MONTHLY REVIEW

of Ninth District Agricultural and Business Conditions

FEDERAL RESERVE BANK OF MINNEAPOLIS

Vol. 9 SEPTEMBER 30, 1949 Serial No. 93

Drop in Residential Prices Only Moderate

As Compared with the General Price Level, Homes Rose Faster Prior to the Fall of '48 But Since Have Declined at a Slower Rate

By OSCAR F. LITTERER

IT HAS BEEN evident for some time that the expected turning point in the postwar business cycle occurred last November. The steady upward pressure on prices has ceased; a buyer's market has supplanted a sellers' market; the pre-war slack seasons in business activity have reappeared; the consumer is again in a position to select the specific item he prefers. This has placed the consumer, through his choices, once more in a position to dictate the type of products that shall be produced.

As a result of the shift to a buyers' market, industry after industry has been forced to make painful adjustments. For instance, manufacturers who have been producing items which were not the consumer's first choice have experienced a sharp decline in the demand for their products. To stay in business they have been faced with the alternative of changing the design and quality of their products to meet the consumers' requirements or of shifting to the production of other articles. These are some of the primary factors in the recent business recession.

In a private enterprise economy, prices serve a vital function. Through the prices consumers are willing to pay for commodities, they determine what shall be produced. Also, fluctuations in the general price level are important to business concerns, since a rise in prices creates inventory profits; whereas a decline in prices results in inventory losses. From 1940 to August 1948, prices increased 116 per cent in the primary markets where commodities are sold in wholesale lots. For more than a year, prices have receded slowly from the peak reached in August, 1948, showing a decrease of 10 per cent according to the index of wholesale prices compiled by the U. S. Bureau of Labor Statistics.

In a period of recession, following several years of rapid price inflation, it is of particular importance to examine the trend of real estate prices. The rise and decline of real estate prices has greater implications than the fluctuations of other commodity prices. Real estate price fluctuations are important to lending institutions, since credit on real estate is extended over a period of years; and to the individual because the purchase of a home very often constitutes a lifetime investment.

SURVEY SHOWS TREND OF REAL ESTATE PRICES

A survey of the trend in residential real estate prices from January 1, 1947, through the first half of 1949 was undertaken this summer. Comparable surveys covering earlier periods were conducted in 1946 and 1947.

In cooperation with a group of representative members of the Minneapolis Board of Realtors, the Federal Reserve Bank of Minneapolis compiled a list of prices paid by purchasers of residential property in this

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- *Prices of residential property in Minneapolis and in the surrounding suburbs reached a peak in the latter half of 1948. At that time, houses were selling at prices which averaged 156 per cent above the 1940 level. Over the same period wholesale prices rose 116 per cent and retail prices 95 per cent.*
- *Since the latter half of 1948, real estate prices have declined at a slower rate than prices of other commodities. During the first half of this year houses sold 8 per cent below the peak.*
- *The largest rise in prices occurred among the low-priced houses. From 1940 to the peak in the latter half of 1948, the increase was 176 per cent. For the medium-priced houses, the average increase was 142 per cent and for high-priced houses 132 per cent.*
- *Newly-built houses are again in competition with older houses on the market. Premiums paid by individuals for houses which could be occupied in a relatively short period of time have disappeared. To meet the competition of the older houses, contractors have reduced prices on their newly-built houses, but, in general, by a smaller percentage than has taken place on older houses. Most contractors have added special features to their houses to make them more attractive to buyers.*
- *The home building industry has not priced itself out of the market. At the present time, it is again moving ahead at a rapid pace. Most residential building is done in periods of rising or high costs.*
- *In the postwar years, residential building has run ahead of family formation, but due to the large deficit in housing accumulated during the Thirties and the war years, there is still a need for a large number of homes.*

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city. The survey included a net total of 2,564 transactions. These transactions were segregated into homogeneous residential areas within Minneapolis and in the surrounding suburbs. The atypical cases were eliminated from each area. On the basis of the typical cases for each area, an average price was computed for each half year interval from January 1, 1947, to July 1, 1949.

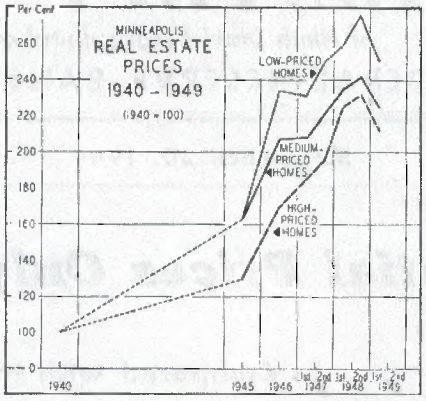
PRICES WERE BOOSTED ABOVE CONSTRUCTION COSTS

In the metropolitan area, the price of houses reached a peak in the second half of 1948. This trend was comparable to the general trend in prices, but the real estate inflation was greater than the average rise in price of all commodities. At the peak, houses were selling at a level which was 156 per cent above 1940 prices; wholesale prices of all commodities increased only 116 per cent over the same period, and retail prices 95 per cent.

At the war's end, the large number of returning servicemen and the civilians shifting from war jobs to civilian occupations were in dire need of shelter. They were forced to pay premium prices to secure houses within 30 or 60 days. Construction of new houses extended over a period of 9 to 12 months due to the shortage of building materials. The need for immediate housing combined with the delay in new construction boosted the price of finished homes above the cost of building a new one.

HOUSES NOW SELLING ABOUT 8% BELOW '48 PEAK

Since completed houses were selling at a premium, it was anticipated that prices might drop sharply when the most urgent need for shelter was satisfied. However, this has not been the case. Houses in Minneapolis and the surrounding suburbs in the first half of this year were selling on an average of only 8 per cent below the peak level reached in the latter half of 1948. This decline was somewhat less than the decrease in the general level of prices.



THE PRICE of medium and low-priced dwellings from 1940-45 rose by the same percentage, but following 1945 lower-priced dwellings rose at a faster rate.

When the survey on real estate prices was conducted for the first time in 1946, the period covered included 1940, 1945, and the first half of 1946. These transactions were divided into low, medium, and high-priced houses on the basis of 1940 prices.

After a careful examination of 1940 transactions and consultation with realtors, it was decided that houses selling for $5,000 or less were generally classified as low-priced dwellings; those selling between $5,000 and $10,000 as medium-priced; and those selling above $10,000 as high-priced. The houses sold for $5,000 or less accounted for 60 per cent of the total transactions secured from realtors for 1940. On the other hand, houses sold for more than $10,000 constituted only 6% of the total. The houses sold between $5,000 and $10,000 made up the remaining 34%.

To divide the transactions for subsequent years into low, medium, and high-priced dwellings, the transactions were arrayed from the lowest priced house to the highest priced house and the 1940 percentage distribution was applied. That is, 60 per cent of the transactions on the lower end of the distribution were classified as low-priced dwellings, 6 per cent of the transactions on the upper end of the distribution were classified as high-priced dwellings, and the remaining 34 per cent of the transactions in the middle of the distribution were designated as medium-priced dwellings.

