A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1951 September

Contents

Wages still climbing

Higher rates increase income, put pressure on prices. Defense production makes wage-price spiral tough to stop.

WAGE AND SALARY INCOMES have outstripped price increases during the past 12 months even after allowance is made for higher taxes paid. Due to defense spending, a continued rise in individual earnings is in prospect for the balance of this year, and probably into 1952.

Does this mean an inevitable resumption of price increases? Will the pressure of high income cause consumers to bid up prices of the lowered volume of consumer goods to be turned out during the rest of this year? Or will the high inventories of finished goods and increased saving prolong the current respite from hyperactive consumer spending?

Both wage receipts and prices slowed their climb during the second quarter of this year. In fact, prices at the raw material and wholesale levels have been shading downward for several weeks. Up to now, the drops have shown up only slightly at the consumer level. Wage and salary *rates,* on the other hand, are still moving upward for many workers in smaller plants and for salaried employees quite generally.

The advance in *total* wages and salaries since Korea has come from two sides, raises in pay and more people working longer hours. Thus, it would be incorrect to assume that each individual's income has risen more than the prices of the goods he buys. For factory workers, *average weekly earnings* have gone up 11 per cent during the last year, while prices were rising 9 per cent. For some other groups of workers, such as those in trade, finance, and government employment, earnings have increased less sharply.

Other segments of income have accompanied wages and salaries in the upward climb. Rents, dividends, interest payments, and profits of unincorporated business (including farmers) have risen also. Except for dividends, they probably will continue to rise during the period ahead since both rents and interest rates have been rising in recent months.

Wages and inflation

The controversy of recent years as to whether price increases or wage increases initiate the inflationary spiral is relatively pointless. Prices are determined by various demand and supply factors, one of which is wage costs per unit of output.

In boom periods, many firms find it possible, because of the high level of demand for their output, to raise prices to offset increases in unit costs arising from wage increases. However, this is not always true. Often investment in new and more efficient labor-saving equipment has minimized the impact of higher wages on costs.

Whatever the effect of wage increases on costs, the wage increase may serve as a signal to the firm to raise its prices in response to rising demand in prosperous times. When price controls are restraining price increases in response to this higher demand, an increase in unit costs due to wage increases or to an increase in any other costs is used to justify price adjustments.

Since unit costs vary according to the level of output, manufacturers covered by price control will try to obtain maximum price increases in response to cost increases in order to maintain customary profit margins in the event production is cut back to accommodate the defense program. Moreover, a price increase at the manufacturing level normally tends to become still greater by the time the product reaches the consumer, since the jobber's, wholesaler's, and retailer's markups are applied to a higher base price.

Not only do increased wages tend to push up unit costs and hence prices under a system of price controls, but they also provide many consumers with funds to pay higher prices. In an inflationary situation, wage increases, like any cost increases, have this double-barreled effect upon prices, since a rise in costs to one person is an increase in income to another. The higher income augments demand in general. When the increases in costs and demand become so widespread that the upward movement is self-generating, we are in the familiar income-price spiral.

In an economic system based on free markets, raises in wage rates in defense and defense-supporting industries—primarily durable goods manufacturing—can help to attract workers to these industries, either shifting them from less essential employment or encouraging people who previously were not seeking work to accept jobs. However, the higher costs and increased demand resulting from the rise in wage payments both push and pull prices upward, especially since the increased wage receipts are not offset by increased consumer goods output.

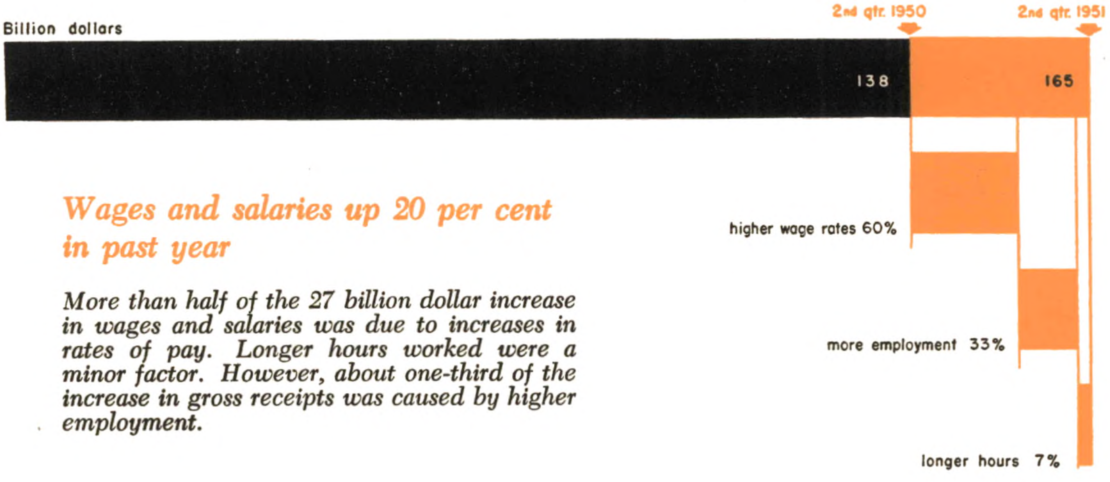
To a considerable degree, it was the realization of the combined impact of cost and income increases on prices which caused Congress to provide that wage stabilization should accompany price control. The post World War II experience demonstrated the difficulty of attempting to administer price controls in the absence of restraints on increases in costs and in demand. Today, with rising incomes and limited output of consumer goods—and with the need for attracting workers to defense industries—those responsible for price and wage controls face a continued series of dilemmas in their efforts to restrain inflation and increase production.

