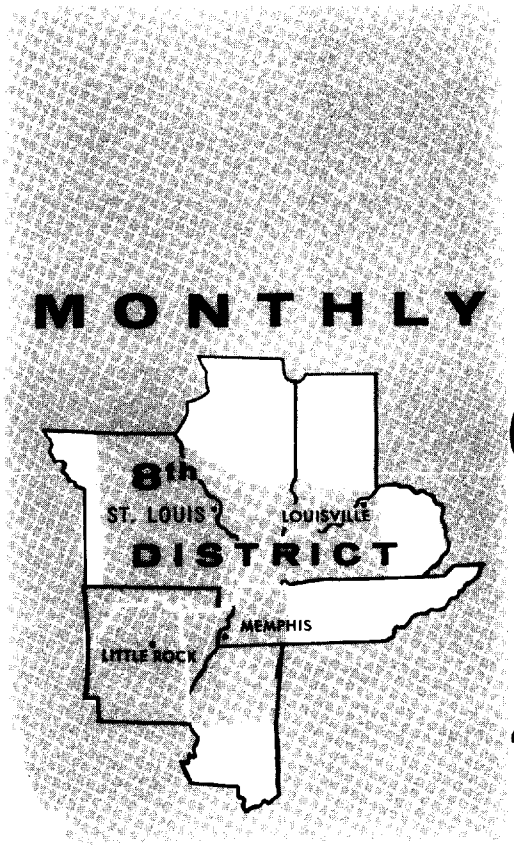


Review

FEDERAL RESERVE BANK
OF ST. LOUIS • P. O. BOX 442 • ST. LOUIS 66, MO.

This issue released to press on September 15

VOL. 41 • No. 9 • SEPTEMBER '59

Current Business Trends

RECENT TRENDS in economic activity in the nation have become increasingly difficult to evaluate as a result of the current steel strike. Superficially, it might appear that the period of economic recovery and expansion which followed the 1957-1958 recession came to a halt in July of this year, when the index of industrial production, seasonally adjusted, declined for the first time since April 1958. Practically all of the decline in the index, however, can be attributed to the steel industry itself. Output of other industries continued to expand. Furthermore, continued growth of retail sales, the large volume of orders for manufacturers' durable goods, and the high level of construction activity are signs of the widespread strength of demand which underlies the economy.

A comparison of the recent decline in industrial production with the one experienced during the 1956 steel strike indicates that the immediate impact of the current strike upon total industrial production may be appreciably smaller than that of the previous one. Build-ups of sizable inventories by steel users during the first half of this year have, so far at least, limited forced production curtailments to but few industries. On the other hand, industries such as coal mining and railway freight transportation whose activity depends to a considerable extent upon the level of steel production appear to have been markedly affected in their operations. The total effect of the strike can, of course, only be appraised after it is over.

Manufacturers' sales, inventories, and new orders maintain strength.

Manufacturers' sales declined from a seasonally adjusted total of $31.2 billion in June to an estimated $30.8 billion in July. Virtually the entire decline was concentrated in the sale of durable goods, mainly products associated with the iron and steel industry. July sales of fabricated metals were unchanged from their previous-month level, while sales of other durables showed a rise of almost 5 per cent. Most outstanding gains were scored in sales of machinery and transportation equipment (excluding motor vehicles and parts), which reached record highs.

Manufacturers' inventories at the end of July were at virtually the same level as a month before. The apparent stability in the value of total inventories fails to show, however, the changes among individual commodities. Steel inventories started to decline during the second half of the month when production was virtually discontinued, while copper inventories reached record levels after sharp build-ups throughout July and early August. Total inventories of manufacturers' durables were up slightly in July, but nondurables showed no change from the level reached in the two previous months.

Manufacturers' new orders maintained their high level in July, in spite of a considerable drop in orders for primary metals. This decline, reflecting to an important extent the wait-and-see attitude adopted by steel consumers after the start of the strike, was virtually offset by further increases in orders for other types of durable goods. New orders for transportation equipment rose 6 per cent during July, and those of nonelectrical machinery rose 3 per cent, reaching the highest level since mid-1956. Electrical machinery also experienced a rise in orders.

