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May 27, 1949

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CURRENT ECONOMIC CONDITIONS AND THE ECONOMIC OUTLOOK*

Economic developments since last fall indicate that postwar business activity is currently undergoing a change of basic significance. The expansive and inflationary factors which brought on the postwar boom--the restocking demands of both business and consumers and the heavy demand for plant and equipment coupled with excessive liquid assets holdings and abundant credit on easy terms--have lost much of their force. The direction of the most important measures of economic activity and prices has been downward and is continuing downward. Despite recent price reductions supply is still tending to exceed demand generally and production and employment are being reduced. Even in such industries as metals and metal products, in which only a few months ago demand appeared to be exceptionally strong, there is evidence of considerable weakness.

While changed economic tendencies present a sobering outlook, the magnitude of declines which have already occurred should not be overstated. Total employment is still at a high level in spite of the recent substantial declines in manufacturing employment and hours of work. Unemployment has increased substantially but it is still not high in terms of past experience and, allowing for seasonal influences, has moderated its rate of increase since mid-February. The total value of national output in the first quarter was about 3 per cent below its peak rate of the fourth quarter of 1948. Total personal income was reduced by less than 2 per cent over this period. Total retail sales in April

* A special report prepared for the Conference of Federal Reserve Bank Chairmen by the business analysis staff of the Board's Division of Research and Statistics.

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were only about 2 per cent below a year ago. Consumer prices are moderately lower than in late summer 1948, and about the same as in May 1948.

On the other hand, many measures of activity and prices--particularly the more sensitive ones--have shown large declines. The general level of wholesale prices at the end of May was 8 per cent below the peaks of last summer but prices of basic commodities have declined 23 per cent since August and the price of steel scrap is down almost 50 per cent since early January. Industrial production in May is estimated at 11 per cent below its postwar peak of late 1948. In the first four months of 1949, bank loans declined about 1.2 billion dollars, as compared with an increase of almost 800 million in the same period last year. Loans declined somewhat further during the first half of May.

The outlook for the period ahead is for further declines in prices, employment, output, and incomes. This expectation is based not only on the pattern of recent developments but also on analysis of the major factors which brought about the postwar inflation but which are no longer operating as expansive influences. It is impossible to foretell this early the extent to which reduced expenditures and incomes will reinforce each other in a downward spiral. It does not now seem likely, however, that the recession will be as great as that either in 1920-1921 or 1937-1938, when industrial production declined by about one-third in a short period. A prolonged and drastic liquidation such as that of 1929-1932 appears quite unlikely.

The accompanying charts present a selection of business indicators with data going back several years for perspective. Data for May 1949 are estimated.

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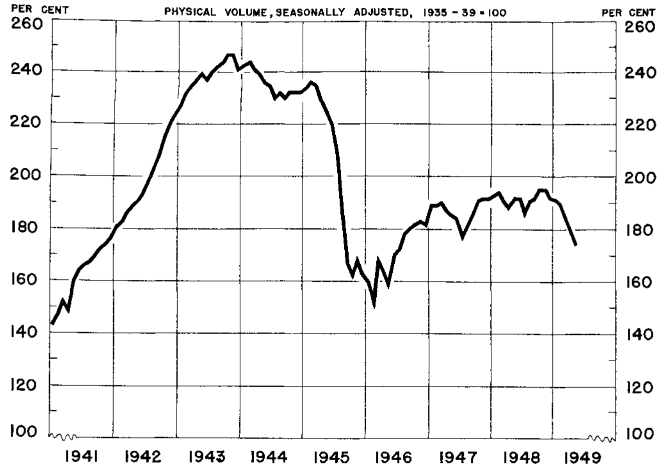
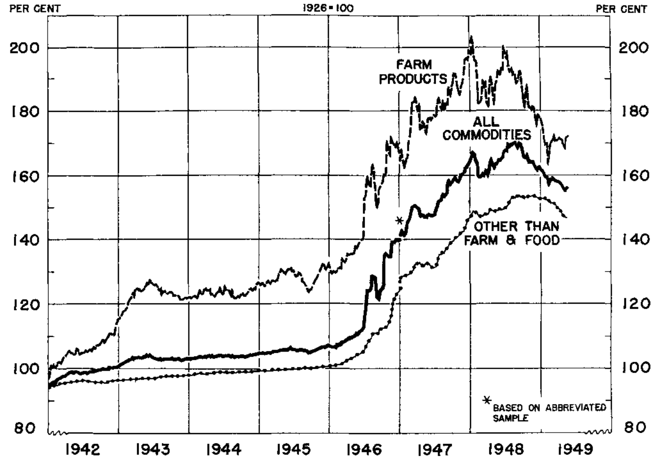
SELECTED BUSINESS INDICATORS