Efforts at wage stabilization

From the beginning of the Korean conflict, the hazard of inflation has been recognized—and talked about. But also, from the start it has been clear that disagreement as to the extent to which inflation could be held down while increasing defense production, and lack of accord as to the kinds of controls to be used would severely limit achievement of inflation control.

Most of the wage rise of the last 12 months took place before administrative controls on wages and prices had been implemented. The Defense Production Act was enacted September 8, 1950, but the wage freeze did not go into effect until January 25, 1951. During the interim consumers, fearing shortages, were clamoring for goods, and prices were advancing rapidly. At

—continued on page 13

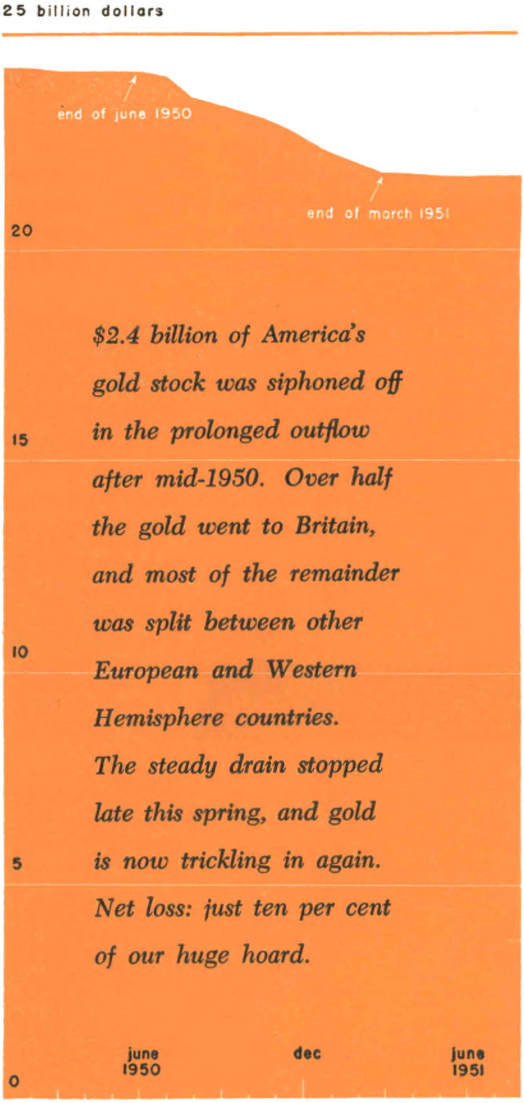


Wages and salaries up 20 per cent in past year

More than half of the 27 billion dollar increase in wages and salaries was due to increases in rates of pay. Longer hours worked were a minor factor. However, about one-third of the increase in gross receipts was caused by higher employment.

Gold: out and in again

After a nine-month exodus, our gold is staying home once more. One reason has been the changing confidence in the world's currencies.



IN THESE TIMES of endless uncertainty and dreary international prospects, Americans have clung to every available evidence of stability. Gold, and more specifically the mountainous rock of gold under Fort Knox, was one such evidence. Although not available to any citizen, it has long been regarded as a symbol of this country's wealth, prestige, and dependability. That it is more than a symbol became apparent early last year when signs of erosion in the rock began to appear. Gold had suddenly begun to melt away. Once the war in Korea got under way, the outflow accelerated to a record clip, and in the nine months between June 1950 and March 1951, our gold stock dropped by some 2.4 billion dollars.

Just as some observers were beginning to sound the alarm, the situation abated. In April and early May the gold outflow slackened. Since then no further loss has occurred; in fact, there has been a slight gain in recent weeks. And at the present time the country's gold hoard stands at a healthy 21,759 million dollars—far in excess of legal requirements for monetary purposes, and still representing almost two-thirds of the world's monetary gold supply outside Russian borders.

There's more than meets the eye

To talk of gold flows as such is obviously a case of putting the cart before the horse. For gold movements are far more a result than a causative factor. In a sense they simply "bring up the rear" in the net total of international transactions. Sales by U.S. exporters give us claims against foreigners. Purchases by U.S. importers give foreign interests claims on us.

Through the complex "clearing house" of international exchange mechanisms, these claims are balanced out against one another; and, if more of this country's foreign trade consists of imports rather than exports, foreigners as a group will usually wind up owning an increased total of deposits (dollar balances) in our banks.

On top of these trade transactions, investment and gift operations also shift ownership of funds across national borders. For example, American purchases of foreign securities, or U.S. oil company construction programs abroad, or Marshall Plan grants will all, at some stage, increase the total of foreign-owned bank balances in the U.S.

It is only with respect to whatever American bank balances they have left after these trade, investment, and gift operations that foreign nationals have the ultimate choice—either of allowing such dollar deposits to lie idle for a rainy day, or of exchanging them for gold.

Why did the outflow occur?

For four years after the end of the war, foreign governments had been selling gold to the U.S. Treasury in a mad scramble for necessary dollars to buy goods in this country. By early 1950, much of the outside world had been able to achieve some kind of recovery—assisted in part by U.S. aid. Most foreign currencies had been devalued to more realistic levels, and dollar earnings in world trade picked up. As a result Governments abroad found themselves in a position to buy back a little of the gold they had previously sold to us.

