MONTHLY Review

FEDERAL RESERVE BANK OF MINNEAPOLIS

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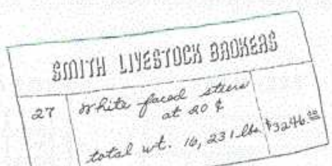
MOST OF THE transactions from which agricultural credit springs, belong to one of the main types depicted below:

CROP EXPENSES and other seasonal expenses usually occur some months before the product is sold. Credit "postpones" payment of these until income is received.

MACHINERY AND EQUIPMENT contribute to production and income over a period of several years. Machinery loans are often repaid more rapidly than income is produced from the use of the machine.



FEEDER CATTLE AND LAMBS represent a special kind of "inventory," which normally increases in value as they are fattened for market.

BREEDING LIVESTOCK are capital assets, contributing income over a period of several years. They are valued primarily for what they produce, not for resale.

Rising Role of CREDIT IN TODAY'S AGRICULTURE

"A SUCCESSFUL farm operator can no more operate without credit today than he can farm without good livestock or modern machinery."

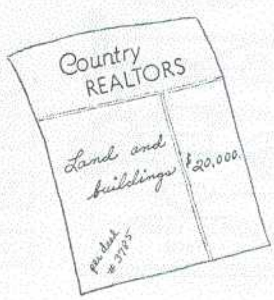
"It's as necessary to know *how to use* borrowed money as it is to know how to use fertilizer."

These are statements by a leading farm management service company of the midwest.

Increased cash outlays for operating expenses, higher investments in operating assets, and the technological revolution in modern farming have led to expansion in the use of credit. There is plenty of evidence, too, that new agricultural technology will change the farming picture even more in the future. Farmers, lenders, farm leaders and educators, therefore, need to understand the role of credit in modern agriculture because of its increasing importance.

Credit on today's farms can serve at least two purposes:

First, credit used to finance various types of production expenses defers payment of such expenses—



REAL ESTATE is normally the basis for long term credit, since land is not considered depreciable. Interest expense is usually a major part of annual payments.

at least from the farmers' standpoint—until the final product is produced and sold. Both expenses and income tend to come at irregular intervals in agriculture. Thus, short-term seasonal crop loans are useful in financing these expenses while the crop is being produced. The same is true of many other farm enterprises for which the time required for production may vary from a few months to a year or more.

Second, credit is also useful in that it enlarges the total amount of capital under the control of the operator. A farmer who owns his land, livestock and equipment has a big investment in these assets. Frequently he is short of working capital. He could sell part of his assets in order to obtain working capital, but this would result in fewer assets to work with, a smaller business volume, and less income. This is what he might have to do if credit were not available.

But credit can provide the needed funds based on the value of his present assets and potential earning capacity. In this way the operator gets the additional working capital he needs, yet he still keeps all of his assets intact. Credit, therefore, permits him to employ a greater total amount of capital in productive enterprises. If his operations are efficient, he is in a position to earn a larger profit and make more rapid financial progress.

Credit Use Follows Changes in Farm Business

The sweeping nature of recent technological developments in agriculture are well known. But these developments are related to more *fundamental changes* in the economic structure of agriculture. The greater use of credit stems from these fundamental changes.

One of these changes is that more of the materials and resources used in farm production are purchased from sources off the farm than was true a few years back. The recipe of farm production today includes larger portions of purchased ingredients, such as fertilizer, chemicals, feed supplements, power and equipment. These manufactured items contribute relatively more to the total output of agriculture; land and buildings contribute relatively less. It takes more credit to finance these operating expenses.

Another development is that investments in machinery, equipment, and similar operating assets make up a larger share of the total investment in a typical farming operation today than before. Conversely, land and buildings are a relatively smaller share of that investment.

Management's function of decision and control is directly exercised over those two aspects of the farm business—operating assets and operating expenses. Such assets do not in themselves produce a profit but only as they are used efficiently.

Because these operating assets and expenses have a larger role in farming today, the manager's decisions are effective over a larger proportion of the total enterprise. Management is, as a result, a highly significant factor in successful farm operations today.