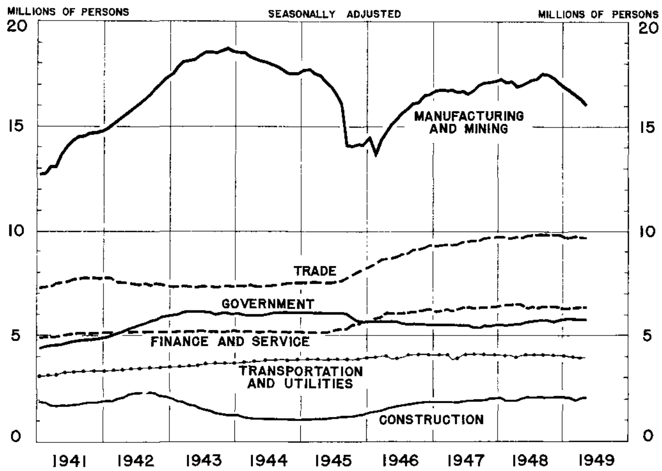
INDUSTRIAL PRODUCTION



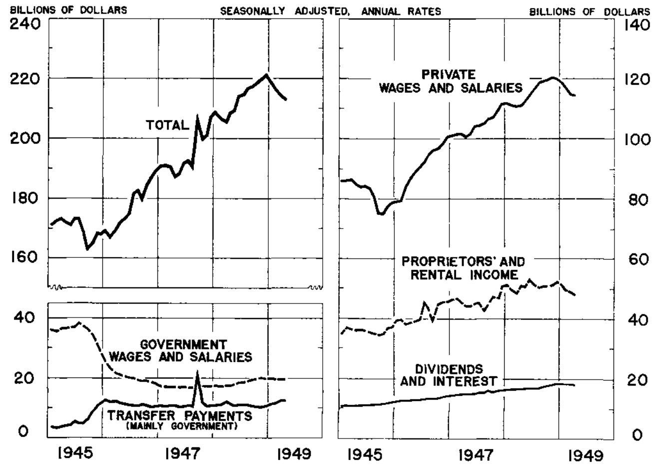
WHOLESALE COMMODITY PRICES



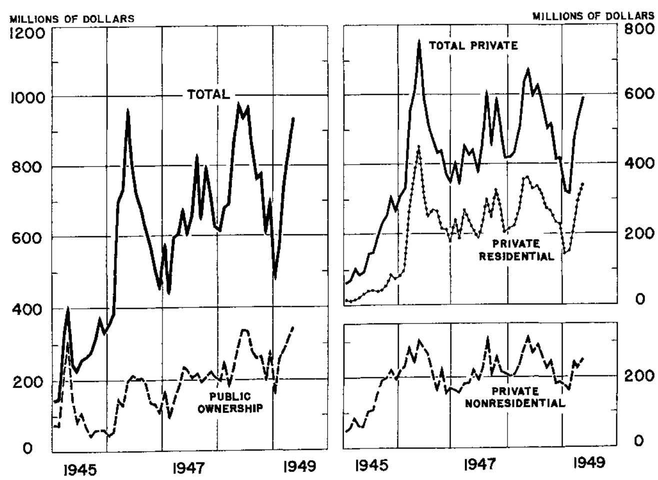
EMPLOYMENT IN NONAGRICULTURAL ESTABLISHMENTS



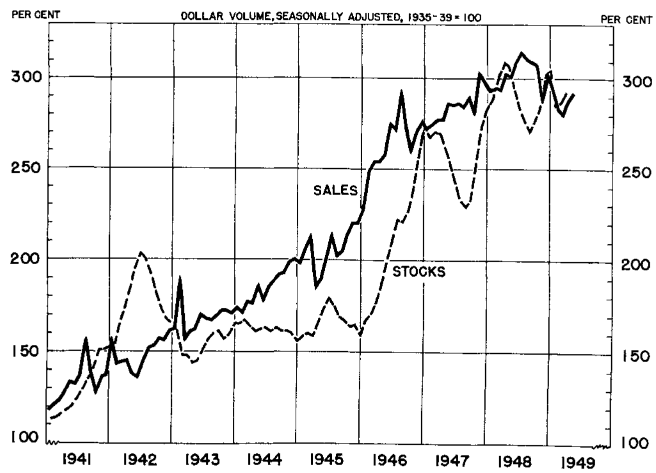
PERSONAL INCOME



CONSTRUCTION CONTRACTS AWARDED



DEPARTMENT STORE SALES AND STOCKS



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Recent Economic Developments

Most broad measures of economic activity and prices have shown declines since late last year. Thus, gross national product, which measures the total current output of the economy at prevailing prices, amounted to an annual rate of about 256 billion dollars in the first quarter of 1949, a decline of 9 billion dollars or 3 per cent from the record rate of the preceding quarter. This decline, which reflected decreases in both production and prices, was the first significant one since the end of the early reconversion period.

A considerable drop in expenditures for personal consumption, a reduction in the rate of inventory accumulation, and declines in expenditures for new private construction and producers' durable equipment accounted for lower total expenditures in the first quarter, as is shown in the accompanying table.

Consumer Income, Expenditures, and Savings

Following a relatively small increase in the fourth quarter of 1948, expenditures on personal consumption declined by almost 4.5 billion dollars (seasonally adjusted annual rate) or $2\frac{1}{2}$ per cent, the first reduction in the postwar period. Expenditures for both durable and nondurable goods declined substantially, with expenditures for services showing a small increase. While total retail sales increased about 1 per cent from March to April, they were 2 per cent below a year ago. Sales of automotive stores were $18\frac{1}{2}$ per cent above a year ago, but sales of all other store types (except drug stores) were lower.

Since the second quarter of 1947, consumer expenditures for current consumption have not been keeping pace with personal income after taxes. Thus, from the fourth quarter of 1947 to the fourth quarter of 1948, the annual rate of total personal income increased by $16\frac{1}{2}$ billion dollars and disposable income

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GROSS NATIONAL PRODUCT AND PERSONAL INCOME

Seasonally Adjusted - Annual Rates
(In billions of dollars)

	1st quarter 1949	4th quarter 1948	1st quarter 1948	1947	1941
Gross national product--total	255.9	264.9	244.9	231.6	125.3
Government, total	40.1	41.5	30.5	28.0	24.7
Federal	23.5 1/	25.2	16.7	15.6	16.9
State and local	16.7	16.3	13.7	12.3	7.8
Gross private domestic investment, total	37.7	42.8	38.0	30.0	17.2
New construction 2/	13.5	14.7	14.3	11.7	5.7
Producers' durable equipment	22.0	22.7	19.8	17.8	7.7
Change in business inventories	2.2	5.3	3.9	.6	3.9
Net foreign investment	1.5 1/	- .4	3.9	8.9	1.1
Personal consumption expenditures, total	176.6	181.0	172.5	164.8	82.3
Durable goods	21.5	22.9	21.3	21.0	9.8
Nondurable goods	101.4	105.1	101.4	96.5	44.0
Services	53.7	53.0	49.8	47.3	28.5
Personal income	216.6	219.6	207.0	195.2	95.3
Disposable income	197.8	199.4	183.9	173.6	92.0
Personal savings	21.2	18.4	11.4	8.8	9.8

1/ The decline in Federal expenditures and the increase in net foreign investment from the fourth quarter of 1948 to the first quarter of 1949 largely resulted from a change in the financing of foreign aid rather than a significant change in the basic situation in either component.