GREATEST INFLATION TOOK PLACE IN LOW-COST HOUSES

Low-priced dwellings, which in 1940 sold for an average price of $3,394, sold at the peak of the inflation, during the latter half of 1948, for an average price of $9,361. This represents an increase of 176 per cent. As a result of the gradual decline in prices, these dwellings during the first half of 1949 sold for an average price of $8,503. This represents a decrease from the peak of 9 per cent.

During the period of general inflation, prices of dwellings in the medium class rose by a smaller percentage than those in the lower class. In 1940 the average price was $6,545, and in the latter half of 1948 it was $15,855, an increase of 142 per cent. On the accompanying chart, which depicts the price trends of the three classes of dwellings, it may be observed that medium and low-priced dwellings from 1940 to 1945 rose by the same percentage, but following 1945 the lower-priced dwellings rose at a much faster rate.

Since the price level has turned downward, prices of dwellings in the medium class have fallen less than those in the lower class. The decrease has been seven per cent as compared with nine per cent cited above for the lower-priced dwellings.

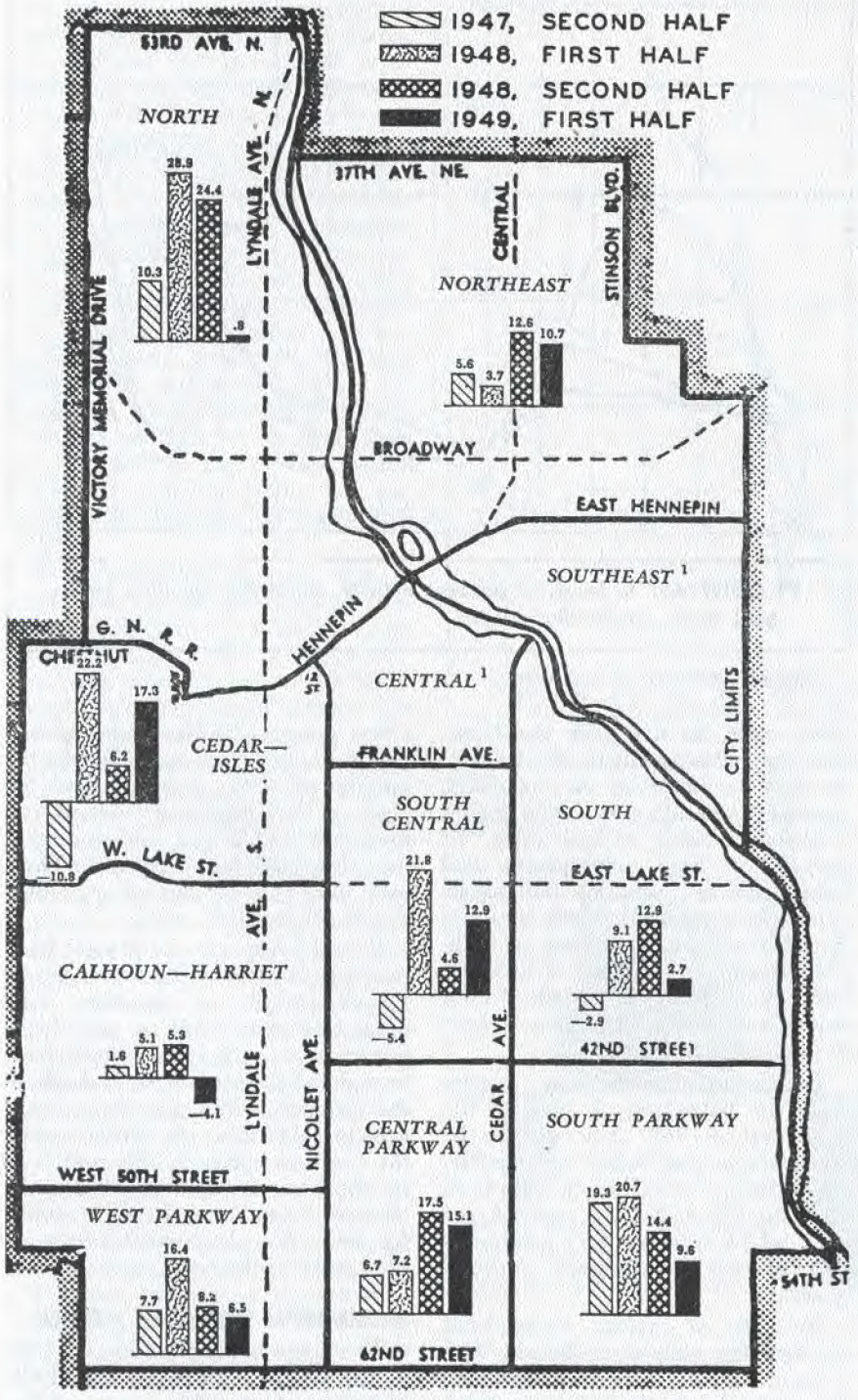
The high-priced dwellings rose less in price during the general inflationary period as compared with the price trend of the other two classes. In 1940 these houses sold for an average price of $12,732, and in the latter half of 1948 for $29,510. This was an increase of 132 per cent. Since the peak was reached prices of these houses have fallen by 8 per cent—or between the percentage drop for medium and low-priced houses.

Even during the period of great demand for shelter, purchasers of residential property were quite selective as to particular areas within the city. Prices of houses in the more desirable areas (areas designated as high

CORRECTION

● Several figures appearing in the special article of the August 31, 1949, Monthly Review were later found to have been incorrectly computed. Value added through processing food products in 1947 aggregated almost $362.5 million (instead of $29.5 million). In 1939, the value added was slightly less than $150 million (instead of $11 million). This made the increase 142% instead of 168%.

PERCENTAGE CHANGE IN MINNEAPOLIS REAL ESTATE PRICES SINCE FIRST HALF OF 1947



REAL ESTATE price changes reflect changes in demand for different types of real estate. With prices in the first half of 1947 at 100 per cent, the per cent increase or decrease by sections of the city is shown on the chart for subsequent half-year intervals.

[1] Omitted because of an insufficient number of transactions in the sample.

rent areas in the 1940 Census) rose noticeably more than those in the less desirable areas. Even though buyers have continued to be selective in regard to location, the prices of homes in the more desirable areas have declined significantly more than in the less desirable areas since the more urgent demand for housing has been satisfied and real estate prices have turned downward. In fact, in the latter areas, only a slight decline has taken place among the lower-priced dwellings. In the suburbs surrounding Minneapolis, the trend of real estate prices has been very similar to those within the city.

The peak of activity in the real estate market was reached approximately one year before the peak in prices. During 1947, the number of transactions rose sharply and the high point occurred during the fall of that year. In 1948 and in the first half of this year, the number of transactions tabulated from representative members of the Minneapolis Board of Realtors declined steadily. The transactions during the first half of this year were down 19 per cent as compared with the high volume in the latter half of 1947. Part of this decline may have been seasonal, for transactions have again increased in recent months. The activity in the real estate market, of course, was influenced tremendously by the return of men from the armed services and the shifting of workers from war plant jobs to peacetime jobs, as mentioned previously.

Following the war, the number of transactions in the low and medium-priced classes increased more than in the high-priced class. Consequently, the decrease also has been greater in the former two classes.

A breakdown of the transactions by type of area revealed a pronounced concentration of activity in the more desirable areas within Minneapolis and within the surrounding suburbs. Since the latter half of 1947 there has been practically no decline in activity in the less desirable areas.

