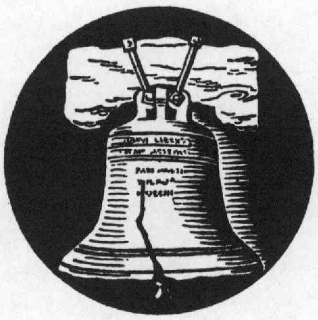
JULY 1950

THE BUSINESS REVIEW

FEDERAL RESERVE BANK OF PHILADELPHIA



BOOM, BUST, OR BALANCE: A MID-YEAR VIEW

The outcome of international conflict may prove to be the key to the near-term business outlook; yet, the business situation itself, while it contains many elements of stability, also contains elements of instability which bear watching. The momentum of the current upsurge in production, prices, and income is likely to carry business along at high levels for several months, perhaps to new records. A serious recession in the foreseeable future seems unlikely, but several factors indicate that a readjustment may be in sight.

CURRENT TRENDS

Practically all May business indicators in the Third District pointed upward. A notable exception was soft coal output. Expanding bank loans carried well into June.

BOOM, BUST, OR BALANCE: A MID-YEAR VIEW

In the excitement of a tense international situation and a rising tide in business activity that is fast approaching a new post-war peak, many people have lost track of the argument concerning the nature of the current boom. At the extremes of the two conflicting views the impartial observer is confronted, on the one hand, with a thoroughgoing pessimism which maintains that what goes up must come down, and probably will come down soon and hard; on the other hand, he is met with a serene optimism which visualizes a steady and ever-expanding prosperity based on growing population and an infinity of wants. Few would support these extreme statements in this form. Most advocates on both sides would make rather extensive qualifications of their positions and, in fact, might find a wide area of agreement with their opponents. The pessimists would concede that long-run changes preclude a return to 1939 price levels. The optimists would avoid the "new era" philosophy of the 1920's and admit the likelihood of minor fluctuations. But the opinions of both groups on the current business outlook would be colored according to their basic convictions.

The events of the post-war period seem to indicate that it is dangerous to start an analysis of business conditions from either of the above assumptions. Despite frequent false alarms, most of what has shot up since 1946 or earlier has come down hardly at all. Unless one makes a radical revision of all previous concepts of "normal" economic levels and timing, the old maxim has little or no usefulness, and probably will be misleading. While a severe slump has been avoided, the moderate recession of 1949 demonstrated the possibility of business fluctuations under existing conditions. Many things have changed in the post-war world, but not enough to guarantee that little dips in business activity will be prevented automatically from becoming big ones.

A big bust is not inevitable, and at the moment there is no evidence that it is on its way. But a reading of recent and current economic history reveals that a tendency toward cyclical fluctuations still exists in our economy and that it will doubtless assert itself from time to time with varying degrees of strength, depending on our ability to anticipate and combat unfavorable developments. This may serve as a preface to the analysis presented in this article. Its conclusions will be that the momentum of the current upsurge in production, prices, and income is likely to carry business along at high levels for several months, perhaps to new dollar and physical output records. But several important factors are developing which make for a possible turnabout in the foreseeable future—perhaps in six months, perhaps in more—and these will bear close watching. At this time there is no reason to believe that such a decline—if it is not avoided completely through the intervention of a larger defense program—will be much more severe than that of 1949.

INDICATORS OF THE BOOM

During the past three months, members of the staff of this Bank have met with bankers and businessmen in a score of cities and towns throughout the Third Federal Reserve District. The impressions of these men with an intimate knowledge of business conditions in their communities have not been entirely uniform. Few localities resemble the statistical average reflected in charts and tables. Nevertheless, the general opinion on the short-run business outlook is unmistakably optimistic. It is based on current consumer buying and industrial activity, on knowledge of orders for future delivery and of plans for expansion. Several Third District communities, notably those in the coal regions, have not shared fully in the recovery of last year, and a few "one-industry towns" have been hard hit by unemployment. Even in these instances, however, business in general is considered to be reasonably good. The present time does not approach the "hard times" previously known in those communities.

The general prosperity of the Third District both contributes to and reflects the high level of business activity throughout the nation. Industrial production in June appears at least to have equaled the former post-war high reached in November 1948. From a low point of 161 in July 1949, the Federal Reserve index has risen—interrupted in several months by major labor disputes—to approximately 195. In the past 11 months the index has recovered the ground it lost during the previous eight months. Durable goods manufacture has paced the upswing with the production of automobiles, the symbol of mass production industry, setting a new record week after week. In recent months, after substantial gains, the nondurable lines have been steady at a level somewhat above that of 1948.

The construction industry is operating at a record level and the most spectacular increase has occurred in residential building. If the statistics did not show this tremendous activity clearly, it would still be obvious to anyone who rides into the suburbs of our cities and towns and sees whole neighborhoods rising out of vacant land almost overnight. The most recent surge in home building began late in the summer of 1949, after a rather shaky first half-year. Fall and winter activity made 1949 the best home building year in our history, and the record of the first five months of 1950—over 50 per cent better than 1948 or 1949—leaves little doubt that this year, contrary to most early expectations, will set another new high mark.

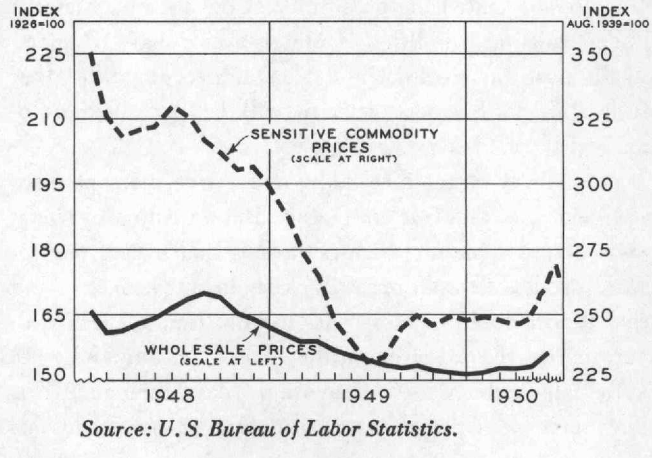
Unemployment, at 4.7 million in February, declined by May to about 3 million. This is close to a so-called "frictional" minimum, the irreducible number of workers moving from job to job—and for the time being, concern over our ability to absorb a constantly growing labor force into industry has largely abated. True, a large number of high school and college graduates, as well as students and others seeking temporary summer employment, will probably swell the group of job-seekers in the coming months. But non-agricultural employment has been increasing and the general impression, as well as the apparent fact, is that while the most desirable jobs are not so easy to find these days as in 1948, practically everybody can find something to do. The average work-week in manufacturing is nearly 40 hours and is above that figure in durable goods industries, indicating that considerable overtime work is being done and that, except for seasonal let-downs, there is some pressure for hiring additional workers.

It might be stated here, in view of impending military requirements, that the inauguration of an extensive defense program in the present situation would entail adjustments of an entirely different nature and magnitude than it did in 1939 or even in 1941. Over 9 million people—17 per cent of the labor force—were unemployed in the former year, and 5.5 million were still out of work in 1941. At present, with a relatively small number of additional workers to draw upon, with the steel industry, to cite one example, working in excess of 100 per cent of its rated capacity, it would not be possible to expand both military and civilian production simultaneously, as was done in the early stages of preparation for World War II. Output for civilian consumption would have to be curtailed.

