UNITED STATES DEPARTMENT OF AGRICULTURE
Bureau of Agricultural Economics

DOMESTIC BUSINESS OUTLOOK

Address by S. Morris Livingston, Chief, National Economics Division, Office of Business Economics, U. S. Department of Commerce, at the 27th Annual Agricultural Outlook Conference, Washington 25, D. C., October 31, 1949.

As background for a look into the future it is desirable to have a clear understanding of where we are today.

In spite of the readjustments which have occurred this year business is still at a high level. The market value of the total national output, as measured by the gross national product, is currently about 5 percent below the peak annual rate of $270 million reached in the fourth quarter of 1948. At no time this year has it been more than 5 percent below that peak. It is still higher than in any period prior to last year.

The 5 percent reduction is in part merely lower prices. In part there has been a real decline in physical volume. The decline in physical volume, however, has not been due to any decrease in total purchases by the ultimate users of the national output.

Consumer expenditures are currently 2 to 3 percent below the fourth quarter peak. Since this is about in line with the change in the cost of living, it means that there has not been any reduction in the physical quantities taken by consumers. There have been important changes in the purchases of some things, but they have tended to offset each other. For example, automobile sales are well above the fourth quarter rate. On the other hand, retail sales of clothing, in dollars are down more than 10 percent.

Consumer expenditures for food and alcoholic beverages are about 5 percent below the fourth quarter peak. But this reduction is compounded of a 3 percent decline in retail food prices plus some reduction in the proportion of the consumer dollar spent in restaurants and other eating and drinking places. The physical quantities of food being taken by consumers have declined little, if any.

Private outlays for construction and producers' equipment are in the aggregate about 5 percent below the fourth quarter peak. This is probably a little more than the decline in the prices of these items. The difference, however, is counterbalanced by the further rise in purchases by Federal, State and local governments, plus a small change in the privately-financed part of our net foreign transactions.

With the total purchases by the ultimate users of the national output reduced only by the amount of the price reduction, two-thirds of the decline in the gross national product, and virtually all of the decline in real output, has been due to the shift from business inventory accumulation at the rate of $9 billion per year in the fourth quarter of 1948 to liquidation at the rate of $2 to $3 billion in the third quarter of this year.

The shift, from a situation in which part of current production was going into business inventories to a situation in which part of current demand has been satisfied by drawing down inventories, affected primarily the production of those goods. When inventories were being accumulated all along the line, manufacturers were turning out more than the ultimate market required. With the shift to inventory liquidation, their sales shrank by more than any reduction in purchases by the ultimate users.

Since inventory changes affect primarily the manufacturer, they explain why there was a disproportionate decline in manufacturing output and employment at a time when broader measures such as the gross national product or the national income indicated comparatively little change. Since the shift from inventory accumulation to liquidation tends to affect some industries and companies more than others, it also helps to explain the uneven geographical incidence of unemployment.

This appraisal puts the recent upturn in manufacturing output and employment in its proper perspective. What has happened is that buyers, who were temporarily out of the market while they reduced their inventories and shortened forward commitments, came back into the market in the third quarter to maintain those inventories and commitments at the reduced level - or in some instances, to replenish inventories which had been reduced too much.

In terms of the physical volume of total purchases by the ultimate users of the national output there has been no recession from which to recover. A return to the peak gross national product reached in the fourth quarter of last year, in the absence of both a return to the high rate of inventory accumulation at that time and a return to the high prices of that time, would require that the purchases by the ultimate users of the national output be substantially above the fourth quarter peak. There is no evidence that such an increase is taking place.

Even before the recent upturn in manufacturing output and employment, it was apparent that the readjustments from boom conditions had not set off a cumulative downward spiral of expenditures and income. They did not cause a major curtailment of business plans for expansion and modernization. The latest Department of Commerce-Securities and Exchange Commission survey of a representative cross-section of American business, covering planned outlays for plant and equipment in the fourth quarter, indicates that these plans are about 10 percent below those reported at this time a year ago covering the fourth quarter of last year. The total for the year is nominally below the expectations reported in the survey made last February.

