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## A Year of Decision

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As 1948 begins, we find ourselves at an unusually important crossroads in history. Decisions made this year and the results of these decisions are likely to exercise a much more profound effect upon future developments in this nation and the world than ordinarily is true of any one year.

During 1947, the American economy operated at a higher level than in any previous peacetime year, and in terms of civilian employment, income flow, and output for civilian use the economy was at the highest level in history. Full employment held throughout the year. The number of Americans working in civilian jobs averaged 58 million in 1947 as against 55 million in 1946 and 45 million in 1939. Personal income came close to \$200 billion in 1947 as against \$177 billion in 1946 and \$73 billion in 1939. Industrial output was close to double the prewar level and agricultural production was more than one-third larger than prewar.

The rest of the world had a far less favorable year in 1947. Hunger still holds millions of people in its grasp. The nations of Europe and Asia are far from the recovery level hoped for by this time. In fact, in many regions of the world 1947 was a year of economic disaster.

In this nation we face many troublesome problems as the new year begins, and I look to 1948 both with hope and misgiving. We have the opportunity and the responsibility to solve the problems. If we fail to grasp the opportunity and discharge the responsibility, the potential ill-results are fright-

ening. If we go forward with purpose and understanding—if we do not underestimate our problems and the consequences of failure to resolve them and thus seek easy but inadequate solutions—we can succeed in maintaining a high level of domestic prosperity and we can lead in the improvement of badly upset world conditions.

### INTERNATIONAL AFFAIRS

The year 1947 saw many developments, both good and bad, in the fields of international relations and policy. On the debit side of the ledger we must list the failure (at least relative to hopes) of the United Nations to settle many pressing problems, the widening of the rift between the two great political-social-economic systems, the break in the movement toward economic recovery in Europe and Asia, and the continuation or outbreak of sporadic fighting in several areas of the world. On the credit side may be found the successful settlement of some issues by UN and the very fact that UN still exists with its machinery for discussion and adjustment of problems without recourse to war, the functioning of the International Bank and Fund, progress toward multilateral trade arrangements, and very importantly, the further development of positive United States foreign policy.

Obviously progress toward better international understanding and relations in 1947 was far less than hoped for at the beginning of the year. Nonetheless, the year did bring a better understanding of

the present position of the United States in the world of today, while some progress was made in limited fields. It is foolish optimism to view the current international situation as good, but it is needless pessimism to regard it as hopeless. The goal of world peace is more important to human welfare than ever before. It is worth great and sustained effort. Failure to make that effort, thus writing off the venture as hopeless, could well have disastrous consequences.

The problem of foreign aid led all public questions during 1947. The severe winter of 1946-47, followed by the widespread drouth of last summer, resulted in much more serious crop deficiencies in Europe than had been anticipated. The long spell of cold weather also curtailed industrial output by making it difficult to mine and distribute coal while at the same time increasing non-industrial demand for it. These two outstanding difficulties, plus a host of others, rather effectively halted the recovery program in Europe, and intensified the economic problems of the whole world.

Reflecting an increasing understanding of our leading world position, the United States is attempting to help rebuild the various democratic nations of the world by pitting our available resources against their needs. The Congress provided for so-called "interim aid" late in December, and is proceeding to consider thoughtfully the longer range European Recovery Program.

So much has been written and spoken about our purposes and policies with regard to foreign aid that I do not intend to go into the question in detail here. Three points, however, might well be stressed again. First, the volume of United States net exports under the full-scale program suggested by the Administration probably will be no larger than it was during 1947, and certainly will be smaller than the war and postwar peak levels. Second, it must be recognized nevertheless that foreign aid has had and will have a definite impact on the United States economy. Even though the major force of inflation is domestic demand, the net export position of this nation has contributed and will continue to contribute to inflationary pressures here. Third, the program will be one that we can afford for a limited time both in terms of resources and in terms of dollars. It will be expensive in both respects, but in view of the objectives and possible attainments, the expense seems merited.

