. The true picture of the liquidity position, however, is not evident in

published statements of assets because the maturity distribution of investments is not included.

Because of unexpected claims, fire and casualty insurance company investment portfolios have a much shorter average maturity than do life insurance companies. They also attempt to maintain a balanced schedule of maturities so that some of their investments are always nearing maturity. The financial managers need not maintain the liquid portions of their assets in the form of U. S. Government securities or cash but may choose, for example, to hold tax exempt municipal bonds which are nearing maturity instead. In this manner, by careful management, they may better achieve the generally conflicting goals of high return on investments and a high degree of liquidity.

Around the Fourth District—

The dollar volume of sales at Fourth District department stores in April was 2 percent above the year-ago month. The increase reflected both the additional trading day included in April this year and the one week earlier date of Easter. The volume of instalment sales showed a 13 percent year-to-year gain during April, but cash sales were unchanged from the year-ago level and 30-day charge account sales were 8 percent below April of last year.

* * *

Unemployment in Cleveland has moved to substantially lower levels. As of mid-May, continued claims filed for unemployment compensation numbered only 13,700 in Cuyahoga County as compared with 16,900 a year earlier, 30,000 two years ago (in the early months of recovery) and 17,000 three years ago.

* * *

After adjustment for seasonal variation, the daily average volume of bank debits at 35 Fourth District centers declined more than 4 percent between March and April.

The Outlook for Meat Consumption and Production

IN 1963 the nation's consumers will be supplied with more meat than in any previous year. The Department of Agriculture expects an unprecedented abundance of meat this year as a result of a significant expansion in the production of beef, pork, and poultry. Anticipated increases of about 5 percent for beef and poultry and 3 percent for pork will more than compensate for an expected decline in the output of veal, lamb, and mutton. Assuming current estimates are borne out, the total quantity of meat produced this year will be 4 percent more than the record volume of last year.

The growth in the available meat supply reflects a decade of expansion that began in 1953. The total annual volume of red meat and poultry in 1952, at slightly over 27 billion pounds, was on a par with the average annual production of the early postwar years. Between the start of 1952 and the end of last year, the annual meat production in the

United States increased nearly one-third, as shown in Table I. Most of the gain in the total output of meat was accounted for by poultry and beef, which registered increases of 69 percent and 61 percent, respectively, during the eleven-year period.

With virutally no gain in output in 1952-1962, supplies of pork failed to keep pace with the growth in the population, and per capita consumption declined. The decline in volume of output of other meats during the period was due chiefly to a shrinkage in veal as the quantity of lamb and mutton expanded sufficiently to sustain consumption at the long-time annual average of about 4.5 pounds per person.

Beef and Poultry Spark Rise in Consumption

Nearly all of the increase in the per capita consumption of meat since 1952 is accounted for by sharp increases in the quantity of beef and poultry consumed, as can be noted in Chart 1.

A more precise indication of the striking increase in consumer acceptance of beef and poultry during the past ten years may be gained from Table II which shows the change in consumption per person from 1952 to 1962.

The sharp increase in the demand for beef and poultry pushed per capita consumption of all meats to new highs in five of the past ten years. The record levels of consumption in the past two years will apparently be exceeded this year when per capita consumption of all meats is expected to edge to a new high of about 202 pounds.

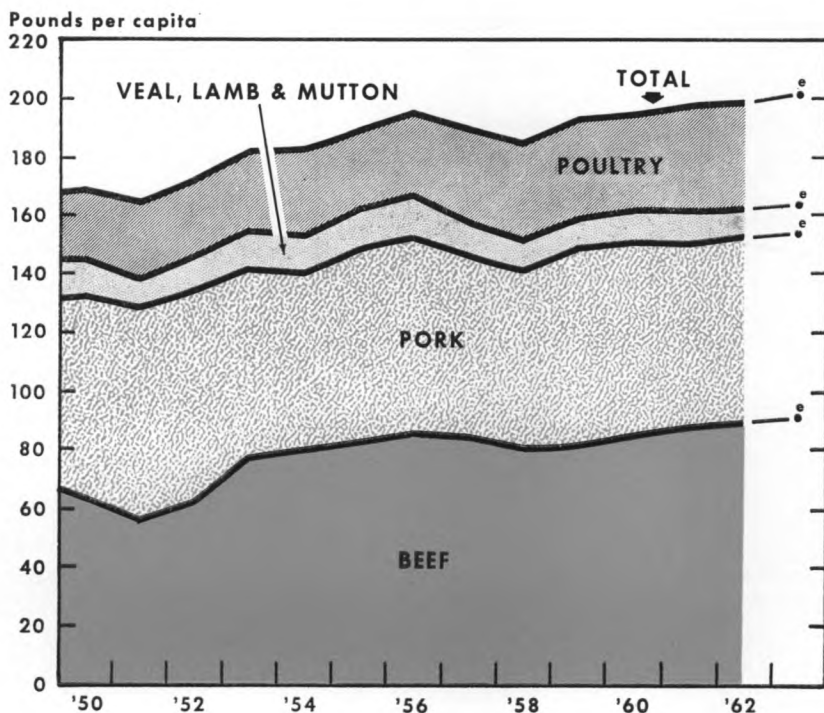
Table I
Output of Meat
in the United States

