

AMERICAN INSTITUTE for ECONOMIC RESEARCH

W E E K L Y
B U L L E T I N

54 Dunster Street, Harvard Square - Cambridge, Mass.

January 1
1940

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Present Trends and Future Developments

Circumstances are such today that there is little temptation to break our long-standing resolution to avoid annual forecasts at the beginning of each new year. When such predictions are not merely silly they may be misleading if they imply a nonexistent ability to make detailed and accurate forecasts for a specific period ahead. However, it is an appropriate time to review our knowledge of those important economic trends which will presumably be responsible for much that happens during the months ahead.

There appear to be five factors of especial importance at this time, and their influence will continue into the indefinite future. The first is the cyclical movement of business, which we have always with us; the second is the long-term price trend, in particular that attributable to the devaluation of the dollar; the third is inflation, primarily of the government-forced variety during recent years; the fourth is the major war in Europe; and the fifth is the political situation in this country, insofar as economic consequences are concerned. Each of these will be discussed in turn.

The Cyclical Recovery

A cyclical recovery of business began in the latter part of May or early June, 1938. It is conceivable that this recovery ended in November of that year, but if that was the case it was only about half as long as the shortest cyclical recovery ever heretofore recorded. In our opinion, it is much more probable that the setback during early 1939 was merely one of those brief interruptions of a cyclical recovery such as have been seen many times in the past. Therefore, we have assumed that the cyclical recovery which began in June, 1938, was still in progress only a month ago.

It is possible that the high point reached by industrial production and commercial activity during November or December, 1939, marked the peak of the recovery in progress during the preceding months. If so, the recovery lasted only 18 months. This is nearly twice as long as the shortest recovery period ever recorded, but 80 per cent of the cyclical recoveries during the past 150 years have extended over a longer period. Furthermore, most of the recoveries that lasted 18 months or less were cut short by relatively spectacular events that had serious economic consequences. In the absence of any such developments there is at present no reason to

believe that the recent recovery should be of relatively short duration.

In the accompanying table the actual durations of 39 successive cyclical recoveries are shown. In order to simplify the data, the table is in the form of a year and month calendar. The asterisk in the space for June, 1938, indicates the first month of the latest cyclical recovery, and the figures in the spaces for subsequent months show the number of cyclical recoveries which have had a duration of the successive periods indicated by the elapsed months from June, 1938.

Year	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sept	Oct	Nov	Dec
1938						*	0	0	0	0	0	0
1939	0	1	1	0	2	0	1	1	1	0	3	2
1940	2	1	5	1	1	2	0	2	0	2	2	1
1941	1	2	1	0	1	0	0	0	0	0	0	0
1942	1	0	1	0	0	0	0	0	1			

Referring now to the table, it will be observed that 27 recoveries lasted longer than 18 months, and that is the status of the cyclical recovery assumed to be still in progress. Approximately two-thirds of them, 19, ended during the succeeding 12 months; 5 more, somewhat less than one-fifth of those which lasted more than 18 months, extended into the second 12 month period after the end of the first year and a half; and 3 of the recoveries shown lasted into the third year after the first 18 months. It is especially interesting to note that all, with the exception of the especially long-lived 3, ended within 17 months after the first 18 months of their duration. Judged solely by this evidence, the chances that the recovery will continue beyond the spring of 1941 seem decidedly slim. However, there would obviously be nothing unusual about a continuation of the recovery for several months beyond the present.

One of the especially interesting features of this historical study is that the three exceptionally long cyclical recoveries all occurred during, or were apparently influenced by, important wars. The longest recovery occurred at the time of the Mexican War and lasted 52 months. The recovery which included the Civil War boom lasted 46 months. Finally, the cyclical recovery affected by the World War boom lasted 44 months. It would be dangerous to assume that a major war will inevitably be accompanied by an unusually prolonged cyclical recovery, but it is certainly reasonable to assert that warfare on a major, even world-wide, scale does not necessarily mean a short cyclical recovery.

Presumably, cyclical recovery movements end because maladjustments arise which create critical

situations and precipitate a collapse. A typical example is found in the rapid upward movement of prices during early 1937. Either buyers refused to pay the higher prices demanded, or the mark-up of retail prices was too great in relation to the increased earnings of wage earners and the other factors of production. In any event, although sales to consumers measured by dollar amount held at high levels throughout the first 9 months of 1937, the physical volume of such sales was steadily declining. Partly as a result of that and apparently in part as a result of inventory speculation, there was an accumulation of unsold goods in the channels of trade; and, as one business after another found it impossible to carry on with the increasing burden, a liquidating movement was precipitated. The extent to which the Government's reversal of its former inflationary practices was responsible for the situation should not be overlooked, but there is no doubt that the maladjustment just described actually existed. Usually there are other maladjustments also involved; and, depending on the circumstances, various maladjustments have played a dominating part in the termination of cyclical recoveries.