2/ Recent revisions in the figures on new construction have not yet been incorporated in this gross national product table.

Source: U. S. Department of Commerce

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(i.e. income after personal taxes) by $18\frac{1}{2}$ billions. Consumption expenditures, however, increased by only 10 billions. In the first quarter of 1949, personal income declined by 3 billion dollars to an annual rate (seasonally adjusted) of 216.6 billions. Disposable income declined by only 2 billion dollars, but expenditures for current consumption declined by $4\frac{1}{2}$ billions. The sharpest decrease in personal incomes took place in wage and salary receipts, as a result of lower levels of employment and hours of work. Income of farm proprietors was also reduced but, aided by the Federal support program, farm income was little changed from a year ago. Personal income declined further in April and probably in May, as well.

The result has been a steady increase both in the aggregate amount of personal savings and in the proportion of disposable income accounted for by savings. In the first quarter of 1949, savings amounted to almost 11 per cent of disposable income, the highest figure since late 1945 and an exceptionally high figure in comparison with most prewar periods. The sustained increase in this ratio in the past 2 years probably represents--at least in its more recent stages--a reduction in the willingness of consumers to spend on current consumption at prevailing high prices. Insofar as these increased savings are used to build up individual holdings of liquid assets or to reduce debt and are not channeled indirectly into new private investment expenditures they represent a net decrease in the total volume of private demand.

Available statistical evidence does not indicate any important shift towards greater concentration of income in the hands of higher income groups, such as would of itself account for the sustained increase in personal savings.

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Preliminary results of the 1949 Survey of Consumer Finance, not yet made available for public information, show the following findings with respect to the distribution of income in 1948.

1. Slightly more than half of all consumers had higher incomes in 1948 than they did during 1947. This was by a slight margin the highest proportion of spending units reporting year-to-year increases in income shown by any of the surveys to date.

2. Higher incomes in 1948 were more frequently reported by units whose 1947 incomes had been below $4,000; declines were suffered most frequently by those with 1947 incomes of $4,000 or more.

3. As a result of the general increases in income, 47 per cent of all spending units received more than $3,000 last year, as compared with 42 per cent during 1947. Approximately 3.5 million more consumers had incomes above $3,000 in 1948 than a year earlier, and about 2.5 million fewer had incomes under $2,000.

Construction

New private construction in the first quarter declined 8 per cent from the preceding quarter and 3 per cent from a year ago. A further drop occurred in April but an increase took place in May. Residential construction showed a marked decline in the first quarter but in both April and May showed an encouraging improvement. In the first four months of 1949, the number of new residential units started was almost 13 per cent fewer than a year ago. However, the increase from March to April this year was slightly larger than the sharp increase in the same period of last year. Public construction has continued to increase strongly and has maintained the total volume of construction activity above the comparable periods last year. Costs of construction and prices of building materials have declined somewhat from their peaks reached in 1948.

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Inventories

In the fourth quarter of last year, nonfarm business inventories were accumulated at an annual rate of 4.1 billion dollars. A substantial portion of this was probably involuntary representing the failure of sales to come up to expectations. In the first quarter of 1949, such accumulations amounted to only 1.4 billions, primarily as a result of determined efforts on the part of many producers to curtail inventories which appeared excessive. An important feature of inventory accumulation since late 1947 has been the sharper increase in manufacturers' holdings of finished goods than of purchased materials or goods in process. Meanwhile, new orders placed with manufacturers have been declining.

Employment

The postwar expansion of employment came to a halt in the fall of 1948. Since then, the demand for labor has declined while unemployment and part-time employment have increased. At 3.0 million in April the number unemployed was almost double that of last October. Part of this increase in unemployment was seasonal in nature but the major cause was the greater-than-seasonal decline in nonagricultural employment and particularly in manufacturing employment.

Seasonally adjusted employment in nonagricultural establishments in April 1949 was 1.6 million less than in October and was more than $\frac{1}{2}$ million less than in April last year. Moreover, many more persons were working part-time than a year earlier. The reductions in employment since last fall have been very widespread and have been reported in practically all major manufacturing and nonmanufacturing industries.

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EMPLOYMENT IN NONAGRICULTURAL ESTABLISHMENTS
(seasonally adjusted)

Industry division	April 1949	Increase, or decrease (-), from: Oct. 1948-April 1949	
		Number of workers	Percentage
	(in thousands of persons)		
Total wage and salary employees	44,026	-1,643	-3.6
Manufacturing	15,357	-1,191	-7.2
Nonmanufacturing	28,669	- 452	-1.6
Mining	918	- 21	-2.2
Contract construction	2,005	- 96	-4.6
Transportation	2,694	- 142	-5.0
Public utilities	1,258	- 1	- .1
Trade	9,688	- 129	-1.3
Finance	1,717	- 23	-1.3
Service	4,626	- 15	- .3
Government	5,763	- 25	- .4
Federal	1,894	- 19	-1.0
State and local	3,869	- 6	- .2

Note: Bureau of Labor Statistics estimates of full- and part-time wage and salary workers in nonagricultural industries, adjusted for seasonal variation by Federal Reserve. Figures for April 1949 are preliminary.