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## THE BUSINESS SITUATION

Bringing our economy into better balance in 1948 is a task that will take the best efforts of business, individuals, and Government. At the beginning of 1947 I wrote in this Review that in the business outlook the factors of strength appeared to outweigh those of weakness, but that there were many "ifs" in the situation. Consequently, economic events of 1947 would demand close and constant appraisal. In general, that statement also applies to the outlook for 1948. It is important, however, to recognize the very different circumstances of today as against one year ago.

The inflationary situation was intensified in 1947, and in January, 1948 the economy seems to be in greater maladjustment than it was in January, 1947. A year ago there seemed to be substantial reason to hope that with intelligent action better balance could be achieved in the economy during 1947. Adjustments seemed necessary, but with moderate restraints it seemed that they could take place and be but mildly deflationary. In the past year, economic unbalance was aggravated. And only to the very optimistic do the inevitable future adjustments now appear "mild". Rather they loom more and more ominous as inflation mounts.

This is not to say that a severe crash is inevitable. We still may be able to moderate it. And even if it comes it will not necessarily occur in 1948. There are few convincing signs so far that the current boom is losing strength. It becomes increasingly important, then, that action to contain further inflation be prompt and effective. If our economy becomes more distorted during 1948 the corrective adjustments will be even more severe when the break finally comes. And it must be recognized that economic maladjustment cannot continue indefinitely.

Total employment in the United States hit the 60 million level at mid-summer with agricultural employment at its seasonal high. Nonagricultural employment rose from 49 million in January to over 50 million late in the year. Unemployment, never over 2.6 million in 1947, was well below 2 million in the fall.

By and large, labor-management relations were good in 1947. The number of man-days lost by strikes was far smaller than in 1946. Because of this fact and because the flow of materials was somewhat smoother, the nation's productive industry could and did operate at an extremely high level throughout the year. In terms of the Federal Re-

serve index, industrial production averaged 188 per cent of the 1935-39 base period, in contrast to an average level of 170 for 1946. Output at the close of 1947, however, was not much higher than at the beginning of the year. In effect, this nation's industrial machine attained capacity and operated pretty much at ceiling levels during the entire year.

The hard fact is, however, that the flow of finished goods was not sufficient, even with the industrial machine at capacity. The demands of business for new plant and equipment and for inventories, of individuals for housing and all types of consumer goods and services, of Government (Federal, state and local), and of foreign nations, in total were greater than supply. And with funds available to make demand effective, prices were bid up and up.

Until midyear, it seemed that the inflationary pressures could be moderated in 1947—there were scattered reports of buyer resistance and deferred expenditures; business demands began to taper off. Then the attitude of consumers shifted sharply and buying resistance crumbled. A wave of optimism spread over the business community and its demand increased. Foreign buying declined somewhat but Government demand stayed high.

As a result, prices rose rapidly. The wholesale price index in January was 176 per cent of the 1935-39 average. In December, it hit 200. Consumer prices in January were 153 per cent of the 1935-39 average. In November, the index was at 165.

The danger of rapidly rising prices has been pointed out by many people. By themselves high prices are not dangerous, but rising prices tend to distort income distribution and there comes a time in the process when people with adequate incomes do not wish to absorb all of the goods produced, and those who want the goods are priced out of the market because their incomes have not kept pace with prices. The price situation was dangerous a year ago—it is more dangerous today.

The root cause of inflation is found in the fact that the available supply of money has outrun the available supply of goods. To cure inflation, production must be brought into balance with effective demand, which means that output must be increased or the supply of purchasing power reduced, or both. Merely to prevent further inflation, a much more limited objective, the supply of money must be prevented from rising further relative to the supply of goods.

With the economy producing virtually at its present capacity, it will be a tremendous task to bring up the level of output in 1948. At best increases in capacity and in productivity will be slow but to the extent that they can aid in increasing production they will prove helpful. Certainly, there should be no deliberate interruptions to production, and it is to be hoped that workers and management can resolve any differences peaceably and not halt the flow of goods.

