AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

Summary

Reports continue to come in of expanding residential construction and increased bookings by machinery manufacturers. A resumption of activity in the capital goods industries will make the difference between partial and full recovery.

The President's message vetoing the Patman bonus bill hardly justifies the hope that he will in the future oppose further tinkering with the country's money mechanism. So long as he fails to realize, or to admit, that a printing press inflation via bonds may be as dangerous as printing currency, the danger of an uncontrollable conflagration will remain.

The major components of the Institute's three basic indexes of production, purchasing power, and prices are discussed in this bulletin. Industrial production in early 1935 included such widely divergent activities as the automobile industry, operating at 298% of its 1932 average, and cement production, which was at 85% of the 1932 average. Much of the irregularity which has so far characterized recovery is directly traceable to Government interference with business.

One dominating factor is responsible for the credit expansion which is now taking place. The accumulating Treasury deficits financed by the sale of Federal securities to commercial banks result in the creation of new checking account money.

Prices of raw materials have increased much more rapidly than prices of finished products. This differential has in part been absorbed by increased mechanical efficiency and in part by a decrease in the manufacturers' profit per unit.

Growing apprehension of the inflation to date, further Government spending, and firm prices have set the stage for the next advance. There are some indications that it may develop quite rapidly.

Production, Purchasing Power, and Prices

A glance at the three basic charts on the last page of this bulletin reveals that a substantial degree of recovery from the 1932-33 depths of the depression has occurred. In the case of the Harwood Index of Inflation, which reflects the amount of purchasing power currently available in the banking system in excess of normal requirements, and in the case of the commodity price index the upward trends have been nearly continuous. The irregularity which has characterized revival in the volume of industrial production is shown in the first chart on the page.

Each of these indexes presents a composite picture of a number of more or less independent factors. We believe that it will assist clients to understand the situation if we describe briefly the movements of the major individual series which make up each of the complete graphs.

Although eccentric trends of any of these components may affect the complete index to a marked degree, the "weight" or relative value given to an individual series is such that fluctuations in that series affect the composite curve to the same extent that changes in the volume of production for the industry actually influence general economic conditions. As an illustration, the automobile industry is given a larger weight in the Index of Industrial Production than that of any other single industry (with the exception of steel, which is classed as a semi-manufacture) because of its great volume and also because of the large number of industries such as steel, rubber, glass, machine tool, textile, etc., which are vitally affected by the activity of this industry.

Net demand deposits, which are the principal factor in the base for calculating the ratio form of the Harwood Index of Inflation, have risen so rapidly that the inflationary credit expansion, which has recently been taking place, has been somewhat minimized. In computing the ratio form of this Index, total purchasing power available to the public is used as the numerator, and the same amount minus the inflationary credit originations of the banking system is the denominator. As expansion takes place in these circulating media, the effect produced on the Index in ratio form is similar to the results of plotting absolute figures on a logarithmic scale, thereby obviating misleading distortions of the chart.

In the case of the United States Bureau of Labor Statistics Index of Wholesale Commodity Prices, on which the Institute's Index is based, there has been great irregularity in price fluctuations for different classes of commodities since 1932. For example, raw materials have advanced 39% while finished products have risen but 16%.

The Course of Industrial Recovery

This Institute has repeatedly commented in these bulletins on the relative stability of the consumer goods industries in comparison with the capital goods industries. An analysis of production volumes indicates that declining activity during the depression was less marked in such industries as food products, clothing, shoes, paper and printing, petroleum refining, and other lines

in which consumption follows within a few months of production. For this reason, percentage comparisons of the extent of recovery from the depths of the depression may be somewhat misleading. For example, steel ingot output is now approximately double the volume of 1932, while shoe production is but 24% above the 1932 level. Yet the volume of steel production remains in a relatively depressed state, while the number of boots and shoes being turned out compares favorably with output during pre-depression years. The units of footwear produced in 1934 (357,121,000 pairs) were only slightly exceeded by output in 1929 (361,392,000 pairs).

Recovery in the textile industry has been highly irregular. In the case of production of cotton and woolen goods a substantial increase occurred in 1933 which was followed by a relapse in 1934. At the present time production of cotton goods remains at a low ebb, while production of woolen goods, due in part to large Government orders, is 85% above the 1932 level. Consumption of cotton still remains in the vicinity of the low for the depression.