Consumer buying power has been well maintained. Total disposable personal income--which is the total of all wages, salaries, dividends, interest, rents, incomes of farmers, unincorporated businessmen and professional people and other personal income, after taxes--is only about 3 percent below the fourth quarter peak. This is about in line with the drop in the cost of living. With the increase in unemployment benefits, and in spite of the decrease in employment, the buying power of wage and salary workers in the aggregate has been more than maintained.

This rather favorable picture naturally leads to the question why the readjustments from boom conditions have not produced a more severe recession. One reason, of course, is the remaining backlog of demand for durable goods. In important areas, such as housing and automobiles, these demands have proven to be still too strong and too urgent to permit much of a let-down.

Even more important has been the net effect of government actions. These actions might be discussed in detail in terms of the cushioning effect of farm price supports and unemployment benefits which helped to maintain consumer buying power, and the rising trend of public works and defense outlays at a time when certain private sectors of demand were beginning to taper off. The net effect, however, can be summarized in terms of the shift in the government fiscal position.

Using the national income and product accounts, the combined Federal, State and local government surplus in the fourth quarter of last year was at the seasonally adjusted annual rate of about $5 billion. In other words, government was withdrawing from private spending power, in taxes and other receipts, $5 billion per year more than it was paying out.

By the third quarter of this year there was a deficit of about the same magnitude. On the expenditure side, this change is compounded of some net increases in government purchases plus the rise in unemployment benefits. On the receipt side, the major element is the decline in corporate profits with the resulting reduction in the amounts which must be set aside out of those profits for taxes.

With that summary of where we are today, let us turn to the future.

Private outlays for construction and producers' durable equipment, which are usually the major variable in business fluctuations, will probably continue to drift downward next year, but no sharp contraction is to be anticipated. So far as producers' equipment is concerned, this appraisal rests on two conclusions drawn from a comprehensive analysis of the demand for such equipment which we published last June.

The first of these two conclusions is that a further decline of 10 to 20 percent, in constant prices, would bring total outlays for all sorts of producers' equipment next year approximately in line with the secular level necessary to take care of normal replacements plus the normal long-term growth in the country's stock of such equipment. This is in addition to the decline of roughly 5 percent which has already occurred from the peak reached in the fourth quarter of 1948.

The second conclusion is that the remaining backlog of deferred demands for producers' equipment is large enough to maintain the average level of outlays over the next several years above what would be necessary merely to take care of normal replacements and growth.

This remaining backlog is primarily in terms of deferred replacements rather than deferred growth in the total stock of equipment in use. The farmer who needed a tractor and did not have one has been under strong compulsion to buy a tractor on whatever terms he could get it. The farmer who had a tractor which was overage, and under more normal conditions would have been retired from service, has usually found it desirable to continue to use that tractor, even at the expense of considerable inconvenience and inefficiency plus high repair bills, rather than buy a new tractor under the market conditions which have existed since the end of the war. The result is that the number of tractors on farms has grown enormously, but most of those tractors which were already overage at the end of the war are still in service. The same situation exists for most other types of producers' equipment.

Because these replacements can be deferred until the buyer is in a more favorable position, they have not prevented, and will not prevent a decline in outlays. The fact that this backlog does exist whenever the seller is willing to make sufficient concessions to the buyer does help, however, to hold the reduction to fairly modest proportions.

Analysis of the various elements of nonresidential construction leads to the same general conclusion - and for much the same reasons. Total outlays in 1949 will be down a little from 1948. 1950 is likely to be below 1949, but not drastically so.

After declining in late 1948 and early 1949, residential construction has since shown renewed strength. Total outlays this year will be about 5 percent below 1948, but the backlog of unfinished construction carried over into 1950 will probably be larger than a year ago.

This upturn is due in part to the increase in multi-family construction resulting from the liberal FHA terms after the hiatus in those provisions last year. It does not warrant the conclusion that there is a basic reversal of the downward trend. On the other hand, the backlog of demand for housing is still large - although the current rate of construction is eating into that backlog rather rapidly.