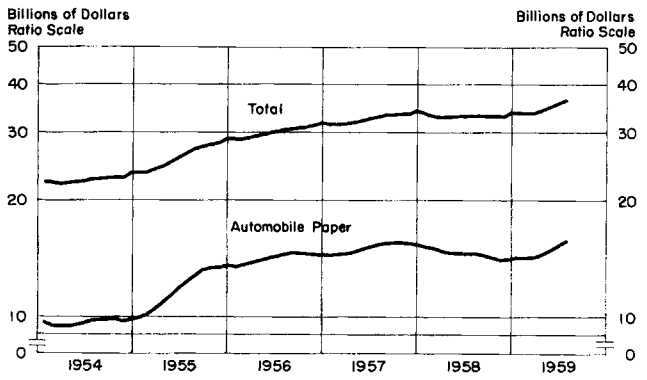
Retail sales remain at high levels.

Retail sales have continued to be one of the important factors behind the strength of the present economy. Most pronounced gains this year have been scored in the durable goods sector, with automobiles

providing the major consumer attraction. Sales of domestically produced automobiles, which in the first six months of this year were approximately 46 per cent larger than in the first half of 1958, continued strong in July when sales exceeded those in the like month of last year by about 30 per cent. Preliminary estimates for August indicate that sales for that month may have been 45 per cent larger than in August 1958. Present strength in the automobile market is also reflected in the continued rise in prices for used automobiles and in the growth of consumer instalment credit.

CONSUMER INSTALMENT CREDIT

Outstanding at End of Month



Source: *Federal Reserve Bulletin.*

Strong demand for appliances and TV sets, as well as for furniture, has aided automobile sales in providing a broad basis for total demand for consumer durable goods. Although recent data on the sale of these products are not readily available, low inventories and the volume of new orders placed by retailers indicate brisk business. Among nondurable consumer items, both apparel and general merchandise have experienced marked increases in sales. Department store sales were 7 per cent higher in July than in the corresponding month a year ago, while sales in the first seven months of this year exceeded those in the like period of 1958 by 8 per cent.

Spending on residential construction tapers off.

Construction activity continued at a high level in July and August, although expenditures on construction are estimated to have risen less than seasonally in both months. One of the factors behind this less-than-seasonal rise appears to be a decline in spending on residential construction in August. The value of commercial and industrial construction put in place during the same month rose, however, bringing total spending on private construction to approximately $3.6 billion, the same amount as in July and about $0.5 billion larger than in August of last year. Private construction expenditures during the first eight months of this year totalled an estimated $24.8 billion, 16 per cent above the amount spent in the like period of last year. Outlays on residential construction during the same period exceeded those of 1958 by about 31 per cent, while in August alone residential construction expenditures were approximately 22 per cent higher than in the same month of 1958.

Public construction expenditures in August remained at the July level, after seasonal adjustment. Since the beginning of this year public outlays have amounted to about $10.8 billion, as compared with $9.5 billion during the January-August period of 1958.

Wholesale prices and retail prices show growing divergences.

Since April of this year the average wholesale price index has shown a gradual decline, dropping from 120.0 per cent of the 1947-1949 average in April to 119.2 in the week ended August 25. On the other hand, average consumer prices rose from 123.9 of the 1947-1949 average in April of this year to 124.9 in July.

The recent decline in the wholesale price index has been largely the result of lower prices of farm commodities. Prices of industrial raw materials on the other hand have been rising.