Production of basic materials, such as lumber and cement used in the building industry, has shown no marked recovery as yet. However, prospects for increased building activity, not only in public works but in private enterprises, is expected to change the situation for the better.

Increased production of automobiles has been the most important factor in bringing about a substantial degree of recovery in general business activity. Automobile production in 1933 was 38% greater than in 1932. In 1934 it was 97% above the 1932 level, and in the first quarter of this year 198% above the 1932 average. The rate of activity during the first quarter of this year is probably higher than can be maintained throughout the remainder of 1935, but production has already been sufficiently great to insure an increased volume in comparison with 1934.

The two major series representing general manufacturing activity, namely, electric power production and freight car loadings, which are included in the Institute's Index of Industrial Production, offer interesting comparisons. In the case of the electric power industry, the long-term trend is very definitely upward, while in the case of railroad freight car loadings, there is an unfavorable secular trend due chiefly to truck competition.

The detailed figures, based on the monthly average for 1932 as the 100 index number, are shown in Table I, below:

TABLE I

INDUSTRIAL ACTIVITY

Annual Monthly Average for 1932 = 100

	1932	*1933*	*1934*	First Quarter *1935*
Automobile production	100	138	197	298*
Boot and shoe production	100	113	115	124
Car loadings	100	103	109	116
Cement production	100	80	98	85
Cotton consumption	100	126	107	106
Electric power production	100	103	110	116
Lumber production	100	129	128	127
Pig iron production	100	153	178	187
Steel ingot production	100	172	182	199
Wool consumption	100	139	107	185

*Probably higher than the average for the year will be.

The Institute's Index of Industrial Activity portrays three distinct spurts towards recovery. The one occurring in 1933, based on inflationary prospects, collapsed abruptly during the middle of the year. Another rally at the beginning of 1934 was brought to an end when NRA restrictions came into force. Minor declining tendencies have recently been evident, but we believe that this will not become a definite downward trend of important proportions, barring developments at present unpredictable.

Purchasing Power

A number of conflicting influences have combined to form the complete picture presented by the Index of Inflation. The dominating factor has been the purchase by commercial banks of several billion dollars worth of Government securities. The bonds have been paid for by new credits to Treasury checking accounts and these demand deposits have been transferred to individuals and businesses by the spending program.

Deflation in credit which occurred during the depression culminated in the bank moratorium of early 1933. Since that time a number of significant changes have occurred.

In comparing current data with those of March, 1933, it is found that radical changes have occurred in only four items of vital importance to the banking system. Investments have increased by more than $5,000,000,000 from $11,420,000,000 to $16,490,000,000. Most of this increase has resulted from the purchase of Government securities. There has also been an increase in Government securities held by the Federal Reserve Banks in the amount of $566,000,000.

In March, 1933, loans on securities made by commercial banks totalled $4,550,000,000. They are now $3,797,000,000, a decrease of approximately three-quarters of a billion dollars.

The constrictive effect of currency hoarding during 1933 decreased after the banking crisis. At the time of the bank moratorium, currency hoarding amounted to about $2,150,000,000. There was a sharp decline immediately following the Government's nationalization of gold and at the end of 1933 hoarding had been reduced by more than one billion dollars. At present, estimates of the Federal Reserve Board place them at approximately $600,000,000.

After analyzing these major changes in the banking system, we find that only one has been deflationary in character. The decrease of loans on securities to the extent of $750,000,000 has partially offset the reflationary effect of money withdrawn from hoards, the increase in Government and private investments by the commercial banks, and the purchase of Government securities by the Federal Reserve Banks.

Time deposits, which should represent savings, have increased to a comparatively slight degree during this period. In March, 1933, they were approximately $8,700,000,000 and at present the total is $9,150,000,000. This increase has been partially offset by a decrease in loans to commercial banks by the Reconstruction Finance Corporation. Such loans were nearly three-quarters of a billion dollars in May, 1933, and have since been reduced by $200,000,000.