NEWLY-BUILT HOUSES AGAIN IN COMPETITION WITH USED

Premiums paid by individuals for houses which could be occupied within 30 or 60 days have disappeared from the real estate market. As a result, newly-built houses are again

in direct competition with the older houses on the market.

Contractors have reduced the prices on their newly-built houses, but in general the reduction has been less than on older houses. Most contractors have met the return of competition by adding extra features to their houses to make them more attractive to buyers. In some instances, especially in low-priced houses, prices have been kept at the 1948 level. Contractors report that buyers have become more selective in regard to the quality of the house and the location.

HOME BUILDING INDUSTRY NOT PRICED OUT OF MARKET

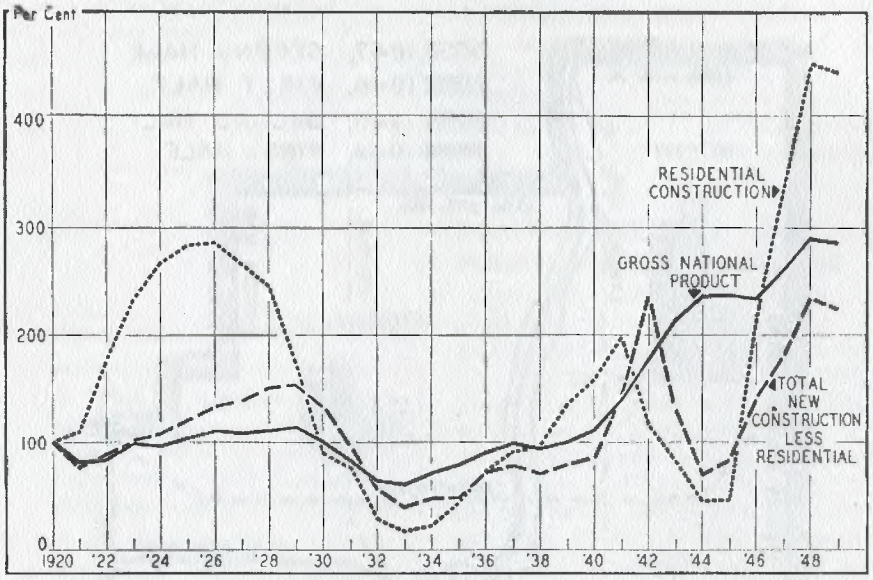
In a study of real estate price trends, it would be desirable, if a reliable estimate could be made, to include a projection of prices over the next several years. However, the real estate cycle, as well as the general business cycle, is irregular. Therefore, the present cycle cannot be extended on the basis of past cycles such as that following World War I, or that for the period of the latter Twenties and early Thirties. On the other hand, some general observations can be made in regard to the real estate cycle which may be helpful to those who are forced to formulate an estimate of future real estate price trends.

Total non-farm residential building, total new construction (except residential), and general business activity, as measured by gross national product, were plotted on the accompanying chart from 1920 to date. A comparison of the movement of the three series reveals some significant relationships.

Residential building closely follows the cycle of total construction and of general business activity, although it fluctuates more widely. In other words, the residential building boom in the Twenties roughly paralleled the boom in other types of construction and in general business conditions. In the great depression of the early Thirties, residential building for a few years almost ceased.

The parallel between residential building, on the one hand, and other types of construction and general business activity, on the other, has some important implications at the present time. High construction costs, if they are not out of line with other costs, do not price the home building industry out of the market. As may be observed on the chart, most of the building was done during a period of rising or high costs. In periods of high employment and brisk business conditions, individuals enter into contracts for new housing. A relatively small number of individuals achieve the ideal of accumulating their savings in periods of high prices and purchasing their houses in periods of low prices.

COMPARISON OF CONSTRUCTION AND BUSINESS ACTIVITY, 1920-1948



IN CONTRAST to levels of business activity, residential building undergoes much greater fluctuations.

Source: Department of Commerce.

Construction costs rose rapidly from the beginning of 1946 to the latter part of 1948. According to the construction cost index compiled by *Engineering News Record*, costs from 1940 to October 1948 rose 98 per cent, which was less than the rise of 116 per cent for wholesale prices in general.

In spite of cyclical fluctuations, construction costs since World War I have shown a gradual increase. For example, in the 1920 recession the costs did not recede to the 1913 level. In the Great Depression of the early Thirties, although costs dropped slightly below those of the early Twenties, they remained more than 50 per cent above the 1913 level.

Since 1933, with the exception of a few years, there has been a steady rise in construction costs. By the beginning of 1942, costs equalled the peak of the inflationary period following World War I, and since that time they have far exceeded it. Thus, over long periods there is a gradual rise in construction costs.

In many respects, the present business situation is without parallel in former periods of transition from boom to recession. Since 1930, legislation and national policy have brought about some basic changes in the economy which may have modified, in some measure, the course of the business cycle. If this proves to be the case, the construction cycle, likewise, may have been modified, for there is a close parallel between the course of the two cycles.

MORE NEW HOUSING NEEDED

The large number of houses built in the postwar years has raised the question of possible over-building which might eventually send real estate prices below the cost of construction. In an attempt to shed some light on this question, statistics on family formation and residential construction were studied over the period from 1920 to date.

The annual increase in the number

of families was computed from estimates of the Bureau of the Census and represents the actual change from year to year in the number of families living in the United States. This increase and the annual number of new dwelling units built were plotted on the accompanying chart.

A comparison of these series indicates that residential building in some years ran ahead of family formation and behind in others. To illustrate the relationship between the two series, annual ratios of new dwelling units to yearly increases in the number of families were plotted in a vertical bar chart. From this chart it is evident that residential building ran ahead of family formation in the Twenties and fell far short of it in the Thirties. In the postwar years, residential building again has exceeded the high rate of family formation.