Although it is often impossible to see what the maladjustments were until the subsequent liquidating process reveals the hidden weaknesses, there is usually at least some indication of an unbalanced situation in the business world before the end of a cyclical recovery. Today, any such outgrowth of the recent recovery seems to be nonexistent. This is not to assert that there are no unsound features in the present economic situation here in the United States, but those that are apparent do not appear to be business cycle phenomena. Therefore, insofar as the cyclical factors are concerned, there is no apparent necessity for a cyclical depression during the next few months. There is some possibility that inventories are being unduly increased, but all the available evidence indicates that this development has not reached a magnitude which might be expected to cut short the cyclical recovery.

Long-Term Price Trends

Presumably, subscribers have read the discussion of price trends given in the "Explanation of Basic Charts." From time to time during the past several months the latest data have been discussed in the bulletins. Each succeeding report of monthly or annual gold production further confirms the conclusions that have been emphasized repeatedly.

A major portion of the increasing gold production of the world reaches the banking systems of the principal nations and becomes, or is represented by, new purchasing media in the channels of trade. As long as the annual increase in gold production continues to be above normal, a slowly rising trend of commodity prices is probable. There will be setbacks from time to time, but it can confidently be expected that the irregularly upward trend which has been evident since 1933 will continue for several years.

During a period when the long-term trend of prices is upward, each succeeding rally, which may extend over several months, usually reaches a higher level than the last preceding, and each successive decline usually fails to reach as low a level as the reaction which preceded it. Under such circumstances, the mistakes which business men inevitably make, either in acquiring inventories or in their purchases of new plant and equip-

ment, are counterbalanced in part by the slow upward movement of prices. This means that bankruptcies, with their attendant painful and disturbing liquidation of business assets, are fewer than they otherwise would be during such a period, and the net effect is that this important economic trend has a slightly stimulating effect on business activity.

Inflation

Most of the inflation seen during the past seven years has been a result of the Treasury's deficit financing. Apparently, this source of inflationary purchasing media will continue to be by far the most important for some time to come. The latest data were shown in last week's bulletin, and little further discussion is required here.

It is important to observe, however, that the downward trend in our Index of Inflation which prevailed from November, 1938, through early 1939 apparently will not be repeated during the next few months, although this has not yet been finally determined. The latest Treasury data indicate that spending is running far ahead of the Government's current income. Last year at this time, on the other hand, government spending was at a lower rate; and this, combined with large tax payments, resulted in a temporary reversal of the inflation trend.

There will probably be much talk of economy in the next few months, but real economy is hardly to be expected from the present Administration. It is far from certain that the monetization of Federal deficits will cause substantial further inflation during the next several months, but it does seem probable that the brief deflationary interlude seen last year will not be repeated. (This does not imply that there cannot be a brief recession of business activity as the result of inventory readjustments. We simply wish to make it clear that no marked reversal of the inflationary trend which has prevailed since early 1938 is expected.)

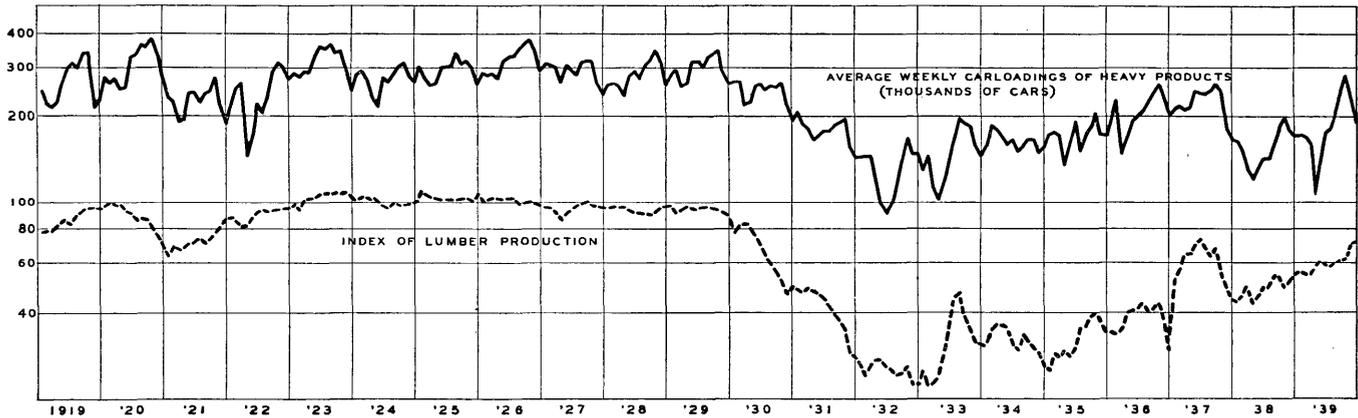
War

That the war in Europe has already been responsible for increased orders from the South American and other countries is apparent. Whether such orders approach in magnitude the amounts predicted as possible in our discussion entitled "Wartime Economic Trends" is not known and probably will not be known for several months. However, the trend is in the expected direction.

