# A STUDY OF THE MONETARY POLICY DURING THE RECESSION OF NOVEMBER, 1948 TO OCTOBER, 1949

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# CHAPTER I

## INTRODUCTION

The significance of the recession of November, 1948, to October, 1949[1] does not lie in its amplitude; nevertheless, this period is of considerable importance. A careful study of this cyclical experience gives one a better understanding of the forces making for stability and instability during the postwar period, and indicates the sensitive nature of our economic system to short-run developments. Further, it points up very clearly the difficulties faced by the monetary authorities in attempting to promote economic stability and, at the same time, to maintain an orderly market for Government securities.

The purpose of this study is to establish what business conditions existed during the recession, to ascertain what monetary policies, if any, were adopted to combat the deflationary tendencies, and to discover what role our monetary policy played in bringing about the recovery.

As used here, the term monetary policy refers to changes in five credit controls administered by the Federal Reserve System:

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[1]The dates which mark off this recession are those established by the National Bureau of Economic Research. For a discussion of the method which they use to date movements in economic activity, see Wesley C. Mitchell, What Happens During Business Cycles, Chapter 3.

open market operations, rediscounting policy, reserve requirements, margin requirements, and consumer credit regulations.

The main purpose of monetary policy is, in the opinion of the author, to assist in the achievement of economic stability by controlling the flow of credit, particularly bank credit. In this text, economic stability refers to the maintenance of production and employment at high levels together with a stable general price level. There may well be other purposes that are important, but this study is exclusively concerned with monetary policy as a means of achieving economic stability.

In spite of the fact that the main concern is with monetary policy, it does not seem possible or even advisable to completely exclude the influence of fiscal policy. In order to have an effective program for economic stability, it is important that the actions of both monetary and fiscal authorities be coordinated. Consequently, some discussion is devoted to problems of a fiscal nature, especially as they affect the general level of aggregate demand.

Several problems were encountered in writing this paper. First, much relevant statistical data was available on a monthly basis, while some data was available only on a quarterly basis. In a recession as short as this one, weekly data would have been of more value, but, in most cases, simply could not be obtained. Second, the preliminary statistical data available at the time of the recession was constantly being revised. For this reason, some of the data presented is somewhat far removed in time from the period under consideration.

This study begins with a look at the business and financial developments during the war and postwar period until the latter part of 1948. This background is essential to an understanding of the recession. Without some knowledge of the forces which motivated the economy during the war and postwar period, the recession would appear as an isolated phenomenon unrelated to the previous developments. Having gained this essential knowledge, attention is turned to the recession itself.

The business conditions during the recession are studied mainly by analysis of the relevant statistics. An attempt is made to establish relationships between movements in economic activity in the hope that it will indicate the nature of the downturn. Further, the author seeks an explanation for the mildness of the recession and the quick recovery that followed the downswing.

Next, the response which the monetary authorities made to the developments of the recession is presented in detail. This is accomplished by presenting the policy actions of the Federal Reserve throughout the recession.

Finally, the author attempts to discover any relationship that exists between the monetary policy followed during the downturn and the recovery from the recession.

This study should in no way be interpreted as a criticism of the monetary policies that were followed. The author has made no attempt to judge the correctness of the policy. The facts are simply presented -- any evaluation is left to the reader.

# CHAPTER II

## BACKGROUND

The period of the Second World War was marked by an upsurge in output, employment, and prices. Inflation threatened, but was held in check by direct wage and price controls. Clearly though, while inflation may be postponed by such measures, the inflationary pressures are still there and must be dealt with sooner or later. An examination of some statistics will indicate how great this wartime expansion was.

The Index of Industrial Production rose from 109 in 1939 to 235 in 1944. Agriculture likewise showed an unprecedented increase. In spite of a slight drop in agricultural employment, total output in 1944 was 30 per cent above the 1935-39 average.[1]

The force operating to cause this tremendous expansion was the increase in federal government purchases of goods and services which grew from 1.25 billion dollars in 1939 to 88.6 billion dollars in 1944. "In this latter year, government expenditures in the aggregate amounted to over 45 per cent of the total expenditures of the nation."[2]

Soon after the beginning of the war, the economy was approaching full employment and the shift of productive resources to war uses

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[1]James Arthur Estey, Business Cycles (New York, 1956), p. 125.

[2]Ibid., p. 126.

required that fewer consumer goods be produced. Consequently, rationing was established as a means of allocating the scarce goods among consumers.

> The inflationary force is indicated by total deposits and currency outside banks, which increased from $70 billions in June, 1940 to $175 billions in December, 1945. Had these increased funds been utilized at the usually increasing rates of turnover that seem to have accompanied business expansions in the past, a dangerous inflation would have resulted. Actually, the rate of turnover of deposits, save in New York City, fell during the war. Turnover of total deposits fell from 13.1 in 1942 to 9.7 in 1945, and of demand deposits from 18.4 in 1942 to 16.1 in 1945. This change of pattern of spending in relation to receipts was presumably not voluntary, but rather the result of the allocations and rationing and price fixing imposed by government.[3]

Two other monetary effects combined to make the inflationary potential even greater. First, the total of liquid assets held by the public increased much more than the increase in the money supply. "Non-bank investors absorbed more than a hundred billion dollars in government bonds between 1939 and 1946."[4] These bonds, which could be readily converted into cash, served to make the public more willing and able to spend than would otherwise have been the case. This increase in liquid assets in the hands of the public had much to do with consumption rising much faster than disposable income after the war.

The second inflationary pressure was the result of the obligation to support the government bond market assumed by the Federal Reserve Banks during the war. This situation injected an inflexible element into the monetary controls exercised by the Federal

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[3] Robert A. Gordon, Business Fluctuations (New York, 1952), p. 422.

[4] E. A. Goldenweiser, Monetary Management (New York, 1949), p. 65.

Reserve Banks. It became impossible for the Federal Reserve Banks to freely engage in open market operations aimed at limiting the supply of bank reserves. This was not a problem during the war since all other considerations were secondary to winning the war, but with the cessation of hostilities it became a major issue. Not only was the Federal Reserve prevented from freely selling bonds in the open market, but

> ...it also had to support the bond market while insurance companies and other business firms liquidated part of their bond-holdings in order to use the funds in ways which increased the volume of private spending.[5]

Also, this policy enabled commercial banks to rapidly expand their loans after the war because of the security which their large holdings of these highly liquid government securities provided.

"Shortly after American entry in the war, rates in the market for government securities presented a spread from 3/8 per cent for three months' bills to 2 1/2 per cent for long-term bonds."[6] The authorities decided that the war should be financed at a long-time money rate not exceeding 2 1/2 per cent. Such a policy was intended to convince investors that nothing could be gained in holding off in their purchases of government securities since none would be issued yielding a higher rate of return. "Along with the determination to maintain the 2 1/2 per cent rate on long-term bonds, a policy was adopted of maintaining the existing pattern of rates."[7]

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[5] Gordon, p. 422.

[6] Goldenweiser, p. 65.

[7] Ibid.

In line with this decision, the Federal Reserve stood ready to purchase at 3/8 per cent any three-month Treasury bill offered. In addition, banks were permitted to repurchase the securities at any time, and at the same rate. Thus, Treasury bills became tantamount to money and banks carried their excess reserves in this form since they could be easily and quickly converted into legal reserves at any time.[8] Further,

> The Federal Reserve also established a preferential discount rate of 1/2 per cent for paper secured by short-term governments. This established the right of way of government securities over any other kind of paper, but was not, in fact, used to any great extent because banks had little occasion to borrow from the Federal Reserve.[9]

It should be noted, however, that inflationary dangers were not completely ignored during the war period.

> Throughout the period of war financing, there was recognition that in so far as possible borrowing should come from non-banking sources, because these sources are less inflationary.[10]

Also, banks were not included in loan drives beginning with September, 1943, hence, not being potential purchasers they could not be depended upon to help loan-drive directors reach their local quotas. Further, banks were prohibited, with minor exceptions, from purchasing securities maturing in more than ten years and yielding a return of more than two per cent and the Federal Reserve was given power to limit the extension of consumer credit, particularly installment purchases.[11]

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[8] Goldenweiser, p. 69.

[9] Ibid.

[10] Ibid., p. 71

[11] Ibid., p. 72.

Such measures as the above indicate that the monetary authorities were aware of the inflationary dangers in this period and attempted to reduce these dangers as much as possible and still maintain the steady flow of money needed to finance the war.

Even before the war ended there were many, particularly in governmental circles, who believed that the United States would face serious unemployment with the cessation of hostilities. Such beliefs emphasized the disruptive effects of demobilization and conversion of war industries to peace time production which, it was held, necessarily would follow the war. Further, the huge drop expected in government spending was viewed with much concern.

According to an estimate by E. E. Hagen,

> The probable level of gross national product based upon estimated levels of consumption, business investment, and government expenditures, indicated a volume of unemployment that might reach six million in the last quarter of 1945, and be as high as eight or even eight and one-half million in 1946, and this after allowing for a shrinkage of the labor force below the abnormally high levels of the war.[12]

Such predictions as this, of course, were not borne out.

> The postwar decline that set in early in 1945 and ended early in 1946 was unexpectedly mild. Gross National Product, which reached the peak of $221.6 billions (at annual rates) in the second quarter of 1945, fell to $191.7 billions (at annual rates) in the first quarter of 1946. The Industrial Production Index of the Federal Reserve Board fell from the high level of 235 in 1944 to an average of 160 for the first quarter of 1946 (1935-39=100). The anticipated volume of unemployment failed to arrive. The highest level of unemployment, that of March, 1946

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[12] E. E. Hagen, "Output and Demand after the War," Post War Economic Studies Number One, Federal Reserve Board, and "The Nation's Economic Budget," Studies in Income and Wealth, X, National Bureau of Economic Research, as quoted by James Arthur Estey in Business Cycles, p. 129.

did not exceed 2.7 million workers. Thereafter expansion of output and employment was renewed.[13]

Total government purchases of goods and services fell from an annual rate of nearly 100 billions in the first three months of 1945 to about 35 billions in the first quarter of 1946. Thus, in the short period of a year the government reduced its contribution to aggregate demand by an amount equal to almost 30 per cent of the total GNP at the beginning of the period.[14]

The question immediately presents itself as to why the downturn, as a result of reconversion, was so mild and so brief. It appears that there were forces present which tended to force private spending to rise despite the depressing effects of the decline in government orders.

