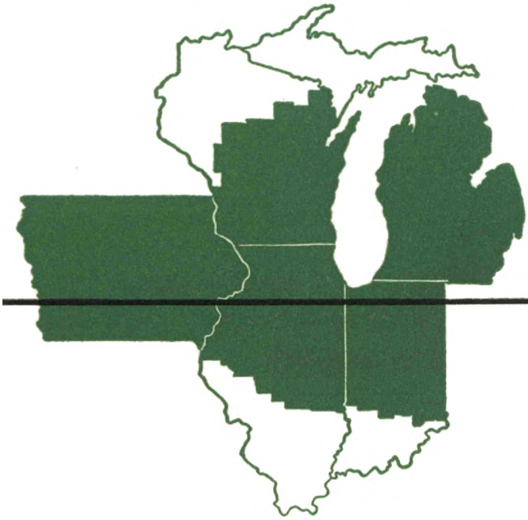
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1952 December

Contents

Instalment credit upsurge

Consumer debt has been rising at a fast clip since early spring and is now approaching an all-time high in relation to income.

FOLLOWING THE ENDING OF REGULATION W early last May has come a strong new upsurge in consumer instalment borrowing. How much of this increase in the use of credit has resulted from easier credit terms and how much may represent a basic rise in the demand for consumer durable goods cannot be determined. Whatever the causes, however, total instalment debt jumped 16 per cent between April 1 and the end of September, a rise of 2 billion dollars in six months. This gain contrasts sharply with that of the same period in 1951 when such debt rose only 200 million dollars, and is only slightly less than during the comparable months of 1950 which included the first post-Korean wave of "scare" buying.

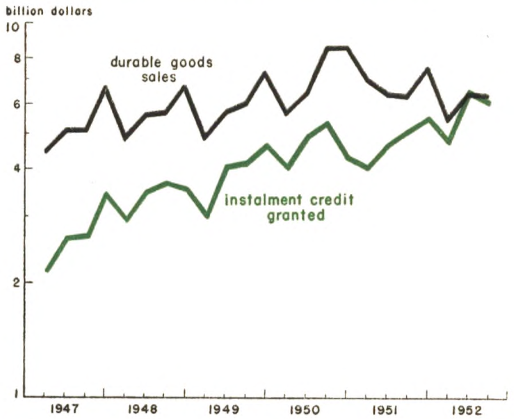
The immediate effect of this rise in instalment debt has been to add about 2 billion dollars to consumer purchasing power. Since a large part of all time-payment credit is extended for purchase of consumer durable goods, these additional funds have directly stimulated sales of automobiles, home appliances, television sets, and other durables. As a result, inventories have been reduced and production increased.

Credit expansion boosts demand

Changes in the level of instalment debt reflect movements in the two components of such debt—new credit extended and repayments on credit already outstanding. When debt is rising, the level of new credit-based demand exceeds the drains on consumer purchasing power resulting from repayments of debt. Conversely, when debt is declining new extensions of credit fall below the less volatile level of repayments. Consumers generally are most willing to take on new credit obligations when incomes are high or rising and the job outlook appears bright. When incomes and employment are falling off, however, the purchase of durable goods on instalment credit is one of the most likely candidates for "postponement" in any attempt to trim the family budget. Consequently, changes in the level of instalment debt tend to accentuate fluctuations in consumer buying as business activity and aggregate income rise and fall.

Since April, new credit extensions have spurted sharply upward while repayment volume has risen only slightly. Suspension of Regulation W contributed to these diverse movements in two ways. First, easier credit terms probably attracted new marginal buyers and made possible an upgrading in the quality

Consumer instalment credit extensions have increased greatly relative to sales of durable goods



The proportion of durable goods sales financed with credit is not this large, since a substantial amount of instalment credit is extended for other purposes. In addition, durable goods expenditures as reported include only dealers' mark-ups on used cars.

of merchandise purchased without a corresponding increase in the amount of cash required or the monthly payment burden. Second, lower down payments automatically increased the amounts of credit extended relative to instalment sales, while longer maturities on new contracts held down the level of repayments.

The consequent rise in instalment debt has been one of the largest gains ever experienced in so short a period. This fact is significant primarily because of the economic environment in which the advance took place and is continuing. Any credit expansion during a period of high business activity when labor is short and many materials in limited supply, is accompanied by inflationary dangers that would not be so pressing in a less vigorous economic climate. Thus, present concern over the rate of increase in instalment debt does not center so much on the impetus that such credit lends to greater cyclical swings in the consumer durable goods industries, as on the extent to which its stimulative effects tend toward a renewal of inflation.

Evidently, the fact that the initial impact of larger instalment credit extensions is largely on consumer durable goods sales has drawn attention from this possibility. The demand for consumer durables had been at a reduced level for more than a year prior to the moderate upturn this spring and cash purchases apparently continued to fall gradually further during most of this period (see chart). Stocks of most durable goods had been more than ample and excess plant capacity existed in virtually all consumer durable lines. Under these circumstances, demands for durable goods stemming from the rise in credit buying have been met with little difficulty. As a result, no serious upward price pressures have developed as yet in these lines.

Debt burden growing

Renewal of the upward movement in instalment debt has generated some concern that people are assuming too heavy a debt burden in relation to their income, financial resources, and stability of employment. This is quite a different economic issue from that of the effects of changes in debt in times of full employment, and one on which the facts are subject to widely varying interpretations.

The postwar rate of growth in consumer instalment credit has far surpassed that of any other type of debt. Total instalment debt has increased from less than 2.5 billion dollars at the end of 1945 to about 15.5 billion dollars currently, showing substantial gains in every year except 1951. Much of this expansion was simply a process of "catching up," reflecting the extreme scarcity of consumer durable goods during the war and, consequently, and abnormally low level of instalment credit at the war's end. As compared with 1940, the rise is much less spectacular relative to gains in other types of debt.

