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Monthly Review
OF THE FEDERAL RESERVE BANK OF MINNEAPOLIS

High production supports economy

This time of year, when crop maturity throughout the Ninth district 'hangs in the balance' during the latter stages of development and until final harvest, the drama of crop development and the perils it must survive tends to dominate the economic stage. Good crop production not only represents large marketings by farmers, but also a large volume of farm commodities handled and processed by marketing and transportation industries both within the district and outside of it. Poor crops obviously result in less activity for district industry and commerce, as well as a smaller volume of marketings for farmers directly.

The scene, the characters and the general suspense are much the same year after year. Yet the specific conflicts which unfold as each season progresses are distinctly different. Typically, weather and crop conditions are often described as 'very unusual this year.'

This year is no exception. The season's crop perils frequently have been associated with too much moisture rather than the too-little-and-too-late moisture that characterized the 1956 season. Generous early season rains and cool weather favored the development of early-seeded small grains, but retarded the planting and growth of corn in many cases. This is in direct contrast to last year, when early dryness and heat hurt small grains but corn and soybeans came on to bumper harvests.

Such district developments closely parallel

Discount policy: 1940-1957

A brief review of the past 17 years of discount experience at the Federal Reserve Bank of Minneapolis . . . . . . see page 6.

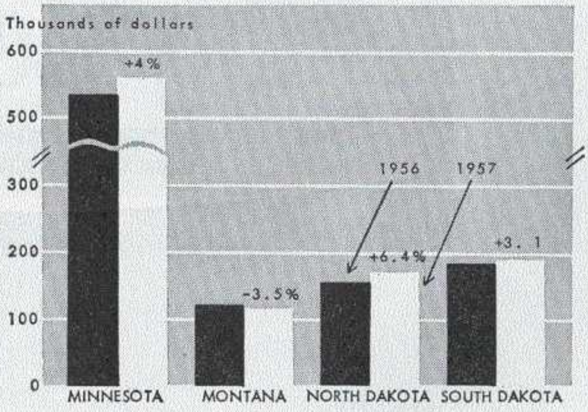
actions on the national stage—which saw the prolonged drouth over extended areas of the southern and western plains dramatically broken by widespread and in many areas excessive rains. In the eastern corn belt, too, wet and cool weather during the spring season delayed corn planting and early growth. Total crop production for the nation, as estimated on July 1, was smaller than a year ago and possibly the smallest since 1951.

Small grains, pastures and hay have grown lush and green across most of the district with many areas of the Dakotas and Montana reporting the finest stands and early development of small grains in many years. How much July heat and some local deficiencies of surface moisture may subtract from prospective yields, the actual harvest will determine. As emphasized by several crop reporters, the rank early growth and heavy stands of small grains may prove a liability if subjected to extended heat and dryness, particularly on the lighter, sandy soils.

The generous rainfall in most of the district was too heavy in many areas of Minnesota and southeastern South Dakota and caused substantial damage to crops. Nevertheless, the general crop conditions by mid-July seemed to assure abundant feed production. Corn was the only major district crop for which the July 1 crop report estimated a substantial reduction from last year. Farmers, bankers and local businessmen alike were disposed to look toward the approaching harvest with their fingers crossed in guarded optimism.

Other encouraging elements in the district's economy include a higher level of farm income in the first half of 1957, supported by higher livestock prices. At midsummer, some farmers were beginning to receive their government payments for soil bank participation. Participation of farmers in district states ranks high in comparison with other states. Farm machinery sales are reported as substantially higher than a year ago in most areas of the district.

Employment and most other indicators of business activity maintained a high level through June. Tourist trade particularly was noted as being unusually active this year. District registrations of new automobiles for the year so far are slightly ahead of the 1956 registrations.



DISTRICT FARM INCOME for the first five months of 1957 ran ahead of a year ago by about 3 percent. Larger cash receipts from both crop and livestock sales figured in the increase.

Within the district as well as in the entire nation, economic developments appear to be maintaining a reasonable balance between strengthening factors on the one hand and important areas of slackened activity on the other.

