

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 31, 1939

To Chairman Eccles

Subject: _____

From Emile Despres

The attached memorandum and table were
prepared at Currie's request.

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October 30, 1939

Outlook for Income-Generating Expenditure in Early Months of 1940

Most items of income-generating expenditure can now be estimated with fair accuracy for the first four months of 1940. The course of inventories is necessarily uncertain, however, and will depend upon the future state of business expectations. It seems safe to assume that business will make no active effort toward further expansion of inventories after the present period of accumulation, based upon orders placed immediately following the outbreak of war, has come to an end. There are, then, three remaining possibilities. First, a moderate decline in incomes and prices may produce some passive accumulation of business inventories, particularly if businessmen, foreseeing a larger demand in the future, are reluctant to press their stocks on a receding market. Second, business as a whole, although unwilling to permit an actual expansion of its inventories, may be willing to continue holding high stocks in anticipation of somewhat larger demand in the future. Finally, business may make a concerted effort to reduce inventories. This policy would probably be followed if the prospects of an early peace appeared good or if, for other reasons, business was intensely skeptical regarding war demands. If there seems to be little prospect of early peace, the second of the above hypotheses appears, on the whole, to be the most probable.

The size of the decline between the last four months of 1939 and the first four months of 1940 in the average rate of total income-generating expenditure depends largely upon these inventory decisions. Under the first possibility discussed above, the decline would be about 14 per cent; under the second possibility, 20 per cent; and under the third possibility, 25 per cent. On the assumption of a constant and instantaneous relationship between total income-generating expenditure and gross national product, one would expect a parallel decline in gross national product and a somewhat more than a proportionate decline in national income, during the first four months of 1940. The data for past years indicate that the relationship between income-generating expenditures and gross national product, although nearly constant, has not been instantaneous. There are delays in the process by which changes in income-generating expendi-

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tures produce movements in income-generated expenditures, with the result that wide and rapid fluctuations in income-generating expenditures, such as are caused by quick movements in inventories, produce only a dampened effect on gross national product. Thus, part of the growth in incomes resulting from inventory accumulation during the final four months of 1939 will not be reflected in cash expenditure on perishable consumer goods and services until the early months of 1940. Similarly, the contraction in incomes resulting from retardation, cessation, or reversal of inventory accumulation in the first four months of 1940 will not be reflected in income-generated expenditure until later in the year. Thus, the fluctuations in gross national product will be considerably smaller than in the total of strategic expenditures shown in the table.

On the whole, it appears probable that the average rate of total consumer expenditure for perishable goods and services will differ only slightly in the first four months of 1940 from that of the last four months of 1939. Consequently, the decline between these two periods in the average level of national income will be equal to only about one-fifth of the decline in the income-generating expenditures shown in the table, suggesting a decline in national income of from 3 to 5 per cent. Between December 1939 and April 1940 the drop in the monthly rate of national income should be approximately double this amount, or from 6 to 10 per cent. The drop in basic industrial output will doubtless exceed that in national income. In the absence of concerted liquidation of inventories, this decline should, however, be less than the September-December advance; it may be expected that the slight increase in income-generating expenditures apart from inventories, combined with the delayed impact upon consumer outlay of the present expansion in incomes, will hold industrial activity at above prewar levels through April 1940.

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(Annual rate of expenditure, seasonally adjusted,
in billions of dollars)

	Last 4 months 1939	First 4 months 1940	Per Cent Change
Income-Generating Expenditures:			
Plant and equipment	6.7	7.1	
Housing and non-profit construction	2.6	2.8	
Foreign balance	0.5	0.8	
Government	3.5	3.2	
Consumer credit	-0-	-0-	
Subtotal	13.3	13.9	
Inventories I (passive accumulation after year end)	4.0	1.0	
Inventories II (constant after year end)	4.0	-0-	
Inventories III (concerted de- cumulation after year end)	4.0	-1.0	
Total I	17.3	14.9	-13.9
Total II	17.3	13.9	-19.7
Total III	17.3	12.9	-25.4

Statistical Note: Estimates of inventories exclude work in process and finished stocks in the capital goods field. Estimates of plant and equipment and housing and non-profit construction have therefore been compiled on an activity, "value added", or "income generated" basis, in order to reflect work in process in capital goods lines.

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