	Per cent increase	
	Dec. 1945 to Sept. 1952	Dec. 1940 to Sept. 1952
Consumer instalment debt	545	180
Urban home mortgage debt	200	210
Short-term corporate debt	105	200
Long-term corporate debt	80	60

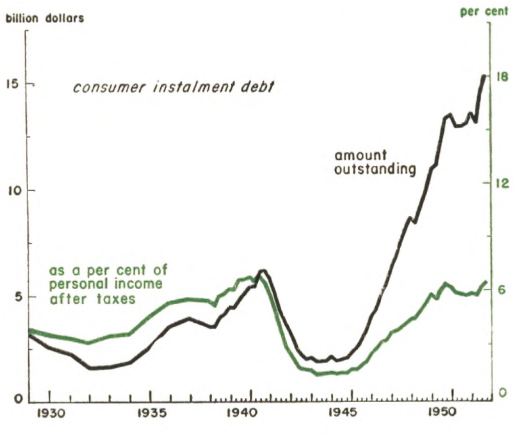
Dollar comparisons of instalment credit with earlier periods, however, give little indication of changes in the relative significance of such debt. The ability of consumers as a group to carry debt must be measured against their over-all financial position which has improved greatly in three important respects over the past decade.

First, personal income after taxes has increased about 200 per cent from its 1940 level. In relation to income, instalment credit is now no higher than during most of 1940 and 1941, the peak prewar years, although the trend has been sharply upward since Regulation W was suspended (see chart). Second, income after adjustment for price changes has expanded considerably since 1940, even allowing for the growth in population. This suggests that basic living costs are being met with a smaller proportion of current income, thus freeing a larger share for saving, spending on better quality and luxury goods and services, and for meeting debt service and repayment obligations. Third, personal holdings of liquid assets such as demand deposits, savings accounts, and Government bonds have grown steadily during the war and postwar years. Total holdings now amount to about 190 billion dollars, more than three and one-half times the 1940 year-end total. Thus consumers possess a much greater reservoir of purchasing power than was the case before the war.

The *1952 Survey of Consumer Finances* provides information concerning the distribution of consumer debt as of the beginning of this year. According to the Survey, nearly half of all consumer spending units had no appreciable short-term debt at that time. Of those who reported consumer debts, about two-fifths owed less than 200 dollars, 30 per cent owed between 200 and 500 dollars, and three out of 10 had obligations of 500 dollars or more. In relation to income, total debt amounted to less than 10 per cent of 1951 earnings for nearly three-fifths of all borrowers and to 20 per cent or more for one-fifth. Moreover, only 3 out of every 10 borrowers held liquid assets equal to or exceeding their total short-term debt.

Thus consumer debt is heavily concentrated in a relatively small proportion of the total population. A minority of the consumer-borrowers have total debts which are large in either absolute amounts or as a proportion of their earnings, and a large majority do not hold liquid assets which cover their total debt. This suggests that the level of such debt is vulnerable to declines in income and employment.

Consumer instalment debt resumes sharp advance and approaches prewar peak in relation to personal income



Buying patterns influenced

Instalment credit serves an important and useful function in our economy. By making possible the purchase of relatively expensive products through the pledging of fixed payments out of future income, a much larger and broader market is created for durable goods. Extensions of new credit in large part add to the demand for such consumer "capital" goods, while repayments absorb funds which otherwise would be available for other uses, including expenditures on nondurable goods, personal services, and saving. Thus a high but stable level of instalment debt simply evidences a proportionately larger diversion of income on the part of consumer borrowers into the purchase of automobiles, appliances, and other "big ticket" items.

The rapid expansion in debt this year, however, evidences a growing reliance on credit buying to maintain sales. This may mean that the demand for consumer durables is becoming increasingly susceptible to a downturn in business activity. Should income and employment decline, instalment credit extensions might well fall off sharply. So long as personal income continues at current levels, however, there is little reason to expect an abrupt drop in credit-based demand.

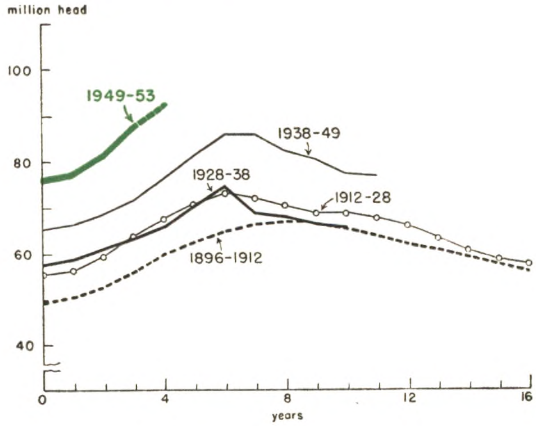
Beef for more people

With the cattle herd building rapidly toward 100 million head, there will be abundant beef supplies the next few years.

A WIDELY PUBLICIZED BUILD-UP in the nation's cattle herd has been under way since 1949. While consumers have waited impatiently for "more and cheaper beef," farmers and ranchers have increased herds rapidly—about 20 per cent in four years. But this retention of cattle on farms for herd expansion reduced the number slaughtered; beef and veal production dropped below 10 billion pounds in 1951, the lowest since 1943. However, the supply curve turned upward in the second half of this year and consumers can now look forward to a period of abundant beef supplies.

The cattle herd is now expanded sufficiently to permit both an increase in slaughter and inventory on farms. Should the current build-up trace a pattern similar to that of previous "cycles," the total would reach about 100 million head by the mid-50's. A record increase of 6 million last year brought the herd to 88 million on January 1, 1952. By year end the number is expected to show a further increase to about 93 million. The cattle herd would then be about 9 per cent larger than the peak reached in the previous cycle in 1945.