There has been a substantial shift in inventory buying. From an annual accumulation rate of plus $5 billion in the fourth quarter of 1956, inventory purchases dropped to a liquidation rate of $0.8 billion in the first quarter of 1957, and the second-quarter inventory accumulation has continued to be relatively small. This has been a major factor in offsetting the effect of further increases in expenditures by consumers and government and the effect of business capital outlays.

Continued rising trends in consumer and wholesale prices, incomes and bank lending suggest that the inflationary currents within our economy are still running strong. However, for the moment at least, inflationary pressures appear somewhat less acute as the inventory adjustment has brought the over-all rate of industrial purchases and orders more comfortably in line with production capacity.

The following selected topics describe particular aspects of the district's current economic scene:

MOISTURE AFFECTS CROP OUTLOOK

In distinct contrast to a year ago the midsummer fortunes of district farmers were characterized by abundance to *overabundance* of moisture. These conditions were highly favorable to the early growth of most small grains. Many areas of the Dakotas and Montana which are normally inclined to dryness reported the best early crop development in many years. Later heat and dryness have hurt crop prospects in some areas, however.

Farmers in many parts of Minnesota and eastern South Dakota, on the other hand, have been plagued by too much rain. Some crops have been destroyed or seriously harmed by inundation, and the cold wet spring materially delayed the planting and early growth of the corn crop. The slow early progress of corn in these areas is further complicated by weed development and the difficulty of applying proper control measures under existing conditions.

Nevertheless, the total crop prospect for the district presented a generally favorable picture at midsummer. Corn in fact is the only crop for which a substantial decrease in production is estimated. The July 1 estimate was for about 400 million bushels produced within the district compared with 470 million a year ago, or a reduction of about 15 percent from the actual corn harvest of 1956. The district wheat estimate is 7 percent above a year ago. Greatest increase is in oats—with a one-third increase in production estimated from a planted acreage roughly 5 percent smaller than last year. Total bushel production of all small grains and corn, as estimated on July 1, indicates a total 1957 production about 5 percent larger than a year ago in this district.

This compares with a smaller total crop estimate for the nation as a whole. For the nation, corn production was estimated at 13 percent smaller than a year ago on July 1. The estimate for all wheat was down 6 percent. Most small grains production will be higher—but based on midyear forecasts the total crop output of 1957 might be the smallest since 1951, according to the USDA's crop reporting service.

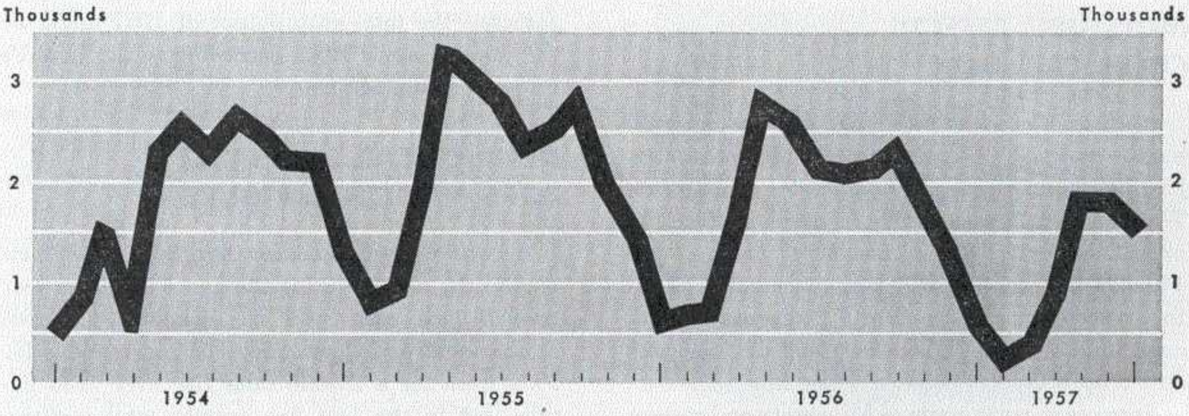
DISTRICT CAR SALES RISE TOPS NATIONAL FIGURE

According to registration figures, sales of new cars in the nation during the first half of the year probably exceeded by a very small margin sales in the same period of 1956. The expectations for 1957 were for a sizable sales rise over 1956 figures, but in the first five months total registrations were up only 0.2 percent. On the basis of the reports, automobile sales in June did improve moderately over May. The daily average in the last 10 days of the month rose to a 20-month high. Even with this improvement, when the registrations have been compiled for June, the total for the first half of the year may be up only slightly from a year ago.