Another check on inflation would result from a reduction in demand. Business should go slow in bidding for goods for inventory accumulation and even for new plant and equipment. We need additional plant capacity, but when goods are withdrawn from the market to build this capacity, unless other consumers are willing to forego those goods temporarily, greater inflationary pressures result. Thus it seems best to move cautiously for new plant—increase it where such increases can be achieved with the least ill-effects, but not so rapidly as to accelerate the current price rise, and finance it out of current savings. Individual consumers also should exercise restraint in buying and should increase their savings. If consumers will defer unnecessary purchases and permit industry to use current goods to increase capacity, inflationary pressures can be moderated. Government expenditures also should be held to a minimum.

As I mentioned earlier, the outlook for 1948 offers less encouragement than was reasonably felt a year earlier, even though high level activity seems indicated for the year as a whole. The economy is not well adjusted and inflation will increase in intensity if most vigorous efforts are not put forth to combat it. The keys to the situation are: (1) restraint in spending on the part of business, individuals and Government; (2) holding production at the highest level attainable; and (3) fiscal and monetary action.

I sincerely hope that in the main voluntary restraint will prove sufficient, even though Government action may be needed in some areas. Exports must be controlled both to protect the domestic economy and to serve the areas where needs are greatest. Limited power to discourage nonessential uses of basic materials that are in short supply may become highly important. If these limited authorities are not adequate, other involuntary restraints may have to be imposed. The trouble is, there will not be too much time in which to determine action.

## THE AGRICULTURAL OUTLOOK

It is too early to judge what will happen to farm production in 1948. As usual, weather will be the major determining factor. Demand for the output of United States agriculture should be about as high as in 1947. Foreign crops may be better, but foreign demand will remain high. Our shipments of food abroad this year have been far from the amount that was needed and even if there is larger foreign production in 1948 there will be need for heavy exports from the United States. On the domestic side, continued high income should maintain demand here. On balance then, if we have a high level of farm production in 1948, the supply of grains should be in somewhat better balance with demand; with poor crops, upward pressure on farm prices will be intensified. In either case, the price for livestock products is likely to continue high.

Agriculture fared very well in 1947. Total farm output was close to the record level of 1946, despite weather that was not as favorable as in the past few years. In the aggregate, farm production was more than one-third larger than prewar, with bumper crops of wheat and rice and almost record harvests of many other farm products. The major exception to the generally good production record was the corn crop, which—almost a billion bushels short of last year's harvest—was the smallest of the past decade.

With the fourth largest annual farm production in our history marketed at the highest average level of farm prices on record, cash farm income came close to \$30 billion in 1947, one-fifth higher than in 1946. Net farm income is estimated at \$18 billion, also a fifth larger than a year earlier.

The high level of farm prices in 1947 reflected substantial foreign demand for products of American farms, superimposed upon very large domestic demand. The almost disastrous crop season in Europe, coupled with the short United States corn crop, focused very heavy demand upon the 1947 wheat harvest, and upon feed crops in general. In turn, higher prices in these areas worked through into higher prices in others. As a result, the index of prices received by farmers for all farm products approached 290 per cent of the 1910-14 base in the last quarter of the year, about 10 per cent higher than in the comparable period in 1946, and triple the 1939 level.

With the great need for food all over the world, American farmers are being asked to turn in another record-breaking crop this year. I am confident that they will respond insofar as possible. I hope that the continued pressure for farm production will be

met with minimum losses to soil productivity. For seven years we have, in effect, mined our farms. It has been necessary to do so, but it is vital that at the same time we do everything possible to maintain the land. This is not an easy task, but efforts to accomplish it will pay long-term dividends.

In general, farmers have used their excellent incomes wisely during the war and postwar years. They have paid off debts and are in good financial position. They should continue this practice, both as a curb against inflation and as a precautionary step for the future.

As a final word on agriculture, I hope that the prosperity of farmers does not evoke a major movement back to the land. So far, the agricultural population loss has been a healthy development for the long-term economic future of the farmers. It has raised individual productivity on the farm and per capita farm income. The long-range movement in agriculture is toward a smaller farm labor force. If the movement back to the farm is kept within reasonable bounds, as it has been, it will serve three purposes: (1) It will leave agriculture in better shape for the probable decline in demand sometime in the future when foreign needs taper off, (2) it will prevent additional pressure on the farm land market, and (3) it will keep the nonagricultural labor force where it is needed now.