Build-up of cattle herd follows usual pattern, 11 million added in past two years



More beef for everyone

What does this mean in terms of the future beef supply? From a cattle herd maintained at 100 million head, annual production of beef and veal would be on the order of 13 to 14 billion pounds. Compared with 1952 production this would represent an increase of about 25 per cent. The average supply per person, however, would show a somewhat smaller rise due to the persistent growth in number of consumers.

Prospects for a continued increase in the nation's population have aroused some concern relative to agriculture's capacity to provide adequate food supplies. The major concern has been with prospective supplies of livestock products since these usually are squeezed out of diets in societies experiencing population pressure on food supplies. The U.S. population increased about 19 million in the 1940's and the 1950's now promise to repeat this performance. According to Bureau of Census projections, population growth over the next three years will average over 170,000 a month—the equivalent of cities the size of Des Moines, Flint, or Grand Rapids.

Even with such a rise in population, the indicated beef and veal supply from domestic production would reach about 83 pounds per person by the mid-50's. Although a record and far above the relatively low 1951 consumption rate of about 63 pounds, this would be only three pounds above the high-level consumption achieved in 1947 when beef supplies were augmented temporarily by a cutback of about 3 million in the number of cattle on farms.

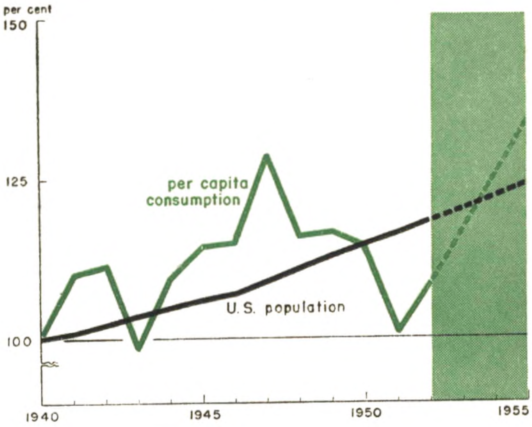
Since beef and veal usually account for a little less than one-half of the total meat supply, the effects of changes in their output may be either offset or amplified by changes in supply of other meats. Per capita meat consumption, although fluctuating less than consumption of beef and veal alone, often shows substantial changes. For example, it increased 20 pounds from 1939 to 1944 and declined 14 pounds from 1947 to 1951.

Pork, the other major component of the meat supply, will probably continue to be available in proportion to the available supplies of feed grains, especially corn. Thus, there is little reason to expect pork supplies to be an important offset to the expansion in beef and veal supplies indicated for the next few years. A large part of the indicated increase in beef and veal production, therefore, probably will be a net addition to the total supply of meat available to domestic consumers.

Population, of course, will show further growth beyond 1955, probably exceeding 170 million by 1960. Unless beef and veal production continued to expand, per capita supply would of course decline. But over the longer term there is little reason to assume a stable or declining supply.

The volume of beef produced over a period of years is determined largely by consumers' food preferences and purchasing power and by farmers' adjustments to these demand and price developments. The nation's beef production capacity can be expanded substantially, but this will likely occur only at a rather slow pace unless there is a sense of urgency to "get the job done." And with beef prices on the downtrend, the stimulus to continue rapid expansion probably will be less effective than in the past two years. It is important to note, however, that consumer spending patterns of

Beef and veal supply set for sharp rise, record consumption indicated . . .



recent years have shown a preference for beef over other meats. If this is maintained, farmers can be expected to make some further shift of resources to beef production.

Feed a limiting factor

While there is little basis for concern relative to the capacity of agriculture to provide adequate food and fiber supplies over a long period of years, it nevertheless is not clear that there is adequate feed production capacity *at the present time* to support a cattle herd of 100 million head. One expert with long experience in the analysis of livestock production and price trends has stated that "any increase above 95 million, except a purely temporary one, would probably be close to a danger level unless feed production is stepped up very rapidly." More recently, state college and USDA experts, in a study of Agriculture's Capacity to Produce, concluded that farms and ranches could reasonably be expected to provide feed for a cattle herd of about 93 million by 1955. It now appears that this number will be reached by year end.

If such estimates are reasonably accurate, the feed supply will be an increasingly important factor limiting the expansion of the cattle herd. An immediate threat is the possibility of widespread and continued drought. Weather conditions in several important areas in recent months have been a forceful reminder of this fact and, if continued, will halt the current expansion in cattle numbers and possibly bring some liquidation. Since a large part of the nation's cattle is grown in areas of limited and uncertain rainfall, this threat is always present. But as the cattle herd presses more closely on current feed production capacity, exposure to the effects of adverse weather increases.

Cattle herds have been expanded in all regions in recent years. The more humid areas, however, have the greatest potential for future expansion. In the capacity study referred to above, it was concluded that the Southeast by 1955 could attain a 15 per cent increase over 1952 in number of cattle on farms. The Mississippi Delta, Appalachian, Corn Belt, and Lake states also have or can readily develop feed capacity for substantially larger herds. Recent experience indicates that grass and hay production can be stepped up sharply by the adoption of improved management practices in these regions.

Liquidation boosts beef supply

Whenever the number of cattle on farms is drawn down, beef and veal supplies expand temporarily and prices tend to decline relative to prices of other commodities. A large part of the supply fluctuations of past years can be traced to the alternate expansions and contractions in the nation's cattle herd.

The drought of 1934 caused a sharp reversal in the uptrend in cattle which had started in 1928. The number on farms was reduced 5½ million that year and beef and veal production increased over 30 per cent from the preceding year. In the absence of severe feed shortages, downturns in cattle numbers have been much less rapid and with a correspondingly smaller impact on beef and veal supplies.

