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EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

October 15, 1952

MEMORANDUM

To: The President

From: Council of Economic Advisers

Subject: Quarterly Report on the Economic Situation

The Economy During the Third Quarter

General developments

The Council stated in its Midyear 1952 Economic Review that if the main components of total demand followed the course which seemed most likely at the time, " . . . the outlook is for a period of high prosperity in the near future without dangerous inflationary pressures." It is possible to summarize the general developments of the past three months in terms of that statement: total output remained virtually at its second quarter level; prosperity continued high; and while inflationary pressures persisted, general price movements were not significant enough to suggest that the stability of the economy was being endangered.

But this broad picture does not reveal two striking features of the quarter: the sharp reduction of many forms of activity as the steel strike progressed from June through July and the rapid recoveries achieved after the strike, when production of some commodities exceeded prestrike levels.

When the third quarter opened, the output of steel had been pulled down from a weekly level of more than 2,000,000 tons to a mere 300,000 tons. But just before the quarter ended, production established a new record of 2,160,000 tons a week, a record which has since been exceeded.

Automobile and truck assemblies dropped from the weekly average of 115,000 units during the month before the strike to 27,000 units during the week ended July 19. (Vacations and change-overs in models also helped to cut production.) But recovery was speedy. During the week ended September 20, 138,000 units were assembled, the largest number in 15 months.

Industrial production also clearly showed the effect of the banked steel furnaces and various strike-induced curtailments. The index had already slipped down 3 percent in June; during July it dropped 5 percent. But by September it had more than recovered, climbing to the postwar peak of 223 percent (1935-39=100), which had been attained in April 1951.

Gross national product, at seasonally adjusted annual rates, did not increase significantly during the third quarter as a whole. However, there was a moderate rise in consumer buying, which seemed to be gaining strength near the end of the quarter. It showed up entirely in soft goods and services, as spending for durable goods was reduced. Private investment increased slightly; the rate of government purchases of goods and services was unchanged; and, for the third consecutive quarter, net foreign investment declined.

The influence of the strike extended to income and even to credit. In July, total personal income declined about 3 billion dollars (seasonally adjusted annual rate), with most of the drop accounted for by labor income, although other major components showed minor declines. By August, however, total personal income topped the June figure. Labor income jumped in August to an annual rate nearly 2 billion dollars above the June level, while farm income and transfer payments continued to fall. Consumer instalment credit soared to a record monthly rate after the suspension of Regulation W in May, a large proportion of the new loans going to buyers of automobiles. But in August, as the stocks of many automobile dealers were exhausted, instalment credit returned to a more leisurely rate of growth. The seasonal rise in business loans was held down for a time, with declines in loans to manufacturers of metals and metal products partly offsetting the growth of loans for the marketing or processing of farm crops.

While many hours of work were lost during the third quarter, there was no very great change in the number of workers with jobs. Civilian employment totaled about 62.3 million in September, and unemployment fell to 1.4 million, the lowest monthly level of the postwar period.

The structure of prices was relatively stable during the third quarter. The index of consumers' prices was about 1 percent higher on August 15 than on June 15, with food prices largely responsible for the rise. However, during the month of September, food prices slipped downward. Wholesale prices, which had been dropping more or less steadily for 8 months, rose slightly in both July and August. On the basis of the weekly index, however, wholesale prices declined in September.

Military expenditures

Expenditures by the Department of Defense for its own military functions and for foreign military aid dropped sharply in August, and while they rebounded in September, they did not exceed the level of July. The total for the third quarter--the first quarter of fiscal 1953--was 11.4 billion dollars. This was 200 million below expenditures in the previous quarter, and far below the level that seemed necessary to reach the fiscal year total of around 52 billion dollars, as estimated in the August Budget Review.

Foreign trade

As was indicated above, while the domestic demand for our products was on the whole relatively stationary during the third quarter, foreign demand fell off. During July and August, total merchandise exports from the United States declined substantially below the level of the first half of this year; and they were also below the level of the third quarter of 1951. The decline from the first half was primarily in volume, as there was little change in the average of export prices. The greatest decreases were in U. S. exports of food and raw materials, reflecting increased supplies of these commodities in other parts of the world. However, nearly all categories of exports were significantly affected because of the fact that a number of our best foreign customers experienced balance of payments deficits and imposed restrictions on imports as one means of correcting the deficits.

United States imports during June and July were somewhat below those of the comparable period of last year as declines in prices abroad, primarily of raw materials, more than offset an increase in the physical quantities of goods entering the country. The low level of our imports foreshadows continuance of the current low level of our exports and thereby serves to underscore the need to find means of increasing our imports if we are to help other countries in becoming more self-supporting with a minimum of strain on our economy.

The Economic Outlook

The economic outlook for the next 6 to 9 months does not appear to be greatly different from that outlined in the Council's Midyear Review.

The rise in expenditures for national security during the present fiscal year, while probably moderately less than was expected in July, will continue to be the most important lifting element in the total demand for goods and services.