One of the main factors causing private spending to rise was the fact that "consumption increased rapidly in the face of a decline in the GNP".[15] This fact can be explained by two important reasons.

First, disposable income of individuals remained virtually constant during the year despite the decline in total GNP. Second, there were powerful forces operating to increase the ratio of consumption to disposable income and to reduce the volume of personal savings.[16]

The stability of disposable income can be ascribed to three factors. First, there was a sharp rise in government transfer payments at the same time the Gross National Product was falling. Second, a decline in personal taxes bolstered disposable income. Third, although corporate profits declined by nine billion dollars between

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[13] Estey, p. 130.

[14] Gordon, p. 426.

[15] Ibid., p. 429.

[16] Ibid.

the first quarter of 1945 and the first quarter of 1946, dividend payments showed no decline.

The reason for the increased ratio of consumption to disposable income is explained by the fact that

> ...consumers' expenditures were abnormally low during the war years; the propensity to consume was held down by shortages, rationing, price controls, and the wartime savings campaign.[17]

At the close of the war, however, rationing was ended quickly and consumers set out to satisfy their pentup demands. Thus, this rise in the propensity to consume was an important factor stimulating economic activity.

The existence of a very considerable backlog of demand likewise caused private investment to rise rapidly. Three types of domestic private investment must be distinguished -- business expenditures on plant and equipment, residential construction, and inventory accumulation. It was the expansion in the first two which was particularly responsible for the postwar investment boom.[18]

There were two compelling reasons for investing in new plant and equipment. First, the need for expansion and modernization, and second, the need to expand capacity to satisfy the new high level of demand.

> As a result of these forces, expenditures on nonfarm plant and equipment exceeded twenty billion dollars in each of the years 1947-50 -- about double the level of 1929 and 1941, the two previous peak years.[19]

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[17]Gordon, p. 430.

[18]Ibid., p. 436.

[19]Ibid.

At the close of the war, an acute housing shortage existed and, despite rising building costs, residential construction rose rapidly. Other factors than the shortages caused by war served to raise the demand for housing.

> ...a continued high marriage rate, the high level of income, the large volume of liquid assets, and the liberal terms under which mortgage credit could be secured. Here was a strong and largely autonomous stimulus to investment which provided powerful support to the postwar level of business activity and was largely immune to minor deflationary shocks.[20]

The demand by foreign countries for our goods played a role of some importance.

> Total exports and our export surplus rose rapidly to a peak in 1947. While both declined thereafter, the volume of exports continued to be abnormally large. The net export surplus reached a peak of 11.5 billion dollars in 1947 and then fell by 5 billion dollars during the next two years.[21]

The rise in aggregate demand in the postwar years reflected the rise in both consumption and private investment.

> Although government expenditures on goods and services remained much higher than before the war, they averaged about the same fraction of the total Gross National Product as in 1939.[22]

The size of the public debt declined substantially in the period between the end of 1945 and the end of 1948. Bank loans, on the other hand, expanded rapidly. The effect was a net increase in the money supply in the hands of the public despite the decline in the commercial banks' holdings of government securities.

> Bank-credit expansion based on newly issued United States government securities ended in 1945. The government

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[20]Gordon, p. 437.

[21]Ibid.

[22]Ibid., p. 438.

> had acquired extraordinarily large cash balances through excess subscriptions to the Victory Loan in the autumn of 1945, and these balances were utilized to reduce bank-held debt. The decline in government-security holdings by the banks was offset to a substantial degree by a rapid growth in loans. From a low level of about $19 billion in the middle of 1943, bank loans rose continuously to almost $40 billion in the early months of 1948. This expansion of loans prevented a decline in the money supply and reflected as well as encouraged a rapid expansion of expenditures by industrial enterprise.[23]

The monetary expansion in the last half of 1947 was very substantial. Three factors combined to produce this effect.

> Accelerated commercial bank loan expansion, a large gold inflow, and some nonbank selling of Government securities to the Federal Reserve Banks all tended to add to the volume of deposits and currency.[24]

These expansive factors were offset, to a limited extent, by a Treasury cash surplus, but the growth in the money supply nonetheless approached six billion dollars.

Bank loan expansion and gold inflow continued to exert an expansionary force on the private money supply, but in spite of this "deposits and currency declined 4.5 billion dollars"[25] in the first half of 1948. This decline can be attributed to a large Treasury surplus which was used to retire bank-held securities or to increase the deposit balances of the Treasury. Additionally, "the Government security market transactions of nonbank investors as a group tended to reduce the private deposit and currency supply."[26]

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[23] Goldenweiser, pp. 76-77.

[24] Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, October, 1948, XXXIV, No. 10, 1209.

[25] Ibid.

[26] Ibid., p. 1210.

During the war, the growth in the money supply was greater than the growth in the use of money. Soon after the war, however, with a decreasing rate of growth in the total supply, the rate of turnover of the available supply increased. This presented itself as a further inflationary danger. Even with no increase in the money supply, a further substantial inflation was possible in the future. Also, if any additional increases in the money supply were accompanied by a continued rise in the velocity of money, the inflationary pressures would be intensified.[27]

Commercial banks were in a position in Ocotber, 1948 to meet any demand for loan funds which might have been forthcoming. While the banks did not have a large operating volume of excess reserves,

> they hold about 65 billion dollars, or over 40% of their total assets, in United States Government securities. About 20 billion dollars of these securities mature or are callable in less than one year and over 50 billion in less than five years.[28]

These securities could be turned in for cash or sold in the market and if no other buyer were found, the Federal Reserve was obliged to buy them in accordance with their agreement to maintain a stable market for Government securities. If the Federal Reserve System purchased them, they automatically increased member bank reserves and made a multiple expansion of deposits possible. Hence, banks were in possession of adequate resources for expanding loans by a very substantial amount.

As the wartime controls were dropped following the war, a sharp rise in prices occurred and continued into the autumn of 1948.

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[27] Federal Reserve Bulletin, October, 1948, XXXIV, No. 10, 1210.

[28] Ibid.

> Wholesale commodity prices increased from 110 in mid-1946 to 170 at the beginning of 1948, and despite a sharp break in agricultural prices in the early months of 1948, the general upward price movement continued. Consumer prices in the middle of 1948 were at the highest level on record.[29]

In general, the period of the war was one of great expansion in employment, production, and income. Wartime controls prevented a corresponding rise in prices. The shortages and rationing of consumer goods meant that the increase in the money supply would exceed the supply of consumer goods. Thus, the inflationary pressures were present but were not active until after the war when the wartime restrictions were dropped. With the removal of controls, the consumers set out with their accumulated cash and highly liquid assets, to satisfy their demands. Investment likewise increased as postponed modernization and expansion were undertaken. Government expenditures fell off a great deal but this decrease was more than offset by the rising expenditures in the private sector of the economy. Banks had built up huge excess reserves in the form of highly liquid government securities and, with the monetary authorities ready to maintain a stable market for these securities, the banks were ready and able to meet all demands for credit which were forthcoming. Under the pressures created by this situation prices rose tremendously and the postwar inflation began and continued until the latter part of 1948.

The controls established during the war were abolished soon after the close of the war. The monetary policies adopted to finance the war, however, continued into the postwar period. In the

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[29] Goldenweiser, p. 75.

summer of 1946, the preferential rate for discounts secured by short-term governments was discontinued. This, however, was little more than symbolic since banks made very little use of the opportunities to borrow from the Federal Reserve. It was another year later before the buying rate of 3/8 per cent for Treasury bills came to an end. "The most important of the factors limiting control of credit expansion namely, the support of long-term governments at 2 1/2 per cent, was still the policy of the monetary authorities in 1948."[30]

> In the period since mid-1947 a moderate restraint on bank credit expansion was achieved by the use of Treasury surplus funds to retire securities held by the Federal Reserve Banks. Drains on bank reserves achieved in this way were the most important means of restraint on bank credit expansion.[31]

This restraining effect, however, was partially or completely offset by tax reductions effective in May, 1948 and by increased Government expenditures for defense and foreign aid.

In September of 1948, under the new authority granted by Congress, the Board increased the reserve requirements for all member banks.

> The latter increase, which absorbed into required reserves a total of about 2 billion dollars, corresponded approximately to net Federal Reserve purchases of Government securities from nonbank investors in recent months, and necessitated little or no decline in the total of bank loans and investments from the level prevailing three months earlier.[32]

In the twelve month period ending June 30, 1948, the total loans by commercial banks expanded by six billion dollars.

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[30]Goldenweiser, p. 76. This policy was discontinued by the Treasury and Federal Reserve "Accord" of March, 1951.

[31]Federal Reserve Bulletin, October, 1948, XXXIV, No. 10, 1205.

[32]Ibid.