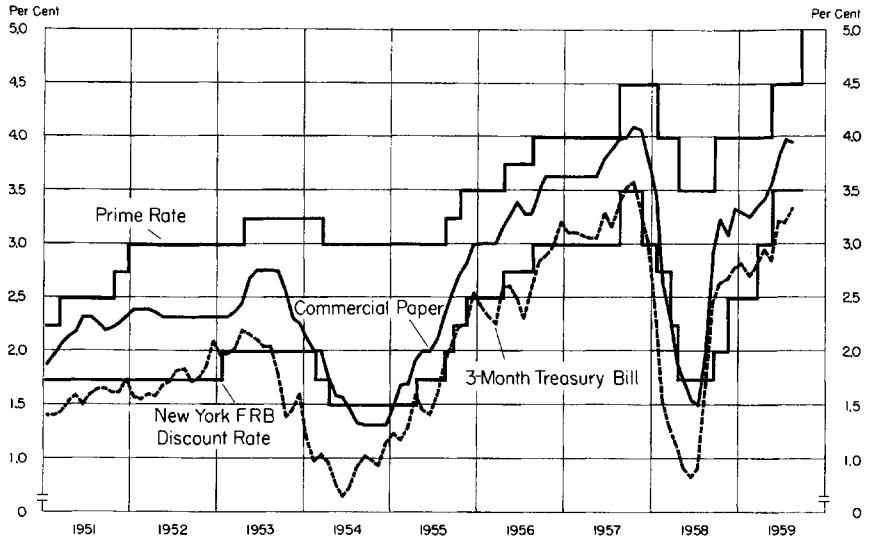
The recent rise in average consumer prices appears to be quite general with processed foods accounting for a considerable part of the upswing in July. Food prices usually increase in the spring and early summer months and decline in late summer and fall. There also were price rises on such items as clothing, used cars, household expenditures, insurance rates, and medical care. The introduction of higher state and local sales taxes had a marked effect upon the consumer price index in July.

Exports show signs of recovery.

U. S. merchandise exports in June and July were substantially above the low level of early this year. This was the first significant increase in exports in over two years. In the early spring, agricultural exports began to pick up, partly under the impetus of government financing programs, while in June and July exports of nonagricultural products also advanced strongly.

Imports, on the other hand, showed some signs of leveling off in June and July after rising by more than one-fifth over the preceding twelve months.

Interest Rates and Credit



The prime loan rate, . . .

ON SEPTEMBER 1, 1959, the prime loan rate at commercial banks, the minimum interest rate the banks charge their most credit-worthy customers, was raised from 4½ to 5 per cent. This was the third ½ per cent increase in the past year and brought the rate to its highest level since 1931.

The prime rate does not fluctuate on a day-to-day basis and, therefore, does not reflect daily demand and supply conditions in financial markets. Changes in the prime rate occur only intermittently and are usually triggered by one or several New York banks. Such changes provide a measure of bankers' reactions to many factors, particularly their recent loan demand experience and their expectations for the near future.

. . . bill rate, . . .

Although the prime rate moves only in discrete intervals, historically it traces a pattern which is in general conformity with the movement of short-term market rates of interest (see chart 1). After a temporary decline in July and August the rate on 3-month Treasury bills rose during most of August and into September and bills were traded at just over 4 per cent on September 10. This increase in the bill rate is associated with the heavy demands for funds by the Federal Government. In August the Treasury refunded $14 billion of maturing securities and raised $1 billion in new cash which was paid on August 19. In addition, the Treasury increased its weekly bill offerings by $200 million over the usual amount in each of the weeks dated August 13, 20 and 27.

. . . and other rates rise, . . .

The increase in the bill rate was accompanied by increases in the commercial paper, bankers' acceptance and sales finance company rates as the demand for short-term funds by the private sector of the economy continued to expand. Loan demand in the month of July came from consumers and business, including agriculture. In the consumer field, short-term instalment credit extended by banks and others showed a record growth of some $500 million in the month after seasonal adjustment. Similarly, real estate loans at commercial banks expanded more during July than is customary for this period. Eight Federal Reserve Banks raised the discount rate to 4 per cent effective September 11, and by the 14th, three more had done so.

. . . as loan demand continues heavy.

According to data from the weekly reporting member banks, which make about three-fourths of the loans granted by all commercial banks, the heavy loan demand continued in August. For the four weeks ended September 2 loans at these banks increased approximately $500 million. Real estate loans increased $80 million, the "all other" loan category, which includes consumer instalment credit loans, advanced $150 million, and commercial and industrial loans rose $270 million. Indications from a sample of the weekly reporting member banks, which provide information on loans by industry, are that strength in demand for business loans during the four weeks stemmed especially from manufacturers of foods and textiles. Outstanding loans to metal and metal product manufacturers, which declined $85 million on average for the preceding five years during this four-week period, decreased only $55 million. The behavior of loans in this particular category is striking in view of the widespread expectation that the reduction in steel inventories following the strike July 15 would ease the pressure for short-term credit at these concerns.