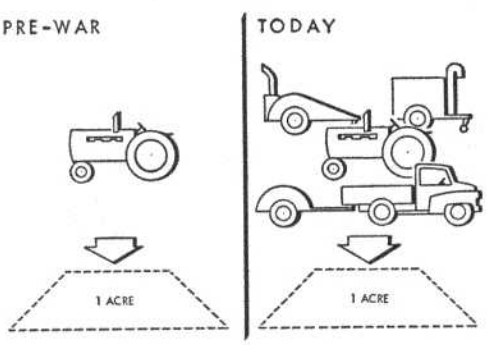
Management's role in farming is likely to be even more important in the future. Land acreage is limited. Therefore, further increases in farm output to feed a growing nation will depend more on use of fertilizers, irrigation, better crop and livestock management and other more intensive practices. Even larger investments in machinery and operating equipment can be expected which will put still more emphasis on the role of management.

Credit is Used in These Ways

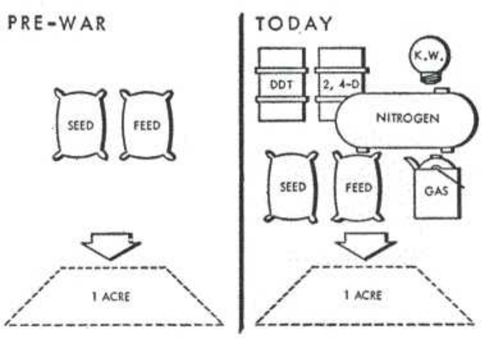
Credit use in agriculture is frequently discussed in terms of short-term, intermediate-term, and long-term — a convenient breakdown. But it is also helpful to consider credit in terms of its various uses in farming operations today. They are as follows:

CROP EXPENSE: The financing of normal crop expenses such as fuel, seed, and fertilizers by credit spans the gap between the time that expenses are incurred and the time when the production

MACHINERY and equipment make up a larger share of total investment in farming today. Fixed assets (such as land and buildings) are a smaller share.



A LARGER share of total output stems from purchased supplies—such as fertilizers, chemicals, feed supplements, power and machinery. Land contributes relatively less.



process is completed and the income received.

The fact that money is borrowed to pay these expenses does not change the amount of annual expense involved (except for interest charges) any more than if the expenses were paid immediately from the farmer's assets. The effective use of credit, therefore, does not involve any greater or lesser commitment of income except as indicated above by the addition of the interest charge.

MACHINERY AND EQUIPMENT: Machinery and equipment are productive assets which normally contribute to income over a period of several years. The expense involved is properly spread over the useful life of the asset, in the form of depreciation expense. But loans for the purchase of machinery and equipment are frequently paid off in a much shorter period. When this is done, repayment of such debts in excess of the added income created during a particular period must come from some other source. Thus, rapid repayment of such debts may involve a greater commitment of income for a particular period.

Actually, when several items of equipment are purchased over a period of years, rapid payment of individual loans may sometimes approximate the amount of depreciation expense (and income) chargeable to all items of equipment. When this is true, such payment may not constitute any special burden on current income.

FEEDER LIVESTOCK: Feeder cattle and lambs represent a special type of "inventory"—they can almost always be resold at or near their purchase value. Money to repay such loans becomes available when the livestock are sold.

Since the value necessary to liquidate the loan is contained in the assets themselves, repayment does not involve any direct commitment of other income.

BREEDING LIVESTOCK: Breeding livestock, including dairy cows, are usually considered capital assets. Such assets have added value because of the production that is obtainable from them. The proceeds from such investments are obtained over a period of several years.