It has been rumored that the Treasury is planning to issue $100,000,000 of securities per week during the coming year. At that rate, the Index of Inflation will rise sharply since the offsetting factors, such as a further decrease in hoarding, Federal tax receipts, increase

in genuine savings, and decreasing loans on securities, are not likely to be in sufficient volume to diminish the effect of rapid Government spending. Indeed, some of these factors may reverse recent trends and thereby augment the degree of inflation.

The Rise in Commodity Prices

Following devaluation of the dollar, commodity prices rose rapidly during the succeeding six months and have since continued to rise, although at a more moderate rate. We have already pointed out that raw materials have risen more rapidly than finished products have. Farm product prices, due to a number of causes, have moved upward farther than prices of other commodities. Although the average price of farm products in 1933 was but 7% greater than the average for 1932, in 1934 this class of commodities was 36% above 1932, and in the first quarter of this year averaged 63% above the 1932 level. In contrast with greatly increased prices for farm products, iron and steel price increases of 8%, building materials 19%, and petroleum products 10%, seem moderate indeed.

Living costs are not much higher today than in 1932, primarily because of somewhat lower rentals. Usually there is a lag in rent charges as compared with wholesale commodity prices. The accompanying table shows the price trends for major groups, referred to the average for 1932 as a base, or 100 index number:

TABLE II

U. S. Bureau of Labor Statistics
Commodity Price Indexes—1932 = 100

	1932	*1933*	*1934*	First Quarter *1935*
Finished products	100	100	111	116
Raw materials	100	103	125	139
Farm products	100	107	136	163
Building materials	100	108	121	119
Electricity	100	90	88	86
Petroleum products	100	91	111	110
Iron and steel	100	99	109	108
Metals, nonferrous	100	120	136	135
Clothing	100	115	131	125
Cotton goods	100	132	160	153
Woolens and worsteds	100	120	138	127
Boots and shoes	100	105	114	113

Supply, Demand, and Prices

Reports of retail trade, especially from the Middle West, indicate that buying is again increasing after the few weeks of hesitation following the Easter season. It is expected that this tendency will become more pronounced in the weeks ahead. Government spending has already been accelerated and the additional purchasing power which this provides may be further augmented by speculative profits if the stock market continues to push upward.

Supply

Although steel ingot production receded 1½% to 43% of capacity during the past week, there seems to be no immediate indication that the industry is in an adverse technical position. Firming prices for steel scrap suggest that when renewed demand occurs steel makers will not be at the mercy of a buyer's market.

Electric power output of 1,700,000,000 kilowatt hours during the past week was 3% above that of the corresponding week in the previous year and indicates no recession in general manufacturing activity to date.

Demand

The latest flurry in demand has occurred in the woolen goods industry. Large Government orders in combination with an unlooked-for reduction in stocks has placed the industry in a position to obtain higher prices. Recently, industrial and other purchasing agents have begun to view the prospects for inflation with greater seriousness.

Prices

Commodity prices have been firm except for the grains. Many commodities are now in a position such that increasing demand will immediately result in sharply rising quotations.

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Statistical Summary

For the convenience of clients who wish a more detailed statement of the three basic indexes presented than may be obtained from the charts we make the following tabulation showing the data for each month during 1934 and for the first four months of 1935. Subsequent figures will appear in later monthly bulletins.

