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CORPORATION CASH, INDIVIDUALS' CASH, AND INFLATIONARY PRESSURES

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The growth of demand deposits and currency of individuals and unincorporated business apparently continued at a rapid rate in the first half of 1942, with the six-months' increase amounting to about 3 billion dollars out of a 3.8 billion increase in total deposits and currency. For the entire year 1941, the corresponding figure was estimated at about 6 billion dollars out of a 7.5 billion total growth. Currency in circulation absorbed a slightly larger proportion of the increase in individuals' cash holdings than in 1941, and demand deposits slightly less. Currency in circulation outside banks increased 1.3 billion dollars in the first half of 1942, as compared with 2.3 billion in the year 1941.

Government deposits, including those of State and local governments and the Federal Government, did not change much in the first six months of 1942, as compared with a 1.5 billion increase in 1941. Savings deposits reached their peak last year and declined in the first half of this year. Cash of financial corporations probably decreased, too, judging by monthly reports for leading life insurance companies. The ample supply of Government securities makes any increase in cash holdings of investment institutions unlikely. Available mid-year reports of industrial corporations show cash movements--described in the latter part of this memorandum--which suggest that the overall growth in non-financial corporations' cash was a little over 1 billion dollars in the half year, somewhat greater than in 1940 and much greater than in 1941, when tax-anticipation notes first became available and absorbed most of the total growth in cash assets of business corporations.

Outlook: cash holdings of corporations and individuals

In the first half of 1942, the estimated rates of increase in demand deposits and currency of individuals (including unincorporated business) and of non-financial corporations were both in the neighborhood of 10 per cent. As the rate of war expenditure rises and the money supply is increased more and more rapidly through purchases of Government securities by the banking system, we must expect a growing divergence between the rates of increase in cash of individuals and of corporations. A larger and larger part of the hugh expected growth in the money supply is likely to come to rest, at least temporarily, in the hands of individuals--unless individuals can be persuaded or required to lend much more to the Government than is now expected, in which event the growth of the money supply need not be so great. The inflationary dangers of a vast increase in the money supply, based on heavy participation of the banking system in war financing, will appear still greater if this likelihood is borne in mind.

Assuming that prices and costs are kept more or less under control, corporation cash is not expected to rise in proportion to this projected increase

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in the money supply. The forces determining corporation cash holdings are now largely independent of the total growth in assets and liabilities of the banking system. Tapering off of expansion in work in process and other inventories, as well as in receivables, will tend to strengthen cash positions, and the same is true of reductions in plant and equipment outlays. On the other hand, profits are rigorously limited by corporation taxes. Earnings earmarked for tax payments will continue to be invested in tax-anticipation notes to a considerable extent. Dividend payments and retirement of debt will absorb surplus cash funds in many cases. If price controls weaken, corporations may try to hold on to liquid resources in order to maintain their reserves of purchasing power, but the first impact of incipient price inflation--at least on war industries-- will be on the cost side and mounting dollar volumes of inventories and receivables will tend to check cash accumulation.

The likely growth in business corporation cash over the coming year 1943 should not be set at more than 4 to 6 billion dollars at the outside (as compared with the recent rate of about 2 billion a year). On the other hand, unless there is a marked stepping up of individuals' purchases of bonds, the growth in the money supply may amount to as much as 30 billion dollars, or a rise in one year of over 40 per cent in total demand deposits and currency. Already in the third quarter of 1942 the growth appears to have exceeded 5 billion dollars. A money expansion of 30 billion dollars in 1943 would probably mean a growth, within a single year, of around 25 billion in demand deposits and currency of individuals (and unincorporated business). This is approximately four times the recent rate of growth (about 6 billion a year) and would mean an increase in 1943 of 60 per cent or more over holdings at the end of this year.

There is no logical impossibility in a 25 billion dollar increase within one year in the cash of individuals (and unincorporated business), even without price and income inflation. Production and incomes will be considerably higher in the aggregate, though gains will taper off. But goods available for consumers will be much less than in 1942, even allowing for large use of present inventories. Individuals' current financial savings in all forms may quite conceivably exceed those of 1942 by 20 billion dollars or more, despite higher taxes. Certain forms of saving, such as liquidation of debt, will be less important than in 1942, and this will further increase the volume of saving taking other forms, such as bonds and cash. Purchases of securities by individuals will increase, but the kind of estimate of the money supply with which we are dealing does not allow for a very great increase in individuals' purchases of securities. If individuals do not greatly increase their buying of Government bonds, the Treasury will have to rely on the banks. This is why the money supply may increase so much next year. Failure to buy bonds with unspent income is also the reason why individuals' cash will increase so much, according to these estimates. But if individuals can be persuaded or required to lend a substantial part of their increasing savings to the Government, both bank investments and individuals' cash holdings can be held to lower levels.

