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THE CURRENT BUSINESS SITUATION AND OUTLOOK THROUGH JUNE 1949

(Consensus of the meeting of the Committee on Current Business Developments in Boston, October 16 and 18, 1948, drafted by Dewey Daane [Richmond], Frank Garfield [Board of Governors], George Garvy [New York], and Alfred Neal [Boston].)

I. Review of Developments since April 1948

In the last report prepared at the beginning of May 1948, this committee concluded "that through the end of October production and employment will continue at high levels, and that wholesale prices and living costs will advance beyond previous peaks." While taking note of some elements of weakness that were clearly discernible, the committee expected that "during the period under review depressing tendencies would be offset by stimulating forces."

On the whole, despite some diminution in the rate of increase, the economic life of the nation during the past six months was characterized by continued inflationary pressures inherited from the war period. The expanded military and foreign aid programs and the income tax reduction initiated last spring have proved to be important influences in stimulating business and consumer buying. Production has been generally maintained at levels higher than a year ago. Total industrial production has been sustained with only minor fluctuations and the Board's index for October (seasonally adjusted) is expected to be 93 per cent above the prewar average. In agriculture, crops are much larger than last year but supplies of livestock products have decreased. During the past six months, employment has been generally running one to two million above the corresponding months a year ago. In September, seasonally adjusted employment reached a new record level. As expected in our last report, wholesale prices and the cost of living both exceeded previous peaks in the period May - October 1948.

Demand for business, consumer, and real estate credit continued strong. In a special session of Congress, which was not anticipated in our May report, some additional powers were granted to the Federal Reserve System. Under these new powers reserve requirements were raised and instalment credit controls were reinstituted. It is too early to appraise fully the effects of these actions to date or of the tightening which has occurred in the real estate mortgage field, but the volume of bank loans outstanding has continued to increase since the impositions of such controls and the demand for credit apparently has not lessened.

The supply of consumer goods has improved since this spring, with automobiles, refrigerators, and some types of furniture and floor coverings remaining the only major areas of shortages. In some industries, especially consumer goods industries, however, weak spots developed. In a few areas, particularly in some branches of the textile and leather industries, operations were curtailed, mainly by working shorter hours or cutting down the number of shifts. Coal output has been in excess of use and stocks have accumulated. As supply has caught up with demand and as backlogs have become less pressing or disappeared, even some durable goods industries have begun to undergo a process of line-by-line adjustments which in the nondurable and semidurable goods field (frozen foods, textiles, apparel) began earlier. Such adjustments have involved improvements in quality (furniture), elimination of off-brand products (small appliances) and occasionally price reductions (radios). Some marginal producers and distributors, mainly postwar entrants, have been experiencing serious difficulties.

Nevertheless, during the last six months, as earlier in the postwar period, such adjustments were limited to a few industries at any time and neither involved widespread unemployment nor started chain reactions affecting industry in general. The strength of demand has been such that resources released by successive readjustments usually found employment elsewhere. In general, after relatively short periods of adjustment, such industries have been able to adjust prices and production sufficiently to return to high levels of output, although somewhat below their postwar peaks.

The basically strong position of business during the last six months was reflected in the labor market. As profits and living costs have risen to new record levels, industry has granted further wage increases. The General Motors settlement occurred late in May (immediately after the meeting of this committee). The third round of wage increases spread throughout the economy, but it was generally not quite as large as the previous rounds. Work stoppages continued to be relatively few in number and generally not of great importance.

The strong outlook and continuous pressures of demand against available supplies were also reflected in price increases by industries where administered prices prevail. Prices of steel, nonferrous metals, and of many durable goods have been advanced again recently.

On balance, then, the last six months was a period of continuing prosperity in which the rate of increase of prices and of other value indicators leveled off, while physical indicators generally began or continued to move sidewise as ceilings in materials, labor supply, or plant capacity limited further expansion of output.

II. Assumptions upon which the Present Statement is Based

The evaluation of the outlook through June 1949 is based on the following assumptions that appear to us to be the most realistic that can be made at this time:

(1) The international situation will remain in a state of serious tension centered on the West-East conflict. New incidents may arise but will not lead to the outbreak of actual hostilities.

(2) Foreign economic aid will be supplemented by military aid on a moderate scale. Economic conditions in most foreign countries will improve further, but inflation will continue to be a world-wide problem.