Rising wages and salaries paid out by industry helped push personal income up to record levels in the early months of 1950. It was the $2.8 billion payment of the veterans insurance dividend, however, which made this period unusual. During the first quarter of 1950, after taxes were taken out of their incomes, American consumers could draw on a stream of funds that was flowing at a rate of over $200 billion a year. The previous high, reached at the end of 1948, was $196 billion. Lower farm incomes held the current totals down somewhat, so that if payments to veterans were excluded, we should not have reached the former peak. But there is no doubt that the receipt of veterans' payments boosted both immediate spending and the less tangible item of consumer confidence, and those payments must be included in an appraisal of the boom.

High consumer incomes, added to the rising profits of business corporations, have begun to put some strain on the economy's ability to supply goods and services. Actual shortages exist in only a few instances, notably in certain steel products and building materials. However, the trend of prices is ample testimony of the boom's progress. The most comprehensive indicator of general market conditions is the index of some 900 wholesale commodity prices. This index, as the chart shows, hit a low point in December of 1949. Substantial farm products and food price declines were chiefly responsible for this timing. Industrial prices had leveled off several months before and were by then tending upward. Since December, wholesale prices, including prices of farm products, moved upward with practically no interruption until well into June. In May, they were slightly above prices for the previous year and they had risen 3 per cent in five months.

RECENT PRICE TRENDS



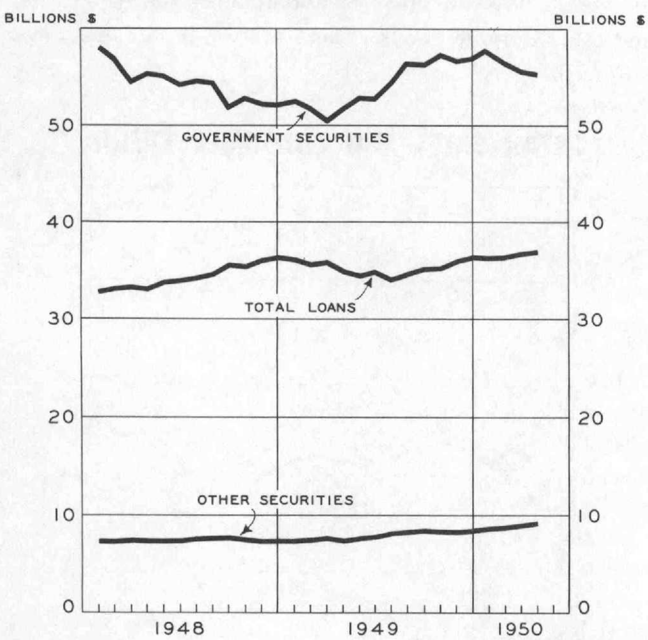
Source: U. S. Bureau of Labor Statistics.

The prices of certain "sensitive" commodities—basic industrial products, foods and raw materials—have shown more marked and, in some cases, sensational advances. Within the past few months, steel scrap, zinc, copper, lumber, and other important goods have been bid up in price in a manner reminiscent of the second half of 1947. As the chart indicates, prices of "sensitive" commodities fluctuate considerably more widely than wholesale prices. Such fluctuations do not forecast the magnitude of general price changes; they often indicate the direction of broad price changes which may be ahead. Changes in prices of cost-of-living items, on the other hand, lag behind wholesale price movements. The consumer did not feel the results of higher costs this year until March. By May, he was paying about as much for essential needs as he had been a year earlier.

Banking Developments

Banking activities reflect the business recovery which got under way last fall. The shift from inventory liquidation to inventory accumulation and the general rise in the volume of business activity and employment have resulted in an increased demand for bank credit. Commercial bank loans and investments, after a small decline in the early part of 1949, turned up sharply in the latter part of the year and continued to rise, except for small declines in February and March, 1950. The rise in total earning assets—especially the relatively higher yield real-estate and consumer loans—resulted in an increase in earnings. Net earnings for 1949, despite an increase in expenses, were above 1948. Preliminary reports indicate that they may be slightly higher in the first half of this year than in the first half of 1949.

MEMBER BANK INVESTMENTS - U. S.



Source: Board of Governors of the Federal Reserve System.

Member bank investments, despite a decrease in Government security holdings in the early months of 1950, exceed the year-ago level by nearly $5 billion. A major part of the increase in investments, which began in the latter part of 1949, has been in Government securities; however, banks have also added substantially to their holdings of corporate and municipal bonds. The rise in investments reflects, in part, the purchase of securities made possible by the reduction in reserve requirements in 1949. An additional factor was the reduced business demand for bank credit which resulted from the business readjustment during the first part of last year.

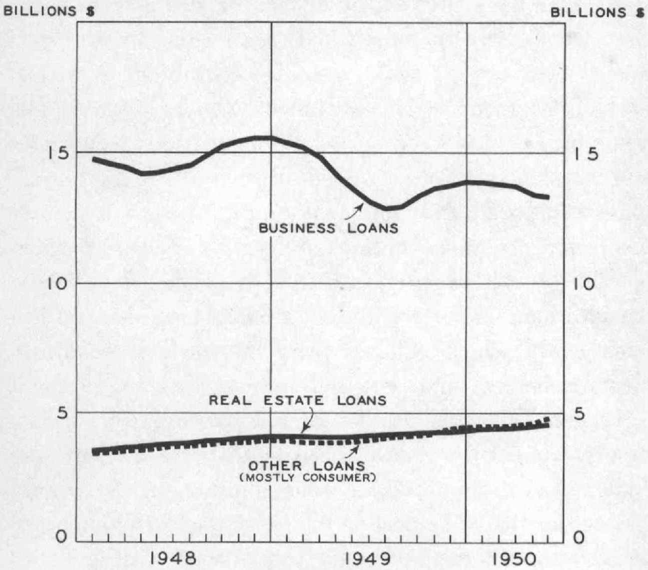
Treasury receipts usually exceed expenditures in the first quarter of the year and this tends to put pressure on bank reserves, resulting in some liquidation of Government securities. The decline in commercial bank holdings of Governments in the first quarter of this year, however, was less than last year when the Treasury's first-quarter cash surplus was considerably larger.

Commercial bank loans are now at an all-time peak. Loan trends since mid-1949 reflect the business recovery which has been under way since last fall. Member bank loans are higher now than at the beginning of the year both in the Third District and in the United States. During the corresponding period last year there was a substantial liquidation of loans.

Loans to business firms, the largest segment of member bank loan portfolios, reflect the improved business situation. Such loans began to rise shortly after the middle of 1949, and the contraction in the first part of 1950 has been much less than during the same period last year. At that time, most business firms were reducing capital expenditures, liquidating inventories, and in general slowing down their volume of operations. In the Third District, business loans have been rising this year in contrast to a sizable decline during the first half of 1949.