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Although declines in employment since last October have been general, the largest relative reductions have been concentrated in manufacturing industries and in transportation and construction. These industries frequently respond more quickly and sharply to changing economic conditions than many other major segments of private employment such as trade, service, public utilities and finance. Nonmanufacturing activities as a whole declined by less than 500,000 or about 1-1/2 per cent between October and April with some reductions reported in every division. In contrast, manufacturing employment was 1.2 million or 7 per cent lower in April 1949 than in October 1948. Average hours of work have also declined sharply. The combination of lower employment and hours of work resulted in a decline of over 11 per cent in total man-hours worked in manufacturing in April as compared with October of last year. The reduction in factory man-hours has been very widespread among the industries as shown in the accompanying table. Durable goods industries as a whole reported almost 14 per cent fewer man-hours of work in April than in October of last year while nondurable goods industries reported 9 per cent fewer.

Between early March and the middle of May unemployment compensation claims showed little change, partly as a result of seasonal increases in employment in outdoor activities offsetting further filing of claims by workers layed off in some other activities. Although unemployment has remained fairly level since mid-February it is likely to increase again by summer as new workers enter the labor market in large numbers after the school term is ended.

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PERCENTAGE CHANGES IN MAN-HOURS WORKED IN MANUFACTURING INDUSTRIES

Industry group	Percentage decrease (-), April 1949 from: October 1948
All manufacturing	-11.4
Durable goods	-13.6
Nonferrous metals and products	-18.0
Lumber and basic timber products	-17.8
Machinery, except electrical	-15.6
Iron and steel and products	-15.1
Electrical machinery	-14.9
Furniture and finished lumber products	-13.7
Stone, clay, and glass products	-12.6
Transportation equipment except automobiles	- 5.6
Automobiles	- 3.8
Nondurable goods	- 9.2
Textile-mill products	-19.0
Rubber products	-15.7
Tobacco manufactures	-14.2
Miscellaneous industries	-14.0
Paper and products	-11.3
Leather and products	- 9.8
Chemicals and products	- 8.3
Food	- 4.9
Apparel and finished textile products	- 2.4
Printing and publishing	- 2.4
Petroleum and coal products	- 1.7

Note: Based on Bureau of Labor Statistics data on the number of production workers, adjusted for seasonal variation by Federal Reserve, and average weekly hours of work in major industry groups. April 1949 figures used in computations are preliminary.

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Weakening in the labor market and the reductions in living costs since late last summer has been reflected in wages. Average hourly earnings in manufacturing declined slightly from a peak $1.38 an hour in January, largely because of curtailment of over-time **premiums.** Weekly wages were also reduced owing to the reduction in average hours of work, and at $52.62 in April they were $2.39 below the end of 1948. Recent wage settlements have tended to be made on the basis of no increase or fairly moderate increases in rates.

Decline in Industrial Production

Industrial production has declined 11 per cent since last November, according to the Board's seasonally adjusted index. The index was at 195 per cent of the 1935-39 average in November and is estimated at 174 in May.

The decline has been general throughout manufacturing and mining. Activity decreased in 17 of 19 major industry groups, in most cases substantially. Output of durable and nondurable manufactures each declined 11 per cent, and minerals, 10 per cent. Changes between November and May are shown in the table.

Although declines in industrial production have been general, reductions in output in four groups--the textile, machinery, chemical, and fuel groups--have accounted for two-thirds of the drop in the total index since November.

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INDUSTRIAL PRODUCTION

(seasonally adjusted)

	May 1949 (1935-39 = 100)	Percentage change to May 1949 from November 1948
Industrial production, total	174	-11
Durable manufactures	205	-11
Machinery*	231	-16
Lumber and products	125	-14
Nonferrous metals and products*	163	-13
Stone, clay and glass products	187	- 8
Transportation equipment*	220	- 8
Iron and steel*	212	- 5
Nondurable manufactures	158	-11
Textiles and products*	123	-25
Alcoholic beverages	169	-22
Paper and products*	144	-15
Rubber products*	176	-13
Chemical products	226	-12
Petroleum and coal products*	206	- 9
Printing and publishing	147	- 5
Tobacco products	162	- 5
Leather and products	102	- 1
Foods	163	+ 3
Minerals	144	-10
Crude petroleum*	155	-12
Coal*	130	-12
Metals	126	+ 4

*Same as unadjusted. Changes shown (mainly for textiles) may be affected by seasonal influences which were not important under earlier shortage conditions.

Note: May figures estimated.

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The decline of 25 per cent in textile output has reflected mainly very sharp curtailments in the wool and rayon textile industries, mostly since February. Activity at cotton mills has shown a more moderate decline since November, when output had already been reduced 25 per cent from earlier postwar peak rates to a rate about 20 per cent above prewar.

The decline of 12 per cent shown for the chemical group reflects in large part a sharp cut-back in rayon staple fiber and yarn production, as a result of reduced production of rayon textiles, and a decline in output of industrial chemicals.

Crude petroleum output has been curtailed 12 per cent since November and coal production has been similarly reduced. Last autumn fuel stocks had already been built up and export demand had declined. Subsequently, domestic demand was reduced, owing in part to unusually warm winter weather. Gasoline production has been reduced only moderately.

Production of many types of electrical machinery and other machinery has declined, with the sharpest curtailments at factories making consumer durable goods, such as washing machines and vacuum cleaners. Production of agricultural equipment and heavy equipment for public utilities has continued at peak levels and output of machinery generally, although down about one-seventh since November, is still very high relative to prewar.

In addition to declines in these four groups, there have been marked reductions in activity in many other industries, notably the lumber industry, iron and steel and nonferrous fabricating industries, and at paper mills.

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Passenger automobile production in April was at the highest level of the postwar period, while output of trucks and busses and of replacement parts was below earlier peak levels. In May, a strike at plants of a major automobile producer has reduced activity in this industry substantially. In railway equipment lines, output has continued at a very high rate although, in the case of freight cars, very few new orders have been placed in recent months and the large order backlogs have been sharply reduced. Activity in the aircraft industry has continued to increase as a result of the large volume of orders for military planes.

