

Fed Reserve

July 12, 1950

THE CURRENT ECONOMIC SITUATION



The Korean crisis in late June was superimposed upon an economy in which demand was already exceptionally strong and in which output goods and services was in excess of former postwar peaks, both in terms of physical volume and dollar amounts. New orders had risen substantially and businessmen were revising upwards their earlier plans for expenditures on plant and equipment. Prices of key materials, especially farm products, nonferrous metals, and building materials had already advanced sharply and consumers' prices were tending upwards. The number of persons employed had risen appreciably and unemployment had declined since winter, to a level about 1 million above the exceptionally low levels of June 1948. Credit was easy and interest rates generally had remained at low levels. Prices of common stocks had risen sharply to levels higher than at any time since August 1946.

The current international crisis has been accompanied with many uncertainties, reflected in sharp declines in common stock prices, but has created strong additional demands on an economy already operating close to capacity. Shortages have developed in many key industries. Prices have advanced further. The likely increases in defense expenditures indicate a strong probability of mounting shortages of important materials, a tightening of the labor supply, and an accentuation of inflationary pressures generally. Memories of World War II are prompting some scare buying of commodities. Incentives are very strong for accumulation of inventories by both businessmen and consumers, especially of items likely to be in short supply. Impetus is being given to further upward revisions of business plans for investment in plant and equipment.

Recent price developments. - Wholesale commodity prices rose rapidly from March to June 6, with the all-commodity index up 4 per cent in that period and the index of 28 basic commodities up 10 per cent. Following June 6, there was some reaction in prices, but since the invasion of Southern Korea on June 24, prices have again advanced sharply.

In the past 3 weeks the index of 28 basic commodities has risen over 6 per cent and the total increase from March has been nearly 14 per cent. Both imported and domestic commodities have participated in the increase. Sharp rises have occurred in recent weeks in prices of hogs, rubber, coffee, cocoa, wool, cotton, and tin. Prices of steel scrap and most non-ferrous metals, however, which had risen very sharply prior to early June have shown little change recently, with prices of steel scrap and lead below earlier peaks. Cotton prices rose the permissible limit of 2 cents a pound on July 10, reflecting official estimates of acreage almost one-third less than a year ago, as well as the international developments.



Increases in the all-commodities wholesale price index have been substantial, and average prices are half way back from the low of early 1949 to the peak of late summer 1948. As of July 4, this index increased about 5 per cent from mid-March and there appears to have been a further increase in the past week. Much of the increase has been in farm products, which are now 11 per cent higher than at the beginning of the year, and in foods, but other commodities also advanced and are now only 3 per cent below their November 1948 high. Prices of building materials are 6 per cent higher than at the beginning of the year, with lumber showing sharp advances. After modest declines earlier in the year, textile prices are again advancing.

Very strong demand for metals and metal products, which had earlier been reflected in price increases for nonferrous metals and steel scrap, is more recently being manifested in higher prices for such products as stainless steel.

Consumer prices are estimated to have risen in June for the fourth consecutive month, reflecting primarily higher retail prices of meats. Rents continue to advance, while moderate increases have been announced in prices of carpets, furniture, fuel, and apparel.

Industrial production. - The Board's index of industrial production in June is estimated at a new postwar peak of 197 as compared with the earlier postwar peak of 195 reached in late 1948. A further increase is expected in July, after allowances for usual vacation shutdowns.

Both durable and nondurable goods were at postwar highs in June, but expanded production of durable goods continued to account for most of the rise in total industrial production. Output of steel was maintained at record levels, with production at more than 100 per cent of capacity for the third consecutive month. Operations were reduced about as usual in early July but are now returning to capacity levels. Automobile production increased by 22 per cent in June to a new peak. Output of building materials and machinery continued to advance, with output of machinery only moderately below the 1948 peak.

Further advances occurred in June in output of textiles and paper, and of rubber, chemical and petroleum products. Output of minerals, which is moderately below its peak of late 1948, advanced sharply in June with gains in production of metals, petroleum, and coal. Most of these increases are expected to continue in July.

Credit developments. - Bank credit and monetary expansion, which was interrupted in 1948 and the first half of 1949, was resumed in the 12 months ending June 1950. Privately held deposits and currency amounted to about 170 billion dollars on June 30, a new peak for that date about 4.5 billion dollars more than a year earlier. Bank credit and monetary expansion in recent months has resulted primarily from a mounting volume of real estate and consumer loans, together with sustained bank investment in State and local government securities. The decline in loans to business in the first half of 1950 was much less than might be expected on seasonal grounds. Loans at commercial banks increased by about 700 million dollars during June as compared to only 100 million dollars a year ago and 400 million dollars in June 1948.

Total consumer credit outstanding rose by almost 500 billion dollars in May, the largest May increase on record. At a level of 19.1 billion dollars it was 3.2 billion dollars larger than a year ago. Instalment credit rose by 350 million dollars a month for May, with automobile sale credit continuing to account for a rising share of the increase. At the end of June, it is estimated that total consumer credit outstanding amounted to almost 10 per cent of disposable personal income as compared to 4.4 per cent at the end of 1945 and 11.4 per cent at the end of 1939.

After some slackening in the first half of 1949, mortgage debt on 1 to 4 family dwellings has been rising at close to the peak rates of 1947 and 1948. The increase in such debt outstanding in the first half of 1950 was at an annual rate of about 5 billion dollars, the same as in 1947 and 1948 and a third higher than in 1949. At the end of June 1950, such mortgage debt outstanding is estimated at about 20 per cent of personal disposable income as compared to 13 per cent at the end of 1945 and 25 per cent at the end of 1939.

In the stock market increased activity over the past year has been financed in part by expansion of bank credit, chiefly through borrowing from banks by brokers in order to finance growing margin accounts and, to a lesser extent, through loans by banks directly to customers for purchasing securities.

Despite a modest firming in yields on both long and short-term government securities largely as a result of Federal Reserve Open Market operations, interest rates continue generally low with credit readily available.