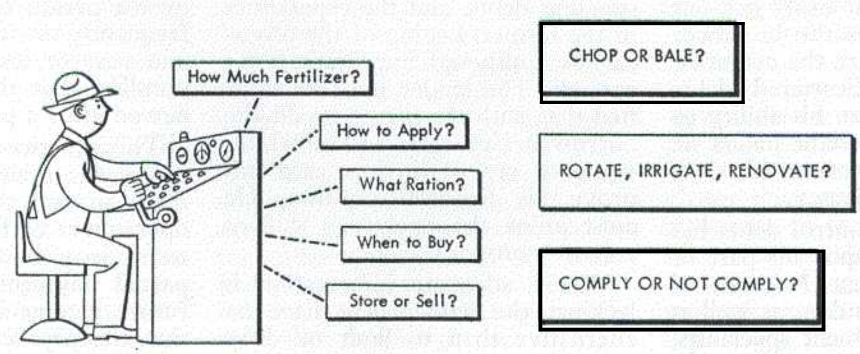
As in the case of machinery loans, loans for purchase of breeding stock are sometimes repaid more rapidly than income is produced from them. When this is true, the balance may have to be paid out of other income.

LAND AND BUILDINGS: Loans for the purchase of real estate are usually made over a long period of time, since the value of land is not considered depreciable. (Buildings are depreciable, of course.) Repayment of such loans normally comes directly out of general income earned from the farm, *after* production expenses are paid. Such loans are frequently of substantial amount and amortized over a long period. Interest charges usually constitute an important part of the total annual payment—even though the rate of interest is almost always lower on real estate debt than on non-real-estate debt.

MAJOR FARM IMPROVEMENTS: Investments in major farm improvements have become common in recent years. Projects involving irrigation, drainage, terracing, and contour farming, liming, and other practices designed to improve the long-run productivity of farm land represent investments of this type. They are logically financed by real estate credit.

FAMILY CONSUMPTION: Credit extended to farmers to finance expenditures for home improvement or other family consumption must be repaid out of existing income sources, since such spending creates no added earnings of its own. Such loans do not change the total amount of income available for spending. To the extent that money is borrowed for purchases today, less income will be available for spending during the period that the loan is being repaid.

FACED WITH more complex alternatives, management's job is more difficult—and more important to financial success. Management, confronted by choices over the use of many new kinds of machinery, other equipment, and supplies, exercises decision over a larger "share" of the business than formerly.



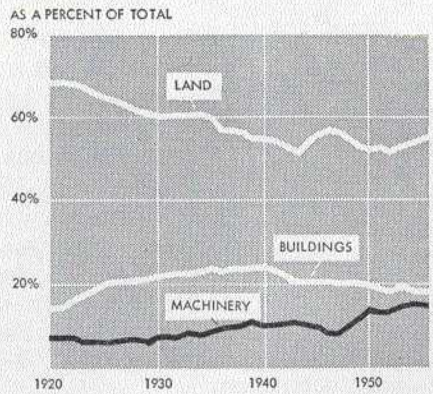
TOTAL FARM DEBT

BY TYPE OF ASSET

Source: U. S. Department of Agriculture.

VALUE OF PHYSICAL ASSETS

ON FARMS IN THE U. S.



Source: U. S. Department of Agriculture.

Credit Costs and Returns

Machinery, feed, fuel, and fertilizer suppliers commonly extend credit to farm customers. Some of it is extended under formal agreement; some of it is simply "on the books."

Buying on time, or letting bills accumulate unpaid on a dealer's books, is a debt liability just as surely as if they arranged with their local banker for a loan to cover these same expenses.

Purchase of larger machinery and equipment items on installment contracts through dealers has become common in recent years. Interest costs are usually higher than on a direct loan, but repayment terms are frequently liberal.

Debt Control Important

Not only is excessive use of dealer credit likely to be more expensive, but scattered debts accumulating in this way can easily get out of hand. Sometimes the borrower may not fully realize the extent of such obligations. Scattered debts sometimes jeopardize his ability to get much needed credit unless he is willing to concentrate his debt with one lending agency.

The ability to control debts has thus become an important part of financial management. It is one of the reasons why lenders, as well as most farm management specialists, recommend that farm operators try to deal with one lender who is well acquainted with their business and character. This usually results in better credit service, better control of debts, and lower costs. Such a lender is more apt to "go along" with a borrower he knows when special needs arise.

Borrower-Lender Relations

As management's role in farming becomes more important, sound lending becomes more directly contingent upon the manager's ability. In a sense, physical assets that may be pledged as security constitute correspondingly less security, since the assets themselves can produce profits and income only as they are used effectively.

