

Outline of Remarks before
Convention of Wisconsin Bankers Association
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THE CURRENT ECONOMIC SITUATION

I. Introduction:

- A. For over seven years, we have been in a war and postwar boom. Thus, in the fourth quarter of 1948 when the boom was close to its peak
1. Gross national product (reflecting changes in both production and prices) was at an annual rate of 265 billion dollars as compared with 90 billions in the year 1939, an increase of almost 200 per cent.
 2. Industrial production (1935-39 = 100) averaged 194, as compared with 109 in 1939.
 3. Employment in nonagricultural establishments (seasonally adjusted) averaged 45.5 million persons, as compared with 30.3 million in 1939.
 4. Unemployment averaged 1.8 million persons compared with 9.5 million in 1939.
 5. Wholesale prices had increased by 112 per cent and consumer prices by 73 per cent from 1939.
- B. This boom appears to have come to an end late last year. This evaluation is made on the basis of both -
1. Analysis of the basic factors which caused the boom and which have now largely run their course.
 2. The fact that most measures of economic activity and prices have been generally downward since last fall or winter.
 - a. Thus, gross national product declined to an annual rate of 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 was the first significant decline since the end of the early reconversion period. A further decline of 2 or 3 per cent is estimated for the current quarter.
 - b. In May industrial production was 12 per cent below its postwar peak of last November.
 - c. Wholesale prices have declined 8 per cent (in the first week of June) and consumer prices 3 per cent (estimated May) from their peaks of late August.
 - d. While employment is still at a relatively high level, unemployment has increased substantially, amounting

to 3.3 million persons in May.

- C. Corporate profits before tax for the first quarter of 1949 are estimated to be at an annual rate more than one-seventh below the postwar record level of the 4th quarter.
- D. In the first five months of 1949, bank loans are estimated to have declined about 1.5 billion dollars in contrast to an increase of 1.5 in the same period last year.
- E. The basic questions that now confront us are -
 - 1. How severe will the adjustment or recession be?
 - 2. How long will it last?
 - 3. What actions should be taken by (a) private business and (b) Government to improve the situation?
- F. We must not overlook the fact, however, that despite recent declines employment, production, prices, and profits are still all high in relation to 1939.

II. The postwar boom was largely the outgrowth of wartime developments and policies.

- A. The length of the war and the intensity of our effort created vast postwar demands-
 - 1. For replenishment of inventories.
 - 2. For plant and equipment by industry and farms.
 - 3. For consumer durables and housing.
 - 4. For schools, roads, and other state and local improvements.
 - 5. High incomes contributed to demand for all sorts of commodities and services.
- B. The war and postwar developments also provided the financial resources to make these demands effective.
 - 1. Holdings of liquid assets were at record levels and fairly widely distributed--largely as a result of our heavy reliance on borrowing to finance war expenditures.
 - a. More than half of our wartime expenditures were financed through borrowing. From December 1939 to December 1945 the national debt, other than that held by Federal agencies and trust funds, increased by over 200 billion dollars.
 - b. From the end of 1939 to the end of 1945, personal holdings of liquid assets (i.e. currency, bank deposits, and Government bonds) more than tripled, increasing from about 50 to over 150 billion dollars.
 - 2. Incomes were high and rising.
 - 3. Profits were high and profit prospects good.

4. Credit was easily available and cheap.

- C. At the same time, the highly unsettled international situation, resulted in heavy Federal expenditures both for foreign aid, relief and reconstruction, and defense.
- D. Demand generally was in excess of supply currently available.
- E. As a result of all of these factors prices rose rapidly.

III. Since late last year, most indicators point to a marked change in the nature of postwar economic activity and prices.