In the months after the start of the Korean war, the U.S. trade surplus began to dwindle very rapidly. Our exports rose, but imports increased even faster. Plunged into a program of heavy stockpiling and rearmament, we started big scale buying of foreign raw materials. Prices of these materials zoomed. As a result, foreign dollar earnings, particularly by less-industrialized countries, ran high. Still-sizable grants of foreign aid funds added further to total dollar earnings abroad.

—continued on page 12

Higher savings slow sales

Liquid asset holdings jumped after sales leveled in March. Consumer decisions on buying and saving will go far towards determining the extent of inflationary pressure in the next year.

SINCE LAST MARCH merchants have watched with some concern the development of a strange phenomenon. Incomes of consumers continued to rise, but their expenditures declined substantially. As a result, a widening gap—considerably larger than normal—separated these measures. Once more the public was exercising its right to behave contrary to the manner in which historical statistical relationships indicate they should behave. As retailers contemplated their heavy stocks of goods, two questions were uppermost in their minds: Where is the extra income going? How long will the situation continue?

The hazy prospects for the future of prices during the present emergency stems largely from the uncertain nature of consumer decisions regarding the disposition of their incomes. If saving (unspent income) continues at the rate of recent weeks, there is a good prospect for a continuance of relatively stable prices. If, on the other hand, spending begins to assume a more normal relationship to income after taxes, there will be a strong resurgence of inflationary pressures.

In June, personal income topped one-quarter trillion dollars on a seasonally adjusted annual rate basis, following a steady rise from the first of the year. During the same period retail sales fell 11 per cent.

Higher taxes cannot be blamed for this divergence, since individual tax payments in the first quarter considerably exceeded those of the April-June period. The explanation lies largely in a stepped-up accumulation of liquid assets. When demand was satiated temporarily by the huge volume of purchases which were made during the two waves of scare buying, individuals began to add to savings at a rate somewhat reminiscent of World War II.

Where is the money going?

Despite the widespread warnings of further decline in the value of the dollar, most consumers turned to traditional savings media as repositories for their growing total of unspent income. In only a minority of cases did individuals invest their funds in such "inflation hedges" as common stocks, the commodity markets, or farm land. The usual savings forms–which include currency, bank deposits, life insurance, and savings and loan shares–do not fluctuate in value with changes in the price level. But the great mass of savers are not sophisticated investors. They are unfamiliar with equities or lack the volume of funds necessary for adequate diversification. Under these circumstances the bulk of the increased savings have shown up in larger liquid asset holdings, and will doubtless continue to do so.

During the second quarter the largest increase was recorded for time deposits in commercial and mutual savings banks. These rose by 700 million dollars in contrast with negligible gains in the preceding three months. Net additions to savings and loan shares in this period were larger by 300 million dollars. Life insurance equities increased slightly, and there was some increase in contributions to pension funds. Among the more important forms of liquid assets, only Treasury bonds continued to lose ground.

One short-term effect of the increase in liquid asset holdings was a resurgence of strength in the bond market as institutions acquired additional funds to invest. In July, the downward trend in bond prices was reversed and yields on long-term Treasury bonds decreased by as much as six basis points. Unspent personal income not channeled to savings institutions is extremely difficult to trace. Some consumers used their money to pay off personal debt. Some of the increased currency in circulation in the second quarter may have been retained by individuals. Personal checking accounts are not reported separately, but there may have been some shift in the ownership of demand deposits from corporations to individuals. Finally, inventory accumulation by unincorporated business was substantial and these acquisitions constitute one form of personal savings.

Savings bonds hit hard by inflation

The E-bond has continued to serve as the whipping boy for the "protect yourself against inflation" talk. This failing, of course, is common to all types of savings payable in a fixed dollar amount. Judged in comparison with other savings media, E-bonds stand up well since they combine safety, liquidity, and relatively high yield. Nevertheless, redemptions and maturities have continued to exceed sales by a substantial margin all through the post-Korea period.

If savings grow substantially during the coming year as production of civilian goods is restricted, there may be some return to the savings bond. In the meantime, however, the more vigorously promoted media such as savings and loan shares and life insurance appear to have been successful in weathering unfavorable commentaries on savings payable in fixed dollars.

Spendable income up,
but spending down . . .

	Personal income after taxes	Consumption spending	Personal saving
1946	158.9	146.9	12.0
1947	169.5	165.6	3.9
1948	188.4	177.9	10.5
1949	186.4	180.2	6.3
1950	204.3	193.6	10.7
1951: Jan-Mar	217.5	208.2	9.3
Apr-Jun	222.8	201.7	21.1

Note: annual rates in billions of dollars.

The consumer holds the key

Never before has the average American had so much income to spend as he sees fit. Seldom before has he been so free to determine whether this income should be allocated to spending or saving. This situation—which will be of great importance in the course of economic events during the emergency—rests upon a number of factors.

First, there is less inducement than formerly to attempt to gain security through savings since there is little fear of unemployment. Incomes are high and will rise further as Government spending moves up and individual earnings are increased. In addition, savings already accumulated are large and widespread.

Second, a larger portion of consumption expenditures, currently, are postponable than was true a decade ago. More income is going for durables, nonessential nondurables, and services. For example, in 1939, 10 per cent of consumption expenditures were for hard goods; in 1950 the proportion was 15 per cent. The possibility of cutting back such purchases was illustrated in the second quarter of this year when durable retail sales dropped far more proportionately than did sales of nondurables. The bedrock of consumption spending is food, housing, and essential services. This leaves a wide band of income which may be used for less necessary purposes.