New car sales, based on registration figures, improved more during the first half of the year as an average for the Ninth district than countrywide. Minnesota and North Dakota registrations have been up substantially—6 percent and 18 percent respectively. In Montana and South Dakota, however, they have been down, respectively, 10 and 4 percent. Lower registrations in the latter states may be due in part to the lower farm income in areas stricken by drouth last year.

Averaging the registrations for these four states entirely in the district gives us a figure of 3½ percent above 1956 in the first five months of this year. This volume of sales for the district cannot be called low, except in comparison with the tremendous volume achieved in 1955. In fact, in that year automobile dealers could be said to have 'borrowed' business from the future.

New nonfarm dwelling units authorized for Minnesota, Montana, North and South Dakota



PRICES ON HOUSES CHANGE LITTLE

Prices paid by home buyers in the Twin City metropolitan area during the second quarter of 1957 indicate that house prices again have firmed in those price ranges that had weakened during the winter lull in the real estate market. According to a survey conducted by this bank, the average price paid for houses in the lower price bracket held firm in Minneapolis and immediate suburbs, while in St. Paul and its suburbs it has risen slowly in both the first and second quarters. The average price paid for houses in the medium and higher-price brackets was higher in the second quarter than in the first in both the Minneapolis and St. Paul areas.

The average price paid for houses in the lower bracket (defined as under $14,000) in the Minneapolis area has remained unchanged at $11,500 for the past three quarters. In the St. Paul area, the average price has risen from $9,700 in the fourth quarter to $10,200 in the first quarter, and to $10,500 in the second.

In the medium-priced bracket ($14,000-$24,000) the average price paid for houses in the Minneapolis area had dropped from $18,600 in the fourth quarter to $17,800 in the first, and in the second rose to $18,300. In the St. Paul area the average price has risen steadily in the three quarters from $15,700 to $16,400, and to $16,600.

In the high-priced bracket (over $24,000) the average price paid for houses in the Minneapolis area had declined from $34,300 in the fourth quarter to $31,000 in the first, and rose to $32,600 in the second. In the St. Paul area the average price had declined from $26,500 in the fourth quarter to $25,200 in the first, and rose to $30,000 in the second.

HOME BUILDING IS DOWN

In the Ninth district as a whole the number of new dwelling units authorized by permits during the first half of 1957 was down by nearly one-third from the same period in 1956. Much of the decline in residential building can be attributed to the decrease in the metropolitan areas: namely, Minneapolis, St. Paul, Duluth-Superior and Sioux Falls. In the non-metropolitan areas of the district the number of dwelling units authorized by permits was down less than one-fifth from a year ago.

According to a recent survey conducted among Twin City builders, the number of completed houses held by builders at the end of the second quarter was slightly higher than a year ago. Nevertheless, the number of unsold houses overhanging the market was negligible compared to the number unsold at the end of last year.

In the current real estate market, home builders in the metropolitan centers have confined themselves largely to completing a model house or two and building upon order from owners. The houses being built this year are larger and more expensive than last year. A larger proportion are in the $20,000-and-over bracket.

JUNE BANKING DEVELOPMENTS

The district banking picture in June was featured by continued sizable loan growth at both city and country banks. The $42 million increase of loans reported by member banks was the largest in 20 months and came on the heels of additional loans at both city and country banks in each of the previous three months. In the four months since a loan reduction in January and February, city bank loans rose $71 million or 8 percent while country bank loans rose $49 million or 5 percent. During the comparable period last year, city bank loans were up $48 million and country bank loans were up $21 million.

Deposits furnished district member banks more cash for loan expansion in the four months after February this year than in the same months last year. Country banks gained $10 million this year in contrast to a deposit loss of $28 million last year; city banks gained $72 million this year in contrast to a gain of only $15 million in the period last year. At the end of June, total deposits of district member banks exceeded the year ago level by $156 million; all but $16 million of this gain was recorded in time deposit accounts. Balances owing to banks were up $7 million while other demand deposits rose $9 million.