Output of pig iron and steel during the first quarter of this year was about 4 per cent above the November rate, and at the highest rate on record. In April open hearth steel production declined 3 per cent while electric steel output was curtailed sharply by over 20 per cent. Steel production has continued to decline in May, and the latest weekly scheduled rate of 94.1 per cent of rated capacity compares with the actual March rate of 102.7 per cent. Apparently steel consumption has been declining in recent months and the current rate of steel output appears to be in excess of consumption.

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Recent Price Developments

Since August, prices of basic commodities have declined 23 per cent, all commodities at wholesale 8 per cent, and consumers' prices 3 per cent. Price changes have generally been downward since the beginning of the year, as shown in the table. For farm products and foods, however, marked price declines in January and the early part of February were followed by some increases which raised the general index of wholesale prices and contributed indirectly to a slight rise in consumers' prices from February to April. The index of wholesale prices for the week ending May 17 was 156 as compared with 162 in the last week of December.

The most significant recent development has been the reversal in the metal markets, where price advances persisted through most of 1948. Since December metal scrap prices have dropped about one-half from the exceptionally high levels prevailing at that time. Also, prices for copper, lead, and zinc have fallen sharply and some reductions have been made in prices of iron and steel. The substantial character of actual and prospective price declines under competitive conditions in the metal field has discouraged buying activity and accentuated declining trends in metal processing activity.

At the same time decreases in prices of other industrial goods have tended to become larger and more widespread, but for the most part current prices are still close to the peak levels reached under shortage conditions arising out of the war. Despite recent price reductions many disparities in price and cost relationships remain. Thus, for example, the price of copper, although reduced by about one-fourth in recent weeks, is still

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CHANGES IN PRICES

Group	Percentage decrease to May 17, 1949 from: Dec. 28 1948	Aug. 1949
Basic commodity prices (28 items)	-18	-23
General wholesale index:		
Total	- 4	- 8
Farm products	- 3	-10
Foods	- 5	-14
Other commodities	- 4	- 4
Textile products	- 5	- 7
Fuel and light	- 5	- 4
Metals and products	- 3	- 2
Building materials	- 4	- 5
Consumers' prices	- 1	- 3
Food	- 1	- 6
Apparel	- 5	- 5
Rent	+ 1	+ 2

Bureau of Labor Statistics data; consumers' prices for mid-month periods; May estimated by Federal Reserve.

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high in relation to aluminum. Steel scrap prices are $24 per ton below pig iron prices as compared with a differential of $4 last December and $5 before the war. Cotton prices, at existing Federal support levels, are far above cost of production levels. The current level of cotton prices is 2 1/2 times the prewar level, while prices of acetate staple fiber and silk are at prewar levels. Raw fine wool prices are much higher relative to medium grades than they were before the war and prices of worsted yarns and fabrics are at exceptionally high levels. Prices of pulp wood and timber, although below postwar peaks, are far above prewar levels and the influence of these inflated values is evident in the building materials, furniture, and paper industries.

Business Profits and Financing

The financial position of business corporations considered as a group is still very strong by prewar standards, though it is not quite as strong as a year ago. The dollar volume of corporate liquid assets on hand -- cash and U. S. Government security holdings -- has changed only slightly since early 1947 with a large increase in sales despite large expenditures on inventories, receivables, plant, and equipment. The current interest burden of corporations is also still much lighter than it was before the war despite the large rise in business borrowings from banks and insurance companies during the past few years.

Recent decreases in prices, production, and sales have resulted in a drop in business profits. Corporate profits before taxes are estimated to have declined from a seasonally adjusted annual rate of almost 35 billion dollars in the fourth quarter of 1948 to about 30 billions in the first quarter

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PROFIT MARGINS OF LARGE CORPORATIONS IN SELECTED INDUSTRIES

Ratios of Profits before Income Taxes to Sales or Operating Revenues

(In per cent)

Industry	1949	1948			
	1st Qtr. 1/	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.
Manufacturing - total	14.3	14.1	13.9	14.3	14.9
Primary metals and products	15.2	12.0	11.3	13.2	14.8
Autos and equipment	14.0	13.2	12.9	14.8	14.8
Machinery	11.0	12.0	12.0	10.4	13.1
Food and kindred products	10.7	11.5	12.1	11.7	12.1
Chemicals and allied products	19.7	17.8	17.7	18.4	19.6
Petroleum refining	16.0	20.6	19.3	17.5	16.1
Electric utilities	23.8	23.6	20.8	18.4	20.5
Railroads	5.6	6.4	12.1	15.5	12.9
Telephone	9.3	10.5	11.3	10.0	10.4

1/ Partly estimated.

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of 1949. This is about the same level as a year ago despite the fact that there were inventory losses this year in contrast to large inventory profits a year ago. For most industries the ratio of profits before taxes to sales in the first quarter of 1949 was as large or larger than in the first quarter of 1948 and only moderately below the level of the fourth quarter of last year, as is shown in the accompanying table.

Of the external funds obtained by business corporations thus far this year, security financing through private placement with insurance companies and public sales of new issues to individuals has increased relative to bank borrowing. Total corporate security financing during the first half of this year may be only slightly below a year ago. Business corporations as a group, however, will probably reduce their bank indebtedness by well over one billion dollars, or 10 to 15 per cent, during the first six months of 1949 as compared with practically no change in such indebtedness during the comparable period of last year.

Business loans of banks have dropped sharply during the first five months of this year, and the contraction has been more general as well as sharper than during the first half of 1948. The volume of business loans is currently below the level of a year ago, in sharp contrast to the experience of the previous three years when it increased significantly from year to year.

Should the recent declines in prices, production, and sales continue, business investment, both in dollar and physical terms, will decrease further. Plant and equipment expenditures will decline and inventories may be liquidated rather than increased. Business internal funds would also decline considerably

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because of smaller undistributed profits. New security and bank financing, however, would fall even more sharply than internal funds because of the decline in total business expenditures.