> The outstanding business loans of banks rose about 4 billion dollars from mid-1947 through the third quarter of 1948. The short-term debt of farmers, which in recent years has been at a low level, has increased by more than 25 per cent since mid-1947. Total short-term consumer credit outstanding has increased approximately 3 1/2 billion dollars during the past fifteen months.[33]

During the same period, the Federal Reserve reported,

> ...the aggregate outstanding mortgage debt on 1- to 4-family houses, for example, is estimated to have risen by more than 7 billion dollars or about 25 per cent...
>
> The only significant decrease in the loan portfolios of banks during the past year has been in loans for purchasing or carrying securities. This decline, however, has been more gradual than in the early postwar period and has not been large enough to dampen noticeably the increase in total bank loans.[34]
>
> The Board's Regulation W, relating to consumer instalment credit, was reissued effective September 20, 1948, in much the same form as the regulation was when terminated on November 1, 1947. The new regulation covered instalment sales and loans for the purchase of 12 kinds of consumers' durable goods, excluding articles selling for less than $50. It also covered instalment loans for most other consumer purposes. The regulation required down payments of at least 33 1/3 per cent on purchases of the other listed articles. On all types of instalment credit subject to the regulation, maturities were restricted to 15 months for credits not exceeding $1,000 and 18 months for larger amounts (with monthly payments of at least $70 on amounts over $1,000). Instalment credit in excess of $5,000 was not regulated.
>
> On January 9, 1948 the Board of Governors raised from 1 to 1 1/4 per cent the rate on discounts and advances to member banks.[35]

The margin requirements on stock throughout 1948 remained at the high level of 75 per cent established in 1947.[36]

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[33] <u>Federal Reserve Bulletin</u>, October, 1948, XXXIV, No. 10, 1207.

[34] Ibid., p. 1208.

[35] Board of Governors of the Federal Reserve System, <u>Thirty-Fifth Annual Report Covering Operations for the Year 1948</u>, p. 45.

[36] Ibid.

In summary, throughout World War II and continuing until the early months of 1949, the policies of the monetary authorities were directed to restraining inflationary credit expansion while at the same time maintaining stability in the market for Government securities. The principal factors limiting bank credit expansion after the war were the use of the substantial Treasury surpluses to retire bank held bonds together with the restrictive policies of the Federal Reserve. Such was the policy of the Federal Reserve until early in 1949.

# CHAPTER III

## BUSINESS CONDITIONS DURING THE RECESSION

Prices had been rising steadily since the end of the war, but a reversal in this trend occurred in the late summer of 1948.

> The reversal in movement reflected the passing of widespread scarcities typical of the earlier postwar period and the adjustment in business investment and production which seemed to characterize 1949.[1]

Although these price movements had important effects on the economy, they were not of great momentum and left many sectors of the economy unaffected. The Consumers' Price Index only declined by a little over two per cent from December, 1948 to December, 1949 (See Table I, p. 19) while the Wholesale Price Index only declined about seven per cent (See Table II, p. 20).

The high level of consumer demand together with government price supports for agricultural products served to limit the price declines. Further, there were important elements in the cost structure of industry, such as labor and rental costs, which exhibited almost no change. This also served to temper the price declines. Price changes however, were important for another reason.[2]

The outstanding feature of the price changes was the alteration that occurred in the internal structure of prices.

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[1]United States Department of Commerce, Survey of Current Business, February, 1950, XXX, No. 2, 10.

[2]Ibid.

TABLE I

CONSUMERS' PRICE INDEX*

| CONSUMERS' PRICE INDEX (U.S. Department of Labor) | 1948 | | 1949 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
| All Items (1935-39=100) | 172.2 | 171.4 | 170.9 | 169.0 | 169.5 | 169.7 | 169.2 | 169.6 | 168.5 | 168.8 | 169.6 | 168.5 | 168.6 | 167.5 |
| Apparel | 201.4 | 200.4 | 196.5 | 195.1 | 193.9 | 192.5 | 191.3 | 190.3 | 188.5 | 187.2 | 187.8 | 186.8 | 186.3 | 185.8 |
| Food | 207.5 | 205.0 | 204.8 | 199.7 | 201.6 | 202.8 | 202.4 | 204.3 | 201.7 | 202.6 | 204.2 | 200.6 | 200.8 | 197.3 |
| Fuel, Electricity, Refrigeration | 137.9 | 137.8 | 138.2 | 138.8 | 138.9 | 137.4 | 135.4 | 135.6 | 135.8 | 135.8 | 137.0 | 138.4 | 139.1 | 139.7 |
| Housefurnishings | 198.7 | 198.6 | 196.5 | 195.6 | 193.8 | 191.9 | 189.5 | 187.3 | 186.8 | 184.8 | 185.6 | 185.2 | 185.4 | 185.4 |
| Rent | 118.8 | 119.5 | 119.7 | 119.9 | 120.1 | 120.3 | 120.4 | 120.6 | 120.7 | 120.8 | 121.2 | 121.5 | 122.0 | 122.2 |
| Miscellaneous | 153.9 | 154.0 | 154.1 | 154.1 | 154.4 | 154.6 | 154.5 | 154.2 | 154.3 | 154.8 | 155.2 | 155.2 | 154.9 | 155.5 |

*Survey of Current Business, data obtained from the following issues; January, 1950, p. S-5; February, 1950, p. S-5.

TABLE II

W H O L E S A L E   P R I C E   I N D E X*

| WHOLESALE PRICE INDEX (U.S. Department of Labor) | 1948 | | 1949 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
| All Commodities (1926=100) | 164.0 | 162.4 | 160.6 | 158.1 | 158.4 | 156.9 | 155.7 | 154.5 | 153.5 | 152.9 | 153.6 | 152.2 | 151.6 | 151.3 |

TABLE III

U N E M P L O Y M E N T**

| UNEMPLOYMENT (In Thousands of Persons 14 Years of Age and Over) | 1948 | | 1949 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
| Total Unemployed | 1,831 | 1,941 | 2,664 | 3,221 | 3,167 | 3,016 | 3,289 | 3,778 | 4,095 | 3,689 | 3,351 | 3,576 | 3,409 | 3,489 |

*Survey of Current Business, data obtained from the following issues; January, 1950, p. S-5; February, 1950, p. S-5.

**Federal Reserve Bulletin, data obtained from the following issues; December, 1949, p. 1494; February, 1950, p. 224.

Essentially, this adjustment mirrored the realignment of market forces as the abnormal relations between demand and supply characteristic of the postwar period were replaced by more balanced conditions.[3]

The Gross National Product in 1948 reached $257.3 billion and showed this same total for 1949 (See Table IV, p. 22). Thus, it appears that 1949 was a period of leveling off in over all production. There were, however, some important shifts in the use of the economy's output. These shifts evidenced themselves as variations both in the pace of economic activity and in a changed pattern in the income flow. Such changes became apparent in the last quarter of 1948 and continued until the last half of 1949.

The Federal Reserve Index of Industrial Production fell from 195 in November of 1948 to a low point of 163 in July of 1949 and then began to rise again as production expanded (See Table V, p. 23).

Unemployment rose from 1,831,000 in November of 1948, reached a peak of 4,095,000 in July of 1949 and decreased thereafter (See Table III, p. 20).

Consumers' expenditures during 1949 were $180.6 billion which was three billion dollars higher than consumption expenditures in 1948 (See Table VI, p. 24). The rise in consumption can be partially attributed to the fact that disposable income rose from $187.6 billion to $188.2 billion in 1949 (See Table VII, p. 25).

The behavior of disposable income is accounted for by three important factors. First, payments in the form of dividends and other property incomes were maintained in spite of a reduction in business earnings (See Table VIII, p. 26). Second, there was an increase in

[3] *Survey of Current Business*, February, 1950, p. 10.

TABLE IV

GROSS NATIONAL PRODUCT OR EXPENDITURE*
Seasonally Adjusted Quarterly Totals at Annual Rates
(Billions of Dollars)