Real-estate loans continue to rise slowly but consistently. Member bank loans on real estate have risen $5.4 billion since the end of 1945—from a total of $3.4 billion to $8.8 billion at the end of 1949. Most of the mortgage loans have been on residential property, reflecting the post-war boom in home construction. The rise in real-estate loans of weekly reporting member banks in leading cities reflects the rising tempo of the real-estate boom, the increase for the first half of this year being about $270 million greater than for the corresponding period last year.

MEMBER BANK LOANS - U. S.*



* *Weekly reporting banks.*
Source: Board of Governors of the Federal Reserve System.

Consumer loans continue to rise. Despite the high level of personal incomes, people have continued to go into debt to buy more of the things they want. The rapid rise in this type of credit has been an important factor pushing up the demand for consumers' goods, especially durables. Consumer loans of member banks rose from $1.9 billion at the end of 1945 to $6.6 billion at the end of 1949—an increase of nearly 250 per cent. The rate of expansion at weekly reporting banks thus far in 1950 is above that for the same period last year.

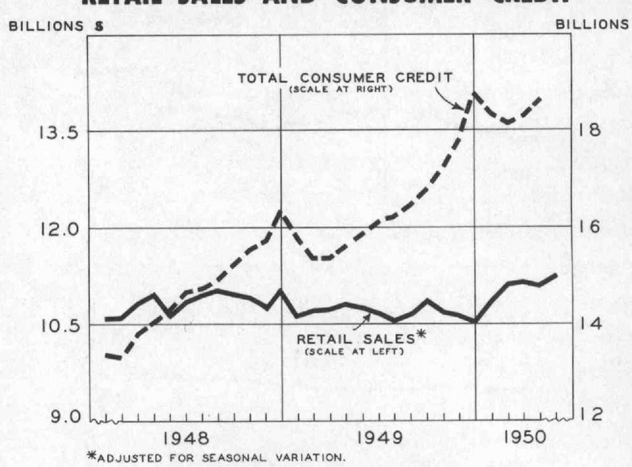
ELEMENTS OF STABILITY AND INSTABILITY

It is always difficult to separate the many interdependent forces which contribute to the character of current business activity and shape the pattern of future events. There are several key factors, however, which might be singled out at the present time as especially significant. These are retail trade, capital expenditures, construction, and inventories. In all of these there are elements of great strength which will act to prolong and stabilize a high level of production and income. At the same time, they contain some unstabilizing elements which may be growing in importance and which may eventually, unless they are offset, serve to bring about a turning point in business activity. It is typical of past business cycles that some unfavorable developments occur in periods of prosperity; their number increases as the peak of the boom is reached. This does not mean to say that the timing of a slump can be predicted with accuracy on the basis of certain business indicators, nor even that the same general pattern of events must always occur. It need not. But it does suggest that we must be watchful, and *before* business looks bad—not afterward.

Retail Sales and Consumer Credit

Total retail sales during the first four months of 1950 have been about 3 per cent above those of 1949, and the monthly totals exceed the monthly average for 1948. This represents a considerable recovery from last summer's doldrums and a sales level about which it would seem there could be little complaint. Yet, some retailers are less than enthusiastic about business. A breakdown of the retail sales figures will show who they are and why they are unhappy. They are the sellers of nondurable goods—things like apparel, especially women's wear, and products of eating and drinking places. Sales of these items have shown some improvement since last fall, but they remain somewhat below 1949 levels and well below the records of 1948. The soft goods retailer has been watching customers turn down his merchandise in favor of automobiles, television sets, and other durable goods. These are the things that have been selling.

RETAIL SALES AND CONSUMER CREDIT



Source: U. S. Department of Commerce.
Board of Governors of the Federal Reserve System.

High demand for durables has sent factories into overtime work and has helped increase employment. But it is well known that the demand for such goods fluctuates more widely than for the more prosaic essentials—food and clothing. Durables have a relatively long life. Once consumers are stocked up with them they tend to cut new purchases rather sharply. Two special factors are contributing to the present high demand for durables. First, a backlog of needs accumulated during the war which has not yet been entirely filled. Housefurnishings for new families in new homes should be included in this backlog. Second, a rapid increase in consumer credit; this is clearly shown in the accompanying chart. The question is raised more and more frequently as to how long it will take until consumers are restocked and, when they are, to what extent they will shift their buying to nondurables or use their cash to pay off debt.

There are two chief means of forecasting consumer demand. One draws on historical relationships of income, population, and other factors to sales and projects them into the future. This method is used by the Department of Commerce and samples of it are frequently published in the *Survey of Current Business.* The other method is to ask consumers what they feel their prospects for employment and income are and how much they intend to buy of certain goods. This, in much oversimplified terms, is the method of the annual survey of consumer finances sponsored by the Board of Governors of the Federal Reserve System. These two methods supplement each other, and although they are far from infallible, they give some insight into durable goods demand. At the present time, they both indicate a level of demand in 1950 which exceeds previous years. Current production and sales of many durables, including automobiles, are so high, however, that backlogs are certainly being rapidly reduced and, unless consumers have revised their purchase plans upward —which is quite possible, considering international developments—sales of automobiles, refrigerators, and other hard goods may taper off somewhat later this year. Higher prices might tend to accelerate this development.

Consumer credit has been a stimulating factor in durable goods sales. Over $19 billion of such credit is now outstanding. During the last year, the total has risen over $3 billion, about $2.0 billion of the increase being instalment sale credit. Thus far this year, instalment credit has risen more rapidly than during the same period in 1949. Both the amount of credit outstanding and the rate of increase are important.

Buying on credit really represents spending future income. Repayment, on the other hand, siphons off current income to pay for goods already purchased and in use. Changes in the volume of consumer credit outstanding affect substantially the time distribution of consumer purchases. When times are good and business prospects are bright, consumers are more willing to spend some of their future income by buying goods on the instalment plan. On the other hand, when business is bad, consumer credit outstanding usually decreases. This type of consumer credit behavior tends to increase demand in times when business is already good and to decrease it during periods of depression.

Is the total volume of consumer credit too high? Is consumer credit increasing too rapidly? These are questions which cannot be answered yes or no. Measured in terms of certain historical indicators, consumer credit outstanding is not out of line with other periods of good business. For example, in relation to ability to pay, consumer credit was 9.1 per cent of personal incomes after taxes at the end of the first quarter of 1950. It was 10.7 per cent in 1941, 12 per cent in 1940, 10.9 per cent in 1936, and 9.2 per cent in 1929. Consumer credit in relation to total consumer expenditures tells about the same story. Instalment sale credit was 23.5 per cent of consumer expenditures for durable goods, as compared to 38.4 per cent in 1941, 38.7 per cent in 1936, and 26.9 per cent in 1929. Thus, in terms of such historical measures, one might say there is no evidence of an excessive expansion as yet.