On the other hand and except for a few specific articles, orders from France and Great Britain apparently have not yet been given in substantial volume. It is not surprising that these countries have preferred to avoid the haste and waste which accompanied their purchases of our goods on such a large scale during the last World War, but it seems probable that orders approaching the magnitude of the estimates given in "Wartime Economic Trends" will eventually appear.

The effect of the war thus far has been to stimulate business activity in this country, and this tendency will probably increase rather than diminish until the end of the war is in sight. When that will be it is impossible to guess, but we see little possibility of an early collapse within Germany, and events elsewhere suggest that the scope of the war may increase, rather than decrease. This would presumably tend to prolong the conflict and therefore extend the effects on business here in the United States which are already evident.

CARLOADINGS OF HEAVY PRODUCTS AND LUMBER PRODUCTION



Political Developments

The evidence of a turn in the political tide is overwhelming. Defeat of the Supreme Court packing plan in 1937 and, later, of the first reorganization plan; the 1938 election results; the more recent and somewhat surprising overthrow of the pension panaceas in Ohio and California; and, last but not least, the reaction of America's parlor pinks and pseudo-liberals to Russia's imperialism; these clearly indicate that, for the time being at least, the trend is away from reckless experimentation with our economic system and toward a better understanding of and deeper respect for those principles embodied in our Constitution that have made it possible for this country to become the great industrial nation of the world.

It is too early to guess whether the turn in the tide will be further confirmed by a change of the parties in power at the coming elections. Even if it were known that such a change would occur, it still would not be certain that the new President would carry out his campaign promises. It is this factor which is the biggest question in the 1940 political scene.

Conclusions

In a survey of economic trends which will exert an influence for some time to come it is also necessary to consider the continuing effects of New Deal legislation. Some of the experiments undertaken on a nation-wide scale during the past few years will have effects which cannot now be foreseen. Furthermore, we know from the record of business activity in France during the past several years that there was no sustained recovery trend until the French counterpart of our New Deal had been discarded and replaced by what would today be called conservative economic policies. It is at least possible, therefore, that a long-sustained recovery will not occur in this country until much New Deal legislation has been jettisoned. The truth of the matter is that no one knows how serious this possibility is because there is no way of measuring the deadening and hampering effect of higher taxes and the prospect of still higher taxes, restrictive legislation of various kinds, disruption of employer-employee relationships, timidity of investors, and the class antagonisms, all of which owe their present discouraging aspects to the New Deal.

With the exception, then, of the various economic features of the New Deal itself, there is no evidence that the more important underlying economic trends are threatening to end the recovery movement and initiate

a downward movement. Because of the depression which prevailed during most of the 1930's, some of our more naive economic observers have concluded that even moderate prosperity is an artificial development, which can be produced only by hothouse methods. This viewpoint is as mistaken as the diametrically opposite belief, widely held during the decade of the 1920's, that a boom or nearly-boom prosperity could be continued indefinitely. Therefore, our judgment can perhaps be summarized as follows:

1. A moderately reactionary trend of business activity during the next few weeks, perhaps largely because of a failure to achieve expected seasonal gains, would not be surprising; but a more serious recession seems improbable.

2. Of the important underlying economic trends (as differentiated from the continuing effects of New Deal legislation already in force) none seem to offer evidence that suggests the early termination or reversal of the recovery movement. Therefore we see nothing to prevent a continuation of business activity at or near recent levels and even further gains.

3. We believe that further substantial improvement sometime during the next several months is possible because we see nothing in present trends which would certainly prevent it and much that will probably foster that development.

4. As far as we can discover, there is no adequate scientific justification for a more detailed or confident prediction regarding future developments. Consequently, much as we should like to discern the outlines of the future more clearly, we are convinced that a more precise forecast would probably not be worth the paper it was written on.

Carloadings and Lumber Production

The accompanying chart, showing carloadings of heavy products and lumber production, traces fluctuations during the past twenty-one years in two statistical series which are primarily affected by changes in the activity of the durable goods' industries.

The Carloadings Record

The commodities included in freight carloadings of heavy products are coal and coke, ore, and forest products, of which coal and coke shipments comprise two-thirds of the total. The steel mills, foundries, and machine shops are the most important users of bituminous coal, and fluctuations in the activity of the metal

industries are reflected in the carloadings' record shown in the chart.