While loan expansion in recent months has exceeded the year ago pace, the table shows that during the entire first half loans rose by less this year than last because of substantial liquidation in January this year. The most recent data, reported weekly by city banks, indicates that loans continued up after June.

Selected Items at District Member Banks
(Millions of Dollars)

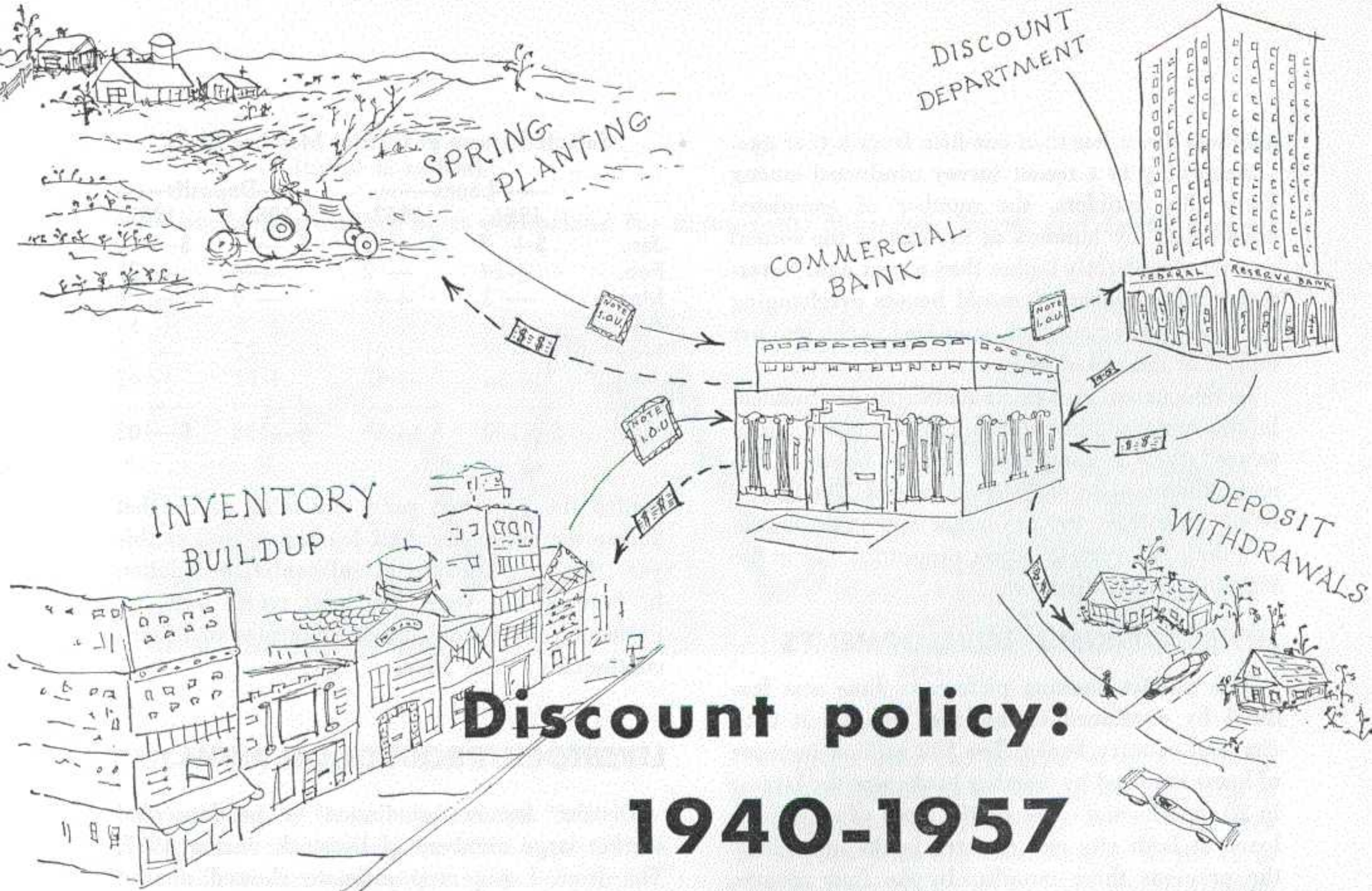
	Loans		Deposits	
	1956	1957	1956	1957
Jan.	$+ 7	$ —62	$ —81	$—160
Feb.	+24	— 2	—44	— 25
March	— 3	+41	— 9	— 6
April	+15	+16	+ 6	+ 51
May	+22	+21	—22	— 5
June	+35	+42	+12	+ 42
Total	**$+100**	**$ +56**	**$—138**	**$—103**