Third, the current flow of funds to savings media is not of a contractual nature and could be reversed in a brief interval. Only in the case of life insurance premiums, mortgage and installment credit repayments, and in a minor portion of the purchases of savings and loan shares are these payments of a compulsory nature.

Fourth, substantial quantities of most types of goods will continue to be turned out in the years ahead if all-out war is avoided. In World War II, by contrast, many of the larger durable goods were not made at all and these outlets for spending were closed. As a result savings bounded upward. Today, the situation is more fluid and less predictable. The goods will continue to be available, but not always in the quantities desired.

Savings rate above normal in second quarter . . .

	Per cent of disposable income saved
1935-39 average	4
1941-45 average	20
1946-50 average	5
1951: Jan-Mar	4
Apr-Jun	9

Fifth, as a result of high production in the post-war years, "backlogs" of consumer durables created by the war and depression have largely given way to a replacement market.

How long can it last?

As we have seen, the current flow of funds to liquid savings and debt repayment could be greatly reduced or even reversed should buying psychology change. A resumption of the general price rise, and a genuine appearance of shortages could easily set the buyers off once more.

At the present time, the very savings the accumulation of which brought respite from inflation constitute a threat to price stability in the future. The high degree of liquidity inherent in most forms of savings to which Americans are entrusting their ready cash makes it possible for consumer buying far to exceed current income. Under these circumstances a higher rate of savings can be only a temporary answer to the inflation problem. A more stable solution would emphasize higher taxes, greater production, and more permanent savings forms.

On the other hand, if it is true that saving will not continue at present rates, little credence can be given to fears voiced in some quarters that business will slide downward from present levels. Prospective defense spending precludes any important decline in individual earnings, and an analysis of past trends indicates that spending is likely to climb higher relative to income.

THE Trend

A "WAIT AND SEE" ATTITUDE dominated business plans during the past month. There was a persisting slowness in some lines of retail trade and a further slackening in consumer goods orders and production.

The probability of shortages next year has not yet moved consumers to increased purchases of durable goods. The higher savings rates during the second quarter indicate that they can do so if and when the inventory and price outlook seems to warrant it. A moderate upturn has occurred in soft goods sales, however, particularly apparel.

Automotive cutbacks in the Eastern Michigan area have not yet been matched by defense production gains. The inauguration of the Controlled Materials Plan (CMP), in addition to faltering new car sales and some work stoppages, brought a locally important lull to this section. Retail sales and bank debits there have declined relative to the rest of the District.

For the balance of the Midwest, business continued at high levels but still lacked the inflationary evidences of earlier months. It now looks like strong upward pressures won't reappear at the trading level before the fourth quarter of the year unless a renewed international crisis comes. On the other hand, important declines in general business are not expected.

Production of steel in the Chicago District continued at peak levels as output of many other kinds of goods dropped off. Steel operations were in excess of 105 per cent of rated capacity in this District, as compared with about 102 per cent for the entire nation. Automobile and appliance production was further reduced. Television output edged down even more, and this decline showed up in sharply reduced operations at furniture shops which make TV cabinets. Output in the District's highly important farm equipment plants eased off, partly in response to slackened demand and high finished inventories, and also because of rising defense production and one large work stoppage.

Output for defense expanded but at a slower rate than most people expected. Many Midwest firms having substantial parts subcontracts are moving into scheduled output at a rapid rate, but production rates for assembled products, such as aircraft motors, tanks, military vehicles other than trucks, and jet engines are increasing much more slowly. Technical production problems and coordination difficulties seem to be the chief causes of the slowness.

Employment in many factories of the District declined, but the layoffs were offset to some extent by seasonal increases in food processing plants, and new hirings in defense plants. As a result of the layoffs, labor markets have eased in all major Midwest centers except Davenport-Moline-Rock Island and Indianapolis. The easing is not sufficient, however, to alleviate the two principal areas of shortage: machinists, engineers, and draftsmen for defense plants; and stenographers, typists, and clerical workers in the traditionally lower-paying establishments.

Labor-management disputes increased during the month. A total of approximately 50,000 workers have been idled by strikes in District factories during recent weeks. Kinds of production affected by work stoppages have been automobiles, tractors, freight car wheels, and paper boxes, with wages the principal item of dispute. Cities affected: Peoria, Detroit, South Bend, Hammond, Chicago. Developments of the last few days indicate progress toward solution of the present stoppages. Nevertheless, the combined effects of wage stabilization, higher taxes, and intermittent layoffs because of material shortages set the stage for further unrest in the months ahead.

Inventories of District department stores declined only slightly during the past month despite accelerated sales promotion programs. Stocks of hard goods, in particular, continue to be very

OF BUSINESS

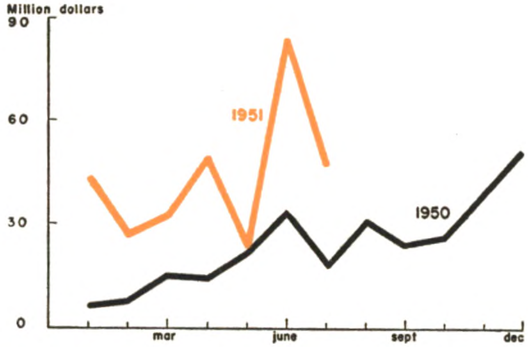
large. Trends in sales, inventories, and orders in Seventh District department stores are about paralleling those for all such stores in the nation. Relaxed credit terms did not stimulate sales immediately, here or elsewhere.