Developments in the Eighth Federal Reserve District

EXPANSION OF BUSINESS ACTIVITY in the Eighth District has paralleled that of the nation during the summer. Bank debits at 22 district centers from May through August averaged more than 10 per cent higher than in the same months of 1958, when they were already rising from the recession low. In some cities of the district, debits have been running more than 20 per cent ahead of last year's volume. Bank debits provide a gauge of business activity as it is reflected in the use of bank deposits by individuals and businesses.

St. Louis area steel production was not halted by the strike. Through July and mid-September production has run at 80 to 90 per cent of capacity, and was scheduled at 97 per cent of rated capacity in the week ending September 19. Coal production does not appear to have been affected as much by the strike in the district as in other areas, with output in August about the same as in June of this year and in August of last year. A considerable part of Eighth District coal is used in electric power plants, and power production has been at high levels.

Construction activity continues at a high rate in the district and recent construction contract awards provide support for a large volume of work for the next several months. During the four months April through July, total contract awards exceeded awards in the same months of the past three years. Residential construction accounts for much of the gain over the last three years. The volume of awards for all other types of construction, furthermore, was exceeded only in 1958. In that year large awards for highway work under the Federal Highway program swelled the nonresidential totals.

The outlook for agriculture in the Eighth District is generally good, with production of major crops greater than last year. The United States Department of Agriculture has forecast that corn production in district states will probably exceed the bumper crop of last year by 19 per cent and will be nearly 30 per cent over the 1948-57 average. It is estimated that cotton production in district producing states will be 57 per cent greater than in 1958. Acreage planted to cotton is about one-fourth greater than last year, and average yields are expected to be about 20 per cent greater than last year and 37 per cent above the 1948-57 average. Soybean production in district states will probably be about the same as in 1958, but crops of oats and sorghum grains may be smaller.

Cash farm income in the Eighth District states for the first six months of 1959 was the same as for the first six months in 1958. The larger volume of marketings offset generally reduced prices. If prices for the rest of the year do not decline more than seasonally, district cash farm income for the year may equal or exceed that of 1958.

Loan developments in the Eighth District were similar to those in the rest of the nation during August. Outstanding loans at district weekly reporting banks rose $16 million (about 1 per cent) in the four weeks ending September 2. Normally loans at these banks rise roughly ½ of 1 per cent at this season. As at banks in other sections of the country, the greatest increase was in advances to commercial and industrial firms. At district banks, commodity dealers and textile, apparel and leather firms increased their indebtedness considerably. "Other," largely consumer, loans rose more than they normally do at this season, and real estate loans increased about the usual amount. An exception to the loan gain was in advances to financial institutions, where sizable net repayments were made.

Total credit outstanding, however, declined moderately at district weekly reporting banks in the four weeks ending September 2. These banks sold securities on balance, in addition to lowering their cash assets and increasing their indebtedness, in order to accommodate customer demands for loans and to meet an outflow of funds. Banks reduced their holdings of Treasury certificates, notes and bonds, but these reductions were partially matched by net purchases of Treasury bills and other securities.

Total deposits at district weekly reporting banks contracted $33 million in the four weeks ending September 2. On the average, deposits have shown little net change in the corresponding periods of recent years, although in the like period last year they fell $64 million. The decrease reflected the bank credit contraction and a net outflow of funds, and it occurred in both demand and time balances.