LIVESTOCK PRODUCTION HIGH

District farmers continued to produce and market large numbers of livestock during 1957. The June 1 pig crop estimate showed district farmers slightly ahead of national production trends. Both Minnesota and South Dakota hog producers farrowed about the same number of sows this spring as a year ago, while national farrowings were slightly less than a year ago. District farrowings during June-November also are expected to be ahead of the moderate national increase.

In addition, the July 1 report of cattle on feed shows a greater district increase than for the nation as a whole. For the 13 major feeding states there were 8 percent more cattle on feed on July 1 than a year ago. But in Minnesota the increase was 28 percent; in South Dakota 9 percent.

Livestock producers are currently being favored by improved prices—with both cattle and hogs currently selling at the terminal markets for about $3 per hundredweight higher than a year ago. A sustained high level of livestock marketings during the coming fall and winter seasons seems assured.



Discount policy: 1940-1957

This second article scans the past 17 years of Ninth district discounting

Three pairs of events had decided effects on the economy in the 17-year interval from 1940 to 1957: two wars, two postwar booms, and two minor recessions. The high levels of economic activity due to wartime demands and the postwar demands of consumers triggered the strong inflationary pressures which were generally prevalent during the period. In this set of circumstances, the central bank's instruments of credit control were vitally needed to restrict credit expansion. However, until 1951 the discount mechanism continued to play the obscure and insignificant role in monetary policy it played in the latter 1930's. In attempting to explain this apparent paradox, an analysis of similar economic intervals will be used to describe the existing circumstances and the significant revival of discount operations since 1951.

1940-1945—all-out war

The outbreak of World War II jolted the entire economy out of the mediocre production levels of the latter 1930's and created almost overnight a situation of overfull employment and very high levels of consumer purchasing power. The extremely high levels of government spending for war purposes created the difficult problem of federal financing.

Although tax rates were boosted sharply and attempts were made to sell government securities to non-bank investors as anti-inflationary measures, large amounts of 'Governments' were eventually sold to commercial banks in exchange for U. S. Treasury demand deposits. The holdings of government securities by all commercial banks between 1939 and 1945 increased by $74 billion, and the corresponding rise in deposits increased the money supply, thus adding fuel to the price-control suppressed inflationary fires.

In the Ninth district during World War II, the economic pace was greatly accelerated, primarily because of the rising demand for agricultural products. High levels of production and high prices created agricultural prosperity after 20 years of generally dismal farm incomes. As a result, bank deposits shot upward. For example, deposits at district member banks increased by 192 percent between 1940 and 1945. Country banks logically showed the greatest gains, and the states of North and South Dakota led the district with deposit gains of 477 percent and 265 percent respectively.

These conditions of wartime pressures and agricultural resurgence had, however, relatively little effect on discount operations. In general, discounting was of negligible importance during this five-year period. The average amount of bills dis-counted remained at the extremely low levels of the latter 1930's until nearly the end of the war. Even the $10.6 million daily average of 1945 failed to reach the discounting levels of 1932 and of many years during the 1920's. It is indeed remarkable to note that *not one* bank in the district's two largest cities, Minneapolis and St. Paul, borrowed from the Federal Reserve during 1939, 1940 or 1941. This nonuse of discount facilities occurred despite the low level of discount rates (1½ percent, reduced to 1 percent in March, 1942), and the preferential rate of ½ percent which prevailed from 1942 to 1946 on borrowings secured by short-term Governments.

The demands for credit in the Ninth district were heavy during these war years. Three major factors explain the lack of discounting. First, and of most importance, the nation's banks entered the war with large amounts of excess reserves which were the result of gold inflows and mediocre business conditions during the latter 1930's. Second, the Federal Reserve System's policy of maintaining a ⅜ percent rate on Treasury bills enabled the banks to acquire additional reserves without penalty. The member banks' privilege of selling Treasury bills to the central bank under repurchase agreements was increasingly utilized. Repurchase agreements (1945 = $724 million for the district) proved more attractive than discounting as a means of acquiring additional reserves. The third factor was the district's favorable balance of trade at the time, as agricultural prosperity provided district banks with additional reserves which reduced the need for borrowing.