There are other factors, however, which point toward the need for greater caution. Total consumer credit rose over 19 per cent in 1948, as compared to an 11 per cent increase in personal income after taxes, and a 7 per cent rise in consumer expenditures; in 1949, consumer credit rose 15 per cent, while personal income and consumer expenditures showed practically no change. Instalment sale credit rose 47 per cent in 1948 and 38 per cent in 1949, but consumer spending for durable goods rose only 7 and 4 per cent, respectively. These trends indicate that there has been an increasing reliance on credit for maintaining consumer spending. There are other reasons for caution. Reports indicate that down payments are still being reduced and the length of the loans increased. There are reports that an increasing number of consumers are getting in an over-extended position with too much of their future income pledged for current and past purchases. If such reports are true, a small drop in incomes might result in a substantial rise in repossessions. A high rate of expansion, especially of instalment credit, is resulting in a substantially enlarged demand for consumer durables at a time when many of these industries are operating at capacity, creating the danger of a let-down later on, should the rate of expansion decrease. Credit expansion, whether for consumer purchases or other purposes, brings no real benefit if it raises prices instead of increasing production. It would be a real contribution toward business stability if more consumer credit purchases were made during periods of economic slack and less during boom periods.

Capital Expenditures

Expenditures for plant and equipment, though a small proportion of gross spending for the whole economy, are nevertheless of great importance in business fluctuations. In 1949, such outlays dropped over $1 billion from the record $19.2 billion of the year before, and early in 1950, business reported to the Department of Commerce that it anticipated a decline for this year of about $2 billion more. That report checked roughly with this Bank's own survey of Philadelphia manufacturers' intentions taken several months before. It now appears that businessmen have changed their minds. For the first nine months of 1950, plant and equipment expenditures apparently will be only about 6 per cent under 1949, and there are indications that fourth-quarter expectations, when they are reported, will narrow the difference even further. Thus, the evidence up to this point does not allow one to expect a stronger stimulus to business activity from this source than last year's, but the expected decline has not materialized and a substantial drop does not seem likely in the near future.

There are three reasons, perhaps four, why capital outlays have been greater than expected. First and foremost, consumer demand held up well during 1949 and has apparently been increasing in recent months. Second, it has become clear that last year's decline in construction costs was short-lived as well as slight and that further building delays might prove costly. Third, by the end of 1949 business had recuperated financially from the recession of 1948-1949. Corporate financial statements showed high liquidity ratios, plenty of cash, and rising profits. Large internal funds were available for expansion and modernization, and interest rates had remained low.

Though it appears that the decline in new security issues which began in mid-1949 has ended, at least for the time being, the amount of new capital raised in the securities market during the first half of 1950 was below that of the same period last year. Completion of many large post-war expansion programs and the decline in the practice of repaying long-term bank loans with the proceeds of new security issues are two factors which may be responsible for the lower total. However, the consistent rise in the stock market during the past year, until war fears became dominant, has been favorable to equity financing. New stock issues have increased moderately since the latter part of 1949, while the volume of bond issues has declined. As a result, stocks—common and preferred—made up 30 per cent of total corporate issues for new capital in the first five months of 1950 as compared to 20 per cent in the same period last year.

The fourth possible reason for greater capital outlays assumes greater importance as this article is written. Rising international tension and the anticipation of a greater military effort may have caused reconsideration of production requirements in some instances or a desire to obtain equipment which might later be unavailable. Thus far this has probably been a minor consideration. A mad scramble for machinery and plant facilities at the present time would serve no good purpose.

Construction

The tremendous strength shown by the building industry in 1950 is thought by many to be the main support of the boom. Over $8 billion worth of new construction in the first five months of this year—about 20 per cent more than 1949—is strong evidence in favor of that view. As might be expected from the discussion of capital expenditures, private non-residential building has not shown any increase; and while Federal, state, and local government construction has expanded, this segment is not a large proportion of the total. It is residential building that has sparked the construction boom. Well over half a million new non-farm housing units were started between January 1 and the end of May. It now appears that 1,250,000 new homes will be built this year, in comparison with last year's record 1,025,000 and 1925's 937,000. It is undoubtedly true that these are smaller houses and apartments than were built in pre-war years, but additional and more costly special features help make up for the difference.

Who are buying the new homes and how long can home building continue at this pace? They are being purchased by newly formed families, by families who formerly were "doubled up" with others, and by families able to afford better living conditions. Under normal circumstances, about 500,000 new housing units would be required annually to take care of the net increase in families. Another

200,000 units would be required to replace obsolete structures. This is the extent of the "normal" demand. At present, and since 1946, we are cutting into a backlog created during the war years and, to some extent, during the depression years of the 1930's. The size of the backlog is variable, depending partly upon the level of personal incomes and the terms of financing for the average family. It has been estimated in recent months at anywhere between 1 million and 2.5 million units. Even the lowest of these figures would sustain current home building rates for some time to come.

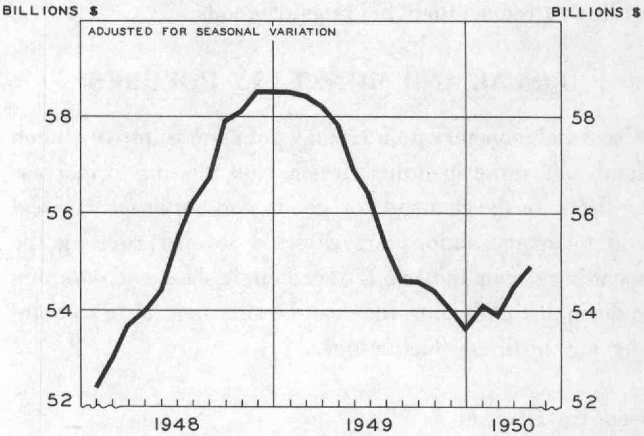
The *potential* demand for homes, of course, does not guarantee sales. In the spring of last year, when the need for housing was, if anything, greater than now, a considerable inventory of unsold new homes developed, and builders and mortgage lenders became apprehensive. Such evidence as is now available, however, points to a favorable sales outlook for the near future. In spite of the record number of housing starts in the Philadelphia area early this year, for instance, there are virtually no finished homes in the popular-price brackets that remain unsold at the present time. Builders are responding to this situation, and a record level of new construction contract awards insures a high level of activity for several months.

Two developments call for serious attention, however: shortages of certain building materials are threatening quality, and increased materials costs are raising the prices of homes. For the time being, the building industry seems to have reached the limit of its capacity; yet, at the same time, mortgage credit on extremely liberal terms is expanding rapidly—over $1 billion a month—and stimulating the immediate demand for homes. Unfortunately, a situation of this kind is not unfamiliar to those who have long experience in the real-estate market. It is incumbent upon builders and mortgage lenders of all types, as well as those in Government who are deeply involved in home financing, to remain cautious and to take action which will avoid inflationary developments in the housing field.

Inventories

In the absence of a significant expansion of the defense program, the cycle of inventory accumulation and contraction may well be the most important factor in timing a future change in business activity. It was a change from accumulation to reduction of stocks, from 1948 to 1949, which played the main role in bringing about a mild recession during the latter year. When business accumulates goods the effect is the same as that for other types of investment —additional wages are paid out for goods which must be withheld from the consumer. Business, in other words, becomes its own new customer. When inventories are reduced, that customer is lost. Production falls below consumption.

TOTAL BUSINESS INVENTORIES



Source: U. S. Department of Commerce.