| | 1948 | | | | | 1949 | | | | | 1950 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | Year | I | II | III | IV | Year | I | II | III | IV | Year |
| GROSS NATIONAL PRODUCT | 247.9 | 255.5 | 261.9 | 264.0 | 257.3 | 259.9 | 257.2 | 256.5 | 255.5 | 257.3 | 264.9 | 275.9 | 294.4 | 305.0 | 285.1 |
| PERSONAL CONSUMPTION EXPENDITURES | 174.1 | 176.8 | 179.5 | 180.1 | 177.6 | 178.4 | 180.4 | 180.1 | 183.5 | 180.6 | 185.2 | 189.1 | 202.9 | 198.8 | 194.0 |
| Durable Goods | 21.4 | 22.2 | 23.0 | 22.3 | 22.2 | 21.6 | 23.4 | 24.2 | 25.1 | 23.6 | 25.7 | 26.4 | 33.2 | 29.2 | 28.6 |
| Nondurable Goods | 97.9 | 98.6 | 99.0 | 99.4 | 98.7 | 98.0 | 97.3 | 95.6 | 96.6 | 96.9 | 96.7 | 98.3 | 103.9 | 102.7 | 100.4 |
| Services | 54.8 | 56.0 | 57.4 | 58.4 | 56.7 | 58.8 | 59.6 | 60.4 | 61.7 | 60.1 | 62.8 | 64.5 | 65.8 | 67.0 | 65.0 |
| GROSS PRIVATE DOMESTIC INVESTMENT | 38.6 | 41.2 | 42.5 | 42.4 | 41.2 | 37.0 | 32.1 | 32.0 | 29.1 | 32.5 | 39.9 | 49.0 | 53.4 | 62.6 | 51.2 |
| New Construction | 17.1 | 18.1 | 18.4 | 18.0 | 17.9 | 17.3 | 16.9 | 17.1 | 18.6 | 17.5 | 20.7 | 22.0 | 24.1 | 24.1 | 22.7 |
| Residential Nonfarm | 8.3 | 8.9 | 8.8 | 8.3 | 8.6 | 7.8 | 7.6 | 8.2 | 9.6 | 8.3 | 11.2 | 12.4 | 13.7 | 13.1 | 12.6 |
| Other | 8.9 | 9.2 | 9.5 | 9.7 | 9.3 | 9.6 | 9.3 | 8.9 | 9.0 | 9.2 | 9.5 | 9.6 | 10.4 | 11.0 | 10.1 |
| Producers' Durable Equipment | 18.4 | 18.9 | 19.7 | 19.5 | 19.1 | 18.2 | 18.3 | 17.9 | 16.9 | 17.8 | 16.6 | 19.6 | 24.4 | 23.8 | 21.1 |
| Change in Business Inventories-Total | 3.0 | 4.3 | 4.4 | 4.9 | 4.2 | 1.5 | -3.1 | -3.0 | -6.3 | -2.7 | 2.5 | 7.3 | 4.8 | 14.7 | 7.4 |
| Nonfarm Only | 2.6 | 2.9 | 2.9 | 3.6 | 3.0 | .9 | -2.0 | -1.3 | -5.1 | -1.9 | 2.6 | 6.3 | 3.5 | 13.3 | 6.4 |
| NET FOREIGN INVESTMENT | 3.9 | 1.9 | .6 | 1.3 | 2.0 | 1.4 | .4 | .9 | -.5 | .5 | -1.5 | -2.3 | -2.5 | -2.4 | -2.2 |
| GOVERNMENT PURCHASES OF GOODS AND SERVICES | 31.2 | 35.6 | 39.2 | 40.2 | 36.6 | 43.1 | 44.4 | 43.5 | 43.5 | 43.6 | 41.3 | 40.1 | 40.7 | 46.0 | 42.0 |
| Federal | 16.9 | 20.5 | 23.2 | 23.4 | 21.0 | 25.6 | 26.6 | 25.1 | 24.5 | 25.4 | 21.9 | 20.7 | 20.7 | 25.1 | 22.1 |
| National Security | 14.5 | 15.5 | 16.8 | 17.1 | 16.0 | 19.4 | 20.5 | 19.5 | 17.8 | 19.3 | 17.0 | 17.2 | 17.8 | 22.1 | 18.5 |
| National Defence | 11.4 | 11.5 | 11.2 | 12.2 | 11.6 | 13.6 | 13.9 | 13.6 | 13.2 | 13.6 | 12.6 | 12.2 | 14.0 | 18.2 | 14.3 |
| Other National Security | 3.1 | 4.1 | 5.5 | 4.9 | 4.4 | 5.8 | 6.6 | 5.9 | 4.7 | 5.7 | 4.3 | 5.1 | 3.7 | 3.9 | 4.3 |
| Other | 3.5 | 5.4 | 6.7 | 6.6 | 5.6 | 6.6 | 6.3 | 6.4 | 7.0 | 6.6 | 5.2 | 3.8 | 3.2 | 3.3 | 3.9 |
| Less: Government Sales | 1.1 | .4 | .3 | .3 | .5 | .3 | .3 | .7 | .3 | .4 | .3 | .2 | .2 | .3 | .3 |
| State and Local | 14.3 | 15.1 | 16.0 | 16.8 | 15.6 | 17.5 | 17.8 | 18.4 | 18.9 | 18.2 | 19.4 | 19.4 | 20.0 | 20.8 | 19.9 |

*1954 National Income Supplement to Survey of Current Business; data for 1948, p. 225; data for 1949-50, p. 224.

TABLE V

FEDERAL RESERVE INDEX OF INDUSTRIAL PRODUCTION*

Adjusted Figures

| | 1948 | | 1949 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| INDUSTRY | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
| Adjusted Combined Index (1935-39=100) | 195 | 192 | 191 | 189 | 184 | 179 | 174 | 169 | 161 | 170 | 174 | 166 | 173 | 180 |
| Manufactures | 201 | 199 | 198 | 196 | 193 | 184 | 179 | 175 | 168 | 178 | 184 | 176 | 179 | 188 |
| Durable Manufactures | 229 | 231 | 227 | 225 | 223 | 212 | 201 | 194 | 185 | 193 | 199 | 175 | 181 | 204 |
| Nondurable Manufactures | 178 | 173 | 175 | 173 | 168 | 162 | 161 | 160 | 154 | 165 | 173 | 177 | 177 | 175 |
| Minerals | 161 | 156 | 149 | 149 | 136 | 148 | 145 | 133 | 123 | 129 | 119 | 112 | 141 | 132 |

*Survey of Current Business, data obtained from the following issues: January, 1950, p. S-2; February, 1950, p. S-2; March, 1950. p. S-2.

TABLE VI

PERSONAL CONSUMPTION EXPENDITURES BY MAJOR TYPE*
Seasonally Adjusted Quarterly Totals at Annual Rates
(Billions of Dollars)

| | 1948 | | | | | 1949 | | | | | 1950 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | Year | I | II | III | IV | Year | I | II | III | IV | Year |
| GOODS AND SERVICES, TOTAL | 174.1 | 176.8 | 179.5 | 180.1 | 177.6 | 178.4 | 180.4 | 180.1 | 183.5 | 180.6 | 185.2 | 189.1 | 202.9 | 198.8 | 194.0 |
| DURABLE GOODS, TOTAL | 21.4 | 22.2 | 23.0 | 22.3 | 22.2 | 21.6 | 23.4 | 24.2 | 25.1 | 23.6 | 25.7 | 26.4 | 33.2 | 29.2 | 28.6 |
| Automobiles and parts | 6.9 | 7.0 | 7.6 | 7.8 | 7.3 | 8.0 | 9.8 | 10.0 | 10.1 | 9.5 | 10.6 | 11.6 | 14.2 | 13.1 | 12.4 |
| Furniture and Household Equipment | 11.1 | 11.7 | 12.0 | 11.2 | 11.5 | 10.3 | 10.3 | 11.1 | 11.9 | 10.9 | 11.9 | 11.5 | 15.6 | 12.8 | 12.9 |
| Other Durable Goods | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.3 | 3.3 | 3.1 | 3.2 | 3.2 | 3.2 | 3.2 | 3.5 | 3.4 | 3.3 |
| NONDURABLE GOODS, TOTAL | 97.9 | 98.6 | 99.0 | 99.4 | 98.7 | 98.0 | 97.3 | 95.6 | 96.6 | 96.9 | 96.7 | 98.3 | 103.9 | 102.7 | 100.4 |
| Clothing and Shoes | 19.3 | 19.6 | 19.7 | 20.0 | 19.6 | 19.5 | 18.8 | 17.7 | 18.0 | 18.5 | 17.9 | 18.0 | 19.1 | 18.8 | 18.5 |
| Food and Alcoholic Beverages | 57.1 | 57.4 | 57.2 | 57.3 | 57.3 | 56.8 | 56.6 | 56.1 | 56.5 | 56.5 | 56.6 | 57.7 | 60.7 | 60.4 | 58.8 |
| Gasoline and Oil | 4.1 | 4.2 | 4.4 | 4.4 | 4.3 | 4.5 | 4.8 | 4.8 | 4.9 | 4.7 | 4.9 | 5.1 | 5.1 | 5.1 | 5.0 |
| Semidurable Housefurnishings | 2.2 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.1 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.9 | 2.4 | 2.4 |
| Tobacco | 4.1 | 4.0 | 4.3 | 4.2 | 4.1 | 4.2 | 4.3 | 4.2 | 4.3 | 4.3 | 4.3 | 4.4 | 4.5 | 4.5 | 4.4 |
| Other Nondurable Goods | 11.2 | 11.1 | 11.2 | 10.9 | 11.1 | 10.7 | 10.7 | 10.6 | 10.8 | 10.7 | 10.8 | 11.0 | 11.6 | 11.4 | 11.2 |
| SERVICES, TOTAL | 54.8 | 56.0 | 57.4 | 58.4 | 56.7 | 58.8 | 59.6 | 60.4 | 61.7 | 60.1 | 62.8 | 64.5 | 65.8 | 67.0 | 65.0 |
| Household Operation | 7.9 | 7.9 | 8.1 | 8.1 | 8.0 | 8.3 | 8.4 | 8.3 | 8.8 | 8.5 | 9.1 | 9.3 | 9.4 | 9.8 | 9.4 |
| Housing | 16.9 | 17.3 | 17.8 | 18.3 | 17.5 | 18.7 | 19.2 | 19.6 | 20.2 | 19.4 | 20.7 | 21.1 | 21.6 | 22.0 | 21.4 |
| Personal Services | 3.8 | 3.8 | 3.8 | 3.9 | 3.8 | 3.8 | 3.8 | 3.8 | 3.9 | 3.8 | 3.8 | 3.8 | 3.9 | 4.0 | 3.9 |
| Recreation | 3.8 | 3.8 | 3.8 | 3.9 | 3.8 | 3.9 | 3.8 | 3.9 | 3.9 | 3.9 | 3.9 | 3.9 | 4.0 | 4.0 | 3.9 |
| Transportation | 5.7 | 5.8 | 6.0 | 6.1 | 5.9 | 5.9 | 5.9 | 5.8 | 5.7 | 5.8 | 5.7 | 5.8 | 5.9 | 6.0 | 5.8 |
| Other Services | 16.8 | 17.3 | 17.9 | 18.1 | 17.5 | 18.2 | 18.5 | 18.9 | 19.2 | 18.7 | 19.7 | 20.5 | 21.0 | 21.2 | 20.6 |

*1954 National Income Supplement to Survey of Current Business; data for 1948, p. 237; data for 1949-50, p. 236.

