Remarks before
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Since the end of the war we have attained the objective of high levels of employment. Nevertheless there has persisted a widespread uncertainty as to our ability to sustain these levels. Our fears stem, in part, from our experience in the thirties and from the knowledge that recurrent boom and recession have always been characteristic of our economy. Especially are we afraid that the inflation of the past few years has set in motion forces that will eventually make a downturn both inevitable and severe.

We are beset by conflicting interpretations of the present and expectations of the future. We are apprehensive that we shall sustain further inflation. Every dip in price and every slackening in sales—whatever the commodity may be—is taken as proof that a general downturn is upon us. We also have the argument that despite the distortions which have developed in recent years the economy is fundamentally so strong that full employment, production, and income will go on more or less indefinitely, rolling over one difficulty today and another tomorrow—all the time approaching closer and closer to an equilibrium which is not defined. It is clear that the current economic situation is not a figure or a combination of figures, but an interpretation which looks both forwards and backwards.

Postwar Inflation

The war has been largely responsible both for the high levels of employment and for the inflation that characterized the postwar years. During the war, about two-fifths of our gross national product was devoted to prosecution of the war. The expenditures for war goods created consumer and business incomes for which there was no matching supply of available goods.

Had it been possible to finance all war expenditures through taxation we would have soaked up this excess of purchasing power and prevented the large-scale increase in liquid assets. Such a rigorous policy was not feasible, and the war was financed through a combination of borrowing and increased taxes, with taxes accounting for less than half the total amount raised. From December 1939 to December 1945 the national debt, other than that held by Federal agencies and trust funds, increased by 210 billion dollars. Of this increase, nearly 115 billion was accounted for by non-bank investors; about 75 billion was held by commercial banks, and about 20 billion by the Federal Reserve Banks.

Price and wage controls and rationing kept prices remarkably stable during the war, even if allowance is made for activity in black markets. But this stability was possible only because consumers and industry in general exercised remarkable restraint in the use of their income by saving voluntarily, rather than attempting to secure larger individual portions of the limited civilian output. Thus, about one-fourth of personal income after payment of taxes was saved in 1944 as compared to less than
5 per cent in 1929 and to about 7 per cent today. A very large share of these wartime savings took the form of liquid assets, i.e., currency, bank deposits, and government bonds. From the end of 1939 to the end of 1945, personal holdings of liquid assets more than tripled, increasing from about 50 to over 150 billion dollars.

After the war the economy had available for spending not only high current incomes but the large accumulation of war savings as well as exceptional access to credit. Incentives to spend were strong in view of the great backlogs of demand for both consumer and producer goods. At the same time, we had heavy responsibilities abroad both for relief and reconstruction. It simply was not possible to increase production fast enough to meet demand. Moreover, increasing production itself increases current income correspondingly.

Inflation was bred in such a war and postwar situation. Inflation means that effective demand—i.e., demand backed by purchasing power—exceeds the current supply of goods and services at prevailing prices. Prices advance in such a situation unless they are controlled and each advance generates further advances. Rising prices have resulted in rising incomes and expanding credit which have maintained a gap between effective demand and supply. This now familiar spiral of increased prices followed by increased income has been repeated again and again since the end of the war. Wholesale prices have increased about 120 per cent since 1939, consumer prices 75 per cent, and personal income 190 per cent. A very large proportion of each of these increases has come after 1945.

At the end of the war, notwithstanding all the inflationary forces, we removed such wartime controls as might have been used as transition safeguards. These included controls over prices and wages, consumer credit, material allocations, and the high levels of wartime tax. In addition, the extreme gravity of the housing shortage led to easy mortgage financing. The agricultural program resulted in price support for farm products at levels which prevented large crops from having a deflationary effect as they might otherwise have had. Desires to grant taxpayers some relief after the long years of high taxation brought tax reduction at a time when incomes were already excessively high in relation to the available supply of goods. In short, when a policy desirable for other reasons came in conflict with price stability, stability frequently was sacrificed.