Bank debits declined during July by about six per cent in the 50 leading centers of the District. The decline was partly seasonal but in addition reflected longer vacation shutdowns, material shortages, and lessened sales and orders. Leading Michigan cities registered declines somewhat larger than the average for the District. Total debits for the District were 1.4 per cent above last year, reflecting the inflation and the rise in general business which has taken place.

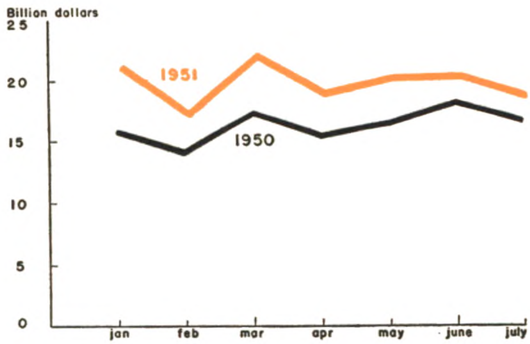
Construction contract awards for commercial and industrial building in this section continue high and assure a high level of activity throughout the year. Nevertheless, the recently changed NPA rulings resulting from the tightening in structural steel—among the most critical of materials at the present time—probably means a sharp decline in industrial and commercial awards during the next few months. Chances are good that the high current activity will be followed by a sharp drop in this type of building.

Farm real estate values continued the rapid rise which started early last year. The advance from April to July was approximately two per cent. This was less than the January to March change, but the rise is substantial in view of the fact that farm real estate values normally change slowly. The number of transfers remains at a low level and this probably results in an understatement of the rise in values. Crop prospects continue good although the effects of floods and cool weather probably will reduce corn output somewhat.

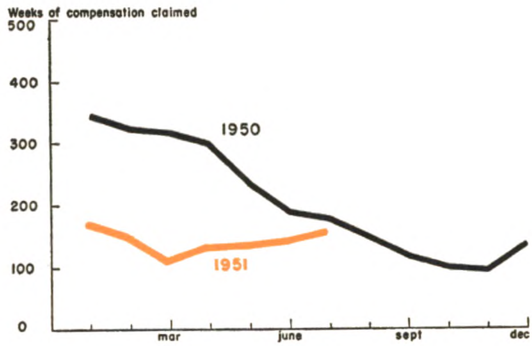
Contract awards *for new District factories above last year*



District bank debits *dip, but still high*



Claims filed *for unemployment still low in Midwest*



Controllers curbed

New Control Bill is weaker but most features remain the same. Consumer credit terms are eased and many firms can qualify for price increases.

Now that the dust has settled following the battle for a new Defense Production Act it has become apparent that while some features of the control machinery have been altered, the basic design remains unchanged. Priorities and allocations, price and wage ceilings, selective credit controls, and special authority to speed defense production are with us for at least another year.

Certain important obstacles, however, have been placed in the path of price and consumer credit regulators. Proponents of stronger controls were soundly trounced by those who prefer greater reliance on price adjustments during the emergency. Modifying amendments already are being considered, but unless serious new international or domestic problems arise, the whole issue will not be reopened until next June 30 in the midst of pre-election politics.

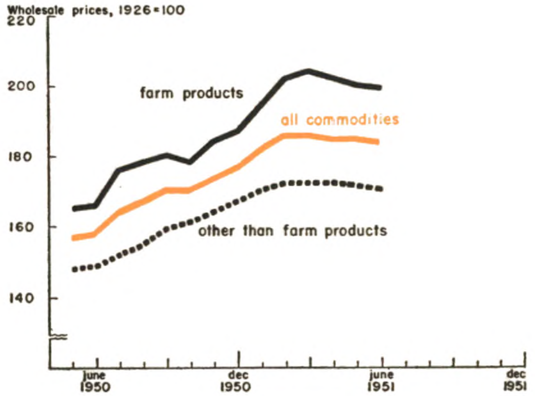
The adequacy of the new Act to deal with problems of inflation will continue to be a subject for debate. Almost immediately after enactment, however, a number of requests for price adjustments were filed to account for higher costs. Perhaps the current state of the retail and wholesale markets will prevent many processors from taking advantage of leaks in the ceilings.

Are controls necessary?

Few observers doubt that inflationary pressures will be strong, as defense spending continues to mount from the current annual rate of over 35 billion dollars to an estimated 65 billion in mid-1952. Administration leaders insist that much stronger controls than those provided in the new Act are needed to meet this threat to stable prices.

Whatever its shortcomings, the new Defense Production Act was the result of a vast expenditure of time and effort. During the six weeks ending August 1, Congress concentrated its efforts on this measure. The original Act was extended one month to permit final points of dispute to be ironed out.

Prices could start upward once more



Many congressmen would willingly have solved the whole problem by throwing out the control mechanism. After all, most prices have been stable or tending downward since March. However, the warnings of such men as Charles E. Wilson and General George C. Marshall together with the possibility of political repercussions which might follow another out-of-bounds price rise sufficed to keep the controls alive. It was considered desirable to keep the administering agencies functioning even though controls might not have been needed at the moment. Price ceilings cannot be turned on and off by Government fiat. Enforcement requires a large, well-trained staff which cannot be recruited overnight.

Adjustments will be upward

The main changes in the control law require relaxation of regulations in those cases in which Congress felt the administrators had been too tough. The Capehart "anti-rollback amendment" rules out any price ceilings which do not reflect "direct and indirect" cost increases since Korea. Agricultural products cannot be pegged lower than parity or 90 per cent of the May 19, 1951 prices—whichever is higher.