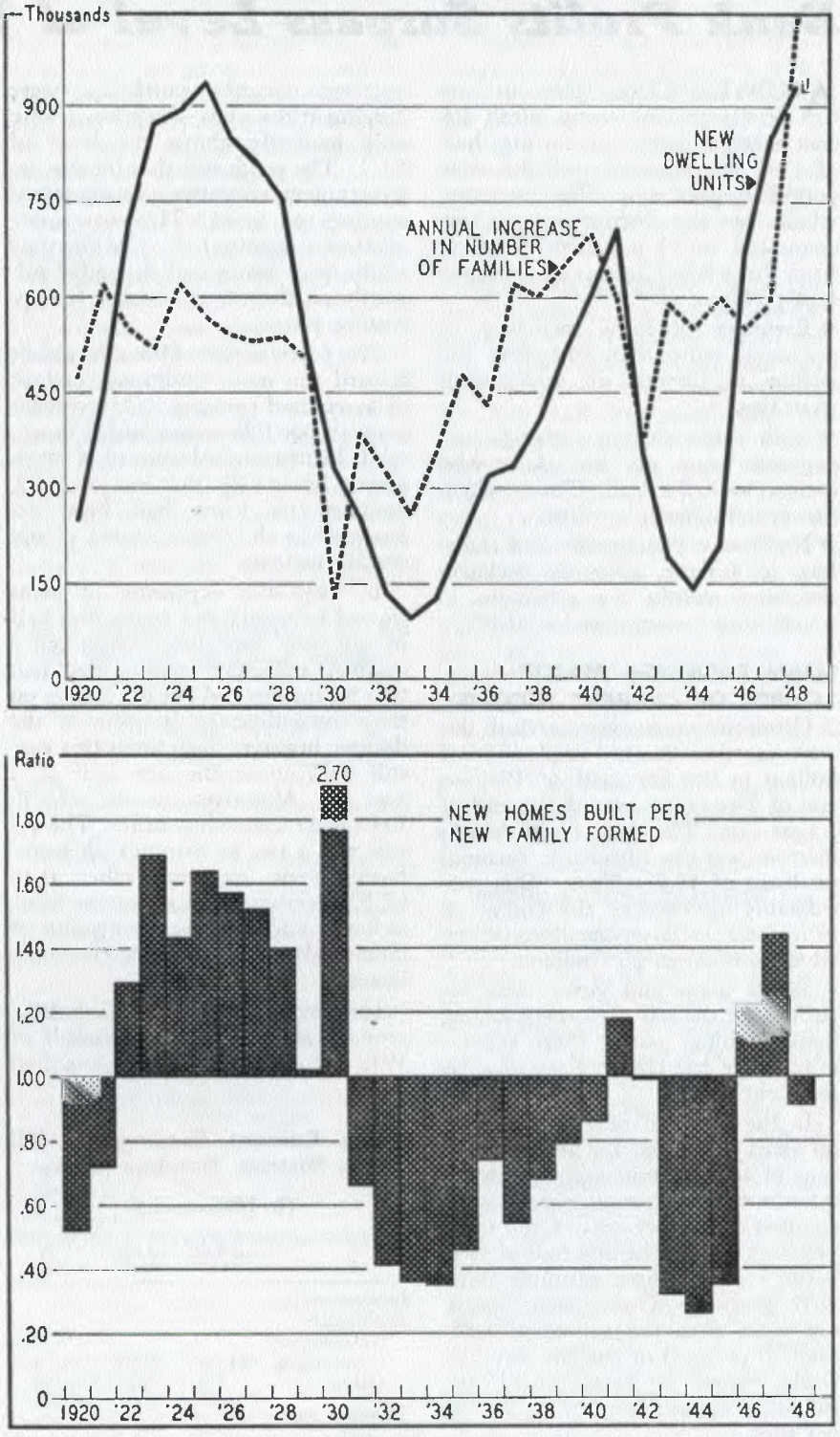
It is interesting to note that in 1930, when residential building contracted rapidly, family formation contracted still faster. In 1948, the situation was reversed: residential building expanded rapidly, but family formation expanded still faster.

Even though residential building in recent years has run ahead of family formation, it does not appear that too many dwelling units have been built, for a large deficit accumulated in the Thirties and in the war years. Furthermore, no allowance has been made for the loss of dwelling units through obsolescence and fire. However, residential building must taper off as the rate of family formation declines or a saturation point will be reached. Furthermore, an excess of certain types of dwelling units may appear while there is still a shortage of others. For instance, the trend is now shifting toward apartments. When they are in ample supply single dwelling units, such as bungalows built of inferior materials, may sell below the cost of construction. Some individuals have been compelled to buy bungalows when they would have preferred apartments.

END

ACKNOWLEDGMENT—Theodore J. Sielaff, professor of statistics, Macalester college, St. Paul, assisted in the study of real estate prices by undertaking the statistical work.

NUMBER OF NEW DWELLING UNITS RELATED TO THE NUMBER OF NEW FAMILIES, 1920-1948



CONSTRUCTION has fluctuated greatly since 1920 in relation to the increase in the number of families over the same period.

Source: Bureau of the Census, Department of Commerce.
[1] Estimated.

BANKING

Bank Profits Surpass Level of Year Ago

A SUBSTANTIAL gain in net profits was shown by Ninth district member banks in the first half of 1949 as compared with the same period a year ago. The increase, which for the district as a whole amounted to 37 per cent, stemmed from three major factors in the earnings picture:

- Earnings on loans increased 17 per cent, more than offsetting the decline in interest on government securities.
- Both gross current earnings and expenses were up, but dollar-wise income took the lead. The result: a rise in net current earnings.
- Net losses, charge-offs, and transfers to reserve accounts declined, reflecting mainly the reduction in transfers to reserves for bad debts.

LOAN EARNINGS MAJOR SOURCE OF CURRENT INCOME

Gross current income in Ninth district member banks totalled $41.8 million in the first half of 1949—a rise of 7 per cent over the record of a year ago. The main factor in this increase was the advance in earnings on loans of $2.7 million. This considerably outweighed the falling off in interest on government securities, which was down $0.5 million.

While loans and government securities are the star performers among bank earning assets, their relative importance has changed significantly in recent years.

In the first half of 1949, earnings on loans accounted for about 44 per cent of total current earnings, while interest on government securities accounted for 32 per cent. Only three years earlier—in the first half of 1946—the roles of these earnings assets were reversed. Government securities were then the source of more than 50 per cent of current earnings, while income on loans trailed considerably behind, accounting for 26 per cent.

The story behind this changing pattern of bank earnings lies, of course, in the shifting structure of bank assets. In the first half of 1946, bank assets reflected the heritage of the financing of World war II. Government security portfolios were bulging at the sides, while loans were only modestly above the level of 1941. The result was that interest on government securities overshadowed earnings on loans. This was somewhat of a novelty for, up to the time of the war, banks had depended primarily on their loan pouches for operating income.

The postwar period brought a shift toward the more traditional pattern of assets and earnings. Government security portfolios were scaled down, while loans marched upward in seven league boots. By the end of 1947, earnings on loans had been recrowned as the major source of operating income.

In 1948 the expansion of loans slowed to a walk and in the first half of this year total loans registered a decline, reflecting mainly the fact that businesses had put the brakes on their expenditures. In spite of the decline, however, loan totals this year still held above the first half of a year ago. Moreover, interest rates in 1949 were somewhat stiffer. The result was a rise in earnings on loans. Earnings on securities other than U. S. government also rose this year, as banks added to their portfolios of municipals and high grade corporate issues.

In contrast, holdings of U. S. government securities in the first half of 1949 averaged considerably less than

Gross Current Earnings of All 9th District Member Banks

(In Millions of $)

	1st Half 1948	1st Half 1949	% Change
Interest and Dividends:			
Government Securities	$13.8	$13.3	— 4%
Other	1.8	2.0	+11
Earnings on Loans	15.9	18.6	+17
Service Charges on Deposit Accounts	2.3	2.7	+17
Other Earnings	5.2	5.2	....
Total	$39.0	$41.8	+ 7%

- ***Net profits of Ninth district member banks totalled $8.2 million in the first half of 1949—up $2.2 million over first half of 1948.***
- ***Decline in transfers to reserves for bad debts explained in part the rise in net profits.***
- ***Loan earnings were up 17 per cent.***

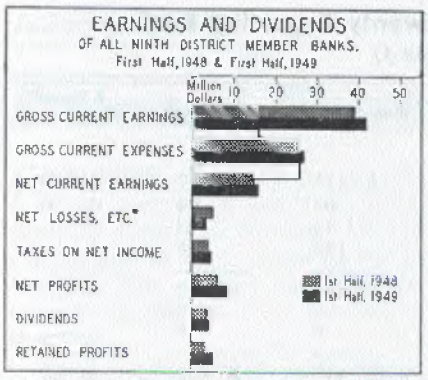
those of a year ago. Moreover, yields on governments have been slipping downward since around the first of the year. These two reasons account for the decline in interest on government securities. It should be noted, however, that since April there has been a reversal of the postwar downhill trend in holdings of government securities. Reductions in reserve requirements and heavy repayments of loans gave rise to idle funds which bankers, to some extent, put to work in the government security market.