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Outlook: pressure on the retail price structure

The inflationary implications of currently accepted estimates of individuals' bond purchases, and the estimates of cash holdings to which they lead, can be vividly seen by contrasting the nature of the projected cash accumulation with what has already occurred.

The increases in 1941 and the first half of 1942 in cash of individuals (and unincorporated business) were related to tremendous increases in consumer incomes. For example, it has been estimated that families and single consumers with incomes under $3,000 in 1941 (eighty-four per cent of all families, to whom has gone two-thirds of the aggregate increase in incomes this year over last) are now receiving incomes $300 a year higher, on the average, than a year ago. This average covers many families with little or no gain who are feeling the pinch of a rising cost of living, but it also covers many families with steadier work at higher wages and many in which additional members are going to work. Suppose the "average" family in this great group has increased its currency on hand and its bank deposits by $80 over the year, or about the amount of two and a half weeks' pay at present. That would account for nearly 3 billion dollars of increase a year in money holdings of individuals, much of which would be in currency. There has probably been some increase in holdings of unincorporated business, too. The remaining 2½-3 billion dollars--and possibly more, if the increase for lower-bracket families has been put too high--must be found in holdings of the upper sixth of families and single persons. Though their gains (especially in the $3,000-$10,000 range) have not been so great, families whose incomes were over $3,000 last year still receive nearly half the nation's total consumer income. In the upper brackets, provision for increased taxes may have been a significant force for cash accumulation. To sum up, the growth of individuals' cash up to the middle of this year may be explained by greater liquidity due to large gains in income of many in the lower brackets and to a combination of income gains and other factors in the higher brackets.

Contrast this with what may happen next year. In 1943 similar forces will still be at work, but by far the largest part of a 25 billion dollar annual increase in cash of individuals (and unincorporated business) would come from restriction of consumption, rather than from gains in untaxed income. Many families would find it necessary, because of limited supplies, to add an amount equal to several months' income to their cash accumulations. The facts of the production outlook do seem to indicate that individuals will be obliged to accumulate large sums of unusable purchasing power. Can they be persuaded or required to lock up this purchasing power in Government bonds for use after the war? If so, we shall be able to limit both bank financing and cash accumulation by individuals. If not, this purchasing power overhanging the retail markets will constitute a tremendous obstacle to successful price control and equitable rationing.

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ESTIMATED DISTRIBUTION OF DEPOSITS AND CURRENCY
Year-ends, 1939-1941, and June 30, 1942
(in billions of dollars

	Dec.31,1939	Dec.31,1940	Dec.31,1941	June 30,1942
Total deposits and currency	64.1	70.8	78.3	82.1
1. U.S., State and local governments	4.3	4.6	6.1	6.2
2. Financial corporations, banks' trust departments, and foreigners	6.1	6.9	6.5	6.3
3. Savings deposits	24.7	25.3	25.4	25.1
Remainder	29.0	34.0	40.3	44.5
4. Non-financial corporations	8.5	10.3	10.5	11.7
5. Demand deposits and currency of individuals (incl.unincorp.business)	20.5	23.7	29.8	32.8
5a. Currency outside banks	6.4	7.3	9.6	10.9
5b. Demand deposits of individuals (incl. unincorp. business)	14.1	16.3	20.2	21.9

Movement of industrial corporations' cash assets, 1st half of 1942

44 industrial corporations (excluding General Motors) with assets over 25 million dollars on June 30, for which semiannual balance sheet reports are available, showed an increase of 15 per cent in their cash holdings (exclusive of marketable securities and tax notes) in the first half of 1942. 32 smaller corporations, with assets between 10 and 25 million dollars, showed a similar percentage increase in cash (17 per cent, to be exact). 75 still smaller companies, with assets between 1 and 10 million dollars, had an increase of about one-third, but this result may conceivably be far from representative of all corporations of this smaller size. Even the gains of the larger corporations in the sample cannot be used as a guide to overall figures without considering other changes in their balance sheets.

Changes in cash for large corporations depend to a considerable extent on simultaneous changes in their holdings of marketable securities and tax

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notes. Total cash and equivalent of the 44 companies with assets over 25 million dollars increased 4 per cent, as against increases of 5 per cent and 9 per cent in the first and second halves of 1941. In the next smaller size group the gain in the first half of 1942 was a little over one-quarter; this was greater both in dollar amount and percentage rise than the gains in each half of 1941. The 75 smallest companies for which figures were collected had a greatly accelerated rate of increase in cash and equivalent, about 38 per cent of the end-of-1941 amount, as compared with an increase over the full year 1941 of only 29 per cent.