Government

Federal Government expenditures decreased sharply from the end of the war to late in 1947. At that time Federal spending started again to rise mainly on account of national defense programs and our international obligations. This rise was fairly steady from the latter part of 1947 to the end of 1948. A major part of the increase occurred in the purchase of goods and services from industry and individuals. In the fourth quarter of 1948 such expenditures were at an annual rate of about 9 billion dollars higher than a year earlier. This was almost equal to the rate at which all private expenditures for goods and services increased.

In addition, the Federal Government also exerted, through various other programs and policies, strong upward influences upon the expenditures of other sectors of the economy. Grants-in-aid to state and local governments increased. Residential construction was encouraged by easy financing arrangements. The desirability of supporting the Government bond market has been a factor making for easy availability of credit for business investment. The reduction in personal income tax rates in 1948 left more income available for spending in a period in which spending was already high.

In the more recent period Federal expenditures have continued to rise and further increases from current rates are indicated. The President's Budget message of January recommended substantial increases in expenditures in

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fiscal 1950 over those in fiscal 1949. Legislative action thus far indicates that total expenditures are likely to equal or exceed the Budget message estimates.

The increases anticipated for the rest of this year, however, are of a different character and have a different economic significance than those of 1948. Federal purchases of goods and services will probably not increase substantially over present rates of such purchases. The major increases are expected in those expenditures which rise semi-automatically as the economy weakens -- such as unemployment compensation and the farm support program.

At the end of this calendar year or early next year, the National Service Life Insurance Fund is expected to pay out large sums as dividends although the amount and the timing of payments is not known. This payment, particularly if it is concentrated in a short period of time, could provide an important stimulus to the economy.

As a further result of the decline in economic activity, Federal tax receipts are also expected to decline. The consequence of rising expenditures and falling receipts will be a reduction in the expected cash surplus in fiscal 1949 and a substantial cash deficit in fiscal 1950.

It is important to note that this deficit results in great part from the impingement of a decline in business activity upon our tax system and certain of our fundamental economic programs. To cut expenditures or to raise taxes in attempts to eliminate such a deficit would mean the removal of the cushioning effects that such a fiscal system may provide. Such attempts would also be partly self-defeating since the removal of this support would result

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in still lower levels of activity, employment, and income, further increases in unemployment compensation and relief payments, and further reductions in tax receipts.

State and local expenditures for goods and services have also been a strongly expansive factor in the postwar period. In calendar 1948, such expenditures were almost twice the 1945 total. In the first quarter of 1949, they amounted to an annual rate of 16.7 billions. In view of the intense need for schools, hospitals, other public buildings and roads, it is likely that state and local expenditures will continue to increase for the remainder of this year -- but probably at a lower rate than in 1948, in view of growing fiscal problems of such governments.

The Economic Outlook for 1949

Recent and current developments clearly indicate that the economy is undergoing a period of downward readjustment in business activity and prices. Statistical indicators of the current situation reflect basic changes in the nature of the expansive and inflationary factors which brought on the postwar boom. Sustained high levels of production have virtually eliminated deferred demands for most consumer goods and inventories generally have been replenished at all stages of production and distribution. Demands from abroad also are less urgent than earlier and are tending to taper off.

Business has been spending on plant and equipment at an unprecedented rate in an attempt to make up for under-investment during the war and to provide adequate capacity for meeting demand arising out of high postwar incomes. With more of the immediate postwar expansion program approaching completion, total

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business investment expenditures are likely to be gradually curtailed during 1949. Thus the latest Commerce-SEC survey estimates that planned expenditures on new plant and equipment this year will be about 5 per cent below those of 1948.

More serious in its implications that this rather moderate reduction in the total for the year is the expectation that expenditures in the second half of this year will be 14 per cent below those of the second half of 1948. For manufacturing industries the decline in capital expenditures in the latter half of 1949 is estimated at 22 per cent. Although railroad expenditures for such purposes are expected to be high in the first half year, a reduction below a year ago is indicated for the second half. Already orders for new rolling stock have been sharply reduced and order backlogs have been worked down considerably. On the other hand, planned expenditures for electric and gas utilities in the latter part of the year indicate levels 5 per cent above the second half of 1948. Even here, however, there have been some recent statements to the effect that investment plans may be cut back.

While industry is apparently planning to reduce its expenditures for plant and equipment and to curtail rather than accumulate inventories, consumers are tending to save greater proportions of their disposable incomes. Throughout 1948 disposable income increased faster than consumer expenditures and in the first quarter of 1949 consumer expenditures dropped more than disposable income declined. In both periods, the effect of these movements was to leave larger dollar and percentage margins for personal savings. Meanwhile, the direct use of personal savings for investment by farm operators and other

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unincorporated enterprises and for the purchase of new houses is being reduced while corporate investment demands are also tending downward. New security financing, bank loans to business, and undistributed corporate earnings have also been reduced since last fall. A continuation of these trends looks towards lower levels of income.

Prospective reductions in private expenditures for investment and consumption might conceivably be offset fully or in part by increased government expenditures on goods and services. In fact, since late 1947, the Federal Government has greatly increased its rate of purchase of goods and services, as has been pointed out in an earlier section of this analysis. While both Federal and state and local expenditures are expected to increase further in the remainder of 1949, such increases will be much smaller than last year and are highly unlikely to be great enough to offset prospective declines in private spending.

Taking the outlook as a whole, the prospects are, therefore, for further reductions in production, employment, prices, and incomes. The critical question which cannot be answered with any great degree of assurance -- is the extent to which falling prices, price disparities, curtailed orders, liquidation of inventory, reduced consumer spending, lower investment, and declining income may cumulate to a severe and prolonged depression.

In evaluating the prospects, however, we must take into account the many supporting factors which are now present and which should moderate the speed and limit the depth of any cumulative adjustment. Among these cushions are the following:

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As employment declines the Government automatically pays out unemployment compensation benefits which partially maintain the income and expenditures of the unemployed.

Payments under the farm support program similarly help to maintain income and reduce the dangers of unlimited price declines.