(3) Federal Government expenditures, bolstered by the rearmament program, the anticipated military aid for Western Europe, and disbursements under the farm price support program will increase. It is, however, not anticipated that any significant new tax legislation will be enacted before the end of the current fiscal year (if at all). Some cash surplus will be available in the first quarter of 1949. While the Treasury cash position may exert some downward influence during the first quarter of 1949, it is anticipated that this will be largely offset by the effect of operating deficits in the fourth quarter of this year and the second quarter of 1949. On the whole, the effect of the Treasury's operations on the money supply will not be important in either direction.

(4) Little modification in the existing economic legislation is expected through the end of June 1949, although it is realized that the military preparedness program eventually may require limited controls. In particular, it is expected that the agricultural price support program will remain essentially unchanged for basic crops planted during the period considered.

Since one purpose of this report is to provide material for developing monetary policy, no change in monetary policy is assumed, i.e., it is assumed that monetary policy will continue to be aimed at prevention of further inflationary expansion of credit outstanding.

III. Outlook through June 1949

International Developments

Political and economic developments abroad continued to have an important influence on the domestic situation this year. On the one hand, growing tension has brought about adoption of the economic aid program and has led to new rearmament measures. In recent months, however, improvement in economic conditions in large parts of Europe has reduced some of the most urgent needs for exports from this country. These tendencies are likely to continue in the period ahead.

The foreign balance surplus on current account in the calendar year 1948 may approximate $8 1/2 to $9 billion, and in the fiscal year 1949 may be above $9 billion, as against $11.3 billion in the calendar year 1947 and an annual rate of less than $8 billion in the first half of 1948. The slightly increased gap on current account is predicated on the assumption that imports will continue at present high levels but that ECA shipments will rise sharply during the period ahead; off-shore procurement may tend to cushion further declines in exports to Latin America. Current procurement and reimbursement authorizations indicate a definite shift in ECA shipments from food, fertilizer, and so-called "relief" commodities to industrial raw materials and capital equipment. Latest estimates by the Organization of European Economic Cooperation of goods needed in 1949 further emphasize this shift. Furthermore, as more countries are induced to utilize loans in addition to grants, the tendency towards recovery items is likely to be accentuated.

The combination of foreign aid, military lend-lease, and defense expenditures seems likely to intensify demands on our domestic resources and impose further pressure in such key areas as steel, nonferrous metals, and some types of electrical machinery during the forecast period.

Looking further into the future, it appears that if there is any decrease in expenditures under the European Recovery Program, it will be offset by increases in military lend-lease. Another offset to a possible decrease in expenditures for European aid may arise from increased appropriations for aid to China and Japan. The repercussions of the continuing international tension through expanded domestic defense expenditures may have an even deeper effect than direct foreign expenditures.

On balance, therefore, the foreign situation and the aid and defense expenditure programs will continue to be a definite expansionary element in the domestic economic outlook not only in the period up to mid-1949, but also well beyond that time.

Developments in Agriculture

Prices of grains and other major crops are now down to about support levels and may be expected to stay there throughout this period. This is in marked contrast to the rising crop prices in the latter part of 1947 and also to the declining crop prices of recent months.

The declines which have occurred this year have been interpreted by some observers as marking a decisive turn in the whole agricultural situation and perhaps even in the outlook for the whole economy. It is evident that declines since January in prices of food and feed grains and also of cotton and cottonseed have resulted in reductions in important raw material costs and have introduced an element of uncertainty into markets for products made from these materials. Livestock and meat prices have fluctuated widely this year and in the cotton textile field many prices have declined. Prices for fats and oils, influenced partly by the prospect of greatly increased supplies of cottonseed oil and of foreign fats and oils, have been reduced.

Striking as these developments in agriculture have been, however, their importance in stemming inflationary developments in the period ahead easily may be overemphasized. As already noted, major crop prices are now at the support levels which will prevail through this season. Market supplies of meat animals, except for poultry, cannot be increased quickly except by marketing of animals now on farms. Storage stocks of meat have been drawn down this year and, much more important, the number of meat animals on farms has been further reduced. Any periods of weakening in meat prices such as those earlier this month are likely to reflect special or seasonal influences and to be followed by reduced marketings and renewed price advances, assuming that consumer disposable income is maintained. The effect of increased feed supplies may be more important for dairy products in this period than for meat although feeding of dairy cattle has been at a high rate for some time.