In view of the instability which has characterized the nation's cattle herd in previous years, it may be unrealistic to assume that the number of cattle on farms will stabilize at some level. If the present build-up reaches the indicated number of about 100 million head and then is followed by some liquidation, per capita beef and veal supplies would exceed those indicated for the mid-50's, possibly by substantial margins. In this circumstance, even with high levels of employment and income, beef and cattle prices would drop sharply. Typically, as slaughter increases and prices decline, high cost producers experiencing narrow profit margins or losses are induced to reduce their herds. This adds to the beef supply, accentuates the downward pressure on prices, and prolongs the decline in number of cattle on farms.

Although cattle prices declined sharply as slaughter turned upward this year, consumers have benefited only slightly as the major declines have been in grades of cattle used largely for breeding or further feeding before being slaughtered. But with substantial supply increases in prospect, consumers have now arrived at the threshold of their long-sought doorway to "more and cheaper beef." Nor is this necessarily a momentary millennium. Farmers' and ranchers' capacity to expand production indicates that beef and veal can continue to play an important role in American diets even though population shows substantial further growth.

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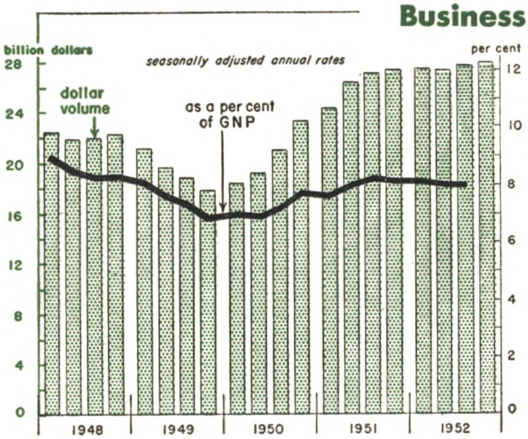
THE Trend OF BUSINESS

IF THE TREND in the closing months of 1952 is any guide, 1953 should be a banner year. Most measures of over-all activity are ringing up new peacetime records with each passing month. Yet many observers profess to see signs of a shift in tempo. Whether such a shift will in fact occur is a matter of hot debate, but there seems to be general agreement upon the areas in which any basic change would start. For the most part, these are the same sectors which have supported our great postwar boom.

As an aid to individual appraisals of the outlook, the past record and present position of these critical areas are outlined below.

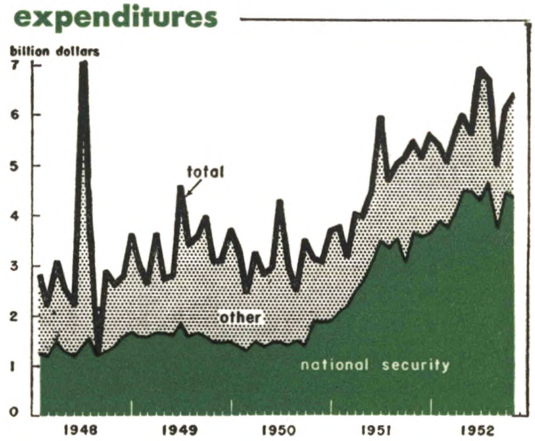
Business plant and equipment expenditures



are at an all-time peak in gross dollar volume. Fourth-quarter outlays are estimated at 27.9 billion, seasonally adjusted annual rate. These purchases are absorbing a smaller share of total output, however, than was true during 1948. With the sharpest post-Korea rise past, relatively more money is being invested in equipment in preference to new plant. Recent surveys indicate this tendency will carry through 1953, with total outlays close to 1952 levels. A review of the implications of such additions to capacity begins on page 13 of this issue.

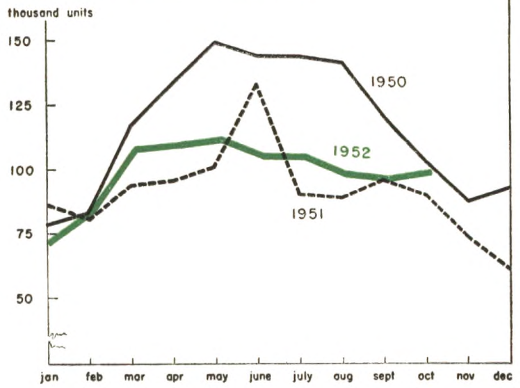
United States Government budget expenditures

have increased more sharply than any other type of spending since Korea. Major reason, of course, has been the increase in national security takings. Such outlays were at an annual rate of 52 billion dollars during the third quarter of 1952. Because of commitments already made, national security expenditures are expected to creep up to more than a 60 billion annual rate by June 1953. Total budget expenditures, now at 6.4 billion dollars a month, would rise to a monthly rate of 7 billion dollars as a result.

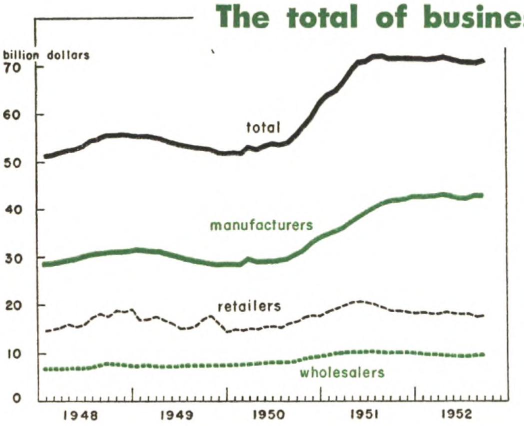


Residential housing starts, excluding farm construction,

will pass the million mark for the fourth successive year during December. The 1952 total will not match 1950's record 1.4 million starts, but in all but one month since February 1952, starts have topped 1951 figures. Any stimulative effects from the easing of credit restrictions on mortgage terms have not yet been reflected in reported starts. Conceivably such stimulation could become important during 1953, but not unless the market for long-term investment money turns easier. Latest forecasts put 1953 starts at close to 1 million units.