TABLE VII

DISPOSITION OF PERSONAL INCOME*

Seasonally Adjusted Quarterly Totals at Annual Rates

(Billions of Dollars)

| | 1948 | | | | | 1949 | | | | | 1950 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | Year | I | II | III | IV | Year | I | II | III | IV | Year |
| Personal Income | 201.5 | 208.1 | 212.3 | 212.8 | 208.7 | 208.9 | 207.6 | 205.5 | 205.3 | 206.8 | 218.5 | 220.7 | 229.2 | 239.8 | 227.1 |
| Less: Personal Tax and Nontax Payments | 23.2 | 20.8 | 20.2 | 20.4 | 21.1 | 18.7 | 18.7 | 18.6 | 18.6 | 18.7 | 19.4 | 20.0 | 20.7 | 23.6 | 20.9 |
| Federal | 21.1 | 18.7 | 18.0 | 18.2 | 19.0 | 16.3 | 16.2 | 16.2 | 16.1 | 16.2 | 16.7 | 17.3 | 17.9 | 20.8 | 18.2 |
| State and Local | 2.1 | 2.1 | 2.2 | 2.2 | 2.1 | 2.4 | 2.4 | 2.5 | 2.5 | 2.5 | 2.7 | 2.7 | 2.8 | 2.8 | 2.7 |
| Equals: Disposable Income | 178.3 | 187.3 | 192.1 | 192.4 | 187.6 | 190.2 | 188.9 | 186.9 | 186.7 | 188.2 | 199.1 | 200.7 | 208.5 | 216.2 | 206.1 |
| Less: Personal Consumption Expenditures | 174.1 | 176.8 | 179.5 | 180.1 | 177.6 | 178.4 | 180.4 | 180.1 | 183.5 | 180.6 | 185.2 | 189.1 | 202.9 | 198.8 | 194.0 |
| Equals: Personal Saving | 4.2 | 10.6 | 12.6 | 12.3 | 10.0 | 11.8 | 8.6 | 6.7 | 3.2 | 7.6 | 13.9 | 11.6 | 5.6 | 17.4 | 12.1 |

*<u>1954 National Income Supplement to Survey of Current Business</u>; data for 1948, p. 229; data for 1949-50, p. 228.

TABLE VIII

CORPORATE PROFITS, TAXES, AND DIVIDENDS*
Seasonally Adjusted Annual Rates
(Billions of Dollars)

| QUARTERLY DATA | Profits Before Taxes | Income Taxes | Profits After Taxes | Cash Dividends | Undistributed Profits |
|---|---|---|---|---|---|
| 1948 | | | | | |
| Third Quarter | 36.6 | 14.4 | 22.2 | 7.9 | 14.3 |
| Fourth Quarter | 34.5 | 13.6 | 20.9 | 8.3 | 12.6 |
| 1949 | | | | | |
| First Quarter | 29.4 | 11.5 | 17.9 | 8.3 | 9.6 |
| Second Quarter | 26.4 | 10.6 | 15.8 | 8.2 | 7.6 |
| Third Quarter | 28.9 | 11.4 | 17.5 | 8.1 | 9.4 |
| Fourth Quarter | 29.5 | 11.2 | 18.2 | 8.9 | 9.3 |

*<u>Federal Reserve Bulletin</u>, June, 1950, XXXVI, No. 6, p. 714.

government transfer payments, and third, lower individual income taxes left more money available for consumption expenditures (See Table VII, p. 25).

There was a decline in gross private domestic investment other than inventories during 1949, but it was relatively mild only amounting to about $1.8 billion (See Table IV, p. 22).

Residential construction began to decline in the third quarter of 1948 and continued into the second quarter of 1949 (See Table IX, p. 28). After this decline, which was a substantial one, residential construction picked up and was a force making for expansion during the rest of the year.

Business expenditures for new plant and equipment declined throughout 1949, "reflecting the gradual completion of war-deferred expansion programs and probably also the effects of lower sales and profits expectations."[4] (See Table X, p. 29)

Business pruchases of durable equipment declined by about $1.3 billion between 1948 and 1949 (See Table IV, p. 22).

By far the most significant change was that in business inventories. During 1948 there had been net additions to business inventories whereas in 1949 there was a net reduction (See Table IV). As can be seen from Table IV, there was a decline in inventory investment between the fourth quarter of 1948 and the fourth quarter of 1949 of $11.2 billions.

This shift from a situation of building up inventories to one of selling out of inventories without replacing them indicated that

[4] <u>Survey of Current Business</u>, February, 1950, p. 45.

TABLE IX

C O N S T R U C T I O N   A C T I V I T Y*
(Millions of Dollars)

| CONSTRUCTION ACTIVITY | 1948 Nov. | 1948 Dec. | 1949 Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| NEW CONSTRUCTION, TOTAL | 1,646 | 1,447 | 1,293 | 1,172 | 1,267 | 1,370 | 1,576 | 1,735 | 1,833 | 1,903 | 1,922 | 1,879 | 1,767 | 1,612 |
| Private, Total | 1,256 | 1,129 | 1,002 | 905 | 951 | 989 | 1,108 | 1,229 | 1,301 | 1,343 | 1,368 | 1,343 | 1,295 | 1,225 |
| Residential (Nonfarm) | 615 | 547 | 475 | 400 | 420 | 445 | 530 | 600 | 650 | 675 | 710 | 715 | 715 | 690 |
| Nonresidential Building, except Farm and Public Utility, Total | 325 | 305 | 285 | 271 | 262 | 251 | 257 | 268 | 269 | 264 | 263 | 261 | 266 | 261 |
| Commercial | 106 | 93 | 82 | 78 | 79 | 76 | 83 | 92 | 91 | 85 | 83 | 82 | 86 | 84 |
| Industrial | 116 | 114 | 110 | 104 | 96 | 89 | 82 | 76 | 72 | 71 | 70 | 68 | 68 | 68 |
| Farm Construction | 22 | 13 | 12 | 10 | 18 | 30 | 40 | 50 | 60 | 75 | 65 | 50 | 25 | 15 |
| Public Utility | 294 | 264 | 230 | 224 | 251 | 263 | 281 | 311 | 322 | 329 | 330 | 317 | 289 | 259 |
| Public, Total | 390 | 318 | 291 | 267 | 316 | 381 | 468 | 506 | 532 | 560 | 554 | 536 | 472 | 387 |
| Residential | 7 | 7 | 8 | 8 | 10 | 14 | 15 | 17 | 20 | 23 | 27 | 27 | 24 | 22 |
| Military and Naval | 11 | 9 | 7 | 7 | 9 | 8 | 9 | 9 | 10 | 12 | 14 | 14 | 12 | 9 |
| Nonresidential Building | 116 | 110 | 110 | 108 | 122 | 134 | 141 | 144 | 148 | 152 | 155 | 158 | 151 | 142 |
| Conservation and Development | 58 | 50 | 40 | 39 | 45 | 56 | 67 | 74 | 75 | 77 | 77 | 74 | 65 | 56 |
| Highways | 131 | 83 | 68 | 52 | 68 | 100 | 160 | 185 | 200 | 215 | 200 | 185 | 145 | 92 |
| All Other | 67 | 59 | 58 | 53 | 62 | 69 | 76 | 77 | 79 | 81 | 81 | 78 | 75 | 66 |

*Survey of Current Business, data obtained from the following issues: January, 1950, p. S-6; February, 1950, p. S-6.

TABLE X

NEW PLANT AND EQUIPMENT EXPENDITURES*
(Millions of Dollars)

| | 1948 | 1949 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| INDUSTRY | Dec. | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
| All Industries, (Quarterly Total) | 5,410 | | | 4,460 | | | 4,660 | | | 4,370 | | | 4,630 |
| Manufacturing | 2,320 | | | 1,850 | | | 1,880 | | | 1,690 | | | 1,830 |
| Mining | 220 | | | 190 | | | 190 | | | 180 | | | 180 |
| Railroad | 410 | | | 360 | | | 380 | | | 310 | | | 300 |
| Other Transportation | 170 | | | 130 | | | 140 | | | 140 | | | 120 |
| Electric and Gas Utilities | 850 | | | 680 | | | 780 | | | 790 | | | 890 |
| Commercial and Miscellaneous | 1,440 | | | 1,260 | | | 1,290 | | | 1,260 | | | 1,320 |

*Survey of Current Business; data obtained from the following issues; February, 1950, p. S-1; May, 1950, p. S-1.

businessmen were following a more cautious buying policy. They were unsure about prices and sales and this reflected itself as a decline in inventory investment.[5]

In the last half of 1948, widespread cutbacks in new orders began and continued on an accelerated scale until February of 1949 (See Table XI, p. 31). Production, of course, was lowered in response to these cutbacks. It was not until the second quarter of 1949, however, that the inventory liquidations became evident as businessmen cut production below final purchases by buyers.

The international account was also a deflationary force, although not of great magnitude. Net foreign investment fell from 1.3 billion dollars in the fourth quarter of 1948 to -.5 billion dollars in the fourth quarter of 1949 (See Table IV, p. 22).

Because of the increase in consumption and Government expenditures, aggregate demand was maintained despite the decline in investment. All three levels of government combined ran a cash surplus of $8.5 billion in 1948, but incurred a $3 billion deficit in 1949.[6]

This tended to cushion the downturn and, together with the decrease in personal income taxes, was important in explaining the speed with which the economy recovered.[7]

The fact that aggregate demand continued at a high level was the main factor explaining the increase in purchasing in the latter

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[5] Survey of Current Business, February, 1950, p. 3.

[6] For a detailed account of the receipts and expenditures of the Federal Government, see Table XII, p. 32.

[7] Survey of Current Business, February, 1950, p. 5.

