AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

WEEKLY BULLETIN

February 19 1940

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

A Lesson from Abroad

During the past few decades, all of the principal industrial nations of Europe have offered instruction in that important economic study, the cause and consequences of inflation. It is now apparent that some of these lessons are to be repeated, and it is possible that new ones will be added. Inasmuch as events in this country may develop along lines somewhat similar to one or another of the various inflationary progressions that have occurred or are occurring abroad, it will obviously be wise to follow current developments in the managed-money field.

Several months ago various English economists foresaw the danger of inflation as the result of vastly increased government expenditures for war purposes, and there has been much discussion of the subject in various English periodicals since that time. Dr. Keynes has urged a program of forced loans that would make it mandatory for all receiving incomes in Great Britain to save varying proportions, depending on the amounts of the incomes received, and invest the funds in government bonds. It has been suggested that steps could be taken to insure that the bonds would be retained by the individuals who received them. Of course, the effect of this would be to lessen the demand for consumption goods by the civilian populace, and the corresponding proportion of industrial output would thereby become available for war purposes.

Such procedure would be sharply at variance with that followed during the last World War, when all countries resorted to inflation by one means or another. Inflation accomplishes the same purpose of restricting consumption on the part of the civilian populace, because it forces a rapid rise in the cost of living. Usually the members of the great middle class and unorganized labor are the principal sufferers under such circumstances, because the wealthy are able to share in war profits by a wise choice of investments, and unionized labor is usually able to obtain wage increases that almost if not fully counterbalance the rise in the cost of living.

The Government in England seems to be unable to make up its mind whether to adopt a policy of inflation or to choose something on the order of Dr. Keynes' suggestion. As a matter of fact, there seems to be little public approval of the forced-loan scheme, and the financing thus far undertaken by the Government has already resulted in some degree of inflation. Savings bonds offered to the public and other government issues have been well taken, but the rate of spending for war purposes is so great that voluntary savings are far below the amount that has been and will be required.

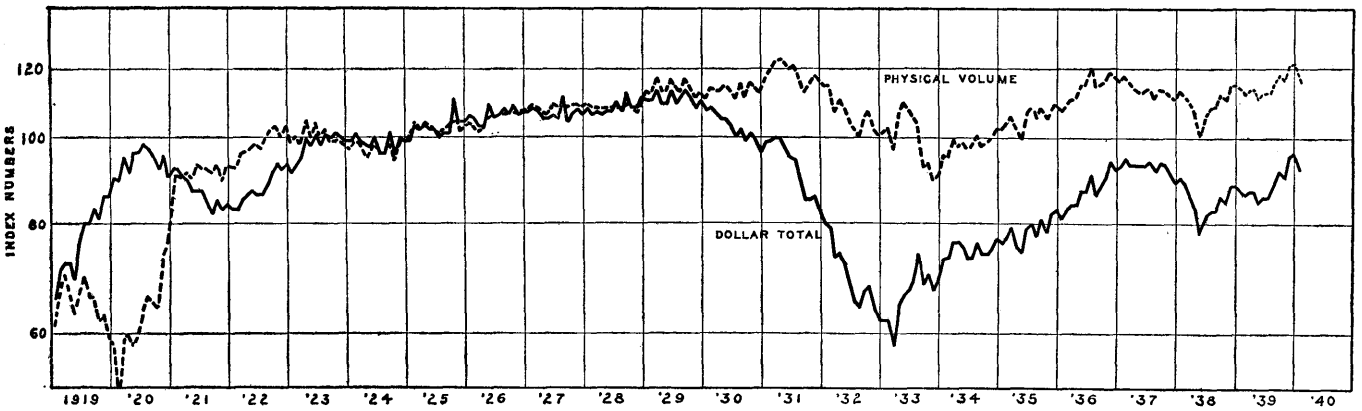
It seems improbable that the system of forced loans will be adopted. The truth of the matter is that such loans would have to be on such a large scale that many individuals would find it impossible to meet their current obligations. The program would mean virtual bankruptcy for many families, and the forced abandonment of mortgaged homes and other property not yet paid for. There is little doubt that the average person will prefer the vague future dangers of inflation to the immediate drastic lowering of living standards that would follow if the forced-loan program were adopted on a sufficiently large scale to meet wartime expenditures.

