TREASURY DEPARTMENT

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J. W. S.

TO Secretary Snyder

FROM Mr. Haas

Subject: Comments of Federal Reserve Banks on Current Business Situation

You asked me to summarize the replies to a letter sent by Mr. McCabe to the directors of the Federal Reserve Banks, asking for their comments on current conditions in businesses of which they had first-hand knowledge.

The seven questions asked by Mr. McCabe are listed below, with a summary of the opinions of the directors expressed in their replies to each question.

(1) In the case of the company or companies with which you are most familiar, has there been any substantial change in the plans for investment in new facilities (plant or equipment) since October 31, 1948? Do you feel that expenditures of this type in 1949 will run ahead of or behind expenditures in 1948?

It is the belief of nearly all directors that the election results have had no noticeable effect on capital expenditures for which plans had already been made. These will be completed as planned, which will help maintain capital expenditures at a high level during the first quarter or first half of 1949.

Greater caution, however, will be shown in new capital investment that is still in the discussion stage, and many of these will now be held in abeyance pending a clearer picture of prospective profits, of Congressional action -- particularly on taxes and labor laws, and of the trend in construction costs.

The very general belief is that capital expenditures in 1949 will be noticeably less than in 1948, to some extent because of the hesitation mentioned above, but more largely because of the completion of postwar expansion programs. The reduction is expected chiefly in the second half of 1949. However, a large volume of capital expenditures will continue. The bank directors expect a shift in the character of capital expenditures from expansion of plant to modernization of equipment. No reduction is expected in utilities, nor perhaps in the railroad and oil industries, while Federal, state, and municipal construction is expected to continue at a high level.

(2) Do you feel that there is a noticeable effort on the part of most companies with which you are familiar to increase or decrease commitments to purchase raw materials and other supplies?

The majority believes that most companies are tending to operate on a hand to mouth basis for most raw materials and other supplies, and that there has been a noticeable effort to decrease commitments. This is not true, however, of certain materials that are in short supply, such as steel and other metals. The attempt in these cases is to build up stocks.

Some mention is made, however, that the influence on raw material inventories is not marked, because of previous attempts to curtail. Some report that decreases in commitments are partly due to the knowledge that supplies (particularly in soft goods lines) can be readily obtained when needed.

(3) What is the inventory policy of concerns of which you have knowledge? Are they planning to (a) increase, (b) decrease, or (c) hold inventories constant? Do you know of cases where inventories are increasing where the increase is involuntary, i.e., due to unexpected falling off in sales?

The general policy of most companies is to decrease inventories. In view of the possibility of price declines, many are attempting to hold them to the lowest practicable working levels. An exception is noted in the case of scarce goods, where an attempt is being made to increase inventories, and some increases of a seasonal nature are mentioned.

Unsatisfactory sales levels have been responsible for some involuntary increases in inventories, as mentioned in about half of the reports. Cases cited are in the textile industry, the Pennsylvania petroleum industry, and in retail markets for clothing, shoes, furs, furniture, and various household appliances. In the Minneapolis district, a few firms are reported to have become so over-extended that corrective action by the banks has been necessary.

(4) Are you aware of any pressure in your district as yet for a fourth round of wage increases? Do you feel that such pressure is imminent, even if the Bureau of Labor Statistics' cost of living index remains constant or recedes slightly?

There was a divided opinion on this question. Some reports indicated heavy current pressure for a "fourth round" of wage increases, notably in the San Francisco and Chicago districts. Perhaps the majority indicated no appreciable current pressure, but an expectation that an increase would eventually be granted, probably smaller in scope than previous increases, and concentrated more largely in fringe benefits. In the South, it was generally believed that wage trends would follow wage developments in the key industries.

In the New York district there was general agreement that wage demands were easing somewhat. It was believed that pressure for increases would be softened by a decline in living costs, possible rising unemployment in certain lines, and by the desire of labor leaders to obtain and hold public sympathy pending Congressional action on the Taft-Hartley law.

It was quite generally felt that, while living costs would be a factor in wage demands, some wage increase would be granted even if living costs declined, unless the decline were precipitous.

(5) Do you anticipate any increase in prices by the companies with which you are familiar within the next six months even if there is not a further rise in wages?

The feeling is general among the bank directors that there will be few price increases in the next six months unless forced by large wage increases. A few increases may be made in some metals and hard goods, and perhaps in the utility and transportation industries. In other fields, however, the development of stronger competitive conditions has made it difficult to increase prices even with higher wages.

Directors in the Chicago district report an increasing reluctance among business managements to increase prices. Several companies in this district say that they can absorb some higher costs next year because new plants will be operating at greatly improved efficiency, labor productivity is increasing, and material costs have been reduced by fewer gray market purchases. The increase in labor productivity is also mentioned by the St. Louis district, and greater efficiency is mentioned by the Minneapolis district, as contributing to an absorption of higher wage costs by manufacturers.

(6) <u>Are there any elements in the economic situation today which you regard as especially significant or critical from the point of view of business?</u>

The business elements viewed as especially significant or critical cannot accurately be ranked in order of importance, since many of the letters gave no indication of their relative importance in the minds of businessmen. It is fairly clear, however, that businessmen were most concerned about two elements: Uncertainty over Government policies, and apprehension over the effect on business of the return to buyers' markets.

In the following list of the more important factors, an attempt has been made to rank them roughly in the order of frequency with which they were mentioned:

(a) Uncertainty over Government policies, with considerable apprehension over the high level of Government expenditures, the extent of possible direct Government controls, and the prospect of higher taxes -- particularly fear of an excess profits tax.

(b) Concern over the return to buyers' markets, together with increasing consumer resistance to price increases. Mention is made that the present markets are over-shadowed by price-conscious consumers, expecting lower prices.

(c) The present high break-even points, with increased rigidity of cost factors. This is believed to be an especially important problem for the smaller and the less efficient companies.

(d) Difficulty of obtaining equity capital, particularly in view of the greater need for ample working capital under present conditions.

(e) General uncertainty over the future, both in the domestic situation and in international affairs.

(f) Miscellaneous elements -- The high level of prices, fear of price control, high inventories, high industrial capacity, probable decline in capital expenditures, and imminence of agricultural surpluses.

(7) What would you say are the major "question marks" in the businessmen's minds today in making critical decisions related to expansion or contraction of their activities?

The same difficulty of ranking appears in the answers to this question, which is closely related to the preceding one. An approximate ranking of the major question marks in the minds of businessmen today, as revealed in the bank directors' reports, is given in the following list:

(a) Uncertainty over Government policies, particularly policies toward business -- including the extension of direct controls (especially price control) if expenditures increase sharply -- and policies toward labor which will directly affect business. Probable revision of the Taft-Hartley Act that will be detrimental to business is mentioned in several letters. "After January 1, 1949, business will be operating under an unknown set of rules."

(b) Uncertainty over taxes -- whether, how soon, and how much corporate taxes will be increased, and what form they may take.

(c) General uncertainty over the business situation, the probable duration of the boom and extent of subsequent decline. "Have we passed the peak?"

(d) Uncertainty over the outcome of the tense international situation and the possibility of war.

(e) Uncertainty as to how business can cope with the problem of high break-even points under conditions of rising wages, rigid cost structures, and increasing consumer resistance to price increases.

(f) Miscellaneous questions -- Decline in demand for capital goods, possibility of strongly deflationary monetary actions by the Government, apprehension over Administration shift to "pro-labor and anti-business" attitude, possibility of imminent surpluses of agricultural products and decline in farm income.