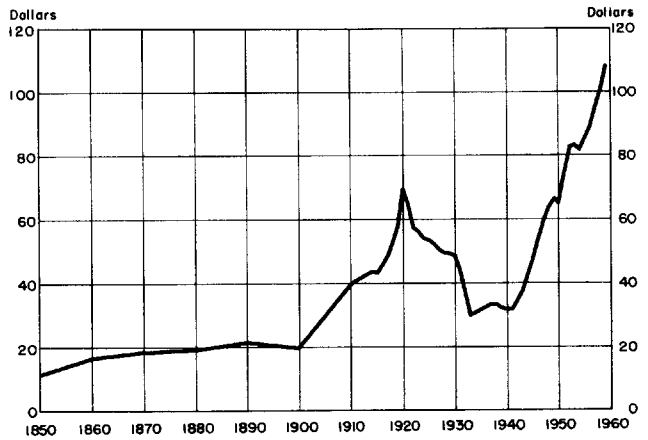
Farm Real Estate Values

FARM REAL ESTATE VALUES in the United States have moved upward with a few interruptions and at a fairly rapid rate since the depression years of the thirties. During the war years farm real estate lagged behind net farm income. Following the war and the Korean conflict, farm income declined, but the rise in real estate values was unabated. By 1955 the index of farm real estate values moved above the index of net farm income for the first time since 1934 (1912-1914=100 for each index). Despite this movement of the farm real estate value index above that of net farm income, a high degree of optimism apparently remains on the part of investors concerning the future of such values. Farm real estate moved up 8 per cent for the year ending March 1, 1959, maintaining a position somewhat above farm income relative to the base years. Whether or not this optimism is justified, remains to be seen. Such values would be expected to vary in accordance with anticipated net farm income and net returns on other forms of capital. At present these factors suggest that there may be a slackening in the high rate of gain of recent years in farm real estate values or perhaps a leveling off or downturn. However, intangible factors, such as prestige and security values of land ownership, could alter the trend that might logically be expected.

Farmers and other investors continued to bid up prices of farm real estate in early 1959 despite an outlook for a reduction in farm income. Average market value of farm real estate (farmland and buildings) in the United States advanced 8 per cent in the year ending March 1, 1959 to a new all-time peak of $125 billion, or an average of $108 per acre. This fifth consecutive increase pushed values up to 168 per cent of the 1947-49 average and to more than three times the 1940 level.

The long-term trend in farm real estate values has been upward.[1] However, there have been several brief periods of decline and one major downturn during the past century. A large public domain acreage coupled with low prices charged for land by the government and homestead act provisions were probably influential in holding farm real estate values to modest gains in the last half of the 19th century (Chart 1).

Chart 1
AVERAGE VALUE PER ACRE OF FARM REAL ESTATE 1850-1959



Source: U.S. Department of Agriculture, *The Farm Real Estate Market*. Farmland and buildings as of date of census enumeration for years 1850-90, 1900, 1910, 1920, 1930, 1940, and 1950, excluding District of Columbia. The 1954 census data were adjusted to March 1955 on the basis of the change in the index of average value from November 1954 to March 1955. Other years as of March 1 are interpolated by applying the change shown in the revised index of value per acre to census data. Acres in farms are interpolated from census data at 5-year intervals. Acres in farms reported by the 1954 census were used for 1955-58.

Average value per acre rose only $9 from 1850 to 1900 and most of this increase occurred in the first twenty years of the period. In the years 1850 to 1870 average values per acre rose from $11.14 to $18.25, whereas in the next thirty years the rise was less than $2. Furthermore, a substantial portion of increase can probably be attributed to increased value of buildings and other improvements rather than to rising land values. During this half century of rising farm real estate values the all-commodity wholesale price index declined.

Early in the twentieth century per-acre farm real estate values moved up at a faster rate, doubling in the first decade and rising an additional 75 per cent from 1910 to 1920.

Following this rapid rise, a major downward adjustment occurred beginning in 1920 and extending over a period of thirteen years. Average per-acre values declined from a peak of $69.37 in 1920 to $29.98 in 1933, or almost 60 per cent. In this period the wholesale prices of all commodities declined in approximately the same ratio.

[1] Farm real estate value data used in this article were collected by the United States Department of Agriculture and rely primarily on subjective estimates rather than actual sales prices.

The results of this extended readjustment in farm real estate prices coupled with the collapse of farm commodity prices in 1920 and again in the early thirties are now familiar history. Farm real estate debt continued to rise in the 1920 decade reaching a peak of $9.6 billion in 1930, or about 20 per cent of the total value of all farm real estate. With the rapid decline in farm commodity prices and farm income in 1920 and further in the early 1930's, a mass of delinquencies and forced sales occurred.

Farm real estate debt is now relatively low at $11.2[2] billion dollars compared to a total value of farm real estate in excess of $125 billion. Nevertheless, the rapid increase in farm real estate debt in recent years may be cause for concern about the possibility of another decline in real estate values. Recent trends in farm income and the great weight of the Government assistance program for agriculture are causes for questioning the high level of optimism apparent in the farm real estate market. Expected Government subsidies which have for years provided a substantial part of net farm income are doubtlessly incorporated in land values. If public policy should change and reduce such supports, a reaction in land values could be expected.

