THE GENERAL BUSINESS OUTLOOK

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Address by Dr. Edison H. Cramer, Chief of the Division of Research and Statistics, Federal Deposit Insurance Corporation, before the Philadelphia Chapter, American Institute of Banking, Philadelphia, Pennsylvania, October 6, 1953

I am most happy to have been invited by you to discuss a subject which is uppermost in the minds of all of us. It is somewhat surprising that you have asked a practicing economist to describe the business outlook; for we economists have compiled a record for prediction which, to put it charitably, has been something less than noteworthy.

Let me begin by commenting that this appears to be the ideal time, if we are to judge from surface indications, to predict a business depression for the near future. There are any numbers of signs to which I could point: the decline in farm prices, softness in the automobile market, the probable slackening of defense expenditures, or simply a feeling that because we have had a "boom" for so long, it is "time" for a depression. But I think the sign which disturbs most people is that during recent months officials of government, business and labor have been busily reassuring each other and us that there is no prospect of a depression. Perhaps some minor readjustments, it is conceded, but no depression. I believe I would not be far wrong in claiming that the last year in which we were favored with such unanimously optimistic predictions was 1929.

Having thus laid the groundwork for predicting a business downturn, I am going to reverse my field and say, quite emphatically, that in 1954 we shall see continued full employment and prosperity. To give substance to this prediction, I will attempt to forecast the state of nine important

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business indicators a year from now, and then show why I feel we may safely ignore the surface indications of depression which I have just described. Here, to borrow a phrase from a radio commentator, are my predictions:

1. Bank deposits. For total bank deposits, which declined more than 4 percent the first half of this year, I predict about a 7 percent rise during the second half to something more than $200 billion. They should increase about 4 percent next year, bringing the figure at the end of 1954 to about $208 to $212 billion.

2. Total deposits adjusted and currency. This series, published regularly in the Federal Reserve Bulletin, is considered by many economists as the best measure of the supply of circulating medium. Therefore, it is a more significant figure for business fluctuations than total bank deposits. At the first of the year deposits adjusted and currency were $195 billion but a decline somewhat more than seasonal reduced the figure to $192 billion in June. It should increase rapidly during the last half of the year and go above $200 billion, perhaps to $203 billion. An increase of about 4 percent is to be expected in 1954.

3. Interest rates. Interest rates will fluctuate a little, but will not depart greatly from present levels. If there is any change, I expect them to go down rather than up. To have something specific to forecast, the longest-term U. S. government bonds, the 3¼'s of 1978-'83, should not go below par but may go as high as 103 or 104.

4. Prices. The general level of prices will remain comparatively stable. The index of wholesale prices of the Department of Labor, which in August stood at 110.6 (on a 1947-49 base of 100), will not go above 114 nor below 108, and will probably have a narrower range than that. The consumers' price index, which stood in August at 115.0, on the same base period, will

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not go above 118 nor below 112.

5. Value of output of final products. This series is called "gross national product" by the Department of Commerce. In 1952 it amounted to $348 billion. For 1953, the figure will be 6 or 7 percent higher than in 1952, judging by the experience of the first half of the year. My prediction for 1954 is a further 5 percent increase, which will bring the figure to more than $380 billion.

6. Number of persons employed. The number of persons employed will increase approximately in proportion to population, and at the end of 1954 will total about 63 million.

7. Number of unemployed. This figure, which has been declining most of the time since 1949 and was down to 1.5 million in July of this year, will range between 1 and 2 million between now and the end of 1954, with the possibility of a slightly larger figure at times of peak seasonal unemployment. At no time during the period should it reach 3 million.

8. Bank failures. On bank failures, meaning cases in which the FDIC has to put up money, plus failures of noninsured banks, my prediction has a much wider margin, percentagewise. On the one hand, we might have no failures; on the other, a two or three hundred percent increase over 1952. But that is merely saying that we might have as many failures as in 1941, when there were 16. Four or five is a more probable figure for 1954.

It will not come as a surprise, I am sure, that, having made these predictions, I now begin to hedge. But as a matter of fact, I have only two "ifs" to make. The first is that my predictions will hold if we do not become

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involved in a major war. The results of such a war, in this atomic age, is beyond my capacity to predict. We would probably have little unemployment, but beyond that I have no idea what the impact would be on our economy. On the other hand, if we should be so fortunate as to have all out peace, my predictions would still stand. That is to say, I do not think defense expenditures are necessary for full employment and prosperity.