The total of business inventories, seasonally adjusted,



has remained remarkably stable since July 1951 at around 70 billion dollars. Retailers and wholesalers have effected a net cut in their inventories during this time, but these drops have been offset by a persisting rise in manufacturers' stocks. Under other circumstances, such a build-up at the producer level could give cause for expecting some depressing inventory liquidation. In this period, however, an increased degree of inventory stability stems from the portion of producers' stocks which is tied in with defense production programs.

Consumer buying, adjusted for seasonal change,

has picked up gradually since mid-51, whether measured absolutely by total retail sales or by retail sales relative to disposable personal income. In two out of the past five years, the consumer has played a stabilizing role. Steady buying in spite of a dip in disposable income served to moderate the 1949 recession. In early 1951, reduced retail purchases in the face of rising disposable income helped to brake the post-Korea inflation. Looking ahead to 1953, maintenance of present levels of retail buying would stop any sizable business slide-off.

Canadian dollar fluctuates

Supply and demand conditions for U.S. dollars in Canada now determine the exchange rate.

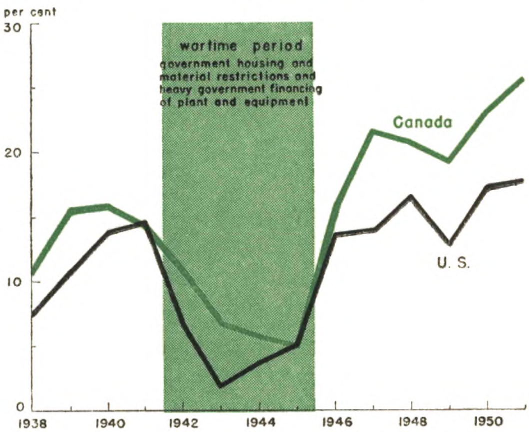
UNITED STATES TOURISTS travelling in Canada last summer were often surprised and, at times, shocked to find that the Canadian dollar commanded more than one U.S. dollar in exchange. Only two years earlier they had been able to buy Canadian dollars for 91 cents U.S. currency. Until recently, however, they were required to give up about $1.04 of U.S. money to obtain one Canadian dollar. Many wondered how this had come about. What was responsible for the increase in the value of Canadian currency and its ensuing fluctuations?

This phenomenal rise of the Canadian dollar —almost 16 per cent in less than two years— and its subsequent strength in the foreign exchange markets of the world has resulted from the large amount of capital flowing into Canada and, more recently, by Canada's merchandise export surplus. In October 1950, the officially maintained fixed exchange rate was abolished. Since then the rate of exchange between the Canadian dollar and other monies has been determined by the supply and demand conditions of these currencies in Canada. It reflects the demand for Canadian currency— by nonresident investors, importers of Canadian products, tourists in Canada, and the like—in relation to the Canadian demand for foreign currencies for payment abroad. Thus, with the Canadian dollar free to find its own level in relation to other monies of the world, a change in any one of the major components of Canada's balance of payments affects the rate of exchange.

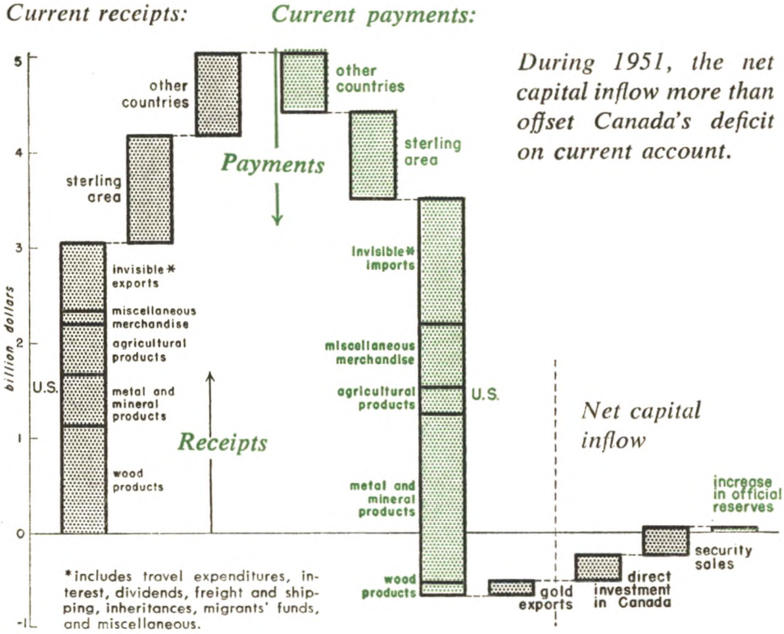
In 1951, capital inflow

Initially, the huge capital inflow—mainly from the U.S.—during 1950 and 1951 was responsible for the rise of the Canadian dollar. Foreign investors realized that Canada offered a profitable outlet for their funds. A large part of the capital inflow was for development of oil resources in western Canada and mineral resources in the Eastern part of the country. In addition, many industrial projects were financed by U.S. parent organizations through transfers of funds to Canada. Except in the wartime period when our industrial capacity was expanded at a phenomenal rate, Canadian industrial growth has kept pace with the expansion in output in the U.S. Likewise, national income in Canada has grown at about the same rate as that of the U.S. In Canada, however, a larger proportion of domestic production has been plowed back into additional plant and equipment. In 1951, about 26 per cent of Canada's gross national product was devoted to private investment, compared to 17 per cent in the U.S. Added to this was the foreign

Large proportion of domestic output devoted to private investment



Canada's balance of international payments, 1951



capital inflow which in 1951 amounted to 3 per cent of GNP in Canada. This foreign capital has competed with Canadian investors in attempting to meet this increased demand for industrial equipment, as well as the expanding demand for consumer goods created by larger incomes and an expanding population.

The volume of foreign investment moving into Canada reached unprecedented heights in 1950. Canadian official reserves of gold and U.S. dollars increased by 625 million during that year. About 75 per cent of the rise came in August and September when much of the inflow was of a short-term nature—in anticipation of an increase in the value of Canadian currency.