CURRENT EXPENSES ROSE LESS THAN INCOME

Gross current expenses of Ninth district member banks rose 7 per cent in the first half of 1949 compared with a year ago. This increase was due mainly to the cost of meeting larger payrolls. Interest on time deposits and other current outlays had also risen.

Operating costs of banks have increased rapidly since the end of the war. From 1946 through the first half of this year the amount banks paid out to meet expenses rose almost 40 per cent. In recent months, however, operating costs have shown signs of stabilizing. The 7 per cent increase in the first half of 1949 was considerably smaller than in the first six-month periods of the earlier postwar years.

The increase in gross current expenses absorbed only a part of the rise in total current earnings, with the result that net current earnings were up. From $14.3 million in the first half of 1948, net current earnings rose to $15.4 million in the first half of this year.



* Net losses, charge-offs, and transfers to reserve accounts on loans, securities, and all other losses and charge-offs.

DIVIDENDS increased slightly, while retained profits showed a marked gain.

NET NONRECURRING EXPENSES DECLINED

This year, as last, there were net losses, charge-offs, and transfers to reserve accounts, but the extent of these charges against current income was considerably less in the first half of 1949 than a year ago. This reduction in net nonrecurring expenses came primarily from the smaller amount of transfers to reserves for bad debts.

According to the Treasury ruling dated December 8, 1947, banks are authorized to set up a tax-free reserve for future losses on loans based upon the loss experience of the past 20 years. Under this ruling many banks have switched from the specific charge-off method of providing for bad debts to the reserve method.

Last year, in many cases, banks adopting the reserve method included transfers applicable to 1947, as well as to the current period. This explains, in part, the fact that the volume of transfers to bad debt reserves in the first half of 1948 was considerably larger than the first half of this year, when such charges applied to the current year only.

To date the reserve method of providing for future losses on loans has been adopted by all the reserve city banks in this district and about 50 per cent of the country banks.

Taxes on net income rose from $3.5 million in the first half of 1948 to $4.2 million in the first half of this year. Since tax rates were unchanged, the increase reflected the fact that taxable income had increased.

DIVIDEND PAYMENTS EDGED UP 3 PER CENT

Net profits after taxes amounted to $8.2 million in the first half of 1949—a rise of $2.2 million over the same period a year ago. In comparison, dividend payments increased only very slightly, rising $0.1 million. On the one hand the relatively small increase in dividends meant that stockholders received a smaller proportion of net profits this year than last. The slice of the net profits pie distributed to stockholders in the first half of 1949 amounted to roughly 41 per cent. Last year 55 per cent of net profits was absorbed by dividend payments.

On the other hand, current dividend policy meant that the capital cushion of banks was heir to a sizeable volume of retained earnings this year. Retained profits of $4.8 million in the first half of 1949 outstripped those of a year ago by $2.1 million.

Gross Current Expenses of All 9th District Member Banks

(In Millions of $)

	1st Half 1948	1st Half 1949	% Change
Salaries and Wages	$11.8	$12.9	+ 9%
Interest on Time Deposits	4.2	4.3	+ 2
Other	8.7	9.2	+ 6
Total	$24.7	$26.4	+ 7%

Disposition of Ninth District Member Bank Earnings

(In Millions of $)

	1st Half 1948	1st Half 1949	% Change
Gross Current Earnings	$39.0	$41.8	+ 7%
Gross Current Expenses	24.7	26.4	+ 7
Net Current Earnings	$14.3	$15.4	+ 8%
Net Losses, Charge-offs, and Transfers to Reserve Accounts	$ 4.8	$ 3.0	—38%
Taxes on Net Income	3.5	4.2	+20
Net Profits	$ 6.0	$ 8.2	+37%
Dividends	$ 3.3	$ 3.4	+ 3%
Retained Profits	2.7	4.8	+78%

AUGUST BANKING DEVELOPMENTS

BANKING developments in Ninth district member banks during August were highlighted by (1) a sharp increase in deposits, reflecting the late summer marketings of the small grain crop, (2) a further reduction in reserve requirements, and (3) the Treasury announcement of a cut in the one-year money rate from 1¼% to 1⅛%.

DEMAND DEPOSITS other than due to banks jumped $38 million during August to a total of $2,185 million. This increase, which took place entirely in country banks, reflected the fact that crop marketings had moved into full swing this month. In addition to the usual seasonal shipments of grain, farmers were hurrying marketings ahead of the railroad freight rate increase effective September 1.

In city banks an increase of $23 million in deposits of individuals, partnerships, and corporations was slightly more than offset by withdrawals from deposits of states, counties, and municipalities and the U. S. Government.

City banks, however, experienced a substantial increase in deposits of banks as country correspondents built up their bank balances.

RESERVE REQUIREMENTS were pared down by 2 per cent on net demand deposits and 1 per cent on time deposits in all member banks in a series of steps during the month. Requirements on net demand deposits now stand at 22 per cent in central reserve city banks, 18 per cent in reserve city banks, and 12 per cent in country banks, and on time deposits at 5 per cent for all classes of member banks. This is the lowest level in effect since 1941.

In Ninth district member banks required reserve balances declined $41 million on a daily average basis comparing the last half of August with the last half of July. Reserve accounts, however, were down only $29 million due to the fact that country banks, primarily, left a share of their freed reserves in excess reserve balances.

GOVERNMENT SECURITY PORTFOLIOS rose $53 million as banks invested funds arising from reductions in reserve requirements

and increased deposits. According to data for the 20 weekly reporting banks, almost all of the increase occurred in bill holdings.

During August the U. S. Treasury launched its program of deficit financing by expanding the weekly Treasury bill offerings. Approximately $600 million of new money was borrowed in the bill market this month.

In addition, the Treasury announced that 2% bonds called for redemption on September 15 and certificates falling due October 1 will be refunded with an offering of 1⅛% CI's—⅛% under the prevailing certificate rate. Also bonds called for redemption December 15, 1949, will be rolled-over with an offering of notes of unspecified rate.

TOTAL LOANS in Ninth district member banks rose $27 million in August, marking the third consecutive monthly increase. The rise was centered in city banks. Business and consumer loans showed increases, and in addition there was a spurt in loans to banks.