Economic Importance of International Situation

Maintaining price stability would have been difficult in any event in the face of an unprecedentedly strong restocking and investment boom for new plant and equipment, inventories, construction, and consumers' durables and semi-durables with demand supported by large and widely-held liquid assets and high and rising incomes. Moreover, a disturbed postwar international situation has been superimposed on an already inflationary domestic one. Postwar has unfortunately not meant peace. Defense expenditures were cut drastically after the termination of hostilities, but they nevertheless remained far above prewar levels. More recently, the intensification of international tension has resulted in a substantially enlarged defense program, with adoption of both a Selective Service program and plans for a 70 Group Air Force. For the fiscal year ending 1949,
the expenditures for defense may run more than 1-1/2 billion dollars above those for the preceding year. The present program if fully carried out, will mean a further substantial increase in the following year.

Furthermore, the war left a large part of the world desperately in need of outside aid. This was true both of our allies and of our former enemies. Our vast foreign aid programs for relief and reconstruction reflect not only humanitarian motives but also a desire for enhanced security. By the spring of 1947, our exports of merchandise had risen to a level close to that in wartime, which included lend-lease. Since then, exports have declined more or less steadily, but are still at very high levels. Meanwhile, imports have continued to increase. As a result of these divergent movements, the excess of exports of goods and services has declined from its peak in the first half of 1947, but is still very great, amounting to an annual rate of over 7 billion dollars in the second quarter of 1948.

The continued excess of exports of goods and services has been financed in a variety of ways, but the most important has been aid furnished by the United States Government. This aid has taken the form of both gifts and loans. It has included credits on sales of surplus property and ships, loans made by the Export-Import Bank, the British loan, contributions to UNRRA and post UNRRA, civilian supplies for occupied countries, interim aid to France, Italy, and Austria, the Greek-Turkish aid program, and most recently the European Recovery Program. Loans have become relatively less important while gifts have become increasingly important. It is estimated that this country will spend or lend more than 6 billion dollars on such aid in the current fiscal year, which is close to the very high rate of the first half of 1947. A large proportion of this year’s aid represents expenditures under the European Recovery Program.

Other major means of financing the export surplus have been liquidation of foreign holdings of gold and dollar assets (which were run down by 4-1/2 billion dollars in 1947 and by about 1 billion dollars in the first half of 1948), operations of the International Bank and the Monetary Fund, and gifts and loans from private sources in the United States.

Recent Developments

Continued development of postwar expansive forces has occurred in 1948. The first quarter was one of some business hesitation, with gross national product showing no change over the fourth quarter of 1947, and with prices of many farm products breaking sharply in February. In the second quarter, however, adoption of the enlarged defense program, the European Recovery Program, and tax reduction furnished a strong upward push to the economy, and especially so since these actions were taken in a situation still characterized by excessive over-all demand. Expansive tendencies were further reinforced late in the second quarter by the responsiveness of large mass-production companies to wage demands after an earlier show of strong resistance to a third-round wage increase. After the signing of a two-year agreement between General Motors and the United Auto Workers on May 29, new wage contracts were soon negotiated elsewhere in the automobile industry and in such other key industries as electrical machinery, rubber, farm equipment, bituminous and anthracite coal, and steel. Wage increases have since spread, and are still spreading.
throughout the economy generally. Although the increases this year have been more selective and diverse than in preceding years, the average increase approximates the rise in consumer prices during the last year.

After the first quarter, further increases occurred in retail sales and consumer and wholesale prices. Gross national product and disposable income (i.e., income of individuals after payment of personal taxes) reached new peaks in the second and third quarters as business, government, and individuals all enlarged their expenditures. Unemployment has continued at a low level, below 2 million persons. The index of industrial production, which had declined in July, recovered in August, and by September was back to its June level.