TABLE XI

MANUFACTURES' NEW ORDERS, NET*
Seasonally Unadjusted Figures
(Millions of Dollars)

| MANUFACTURERS' NET ORDERS, NET | 1948 | | 1949 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Nov. | Dec. | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. | Oct. | Nov. | Dec. |
| Value (Unadjusted), Total | 18,928 | 18,050 | 16,860 | 16,534 | 17,962 | 15,968 | 15,734 | 16,300 | 15,496 | 18,697 | 19,441 | 18,359 | 18,138 | 16,775 |
| Durable Goods Industries | 7,722 | 7,570 | 6,703 | 6,734 | 7,185 | 6,127 | 5,993 | 6,544 | 6,195 | 7,407 | 7,634 | 7,432 | 7,402 | 7,019 |
| Iron, Steel and Products | 2,122 | 2,023 | 2,034 | 1,832 | 1,816 | 1,425 | 1,328 | 1,504 | 1,284 | 1,776 | 1,513 | 1,837 | 1,771 | 1,915 |
| Nonferrous Metals and Their Products | 606 | 582 | 594 | 514 | 570 | 437 | 358 | 418 | 365 | 615 | 583 | 566 | 525 | 508 |
| Electrical Machinery and Equipment | 856 | 786 | 699 | 612 | 754 | 619 | 584 | 702 | 561 | 687 | 810 | 841 | 724 | 788 |
| Machinery, Except Electrical | 1,009 | 1,075 | 918 | 1,016 | 1,151 | 985 | 986 | 1,017 | 858 | 938 | 996 | 970 | 953 | 1,001 |
| Transportation Equipment, Except Automobiles | 481 | 444 | 155 | 384 | 296 | 160 | 495 | 217 | 263 | 244 | 377 | 246 | 711 | 243 |
| Other Durable Goods Industries | 2,649 | 2,660 | 2,613 | 2,376 | 2,598 | 2,501 | 2,241 | 2,686 | 2,865 | 3,146 | 3,355 | 2,972 | 2,718 | 2,564 |
| Nondurable Goods Industries | 11,206 | 10,480 | 10,157 | 9,800 | 10,778 | 9,841 | 9,742 | 9,756 | 9,301 | 11,290 | 11,807 | 10,926 | 10,736 | 9,756 |

*Survey of Current Business, data obtained form the following issues: January, 1950, p. S-4; May, 1950, p. S-4.

TABLE XII

FEDERAL CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC*

Seasonally Unadjusted Figures
(Millions of Dollars)

| CALENDAR YEAR | Federal Cash Receipts from the Public | Federal Cash Payments to the Public | Excess of Receipts (+) or Payments (-) |
|---|---|---|---|
| Quarterly Total | | | |
| 1948 | | | |
| First Quarter | 15,037 | 8,637 | +6,400 |
| Second Quarter | 10,238 | 9,033 | +1,205 |
| Third Quarter | 10,085 | 8,798 | +1,287 |
| Fourth Quarter | 9,560 | 10,486 | - 925 |
| 1949 | | | |
| First Quarter | 13,122 | 9,964 | +3,158 |
| Second Quarter | 8,814 | 11,389 | -2,575 |
| Third Quarter | 10,143 | 10,528 | - 385 |
| Fourth Quarter | 9,267 | 10,753 | -1,486 |

*Joint Committee on the Economic Report by the Council of Economic Advisers, Economic Indicators - May, 1950, 81st Congress, 2nd Session, (Washington, 1950), p. 32.

part of 1949. Since the demand continued strong, businessmen soon attempted to adjust their purchasing to this sustained high level of demand. This fact became readily apparent from the sharp rise that occurred in Manufacturers' New Orders in August and September of 1949.[8]

The primary factor explaining the mildness of the recession was the fact that disposable incomes and total spending remained virtually constant during the period under consideration (See Table VII, p. 25). Further, long-term expectations and investment opportunities remained favorable throughout the period, so long-term investment declined only slightly. The moderate price declines that occurred during this period were probably needed and served to correct some maladjustment in certain areas and hastened recovery.[9]

This 1948-49 downswing was therefore what Gordon has called a "minor recession - created by a reversal of short-term expectations which was reflected primarily in a sharp change in inventory investment."[10]

In general, the period from November of 1948 to October of 1949 appeared to be a time of readjustment. The supply of many goods was catching up with the demand and this exerted a downward pressure on prices. Consumers' backlog of demand particularly for durable goods other than automobiles was leveling off close to being satisfied. There was increasing resistance to higher prices. Private investment

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[8] Survey of Current Business, February, 1950, p. 5.

[9] Gordon, p. 444.

[10] Ibid., p. 443.

slowed down and began to decline under the pressure of slackening in residential construction and inventory depletion.

These factors all combined to bring a leveling off in the rate of growth. The recession appears merely as a pause in the economic expansion which had begun with the Second World War. It would seem that the economy hesitated momentarily to "catch its breath" and then, with renewed strength, moved forward.

# CHAPTER IV

## MONETARY POLICY DURING THE RECESSION

The large increases in bank loans which had characterized the postwar period declined considerably in the last quarter of 1948. Also, sales of Government bonds by nonbank investors to the Federal Reserve System in order to use the funds for other reasons almost came to a complete halt.[1]

The Federal Reserve pointed to the decline in bank credit expansion in the latter part of 1948 as one of the most significant developments in recent months. They noted that "in October and November, the increase in business loans was less than one third that shown in the same months in previous postwar years."[2]

Part of the explanation for the decline in commercial bank credit can be attributed to the fact that businesses enjoyed an increased supply of funds from other sources. Record high profits had allowed expansion from retained earnings. Also, large flotations of securities and loans from nonbank investors had provided substantial sums for business. These nonbank investors had obtained the funds to supply to business by selling Government securities to the Federal Reserve Banks. The demand for credit was reduced further, at this

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[1] Statement on Behalf of the Board of Governors of the Federal Reserve System before the Joint Committee on the Economic Report, February 14, 1949, (presented by Chairman Thomas B. McCabe), p. 3.

[2] Federal Reserve Bulletin, December, 1948, XXXIV, No. 12, 1463.

time, because business firms postponed or cancelled capital expenditures and liquidated inventories. These factors all combined to cause a marked downturn in business borrowing.

These developments carried into the next year and there was a marked decline in business borrowing at commercial banks during the first half of 1949. This contraction continued until August, when loans began an expansion which continued throughout the rest of the year. The decline in business loans was more than offset by loans to farmers, real estate owners, and consumers. "As a result total loans at insured commercial banks increased by more than 500 million dollars in 1949 to a new peak of 42.5 billion."[3] (See Fig. 1, p. 37)

Such were the business and credit developments which the monetary authorities faced. The economic developments of late 1948 and early 1949 presented problems that had not been present in almost ten years. Attention must now be turned to the monetary policies adopted to cope with this situation.

The Board of Governors stated:

> Throughout the year 1949, the general and selective instruments available to the Federal Reserve authorities were coordinated in a flexible program for adjusting the availability and cost of credit to the changing needs of the economy.[4]

When downward pressures on employment, prices, and business activity appeared, the policies of the Federal Reserve shifted from a tight policy to easier credit conditions. Later in the year when there

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[3] Thirty-Sixth Annual Report, p. 16.

[4] Ibid.

LOANS OF COMMERCIAL BANKS *
All Insured Banks

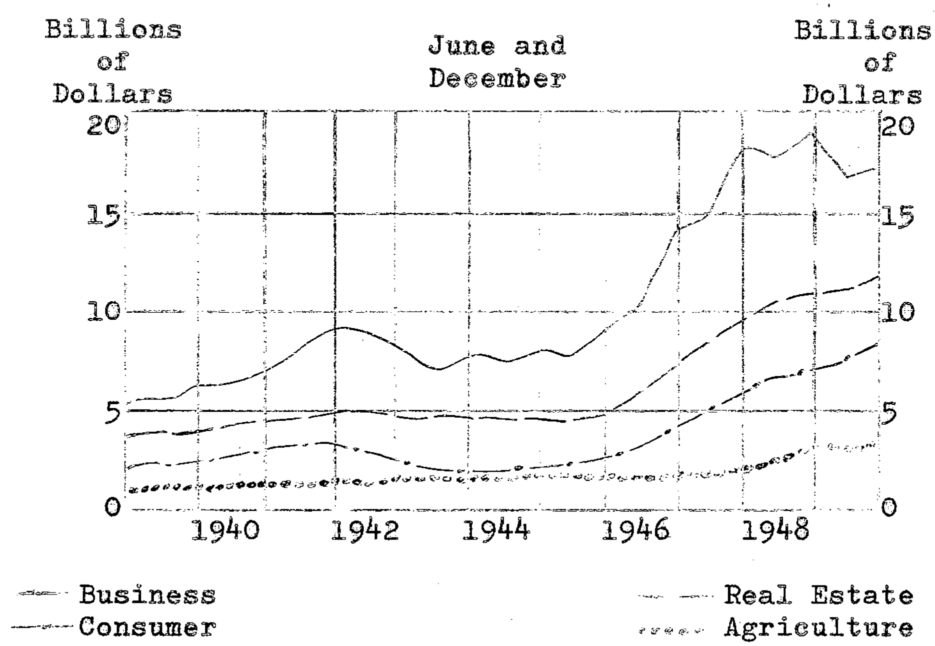


Fig. 1

*<u>Thirty-Sixth</u> <u>Annual</u> <u>Report</u>, p. 17. Note - All insured commercial banks in the United States. Business loans include commercial and industrial loans, open market commercial paper, and acceptances. Consumer loans are partly estimated prior to December 31, 1942.

was increasing evidence of business recovery, the authorities allowed short-term money rates to rise in order to meet a growing demand for credit.[5]

As was pointed out earlier, the necessity to maintain the price of government bonds prevented the Reserve authorities from following a very successful program of credit restraint during the postwar years. Consequently, there was very little scope for an effective reversal of policy when the time came to ease credit controls. Nevertheless, the authorities attempted to adapt their monetary policies to the conditions prevailing in 1949. "By successive reductions in reserve requirements during 1949, the Board of Governors progressively eased the anti-inflationary reserve policy previously followed."[6] (See Table XIII, p. 39) This was the principal factor influencing the reserve position of member banks in 1949. Within the four months of May through August, a total of 3.8 billion dollars worth of reserves was made available to commercial banks. In addition, bank reserves increased because of a return of currency from circulation and a small gold inflow (See Table XIV, p. 40).

Most of the funds that were released by lowering reserve requirements were used to purchase short- and medium-term issues of Government securities. Part of the funds released by the August reductions was needed by the banks as increased bank deposits and loans began about this time and continued throughout the year (See Table XIV, p. 40).