Despite lower crop prices, total cash farm income for 1948 will be close to that of 1947. Over several years of high incomes and limited opportunities to buy goods, farmers have acquired liquid assets in substantial amounts and have paid off many of their debts. Recently they have increased their borrowings, particularly on short term, but their financial position is still exceptionally strong and it seems likely that expenditures by farmers will continue high. New machinery purchases are expected to be large and with further rapid mechanization of farms in recent years growing expenditures will be made for replacement parts.

So far the decline in prices of crops has been reflected to only a limited extent in declines in prices at retail. The retail food index in September was only slightly below the July peak and the October index, while lower, will probably still be above the level at the beginning of the year. Bread prices have not been reduced at all despite the very sharp reduction in wheat while retail prices of butter, cheese, and meats have declined recently. If later in this period food prices should decline further, consumers will be in a position to spend more for other products or to save more.

By next spring prospects for another season's crops will be having an influence in commodity markets and may raise more serious questions concerning the cost of maintaining support prices, but it seems likely that the present law will remain substantially unchanged and that next year support prices for basic crops will be not very different from those for this year's crops.

Prices and Wages

Prices and wages have risen further this year although at a less rapid rate than last year, reflecting the easing of some tight supply situations. The February break in farm prices raised the question at the time as to whether the price rise had ended or a one-time adjustment had taken place. Subsequently, with recovery in livestock and meat prices and increases in prices of a wide range of metals and also of metal products, such as automobiles and agricultural implements, the general level of wholesale prices advanced to a new peak. In recent weeks the general price level has declined again, reflecting not only marked reductions in livestock prices but also reductions in some nondurable goods such as fats and oils, cotton textiles, and chemicals. Fuel prices, which rose very sharply in 1947, have advanced much less this year, partly because the domestic supply situation has been eased by decreased exports following increased coal production abroad. Decreases in exports also have been a factor in the weakness in cotton textile markets.

Consumer prices have increased substantially this year, with advances, on balance, in prices of food and clothing, in rents, and in various transportation and other utility costs. In August and September the official index was at 174.5 per cent of the prewar average, as compared with 168.8 in January. October will show a reduction, owing chiefly to a decline in meat prices which may prove temporary. In the period ahead as a whole, rents and utility charges may be expected to rise further and although reductions in some food and clothing prices may take place, there is little likelihood that these will be of major proportions.

Partly because of increased living costs and high and rising profits, but largely because of strong demand for labor and the low level of unemployment, wage rates were advanced considerably this summer despite earlier efforts of some leading corporations to prevent a third round of substantial wage increases. In the period ahead, living costs and profits are likely to remain at present high levels or even to advance further. A continuing basically strong market for labor will depend on many developments discussed elsewhere. On the supply side, the number of workers will be increased by the return to the labor force of many veterans now at school as well as by the normal growth of the labor force. More than half of the probable increase in the labor force to mid-1949 will be absorbed by inductions into the armed forces. The demand for civilian labor may rise somewhat less than production because of continued technological progress.

The committee believes that rates will continue to rise but that the increase will be less in the first half of 1949 than in the first half of 1948 partly because, contrary to the experience in 1948, contracts in some pace-setting industries will not be up for consideration until the middle of the year.

Consumer Expenditures

At continuing high levels of income and employment it appears that consumer expenditures will be sustained or increase in the period ahead. In the consumer nondurable goods field, price readjustments are expected to continue and this in turn may bring back a number of products (e.g., some textiles) into a wider consumer market. Sales of certain durables, such as vacuum cleaners, radios, water heaters, ironing machines, etc., are running well below last year's levels. Considerable backlogs of demand still exist for automobiles, refrigerators, sewing machines, stoves, television sets, and some types of furniture and floor coverings.

The large volume and wide distribution of liquid assets will continue to support high levels of consumer expenditures. However, there have been some shifts in holdings which may be significant in terms of the future pattern of consumer behaviour. Specifically, the velocity of turnover of these assets may decline with the shift of a portion of liquid assets from veterans and other "temporary savers" to groups of systematic savers. On the other hand, the shift in liquid asset holdings from farmers to non-farm holders may tend to increase consumption.