Furthermore, the nature of the backlog--as with other types of construction and équipment--is such that it does not operate to maintain residential construction activity at the peak rate up to a point, and then abruptly disappear, resulting in a sharp decline in construction to a much lower level. A somewhat greater reduction than this year--say 10 percent--seems reasonable for next year, but the decline is not likely to be substantially more than that unless general business conditions are very unfavorable.

There is no reason to assume that the upward trend of government expenditures will continue indefinitely at a rate sufficient to offset this gradual decline in private capital outlays. There is, however, one very important element still in the outlook. If, as is now expected, the bulk of the National Service Life Insurance dividend is paid out in the first half of 1950 this will be an annual rate of close to $5 billions. That additional buying power put into the hands of consumers should go a long way toward offsetting any weakness in the economy that may develop between now and then.

If the bulk of the dividend is paid out in the first half of the year, the last half will, of course, feel the lack of this sustaining influence.

The devaluation of foreign currencies will tend to make it more difficult for this nation to export, and make it easier for foreigners to invade domestic markets. Its effect on the domestic business outlook, however, should not be overrated.

Essentially, devaluation attempts to accomplish by free market procedures an objective which was inevitable, and which would otherwise involve additional foreign government restrictions on imports from the United States. We can continue to export more than we import only to the extent that we are willing to lend or invest abroad, or to the extent we are willing to give the goods away.

The important point to remember in this respect is that the demand for U. S. goods abroad is still so urgent that foreigners are unlikely to accumulate any large amounts of unused dollar assets acquired by increasing their exports to us and reducing their imports from us.

Since personal consumption expenditures account for more than two-thirds of the gross national product, we cannot afford to ignore potential changes in consumer decisions as to how they will spend their current income. The lessening urgency of consumer demands, for example, was one of the causes of the topping off of the boom at the end of 1948.

One element in the consumer expenditure outlook is the uncertainty as to when automobile production will catch up with demand to the point that the rising trend in automobile purchases, which has been an important sustaining influence in 1949, will be reversed. Current production is far above the requirements of normal expansion and replacements, so that at some point a major adjustment is indicated. The backlog of demand, particularly in terms of replacement of overage cars, is still large, however, and the downward trend, beginning probably sometime in 1950, is likely to be gradual.

Particularly in view of the major addition to consumer buying power to be contributed by the National Service Life Insurance dividend, total consumer expenditures are likely to hold up rather well, at least through the first half of next year.

This analysis of the four major markets adds up to the expectation that the changes in total purchases by the ultimate users of the national output--that is, the total output excluding inventory changes--over the next nine months will not be large in either direction. With demand holding up rather well, but with some of the adjustments to more competitive conditions still incomplete, the general price trend is likely to be very gradually downward.

Granting the possibility of a more significant decline in the second half of 1950, the dollar volume for the year as a whole should not be very far below 1948 and 1949. It should be above any year prior to 1948.

Over a period of as long as a year this appraisal is not altered significantly by including potential inventory changes. The available evidence suggests that business inventories in the aggregate are not excessive. If you accept that conclusion, then it is unlikely that inventory liquidation will be a major factor precipitating a further decline in the gross national product. On the other hand, it is unlikely that inventory accumulation will be resumed on the scale evident in 1948. Within these limits, moderate inventory changes, resulting in intermediate fluctuations in manufacturing output and employment, are essentially unpredictable.

Of course short-term inventory fluctuations are not the only unpredictable element in the outlook. The effect of prolonged steel and coal strikes would be to reduce output and incomes somewhat in the fourth quarter of this year, and throw some additional demand into 1950. It would take a very serious prolongation of these strikes, however, to have any major bearing on 1950 as a whole.

A more important possibility is highlighted by the recent announcement of the atomic blast in Russia. As has happened on several occasions since the end of the war, external developments may once again, particularly through their influence on government spending, be a major unpredictable element in the business outlook.

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