Definite limits were established on the severity of instalment credit terms (see Table). Not only are down payments and maturities eased, but trade-ins will henceforth be permitted as part of the down payment on household appliances, furniture, and where appropriate, in connection with home repairs and improvements.

Previously, consumer credit terms were entirely at the discretion of the Federal Reserve Board. Since the first of the year instalment credit outstanding had declined by more than one-half billion dollars. Some congressmen were perturbed at the "inflexible" manner in which the Board had used its authority in view of the large inventories in the hands of dealers.

Controls will always be extremely difficult to administer properly in a predominantly free economic system, even when controlling agencies are working under flexible directives. In the case of consumer durables covered by Regulation W, the supply and demand situation changed greatly between the summer of 1950 and the period in which the new control bill was under consideration. How will the picture appear next fall and winter?

Will it work?

The fact that *all* cost increases from Korea to last July 26 must be considered in computations under the present law greatly increases the already formidable accounting problems involved in price control. Almost equal difficulties are inherent in the provision that wholesalers and retailers be allowed their "customary" markups. It was the obvious intent of Congress that profitable operations should be possible for every type of good covered by a ceiling.

The Act states that all increases in costs excepting those determined to be "unreasonable and excessive" must be allowed. This type of investigation takes up most of the time of the Bureau of Internal Revenue's staff of agents. OPS investigators have an even greater task. They must determine whether costs are proper in relation to *particular prices.*

The procedure involved in setting new ceilings makes any further price rollbacks extremely

—continued on page 15

Instalment credit terms eased

	Before . . .		After . . .	
	Down Payment	Maturity	Down Payment	Maturity
Automobiles	33⅓%	15 mo	33⅓%	18 mo
Television and home appliances	25	15	15*	18
Furniture and floor coverings	15	15	15*	18
Home repairs and improvements	10	30	10	36

***Trade-in included in down payment.**

Gold *continued from page 5*

Many of the countries that came out on the long end in these months took the opportunity to restock their monetary reserves by exchanging a portion of their dollar earnings here into gold. But other motives also added to gold's allure. Expectations of currency changes made many dollar-owners restive. Rumors of upward valuation of foreign currencies were rife, particularly in the case of the Canadian dollar, the British pound, and the Mexican peso. Speculation on such developments led to sizable transfers of funds by both foreign and domestic interests out of U.S. dollars and into these foreign currencies. Ultimately, these transactions necessitated some residual settlement in gold.

Aggravating this "hot money" movement was the widespread anticipation of substantial relative inflation in the U.S. This encouraged conversion of available dollar balances into gold or into currencies which promised to retain a more stable real value.

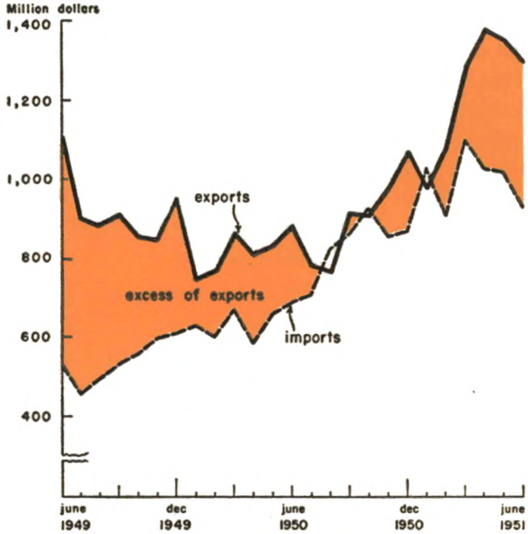
In the nine months after mid-1950, three-quarter billion dollars in gold was actually shipped abroad. Twice as much, however, was simply placed under earmark, i.e., purchased and deposited in the Federal Reserve Bank of New York to be held in trust for the appropriate foreign account. In total, countries in the sterling area were on the receiving end of over half the gold bought from our monetary stock.

Why did it stop?

As the spring of 1951 passed, one after another of these factors lost their punch. United States trade exports rose rapidly, as foreigners with higher incomes and dollar earnings began to find it easier to acquire our goods. For one thing, there had been some earlier relaxing of currency restrictions abroad. For another, the easing of sales at home began to make room for increased export shipments by U.S. firms.

At the same time, U.S. grants of funds for economic purposes were on the wane, while new funds for defense aid were not yet moving abroad in significant volume. Furthermore, price

Changes in our merchandise exports and imports have been a big factor in gold movements



tags on the world's raw materials began to drop, partly because of cutbacks in our stockpiling program. As a result, our purchases of foreign commodities pumped out fewer dollars. All these factors combined to boost our trade surplus once again.

Meanwhile, dollar balances began to reassume some of their former luster as the prospect of profits through changes in currency values faded. In only one important case, that of the Canadian dollar, had such a change actually occurred, and once the new market value was reached, the incentive for further movements of funds to Canada was reduced. The worsening in the British trade position stifled most talk of upward revaluation of the English pound. Most important was the real and psychological impact of the intensified anti-inflationary campaign in America—ranging from the introduction of price and wage controls in January to the Treasury-Federal Reserve "accord" in March. With dollar prices more stable, foreigners had fewer "purchasing power" worries about whatever dollar balances they were still able to acquire. The demand was once again for American goods, not gold.