Capital Expenditures and Inventories

Over the next nine months, producers' expenditures for plant and equipment are unlikely to show any increase over the previous year, and may show some decline. Although various surveys indicate that demand for plant and equipment will taper off during 1949, any downward movement is likely to be moderate, partly because of the heavy demands by the utilities, and could be reversed if continued high profits, foreign developments, and active business cause expectations to change. At present there is fairly widespread reluctance to expand plant and equipment which cannot be amortized very quickly, but there is some evidence that replacement and modernization expenditures may increase again. Furthermore, increased construction by State and local governments will offset at least in part any decline in private construction expenditures.

While the effect of the rearmament program is uncertain (there is some contention that it will not require very much capital expenditure), the increase in armament expenditures appears to be a strengthening factor with regard to business expectations generally and particularly in some industries, such as aircraft. It does not seem likely that lack of funds will be an important factor limiting expenditures on plant and equipment, as business relies mainly on internal funds for capital outlays, and as credit continues to be fairly easy to obtain, from one source or another.

Inventories are at record book values and the consensus is that the accumulation has been partly involuntary. The recent bulge in manufacturing inventories represents a spotty demand situation, particularly with regard to nondurables. Inventories of primary materials like metals, lumber, and rayon held by producers are still very small relative to sales, while stocks of these material in consuming industries have increased and inventories of finished products have quite generally assumed more normal proportions. In agriculture, with large crops, stocks of grains and cotton have greatly increased but livestock holdings have been further reduced. In general some further increase in business inventories is expected.

Residential Construction

Expenditures on residential construction during the summer and early fall months rose further and represented a sustaining force in the economy. Despite a recent decline in the number of units started, and the prospect that starts in the remainder of this year will be below last year's abnormally high year-end level, it appears that residential construction will continue at a high level during the closing months of 1948 and the first part of 1949.

However, there are some soft spots in the residential building situation. Rising construction costs and high prices for houses have eliminated some less urgent buyers from the market. Similarly, the apparently growing tendency of lending agencies to tighten up mortgage requirements, coupled with the high level of consumer prices generally, is making it more difficult for families to carry the costs of new housing. These developments, however, may be offset by further increases in the construction of multiple unit housing, which is being stimulated by both Federal and State legislation. Legislation enacted during the recent special session of Congress seems to have had little, if any, effect so far. On balance, it appears probable that there will be no substantial weakening in residential building activity during most of the period under consideration.

IV. Conclusions

The outlook through June 1949 is for continuing high level activity with inflationary pressures prevailing. We expect that during the coming six month inflationary pressures, inherited from the past war and reenforced by military expenditures called forth by the international situation, will be strong enough to more than offset deflationary forces. The principal indicators of employment, output, and distribution are expected to move sidewise.

The last six months have witnessed a gradual leveling off and even weakening of various props -- foreign trade balance, expenditures for plant and equipment, residential construction -- that have contributed to the maintenance of high levels of employment in the past. One cannot fail to be impressed by the fact that our economy has been able to accomplish numerous adjustments since the war without departing from high levels of output and employment and without preventing further increases in incomes and prices.

Partial adjustments that have been taking place in our economy will continue; weakening of prices of individual products is, however, unlikely to induce businessmen and consumers to expect substantial and general price declines. On the contrary, price concessions (the scope of which is limited by wage contracts, farm price supports, and other elements of rigidity) are likely to call forth increased demand, thus stabilizing output. Localized weaknesses that have occurred repeatedly since VJ-Day have failed to gain momentum and to become generalized; in fact, with important areas of short supply, inflationary forces have continued dominant. In general, as long as no widespread cumlative developments are likely to be started by any of the adjustments anticipated, any drops in prices, production, and employment are likely to be limited to a few fields and to be fully offset by increases elsewhere. The fixed commitments embodied in the Federal budget of more than $40 billion (supplemented by another $15 billion of State and municipal expenditures), the large volume of fairly broadly distributed liquid assets, and the Social Security program should prove to be important stabilizing factors.

We expect employment to remain close to full employment levels, industrial production to continue around present peak peacetime levels, and wholesale prices to remain at high levels; any further slight reduction in farm and related prices being offset or more than offset by increases of metals and of manufactured goods. The cost of living is unlikely to decline from the October level in the period immediately ahead and may increase moderately.

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