END

Assets and Liabilities of Twenty Reporting Banks

(In Million $)

	July 27, 1949	Aug. 31, 1949	Sept. 14, 1949	$ Change July 27-Aug. 31
ASSETS				
Comm., Ind., and Ag. Loans	$ 222	$ 231	$ 227	+ 9
Real Estate Loans	65	66	66	+ 1
Loans on Securities	15	14	13	— 1
Other (largely consumer) Loans	131	152	131	+ 21
Total Gross Loans & Discounts	$ 433	$ 463	$ 437	+ 30
Less Reserves	6	6	6	.....
Total Net Loans & Discounts	$ 427	$ 457	$ 431	+ 30
U. S. Treasury Bills	47	80	106	+ 33
U. S. Treasury C. of I.'s	142	138	146	— 4
U. S. Treasury Notes	20	19	21	— 1
U. S. Government Bonds	478	479	494	+ 1
Total U. S. Gov't Securities	$ 687	$ 716	$ 767	+ 29
Other Investments	104	104	102	.....
Cash and Due from Banks	437	428	481	— 9
Miscellaneous Assets	15	16	17	+ 1
Total Assets	$1,670	$1,721	$1,798	+ 51
LIABILITIES				
Due to Banks	$ 273	$ 330	$ 379	+ 57
Demand Deposits, Ind., Part., Corp.	754	777	812	+ 23
Demand Deposits, U. S. Gov't	46	40	40	— 6
Other Demand Deposits	224	205	195	— 19
Total Demand Deposits	$1,297	$1,352	$1,426	+ 55
Time Deposits	252	252	252	.....
Total Deposits	$1,549	$1,604	$1,678	+ 55
Borrowings	5	.....	3	— 5
Miscellaneous Liabilities	15	17	16	+ 2
Capital Funds	101	100	101	— 1
Total Liabilities and Capital	$1,670	$1,721	$1,798	+ 51

Assets and Liabilities of All Ninth District Member Banks*

(In Million $)

	July 27, 1949	August 31, 1949	$ Change July 27, 1949 Aug. 31, 1949	$ Change Aug. 28, 1948 Aug. 31, 1949
ASSETS				
Loans and Discounts	$ 875	$ 902	+ 27	+ 76
U. S. Government Obligations	1,645	1,698	+ 53	+ 14
Other Securities	224	226	+ 2	+ 25
Cash and due from Banks and Res.	845	842	— 3	— 6
Other Assets	30	28	— 2	— 2
Total Assets	$3,619	$3,696	+ 77	+107
LIABILITIES AND CAPITAL				
Due to Banks	$ 306	$ 370	+ 64	+ 49
Other Demand Deposits	2,147	2,185	+ 38	+ 56
Total Demand Deposits	$2,453	$2,555	+102	+105
Time Deposits	931	931	....	+ 8
Total Deposits	$3,384	$3,486	+102	+113
Borrowings	6	.....	— 6	— 1
Other Liabilities	20	21	+ 1	+ 3
Capital Funds	209	189	— 20	— 8
Total Liabilities and Capital	$3,619	$3,696	+ 77	+107

*This table in part estimated. Data on loans and discounts, U. S. Government obligations, and other securities are obtained by reports directly from the member banks. Balances with domestic banks, cash items, and data on deposits are largely taken from semi-monthly reports which member banks make to the Federal Reserve Bank for the purpose of computing reserves.

Reserve balances and data on borrowings from the Federal Reserve banks are taken directly from the books of the Federal Reserve bank. Data on other borrowings are estimated. Capital funds, other assets, and the other liabilities are extrapolated from call report data.

AGRICULTURE

Farmers' Purchasing Power Drops 17 Per Cent

- **Lower farm prices, smaller crop production, and rigid costs of production put squeeze on net farm income.**
- **Payment of debt may be farmers' best buy today.**
- **Bankers measure farmers' capacity to pay debt by estimating operators' labor income.**

FARMERS' cash income in the Ninth District is currently under pressure from two sources. One is the decline in farm prices in recent months. The other is the sharp reduction in district crop production this year.

Total production of corn, wheat, oats, barley, rye, and flax in 1949 may be approximately 20% less than it was in 1948 and the smallest crop since 1941. A record crop acreage was planted this year, but the early and late season drouths, plus grasshopper and aphid infestation, cut crop yields per acre below recent year levels.

The general level of prices received by farmers in mid-August this year showed a decline of 20% from the peak in January of 1948, 17% from a year earlier, and 9% since the first of this year.

PARITY RATIO LOWEST SINCE 1941

The combination of lower farm prices and smaller crops has apparently nipped off approximately 17% of the district's cash farm income compared with last year for the first seven months of the year. (See table on cash farm income.) Farm marketings of last year's large carryover stocks of grains, plus sales of livestock in the first seven months of 1949, probably have prevented an even more serious decline in cash farm income.

A third factor tending to put a squeeze on farm purchasing power is the high cost of farm production. Prices that farmers pay for items used in production and farm family-living have declined only about 3% from the peak in mid-1948.

It is possible to measure agricultural well-being by comparing the index of prices received by farmers with the index of prices paid. This is called the parity ratio (1910-14 = 100). This parity ratio was 133 at the peak in October of 1946. A year ago it was 117, and in mid-August this year it was 101. The trend will continue downward if price declines of farm products are not offset by equal or greater reductions in prices paid by farmers, which appears unlikely in the immediate future.

Another way of analyzing the reduction in farm purchasing power is to compare the debt paying power of farm products now with some previous period. According to one report, farmers could have paid off a $1,000 debt with only 456 bushels of corn when corn prices were near the peak. Now, it takes about 716 bushels of corn.

In August 1948 a $1,000 debt could be paid with fourteen 220-lb. market hogs. Now, it takes approximately 21 hogs.

It would appear therefore that with further downward farm price adjustments a possibility, the sale of farm products to pay farm debts is one of today's best buys.

FARM CREDIT MAY ACTUALLY EXPAND

As farmers' purchasing power contracts, however, farmers actually may have to borrow more money from banks to carry on normal farm operations.

The increase in size of farms, farm mechanization, and a greater degree of specialization in farm enterprises are all factors tending to increase the use of credit by the individual farm operator.

The reduction in cash farm income and a fairly inflexible level of costs in farming indicate that farmers may also find it somewhat more difficult to repay loans in the future than they have in recent years.

Bankers, recognizing the economic trends in agriculture, may be more cautious in determining whether or not a loan will be of benefit to both the borrower and the lender.

In the future, it appears likely farm loans may be made with greater thought and emphasis on farmers' capacity to employ additional capital as well as their ability to return a profit on their farming operations.

When a farm customer keeps careful records of his income and expenses, it is a comparatively easy task to ascertain the operator's net labor income, which is a measure of his capacity. The banker can safely extend credit only to those farm customers who consistently are able to produce income in excess of costs in normal times.

When a farmer does not have a good set of records, the banker must make his own estimates of a borrower's capacity based on the farmer's financial statements, his income tax returns, farm production records, or such other data that is available.

In judging the capacity of prospective farm customers, there are at least seven factors that may be estimated or measured. These seven factors have been developed by farm management experts at the University of Minnesota, as well as at other

January-July Cash Farm Income*

(Thousands of Dollars)

State	1935-1939 Average	1948	1949	1949 In Per Cent of 1948
Minnesota	$ 180,401	$ 835,591	$ 628,770	75%
North Dakota	44,916	323,158	211,840	66
South Dakota	54,320	333,182	286,131	86
Montana	32,037	141,762	134,473	95
Ninth District[1]	355,582	1,686,873	1,395,030	83
United States	4,100,168	15,427,926	14,023,611	91

*Data from The Farm Income Situation, July-August 1949.