Much of this speculative money went into Government of Canada bonds. Net purchases of Dominion issues by the U.S. in September 1950 totalled 122 million dollars, far in excess of the previous monthly record of 43 million set in August of the same year. This "hot money" swelled the already large stream of investments going into such big developments as Alberta oil and Labrador iron ore.

Following the unpegging, the Canadian dollar swiftly rose from 91 cents to 95 cents in U.S. currency and remained at this level for about a year. The rate of capital inflow continued high, although less than that of the previous year. The net movement reached 563 million in 1951 as compared with 1,011 million in 1950. Trade movements in outstanding Canadian securities in 1951 were, in sharp contrast to 1950, by and large offsetting. Purchases of Canadian stocks and corporation bonds by nonresidents were balanced by net sales of Government of Canada bonds. Net foreign purchases of outstanding Canadian securities amounted to 18 million in 1951, compared with 238 million in 1950. During 1952 direct investment in Canada by nonresidents has been maintained at a high level. According to recent estimates, it will probably reach 275 million this year. However, net sales of Government of Canada bonds held outside the country have continued throughout 1952 and have more than offset foreign purchases of other Canadian securities. Despite a fall in the domestic price of Dominion bonds, the rise in the exchange value of the Canadian dollar offers handsome profits. Every time the exchange rate took a significant jump, the Canadian bond market softened. For example, a U.S. investor who had bought a Government of

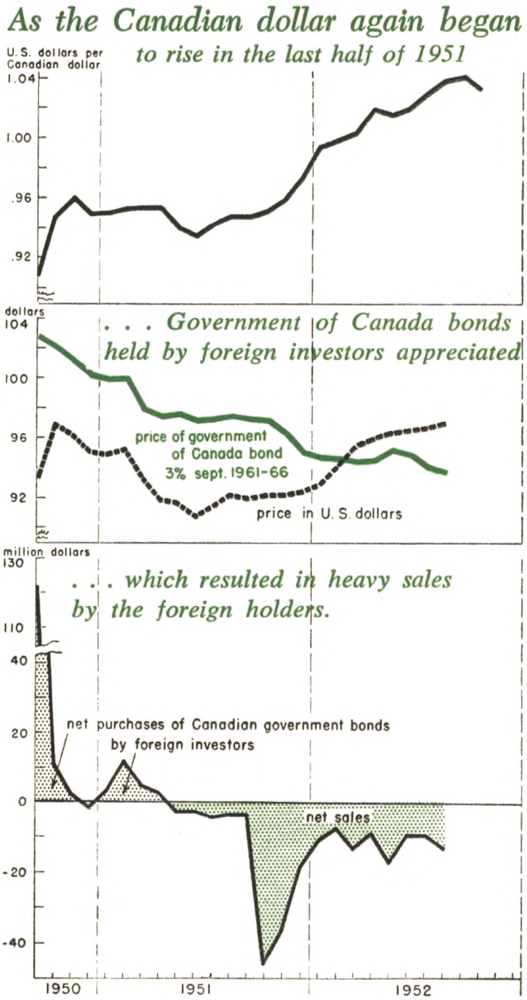
Canada bond for $93.46 in September 1950 could have sold it for $97.03 two years later, a capital gain of 4.9 per cent. Bond yields about a point higher than the yields on comparable U.S. Government bonds may have discouraged additional sales. Whether foreign investors will re-enter the market to take advantage of these high yields remains to be seen.

In 1952, export surplus

As net capital inflow began to taper off, Canada developed a surplus foreign trade account. In the closing months of 1951 Canadian imports declined with the ending of the post-Korean buying rush. The Canadian dollar again started to rise. By mid-August of this year it had reached a 19½-year high at $1.0434. Since reaching this peak, the Canadian dollar remained steady at about $1.04 until late in October.

Throughout most of 1952, Canada has maintained an over-all export surplus, although still importing more from the U.S. than it sells here. The unusually high favorable trade balance over the first six months—164 million—more than offset a net deficit on dividends and other current account transactions between the U.S. and Canada, as well as a deficit on net tourist expenditures. Although in September Canadian imports totalled 8 million more than exports, indications seem to point to merchandise export surplus in the near future. Of the big bumper 1952 harvest, about 400 million bushels of wheat will be available for export. Nonferrous metal as well as newsprint exports are being maintained at a high level. Some experts believe that Canada will have a trade surplus for 1952 of not less than 300 million dollars.

Although the rise in the exchange value of the Canadian dollar may have created some problems for many U.S. importers buying from Canada, the citizens of the U.S. need not be greatly alarmed by this turn of events. The unit of currency in Canada happens to be the dollar—the same as in the U.S. There is, however, no more reason why one U.S. dollar should exchange for one Canadian dollar than for a U.S. dollar to be on a par with a peso, a pound, or a lira. In the longer run, the Canadian dollar may again dip below the U.S. dollar. During November it dropped below $1.02. Whatever the rate may be, however, unless the Canadian Government again establishes a fixed rate of exchange, the rate will be determined by the free interplay of the forces of supply and demand operating in the foreign exchange markets of the world.



The fear of excess capacity

Rapid expansion of productive facilities insures adequate flow of materials for armament and record civilian output.

Two years of the greatest industrial expansion in our history have brought the nation close to the point visualized by the framers of the Defense Production Act of 1950. Basic productive facilities will soon be adequate to handle projected levels of military spending *plus* record civilian goods output.

But these new-found industrial muscles are not looked upon universally as an unmixed blessing. Fears are growing that "excess capacity" may spell overproduction, sagging prices, and shrinking business profits. In addition, there is concern that a contraction of the market for capital goods may be in prospect and that this would bring repercussions to other sectors of the economy.