Consumer financial positions are strong as a result of prevailing high incomes and large and widely distributed liquid asset holdings. Many more consumers than ever before have substantial secondary reserves in the form of life insurance, corporate securities, and equities in homes. It should be pointed out, however, that the Board's recently completed Survey of Consumer Finances indicates that the number of spending units with some liquid assets (i.e., Government bonds, savings accounts or checking accounts) increased only slightly from early 1948 to the first part of this year. Meanwhile, the proportion of units with no liquid assets has risen from 24 per cent in 1946 to 29 per cent this year. Furthermore, on the basis of preliminary data, the median holding for those who had any of the various kinds of liquid assets showed a further decline last year to approximately the level of early 1946.

From the standpoint of providing a mass market for our mass production system, current income also is probably better distributed than in any prior time.

The Board's annual Survey of Consumer Finances shows that there continues to be a large demand for automobiles, appliances, furniture, and houses. At lower prices, potential demands for goods and services would seem to be very great. Where substantial price reductions have occurred recently, increased buying has tended to absorb previously excessive stocks. Survey data reflecting consumer attitudes and expectations show that, while the preponderant expectation is for price declines this year, few consumers expect large declines.

Business financial positions over-all are strong in comparison with prewar, and lower material costs together with increased productivity are providing additional flexibility to financial management.

While a reduction in personal incomes and housing prices may make part of our large mortgage debt vulnerable from the standpoint of the borrower, widespread use of mortgage amortization and of Government guarantees provides the lender with important protections.

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The fact that the postwar period has generally been free of speculative excesses in the securities markets, the strong financial status of industry, and the great strength of the banking system are factors that make a prolonged and drastic liquidation less likely than in other periods of decline.

It seems quite unlikely that the money supply will contract over the months ahead. On the contrary, it seems probable that Treasury deficit financing through the banks will more than offset any loan contraction which might occur, thus having an expansive impact on the money supply.

The supporting factors outlined above will be helpful in cushioning the decline. They are not, however, guarantees of sustained high levels of output and employment. What they do is to permit a transition period to be more gradual than would otherwise be the case and limit the depth of decline. In effect, this means that industry, the banking system, and government are given an opportunity to adopt appropriate policies before the decline gets out of hand. But this opportunity may be largely wasted unless appropriate actions are taken promptly.

Prices should be cut promptly and realistically in order to maintain sales volume at as high a level as possible, thereby helping to sustain both employment and income. Banks and other financial institutions should continue to make available an ample supply of credit at relatively low costs, and without undue pressure on borrowers for repayment. Government economic policy should be directed towards encouraging business and consumer expenditures, easing remaining restrictive policies affecting such expenditures, assuring the continued availability of low cost credit to worthy borrowers, and improving the economy's fiscal and financial structure.

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The accompanying charts on incomes and expenditures portray a fairly moderate set of assumptions with regard to consumer and business behavior for the remainder of 1949. They incorporate what is now known of government plans for spending together with the results of the recent Commerce-SEC survey on planned business spending for plant and equipment. It assumes further declines in prices and industrial production from current levels and that unemployment will be in the neighborhood of 5 million persons by the end of the year as compared with 3 million unemployed in April. A development of this sort assumes considerable underlying strength in the economy. It implies some inventory liquidation and further reductions in business investment and expenditures for new housing. It also implies that resulting declines in consumer incomes will not be seriously cumulative.

Under these circumstances, the Federal cash deficit might amount to 2 billion dollars in calendar 1949 and about 6 billion dollars in fiscal 1950. We must be realistic enough about this prospect, however, to recognize clearly that strong efforts to balance the budget would more likely have unfavorable than favorable consequences on the general economic situation.

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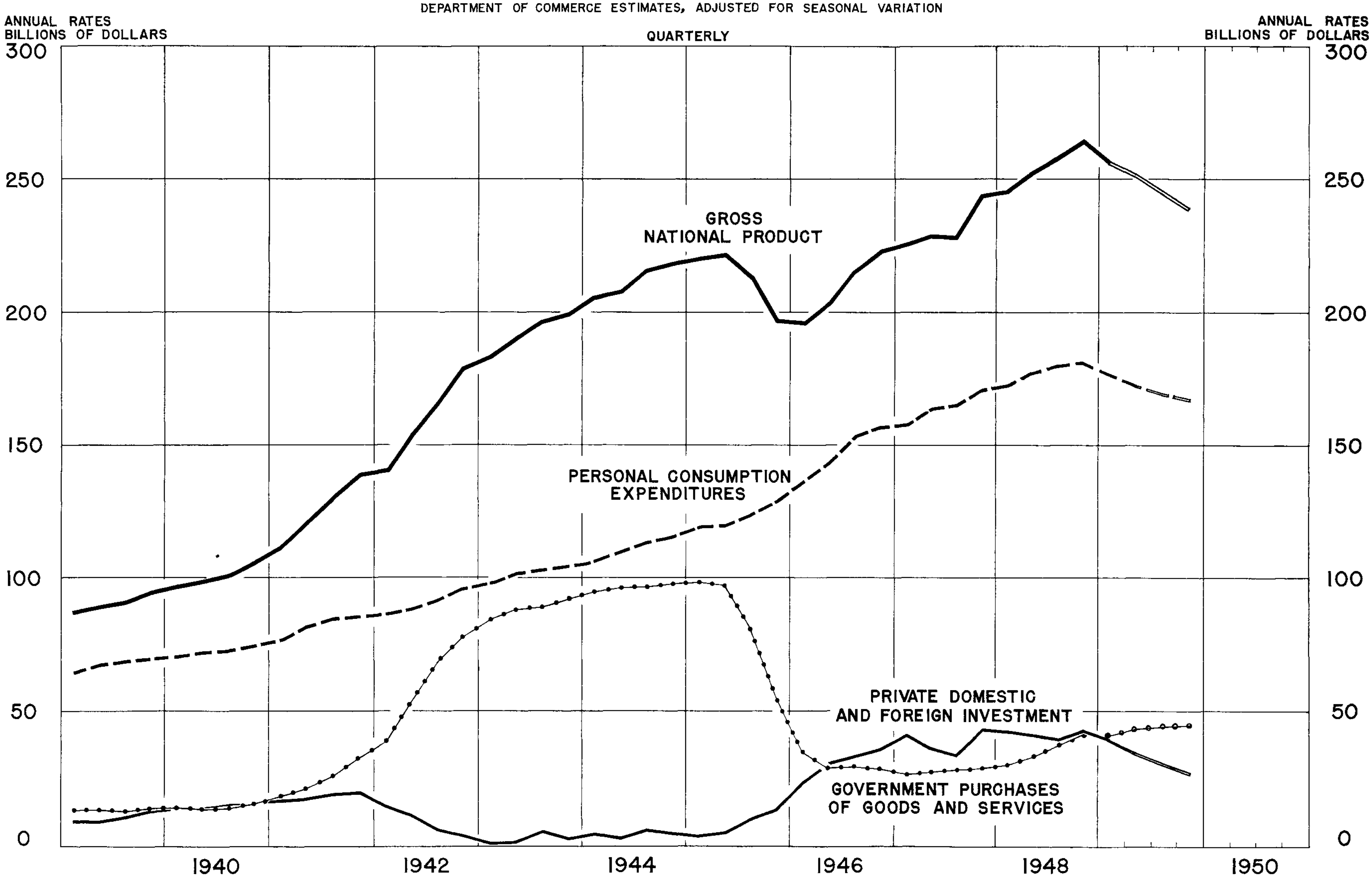
GROSS NATIONAL PRODUCT