Probably, union labor expects to be able to obtain wage increases that will compensate it for such rises in living costs as may occur. On the other hand, if living costs were held at present levels by an avoidance of inflation made possible through the forced-loan program, union labor would have to share with the rest of the population in a drastic lowering of living standards. Another important group, the business men and investors who may profit by the windfall gains that always result during an inflationary progression, constitute an important element of the population that probably prefers to take its chances under a general inflationary program.

The great middle class apparently will not appreciate the dangers involved until it is too late. Consequently, the Government will find that the path of least resistance is that involving an increasing degree of inflation as the war progresses. This subtle method of robbing widows and orphans, life insurance policyholders, annuity owners, and the middle class in general, with their relatively fixed incomes and lack of organization enabling them to demand better treatment, is a procedure that always has, and apparently always will have, a peculiarly strong appeal to politicians who must seek the public favor.

Many people do not realize that, prior to our entry into the last World War, the Nation's leading economists warned against the monetary hazards involved. The Government chose to ignore them; and it soon became almost treasonable to criticize any governmental procedure. This time the early warnings in England have been even more emphatic, but they will apparently not be heeded. In spite of the object lesson

DEPARTMENT STORE SALES



offered by Germany during the great inflation that ended in 1923, and the disastrous sequence of developments in France during the early part of the 1920's and again until a year or so ago; in spite of these striking object lessons so close to home, the English public has obviously not grasped the lessons offered. Those who must safeguard their economic future here in the United States will therefore probably be well advised if they seek adequate protection against inflation trends in this country. It is not at all impossible that we shall turn back on the road toward fiscal sanity, but it would be the height of recklessness to assume that the turn has already occurred.

BUSINESS

Department-Store Sales

After reaching a new postdepression high in December 1939, the Federal Reserve Board's Index of Department-Store Sales, based on dollar totals, declined substantially in January 1940. Although the index dropped from 96 in December to 92 in January, it was then substantially higher than it was in January 1939, when it stood at 88.

As the accompanying chart shows, the decrease in the physical volume of sales was somewhat greater than the decline in dollar totals. Although the rate of retail spending has apparently increased during the past year, the physical volume of goods distributed by department stores was about the same in January 1940 as it was in January 1939. Average department-store prices have increased nearly 4 per cent during the past twelve months.

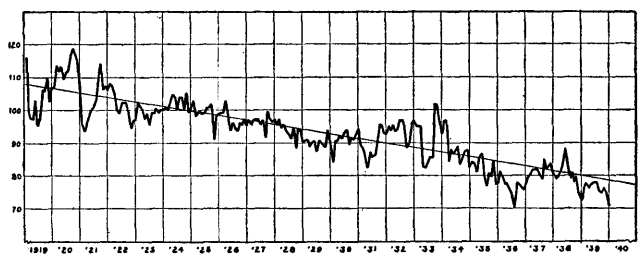
The curtailment in the volume of dollar sales during January was probably in part attributable to the natural reaction from the heavy retail distribution of December. However, another factor of importance in causing the decrease was the adverse weather, which was reported to have seriously affected retail sales, particularly throughout the Southern States, where unprecedented blizzards had a pronounced effect.

Ratio of Retail Inventories to Sales

During the final month of 1939, the ratio of retail inventories to sales declined to the lowest point, with one exception, since January 1919 when indexes on which the ratios are based were first calculated. The Institute's chart presents the ratio of retail inventories to sales with an approximate long-term trend line.

Although the position of the ratio for December, as plotted, is not so far below the long-term trend line as it was at the low point in 1936, it is in the lower range of fluctuations about that line. During the final quarter

RATIO OF RETAIL INVENTORIES TO SALES



of 1939, when the Federal Reserve Board's index of sales was advancing, the index of stocks declined from 71 in November to 68 in December.