The shift in the means of acquiring liquid funds by member banks in the district is well illustrated by the following comparison between the years 1921 and 1945.

Comparative Sources of Earnings,
Minneapolis Reserve Bank

Year	U.S. Governments (000's)	Discounts and Advances
1921	$142	$4,650
1945	3,397	55

Almost a complete reversal had taken place during this interval as the level of discounting fell drastically while holdings of Governments (acquired mostly during World War II) rose tremendously. The 'coat of dust' which the discount window acquired during the latter 1930's continued almost undisturbed during the World War II period.

1946-1949—reconversion, boom, then recession

The postwar era can be divided into two cyclical sections. During 1946 and 1947 the Ninth district experienced unprecedented prosperity based primarily on rising farm incomes. Deposits rose significantly faster than the national average, and retail sales increased 33 percent in the year came a period of readjustment in 1949. The general stability continued, with declines in certain areas and rises in others. Cash farm income dropped 20 percent from 1948 levels, but construction expenditures countered the trend by moving up sharply. The discount rate remained at 1½ percent. Credit, however, was eased through reductions in reserve requirements on three separate occasions.

The amount of discounting during this postwar period remained at relatively low levels. The Federal Reserve policies of supporting government securities at par negated any real effectiveness in the discount rate. Member banks could secure reserves to expand loan portfolios by selling Governments to the central bank without penalty so that activity at the discount window remained minor.

1950-1953—another war, another boom

Economic activity, marked by a rising level in the spring of 1950, surged ahead sharply with the outbreak of the Korean War in June. Spurred on by both war needs and speculative buying, wholesale prices and industrial production rose 15 percent and 23 percent respectively between 1949 and 1951. Loans at city banks rose 26 percent in 1950, and loans at country banks increased by 22 percent despite a drop of 4 percent in cash farm income. Orthodox monetary policy dictated restrictive measures in such a situation, so the discount rate and reserve requirements were raised and consumer credit controls were imposed. However, none of these measures could provide adequate credit restraint as long as the Federal Reserve System continued to buy government securities at par.

The dramatic break from the 'support-at-par' policy occurred in March of 1951. In this significant 'accord' with the Treasury, the Federal Reserve agreed to continue its responsibility of "maintaining orderly conditions" in the government securities market but was no longer committed to provide support for these securities at any specific price.

Suddenly the discount window became a busy place. The average amount of bills discounted in the Ninth district increased by 140 percent in 1951, by an additional 45 percent in 1952, and jumped further by 72 percent in 1953. *More* banks borrowed from the Minneapolis Federal Reserve in 1953 than in any years since 1933, and in *amount* these banks borrowed more funds than in any year since 1922. This activity of the discount window after 18 years of 'riding the bench' was due largely to the abandonment of the 'support-at-par' policy coupled with the continuing high demands for loans. In addition, it appears that some bankers borrowed sizable amounts between 1951 and 1953 for the purpose of reducing excess profits tax liabilities. The discount mechanism had once again been given a role in general monetary policy, and could be coordinated with open market operations. Interestingly enough, the consumer price index rose only 7 percent during the six years following the accord.

1954-1957—postwar adjustment, then more inflation

During the latter part of 1953 and the first half of 1954, the national economy experienced a mild recession in economic activity. It was occasioned primarily by a sharp cut in federal expenditures on war materials and a shift from accumulation of business inventories to net liquidation. Activity in the Ninth district fell less than nationally, partly because agricultural income—of basic importance in this district—declined only slightly. The Board of Governors increased bank lending power by a reduction in reserve requirements, but the increase in member bank earning assets resulted mainly from their purchases of government securities. Further ease in credit conditions occurred as the discount rate was reduced in February (to 1¾ percent) and in April (to 1½ percent). However, member banks needing reserves during 1954 tended to sell Treasury bills rather than borrow from the central bank, so average daily borrowings dropped 74 percent.