The second "if" is very different in character from the first "if". It is a positive condition--something that must be done, rather than something that must be avoided--if we are to keep ourselves on the plateau of prosperity that we are now enjoying. This condition is that the Federal Reserve banks acquire enough assets, but not more than enough, to provide an increase of about four percent per year in bank reserves, or, as an alternative, that the Board of Governors reduce percentage requirements enough so that the dollar amount of reserves is that much more effective.

Let us examine this second condition more closely since it is clearly crucial to my predictions. In requiring that the Federal Reserve authorities increase effective bank reserves by approximately four percent per year, I am in effect asking that the Nation's circulating medium, i.e., its money supply, be increased by about the same percentage. This is so because the largest part of the circulating medium consists of bank deposits. I scarcely need remind an assemblage of bankers that when bank reserves are increased banks are able to increase loans which in turn results in an increase in deposits.

Let me emphasize, however, that I am not making inflation a condition of my predictions. An increase of about four percent in the Nation's circulating medium is not inflationary. Rather, with increasing productivity

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and a growing population an annual increase of about this magnitude is necessary to keep from having deflation. If circulating medium were held constant, the productivity and population factors would make for a declining price level, something few persons would advocate. I want to repeat, as emphatically as I can, that I am not advocating inflation. I do not agree with those who say a slowly rising price level is necessary for full employment.

You might wonder why I consider growth in the volume of circulating medium an important condition. To answer I will have to describe, very briefly, a long-term research project which has been conducted by the Division of Research and Statistics of the Federal Deposit Insurance Corporation. Back in 1934, members of the staff of the Division began to gather statistics about bank failures in the past. It was soon found that in the preceding two-thirds of a century the great bulk of them had occurred during a few periods of severe business depression. With the deposit insurance assessment rate that was adopted in the Banking Act of 1935, it was clear that the Corporation would become hopelessly insolvent in the event of another serious depression. Consequently, it seemed evident that by far the most important piece of work in which the Division might engage, from the point of view of the long-run policies and problems of the Corporation, was to learn as much as possible about the sequence of events leading to business fluctuations in the past.

In 1936, therefore, a study of the causes of bank failures and the relation of banking to business fluctuations was launched. Ever since that time, this project has been pursued intermittently. Being a long range

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project looking to the future, it has repeatedly been pushed aside for work on current problems. In spite of the fact that our research staff is small and only part of its time has been devoted to this project, results have been achieved which provide an understanding of the principal sequence of events in past business downswings and upswings.

Briefly stated, the sequence of events effecting business fluctuations is as follows: changes in effective bank reserves, changes in acquisition of assets by banks, changes in deposits, changes in prices, changes in business activity. In other words, business fluctuations are preceded by fluctuations in the money supply, which in turn are preceded by fluctuations in the reserves available to banks. To use an example, this study shows that the decrease in bank deposits from 1929 to 1933 was preceded by a decrease in bank reserves relative to a reasonable rate of growth, and this was the cause of and did not result from the depression prevailing at that time. That is to say, banking instability causes business instability. This is just the reverse of the theory held by many economists who have become prominent in the last two or three decades. Perhaps that is the reason they have such a notoriously bad record in their business predictions.

I want to add that this is not a brand new theory. It is the basic economic doctrine that developed during the nineteenth century and the first two or three decades of this century. Moreover, this theory has been shared by many who were not professional economists. As some of you know from experience, bankers are blamed for depressions because of this widespread belief that the basic cause of all severe depressions originates in some way from the operation of the banking system. The contribution of this study of ours to which I refer is that it offers the first statistical evidence that this old theory was and is correct.

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Since I have already predicted that we will have continued full employment and prosperity in 1954, it is clear that I am assuming that the Federal Reserve authorities will, in fact, provide the necessary additional reserves either by acquiring assets or lowering reserve requirements. This, it seems to me, is a fairly safe assumption, judging from official statements of Federal Reserve authorities and other writings reflecting those views. That it is the policy of the Government to maintain stability in the purchasing power of money has been confirmed by Treasury officials in recent talks at the joint meeting of the Governors of the International Monetary Fund and Bank. Secretary Humphrey stated: "The stability of the dollar in purchasing power at home and abroad is fundamental in our view." Dr. Randolph Burgess, the Deputy to the Secretary of the Treasury said: "Let me call to your attention what you have all observed, that this Administration has made sound, honest money a major objective. We believe that the maintenance of honest money which retains its buying power and avoids both inflation and deflation, is essential to sound and dynamic economic growth and justice to all people--the producer, the saver, the consumer. It encourages the free exchange of goods at fair prices." 1/ These policies were reiterated at the annual meeting of the ABA in Washington last month.