As the chart shows, business inventories fell during most of 1949. By the autumn of the year, with consumer expenditures holding up well, it became clear that the liquidation of stocks had gone too far. In fact, new orders for manufacturers' goods, especially durables, had been rising for several months. First attempts to accumulate inventory were reflected mainly in still greater new orders. In December, however, manufacturers' stocks began to increase slowly, and by January, retailers had begun to restock their shelves as well. Rising prices for industrial materials were both a result of and a further stimulus to efforts in this direction.

Thus far in 1950, accumulation of inventory has been moderate. As yet the apparent need for greater military production does not seem to have caused an undue scramble for materials. For the entire economy, adjusted for price changes and seasonality, the first-quarter rate of increase in inventories was $1.7 billion a year. When this total is compared to the fourth-quarter 1949 *reduction* of inventories at the rate of $3.7 billion a year, however, it is evident that the inventory situation has been a source of considerable stimulation to business. Undoubtedly, stocks are rising at the present time. In all probability they will continue to do so for several months. An unexpectedly rapid sales expansion may prolong the process but it will not be possible for inventory accumulation to proceed at current rates for an indefinite time. Ultimately—and a guess might place the limit at six to eight months—stocks will be adequate to meet production and sales schedules, and new orders will be reduced somewhat. If the end of the current inventory expansion is like the many others which have preceded it, it may be expected that many businessmen will have overshot the mark and will be required to reduce their holdings of goods.

FISCAL AND MONETARY POLICIES

Fiscal and monetary policies may pour funds into or siphon funds out of the spending stream, thus tending to increase or decrease the demand for goods and services. If fiscal and monetary actions are directed toward swelling the spending stream in periods of economic slack and damping it down during booms, they can be very helpful in smoothing out business fluctuations.

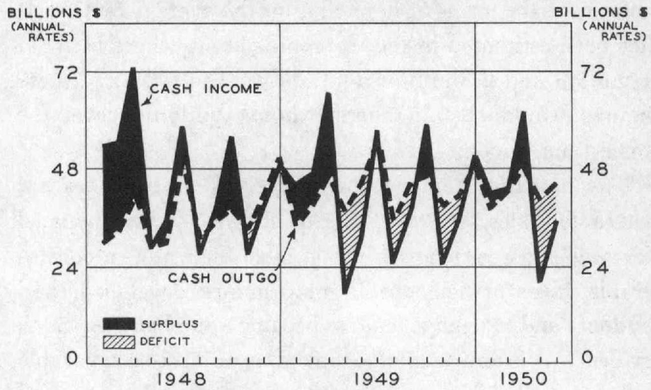
Federal Budget

Treasury receipts and expenditures are now so large that they exert an important influence on the volume of business activity. Cash expenditures and cash receipts of the Federal Government are now running in excess of $40 billion each, annually. Treasury receipts draw down bank deposits and bank reserves, tending to reduce the money supply available for spending. Treasury expenditures, on the other hand, pay funds into circulation, tending to restore deposits and bank reserves. Whether Treasury operations have an expansionary or deflationary effect depends, therefore, primarily on whether cash expenditures exceed cash receipts or *vice versa*. A cash surplus tends to diminish buying power and the total demand for goods and services, while a cash deficit tends to increase them.

If fiscal policy is to exert a stabilizing effect on business activity, there should be a cash surplus in boom periods and a deficit in periods of depression when a stimulus is needed. When neither inflationary nor deflationary forces are predominant, a neutral effect can be achieved by a balanced cash budget. In other words, fiscal policy—like Federal Reserve policy—should be neutral, deflationary, or inflationary, depending on the general business and financial situation.

The Treasury's cash deficit for fiscal year 1950 ending June 30 was considerably less than the estimate given in the budget message of last January. At that time, cash receipts were estimated at $41.7 billion and cash expenditures at $46.5 billion—an excess of expenditures of $4.8 billion. However, cash expenditures were about $3 billion less than the January estimate and, despite a small decline in cash receipts, the cash deficit was less than $3 billion instead of the nearly $5 billion anticipated last January.

FEDERAL RECEIPTS AND EXPENDITURES



Source: U. S. Treasury.

This improvement in the cash budget reflects primarily a slower rate of national defense and related expenditures than was originally estimated. Cash outlays for national defense were about $700 million less for the fiscal year 1950 than the January estimate. Cash payments for various types of foreign aid were down about $1 billion, and net purchases of mortgages by the Federal National Mortgage Association were about $400 million below the earlier estimate.

The outlook for fiscal year 1951 beginning July 1 is uncertain at the present time. Recent estimates placed the cash deficit somewhat below the $2.7 billion estimated last January. However, the outbreak of fighting in Korea and the commitments made by the United States are likely to have an important influence on defense expenditures. Defense appropriations for the coming year may be larger than recently anticipated. The slower rate of spending for certain purposes, particularly military and foreign aid, which resulted in the recent improvement in the budget situation, may prove to be only temporary. The worsening of the international situation makes it impossible to arrive at any accurate estimate of the budget for the next fiscal year; however, a substantial cash operating deficit is in prospect.

Federal Reserve Policy

The problems facing the Federal Reserve System have changed markedly in the last eighteen months. Inflationary pressures which characterized most of 1948 began to subside in the latter part of the year. There was more than the usual seasonal recession during the first part of 1949. Weakness in the Government bond market during much of 1948, reflected in large support purchases by the Federal Reserve System, gave way to considerable strength in 1949. Business loans, instead of continuing to expand, dropped sharply in the first half of last year.

Federal Reserve actions which are directed toward the objective of helping to maintain a stable and a high level of production and employment were shifted to meet the changing situation. Actions to provide restraint were replaced by those designed to make credit easier. Consumer credit regulations were relaxed early in 1949 and reserve requirements of member banks were reduced three times from May to September. The Treasury also gradually dropped the rate on one-year certificates from 1¼ to 1⅛ per cent. Instead of purchasing Government bonds in supporting the market, as in 1948, the Federal Reserve sold Governments to meet the increased demand, reflecting in part the decrease in reserve requirements. Such sales tended to absorb reserves when the objective was to make reserves and credit more plentiful. For this reason, the Federal Reserve modified its open market policy in the latter part of June, sales of Government securities being geared closer to the needs of the general credit and business situation.

As business recovery set in last fall, Federal Reserve actions were again shifted to meet the needs of changing business and financial conditions. A policy of credit ease gradually gave way to one of neutrality as recovery progressed—neither positive action toward credit restraint nor toward credit ease. More recently, as inflationary pressures have begun to appear in the form of an increasing backlog of orders in certain industries operating at capacity and rising prices, there has been a further shift toward mild restraint.

During the first half of 1950, Federal Reserve credit declined about $1 billion, and gold and foreign account operations also tended to reduce reserves by over $500 million. These forces tending to decrease bank reserves were largely but not entirely offset by additions to reserves from Treasury operations, a return flow of currency from circulation, and other factors. The Treasury rate on certificates was gradually raised from 1⅛ per cent on one-year certificates last fall to 1¼ per cent on a 13-month note in the mid-year refinancing operations.

