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RESEARCH REPORTS

Coming Effects of Current Events

An illuminating picture of the irregular progress of recovery in this country is afforded by a survey of the net income of industrial and mercantile companies, class I railroads, and public utilities (exclusive of telephone companies) just made by the Federal Reserve Bank of New York.

The statements of 659 industrial and mercantile concerns, divided into thirty-six major groups, were analyzed. It was found that twelve of these thirty-six major groups operated at a loss in 1931; nineteen in 1932; eleven in 1933; and three in 1934. As this survey clearly brings out, much of the volume of goods produced in 1932 and early 1933 had to be sold for less than the cost of production and marketing. Of course, this condition could not long endure. Had there been no Government price raising program, further reductions in costs and perhaps moderate price increases would have prepared the foundation for a sound and lasting recovery.

However, Government intervention did occur and for a few months in 1933 there was an inflationary rise both in prices and in business activity. Although this minor boom collapsed after a few months, it provided profits which brought many industrial concerns out of the red for the year 1933.

In 1934, the underlying forces of recovery were sufficiently strong partially to offset the adverse effects of Administration policies, with the result that the number of major industries operating at a loss was greatly reduced. According to the latest reports received, all industrial groups which were represented in the survey above mentioned are expected to show favorable net balances for the first quarter of this year. Maintenance of production and distribution at or near present levels throughout the remainder of 1935 should enable all major groups to show small profits, at least.

Reports of earnings by the railroads were much less favorable than the record of the industrial companies. Although not so seriously in the red during 1933 and 1934 as in 1932, class I railroads were operating at a loss, and, contrary to the general recovery trend, suffered greater losses in 1934 than in 1933. In the case of the transportation lines there are two factors to be considered: the burden of funded indebtedness is very much heavier than in the case of most industrial enterprises; and the secular trend of rail traffic is not so favorable. Because of the rapid development of truck competition, the construction of pipe lines for the transportation of oil, and the erection of electric power transmission lines (which reduced bituminous coal shipments), freight revenues were in danger even before the advent of the depression.

Earnings of gas and electric companies during the past few years have shown somewhat different tendencies. From the annual totals in 1931 net profits have steadily declined during each successive year. Substantial net earnings are still reported but the fact of a declining trend has led to a degree of pessimism not as yet warranted by reports of dollar earnings.

Public policies antagonistic to the gas and electric companies will in all probability not be carried to the extremes recently feared. However, in the event of serious monetary inflation the utilities would be in a vulnerable position since they could not hope to obtain rate increases in parallel with rapidly rising costs of production and distribution.

The varied effects of recovery mentioned above can be attributed largely to the experiments undertaken as part of the "new deal." During periods of recovery from previous depressions, abrupt increases in net earnings for nearly all classes of business have followed the moderately larger volume handled during the early months of the recovery process.

Since their inception, NRA policies have increased the cost of doing business without proportionately increasing gross income. If this tendency toward limitation of profits were accompanied by a more rapid decrease in unemployment or by other tangible benefits, there would be less cause for complaint. Unfortunately, the rate of absorption of the unemployed offers little encouragement to NRA supporters. Furthermore, the increase in the nation's purchasing power is nearly all directly traceable to the injection of Federal credit into the banking system. While there has been some increase in savings during the past year it has been less than might normally be expected during the early months of a recovery period.

Future Earnings

Except as it bears upon the prospects for future earnings this discussion of profits during the past three years is primarily of academic interest. However, there are grounds for hope that the future earnings trend will be more favorable. Prospects for modification of the NRA may mean greater freedom in the management of industrial companies with opportunities for obtaining larger profits from an increasing volume of business.

As far as the railroads are concerned the outlook is clouded. Larger traffic movements incidental to an increased volume of business are the primary need of the roads and for this reason we believe that the stronger

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systems will eventually recover their lost earning power. The development of Diesel operated passenger equipment may prove helpful.

In the case of the gas and electric producing companies higher earnings may be looked for over the next few years. After the force of the public campaign against utilities has been spent and rate reductions have been obtained, greater demand for current will almost certainly arise and in the course of time will again increase revenues. The amount of direct Government competition is not likely to be sufficient to affect a majority of the power companies now operating.