Foreign Trade Trends

The discussion of foreign trade in wartime in the February 5 bulletin dealt with preliminary data for December 1939. Last week, the United States Department of Commerce published December figures for trade with separate countries. We are therefore presenting a table for December similar to that for November published on page 11 of the January 15, 1940 bulletin.

UNITED STATES FOREIGN TRADE

	Exports			*Imports*		
	(In Millions of Dollars)					
Destination	*December*		*%*	*December*		*%*
	1938	*1939*	*Inc.*	*1938*	*1939*	*Inc.*
Canada	28.5	43.9	54.0	23.5	32.0	36.2
Mexico	5.8	9.8	69.0	4.8	5.9	22.9
So. and Central America	33.3	52.7	58.2	27.4	41.0	49.6
Belgium	6.0	5.6	*6.7**	3.9	5.1	30.8
France	11.2	36.6	226.8	5.6	3.4	*39.3**
Germany	8.3	....	....	6.3	3.4	*46.0**
Italy	5.1	8.6	68.6	3.4	3.9	14.7
Netherlands	7.6	10.1	32.9	2.9	1.9	*34.5**
Norway	1.7	3.8	123.5	1.4	1.8	28.6
Sweden	5.8	9.6	65.5	4.5	4.5	...
United Kingdom	47.1	50.4	7.0	12.2	15.7	28.7
U. S. S. R.	7.2	11.9	65.3	1.5	1.9	26.7
Other Countries	101.3	124.8	23.2	73.9	126.4	71.0
Total	268.9	367.8	36.8	171.3	246.9	44.0

* Decrease

The outstanding change in foreign trade trends revealed by a comparison of the two tables is the increase in exports during December to France and to the United Kingdom. Although exports to France in November were 4.3 per cent and to the United Kingdom 26.2 per cent less than they were in the corresponding month of 1938, exports to France in December were 226.8 per cent and to the United Kingdom 7.0 per cent greater than they were in December 1938. The great increase in exports to the allied nations obviously reflected the earliest shipments of war supplies. The repeal of the arms embargo provisions of the Neutrality Act in November made it possible to export materials that had been ordered. In other respects, there were no outstanding changes in the foreign trade data during December. Both export and import trade with the neutral nations continued to increase.

Telephones in Use

At the end of January there were approximately 18,640,000 telephones in the United States. This number exceeds the predepression record made in 1930 when there were 17,200,000 instruments in use; and, in spite of the population growth during the past decade, the number of telephones in service per capita is at a new high.

During January there was an increase of 94,400 telephones in service, compared with an increase of 65,400 in January, 1939. The telephone business is primarily affected by changes in commercial activity, and the recent more rapid rate of growth suggests that there has been improvement in the prospects for private enterprise.

The Institute's index of telephone stations in service (on the basis 1926=100) is adjusted for population growth. It advanced from 121.3 in December to 122.0 in January. The index for each month in 1937, 1938, and 1939, and in January 1940, is shown in the accompanying table.

INDEX OF NUMBER OF TELEPHONE STATIONS IN SERVICE PER CAPITA
PER CAPITA MONTHLY AVERAGE 1926=100

	1937	*1938*	*1939*	*1940*
January	108.0	113.6	116.9	122.0
February	108.3	113.7	117.2	
March	109.1	114.2	117.8	
April	110.0	114.6	118.1	
May	110.4	114.8	118.7	
June	110.8	114.6	118.8	
July	111.0	114.6	118.9	
August	111.3	114.8	119.0	
September	112.0	115.4	119.6	
October	112.8	115.9	120.3	
November	113.0	116.2	120.7	
December	113.2	116.4	121.3	

THE FUNDAMENTALS

Supply

There was a moderate decline in the steel ingot production rate last week from 71½ to 68½ per cent of theoretical capacity. The rate was 55 per cent in the corresponding week of 1939 when a downward trend was evident. The *Iron Age* stated that current operations are being supported to some extent by replenishment of inventories by steel mills. On the other hand, consumers of steel are continuing to draw on their stocks, and therefore steel consumption has not declined so rapidly as has steel production.