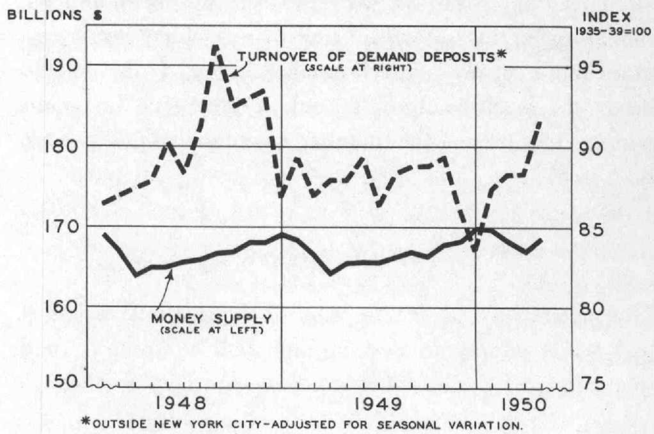
The outlook for the remainder of 1950 is for some drain on bank reserves. Bank loans and bank purchases of securities, especially corporate, state, and municipal issues, are likely to continue to rise. A continued increase in earning assets means an increase in deposits and in the amount of reserves needed to support them. Also, an outflow of gold and a seasonal increase in currency in circulation are likely to result in some net drain on bank reserves.

Money Supply

Fiscal and monetary policies affect the volume of spending primarily through influencing the quantity of money people have available to spend. They cannot directly affect the decisions people make as to how rapidly they spend or turn over the money supply they have.

The quantity of money—currency and commercial bank deposits—in the hands of business firms and individuals has been relatively stable since the end of 1947, except for seasonal declines during the early months of the year. An excess of Treasury cash receipts over expenditures during the first quarter is largely responsible for the seasonal declines. The decrease in the money supply during the first part of this year was smaller than last year, in part because of the liquidation of bank loans a year ago.

MONEY SUPPLY AND VELOCITY



Source: Board of Governors of the Federal Reserve System.

A relatively stable quantity of money has been a helpful factor in maintaining a high level of demand for goods and services. This stability reflects primarily two factors. One is that loans, which tend to expand and contract with the volume of business activity, constitute a much smaller proportion of total commercial bank assets than in the pre-war period. As has already been pointed out, the decline in business loans last year was partially offset by a continued rise in other loan categories, such as real-estate and consumer. More important, however, Government securities, which represent the largest single bloc of bank assets, are not reduced by loan liquidation. For these reasons, a business decline is not likely to bring about so large a proportionate decrease in commercial bank assets and deposits as before the war. A second factor in the relative stability in the money supply last year was the rise in commercial bank investments. This increase was generated in part by the reduction of reserve requirements made once it became clear that the recession was more than a seasonal decline. As member bank reserves were freed by this reduction, a large part of the funds went into Governments and other securities. These purchases increased deposits, thus tending to offset the decrease in deposits brought about by the liquidation of business loans. The fact that commercial bank deposits and therefore the money supply are less influenced by changes in the volume of business activity than formerly should be helpful in maintaining a more stable volume of production and employment.

The rate of demand deposit turnover has been relatively low all during the war and post-war period. However, there has been a slow but fairly steady rise since 1946 except for seasonal changes, both in New York City—which is influenced more by security operations—and in other leading cities. Growing business optimism and anticipatory buying set off by fear of war could result in a more rapid turnover in the money supply. If this should occur, the result would be an enlarged demand for goods and services even if the quantity of money should remain the same.

CONCLUSIONS

The uncertainty of the international situation makes it impossible simply to add up the visible strengths and weaknesses of the business situation and come up with a reasonably definite appraisal of the business outlook. If military operations in the Far East are prolonged or extended, they would soon become the dominant consideration. Their influence would be strongly inflationary and it would be felt very quickly throughout the economy. There is little or no slack available for additional defense production. This article, however, makes no attempt to appraise business prospects under international conditions which are much different from the present.

On the basis of the evidence discussed in this article there is every reason to expect high levels of business activity for the remainder of the year, and there are sufficient elements of stability and expansion in sight to indicate that a major recession is not likely in the foreseeable future. Consumer and business spending have been maintained at high and fairly stable levels. They continue to be supported by high levels of consumer income and business profits, by large liquid asset holdings, and by a plentiful supply of credit available on easy terms. Government spending is more likely to increase than to decrease.

The principal possibilities that might bring about a business readjustment are in sight and they arise out of the nature of the boom itself. Production of automobiles, certain other durables, and new homes (though the backlog for homes is still large) appear to be at rates higher than normal demands can sustain. Moreover, the boom in these industries is being fed in part by rather rapid rates of consumer and mortgage credit expansion. Inventory expansion, now feeding new orders to business, will eventually stop and may turn into inventory liquidation. A sharp downturn in some or all of these areas—which could easily be initiated by satisfied consumer demands, a considerably slower rate of consumer and mortgage credit expansion, or a shift from inventory accumulation to liquidation—might spread and precipitate a general decline in business activity. Only time can tell how strong these possibilities are.

CURRENT TRENDS

Business in the Philadelphia Federal Reserve District continued its upward trend in May. Employment, pay rolls, and production increased over April and so did anthracite output, bank loans, and deposits. Rising contract awards in all major fields promise continued activity at high levels in building and construction. Exceptions in the generally bright picture were department store sales which did not come up to expectations and declining bituminous coal production. Rising prices reflected expanding business activity.

Employment in Pennsylvania factories rose to a level only 2 per cent below last year's. Durable goods industries were chiefly responsible for the increased employment in May. Increased orders for railroad equipment raised employment in the transportation equipment industry for the first time in months. Production increased from April to May in both durable and nondurable industries; in fact, greater output occurred in all but three manufacturing industries, and these showed no change. Production in the automobile industry spurted in response to Detroit demands on local suppliers. Industrial pay rolls generally were higher as a result of both increased hours and record hourly earnings. The longer hours, which indicate some overtime, may mean that employers are lengthening the work-week rather than hiring more employees.

The wholesale price index, slow moving for some time, began to show the effects of the business boom. Intensified buying of hard goods increased the demand for raw materials, and the prices of commodities such as scrap steel, rubber, and lumber rose substantially. Prices of farm products and food also increased, which contributed to the rising cost of living.

May sales at department stores, seasonally adjusted, declined from the April level but were only 1 per cent below a year ago. Preliminary reports for June indicate an improvement in sales. Despite a poor season in late winter and spring, store buyers in the soft goods lines are apparently optimistic, judged by increased orders placed for fall merchandise.

Total loans of member banks continued to rise during May both in the Third District and nationally. All major types of loans—business, real-estate, and all other (mostly consumer)—showed some increase in the Third District, according to information from weekly reporting banks; further increases were reported during the first three weeks of June.

SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	May 1950 from		5 mos. 1950 from year ago	May 1950 from		5 mos. 1950 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production	+ 4*	+ 1*	− 7*	+3	+13	− 3
Construction contracts	+ 5	+59	+35	−1	+47	+53
Coal mining	+13	− 8	− 2	−5	− 8	−14
EMPLOYMENT AND INCOME						
Factory employment	+ 1*	− 2*	− 7*	+1	+ 4	− 2
Factory wage income	+ 4*	+ 4*	− 5*	....	....	....
TRADE**						
Department store sales	0	− 1	− 1	0	0	− 2
Department store stocks	− 4	+ 2	....	....	....	....
BANKING (All member banks)						
Deposits	+ 1	+ 6	+ 5	+1	+ 5	+ 4
Loans	+ 3	+11	+ 6	+1	+ 8	+ 4
Investments	− 1	+ 7	+ 8	+1	+ 8	+10
U. S. Govt. securities	− 1	+ 6	+ 7	+1	+ 6	+ 9
Other	− 1	+12	+13	0	+20	+19
PRICES						
Wholesale	....	....	....	+2	0	− 3
Consumers	+ 1†	− 2†	− 2†	+1	0	− 1
OTHER						
Check payments	+10	+24	+14	+9	+13	+ 6
Output of electricity	0	+13	+ 6	....	....	....

*Pennsylvania. **Adjusted for seasonal variation. †Philadelphia.

LOCAL CONDITIONS	Factory*				Department Store				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change May 1950 from		Per cent change May 1950 from		Per cent change May 1950 from		Per cent change May 1950 from		Per cent change May 1950 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Allentown	0	− 2	+ 1	+ 3	....	....	....	....	+ 9	+11
Altoona	−2	− 2	−15	−17	....	....	....	....	+13	+ 8
Harrisburg	−2	− 8	− 1	− 8	....	....	....	....	+ 8	+15
Johnstown	+7	− 5	+ 6	− 3	....	....	....	....	+ 2	+ 2
Lancaster	0	− 2	+ 2	+ 4	+10	+14	−1	+8	− 3	+ 4
Philadelphia	+1	− 3	+ 4	+ 2	0	− 2	−5	−1	+10	+27
Reading	0	− 2	+ 4	+ 4	− 4	− 3	−2	+5	− 2	+21
Scranton	−2	+ 5	+ 1	+12	....	....	....	....	+12	+22
Trenton	....	....	....	....	− 5	+ 3	−4	−2	+ 5	+11
Wilkes-Barre	+7	−12	+13	−10	+ 4	+ 2	−4	+3	+ 4	+10
Williamsport	0	+ 8	− 3	+ 8	....	....	....	....	+ 6	+12
Wilmington	−1	+ 1	− 1	+ 6	....	....	....	....	+ 5	+25
York	+1	+15	+ 3	+28	− 9	+ 1	−4	+8	+11	+ 7

*Not restricted to corporate limits of cities but covers areas of one or more counties.

MEASURES OF OUTPUT

	Per cent change: May 1950 from month ago	Per cent change: May 1950 from year ago	Per cent change: 5 mos. 1950 from year ago
MANUFACTURING (Pa.)*	+ 4	+ 1	− 7
Durable goods industries	+ 4	+ 1	−11
Nondurable goods industries	+ 2	+ 1	− 2
Foods	+ 4	− 2	− 2
Tobacco	+14	− 6	−11
Textiles	+ 2	+ 8	+ 3
Apparel	+ 3	0	+ 5
Lumber	+ 4	+ 2	− 9
Furniture and lumber products	+ 1	+ 34	+21
Paper	0	+ 6	+ 2
Printing and publishing	0	− 4	− 2
Chemicals	0	+ 2	− 6
Petroleum and coal products	+ 4	− 3	− 5
Rubber	+10	+ 13	+ 3
Leather	+ 1	− 5	− 2
Stone, clay and glass	+ 5	+ 4	− 6
Iron and Steel	+ 3	+ 3	−10
Nonferrous metals	+ 5	+ 6	−10
Machinery (excl. electrical)	+ 7	0	−16
Electrical machinery	+ 2	+ 5	− 4
Transportation equipment (excl. auto)	+18	− 48	−46
Automobiles and equipment	+14	+ 32	+11
Other manufacturing	+ 1	+ 6	− 6
COAL MINING (3rd F. R. Dist.)†	+13	− 8	− 2
Anthracite	+19	− 6	+ 4
Bituminous	−14	− 17	−30
CRUDE OIL (3rd F. R. Dist.)††	+ 4	− 1	− 6
CONSTRUCTION — CONTRACT AWARDS (3rd F. R. Dist.)**	+ 5	+ 59	+35
Residential	+ 6	+133	+77
Nonresidential	+ 2	+ 18	+23
Public works and utilities	+ 7	+ 32	+ 7

*Temporary series—not comparable with former production indexes.
**Source: F. W. Dodge Corporation. Changes computed from 3-month moving averages, centered on 3rd month.
†U.S. Bureau of Mines. ††American Petroleum Inst. Bradford field.

EMPLOYMENT AND INCOME

Pennsylvania Manufacturing Industries* Indexes (1939 avg. = 100)	Employment: May 1950 (Index)	Employment: Per cent change from mo. ago	Employment: Per cent change from year ago	Payrolls: May 1950 (Index)	Payrolls: Per cent change from mo. ago	Payrolls: Per cent change from year ago	Average Weekly Earnings: May 1950	Average Weekly Earnings: % chg. from year ago	Average Hourly Earnings: May 1950	Average Hourly Earnings: % chg. from year ago
All manufacturing	115	+ 1	− 2	278	+ 4	+ 4	$54.19	+ 5	$1.372	+2
Durable goods industries	136	+ 2	− 3	314	+ 5	+ 3	59.92	+ 6	1.489	+2
Nondurable goods industries	96	− 1	+ 1	234	+ 2	+ 5	46.93	+ 4	1.218	+3
Foods	114	+ 1	− 2	246	+ 5	+ 2	48.21	+ 4	1.187	+4
Tobacco	78	− 1	−10	182	+14	− 1	30.58	+11	.805	+5
Textiles	75	− 1	+ 5	188	+ 2	+ 7	44.92	+ 2	1.192	−1
Apparel	88	− 2	+ 1	234	+ 2	+ 5	37.49	+ 4	.972	+6
Lumber	83	+ 2	− 6	193	+ 3	+ 5	43.31	+12	1.092	+3
Furniture and lumber products	99	0	+30	252	+ 1	+43	46.83	+10	1.078	+7
Paper	119	0	+ 4	279	+ 1	+13	50.80	+ 9	1.240	+6
Printing and publishing	131	0	− 4	296	0	+ 1	63.69	+ 5	1.712	+6
Chemicals	113	0	− 1	258	0	+ 7	54.40	+ 8	1.332	+3
Petroleum and coal products	148	+ 3	− 2	320	+ 4	− 2	65.99	+ 1	1.658	+1
Rubber	130	+ 3	+ 6	297	+ 9	+21	56.92	+14	1.457	+4
Leather	84	− 2	− 1	179	+ 1	+ 1	36.60	+ 2	1.103	+6
Stone, clay and glass	120	+ 3	0	284	+ 5	+ 7	53.93	+ 7	1.297	+2
Iron and Steel	129	+ 2	− 1	297	+ 3	+ 5	62.18	+ 6	1.563	+2
Nonferrous metals	118	+ 3	− 1	278	+ 7	+ 8	61.43	+ 9	1.473	+3
Machinery (excl. electrical)	170	+ 1	− 8	387	+ 5	0	57.76	+ 9	1.437	+2
Electrical machinery	208	0	+ 3	443	+ 3	+ 5	59.68	+ 2	1.524	0
Transportation equipment (excl. auto)	131	+18	−47	268	+16	−47	62.20	+ 2	1.578	−1
Automobiles and equipment	134	+10	+24	329	+15	+41	67.23	+14	1.572	+7
Other manufacturing	114	− 1	+ 5	242	+ 1	+15	44.50	+ 9	1.202	+5

*Production workers only.