After a brief and substantial decline in carloadings in April 1939, which was caused by a strike in the bituminous-coal fields, there was a rapid increase in this type of freight traffic, and carloadings of heavy products reached a new postdepression high in October. The series is not adjusted for seasonal variations, and the decline in November and December is largely seasonal. However, comparisons with movements during corresponding months in the preceding years indicate that the decline from the October to the December level was greater than normal in 1939. Probably manufacturers who rushed to obtain fuel during the September-October war boom had obtained enough during those two months.

Lumber Production

The index of lumber production is adjusted for seasonal variations. During the past seven years, fluctuations in the curve of lumber production have been somewhat similar to those in the Institute's Index of Industrial Production. However, the decline during the last quarter of 1937 was not so severe as that of the index including all industries, and the lumber series has followed a more clearly defined recovery trend.

In December 1939 the lumber-production index was close to the recovery high reported in June 1937. The trend of lumber-production primarily reflects changes in residential building activity, but considerable quantities of lumber are also used for other types of construction.

BUSINESS

Postal Receipts

The volume of business in fifty of the largest city postal districts during November increased $3\frac{1}{2}$ per cent in comparison with the total for November 1938. The rate of gain was somewhat less than that recorded in the preceding month. The 1939 data have reflected diminishing gains in recent months, but postal receipts were increasing rapidly toward the close of last year. The monthly series for the preceding three years and for the first eleven months of 1939 are shown in the accompanying table.

POSTAL RECEIPTS IN FIFTY LARGE CITIES
(In millions of dollars)

Month	1936	1937	1938	1939
January	27.4	27.9	27.5	28.5
February	26.1	27.8	27.0	27.7
March	28.8	33.8	31.8	33.5
April	28.9	31.1	29.6	29.8
May	27.9	29.8	28.2	30.9
June	28.3	29.6	28.0	29.8
July	26.7	26.6	24.6	25.5
August	26.0	26.3	26.6	28.2
September	29.3	30.0	29.5	30.0
October	32.9	31.7	30.9	32.0
November	29.2	30.7	31.4	32.5
December	41.3	42.0	42.5	

THE FUNDAMENTALS

Supply

Last week the steel-ingot production rate decreased from $89\frac{1}{2}$ to 74 per cent of theoretical capacity as a result of holiday shutdowns. The change was less drastic than is usual. Commenting on the prospects for the steel industry during the first quarter of 1940, the *Iron Age* stated: "It is not to be expected that the high steel-

production rate of the fourth quarter will extend into 1940, but present indications are that January output will be not far from 85 per cent of capacity. Whether such a high rate can be continued beyond January will depend on developments that cannot yet be clearly foreseen, foreign trade for example. The present expectation is that operations may slowly recede during the quarter."

	1927	1929	1932	1937	1938	1939
Per Cent of Capacity	70.0	63.0	12.5	22.5	40.0	74.0

(Latest 1939 data; corresponding week earlier years)

Electric power output established another new record high last week. Gains were general in all sections of the country.

	1927	1929	1932	1937	1938	1939
Billion Kilowatt Hours	1.48	1.64	1.42	2.09	2.36	2.64

The automobile industry's output of 117,705 cars last week was approximately unchanged from production during the preceding week. Ward's Automotive Reports has estimated that automobile assemblies for the calendar year 1939 in the United States and Canada totalled approximately 3,720,000 passenger cars and trucks. Output was about two-thirds of the 1929 record.

	1929	1932	1937	1938	1939
Units (000 omitted)	24	27	67	103	118

There was a slightly greater-than-seasonal decrease in cotton-mill activity last week, and the adjusted index declined from 147.3 (revised) to 145.1. Although it was reported that the flow of incoming orders was smaller last week, the volume already booked will insure a rate of operations for January not substantially lower than was maintained during the final quarter of 1939.

	1929	1932	1937	1938	1939
New York Times Index	108.8	98.5	92.1	126.6	145.1

There was a greater than seasonal decrease in lumber production last week and the adjusted index declined from 92.5 to 87.2.

	1929	1932	1937	1938	1939
New York Times Index	114.9	29.5	77.1	75.1	87.2

Demand

The Federal Reserve Board's Index of Department-Store sales is not yet available for December 1939, but reports from merchants and from commercial organizations indicate that holiday demand compared favorably with pre-Christmas buying in the years since 1930. With the exception of a few individual lines, store stocks were relatively low before Christmas and are now believed to be insufficient to meet the requirements of the January special sales. Orders have already been placed in the wholesale markets for staple dry goods to replace stocks which are expected to be disposed of this month.

Prices

The behavior of the sensitive wholesale commodity price index was indecisive last week. Advances during early trading sessions were canceled later in the week. Moody's Spot Commodity Price Index was 169.1 on December 21 and 168.9 on December 28. The Dow-Jones Index of Commodity Futures closed at 53.50 on December 21 and at 63.18 on December 28.

American Institute for Economic Research is a non-political, non-commercial organization engaged in impartial economic research.