

INTERMEDIATE AND LONGER TERM BUSINESS

OUTLOOK

A. Intermediate Outlook

A consideration of (1) the nature of the recovery to date and (2) the factors in the present situation that should lead to increased expenditures of an income-increasing type, point to the conclusion that shortly the upward trend of business activity should be resumed. No account is taken in this memorandum of foreign political or military developments.

1. Nature of recovery movement, June- December 1938.

The recovery from June to December 1938 was one of the most rapid on record and could not reasonably be expected to have continued at that rate. In this six-month period the index of production rose as much as in the nineteen-month period from November 1934 to June 1936. If the same rate of increase prevailed in the current six months the index would be at 140 in June. The rapidity of the recovery was attributable to two factors; (a) the cessation of inventory liquidation, and the consequent rebound of production to current consumption levels, (b) the sharp increase in consumption, which was in turn attributable in part to a rapid stepping up of the net federal contribution to buying power from less than \$100 million per month in the first quarter to \$300 million a month in the last quarter, and the substantial increase in residential building expenditures. The attached charts show

the course of the net federal contribution, monthly income payments, consumption, production of consumers' goods, and inventories for this period.

2. Current situation.

The current minor recession is attributable to (a) a leveling off of some of the important income-increasing factors (net federal contribution and housing), (b) a decline in the excess of exports over imports, (c) the absence as yet of any substantial follow-up in plant and equipment expenditures, and (d) a closer alignment of production to current consumption.

3. Outlook for balance of year.

There appears to be good reason to anticipate a resumption of the advance in income-increasing types of expenditures in the near future:

(a) Net federal contribution.

Regardless of the final amount determined upon for W. P. A. for this fiscal year, it is anticipated that the net federal contribution will average over \$400 million monthly in the second quarter. This will constitute an increase of more than \$100 million over the monthly figures in December and January.

(b) Residential building.

Residential building construction has gotten off to an excellent start, mortgage rates are softening, other costs are being kept down, and the spring and summer should witness the

largest volume of residential building expenditures since 1929.

(c) Utilities.

The relationship between generating capacity and output of electrical energy is favorable for an increase in utility capital expenditures.

(d) Railroads.

Owing to the retirement of railroad equipment from 1929 to 1938 inclusive, the railroads are geared to handle barely more carloadings than at the carloading peak of 1938. Any additional traffic increases will almost of necessity force an increase in equipment expenditures.

(e) Mining and manufacturing.

With the exception of a few months around the beginning of 1937, the physical volume of consumption is higher than at any time since 1929. Any further increase will mean a fairly high degree of utilization of productive plant capacity. This, in turn, should lead to an expansion of manufacturing plant and equipment expenditures.

(f) Exports.

The combination of more stable business conditions abroad and armament orders should operate to maintain and perhaps increase the volume of our exports.

(g) Summary of income-increasing taxes.

I It is anticipated that the sum of the income-generating types of expenditures, the more important of which have been

listed above, will approach \$14 billion in 1939 as contrasted with around \$9- \$10 billion in 1938.

4. The national income.

The balance of probabilities, therefore, appears to favor an early resumption of the upward movement. It does not appear unduly optimistic to anticipate a net income of \$67- \$68 billion this year, as contrasted with \$62 billion in 1938, with the income running at an annual rate of around \$70 billion toward the end of the year.

B. Longer Term Outlook.

The outlook for 1940 at this date is most uncertain. The whole matter turns on whether the increase in private capital expenditures will be sufficiently large to offset (1) the scheduled drastic decline in the net federal contribution to buying power and (2) the probable sharp expansion in savings.

1. Net federal contribution.

At the present writing it appears that the net cash deficit will undergo a drastic decline in the first half of 1940 owing chiefly to a heavy increase in tax collections on the one hand, and a decline in P. W. A. and W. P. A. expenditures on the other. It is estimated that the net federal contribution to buying power will decline from a monthly figure of over \$250 million in the last half of 1939 to a figure nearer \$100 million monthly in 1940. These estimates assume that in certain particulars the official budget figures constitute an underestimate of tax collections and an overestimate of expenditures,

and that there will be no additional P. W. A. appropriation.

The anticipated decline in the net federal contribution to buying power will be nearly as drastic as that which occurred from the latter part of 1936 to the early part of 1937, and will impose the same type of strain on recovery. The increase in payroll taxes and the decline in W. P. A. expenditures will, in particular, bear heavily on consumption. A comparison of the movements in the net federal contribution and consumption is shown in an accompanying chart.

2. Owing to the expansion of savings, the amount of money that has to be expended in durable goods production merely to maintain a given income level increases in the course of an upswing. One main source of savings is profits, and profits expand rapidly as the national income rises. Thus, corporate profits, eliminating intercorporate dividends, rose from \$1.7 billion in 1935 to \$3.9 billion in 1936, and for the first nine months of 1937 were running at the annual rate of \$4.5 billion.

3. In order to maintain the recovery movement in 1940 it may be hazarded that to offset the expansion in savings, and the anticipated decline of over \$2 billion in the cash deficit, private capital expenditures (including housing and inventories) should expand by around \$3.5 billion. This would represent an increase of around forty percent over the anticipated volume of such expenditures in 1939. This would represent a very large percentage increase.