Two observations may be made on these results. First, as to the likely increase in cash plus marketable securities and tax notes for all industrial corporations (and perhaps also for all non-financial corporations), the data suggest a more or less steady continuation of the previous two years' gains, roughly estimated at 17 and 20 per cent a year, respectively. Some weight, but not too much, should be given to the acceleration of increase shown by smaller companies in the sample. A 12 per cent increase in cash and equivalent in the first half of 1942 for all non-financial corporations would be about 1.7 billion dollars. During this period outstanding tax-anticipation notes increased 0.5 billion. It appears, therefore, that the half-year's increase in business corporation cash (exclusive of marketable securities and tax notes) may have been about a billion and a quarter dollars, or 11 per cent, as compared with 1.8 billion estimated for the full year 1940 and no more than 200 million dollars or so in 1941 when the tax notes first became available.

Second, as to differences between the very large and the smaller or middle-sized corporations, the data here reported do not necessarily indicate greater liquidity at the present time for the smaller companies than for the large, because the need to provide for rising taxes is responsible for much of the increase in corporation cash and equivalent during the past year or two. If accrued tax liabilities are deducted from cash and equivalent on hand, the sample corporations with total assets over 25 million dollars show a decline from June 1941 to June 1942 of 32 per cent in "net cash," the sample companies in the 10-25 million dollar group a decline of 39 per cent and the 75 smaller corporations a decline of 19 per cent. (This comparison is made for June-to-June in order to even out the variations in half-yearly periods in the relation of cash assets to reported tax liabilities in the different size groups.) In all size classes, cash on hand, not required to liquidate tax liabilities already incurred, has declined over the past year. While the decline for the reporting companies with assets between 1 and 10 million dollars appears to have been less than for larger companies, it must be remembered that the sample, at this size level, is extremely small and quite possibly not representative.

Deduction of the full amount of tax liabilities in measuring "net cash" is not altogether realistic. Of course, taxes accrued one year but not payable until the next are just as much a charge against the first year's earnings as are labor and material costs. Nevertheless, tax liabilities, like other current liabilities, may be met out of future earnings or by future liquidation of inventories and receivables. The desirability of accumulating and

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earmarking cash assets equal to a substantial part, at least, of unpaid tax liabilities is dictated by the great size of these liabilities and by the uncertainty of reliance on future earnings--an uncertainty which grows as companies approach and pass their peaks of wartime operations.

If we take a middle ground, and assume that at present corporations ought on the average to be earmarking cash assets against half their accrued and unpaid profits tax liabilities, we may compute their "free cash" by deducting one-half of tax liabilities from cash on hand. The 44 largest companies show a 5 per cent decline in free cash so defined, from June 1941 to June 1942, while the 32 next largest show a 24 per cent increase, and the 75 smaller companies a 35 per cent increase. These gains in free cash for the middle-sized and smaller corporations occurred almost entirely in the first half of 1942.

Differences among industries

Industrial subgroups of the sample in which decreases between June 1941 and June 1942 in total cash assets net of tax liabilities were least frequent included producers of basic metals (including several smaller steel companies--none of the large companies publishes mid-year reports), producers of oil, and rubber companies. One characteristic shared by these industries is that their inventories and receivables have not increased greatly. But even in these groups, the median company had little or no gain in "net cash."

Substantial increases in cash and equivalent (disregarding tax liabilities), occurred in these same groups.1/ Other significant increases in cash assets occurred among manufacturers of chemicals (partly because of large advance payments on contracts).

In other industrial groups, such as foods, textiles, paper, and a large range of machinery and metal products industries, increases in cash assets from June 1941 to June 1942 varied widely from company to company, with the median percentages of increase not significantly lower than in some of the groups previously mentioned. Total dollar figures for the reporting companies in these groups, however, showed small increases or even decreases in cash and equivalent over the twelve-month interval.

General Motors.

Figures for General Motors Corporation, by far the largest of the companies reporting semiannually, were excluded from the computations for this memorandum because of their peculiar movement which would have distorted the general

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1/ In the oil group, a decrease for the largest company offset increases for eleven other companies.

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conclusions from the sample. General Motors' cash and equivalent showed a sharp decline during the first half of 1942, contrary to the usual seasonal movement in the automobile industry in earlier years, including 1941. This decline was associated with large increases in inventories and receivables.

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