## THE POSITION OF THE BANKS

Great responsibilities face the commercial banks of this nation as 1948 opens. The decisions of individual bankers can aid in moderating the inflationary upswing or can add to its impact.

During 1947, the earning assets of the commercial banks increased by about \$5 billion. Loans rose almost \$8 billion, investments in non-Government securities increased by more than \$1 billion, while holdings of Government securities declined about \$4 billion. The increase in earning assets resulted in a deposit rise of some \$4 billion. The deposit increase occurred entirely in balances of businesses and individuals; Government deposits showed very little net change.

The 1947 record of banking developments was considerably different from that of 1946. In the earlier year the loan increase was smaller (about \$5 billion), while the decline in holdings of Government securities was much larger (about \$16 billion) as the Treasury used its very large War Loan balances accumulated in the Victory Loan to redeem maturing obligations.

In 1947, then, the money supply increased. It rose because the demand for loans increased private

credit more than Treasury redemptions decreased public credit. The Treasury redeemed such bank-held securities as it could from its cash revenue surplus and net receipts from nonmarketable securities, but funds available for this purpose were far smaller than in 1946. In conjunction with Treasury policy the Federal Reserve System moved toward higher short-term rates, in an attempt to prevent further monetization of the public debt and to discourage lending, by making bank reserves somewhat less available and somewhat more expensive.

Nevertheless, borrowing increased. Somewhat more than half the increase in bank loans during 1947 was in loans to business, somewhat more than one-fourth was in loans on real estate, and the balance in consumer loans. Loans for the purpose of purchasing and carrying securities declined in the year.

The rise in business loans resulted from increased demand for working capital stemming in turn from the high level of business activity and increased prices, from desires to add to inventories, and from desires to increase or replace plant and equipment. Consumer loans have risen with the increased availability of durable consumer goods and easing of consumer credit terms. Real estate loans have advanced partly in line with new construction, partly to finance existing property bought at high current prices.

It is important that several facts be noted in connection with the expansion in bank lending. First, rising bank loans tend to increase the money supply. Second, when an increase in the money supply is not matched by an increase in the supply of goods and services, the result (unless the additional supply of money is held idle) is a bidding up of prices. In other words, bank credit expansion without equal expansion of production tends to be inflationary. With an economy operating at virtual capacity, as ours is, credit expansion almost certainly will be reflected in price rises. Third, this is true whether or not individual loans are sound, bankable loans. Even if money created by a bank loan is used for a purpose which concurrently increases the total product, the funds thus created may be used many times in subsequent transactions to bid up the prices of goods without increasing production. Fourth, it is perfectly true that rising prices are a cause of rising loan volume, but it is also true that rising loan volume, in a situation like the present, causes rising prices. This is the old chicken and egg question in a different version.

Thus the very responsible position of commercial banking is made evident. In the interest of stability

the commercial banking system should be most reluctant to expand credit further in 1948. The recent joint statement of the bank supervisory agencies—the Comptroller's office, the Federal Reserve, and the Federal Deposit Insurance Corporation—stressed this point. Only by fairly rigid restraint on the part of individual banks can credit expansion be stopped without extension of existing controls or imposition of new ones.

I want to make perfectly clear that no indictment of individual banks is implied in the above. Banks exist to serve their customers through making credit available for sound, productive purposes. But while most individual bank loans are sound, in the sense that repayment seems assured, taken altogether they increase the money supply and their recipients bid up prices. Therefore, it behooves the banks to appraise very carefully the purposes of borrowing and, insofar as possible, to restrain lending.

Treasury action, of course, will attempt to do what it can to reduce the money supply and inflationary pressure by paying off debt held by the banks. If private borrowing continues at its present rate, however, the prospective Treasury surplus will fall short of offsetting it. The Federal Reserve System also will continue to exercise what restraining effect is possible within the effective limits of its responsibilities in the Government security market.