These possibilities are real but they can be easily overemphasized. Overcapacity in most lines is not now in prospect and such a situation could develop only in a period of full-fledged depression. The post-Korea expansion has been concentrated in particular industries—military hard goods and in the basic industries. Plant additions in many lines not vital to the defense effort have been restricted during this period.

A sharp decline in capital outlays does not appear to be on the horizon. Polls of business firms indicate that next year's plant and equipment spending will come close to 1952's record of 27 billion dollars. If demand for finished products does not slump unexpectedly, capital expenditures may remain within 4 to 5 billion dollars of present levels for several years.

Many of the projects planned for 1953 and following years could be cut off quickly if it appeared that the business climate had chilled. On the other hand, an increase in available funds through higher profits and a downward adjustment of corporate tax rates would provide an additional stimulus. Any progressive manufacturer has a backlog of capital spending plans which could be activated if conditions warranted.

Spotlighting the expansion

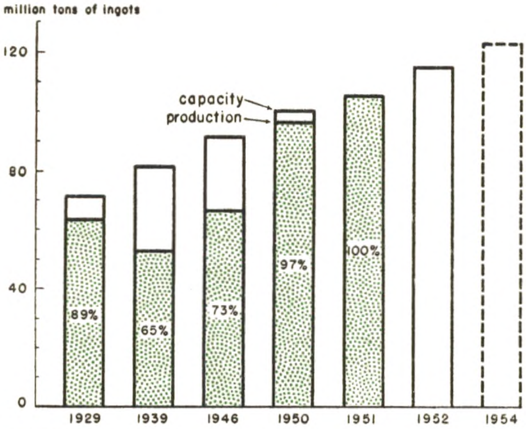
Comparisons of America's over-all ability to produce manufactured goods with earlier periods are difficult and often meaningless. The best relationship between output and capacity varies by industry and depends upon the nature of the productive process and seasonal factors. In addition, the type of goods produced changes through the years. Rough calculations indicate, however, that our factories are now able to turn out twice the physical volume of goods which would have been possible in 1939. During the same period, population has risen by less than one-fifth.

The steel industry, still the backbone of the productive system, is now able to produce ingots and castings at a rate of about 115 million tons per year. Facilities to produce 123 million tons will be available by the end of next year. The later figure compares with an 82 million ton capacity in 1939—a gain of 50 per cent.

Other basic industries have grown even more rapidly. Petroleum refining capacity has more than doubled since 1939. Primary aluminum ingot capacity, still in the midst of rapid expansion, is five times prewar. It is the chemical industry, however, which has shown the greatest gains. Over-all capacity has doubled in the postwar period and output of a number of basic chemicals has risen five to tenfold since 1939.

Increasingly, modern manufacturing depends on a steadily growing supply of electric power. Installed capacity in power plants is now close

Steel goal—123 million tons per year



SOURCE: American Iron and Steel Institute

to 82 million kilowatts—more than twice the 1939 capacity. It is expected that another 35 million kilowatts will be added in the next four years—an amount greater than the entire installed capacity at the end of the utility boom of the 1920's.

The pattern of expenditures on new plant and equipment of the past two years has been guided in considerable degree by Government policy. Priorities have been used effectively and accelerated depreciation has been particularly attractive in a period of high corporate tax rates. There was also an expectation that military and civilian orders would remain at high enough levels to make the ventures profitable.

The threat to stability

As over-all capacity becomes more adequate to handle demand, inflation prospects dim and totally different issues come into focus. Will cutthroat competition, market gluts, and abrupt declines in employment and profits become a constant threat in those industries which have expanded most in recent years?

Textile mills which produce cotton and woolen cloth are often cited as being plagued by "excess capacity." For 30 years many of these firms have suffered periodic letdowns, often quite independent of changes in over-all business activity.

Textiles, however, are a special case. This industry has been the victim of sharply fluctuating costs of natural fibers, a stable technology, a large number of small producers, style problems, and a productive process which is conducive to abrupt spurts and declines in output.

Two of the industries which are sometimes said to be headed for a period of excess capacity are steel and petroleum refining. In recent years steel and refined petroleum products output has been very close to maximum rates. Prior to World War II, however, these industries seldom operated at much more than 80 per cent of rated capacity even in "good" years. In 1929, the top year of the prosperous Twenties, the steel industry turned out less than 90 per cent of the tonnage of which it was capable.

At 80 per cent of capacity, earnings and employment of steel and oil firms of course would be lower, but these industries could hardly be considered "depressed." Actually, some executives see advantages in reserve capacity for emergency use and look forward to an end of the problems involved in doling out limited supplies to eager customers.

A continuing high level

The contribution of a sharp decline in capital outlays to initiating or deepening a recession should it develop cannot be dismissed lightly. It would be unwise, however, to assume that excess capacity in certain types of manufacturing would be primarily responsible for such a development in the period immediately ahead.

Large-scale spending on facilities to prepare low-grade ores, particularly iron ore, for the use of smelters will be important for years to come. Expansion of the electric power industry, which is slated to continue near present rates for several years, is still being retarded by delays in deliveries of turbines and generators.

Other types of expansion which will continue to be important include: (1) manufacturing and commercial projects which have been denied priorities because of shortages of the very materials which are supposed to become overabundant, (2) facilities to produce new products developed by research departments maintained by a growing number of firms, and (3) facilities to fashion finished products from the raw materials, such as aluminum or plastics, which will become more readily available.

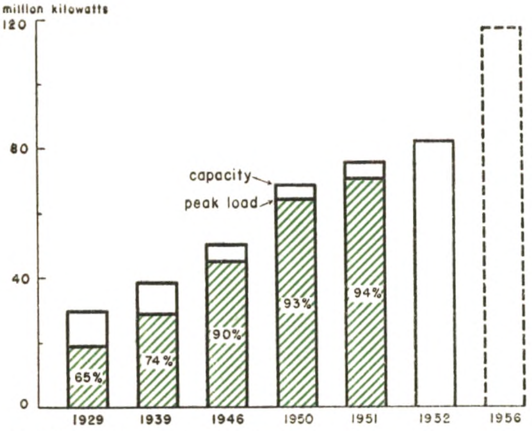
Meeting competition

The continuing need to keep abreast of competition will guarantee a substantial volume of manufacturers' outlays for replacement and modernization. Cost-conscious business firms are often forced to invest additional sums regardless of the rate of operation relative to capacity in order to keep abreast of competitors.