Pros and cons

Nobody likes to give up gold, and our gold loss last fall and winter disturbed many people. Some observers, concerned over the battle against inflation, noted one helpful effect: the anti-inflationary reduction in bank reserves which necessarily accompanied the drain. Actually, considering Federal Reserve open market policy over that time, the gold outflow probably had relatively little *net* anti-inflationary effect on reserves. It merely absorbed bank funds which otherwise could have been mopped up by additional Federal Reserve sales of Government securities.

A far more important and longer-run advantage to this country stemmed from the resultant strengthening of the monetary reserves of important friendly nations. Their need for future U.S. loans and grants was lessened, and their financial positions were buttressed at a time when the whole free world was being subjected to increased political and economic strains.

Similarly, the recent cessation in the gold drain out of this country is not an unmixed blessing, for one of the causes of this reversal has been a deterioration in the trade positions of some nations in whose economic strength we have a major stake. One certain advantage has appeared, however, in connection with the recent change in gold movements. Speculative and "scare" shifts of capital funds, which aid neither the individual countries involved nor the flow of international trade in general, have diminished.

World War II experience suggests that some gold loss may reappear in the near future. Rearmament programs, swinging into high gear both here and abroad, are likely to involve somewhat more U.S. spending and lending abroad than foreign spending here. As a result, moderate increases in dollar balances held by foreigners should occur, and it is only natural to expect that a modest portion of this increase will be converted into gold.

Wages *continued from page 3*

the same time, many industries granted wage increases through escalator clauses, direct negotiations, and in some cases on managements' initiative. However, by the time the wage freeze had been announced, the consumer price level was six per cent higher than when war broke out. Numerous companies, some of them defense-supporting, had not provided for wage increases and were in a poor position to retain workers.

Realizing this situation, the Wage Stabilization Board (WSB) determined that increases up to 10 per cent—since January 1950—would be permitted for those wage and salary workers who had not already received increases of at least that amount. In addition the Board held that escalator clauses in existence prior to January 25, 1951, would continue in force, even though the 10 per cent ceiling were violated.

Escalator clauses important

About three million workers are now covered by automatic cost-of-living clauses, two million of which were under such contracts before January 25. More than three million workers are covered by various types of deferred wage increases, the most common of which is a productivity adjustment. Many in this last group, of course, are included in those covered by escalator wage provisions.

The very large body of workers—mostly in the durable goods manufacturing industries—working under cost-of-living contracts has complicated the job of the WSB. The Board has found it impractical to pursue the obviously inequitable course of turning down cost-of-living increases agreed to by employers for the 40-odd million workers not covered by such formal contract clauses. WSB members agreed on August 3 to permit general increases in accord with increases in the Consumers' Price Index.

Some escalator wage clauses work both ways, but many go only upward. A common case is a provision that the contract can be opened for renegotiation if the price index falls a given amount. Thus, even if prices should drop in the period immediately ahead, there would be no equivalent automatic decline in wage rates.

Percentagewise, Seventh District workers have received increases about equal to those granted in the rest of the nation. Dollarwise, however, the increments have been larger because of the slightly higher general wage level in the Midwest. As of May 1951, average weekly earnings of manufacturing workers in Seventh District states were $70.65, as compared with a national average of $64.35.

The higher District level results from the predominance of durable goods industries. Such industries account for over two-thirds of the wage and salary workers employed in manufacturing establishments in the five Seventh District states, as against a national ratio of one-half.

Michigan leads the Seventh District states with weekly earnings of $74.15 per week. Illinois and Indiana are about at the District average, while Wisconsin and Iowa earnings' levels are closer to those of the nation as a whole. During the last year, however, percentage increases in Wisconsin and Iowa exceeded those in other District states.

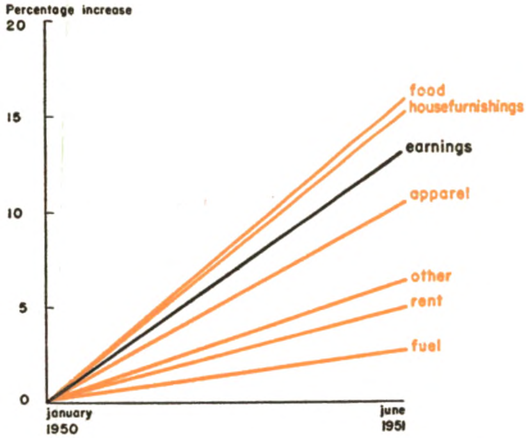
Wage rates have been more important than hours per week in accounting for the earnings' rise in the District. In other words, current higher earnings are not traceable primarily to the working of overtime.

Manufacturing leads in pay raises

Of the 3,700 District wage contract settlements reported by the Bureau of Labor Statistics to have been made between July 1950 and March 1951, about two-thirds were made in manufacturing establishments, although only about 40 per cent of all workers in the District are so employed.

The automatic nature of cost-of-living adjustments and productivity increases in the automotive and machinery industries has meant that the total increases have been greater there than in most other lines. Among nonmanufacturing workers, the building trades have led the way. As is nearly always the case, trade establishments have been slower to make wage adjustments.

Some prices advanced more than hourly earnings of factory workers, some less



About one-fourth of all negotiated wage settlements during the period in this District have included provisions for non-wage benefits, such as pensions, insurance, or hospitalization. Recently, however, wage negotiators have been concentrating more heavily upon direct wage increases than upon fringe benefits.

What of the future?

