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OUTLOOK FOR DOMESTIC DEMAND IN 1954

Talk by Nathan M. Koffsky
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For the past three years this Annual Conference has met in a setting in which there was considerable assurance that prospective demands would increase in the year ahead. Rising demands came from all sectors of the economy--from the Federal Government for an expanding defense program, from State and local authorities for schools, highways and other public construction, from business for new plants, modern equipment and larger inventories, and, as incomes rose, from consumers who increased their expenditures for food, housing and other goods and services which make up a rising standard of living. Now, with demands from some segments of the economy leveling off and in a few instances declining, there is a real possibility that the total demands on the economy in 1954 may be less than in 1953. Yet, the total reduction in economic activity and employment that appears to be in prospect for 1954 is small. And its restrictive effect on the flow of income to persons may well be offset by lower income taxes starting next January, the continued rise in wage rates in some sectors, and an increase in unemployment compensation payments. Total consumer income available for spending in 1954 is likely to be about as large as in 1953, and the domestic demand for food and other farm products also should be about as good.

Demands on the economy have increased sharply in the past year. The flow of expenditures by Government, business and consumers rose 26 billion dollars on an annual rate basis from the third quarter of 1952 to the third quarter of 1953, a gain of 7-1/2 percent. In the preceding year, the increase in total expenditures totaled some 13 billion dollars, a gain of only 4 percent. The rise in demand this year was matched by an increase in output. Price changes have been small. The Consumer's Price Index is currently less than one percent above a year ago, and most of that was due to rising rents and charges for other services. Retail prices of food and clothing are down slightly. The Wholesale Price Index is currently lower than a year ago, but by less than 2 percent. Drops in wholesale prices of farm products and processed foods were almost offset by slightly higher prices of industrial commodities.

While part of the increased output in the third quarter over a year ago reflected slightly higher levels of employment and a bit longer work-week, a very substantial part was due to a sharp gain in productivity per man hour. This has been a very important factor in the gradual transition of the economy to a more competitive situation. By and large, sellers' markets have turned into buyers' markets.

In preparing the basis for appraising the outlook in 1954, it is important to note where the increased demands over the past year came from. Comparing the third quarter of 1953 with the same quarter in 1952:

The annual rate of federal expenditures for national security programs rose 2.3 billions--only 9 percent of the increase in total expenditures.

The rate of State and local Government expenditures, mostly for schools, streets and highways rose 1.8 billion dollars--7 percent of the total.

Investment outlays, including increases in each of housing construction, new business plant and equipment, business inventories and United States investment abroad, rose almost 6 billions--22 percent of the total increase.

The rate of consumer expenditures rose 16 billions--62 percent of the total. Consumers spent about 6 billions more for automobiles and other durable goods, over 4 billions more for food, clothing and other nondurables, and almost 6 billions more for rent and other services.

It is clear that the business boom of the past year has not depended significantly on expansion in the defense program. In fact, programs for the national security now account for a slightly smaller percentage of our total economic activity than a year ago. It is also clear that to a large extent the past year has seen a consumer boom. Consumer incomes, after taxes, have risen some 13 billion dollars, despite the decline in the income of farmers. In addition, consumer credit outstanding rose about 4 billion dollars, mostly for the purchase of automobiles. Thus, the increase in incomes and the greater use of credit have approximately equaled the rise in consumer expenditures. The savings rate of individuals as compared with income has declined a little from a year ago but this probably reflects more the increase in consumer indebtedness rather than a lessening in the accumulation of liquid assets.

What are the demand prospects in the year ahead? First, let us add up such information as we have about demands from the Government sector. Spending for national security programs in the current fiscal year is likely to be less than in the fiscal year which ended last June. In fact, the rate of security outlays was reduced 2 billion dollars in the July-September quarter this year from the previous quarter. Whether or not further reductions are realized as presently planned, depends largely on developments in the international situation, and thus, subject to a considerable degree of uncertainty. It should be noted, moreover, that most of the reduction in defense outlays for the current fiscal year, as indicated in the Budget Review of August 27, was accomplished in the third quarter. While further declines may well be realized during 1954, the steady rise in State and local Government expenditures will be an offsetting factor amounting to 1-1/2 billion or so.