As a result, sound lending today requires more complete information about the entire farming operation — what probable income and expenses will be, a listing of all outstanding debts, and the capabilities of the farmer. Listing of the physical assets, although important, is not enough. The lender must be satisfied that with the use of credit the borrower can earn additional income to repay the loan and improve his financial position. He must judge the operator's skill as a farm manager.

Where adequate information is lacking, the lender may have no alternative than to limit or deny the loan request, even though the actual use might be sound. Thus, whether an individual farmer obtains needed credit may in some instances hinge upon how fully he supplies pertinent information about his business. Carefully kept farm records are particularly useful in this regard.

Intermediate-term Farm Loans

Much has been said in recent years about the need for intermediate-term loans — credit of from one to five years maturity. As expensive machines, more valuable breeding stock, and similar investments become more common, credit terms adapted to longer term needs would seem appropriate. Many lenders have lengthened the terms of such loans in recent years.

Part of the non-real-estate lending to farmers, however, is on a renewal basis. Loans that are expected to work themselves out over a period of 2 or 3 years are frequently written to mature in one year or less, with the understanding that the loan can be renewed after a partial payment.

This practice provides an opportunity for reviewing the status of the loan and the progress of the operator at certain intervals. Thus, terms may be written to require partial payment at the time that future income is expected. At the time this payment is made, the loan can be renewed, with new terms adapted to the financial needs and future income expected at that time.

Further adjustments in the terms of such credit might be helpful and more realistic.

The inspection and review function is an important one—one that is frequently helpful to the borrower as well as to the lender.

Credit Not a Cure-All

Sound use of credit can make an important contribution to more efficient farming, greater income and profits. This is particularly true where capital is the limiting factor.

Use of credit may then make a larger volume of output possible by financing the production expenses of profitable enterprises.

But this should be emphasized—that credit is not a cure-all for inefficient farming or poor management. Credit to finance unprofitable enterprises may merely speed an overzealous borrower on his way to insolvency.

Credit has its place but does not replace other essential ingredients of successful farm operation.

END

CURRENT TOPICS ☆ *Business* ☆ *Banking* ☆ *Farming*

Moderate optimism keynotes economic situation at mid-year point

Business activity in the Ninth district, although distinctly favorable, has not measured up in all categories to that for the country as a whole. Some of these differences are reported in the current topics that follow.

GENERAL rains in June have dispelled the temporary gloom caused by the early-season drought. Currently, crop prospects are considered favorable.

Agricultural commodities, both crops and livestock, have been moving to markets in slightly larger volume than a year earlier as measured by grain cardloadings and livestock receipts.

District farm income during the first four months of the year was almost as high as a year ago. Farm prices have been depressed, but increased marketings are expected to nearly balance cash farm income in the first half of this year with that of 1954.

Business activity at the mid-year point is at prosperity proportions. Personal income has risen as employment increased in industrial and mining areas of the district. Claims for unemployment insurance have declined more than seasonally since the first of the year, and such claims are currently substantially below the level of a year ago.

Department and general store sales for the first half of 1955 now promise to exceed those of the same period of last year by about 3 percent. Bank debits, building permits, lumber sales, carloadings, and new car sales have generally registered higher levels of activity since the first of the year compared with the same period a year earlier. Bank debits, for example, in May were 147 (1947-49=100). A year earlier the index was 130.

The upturn in the district's business economy is further documented by expansion in bank loan portfolios. Loans in member banks as of May 25 were 9 percent higher compared with a year earlier. This upsurge in credit is a reflection of the swelling volume of real estate and automobile sales as well as consumer loans on TV, appliances, and other durable goods.

Unemployment claims drop one-third

The number of people filing new or initial unemployment claims in Minnesota during May was only 6,177. This compares with 9,389 claims a year ago and 4,828 in May, 1953.

In January of this year there were more claims recorded than in the same period a year earlier. The unusually strong seasonal decline in claims since early this year is one indication of the business recovery of recent months.

Old, or "continued claims" for unemployment compensation during May in Minnesota totaled

49,802. This compares with 70,062 a year earlier and 33,375 in May of 1953.