The third major upsurge in production and spending of the post World War II era began late in 1954. This nationwide boom, ignited by a vast expansion in private construction, was kept active by the further fuel of a sharp rise in auto sales financed largely by instalment credit. With the aid of heavy expenditures on plant and equipment, plus rising government outlays, the high level of activity has continued through the middle of 1957.

The Ninth district economy responded less rapidly to the boom developments of 1955 partially because of the continuing decline in cash farm income (down 2 percent from 1954). Deposits at district member banks were down slightly, as was true in the Kansas City district, (both highly agricultural areas), while all other Federal Reserve districts experienced increases in deposits. However, mining and manufacturing industries operated near capacity in this district and member bank loans here increased 15 percent.

In 1956 cash farm income reversed its decline of several years, nonresidential construction hit record levels, and loans increased further by 12 percent. For the first time since 1932, loans exceeded investments at district member banks. Deposits increased by 2.9 percent versus a 1.8 percent increase for the whole nation (preliminary figures).

A huge demand for loans accompanied the rise in production and employment levels. District banks strained to accommodate business and consumer credit applications. Discount activity flourished as excess reserves and Treasury bill holdings of member banks were severely reduced. Borrowings rose from an average of $7 million in 1954 to $42 million in 1955. The number of borrowing banks increased from 70 to 101 and then to 106 in 1956 (although average borrowings declined somewhat in 1956). No let-up in discount activity has developed in the first half of 1957.

When measured relative to required reserves, borrowings in the Ninth district since 1954 have been considerably above the national average. Particularly, this has been true for borrowings of reserve city banks. In 1956, for example, Ninth district reserve city banks borrowed more funds relative to required reserves during 40 weeks of the year than the national average of all reserve city banks. In addition, this borrowing ratio for the Ninth district exceeded the highest ratio for any other district during 26 weeks of 1956. These high levels of borrowing by the reserve city banks have resulted from the rising demand for business loans and the declining level of secondary reserve holdings (short-term government securities).

Discount rates have been raised sharply during the current period of economic expansion beginning in late 1954. The rate was raised four times during 1955 to a level of 2½ percent and then was raised to 3 percent in April of 1956. Ten Federal Reserve banks raised their rates only ¼ percent in April but in August the 3 percent rate was made unanimous. These increasing discount rates have notified the banking community of the restrictive policy favored by the System.

The Federal Reserve–Treasury 'accord' in 1951 restored discount policy to a significant rung on the ladder of monetary controls. By coordinating discount policy with open market operations, monetary policy achieved a degree of flexibility which has greatly aided in stabilizing the nation's economy during the last six years. If erosion of the purchasing power of the dollar threatens, a continued policy of credit restraint will be necessary. Discount operations will play a significant role in implementing such a policy.

LIVELY SEASON EXPECTED AT DISTRICT RESORTS

The number of tourists spending their vacations at resorts in this area depends in part on the summer weather to the south and east. When temperatures are above normal, as they were in July, many families seek relief from the heat in district lake resorts and in vacation spots near the Canadian border. With the weather as hot as it has been and with a relatively high amount of disposable income the common story for many families, the resort areas anticipate a record volume of business for the current season.

Vacation resorts in this region draw their guests from other parts of the country, as well as from the Ninth district. To give an illustration of the magnitude of the resort business here, tourists carry in many millions of dollars in currency each year. Considering the checks and travelers' checks cashed, this figure can be called just a fraction of the expenditure for vacation fun.