[1] Includes 15 counties in Michigan and 26 counties in Wisconsin.

state agricultural colleges, over a period of years. They are as follows:

(1) Crop yields. Is the credit applicant able to produce average to above average crop yields?

(2) Choice of crops. Are crops planted that are adapted to the area and that have a high cash return value?

(3) Returns from livestock per $100 feed fed. This is a measure of the efficiency in converting feed into livestock products.

(4) Amount of livestock.

(5) Size of business. Is the farm big enough to spread overhead costs economically? Size of business may be measured by work units. A work unit represents the amount of work that a farm worker can do in a 10-hour day working at average efficiency. For example, it requires about 10 hours of man labor to produce an acre of corn and 140 hours to care for a milk cow for a year.

(6) Work accomplishment per worker. This is a measurement of the efficient use of labor on a farm. Farm management data are available from the agricultural colleges giving work unit values to each farm enterprise. From these data it is possible to measure accurately work units per worker.

(7) Control over expenses.

A careful analysis of these seven management factors as they affect a farmer's capacity to repay debt should be valuable to the banker extending credit to agriculture. The importance of these seven factors as they were related to farm operators' labor earnings in southwest Minnesota in 1948 are indicated in the chart.

The relation of size of business, crop yields, and livestock feeding efficiency to farm earnings are illustrated in a practical way from farm management records in southeastern South Dakota in 1948. END

Relation of Size of Business to Farm Earnings in Southeast South Dakota in 1948*

Size or Number of Work Units	No. of Farms	Average Operator's Labor Earnings
Under 330	8	$ 4,334
330-575	16	7,396
575 and over	8	10,390

Relation of Crop Yields to Farm Earnings in Southeast South Dakota in 1948*

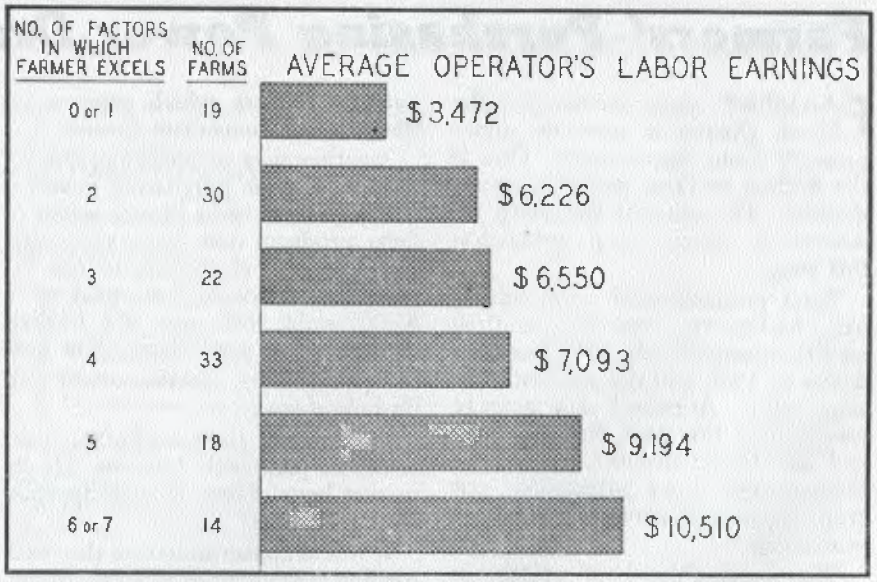
% Crop Yields Were of Average	No. of Farms	Average Operator's Labor Earnings
74	7	$ 3,211
99	18	7,836
134	7	10,439

Relation of Livestock Feeding Efficiency to Farm Earnings in Southeast South Dakota in 1948*

Average Livestock Returns Per $100 Feed	No. of Farms	Average Operator's Labor Earnings
104	8	$ 5,887
165	15	7,889
269	8	8,360

*1948 Farm Record Summary—Agricultural Economic Pamphlet No. 28—South Dakota State College—Brookings, South Dakota.

RELATION OF OPERATORS' EARNINGS TO NUMBER OF MANAGEMENT FACTORS IN WHICH FARMER EXCELS*



OPERATORS' labor earnings, an accurate measurement of a farmer's ability or capacity to use bank credit successfully, show a variation in relation to farm management factors.

Source: Annual Report of the Southwestern Minnesota Farm Management Services, 1948. Report No. 175, May 1949, University Farm, St. Paul.

Average Prices Received by Farmers*

Commodity and Unit	Aug. 15 1937-41 Avg.	Aug. 15 1948	Aug. 15 1949	Parity Prices [1] United States Aug. 15, 1949
Crops				
Wheat, bushel	$0.69	$ 1.95	$ 1.85	$ 2.15
Corn, bushel	.56	1.77	1.04	1.56
Oats, bushel	.24	.59	.50	.970
Potatoes, bushel	.63	1.74	1.58	1.78
Livestock and Livestock Products				
Hogs, 100 lbs.	8.04	26.30	18.39	17.70
Beef Cattle, 100 lbs.	7.44	23.86	19.29	13.20
Veal Calves, 100 lbs.	8.70	27.05	23.45	16.40
Lambs, 100 lbs.	7.94	23.72	20.65	14.30
Wool, lb.	.26	.53	.47	.445
Milk, wholesale, 100 lbs.	1.47	4.43	3.13	3.89
Butterfat, lb.	.29	.86	.64	.639
Chickens, live, lb.	.129	.305	.215	.277
Eggs, dozen	.171	.416	.435	.522

*Data compiled from USDA Agricultural Prices—August 30, 1949.

[1] The term parity as applied to the price of an agricultural commodity is that price which will give to the commodity a purchasing power equivalent to the average purchasing power of the commodity in the base period, 1910-14.

BUSINESS

Lower Farm Income Tempers Business Pickup

- ***Reduced farm income may lessen retail trade and services in western part of the district.***
- ***Department store sales again approximated last year's dollar volume.***
- ***Business failures remain low as compared with pre-war.***
- ***Manufacturing employment has risen slowly from summer low-point.***
- ***Carloadings recovered from slump.***

LIQUIDATION of inventories, which began last fall, and the policy of hand-to-mouth buying set the stage for the current revival in business activity.

Distributors of goods, who had reduced their inventories in anticipation of a decline in the volume of sales, recently began to replenish their stocks as retail sales held up at surprisingly high levels. In recent weeks, the amount of new orders has risen, the freight moving through the economy has increased, and some manufacturers have begun to rehire their laid-off workers. Manufacturing employment in this district has shared in the employment increase occurring in the nation.

In spite of general improvement in the business outlook, it is not anticipated that business will expand over the entire district. In areas where a business recession has not been experienced, notably the western part of the district, including Montana, North Dakota and South Dakota, a rise in business activity can hardly be expected. In this area, employment in the non-agricultural industries this summer was higher than in 1948.

A reason that business conditions in the western part of the district can hardly be expected to improve is that this region suffered a drought during the summer. The farmers' purchasing power was thereby cut materially. As a result, some contraction may occur in retail trade and in services.

Since a third of all wage and salary workers employed in nonfarm industries in Montana are employed in retail trade and service industries, the Unemployment Compensation commission is expecting a more than seasonal decline in employment during the coming fall and winter months.