Last year from January to May only a modest decline of about 8 percent was registered. This year the decline was nearly 45 percent for the same period.

District store sales up, but less than national

Department and general store sales in this district during May were 2 percent above May, 1954, and, during the first 5 months of this year, exceeded the year-ago volume by 3 percent.

The increase in this district was not as pronounced as the national increase. Nationally, department store sales during May were approximately 7 percent above a year ago and for the period January-May also exceeded the 1954 volume by roughly 7 percent.

A comparison of district with national trends reveals that department store sales in this district have failed to keep pace with such sales nationally during the five-year period since 1950.

To a limited extent this may be attributable to a slower growth in population since 1950. Between 1950 and 1954 Ninth district population increased 3.6 percent; nationally, population increased 6.3 percent. However, during this same period the Ninth district index of department store sales remained virtually unchanged at 104, while the national index increased in about the same proportion as did population, namely, from 105 to 111 (1947-49=100).

Growth of savings not as rapid

In the early months of this year time deposits at district member banks grew less rapidly than was true a year earlier. Through April, this year, such growth amounted to $11 million; in the same period last year a gain of $17 million was registered.

In last month's MONTHLY REVIEW it was suggested that the rapid growth of non-CCC loans at member banks in the early months of this year was closely associated with the current high level of sales in autos and homes. These high sales are also responsible—in part—for the less rapid growth of time deposits this year than last.

The money needed for down payments or for "cash deals" is—in many instances — obtained by withdrawal from the time deposit accounts at the banks. Officers of a few institutions where savings are lodged commented that the purchase of stocks, as well as the items mentioned above, has occasioned some withdrawals.

Savings and Loan Associations in the district, too, have reported a slower growth rate so far this year than in the comparable period last year. The net inflow of savings at insured institutions in Minnesota, Montana and the Dakotas amounted to $36.3 million during the first four months of this year in contrast to a gain of $38.5 million a year earlier.

In April, the latest month for which statistics are available, district member bank time deposits fell $7 million; a rise of $2 million was reported in April, 1954. A shift in the tax date from March last year to April this year no doubt accounts for part of the large withdrawals from time deposits in April this year.

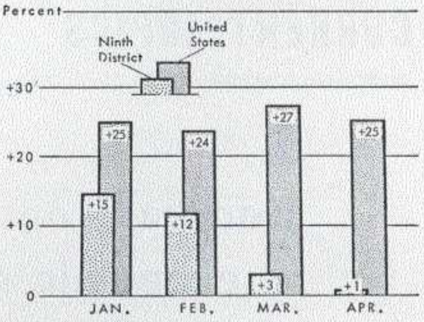
New automobile registrations slow down in district

Sales nationally of new automobiles reached a peak in 1950 following the outbreak of the Korean War which has not been equalled during any of the intervening years. For the first five months of 1955 new car registrations have been at a rate sufficiently high that sales this year could equal or surpass the earlier record.

What has been true nationally is not true in this district, however. During the early months of this year the sales increases in this area have remained substantially below those for the nation. This disparity has become progressively more pronounced as illustrated on the following chart.

TOTAL NEW CAR REGISTRATIONS

Percentage Change 4 Months, 1955, from Corresponding Month Last Year

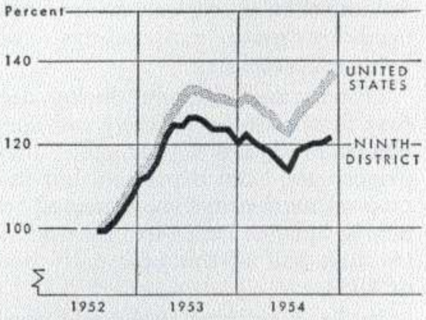


Source: Automotive News.

This is not entirely a recent development. Since the Post-Korean low point reached in 1952, the registration of new cars in the nation has been increasing at a faster rate than in this district.

TOTAL NEW CAR REGISTRATIONS

Twelve-Month Moving Averages of Unadjusted Index Numbers 1952 Average Month=100



Source: Automotive News.