Smugness Out of Place

Announcement of prospective reductions in the lower brackets of British income tax rates has moved officials of the Treasury Department to present comparisons between rates in the United States and in Great Britain. The comparative table makes clear the vastly heavier burden which the British subject is carrying and the large increases required in our tax rates to make them equal Great Britain's.

It is to be hoped that this comparison will be taken as a warning rather than as grounds for self-congratulation. High as the British rates are, they are at present in the process of reduction. The rate of Federal spending is such that our rates must eventually be raised to meet payments on the growing public debt. (An item which does not appear in such a comparison is the state income tax which is an added burden to a large portion of this country's taxpayers.)

Rope for the Next Hanging

Attention has been called to the extraordinary ease in money rates by the record low of one-quarter of one per cent in the rate for call money on the New York Stock Exchange. This situation is primarily due to the large excess reserves of member banks in combination with a reluctance on the part of individuals and bank officers to invest in any but comparatively riskless enterprises on a short term basis.

There is no doubt that the easy money policy of the Government is having the desired effect on money rates. Already private corporations are taking advantage of the opportunity to refund outstanding obligations at substantial annual savings in interest.

Is Credit Inflation Dangerous?

Financial writers for many of the daily papers and even the editors of some of the leading financial and economic journals view with alarm the possibility of inflation via the printing press and belittle the dangers of credit inflation. It is quite generally assumed that a credit inflation must necessarily be less harmful, and that it is much easier to keep within bounds. We do not share this optimistic viewpoint.

The modus operandi of a printing press inflation is so obvious that even the least intelligent citizens of the country would realize the dangers involved. It is a safe guess that direct printing of currency on a large scale would promptly result in a flight from the dollar, withdrawals of savings from the banks, and heavy demands on the life insurance companies for cash surrender values. Such action would precipitate another collapse of all financial institutions in the country, and would therefore force the Government to call a halt before the process was much more than begun. After a brief period of panic, sanity would be restored and the Government would have been taught a much needed lesson.

On the other hand, there are no immediate prospects of such salutary effects of the credit inflation already well begun. The principal danger lies in the fact that few people understand what is going on. That being the case, the process can be carried to greater lengths, with resultant more serious dislocations and maladjustments of business than would otherwise result. A paper money inflation in this country would hardly extend over more than a few months; whereas the impending credit inflation is almost certain to cover several years, and require an additional period of years for the correction of the serious maladjustments that will inevitably arise.

In view of the foregoing, we cannot regard the silver purchase program and the Government spending plans as satisfactory alternatives to a printing press inflation. Nor do we feel that payment of the bonus in advance by a special bond issue constitutes a wise compromise with those who would print currency to make an immediate payment. Far better that the struggle for and against inflation should be brought out into the open in order that the country as a whole may sooner learn the harsh lessons apparently needed to teach the elements of financial wisdom.

Supply, Demand, and Prices

Satisfactory Easter retail buying, more reassuring news from Washington in respect to the probable modification of reform legislation, and somewhat less disturbing news from abroad have all helped business sentiment during the past week. Commodity futures markets responded to the Government's new price for silver. The failure of any marked business recession to appear is gradually convincing observers that the increased activity of the past few months is more than a "flash in the pan."

Supply

Automobile production continues the star performer in the industrial field. To the surprise of many observers, steel production moved upward slightly and it now appears that another peak in the late spring is probable. Power production almost equalled the large gain reported last week over the corresponding week of a year ago. The 5.1% increase indicates that miscellaneous production is continuing at a higher rate than last year.

Demand

The outlook for sustained demand is good. Employment in the automotive and related industries has been better recently than at any time during the past four years. Thousands of wage earners are in a position to buy and prices for farm products are also at high levels. The Government spending program will soon be forcing additional funds into the channels of business and in the absence of any sharp decline in industry, increasing demand seems certain.

Prices

Commodity prices have been firmer. Preliminary data for the Institute's commodity price index for March indicates a fractional decline, the first in six months. Recent gains have more than counterbalanced this decline and the outlook is for continued firmness and possibly marked gains as the spending program develops.