TRADE

Third F. R. District. Indexes: 1935-39 Avg. = 100. Adjusted for seasonal variation	May 1950 (Index)	Per cent change: May 1950 from month ago	Per cent change: May 1950 from year ago	Per cent change: 5 mos. 1950 from year ago
SALES				
Department stores	270	− 4	−1	− 1
Women's apparel stores	223	− 6	−8	−13
Furniture stores	....	+18*	+7*	+ 2*
STOCKS				
Department stores	244	− 2	+2	....
Women's apparel stores	203	− 6	+3	....
Furniture stores	....	+13*	+7*	....

Recent Changes in Department Store Sales in Central Philadelphia	Per cent change from year ago
Week ended June 3	−4
Week ended June 10	+6
Week ended June 17	+6
Week ended June 24	−3
Week ended July 1	+22†

*Unadjusted. †One more trading day in 1950.

Departmental Sales and Stocks of Independent Department Stores Third F. R. District	Sales: % chg. May 1950 from year ago	Sales: % chg. 5 mos. 1950 from year ago	Stocks (end of month): % chg. May 1950 from year ago	Stocks: Ratio to sales (months' supply) May 1950	Stocks: Ratio to sales (months' supply) May 1949
Total — All departments	0	− 3	0	2.7	2.7
Main store total	+ 1	− 1	+ 1	3.0	3.0
Piece goods and household textiles	− 4	−11	+ 4	3.4	3.1
Small wares	+ 2	− 1	+ 2	3.6	3.6
Women's and misses' accessories	+ 1	− 4	+ 8	2.9	2.7
Women's and misses' apparel	− 9	−11	+ 1	2.0	1.8
Men's and boys' wear	− 1	− 1	+ 1	3.9	3.8
Housefurnishings	+10	+10	− 1	3.1	3.5
Other main store	+ 2	− 4	−11	2.8	3.1
Basement store total	− 4	− 7	− 6	1.6	1.7
Domestics and blankets	− 5	− 4	0	2.0	1.9
Small wares	+21	+ 8	− 8	1.7	2.2
Women's and misses' wear	− 8	−12	− 6	1.2	1.2
Men's and boys' wear	− 1	− 3	+ 2	2.1	2.0
Housefurnishings	+ 5	0	−15	1.7	2.1
Shoes	− 2	− 5	− 4	2.6	2.7
Nonmerchandise total	+ 5	+ 1	....	....	....

CONSUMER CREDIT

Sale Credit Third F. R. District	Sales		Receivables (end of month)
	% chg. May 1950 from year ago	% chg. 5 mos. 1950 from year ago	% chg. May 1950 from year ago
Department stores			
Cash	−2	−7	....
Charge account	+3	−1	+1
Instalment account	+10	+17	+28
Furniture stores			
Cash	+5	−6	....
Charge account	0	+3	....
Instalment account	+4	+5	+16

Loan Credit Third F. R. District	Loans made		Loan balances outstanding (end of month)
	% chg. May 1950 from year ago	% chg. 5 mos. 1950 from year ago	% chg. May 1950 from year ago
Consumer instalment loans			
Commercial banks	+70	+68	+22
Industrial banks and loan companies	+13	−1	+3
Small loan companies	−35	−38	+11
Credit unions	+31	+27	+29

PRICES

Index: 1935-39 average = 100	May 1950 (Index)	Per cent change from	
		month ago	year ago
Wholesale prices—United States	193	+2	0
Farm products	217	+3	−4
Foods	202	+3	−2
Other	182	+1	+1
Consumer prices			
United States	169	+1	0
Philadelphia	167	+1	−2
Food	195	+2	−2
Clothing	182	0	−3
Rent	122	0	+1
Fuel	142	−3	−1
Housefurnishings	191	+1	−1
Other	152	0	−3

Weekly Wholesale Prices—U.S. (Index: 1935-39 average = 100)	All commodities	Farm products	Foods	Other
Week ended June 6	195	219	206	183
Week ended June 13	194	216	204	183
Week ended June 20	195	219	206	183
Week ended June 27	195	217	206	183

Source: U.S. Bureau of Labor Statistics.

BANKING

MONEY SUPPLY AND RELATED ITEMS United States (Billions $)	May 31 1950	Changes in—	
		five weeks	year
Money supply, privately owned	169.5	+.9	+3.8
Demand deposits, adjusted	85.3	+.8	+2.8
Time deposits	59.5	+.1	+1.3
Currency outside banks	24.7	+.1	−.3
Turnover of demand deposits	19.8*	+1.0*	+3.7*
Commercial bank earning assets	121.2	+.9	+7.8
Loans	44.1	+.3	+3.2
U.S. Government securities	66.1	+.6	+3.0
Other securities	11.0	0	+1.7
Member bank reserves held	15.8	−.1	−2.3
Required reserves (estimated)	15.3	+.1	−2.0
Excess reserves (estimated)	.5	−.2	−.3

Changes in reserves during 5 weeks ended May 31 reflected the following:

	Effect on reserves
Net payments by the Treasury	+.3
Increase in Reserve Bank loans	+.1
Decrease in Reserve Bank holdings of Governments	−.3
Increase of currency in circulation	−.1
Other transactions	−.1
Change in reserves	−.1

*Annual rate for the month and per cent changes from month and year ago at leading cities outside N. Y. City.

OTHER BANKING DATA	June 21 1950	Changes in—	
		four weeks	year
Weekly reporting banks—leading cities			
United States (*billions* $):			
Loans—			
Commercial, industrial and agricultural	13.5	+.2	+.2
Security	2.3	0	0
Real estate	4.7	+.1	+.6
To banks	.3	−.1	+.1
All other	4.9	+.1	+.9
Total loans—gross	25.7	+.3	+1.8
Investments	42.6	+.6	+3.5
Deposits	76.2	+1.2	+4.2
Third Federal Reserve District (*millions* $):			
Loans—			
Commercial, industrial and agricultural	518	+19	+48
Security	52	+5	+14
Real estate	117	+4	+26
To banks	14	+4	+6
All other	331	+6	+54
Total loans—gross	1,032	+38	+148
Investments	1,835	+9	+157
Deposits	3,164	+74	+267
Member bank reserves and related items			
United States (*billions* $):			
Member bank reserves held	16.2	+.2	−2.1
Reserve Bank holdings of Governments	17.7	+.4	−1.5
Gold stock	24.2	0	−.2
Money in circulation	26.9	0	−.4
Treasury deposits at Reserve Banks	.5	+.1	0
Federal Reserve Bank of Phila. (*millions* $)			
Loans and securities	1,180	+24	−135
Federal Reserve notes	1,600	−5	−16
Member bank reserve deposits	771	+10	−93
Gold certificate reserves	1,325	−7	+93
Reserve ratio (%)	52.9%	−.9%	+4.4%