- A. Reflecting the changed situation is the fact that a year ago our major immediate concern was with rising prices and measures designed to curb inflation; while currently our major concern is with declines in employment and industrial output.
- B. The magnitude of the declines which have already occurred should not be overstated, although many measures of activity and prices--particularly the more sensitive ones--have shown large declines.
- C. As pointed out earlier, gross national product declined by 3 per cent in the first quarter of this year and has probably declined further since then. The decline in the first quarter was largely accounted for by a considerable drop in expenditures for personal consumption, a sharp reduction in the rate of inventory accumulation, and declines in expenditures for new private construction and producers' durable equipment.
 - 1. Following a small increase in the fourth quarter of 1948, expenditures for personal consumption declined by almost 4.5 billion dollars (seasonally adjusted annual rate) or 2-1/2 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. Such expenditures appear to have levelled off since the first quarter.
 - a. 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 18-1/2 per cent above a year ago, but sales of all other store types (except drug stores) were lower.
 - b. Department store sales in May were about 5 per cent below a year ago.
 - 2. Nonfarm inventories were accumulated at an annual rate of over 4 billion dollars in the fourth quarter of 1948. In the first quarter of 1949 this rate dropped to about 1.5 billion dollars. On the basis of data through April, it appears that inventories are being liquidated in the current quarter.

3. Expenditures for new private construction showed a decline (at an annual rate) of more than 1 billion dollars or 8 per cent in the first quarter. In April and May, however, such expenditures leveled off, and in terms of contracts awarded which would become expenditures later, increased somewhat.
 - a. 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 May was greater than a year ago, and the number of new starts in May this year was only 5 per cent below the very high number of a year ago when they amounted to 100,000 units.
 - b. Public construction has continued to increase strongly and has maintained the total volume of construction activity above the comparable periods of last year.
 - c. Costs of construction and prices of building materials have declined somewhat from their peaks of last year.
- D. Noteworthy has been the steady decline in industrial production for the past 7 months. The Board's seasonally adjusted index is estimated at 172 in May, (1935-39 = 100) a decline of 12 per cent from the postwar peak of 195 of last November. A further substantial decline now appears highly probable for June.
 1. The declines have been general throughout manufacturing and mining, with output declining in nearly all major industry groups and with output of durables and nondurables each declining 13 and 11 per cent respectively.
 - a. Especially large reductions have taken place in textiles, machinery, chemicals, and fuels.
 2. Steel production has declined steadily. For the week beginning the 13th of June the scheduled rate was 86.7 per cent of capacity compared with the actual March rate of almost 103 per cent.
 3. Output of passenger automobiles, however, has been maintained at very high levels, except for the Ford strike.
- E. 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.
 1. Unemployment was 3.3 million in May compared to 1.6 million in October and 1.8 million a year ago. A further increase is expected in June as new workers enter the labor force from schools and as industrial employment declines further.
 2. Seasonally adjusted employment in nonagricultural establishments in May 1949 was 1.9 million less than in October and about 1 million less than a year ago.

- a. Although declines in employment since last October have been general, the largest relative reductions have been concentrated in manufacturing, transportation, and communication. Average hours of work have also declined sharply in manufacturing from 40.0 in October to 38.3 in April.
 - b. Total seasonally adjusted man-hours worked in manufacturing in April 1949 were 11 per cent fewer than in October 1948 and declined further in May.
3. Weakening in the labor market has been reflected in wages.
- a. Average hourly earnings in manufacturing have declined slightly below the December peak.
 - b. Weekly wages in manufacturing have been reduced owing to the reduction in average hours of work and in April were \$52.62 or \$2.39 below the end of 1948.
 - c. Total wage and salary receipts declined 5 billion dollars from their peak in November 1948 to April 1949, when they were at an annual rate of 133 billion dollars, and were reduced further in May, probably by an additional 1 or 1-1/2 billion.
- F. Personal income had declined by 7 billion dollars, or over 3 per cent, from its peak in December 1948 to April this year when it reached 214 billion dollars. It is estimated to decline further in May, probably by about 2 billion dollars.
- G. After reaching their postwar peaks in August of last year prices of all commodities at wholesale have declined 8 per cent, and consumers' prices 3 per cent.
1. Significantly, prices of all commodities other than farm products and foods have been declining steadily in recent months and for the week of June 7 were 5.5 per cent below their highs of mid-November last year and almost 3 per cent below a year ago. These price declines have been widespread.
 2. Prices have weakened in the metals markets this year. Since December metal scrap prices have dropped about 50 per cent. Prices for copper, lead, and zinc have fallen sharply, and some reductions have been made in prices of some iron and steel products.
 3. Prices of basic commodities have declined more than 27 per cent from August to the middle of June.
- IV. The economic developments described above seem to indicate that the postwar expansive forces have finally lost much of their vigor. Three years of high-level industrial production and more than ample harvests have converted shortages to surpluses at prevailing prices.