Farm real estate values tend to be supported by the favorable experiences of those who have invested in land in the last quarter century and by prospects for further farm enlargement. Practically all who have invested in land since 1932 and held it for a few years realized a capital gain on the investment. This record of success and the substantial supply of funds in the hands of individuals searching for investment opportunities have probably been factors in bidding up farmland prices, and this long record may continue to be an optimistic factor in the near future. The expectation of price increases in other sectors of the economy may also help sustain farm real estate values.

The gain in farm real estate values in recent years reflects primarily increased values of land rather than of buildings. From 1940 to 1959 the average value per acre of land only, rose from $21.90 to $83.42 or almost 300 per cent, whereas, the value of buildings rose about 175 per cent. The proportion of farm real estate value represented by buildings has declined steadily since 1940. At that time farm buildings represented about 31 per cent of the total value of farm real estate compared to 23 per cent in 1959.

The demand for land for farm enlargement purposes continues to be an important factor in determining farm real estate values. About forty per cent of all farm land purchases in 1958 were for farm enlargement purposes compared with 38 per cent in 1957, 33 per cent in 1956, and an average of 25 per cent for the years 1950-1953[3]. The demand for additional land by farm operators is explained by the proportions in which some productive resources can be applied to others. One tractor requires one operator and about the same quantity of equipment to operate 160 acres as 200 acres. This incentive to purchase additional acres may continue to be an important factor in determining farm real estate values over the next decade.

Farm technology on the other hand may have had a depressing effect on land values. Rapid strides have been made during the past quarter century toward increasing the productivity and effective supply of farm land. An increase in the effective supply of land in the absence of a corresponding increase in the value of farm products, would be expected to presage a reduction in farm land prices.

In theory farm real estate like other forms of capital is valued for its ability to produce or provide services. Prices will tend to be bid up until the expected rate of return on the money invested in farm real estate is the same as on money invested in other types of capital. As expected returns are to some extent predicated upon recent experiences it would appear that an analysis of whether or not farm real estate is sufficiently productive to sustain present values or to induce further price increases would be a simple calculation. Unfortunately, this is not the case, as the actual productivity of a specific tract of land is not readily determined. Each unit of farm real estate differs from every other unit. Land is made up of many grades or classes with varying productive capacities. It is usually evaluated and transferred as a composite part of real estate including buildings, improvements, and possibly crops. Furthermore, land has associated with it strong traditional and social value judgments. Even the location often presents evaluation problems since accessibility is such an important factor.

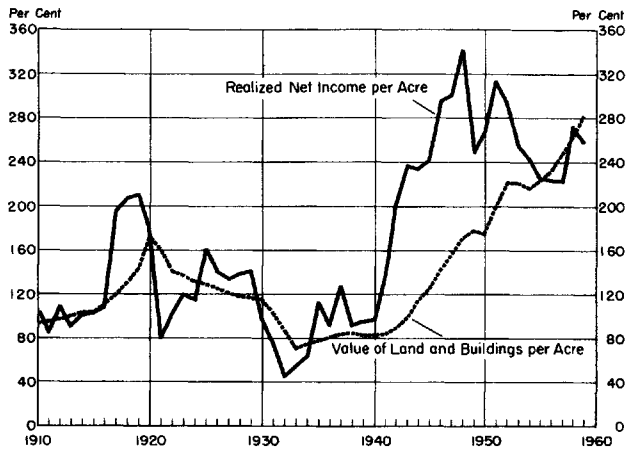
Farm income and farm real estate values were closely related in the three decades prior to 1940 as can be seen in chart 2 (page 108). Indices of farm income and farm real estate prices generally moved together with income changes somewhat more pronounced than changes in real estate values. The two indices moved in the same direction during 20 of the 30 years 1910-1940 (value of farm real estate as of March 1 of the following year). Furthermore, the spread between

[2] U.S.D.A. preliminary estimate for January 1, 1959.

[3] United States Department of Agriculture, *The Farm Real Estate Market*, October 1958.

the two was narrowing in most of the years that the indices were moving in opposite directions.