In providing for stability in the purchasing power of money, Federal Reserve authorities have clearly implied that they will insure that the banks are given sufficient reserves for the job. This was indicated, for example, in a recent article in a leading financial journal several months ago. The July 15 issue of the Finance stated flatly that the Federal

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Reserve officials were assuming "that a growing economy such as ours needs an increase in the money supply of about three percent a year, in order... 'to gas the motor without exceeding the speed limit'". Additional indication of the intention of Federal Reserve officials to provide necessary reserves is found in the last annual report of the Board of Governors. There, Federal Reserve policy for 1952 is officially described as having been "designed to limit bank credit expansion to amounts consistent with the requirements of a growing economy at a high level without inflation."

Perhaps the clearest confirmation of this policy is the record since 1947. During 1952, for example, there was no change in percentage reserve requirements. But in 1952 Federal Reserve bank assets increased by 3.9 percent, member bank reserve balances by 4.3 percent (computed from December daily averages), total bank deposits by 3.8 percent, and the total circulating medium of the nation, measured by "total deposits adjusted and currency", by 4.7 percent.

Let us also take a look at current figures, using data for July in comparison with those of the same date in 1952. The increase for the 12-month period in Federal Reserve assets was only 0.4 percent, and member bank reserves (using daily averages) declined by 4.3 percent in dollar amounts. But the change in percentage reserve requirements at the beginning of July, together with changes in the proportions of member bank deposits among the categories subject to different percentages, turned this into an increase of 3.8 percent in the effective amount of reserves. The change in

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1/ American Banker, September 11, 1953, pp. 1 and 6.

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total bank deposits, according to Federal Reserve estimates, was an increase of 3.9 percent and the growth in total deposits adjusted and currency was also 3.9 percent.

In view of the record since December 1947 and of the statements of the Federal Reserve authorities and Administration officials that they will seek price stability, I am sure you will agree that there is good reason to assume that my essential condition--the provision of adequate reserves for the banking system--will be fulfilled. If I had to put it in the form of a prediction, my tenth if you will, it is that member bank reserve balances will be more than $20 billion in December of 1953 and about $21.5 billion in December of 1954. And I would remind you again that, first, such expansion depends almost exclusively on the policies of the Federal Reserve banks in acquiring assets and, second, that an appropriate reduction of reserve requirements can have the same effect as an increase in reserves; in which case the above prediction of $21.5 billion is not a necessary condition.

Since it is entirely possible that I will see some of you again in a year or so, and since I am leaving behind nine separate sets of figures with which I may be confronted when we meet, let me close with a few remarks about the relationship between the analysis of business fluctuations I described earlier and my predictions. It is possible that my predictions are wrong and that we will have an economic downturn of major proportions. If this happens in spite of an increase in member bank reserves to the extent I have assumed, then I will have to admit that my analysis of business fluctuations has been faulty. But if there is not the necessary increase in

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member bank reserves, I will apologize only for my assumption of what Federal Reserve policy would be. My predictions, it is true, will have been wrong but I will continue to maintain that they were based on a correct analysis.

There is one final point I would like you to bear in mind; and this returns us to the apparent signs of an approaching downturn with which I opened this discussion. If the Federal Reserve authorities provide member banks with necessary reserves and if my predictions turn out to be substantially correct, I would contend that this constitutes strong evidence to the effect that my analysis of the relationship between banking and business fluctuations is valid. When there is every indication of prosperity and numerous factors to which such prosperity may be attributed, it is difficult to maintain that one particular factor was causal. But when, as appears true today, the horizon abounds with apparent signs of economic downturns, when the supposed stimuli of government deficits and huge defense expenditures are clearly to become less potent, if not nonexistent, than wise monetary policy may be viewed clearly and assessed on its own merits.

If my tenth prediction is correct, then my nine predictions really boil down to just one: in 1954 it will be clearly demonstrated that correct monetary policy results in banking and business stability. If monetary policy is as important as our studies indicate, we can have an indefinite period of prosperity, without inflation, and we need never again have a long and serious business depression in the midst of vast productive capacities and unused resources.

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