- A. Inventories have been adequately built up at all stages of production and distribution for practically all commodities. In fact, inventories are currently being reduced as pointed out above.
 - B. Backlog consumer demands for durables have been satisfied, except possibly for autos.
 - C. The expansion program of industry for plant and equipment are nearing completion in many cases. Thus, the 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 than 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 the second half of 1948. For manufacturing industries the decline in the second half of 1949 is estimated at 22 per cent. On the other hand planned expenditures for electric and gas utilities show increases over a year ago.
 - D. Demands from abroad are also less urgent than earlier, as the process of reconstruction makes headway.
 - E. Government--Federal and state and local--is likely to increase its expenditures on goods and services for the remainder of this year but such increase will be less than last year when private demand was more urgent than currently. Furthermore, the personal income tax reduction of last year resulted in a sharp increase in consumer income available for personal spending. This will presumably not be repeated this year.
- V. While it is clear from the recent record of major business indicators that we are in a period of downward readjustment of employment, activity, and prices, it should be stressed that the deflationary process has thus far been an orderly one.
- A. I shall not attempt to predict the detailed course of activity for the period ahead. We must remember, however, that ours is a cyclical economy and that there has been much variation in the intensity and duration of the downswings. In 1924 the downward adjustment was moderate and short. In 1920-21 and 1937-38 industrial production declined by one-third in a short period. From 1929 to 1932, liquidation was prolonged and drastic.
 - B. In appraising the prospects, however, we must take into account the many supporting factors which are present and which should moderate the speed and limit the depth of any cumulative adjustment. Among these are the following:
 - 1. Unemployment compensation benefits which partially maintain the income and expenditures of the unemployed. On the average, those covered by such benefits receive about \$20 a week for a maximum of about 6 months.

2. Payments under the farm support programs are maintaining incomes and reducing the dangers of unlimited price declines.
 3. Continued large and widely-distributed holdings of liquid assets--Government bonds, savings and checking accounts. It should be pointed out, however, that the Board's recently computed Survey of Consumer Finances indicates that the proportion of units with no liquid assets has risen from 24 per cent in 1946 to 29 per cent this year.
 4. While a reduction in personal incomes and housing prices may make a 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.
 5. 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.
 6. The current reduction of inventories has resulted in production lower than consumption in some lines and the basis is being laid for renewed buying and increased production. In this connection, the Board's annual Survey of Consumer Finances shows that demand for automobiles, appliances, furniture and houses continues to be large.
 7. Government expenditures are high and likely to increase further. It is likely that budget expenditures in fiscal 1950 will amount to about 44 billion dollars.
 8. The expected payment of over 2 billion dollars of dividends on National Service Life Insurance in the first half of next year may prove an important expansive factor.
- VI. While the cushions mentioned before will be of great help in limiting declines in activity, they do not assure high levels of output and unemployment. Both the private sector of the economy and government must adopt appropriate policies to attain this.
- A. An excessive concern with security and liquidity may well prove self-defeating. We must not forget that a major factor in the adequate working of the free enterprise system is the willingness--even the eagerness--of businessmen to assume risks.
 - B. A bold approach should be taken towards reducing costs and prices. Prompt and realistic price reductions--even if they require reduced profit margins--would help maintain sales and thereby both incomes and employment.
 - C. Banks and other financial institutions should continue to make available an ample supply of credit at relatively low cost and

without strong pressure on borrowers for repayment.

- D. Government policy should be directed towards encouraging business and consumer spending. In part, this may be accomplished by expanding Government expenditures and by appropriate tax policies, such as reductions in excise taxes. Declines in economic activity are likely to result in a Federal cash deficit for fiscal 1950. We must be realistic enough about such a prospect to realize that drastically cutting expenditures or raising taxes in an effort to prevent a deficit would be partly self defeating since they would probably result in still lower levels of activity, employment, and income, further increases in unemployment compensation and relief payments, and further reductions in tax receipts.