The decade of the 30's was not the "dry spell" for capital outlays as is commonly believed. Available data indicate that during the seven years prior to World War II manufacturers purchased about as much new machinery and equipment as in the seven years ending in 1929. Despite unemployment and "excess capacity" in the 1930's steel firms installed continuous rolling mill equipment. Each major producer had to follow the trend or be left at a competitive disadvantage.

Operating costs may be reduced through better location with regard to markets, power, raw materials, labor supplies, and local taxes. Savings also result from the improved plant layout made possible by single story structures situated away from congested areas. Most important, however, are the advantages to be gained through increased use of equipment which economizes on labor.

Electric power — double prewar and still rising



SOURCE: Federal Power Commission

Burden or benefit?

The main reason for pushing the expansion of basic industry since Korea was to permit the armament program to proceed without reducing civilian living standards materially. Before the stretch-out of arms production and the completion of capacity additions, it was expected that many metal-using civilian products would become scarce and that employment in these lines would decline.

Our expanded industrial plant constitutes a great national asset serving as a bulwark against further inflation and a deterrent to aggression. If a substantial reduction of defense requirements occurs, problems of adjustments to lower levels of operation in some lines will doubtless arise. In times of emergency, however, difficulties involved in having "too much" are preferable to the risk of having "too little, too late."

Should demand ease, a portion of existing capacity in basic industries would be dismantled or withdrawn from production since the new plants are often far more economical to operate than the old. Rising population and long-run growth in per capita consumption of raw materials will steadily close whatever gap remains.

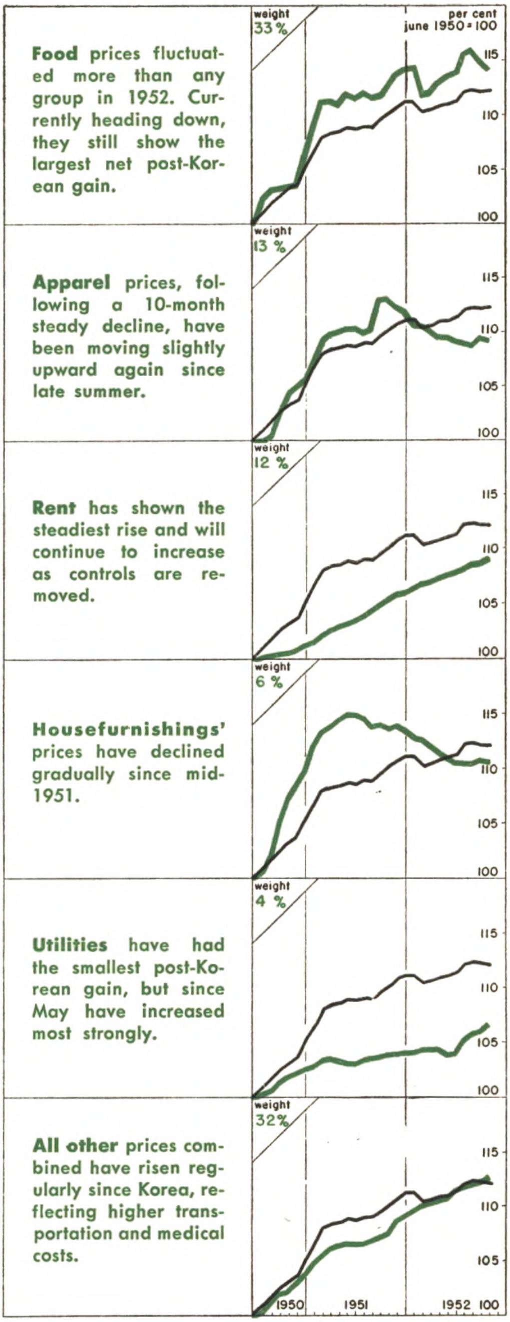
Consumer prices

SURVEYING THEIR HOLIDAY-CROWDED BUDGETS, Americans these days are likely to be more than usually conscious of the "high cost of living." Contrary to many popular impressions, however, 1952 has been a year of relative stability in retail prices as indicated by the Consumers' Price Index. In mid-October, that index stood at 190.9 per cent of its 1935-39 average, a shade below the all-time peak last August and about 1 per cent above the beginning-of-year level.

As an over-all measure, the Consumers' Price Index encompasses price movements in virtually every service and commodity purchased by moderate-income families in large cities. To make the index reflect only price changes, an effort is made to confine measurements to goods and services of constant quality. Currently, a price change in any commodity is "weighted" by the portion of family spending that went for that commodity in January 1950.

As might be expected, food is the most important single component. On the other hand, rent accounts for only 12 per cent of the total weighting. This is because a sizable portion of moderate-income families are homeowners, whose "rent" is considered to include cash operation outlays, but omits principal payments on mortgages. Furthermore, rent controls held down the proportion of rental spending in the base period. The "all other" category includes several important types of consumer outlays, the largest of which is transportation. Reflecting auto costs and streetcar fares, transportation is weighted at 11 per cent. Medical care is about 5 per cent and outlays for alcoholic beverages and tobacco 4 per cent.

As the next column indicates, many family budget items have undergone sharply different price movements since mid-1950. It is only as these divergent movements are combined, according to their assigned weights, that the recent stability in the total index emerges.



LEGEND: Component indexes —; total index —.

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Business Conditions

a review by the Federal Reserve Bank of Chicago

Index for the year 1952

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