Some decline in private investment outlays appears probable. Business investment in new plant and equipment, which has been stimulated by rapid tax amortization on defense-related facilities, has been appreciably higher so far this year than last. Much of the defense-related expansion in capacity will be completed by the end of this year, unless new considerations stemming from international developments should require otherwise. The productive plant of American industry has generally been greatly enlarged in recent years and it might well be expected that business outlays for plant and equipment may be less next year than this. The survey of anticipated capital expenditures conducted by the Securities and Exchange Commission and the United States Department of Commerce indicated a 5 percent reduction in the fourth quarter of this year from the third. Yet there are good reasons why any further decline would be small. The shift to a more competitive economy places sharp emphasis on cost reduction even though there may be less on expanding plant capacity. Large depreciation reserves and undistributed earnings are available to finance this. Furthermore, the boom in commercial construction which is following the trend to the suburbs seems likely to continue in 1954. In view of the continued cost-price squeeze in agriculture, farm investment in buildings and equipment may remain at reduced levels.

Nonfarm housing starts have declined since last spring, more than is accounted for by seasonal changes. The current annual rate of starts is somewhat under one million units compared with a rate of over 1.1 million units last April. While residential construction may decline some further over the year ahead, the formation of new households continues large at a rate of some 950,000 a year. Recent reports in the press indicate that mortgage financing is becoming more readily available.

The business inventory position is perhaps the most sensitive and most vulnerable segment of the economy. Through most of 1953, there has been a considerable rise in business inventories, which are 6 billion dollars larger than a year ago. But the level of business sales has also increased proportionately and the ratio of inventories to sales is now about the same as a year ago. Although the inventory ratio is higher than in most other postwar years, it is substantially below the prewar ratio. It seems quite unlikely that without further expansion in the economy, business will continue to accumulate inventories next year. This will likely be a minus factor for the economy as a whole since part of current production is going into inventories. Yet, unless business sales turn down significantly, there is not likely to be real pressure to reduce the over-all level of inventories, although some items such as used automobiles may be affected. One encouraging factor is that the rate of inventory accumulation has been slowing in the second half of 1953.

There does not seem to be any significant change in view in our net trade position with foreign countries. Imports are running higher than a year ago, and total exports are also larger, despite the reduced level of agricultural exports. If foreign aid continues in the next fiscal year, some countries will continue to accumulate dollar holdings, Turning to the consumer sector, some decline in private investment and the possibility for some net reduction in total Government expenditures suggest a slightly lower level of employment and perhaps some reduction in the work-week, particularly in overtime. Yet there are offsets in view which appear likely to absorb much of the impact on incomes of some lessening in economic activity. Income tax reductions will provide some 3 billion dollars to consumer spendable income after January 1, even though the increase in social security payments scheduled under existing laws may offset perhaps 3/4 of a billion. Unemployment compensation would also cushion the loss of income for those who may become unemployed. Spendable income to consumers may well average about the same in 1954 as in 1953, and a year from now is not likely to be much under current record rates. Some expenditures by consumers may be reduced, particularly for some durable goods where 1953 purchases have been at a very high rate and consumer credit an important factor. But consumers expenditures for food should not be much affected, if the level of income is held. Food expenditures have been maintained at a rate of 27 percent of consumers spendable income through most postwar years including the recession year, 1949.

The arithmetic of this appraisal points to only a relatively small reduction in total demands on the economy from Government, business and consumers. One might well inquire whether the additive effects of a number of relatively small reductions might not be greater than their sum, particularly if a feeling of pessimism should pervade the economy. Yet it seems quite logical that this need not be cumulative. Some adjustments have already been made--the reduction in defense outlays in the third quarter, the possibility that most of the reduction in business plant and equipment outlays is occurring in the current quarter, the gradual decline in housing starts since earlier this year, and the slackening rate of inventory accumulation in recent months. There is real prospect that such others as may occur will also come in piecemeal fashion. While the human equation--consumer behavior--is still pretty much unknown, there is little to suggest a tightening of the purse strings, if incomes are maintained. Almost 4 million new babies each year are not conducive to increasing the savings rate. And, if there is one thing that stands out in the broad sweep of our history, it is that the American consumer increases his takings of goods and services as fast as he can--and gives ground very reluctantly and only under pressure.