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[5] Thirty-Sixth Annual Report, p. 3.

[6] Ibid., p. 4.

TABLE XIII

MEMBER BANK RESERVE REQUIREMENTS IN 1949*
(Percentage of Deposits)

| DATE | Net Demand Deposits | | | Time Deposits | |
|---|---|---|---|---|---|
| | Central Reserve City Banks | Reserve City Banks | Country Banks | Central Reserve and Reserve City Banks | Country Banks |
| In Effect | | | | | |
| January 1, 1948 | 20 | 20 | 14 | 6 | 6 |
| January 1, 1949 | 26 | 22 | 16 | 7½ | 7½ |
| Changes in 1949, Effective-- | | | | | |
| May 1 | | | 15 | | 7 |
| May 5 | 24 | 21 | | 7 | |
| June 30 | | 20 | | 6 | |
| July 1 | | | 14 | | 6 |
| August 1 | | | 13 | | |
| August 11 | 23½ | 19½ | | 5 | |
| August 16 | | | 12 | | |
| August 18 | 23 | 19 | | | |
| August 25 | 22½ | 18½ | | | |
| September 1 | 22 | 18 | | | |
| In Effect | | | | | |
| September 1 - December 31 | 22 | 18 | 12 | 5 | 5 |

*Thirty-Sixth Annual Report, p. 5.

TABLE XIV

MAJOR FACTORS AFFECTING MEMBER BANK RESERVES*
(Billions of Dollars)

| FACTOR | 1948 | 1949 First Quarter | 1949 Second Quarter | 1949 Third Quarter | 1949 Fourth Quarter | 1949 Year |
|---|---|---|---|---|---|---|
| Factors Affecting Total Reserves: | | | | | | |
| Gold Inflow | +1.5 | +0.1 | +0.2 | +0.1 | -0.2 | +0.2 |
| Return of Currency from Circulation | +0.6 | +0.8 | -0.1 | +0.1 | -0.2 | +0.6 |
| Treasury Cash Transactions | -5.7 | -1.4 | +0.9 | -0.7 | +0.4 | -0.9 |
| Federal Reserve Purchases (+) or Sales(-) of U.S. Government securities in the Open Market, Net | +6.3 | -0.6 | -2.2 | -1.3 | +0.9 | -3.3 |
| Other Factors, Net | -0.1 | -0.3 | -0.1 | -0.1 | -0.3 | -0.5 |
| Changes in Member Bank Reserves: | | | | | | |
| Total Reserves | +2.6 | -1.4 | -1.3 | -1.9 | +0.6 | -3.9 |
| Excess Reserves | -0.3 | -0.5 | +0.3 | -0.2 | +0.2 | -0.2 |
| Required Reserves | +2.9 | -0.8 | -1.5 | -1.7 | +0.4 | -3.7 |
| Factors Affecting Required Reserves: | | | | | | |
| Board Action on Reserve Requirements | +3.0 | ---- | -1.6 | -2.2 | ---- | -3.8 |
| Deposit Changes | -0.1 | -0.8 | +0.1 | +0.5 | +0.4 | +0.1 |

*Thirty-Sixth Annual Report, p. 5.

There was a strong demand for Government securities through all of 1949. The action of the Federal Reserve and the Treasury, allowing short-term rates to rise between mid-1947 and October, 1948, encouraged banks to hold more short-term Government issues, and the widespread selling of Government bonds by nonbank holders had slowed down considerably by the end of 1948.[7] (For a detailed account of the ownership of Government securities, see Table XV, p. 42).

> Throughout the first half of the year 1949, the Federal Reserve sold Treasury bonds from the System portfolio in response to market demand, primarily from nonbank investors. These sales absorbed reserve funds released by seasonal declines in currency and deposits and a reduction in Treasury balances.[8]

Following the policy of maintaining short-term money rates for Government securities, the Federal Reserve would sell these short-term securities to commercial banks as the lowering of reserve requirements made the demand for these securities rise.[9]

In June of 1949, however, a change took place in their policy. On June 28th, before reserve requirements were lowered on June 30th, the Federal Open Market Committee issued the following statement:

> The Federal Open Market Committee, after consultation with the Treasury, announced today that with a view to increasing the supply of funds available in the market to meet the needs of commerce, business, and agriculture, it will be the policy of the Committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve Banks with primary regard to the general business and credit situation. The policy of maintaining orderly conditions in the Government security market, and the confidence of investors in Government bonds, will be continued. Under present conditions the maintenance

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[7] Thirty-Sixth Annual Report, p. 7.

[8] Ibid., p. 8.

[9] Ibid.

TABLE XV

OWNERSHIP OF UNITED STATES GOVERNMENT SECURITIES
DIRECT AND FULLY GUARANTEED*
(Par Value in Millions of Dollars)

| End of Month | Total Interest Bearing Securities | Gross Debt | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Total | Held by Banks | | | Held by Nonbank Investors | | | | | | | |
| | | | Total | Commercial Banks | Federal Reserve Banks | Total | Individuals | Insurance Companies | Mutual Savings Banks | Other Corporations and Associations | State and Local Governmrnts | U.S. Government Agencies and Trust Funds | |
| | | | | | | | | | | | | Special Issues | Public Issues |
| 1948 | | | | | | | | | | | | | |
| September | 250,564 | 252,738 | 85,913 | 62,500 | 23,413 | 166,825 | 67,300 | 22,300 | 11,700 | 20,800 | 7,800 | 31,221 | 5,606 |
| October | 250,348 | 252,513 | 86,142 | 63,100 | 23,042 | 166,371 | 67,400 | 21,900 | 11,600 | 20,700 | 7,800 | 31,223 | 5,626 |
| November | 250,444 | 252,563 | 85,806 | 62,600 | 23,206 | 166,757 | 67,400 | 21,700 | 11,500 | 21,200 | 7,900 | 31,400 | 5,617 |
| December | 250,630 | 252,854 | 85,933 | 62,600 | 23,333 | 166,921 | 67,600 | 21,500 | 11,500 | 21,200 | 7,900 | 31,714 | 5,603 |
| 1949 | | | | | | | | | | | | | |
| January | 250,467 | 252,656 | 84,809 | 62,700 | 22,109 | 167,847 | 67,900 | 21,600 | 11,600 | 21,600 | 7,900 | 31,760 | 5,645 |
| February | 250,626 | 252,747 | 84,542 | 62,200 | 22,342 | 168,205 | 68,200 | 21,500 | 11,600 | 21,500 | 7,900 | 31,804 | 5,697 |
| March | 249,593 | 251,666 | 82,288 | 60,600 | 21,688 | 169,378 | 68,600 | 21,400 | 11,600 | 22,100 | 8,000 | 31,926 | 5,737 |
| April | 249,528 | 251,553 | 82,994 | 61,900 | 21,094 | 168,559 | 68,400 | 21,200 | 11,600 | 21,700 | 8,100 | 31,833 | 5,686 |
| May | 249,909 | 251,912 | 82,504 | 62,800 | 19,704 | 169,408 | 68,700 | 21,000 | 11,600 | 22,400 | 8,100 | 31,914 | 5,618 |
| June | 250,785 | 252,798 | 82,543 | 63,200 | 19,343 | 170,255 | 68,800 | 20,900 | 11,600 | 22,500 | 8,200 | 32,776 | 5,498 |
| July | 251,903 | 253,902 | 83,429 | 64,900 | 18,529 | 170,473 | 68,900 | 20,700 | 11,600 | 22,600 | 8,200 | 33,049 | 5,471 |
| August | 253,945 | 255,879 | 84,224 | 66,700 | 17,524 | 171,655 | 69,100 | 20,600 | 11,600 | 23,300 | 8,300 | 33,358 | 5,492 |
| September | 254,783 | 256,709 | 84,510 | 66,500 | 18,010 | 172,199 | 69,200 | 20,500 | 11,600 | 23,300 | 8,100 | 33,914 | 5,500 |
| October | 254,901 | 256,805 | 84,716 | 67,400 | 17,316 | 172,089 | 69,300 | 20,500 | 11,500 | 23,400 | 8,100 | 33,810 | 5,477 |
| November | 255,150 | 257,011 | 84,582 | 66,900 | 17,682 | 172,429 | 69,300 | 20,400 | 11,400 | 23,800 | 8,100 | 33,829 | 5,491 |

*Federal Reserve Bulletin, data obtained from the following issues: March, 1949, p. 280; July, 1949, p. 832; November, 1949, p. 1378; March, 1950, p. 350.

> of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.[10]

When member banks sought to purchase short- and medium-term Government securities following the reduction in reserve requirements of June 30th and July 1st, the Federal Reserve refrained from selling securities from the System account. "Rates on Treasury bills fell within a few days from 1.16 per cent to below 1 per cent."[11] A similar drop also occurred in yields on certificates. Shortly after this, in order to restore more orderly conditions in the market, the Federal Reserve resumed the sale of short-term securities from its portfolio. The yield on these short-term Government securities rose but did not reach the level prevailing before the end of June.[12]

"The average yield on long-term Government bonds declined from 2.38 per cent for June to 2.24 per cent for August."[13] The sales of Treasury bonds by the Federal Reserve were negligible in the last half of 1949, in contrast to sales of three billion dollars in the first half of the year. The purpose of the Federal Reserve discontinuing its policy of making Government bonds available in response to market demand was to avoid absorbing funds that might otherwise be available for private borrowers. When conditions in the money market became somewhat tight, the System purchased short-term Government securities to meet temporary reserve needs of member banks.

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[10] Thirty-Sixth Annual Report, p. 8.

[11] Ibid.

[12] Ibid., p. 9

[13] Ibid., p. 11.

During periods when there was an overabundance of funds in the short-term money markets, the System sold bills and certificates from their portfolio or allowed maturing bills to be redeemed without replacement.