Should the present business trend continue, it may very well be that the western part of the district may experience some contraction in the general volume of business activity while the eastern part of the district is pulling out of a mild business recession.

SEPTEMBER DEPARTMENT STORE SALES UP

In recent weeks, department store sales have strengthened materially. According to the weekly reports received from stores in the Twin Cities and Twin Ports, sales during the first half of September were equal to the dollar volume of the corresponding period in 1948.

Department store executives report that consumers are not holding back as much on their purchases as they did in the early part of the summer. Apparently consumers have become convinced that prices have again stabilized or they have reached the position where it is necessary to replace some of their soft goods.

On the basis of a preliminary tabulation, sales among departments varied greatly from those of a year ago. August sales of men's clothing and of silverware and jewelry were about equal to those of a year ago. The sales of radios, phonographs, television sets, records, etc., were much larger than in 1948. On the other hand, sales of major household appliances declined by the greatest amount in comparison with last year's sales.

There has not been a prolonged decline of any severity in department store sales in this district. For instance, sales during the first eight months of 1949 averaged 6 per cent below the dollar volume of the corresponding period in 1948. According to the index of retail prices compiled by the United States Department of Commerce, prices have dropped 4 per cent from the peak. However, this is a very conservative estimate, since only the regular retail prices are compiled in the index. Retailers have offered frequent special sales to induce consumers to buy. Very likely retail prices have declined as much as sales. If this is the case, consumers have been buying as much merchandise in physical volume this year as in the peak year of 1948.

BUSINESS FAILURES ROSE MODERATELY

Even though retail sales have held up well, retailers' profits have declined. In previous postwar years, retailers had some inventory profits, while this year they have suffered some inventory losses. Furthermore, the profit margin has been reduced

Northwest Business Indexes

(Adjusted for Seasonal Variations—1935-1939 = 100)

	Aug.'49	July '49	Aug. '48	Aug. '47
Bank Debits—93 Cities	340	347	350	314
Bank Debits—Farming Centers	413	403	436	365
Ninth District Dept. Store Sales	269p	261	290	271
City Department Store Sales	281p	272	304	280
Country Department Store Sales	258p	251	277	262
Ninth District Department Store Stocks	290p	283	332	256
City Department Store Stocks	245p	246	279	228
Country Department Store Stocks	327p	312	375	279
Country Lumber Sales	162p	147	149	124
Miscellaneous Carloadings	127r	116r	129r	126r
Total Carloadings (excl. Misc.)	112r	119r	125r	122r
Farm Prices (Minn. unadj.)	226	230	289	296

p — Preliminary.

r — Revised data—the seasonally adjusted indexes for miscellaneous carloadings and for total carloadings (excluding miscellaneous) have been revised from 1936 to date.

with the increase in competition resulting from the return of the buyers' market.

Business failures have increased as was expected, but the number of failures is still small compared to the number prior to the war. In the first seven months of this year, Dun and Bradstreet reported 69 business failures for this district; for the same period last year, there were 42 failures. In the latter Thirties, well over 200 firms failed annually.

MANUFACTURING EMPLOYMENT SHOWED SMALL GAIN

Employment has declined noticeably in the eastern part of this district as compared to a year ago. According to the Upper Peninsula office of the Michigan Unemployment Compensation commission, nonfarm employment in mid-July was estimated at 69,870, which was approximately 10 per cent below the level of a year ago.

Some rehiring of labor has taken place in plants manufacturing food products, apparel, furniture, primary metals, transportation equipment and leather goods. In the lumber and wood products industry, employment continued to dip.

Index of Department Store Sales by Cities

(Unadjusted 1935-39 = 100)

	August [1]	Per Cent Change [2] from Year Ago August	Jan.-Aug.
Minneapolis	264	+ 0	— 4
St. Paul [3]	195	—19	—10
Duluth-Superior	257	— 2	— 3
Aberdeen	366	—12	—15
Bismarck	284	— 2	— 3
Fairmont	295	— 3	— 8
Grand Forks	247	— 2	— 2
Great Falls	339	+14	+ 4
La Crosse	205	— 6	— 7
Mankato	214	— 9	— 5
Minot	266	+ 2	— 7
Rapid City	327	—15	—12
Rochester	223	— 1	— 2
St. Cloud	248	—18	—11
Sioux Falls	327	+ 0	— 4
Valley City	180	—12	—14
Willmar	266	— 6	— 5
Winona	245	+ 3	— 3
Yankton	240	—10	—16

[1] Based on daily average sales.

[2] Based on total dollar volume of sales, August 1949 having 27 trade days; August 1948, 26.

[3] Reflects labor difficulties at St. Paul stores during latter half of August.

Sales Ninth District Department Stores*

	% Aug. 1949 [1] of Aug. 1948	% Jan.-Aug. 1949 of Jan.-Aug. 1948	Number of Stores [2] Showing Increase	Decrease
Total District	95	94	75	189
Mpls., St. Paul, Dul.-Sup.	95	94	4	23
Country Stores	96	95	71	166
Minnesota (city and country)	95	95	23	68
Minnesota (country)	97	96	22	46
Central	90	89	2	5
Northeastern	100	97	2	3
Red River Valley	104	92	2	2
South Central	92	97	3	11
Southeastern	100	98	4	8
Southwestern	99	96	9	17
Montana	100	97	7	13
Mountains	95	95	2	8
Plains	108	100	5	5
North Dakota	99	99	24	24
North Central	104	96	5	5
Northwestern	102	92	4	2
Red River Valley	97	103	7	10
Southeastern	98	100	7	6
Southwestern	(3)	(3)	....	....
Red River Valley-Minn. & N. D.	98	101	9	12
South Dakota	93	91	6	39
Southeastern	97	94	3	11
Other Eastern	87	87	0	25
Western	97	95	3	3
Wisconsin and Michigan	91	92	12	44
Northern Wisconsin	92	95	4	12
West Central Wisconsin	91	92	8	23
Upper Peninsula Michigan	88	87	0	9

* Percentages are based on dollar volume of sales.

[1] August 1949 had 27 trade days; August 1948 had only 26.

[2] August 1949 compared with August 1948.

[3] Not shown, but included in totals. Insufficient number reporting.

Employment in the non-manufacturing industries has also increased. Larger working forces were reported in construction, wholesale and retail trade, and service establishments.

In the Twin Cities, where a large part of manufacturing in Minnesota is concentrated, employment has risen gradually from the low point reached in June. Concerns producing textiles, apparel, metal products and transportation equipment absorbed most of the increased labor force.

FREIGHT MOVEMENT UP

The movement of freight in this region has recovered materially from the unusual winter slump. In the first two months of this year, carloadings, exclusive of miscellaneous freight, were below the 1935-1939 monthly average. During the summer months, the number of cars loaded has again risen to approximately 20 per cent above the pre-war average.

Fabricated materials, which fall largely into the classification of miscellaneous carloadings, in August again moved in substantial volume through the economy. The index for August stood at 127 per cent with an adjustment for seasonal variation. This was very close to the average monthly volume of fabricated materials moving through the economy in 1948.

Outstanding orders at department stores usually rise during the summer months, but this summer the increase was greater than usual. For instance, the value of orders outstanding at a sample of stores in this district at the end of July was 48 per cent larger than at the end of June.

END