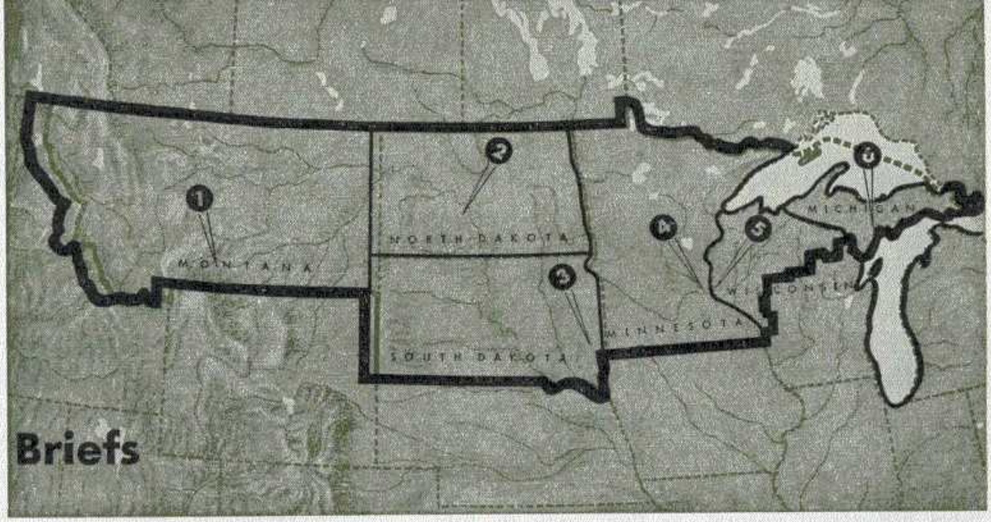
Another figure which has some significance in indicating tourist volume is registrations at state and national parks. Through June these exceeded totals of a year ago by substantial margins, as have registrations at boys' and girls' camps.

New tourist accommodations have been and are being built in likely spots all over the district, but, outstandingly, construction for anticipated tourist traffic is going on in the upper peninsula of Michigan. When the bridge across the strait of Mackinac is opened to the public this fall, the upper peninsula will be more accessible to the lower part of the state. Resort owners are expanding their facilities in the expectation of increased tourist business next year. Even this year on the peninsula operators of established resorts report good occupancy and reservations for the season.

A factor of considerable importance to the tourist industry is the spendable income families have at their disposal. Vacation expenditures are, no doubt, among the first to be reduced or eliminated when personal income declines. Looking at the figures for the first half of 1957, we see a continued rise in personal incomes. Although the average weekly earnings of manufacturing production workers have declined since last December, total wages and salaries have continued to rise, but at a slower rate.

In contrast, transfer payments—in particular, social security payments—have shown a larger rise this year. Farmers in particular have benefited from the large district increase in social security benefit payments. While retired farmers on social security do not as a rule spend their summers in resorts, their expenditures for merchandise and services have added to the volume of business transacted.

The growth in income from productive sources has been small, but there has been an over-all increase in personal income among all classes. Undoubtedly, this will have an effect on vacation expenditures. With such an auspicious start of the season, almost all of the businessmen in communities which serve the resorts are optimistic about the summer's business.



Economic Briefs

1. Parking ramp set for Billings

Contracts have been let for construction of a 194-car parking garage in Billings, Montana. The $500,000 structure is expected to be completed in November.

2. $6 million N. D. refinery installation

A premium gasoline now being introduced by the Standard Oil Company of Indiana has necessitated a new $6 million installation at the Standard refinery at Mandan, North Dakota. The installation—an ultraformer—can turn out 6,000 barrels daily, which is the predicted demand for the new gasoline in the area served by the Mandan refinery.

3. New college facilities for Madison, S. D.

Two building projects totaling an outlay of $631,000 are slated for the General Beadle State Teachers College at Madison, South Dakota. The new facilities for the school are a men's dormitory and a gymnasium-armory. This latter building will be used jointly by the college and the National Guard.

4. $23 million contract to build guided missiles

Northern Ordnance, Inc. of Minneapolis was awarded $23 million worth of navy contracts for the construction of guided missile launching systems. The firm is already in production on $9.5 million worth of navy contracts for guided missile equipment.

The firm's management does not expect the new contracts to add workers to the payroll but does expect the new production to keep employment steady with last year's level.

5. Region's biggest marina begun in Wisconsin

Work is starting at Hudson, Wisconsin, on a $750,000 marina with docks for 1,000 cruisers and larger yachts. The project, which will take four or five years to complete, will open on a limited scale this summer. It will be the largest marina in the district.

6. $1.5 million Escanaba phone improvements

Michigan Bell Telephone Company has plans underway to install a dial telephone system in Escanaba, Michigan. The utility firm estimates that the modernized system can be in operation by the summer of 1958.

An addition to the Escanaba telephone building is included in the project, bringing the total cost of the improvements to $1.5 million.