Slackening in Monetary Expansion

Expansion in bank loans has continued to make a substantial contribution to total spending power, though not on quite as large a scale as last year. Loans of all banks are estimated to have increased 1.8 billion dollars between the second and third quarters, as compared to the 2 billion dollar expansion in the corresponding period last year. Though smaller in total, the second-to-third quarter growth of loans this year has followed a pattern not much different from that of last year. Increases have taken place in all three of the main loan categories—business, real estate, and consumer loans with the smaller increase this year chiefly accounted for by a decline in the rate of growth in the business category. Currently, business loans are increasing only about one-fourth as rapidly as they were at this time last year.

Incomes Increasing

Personal income continues to increase, both as a result of increasing employment and of the spreading of wage increases throughout industry. Despite the sharp drop in prices of many crops, net income of farm proprietors has been maintained at a level above the already high level of last year. The price-support program combined with the large volume of marketings prevents substantial declines in farm incomes. Personal holdings of liquid assets are still very large and are widely distributed, despite some tendency to concentration in the hands of upper income groups. Re-establishment of Regulation W has slackened the rate of growth but has not precluded the further expansion of consumer credit.

These factors—high current income, large past savings, and ready access to credit—reinforced by the continued backlog of demand for some durables (e.g., automobiles) furnish a strong basis for continued high levels of personal consumption.

Anti-inflationary Developments

Taken together, all these indicate a considerable degree of current strength. Nevertheless, there are also evidences that in some important areas supply is equalling or exceeding demand at current prices. These products include not only some finished consumer goods but some raw materials as well. As these products tend to stabilize or fall in price, they serve to relax somewhat other upward pressures on costs and prices elsewhere in the economy. Probably the most important development of this sort has been the record breaking crops of this year, which
have resulted in reduction of prices of wheat, corn, and cotton to support levels.

Possible balance or even excess of supply at current prices are also reported in connection with such products as cotton textiles, shoes, men's clothing, liquor, housefurnishings, coal, paper, and radios. There have been reports of more than seasonal weakness in prices of used cars.

It may also be noted that wholesale prices in general have shown smaller increases so far this year than in 1947. Furthermore, considerable divergence has developed in price movements of various commodities. Great strength has been shown by metals and moderate strength in such industries as building materials and fuels. On the other hand, prices of some foods, hides and leather, textiles, paper and pulp, and chemicals are close to or below their January levels.

Another possible symptom of general weakness may be read into the fact that new housing starts have declined and are below last year. The declines this year at this time may be interpreted as an indication of some softening in the market, reflecting the facts that the most urgent demands for housing have been met, and that consumer resistance to the extremely high prices charged for houses is becoming effective. Nevertheless, construction costs have continued to advance steadily and the index of wholesale prices of building materials in early October was at its peak.

General Prospects

Signs of general weakness must be watched closely, because after the great price increases of recent years, the economy is becoming increasingly vulnerable both to sharp price declines in particular areas and to the effects of such declines on credit and on business and consumer expectations generally.

It is well to remember, however, that the postwar boom has already over-ridden many deflationary forces and periods and that greater strength in some lines may well continue to offset weakness in specific lines. In the past two years we have overcome the sharp break of stock prices in the fall of 1946, the weakness in nondurable goods and trade in the first half of 1947, some reduction in new private construction in the second quarter of 1947, the sharp break in prices of many farm products in February of this year, and the large Federal cash surplus in the first quarter of this year and the use of much of this surplus to retire bank-held debt.

More important than all of these things in conditioning my thinking about current economic trends is the continued state of tension in international affairs. Our defense requirements have precluded over-all reduction in Federal expenditures. The enlarged defense and foreign aid programs adopted last spring are being carried out at an accelerating rate. Their full economic effects will not be felt until next year. Who can say that the present programs represent the peak of defense and foreign assistance efforts? Under the circumstances it would be dangerous to assume that inflationary forces have run their course. While the recent indications of moderation of some inflationary pressures are hopeful signs, the direction of most broad measures of economic activity continues
upward. All of our energies and abilities must continue to be directed
toward establishing a permanent peace without which our hopes for
achieving lasting economic stability at high levels of employment and
production cannot be realized.