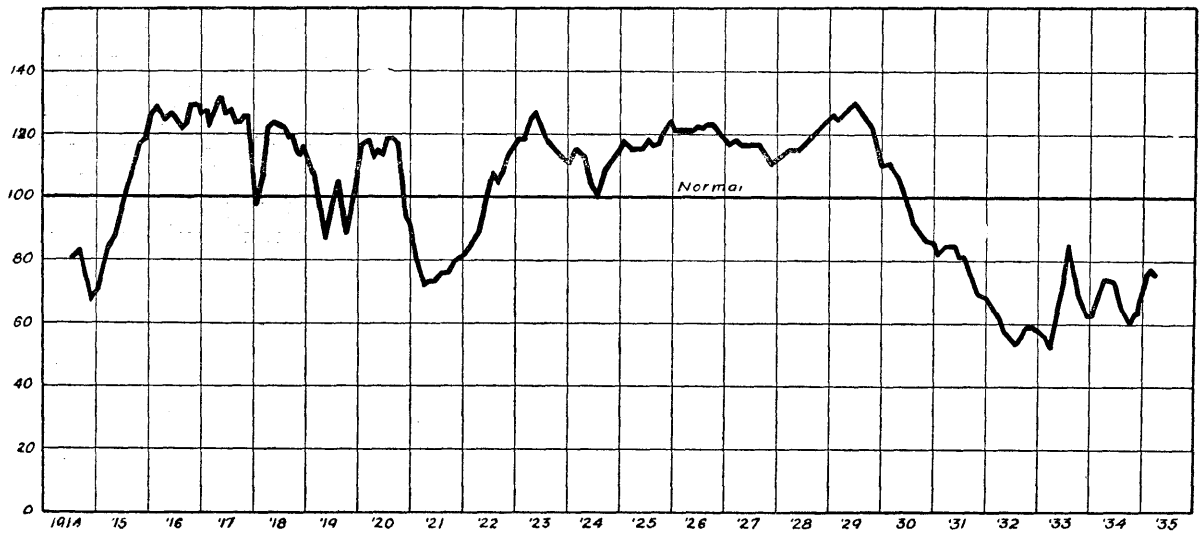
Production, Purchasing Power and Prices—1934

	Jan.	*Feb.*	*Mar.*	*Apr.*	*May*	*June*	*July*	*Aug.*	*Sept.*	*Oct.*	*Nov.*	*Dec.*
Index of Industrial Production	66.4	71.6	75.2	74.8	74.2	71.3	65.4	63.3	60.0	63.7	64.0	71.7
Index of Inflation (Ratio form)	98.7	102.0	102.0	103.1	103.0	104.9	105.8	105.7	106.1	107.5	107.5	109.5
Commodity Price Index	126.0	128.7	130.0	128.9	131.5	131.5	131.3	134.2	136.7	134.5	134.7	135.7
Commodity Price Index (In terms of old gold dollar)	75.9	77.4	77.7	76.4	78.7	78.9	79.0	80.7	82.2	80.7	80.8	81.4

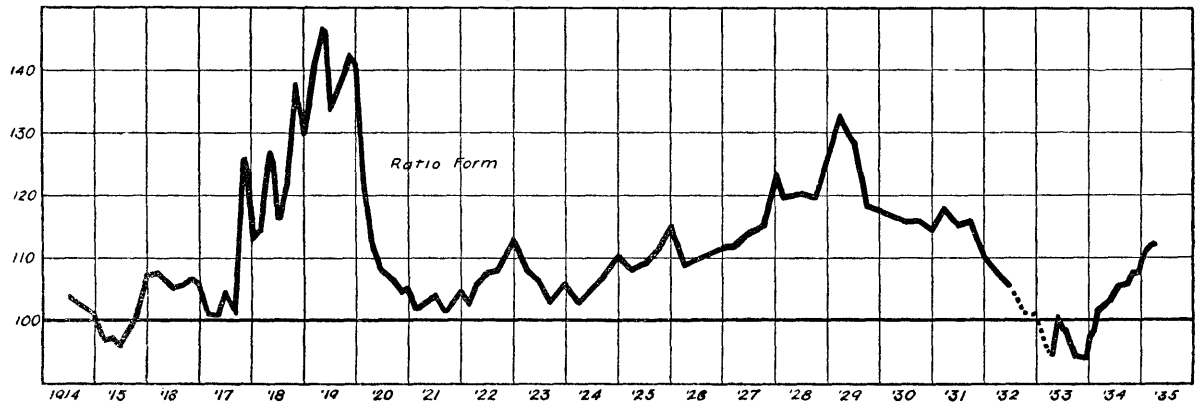
	1935 *Jan.*	*Feb.*	*Mar.*	*Apr.*
Index of Indus. Production	76.5	77.4	75.8	73.9
Index of Inflation (Ratio form)	111.8	113.0	113.5	114.4

	1935 *Jan.*	*Feb.*	*Mar.*	*Apr.*
Commodity Price Index	138.6	141.0	140.5	141.0
Commodity Price Index (In terms of old gld. dol.)	83.2	84.5	84.5	84.5

INDUSTRIAL PRODUCTION.



HARWOOD INDEX of INFLATION



COMMODITY PRICES.