DEPARTMENT OF COMMERCE ESTIMATES, ADJUSTED FOR SEASONAL VARIATION



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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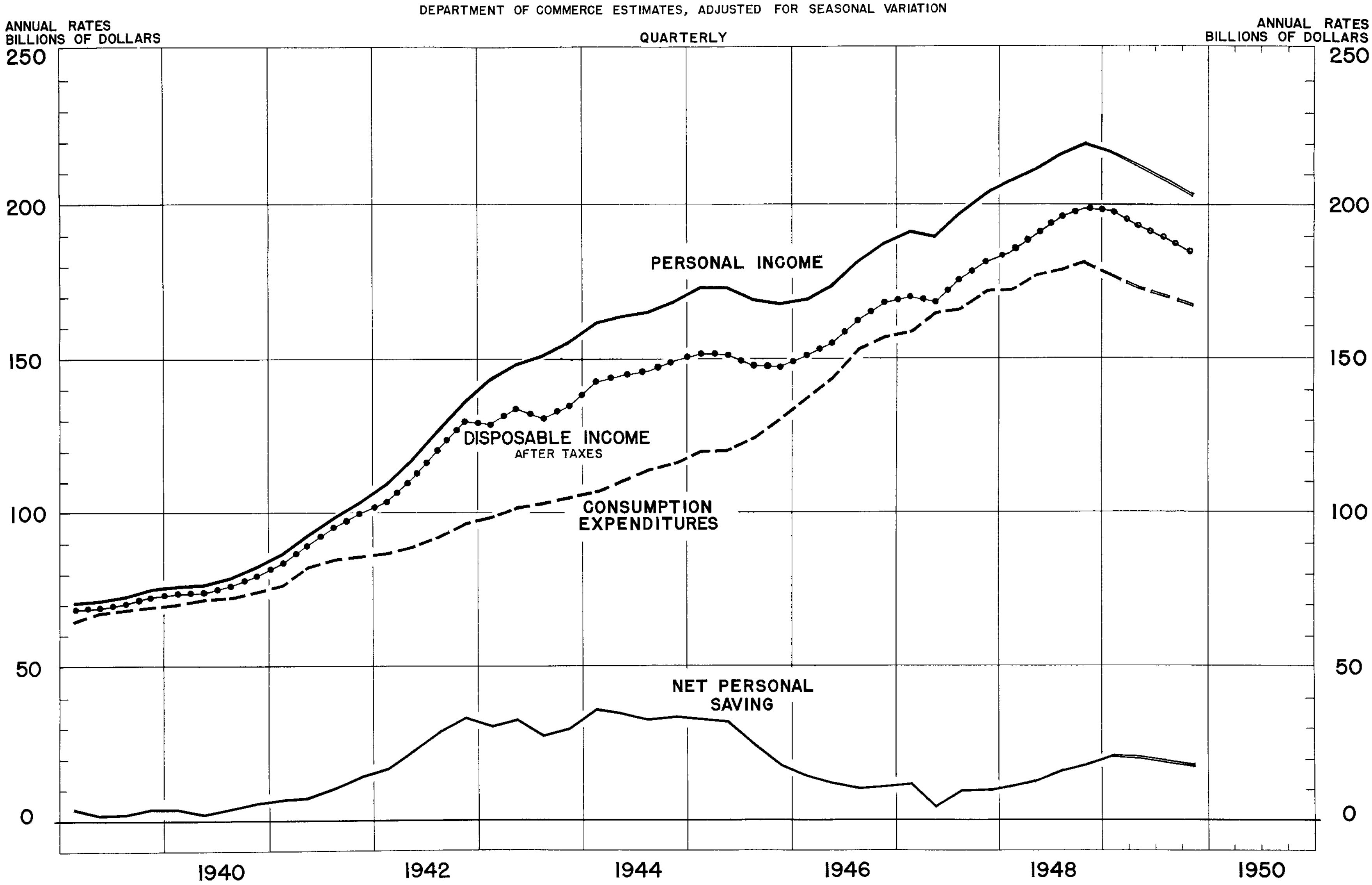
PERSONAL INCOME, CONSUMPTION, AND SAVING

DEPARTMENT OF COMMERCE ESTIMATES, ADJUSTED FOR SEASONAL VARIATION



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