Prices have leveled off during the last two to three months. There is some prospect that present conditions will make for a temporary period of tranquility. The escalator contracts seem to be the "spark plugs" of wage movements, and they will be inoperative. Consumer psychology at the present time favors lessened demand and increased saving. With ample inventories, even the current reduced output of consumer goods should be sufficient to meet the additional demand generated by defense production income for a time. This would allow cost-price patterns to "jell" and permit a temporary period of wage-price stability.

On the other hand, the volume of defense expenditures will increase steadily, pouring out additional income. It isn't realistic to expect increased productivity and high inventories fully to offset this outflow of money, and people will not long continue to save record high proportions of their income.

Not only that, the defense program will make demands upon materials which will require a substantial reduction in the output of some consumer goods. The pressure of income with no place to go will, as always, push prices upward either legally or via the black market.

In any case, there is no expectation of a significant general decline in wages, prices, or employment. On balance, the long-run pressures are on the upward side. Renewed international tension would, of course, increase them.

Defense Act *continued from page 11*

difficult. In addition, there will be continuing requests for inclusion of additional costs, up to the July 26, 1951 cut-off date, and adjustment of ceilings. The chance that prices would be forced downward from present levels has disappeared. As a result pressure for wage increases—at least within the 10 per cent formula—will be intensified. On August 3, the Wage Stabilization Board unanimously affirmed a resolution which would permit reopening of contracts to adjust wage rates to the cost of living. Employer resistance to wage demands will be lessened insofar as these costs can be passed on in higher prices. If manufacturers obtain price increases based upon costs, it is likely that most labor groups not now covered by cost-of-living adjustment clauses will feel entitled to such treatment.

There is some indication that further powers may be granted to the controllers in special enactments. For example, bills have been introduced in both houses allowing the establishment of slaughter quotas for meat packers. Unless stringent new measures are enacted it is apparent that the law will permit a good deal of flexibility in the price level on the upside. Opponents of additional legislation maintain that this flexibility will be deflationary in the long run because production will be encouraged.

Defense bond drive under way

September 3-October 27 marks the span of the first formal campaign to sell more savings bonds to the American public since the beginning of the Korean war. No national sales quota has been set, but local drive chairmen have been authorized to establish their own goals. Aimed at stimulating systematic and regular investment through the Payroll Savings and Bond-A-Month plans, the Drive is an all-out effort to renew and reinvigorate the recently lagging savings bond program. In the past 12 months E bond redemptions, totaling 4.3 billion dollars, have exceeded sales by more than one billion dollars.

The security offered during the Drive is the familiar Series E savings bond, 35 billion dollars of which are presently outstanding. Returning 4 dollars for 3, the bond yields 2.9% if held for 10 years and a somewhat lower rate if cashed before then. It is subject to voluntary and automatic renewal upon maturity for an additional 10 years at slightly more advantageous terms.

Heavier sales of savings bonds to individuals of moderate means will help to absorb the increased income of consumers resulting from the expanding defense program. In addition, such sales will provide the Treasury with additional cash for meeting the cost of defense and reduce the need for inflationary sales of securities to banks.

Business Conditions *is published monthly by the* FEDERAL RESERVE BANK OF CHICAGO. *Subscriptions are available to the public without charge. For information concerning bulk mailings to banks, business organizations, and educational institutions write: Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago 90, Illinois. Articles may be reprinted provided source is credited.*

Loan Prospects

The District's post-Korea loan rise has been slowing down. Big question now: the trend this fall.

THE KING-SIZED FIGURES on bank loan expansion which characterized much of the post-Korea period have disappeared in recent months. Among the major loan classes, the biggest second quarter rise in this District was only 3.3 per cent; and this came, surprisingly enough, in retail auto instalment paper, supposedly the area most smitten with indigestion from the emergency diet of credit controls. The present pause in loan expansion, however, is not necessarily indicative of what lies ahead. Summer months almost always bring a lull in lending. The key to the question of a "second round" of credit expansion lies in the fourth quarter of this year.

Seasonal and Defense Needs

Several factors are sure to induce new lending by banks in the coming months. Large farm crops are going to require considerable financing, either through direct loans to farmers and commodity dealers or through crop loans guaranteed by the Commodity Credit Corporation. Other producers and distributors are also going to need some bank money in order to handle seasonally larger operations and seasonally different demands. The usable funds which they can wring out of their present high-inventory positions will not come in the precise quantities and at the exact times needed.

The steadily rising tide of defense loans is already evident. Just since March, businesses have taken nearly 75 million in borrowed funds out of the District's largest banks to finance the execution of defense contracts. Both expansion of plant and conversion of present facilities to handle defense lines tie up a lot of cash funds, and businesses will need an increasing volume of bank aid as defense programs mature.

There are some elements, of course, on the other side of the fence. The mere fact that we have been through a very rapid loan expansion means that the volume of repayments will be quite heavy. This, plus the restrictive effects of Regulations W and X, will probably hold the growth of consumer credit to a minimum and keep the continuing rise in mortgage credit within modest limits. In business loans, however, the offsetting effect of repayments is likely to be only partial. Some rise here seems unavoidable, unless the Voluntary Credit Restraint Program is unusually effective.

We have come through a record period of District loan expansion, concentrated in commercial loans, in big cities, and in big banks. When this has happened in the past, nonbusiness lending in smaller nonmetropolitan banks has generally tended to "catch up" eventually. This time the "catching up" has not started as yet. Barring the remote possibility of a repetition of the 1950 credit-price spiral, therefore, the District loan rise this fall may well be a reproduction in miniature of last year's outsized pattern.

Since Korea, District bank loans have shown differing rates of growth