The indications of the most recent surveys of investment intentions are that business investment will continue at or near its first half of 1952 level. The chances of decline before the middle of next year have been reduced by the steel strike's effect of pushing the availability of materials for some private investment from this half year into the next half year. The comparative stability of business inventories during the third quarter helps to confirm our view at midyear that the year-long decline in inventory building which began in the third quarter of 1951 was at an end, and suggests that some net inventory buying may be in store during the next quarter or two. In the first half of 1953, the rate of housing construction may be slightly lower than in the first half of 1952.

Total consumer income will be rising, partly because of wage increases, and, with a Federal cash deficit of around 7 billion dollars in prospect for fiscal 1953, the amount of total private income available for spending will be somewhat greater than before. Since there is no specific reason for expecting the rate of saving to change significantly, consumer spending will probably increase moderately in step with the increase in disposable income. The passing of the automobile shortages resulting from the steel strike may result in a fairly sizable pick-up in consumer durable goods purchases before the end of this year.

Finally, it seems unlikely that U. S. exports will rise above present levels, except for seasonal factors.

In sum, total demand will probably continue to grow enough to preclude any general softness in the Nation's markets during most or all of the next 9 months. It is true that the continuing expansion of capacity for materials production and for some consumer goods production will permit further growth of supplies. And, while demand promises to keep pace, the timing of this demand growth will depend largely on the timing of increases in defense spending. If most of the increase in national security expenditures planned for the remainder of this fiscal year should come in the next quarter or two, it would be possible for problems of general economic transition to a defense "level-off" to begin to emerge before midyear. However, the more likely prospect is that demand will remain in near balance with supply throughout the next 9 months.

All of this outlook, moreover, is based on the assumption of no unsettling turn of events internationally. When one removes this assumption and tries to weigh economic risks rather than economic probabilities, then clearly we must remain on the alert against the dangers of inflation. Developments abroad could bring about a new wave of consumer buying and inventory accumulation. With the economy operating at about full capacity in most areas, and with the level of employment very high, most of the force of such an accelerated increase in private demand would be quickly turned upon prices.

Economic Policies

Since the outlook for the remainder of this year and the first part of next year seems to be about as we saw it in July, no major alterations in the Midyear Economic Review's short-run policy recommendations are necessary.

It is plain that this is not yet the time for any let-down or feeling of "having arrived," in either our defense production or stabilization efforts. The further and important build-ups still to be accomplished in military output and in the mobilization base, and the further inflationary risks which they may entail, still have chronological priority over whatever problems a leveled-off defense program may later bring.

First as to specific policies, it now seems desirable to hold the line on taxes. It would be inappropriate to ask for tax reductions at the first opportunity in the first fiscal year after Korea which will show a cash deficit--and a sizable one. On the other hand, it would scarcely seem either feasible or economically justifiable to ask for additional taxes at the outset of the next Congress.

Second, both in the current situation and more particularly in view of the ever-present possibility of some new "incident" in the international situation, the arsenal of anti-inflationary weapons will be inadequate so long as authority to impose controls on consumer and mortgage credit is lacking. Preparations should be made for requesting, at the earliest opportunity, the restoration of these powers by the Congress.

Third, it is important to keep constantly in mind the need for renewal of the Defense Production Act's materials controls provisions before they expire at the end of next June. In the event of some new international "incident," a ready-to-go allocations program and organization would be at the very core of essential action. And even with no further disruption of the international situation, some portions of the materials and production programs of the Act--notably, control over critical Band I materials--will need to remain operative for some time.

Fourth, and perhaps most urgent in terms of immediate policy planning, a difficult and complicated problem is shaping up in the field of price and wage controls.

Due to vast increase in our productive power, which has been a most important factor in holding inflation in check, the Office of Price Stabilization has been able to suspend a number of price ceilings. This is obviously a healthy trend in terms of the long-range interests of our kind of economic system. It is to be hoped that the continuing growth of our productive power will enable acceleration of this process without excessive risks. At the same time, we should be mindful that, even if the ceiling suspensions now in the mill are completed by the end of the year, it is estimated that items representing something like 50 percent of the Consumers' Price Index and 70 percent of the Wholesale Price Index will still be under operating controls on January 1. Moreover, there is little in the economic outlook to indicate significant market softening during the next few months. While the outlook beyond April 30, 1953, the time now established by law for the termination of price and wage control, seems to indicate further easing of some inflationary pressures, the international situation for a long time to come will be uncertain. Consequently, we feel that thought and planning should now be directed toward the administrative and legislative mechanics for maintaining the authority and ability to control prices and wages beyond next April. In view of manifest uncertainties not only in the economic but also in the legislative situation, it is too early to judge with any precision exactly what form the request for the continuation of this authority should take. Alternatives worthy of consideration include the extension of the current law, or some more limited form of operating price and wage controls accompanied by broad standby authority.

Respectfully submitted,

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