	1952	1962	Percent Change from 1952
	(Billion Pounds)		
Poultry	4.2	7.1	+69%
Beef	9.6	15.5	+61
Pork	11.5	11.6	+ 1
Other ⁽¹⁾	1.9	1.8	- 5
All Meat	27.2	36.0	+32%

(1) Slightly over one billion pounds of veal and three-fourths billion pounds of lamb and mutton.

Source: U. S. Department of Agriculture, Livestock and Meat Situation, November 1959 and 1962.

Chart 1.
TOTAL MEAT CONSUMPTION IN THE U.S.
1950 - 1962



An expansion in the per capita consumption of beef and poultry over the past ten years has pushed total meat consumption to a new high despite reductions in the quantities of pork, veal, lamb, and mutton consumed.

e 1963 Estimate.

Source of data: Economic Research Service,
U.S. Department of Agriculture.

Table II
Per Capita Meat Consumption
in the United States

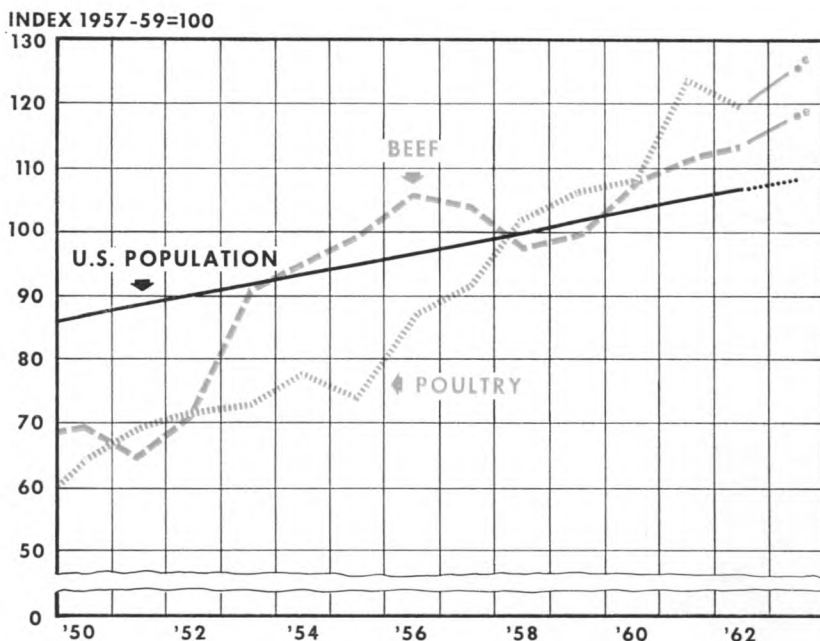
	1952 (Pounds)	1962 (Pounds)	Percent Change
Beef	62.2	89.0	+43%
Poultry	26.8	37.2	+39
Pork	72.4	63.0	-13
Other Meats ⁽¹⁾	11.4	10.5	- 8
All Meat	172.8	199.7	+16%

(1) Veal dropped from 7 to 5 pounds and lamb and mutton ranged from 4.7 to 5 pounds per person during this period.
Source: U. S. Department of Agriculture, *Livestock and Meat Situation*, November 1959 and 1962.

**Consumption Fostered by
Downtrend of Prices**

The expansion in the consumption of meats since the early 1950's has been accompanied by a moderate downward trend in the wholesale prices of red meats and a considerably sharper decline in the wholesale prices of processed poultry, as shown on Chart 2. The wholesale prices of meat reached a postwar high in 1951 and then declined rather steadily to a postwar low in 1956. Following a substantial recovery in 1957 and 1958, wholesale prices of meat leveled off and remained relatively steady for the past three years at

Chart 2.
BEEF AND POULTRY PRODUCTION AND U.S. POPULATION
1950 - 1962



In recent years, the output of beef and poultry has increased at a more rapid rate than U.S. population. With a further significant increase in prospect for 1963, prices of these two meats may be subjected to considerable pressure from an expansion in market supplies.

e 1963 Estimate.