It is not surprising that car registrations in the Ninth district have lagged somewhat the national trend. Both of the factors that seem to account for this are related to the predominance of agriculture here.

One is that population in this district has not expanded as rapidly as for the nation as a whole. The other is the fact that cash farm income has been declining since 1951.

Weather or not . . . .

Perhaps the most significant economic development in the Ninth district of the past month was the abrupt turn-about of crop and moisture conditions—from no rain and near-drought over much of the area to general, soaking rains that quickly revived slack crops and dormant pastures.

Although moisture uncertainties and changeable weather are not a new problem in the district, this year's experience was more general and more dramatic than usual. After favorable weather had given farmers an early start on spring planting, dryness over much of the Dakotas and Minnesota brought pastures and early-seeded crops to a complete standstill. Concern over the weather outlook had sharply curtailed spending in rural areas.

General rains in early June extended over nearly all of the great plains region, including drought areas of the Southwest. District bankers and businessmen report that farmers' spending again has returned to a more normal pattern.

Renewed interest in dairy cows

Demand for dairy cows is reported more active than in recent months in many areas of the district. The Wisconsin Department of Agriculture reports the average cow price in April was $170 per head compared with $160 at the beginning of the year. Part of this may be due to higher prices being paid for cows in the slaughter market, since slaughter is the alternative market for dairy animals of marginal value. But part of it is due to improved confidence in the dairy outlook. Dairy surpluses are significantly smaller than a year ago.

The USDA's report of cattle on farms on January 1, 1955, shows that dairy cow numbers were down in all district states—by from 1 to 4 percent. But at the same time the number of dairy heifers, 1-2 years old, was higher in Minnesota and the Dakotas by some 4 to 6 percent. The number of heifer calves was up 1 to 5 percent, compared with January 1, 1954. END

HIGHLIGHTS FROM NATIONAL CONDITIONS . . . .

Industrial production and construction activity reached new record levels in May, and retail sales continued at their April high. Employment and incomes expanded further, and unemployment declined. Average prices continued to change little in both wholesale and retail markets. Bank loans and other types of private credit increased further.

Employment

Employment (seasonally adjusted) in nonagricultural establishments in May increased 300,000 to 49.2 million, about 1 million above a year ago. Both manufacturing and non-manufacturing employment showed important gains. The average work week at factories in May increased to 40.7 hours, 1.4 hours above a year ago. Average hourly earnings continued to edge up, and average weekly earnings reached a new high of $76.11, which was about $5.00 or 7 percent above the level of a year ago.

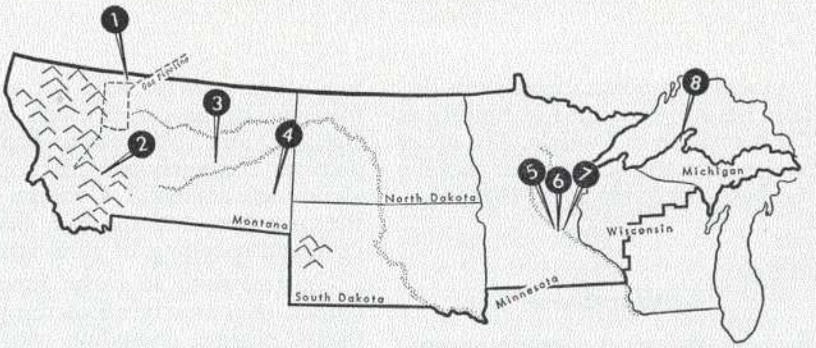
Retail Sales

Department store sales in May and early June were near their advanced April rate, after allowance for the usual seasonal changes. Total retail sales in May were maintained at their April peak, about 8 percent above a year ago. New car sales continued at very high levels, 38 percent above a year ago, and used car sales advanced further. Dealers' stocks of new autos rose somewhat further in May.

Adapted from the National Summary of Business Conditions prepared by Board of Governors of the Federal Reserve System, June 15, 1955.

