11-1971

The Current Business Situation

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The 3rd Quarter GNP figures when examined carefully are not as depressing as many people think. The main depressing influence was the very sharp reduction in inventories relative to sales, particularly inventories of durables. Final sales (GNP-inventory change) rose 7.9% against 8% in the 2nd quarter. After adjustment for price change, the 3rd Quarter rise in sales is larger than the 2nd Quarter increase.

The basic questions about 3rd Quarter GNP are why the inventory accumulation was as low as it was and whether durable inventories will continue to fall. Certainly one part of the durables inventory decline was the run off of steel inventories and the inventories of imported goods following the surcharge. A second, continuing reason for the drop in durables inventories is the uncertainty generated by wage and price controls.

The main problems in the economy at the moment are the uncertainties resulting from the President's August announcement and subsequent events

1. By now even the most avid proponent of controls must have become aware that it is far easier to give general guidelines about what the administration would like to achieve than it is to design a system that achieves them. Proponents of controls are mesmerized by aggregates and neglect the difficulties of translating overall guidelines for prices and wages into specific guidelines for each of the millions of prices and
wages in the economy. This is one main uncertainty. There is no reason to believe that the uncertainties stemming from controls will be reduced in the near future.

2. A second major uncertainty is the future international monetary system. There is reason to hope that pressure on European governments because of the pending sharp recession in Western Europe will encourage negotiators to reach a solution. Any solution that is of lasting value to the U. S. and to the Republican party must permit:

(1) an increase in the export of farm products;
(2) a revaluation of currencies.

In addition, the agreement will most likely:

(3) revalue gold;
(4) agree to consider proposals for more rapid adjustment of exchange rates to changing conditions;
(5) agree to consider at a later date the role of gold, dollars and SDR's in the international monetary System;
(6) remove or phase out the surcharge on imports.

3. A third main uncertainty is the future growth rate of money. Unless the growth rate of money increases, there will be a recession next summer. We expect that the growth rate of money will increase if there is an increase in borrowing, a slowing of the inventory reduction or an international monetary agreement.
These uncertainties make any forecasting difficult. The confident forecasts of $100 million GNP increase in 1972, made shortly after the President's speech, are now being cut back to $85 billion.

Worth noting is the standard forecast of a 3 to 3-1/2% rate of inflation in 1972. This predicted rate of inflation is no lower than the recent 3rd Quarter rate. Apparently, forecasters do not believe that the administration will achieve the 2-1/2 rate of inflation or that price controls will have much effect.

The Myth of the High Savings Rate

A standard story that is told these days begins or ends with the hope that the savings rate will fall. The story is based on the myth that the personal saving rate is exceptionally high because consumers are hesitant to spend.

The problem is that the personal saving rate is not what it seems to be. The savings rate includes purchases of houses. If consumers spent exactly as much as they have but bought durables instead of houses, the savings rate would be much lower. The economy would be in almost the same position.

There are other reasons for believing that the savings rate is a highly misleading indicator of consumer sentiment. One additional reason is that personal savings is a very unreliable number. It cannot be measured directly and is computed as a residual. Revisions are frequently made and are often much larger than the preliminary changes.