Chart 2
INDEXES OF FARM INCOME AND REAL ESTATE VALUES, 1912-14=100



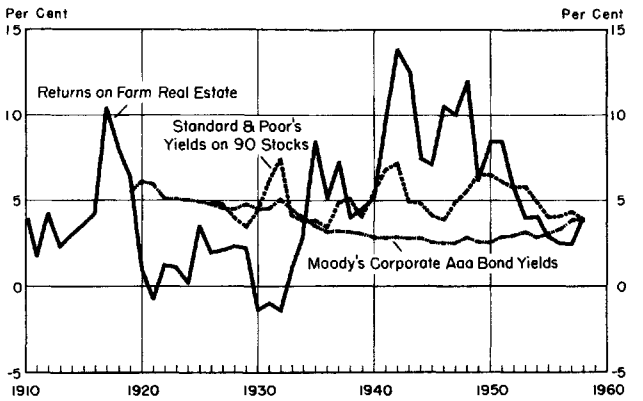
Sources: U.S. Department of Agriculture, *Farm Real Estate Market.* Value of land and buildings as of March 1 of following year. Values for 1910 and 1911 were computed from value-per-acre data divided by 1913 value. Realized net income indexes computed from: U. S. Department of Agriculture, *The Farm Income Situation.*

After the beginning of World War II, however, the relationship did not appear to be so close. Some explanations for this apparent change in the relationship between farm income and farm real estate prices include greater demand for land for nonfarm uses. Utilization of land for urban dwellings, highways, recreation, and industrial establishments is thought to have been more important in determining land values than formerly.

At the beginning of the war, realized net income per acre rose rapidly, reaching a peak in 1948 of 342 per cent of the 1912-1914 average. Value per acre of farm real estate rose but at a substantially slower rate. By 1948 the index of real estate values had reached 170 per cent of the 1912-1914 average or only 50 per cent as high as the farm income index. A substantial downturn in farm income in 1949 and the more prolonged downtrend beginning in 1952 closed part of the gap in the two indices. Following a slight drop in 1953, farm real estate values resumed their long movement upward, and in 1955 regained the 1912-1914 position relative to income (value of farm real estate plotted as of March 1 of following year). Since 1955 the real estate value index has been somewhat above the index of net farm income, with the exception of 1958.

Thus, farm income appears to have been a major factor in determining farm real estate values in the past. The divergence of farm real estate values and income during and following the recent war years might be explained by temporary forces causing an imbalance rather than longer term forces. For example, a similar divergence occurred during World War I (see Chart 3) with income rising faster than real

Chart 3
YIELDS ON COMMON STOCKS, CORPORATE Aaa BONDS AND RETURNS ON MARKET VALUE OF FARM REAL ESTATE



Sources: Returns on farm real estate from: U.S. Department of Agriculture, *The Farm Real Estate Market.* Moody's Corporate Aaa Bond Yields for 1919-28 from: Board of Governors of the Federal Reserve System, *Banking and Monetary Statistics;* for 1929-56 from: U.S. Department of Commerce, *1957 Statistical Supplement to the Survey Current Business;* for 1957 and 1958 from: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin.* Standard & Poor's yields on 90 stocks from: *Standard and Poor's Trade and Securities Statistics.*

estate values. But in 1920 income declined rapidly, pulling down real estate values. The divergence of the indices in World War II may have been a replica of their World War I behavior on a larger scale. The greater impact of World War II on the economy could well account for the greater imbalance. The nation was mobilized for four years of fighting compared to only one year in the earlier war. A larger part of the nation's resources was directed toward the war effort with a greater impact on prices. Furthermore, the Korean conflict occurred in 1950, again disturbing price-making forces before a return to normal following the second World War. This combination of factors may well account for most of the imbalance between farm real estate values and farm income during the last two decades.

The rate of return on farm real estate indicates that such values in 1958 were not too different from prices of other types of capital.[4] In the early World War II years, earnings on farm real estate capital increased rapidly and with the exception of 1949 were higher than yields on either common stock or corporate Aaa bonds throughout the 1940's and into the early 1950's (Chart 3). However, returns on farm real estate declined rapidly following the Korean conflict and by 1956 had dropped below those on either corporate Aaa bonds or common stocks.

[4] The rate of return on market value of farm real estate as calculated by the United States Department of Agriculture is a residual figure. It is the ratio of the remainig portion of net farm income to farm real estate values after allowances are made for labor and returns on non-real estate farm capital.