ECONOMIC *Briefs*

SIGNIFICANT HAPPENINGS IN THE NINTH DISTRICT



1-Gas Import OK'd for Montana

The Federal Power Commission authorized Montana Power Company to import up to 100 million cubic feet of gas daily from Canada (with a maximum of 20 billion cubic feet a year).

Gas will come from the company's Pakowki Lake properties in Alberta, from which it is presently importing a maximum of 40 million cubic feet per day for the sole use of Anaconda Copper Company (a defense measure authorized in 1952). New gas imports will be available to general customers. The company plans to extend service to eleven additional towns.

2-Cement Plant to Enlarge

The Ideal Cement Company announced plans for building a new $6 million cement plant at Trident, Montana. This expansion program will double the output at the firm's Trident installation, which now employs 200 men full time.

3-Key Oil Strike in Montana

Atlantic Refining Company recovered free oil this month from a "rank" wildcat well in Yellowstone county, about 55 miles northeast of Billings. Recovery was from the Amsden dolomite formation at a depth of about 6,100 feet. The find is regarded as highly significant, situated as it is in a 2,000 square mile area where only one well (dry) has been previously drilled. A heavy rush of leasing activity was reported.

4-Add Oil Field near Baker

Shell Oil Company's early June discovery apparently added one more to the string of oil fields along the Cedar Creek anticline. The well, located about a mile north of Baker, Montana, recovered oil from Mississippian-age rocks about 7,200 feet below surface (a shallower formation than is generally productive in other fields in the area). At least three horizons showed oil, with drilling continuing.

5-Atomic Research Pool Formed

Northern States Power Company, Minneapolis Honeywell Regulator Company, and General Mills, Inc., have disclosed a plan to pool their resources and know-how in a joint venture in atomic research. Each of these companies is now engaged in nuclear activities in its respective field.

The Minnesota Nuclear Operations group has been set up to administer the co-operative venture.

6-Standard Oil Office Building Set

Standard Oil Company (Indiana) plans to begin construction immediately on a two-story, block-long regional headquarters building to be located on a nine-acre site in west Minneapolis. The regional office will handle the company's business in Minnesota, northern Wisconsin, and the Dakotas, and will add 290 employees to the firm's present local staff of 155. The building should be completed by October, 1956, at a total cost of about $2.5 million.

7-Record Airport Expansion

Northwest Airlines announced plans to establish its permanent home headquarters and major overhaul base at Wold-Chamberlain airport located just south of Minneapolis. In conjunction with a large airport expansion program, 427 acres of Fort Snelling land was transferred to the Metropolitan Airports Commission by the Veterans Administration.

The expansion program includes: NWA's $15 million building program; a new airport administration building and terminal at a cost of $4 million; installations for other airlines, including a possible base for North Central Airlines at $2 million; installation of high-speed taxi-ways and other improvements, $2.4 million; and construction of a "turn-around" maintenance hangar for Western Air Lines, $1 million.

Funds will come largely from self-liquidating bonds issued by the MAC. Construction is expected to begin by spring of 1956.

8-"Copper Country" Labor Dispute

On May 2 the United Steel Workers (C.I.O.) went on strike against Calumet and Hecla Copper Company in Houghton and Keweenaw Counties, Michigan, idling an estimated 2,100 persons.

Calumet and Hecla filed suit in Federal Court for damages "up to $3.5 million," based on alleged losses to smelter furnaces, copper mines, and equipment when smelter and maintenance crews walked off their jobs. The firm requested an injunction against the strike. On May 23 the company discharged 1,848 of the striking employees, declaring the strike illegal on the grounds that Local 4312 failed to notify federal and state conciliatory agencies that a dispute existed. Later, directors of the company voted authority to the Calumet division to liquidate its assets if two problems were not solved—one of these was said to be the strike, and the other a government stockpile contract.

The union filed a motion of dismissal with the U. S. district court in Marquette on the grounds that the strike is not illegal as charged. The motion also contended that the provisions of the National Labor Relations Act under which the damage suit is being brought are unconstitutional.

Hearings began in Federal District Court, Marquette, on June 1. On June 9, the request for injunction by the firm was denied, and the Court dismissed officials of the union as individual defendants, leaving the suit standing against the union local and international.