	1927	*1929*	*1932*	*1938*	*1939*	*1940*
Per Cent of Capacity	81.0	87.0	27.0	30.5	55.0	68.5

(Latest 1940 data; corresponding week earlier years)

Electric power production decreased slightly last week, but maintained about the same relation to output in the corresponding week of 1939 that prevailed in the preceding week. Electric power production is one of the most sensitive indicators of manufacturing activity, and thus far in the new year has followed the pattern traced early in 1939 when there was a declining trend. During the spring of 1939, industrial activity receded from the best level of 1938, recorded in December; but the decline was limited to 7 per cent, measured by the Institute's Index of Industrial Production, and culminated in May.

	1927	*1929*	*1932*	*1938*	*1939*	*1940*
Billion Kilowatt Hours	1.59	1.72	1.58	2.05	2.27	2.52

The automobile industry produced 95,985 units last week. This output was somewhat less than the average weekly production in January, but exceeded by a substantial margin production during any other corresponding post-depression week.

	1929	*1922*	*1938*	*1939*	*1940*
Units (000 omitted)	122	29	58	84	96

There was a contraseasonal decrease in cotton mill activity last week, and the adjusted index declined from 143.3 (revised) to 135.7. The decrease was foreshadowed in last week's bulletin, when it was reported that the rate of incoming orders had declined.

	1929	*1932*	*1938*	*1939*	*1940*
New York Times Index	*	89.7	87.2	117.8	135.7

* Not available until third week in March.

Demand

Retail distribution maintained the rate of gain from the January level reached in the preceding week, according to reports from merchants throughout the country. Retail volume is normally low at this season. Demand appearing in the wholesale markets is not especially vigorous.

Prices

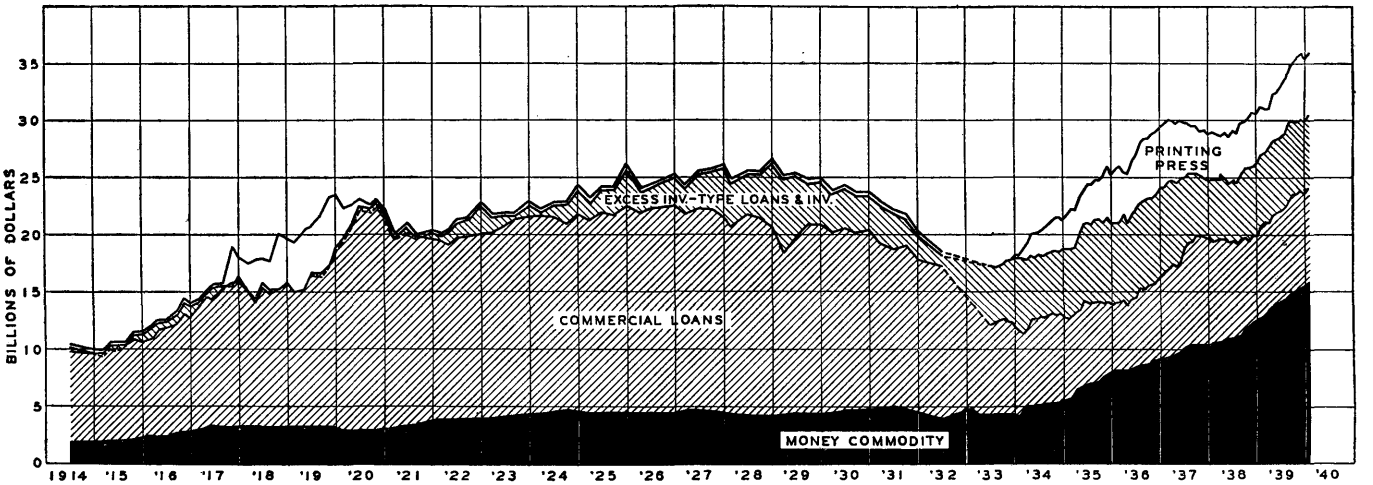
The sensitive wholesale commodity price indexes declined moderately last week. Moody's Spot Commodity Price Index was 159.4 on February 8 and 159.0 on February 15. The Dow-Jones Index of Commodity Futures closed at 59.52 on February 8 and at 58.82 on February 15. There was another decrease in steel scrap prices last week, but it was smaller than those which have occurred earlier in the year.