The action of the Federal Reserve, making short-term Government securities readily available, greatly increased the liquidity of member banks when the reserve requirements were reduced. Thus, when reserve requirements were reduced, these non-liquid reserves could be quickly converted into liquid short-term earning assets. This policy together with the decline in yields on these short-term Government securities "tended to make bank credit more readily available to private borrowers when their demand for credit increased in late summer."[14] This is true because in this highly liquid position banks were more willing to loan and invest. Then, with the decline in yields or short-term Government securities, the banks sought more profitable investment and lending opportunities in the private sector of the economy.

> The Federal Reserve Open Market Committee followed a policy of monetary ease until about the middle of November when it became clear that the adjustment period had ended and expansion was beginning with renewed strength.[15]

"The Federal Reserve Banks maintained discount rates on eligible paper at 1.5 per cent throughout the year 1949."[16] This rate was set in August of 1948 in order to dampen the inflationary

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[14] Thirty-Sixth Annual Report, p. 10.

[15] Ibid., p. 11

[16] Ibid.

tendencies. Since this rate was maintained throughout the recession, the rediscounting policy of the Federal Reserve was probably not an expansionary factor.

In January and February, the first declines since 1945 occurred in outstanding consumer debt (See Fig. 2, p. 46). Responding to this situation, the Board of Governors relaxed, somewhat, the control on consumer credit which had been reimposed September 20, 1948. Consumer installment credit terms were eased effective March 7 and again effective April 27. On June 30th, 1949, the Board's temporary authority to regulate consumer credit expired and all controls were dropped.[17]

The expansion in installment credit, which had begun in 1945, was resumed after February and continued throughout 1949. Installment credit reached a new high level of nearly 11 billion dollars by the end of the year (See Fig. 2, p. 46).

Stock market credit outstanding was close to the lowest level on record in February of 1949. In recognition of the undesirable effects of this situation, the Federal Reserve reduced margin requirements from 75 per cent to 50 per cent on March 30, 1949 (See Fig. 3, p. 47). "Effective May 16, 1949, the regulations were amended to permit a 25 per cent margin in the case of securities acquired through subscription rights when certain conditions are met."[18]

One additional point should be made. The availability of reserves does not appear to have been a limiting factor during the

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[17] Thirty-Sixth Annual Report, p. 12.

[18] Ibid., p. 14.

CONSUMER INSTALLMENT CREDIT *

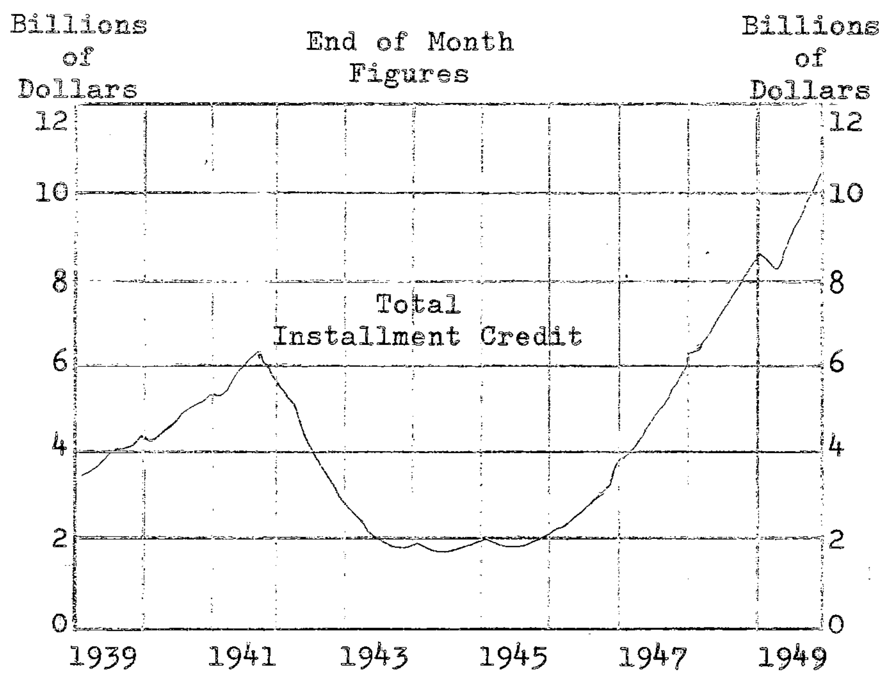
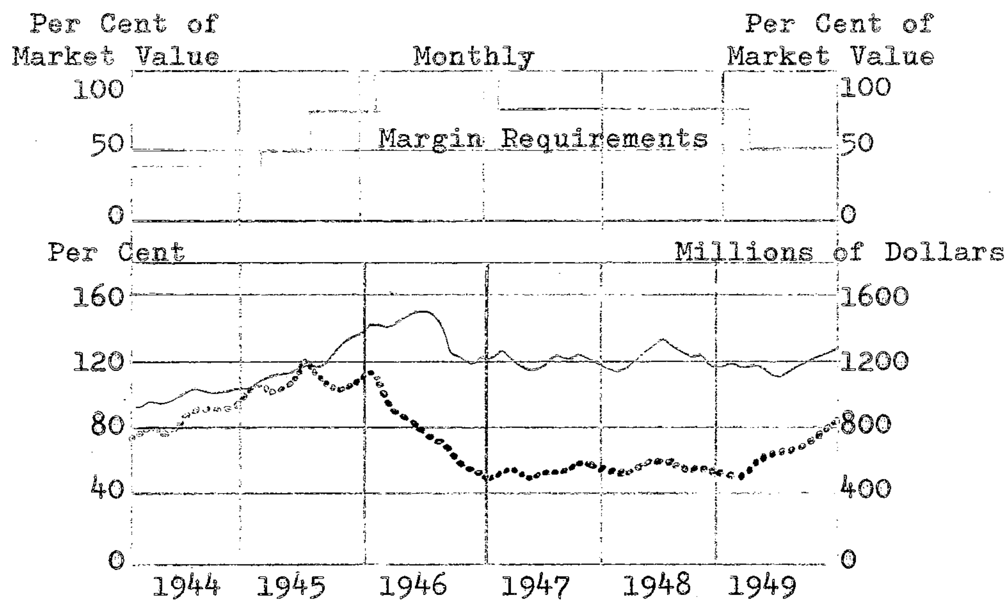



Fig. 2

*Thirty-Sixth Annual Report, p. 13.

MARGIN REQUIREMENTS AND THE STOCK MARKET




Stock Prices 1935-39=100 percentage scale
(Standard and Poor's Corp., 416 Common Stocks)

Customers' Debit Balances dollars scale
(Member Firms of N.Y. Stock Exchange)

Fig. 3

*Thirty-Sixth Annual Report, p. 15

recession. Not only did commercial banks have adequate excess reserves, but more important, they possessed huge amounts of Government securities. Safe in the knowledge that the Federal Reserve would support the price of Government securities, banks held large quantities of these securities (See Table XV, p. 42). It is evident then, that the limiting factor in credit expansion must be attributed to something other than a shortage of bank reserves.

To control the deflationary tendencies, the monetary authorities depended on reductions in reserve requirements, a relaxation of consumer credit controls, and a lowering of margin requirements. As previously mentioned, the rediscounting policy of the Federal Reserve was not an expansionary factor during this recession.

In an attempt to encourage banks and non-bank investors to loan funds to private borrowers, the Federal Reserve allowed the yields on Government securities to fall. Such a decline would make these securities a less favorable investment. The decline in yields was accomplished by the refusal of the Federal Reserve to sell from the System account. A sharp drop in the yield on Government securities resulted from this policy. At the same time this action was taken, the Federal Reserve was also committed to a policy requiring them to maintain an orderly market for Government securities. Consequently, the Federal Reserve was soon forced to abandon this new policy and resumed selling from the System account, thus restoring more orderly conditions in the Government security market.

As can be seen from Table XIV, p. 40, the open market operations of the Federal Reserve were, on balance, deflationary for the year 1949. This is true because the sales of Government securities were much greater than purchases. The open market operations decreased reserves by 3.3 billion dollars in 1949. Table XIV, p. 40 also indicates that reductions in reserve requirements released some 3.8 billion dollars during 1949. Thus, the reductions in reserve requirements were almost completely offset by the open market operations of the Federal Reserve.

CHAPTER V

SUMMARY AND CONCLUSIONS

The recession was a time of readjustment as the supplies of many goods were catching up with demand. Businessmen became somewhat uncertain as to the prospects for the future, and this was evidenced by a decline in inventory investment. It appears, however, that the long-run factors making for economic expansion remained strong.

The principal weapon upon which the monetary authorities relied to encourage expansion was a reduction in reserve requirements. A relaxation of consumer credit controls and reductions in margin requirements were also helpful in mitigating the downturn. The open market operations of the Federal Reserve, however, were deflationary and largely offset the expansionary influence exerted by reductions in reserve requirements. The rediscount rate had been raised to 1.5 per cent in 1948 in order to dampen the inflationary pressures and was not changed at all during 1949. Also, with member banks in possession of adequate excess reserves and secondary reserves, there was little use made of the opportunity to borrow from the Federal Reserve. Thus, rediscounting played almost no part in bringing about the recovery.

On the basis of the information herein contained, the author concludes that the monetary policies followed by the Federal Reserve were not of major importance in explaining the recovery from the recession. Rather, the cardinal factor was the continued strength of the long run expansionary forces in the economy.

A final remark qualifying this conclusion seems appropriate. It is extremely difficult to accurately measure the effects on business activity exerted by certain monetary policies. For instance, the increase in business activity which can be attributed to a relaxation of consumer credit controls or reduction in margin requirements is virtually impossible to assess. There is always a problem in that many factors operating together produce the results, and to determine the influence exerted by each factor seems an impossible task. Consequently, the conclusions are statements of probability based on the author's evaluations of the data, and some margin for error must be recognized.

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