To sum up, the banks should attempt to do their part to hold inflation in check through restraint in bank lending. If they do not, the inflationary situation will worsen, the economy will be in greater maladjustment, and the eventual consequences will be far more severe than if restraint were practiced.

#### REGIONAL DEVELOPMENT

I noted in my report of a year ago that the Federal Reserve Bank of St. Louis was interested in aiding in promotion of a program of regional development for the Eighth Federal Reserve District. This region is and has been a low-income section and we need a better balanced economy in the region to build up its income level.

During the past year, the St. Louis Bank, in cooperation with state bankers' associations and state colleges of agriculture, continued to stress through widespread meetings the desirability of a better balanced agriculture in this district. I am gratified to learn that more and more district banks are carrying on their own agricultural programs with the same end in view, and seeking to extend their facilities to promote better balanced farming.

Through articles in this Review and other media, we also attempted to focus continued attention on the desirability of a better all-around balance in the district economy. As an example, the December issue carried a story of the timber resources of the region and their potentiality as an increased income source. We hope during 1948 to point out in greater detail the possibilities of increasing our industrialization through better use of our forest resources.

These programs are, of course, long range and should be so recognized. But insofar as they can be implemented in the coming year, to aid in increasing the region's and the nation's production

without increasing prices, they will prove helpful in the over-all situation that confronts us.

In conclusion, I want to repeat that 1948 will be a year in which developments will affect the more distant future in considerable degree. Therefore, I hope that all of us can work together to devise sound, intelligent solutions to our problems. Only through combined effort and hard thinking can we achieve the vitally important goals we have set for ourselves. Failure to attain them may bring severe consequences. Success will lead to a better organization of the world for peace and prosperity.

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## Survey of Current Conditions

At the close of 1947 the national economy was functioning at about the peak level of the year. Employment in nonagricultural industries totaled 50.6 million in November, according to the Bureau of the Census, with fewer workers unemployed than at any other time in the year. Industrial production in the last quarter was at about the same level as in the first three months of the year, due primarily to an increase in production of durable goods late in 1947. Total income paid to individuals in October, on an annual basis, amounted to more than \$204 billion and in the first ten months averaged 12 per cent larger than in 1946.

The willingness of consumers to take goods, even at prevailing prices, was evidenced by the fact that the volume of retail sales in the final months continued to total well ahead of 1946 dollar volume. Most of the increase, obviously, reflected higher prices. Wholesale prices early in December averaged approximately 16 per cent higher than a year earlier. Consumers' prices in October, the latest month for which data are available, were 7 per cent higher than in December, 1946; end-of-the-year data when published undoubtedly will indicate a larger spread.

The persistent increase in prices in recent weeks is realistic evidence that inflationary forces continue to dominate the economy. In the six weeks to mid-December the weekly average increase in wholesale prices was a seventh larger than the average rise in the previous 18 weeks, and nearly twice as large as that of the first half of the year.

This rapid rise in prices results from inflationary pressures being generated in a number of sources.

One of these, and one of increasing importance, is the sharp expansion in private credit. Commercial and industrial loans, as well as agricultural loans and borrowings on real estate, continued to increase in volume in December. Together with additional credit extended to consumers, these borrowings constitute a significant source of demand and play an important part in the bidding-up of prices for goods.

### EMPLOYMENT

Between October and November, nonagricultural employment in the nation increased to an all-time high, and in the district was very close to the war-time peak. As the result of a seasonal decrease in agricultural employment, however, total employment during this period declined. Unemployment also declined since a number of agricultural workers left the labor force. For the past year and a half, except for slight seasonal reversals, unemployment has decreased gradually but steadily, as has the average duration of unemployment.

Between September and November the major district cities experienced increases in employment, principally in the manufacturing, trade and service industries. Due to seasonal factors employment decreases are expected in January but by March, according to employers' estimates, the number of persons working is expected to regain the November level. Labor supply and demand in district cities are fairly well balanced, although in many instances the matching of available workers and job openings has been difficult. Memphis and Evansville have brighter prospects for future employment increases, particularly in manufacturing, than any of the other