FINANCE

Sources of Purchasing Media

The total of purchasing media from all sources increased during January, and at the end of the month had slightly more than regained the loss sustained during December. All of the sources contributed to the gain.

SOURCES OF PURCHASING MEDIA



There was an increase of $270,000,000 in purchasing media from the money commodity source during January. The increase was almost identical with the monthly average increase during 1939, which, as the accompanying chart shows, has been followed with minor variations during the past 18 months. Only about 5 per cent of the recent monthly increases in the Nation's monetary gold stocks came from domestic production; the remainder resulted almost entirely from net gold imports.

There was an increase in total purchasing media derived from commercial loans last month. The increase was not so large as the decrease in this type of credit during December, and the total is somewhat smaller than it was in January, 1939.

The increase in purchasing media from the third source (an excess of investment-type assets which represent tangible property with respect to the savings available to the banking system), was relatively small and was caused by moderate increases in the amount of government-guaranteed and "other" securities held by the commercial banks.

There was an increase of more than $100,000,000 in purchasing media from the fourth source. After accumulating bank balances as a result of the December financing operations, the Treasury began to reduce its checking accounts in January. Government deposits with the banks are deducted from the total of purchasing media derived from the printing press because such deposits represent funds not yet available to business.

In discussing the Harwood Index of Inflation in the January 29, 1940 Monthly Bulletin, we stated (page 20), "Deflationary influences of a seasonal character will assist the Treasury in financing its deficit spending from savings. Because of the high rate of industrial activity during the past three months, the Government will probably receive large sums in the form of Social Security taxes, which will be paid to the Treasury in February." Such taxes during the first eight days of February were $121,000,000 compared with payments of $111,000,000 during the corresponding period of 1939. The net deficit during this eight-day period was $15,000,000, compared with a net deficit of $40,000,000 in the first eight days of February, 1939. Large Federal income tax payments are expected to have a similar effect in March, and further gains in aggregate purchasing media during the next two months may be limited to the amount of increases in the Government's monetary gold stocks.

New Capital Issues

The volume of new capital issues during the first month of 1940 was not large, but it at least continued an improving trend. There have been small but steady gains since September 1939. The monthly figure in January finally reached the best level since that recorded in July, 1939.

One feature of the January, 1940 new corporate financing was the relatively high proportion of common stock offerings, which comprised about 40 per cent of the total. The reason for this is probably to be found in the attitude of SEC officials, who apparently believe that funds for new ventures or the expansion of old ones should be financed by "risk money."

New corporate financing in each January during the past 15 years is shown in the following summary:

New Corporate Financing in the United States

Year	*January*	*Year*	*January*
	(In Millions of Dollars)		
1926	510.8	1933	22.2
1927	489.9	1934	6.0
1928	372.1	1935	5.3
1929	551.3	1936	72.9
1930	565.8	1937	96.6
1931	399.8	1938	46.4
1932	46.7	1939	5.9
		1940	32.1

Source: *Commercial and Financial Chronicle*

SECURITIES

Bonds

The bond market failed to maintain the gain recorded in the preceding week, and the averages declined nearly to the level of a fortnight ago. The Dow-Jones Average of 40 Bonds was 89.59 on February 8 and 89.37 on February 15.

Stocks

Early last week the stock market advanced moderately, accompanied by an increase in the volume of transactions, but in later sessions the volume decreased again, and the averages moved slightly lower. Since September, 1939, market movements in either direction have been minor in degree and brief in duration.

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