Source of data: Economic Research Service,
 U.S. Department of Agriculture.

a level near the mid-point of the postwar high and low. On the basis of available data, it appears that wholesale prices of meat eased again in the first part of this year and will apparently be subject to downward pressures from heavy marketings of cattle and hogs throughout the remainder of the year.

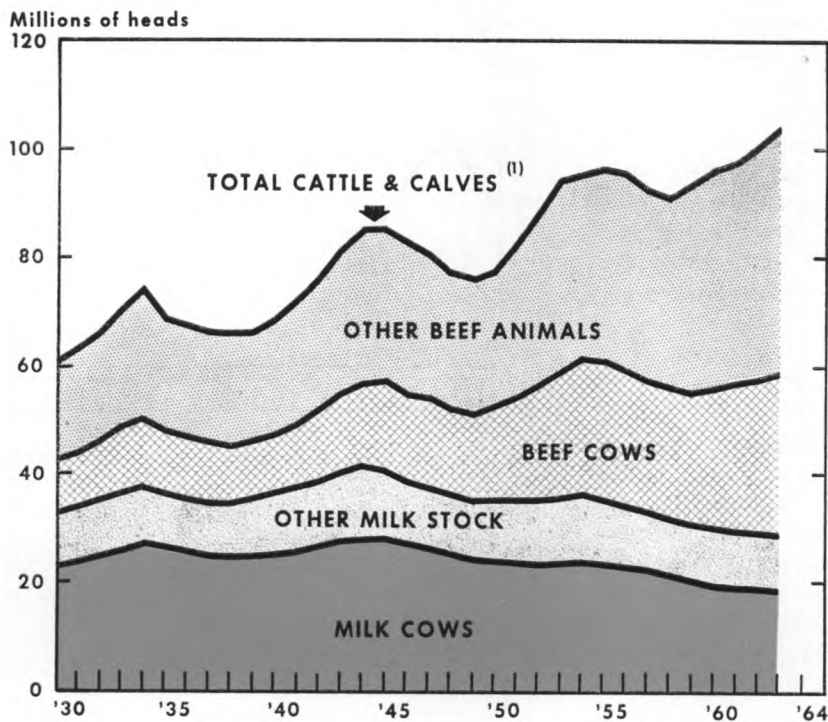
As early as 1951, prices of processed poultry at the wholesale level were more than 10 percent below the postwar high of 1948, and continued to decline until 1961. As can be noted from Chart 2, wholesale prices of processed poultry staged a modest recovery in 1962. Available data, however, suggest a weakening in prices during the first quarter of this year, and prospective supplies of processed poultry seem likely to keep market prices under pressure during coming months.

While not shown graphically or discussed in detail, the pattern of wholesale prices of livestock and live poultry have closely paralleled those of meats and processed poultry over the period shown in the chart.

Trends in the Consumption of Meat

While price is an important determinant in the per capita consumption of meat, it is by no means the sole factor. The partial indifference of consumers to the behavior of meat prices is evidenced in the demand for beef and pork during the postwar period. Per capita consumption of pork trended downward at a rate of nearly one percent a year from 1947 to 1962, despite a downward trend in the retail price of pork that averaged 2 percent a year. In contrast, per capita

Chart 3.
CATTLE ON FARMS
1930 - 1962
(as of Jan. 1)



The most recent cyclical expansion in cattle numbers is of more moderate proportions than the preceding three, but it is associated with a much sharper growth in the number of beef cows and other beef animals than heretofore.

- (1) Total Cattle and Calves includes:
- a. Milk cows and heifers 2 years and older for milk
 - b. Other milk stock
 - c. Beef cows 2 years and older not for milk
 - d. Other beef animals include heifers and calves not for milk and all steers and bulls

Note: Totals indicated for Jan. 1, 1963, are preliminary.
Source of data: U.S. Department of Agriculture.

consumption of beef displayed a strong tendency to rise during the same period even though the retail price of beef was trending upward.

Various explanations are advanced for the decline in per capita consumption of pork during the 1950's. One of the explanations offered is that the increases that occurred in personal income permitted consumers to substitute beef for pork. Another was the comparatively large transfer of persons from farm to urban centers where per capita con-

sumption tends to be somewhat smaller according to household surveys.⁽¹⁾ Probably the most important factor in the decline in pork consumption, however, was the marked increase in per capita consumption of poultry that occurred in response to the sharp decline in prices of poultry meat during this period. Another development that may have contributed to the decline in pork consumption was the use of the home freezer which developed

(1) *Food Consumption of Households in United States*, Survey Reports No. 1, U. S. Department of Agriculture.

rapidly in the 1950's. Beef possesses some advantages over pork, insofar as the use of home freezers is concerned, which may have fostered the consumption of that meat in preference to pork.

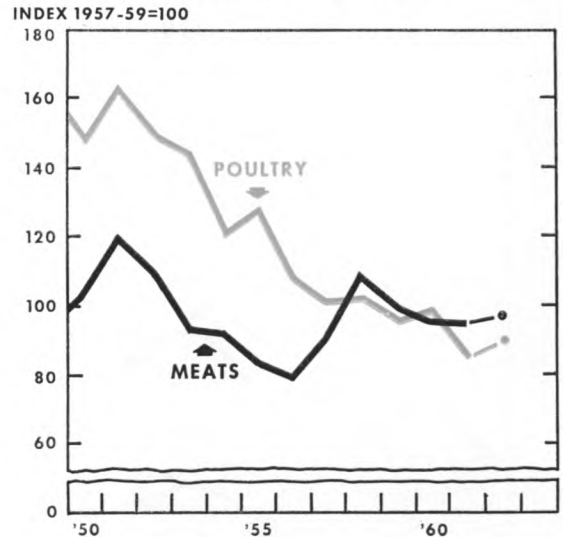
Some analysts have expressed the view that the downward trend in per capita consumption of pork may be leveling out. They point out that the downtrend in poultry prices may not be as important in the future as in the recent past. Moreover, the impact of the home freezer is probably past its peak. Finally, the difference between the price of beef and the price of pork at retail may have reached the point where the price advantage causes consumers to choose pork in preference to beef.

Beef to Continue Plentiful

Regardless of changing trends in the consumption of beef and pork, it is abundantly clear that beef will remain in plentiful supply for some months to come. The inventory of cattle and calves on farms at the beginning of 1963, as shown on Chart 3, was a record 103.5 million head, up 4 percent from a year earlier. The current buildup in cattle numbers is more moderate than in the three previous cyclical expansions, but it is characterized by a much sharper growth in the number of beef cows and other beef animals than heretofore. This development suggests that beef production capacity has continued to rise faster than beginning of the year inventories might indicate. Moreover, the increase in the number of beef cows and beef heifers in 1962 indicates that the calf crop in 1963 may be larger than last year.

In addition to the prospect that cattle inventories may register a further significant expansion in 1963, the number of cattle on feed for market April 1 was well above that of any previous year of record. The 8.1 million on feed on that date was 11 percent more than a year earlier, and sales from this stock during the second quarter are expected to be 7 percent larger than in the same period last year.

Chart 4.
WHOLESALE PRICES



The downward trend of wholesale prices of meat and processed poultry has contributed to the rise in consumption of beef and poultry.

1963 based on 1st quarter data.

Source of data: U.S. Department of Labor
Bureau of Labor Statistics.

Beef and Poultry Expansion Outpaces Population

The recent rate of expansion in the output of both beef and poultry meat has been considerably in excess of the rate of growth in population, as shown on Chart 4. The ultimate effect of the increase in output on the wholesale prices of meat and processed poultry is difficult to assess fully at this time, but it may be significant to note that wholesale prices of meat were at a postwar low in 1956 and wholesale prices of processed poultry reached a similar low in 1961. At the same time, 1956 was marked by an unusually high rate of growth in the output of beef and the rate of expansion in output of poultry meat was at an unusually high level in 1961.

On the basis of preliminary estimates, the rate of expansion in output of beef and poultry meat in 1963 corresponds rather closely to the rate of expansion that prevailed in 1956 and 1961, respectively.

Notes on Federal Reserve Publications

Among the articles recently published in the monthly publications of other Federal Reserve Banks are:

“The Dollar: National and International Bulwark — An Address by Alfred Hayes”, Federal Reserve Bank of New York, May, 1963.

“Banks Step Up Mortgage Lending”, Federal Reserve Bank of Chicago, April, 1963.

“Excess Reserves”, Federal Reserve Bank of St. Louis, April, 1963.

“Banking Structure and Reactions to Monetary Stringency or Ease”, Federal Reserve Bank of Kansas City, March-April, 1963.

“Stabilizing Foreign Exchange Markets”, Federal Reserve Bank of Boston, March, 1963.

“Cash Flows and Corporate Investment”, Federal Reserve Bank of San Francisco, February, 1963.

Recently published by the Board of Governors of the Federal Reserve System:

“Financing the U. S. Payments Deficit”, *Federal Reserve Bulletin*, April, 1963.



FOURTH FEDERAL RESERVE DISTRICT