

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Blitzkrieg

It is becoming more and more apparent that even that narrow body of water, the English Channel, is a formidable military obstacle. Hitler may now be attempting to obtain the complete air superiority that might make possible an actual invasion of England. Unless Germany commands the air, such an undertaking would be even less likely to succeed than England's ill-fated Gallipoli Campaign in the last war.

If twenty-two miles of ocean is such an important barrier, how much broader the Atlantic Ocean seems. Certainly, there is no danger that Hitler can gain air superiority over the Atlantic, even though he may find it possible to control the air over the English Channel. Therefore, we have time to do a little more thinking about the economic aspects of National defense.

The cost of maintaining an army of 2,000,000, including conscripts, the Regular army, and the National Guard, will be a tremendous burden. It is certain that no such burden will be carried by the taxpayers for long in time of peace, and there is real danger that an unwise expansion of our armed forces now will arouse opposition that will in the end force drastic and unwise economy. Such has been our experience before. It would be much wiser to view the problem in its proper perspective, determine what we propose to defend, how we propose to defend it, and make our plans accordingly. We should face the worst possibility and prepare to deal with it according to our means and in that manner which will be least disruptive to the mode of life we consider worth fighting for. There is too much viewing the situation with alarm as a temporary emergency and not enough realization of the fact that this problem may be with us for a long time to come.

BUSINESS

Telephones in Use

Although July is normally a quiet month in the telephone business, there was a net station gain this year of 22,000 instruments in service. This is twice the gain recorded in July last year, when 11,100 telephones were added to the system, and contrasts with a net loss of 9,000 stations during July 1938. There was a small advance in the index of the number of telephones in service, adjusted for population growth.

The index of telephones in service for the first seven months of 1940 and for each month of the preceding three years 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	122.5
March	109.1	114.2	117.8	123.1
April	110.0	114.6	118.1	123.6
May	110.4	114.8	118.7	124.3
June	110.8	114.6	118.8	124.2
July	111.0	114.6	118.9	124.3
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

The steel-ingot production rate decreased from 91 to 89½ per cent of theoretical capacity last week. The decrease was caused by the shut-down for vacation of one large plant in the Pittsburgh district and did not indicate a change in the favorable position of the industry. The automobile industry began to buy steel for its 1941 models last week and a large volume of orders was placed for railroad equipment and rails. Steel exports to Canada and Great Britain last week continued to flow in the heavy volume that was maintained throughout July. Purchases for United States defense projects are slow in developing, but, in the opinion of the *Iron Age*, "will constitute a large reservoir of business for the steel mills later on."

	1929	1932	1937	1938	1939	1940
Per Cent of Capacity	93.0	14.5	83.0	40.0	62.5	89.5
(Latest 1940 weekly data; corresponding week earlier years)						

Electric-power production last week exceeded that in the corresponding week of 1939 by eleven per cent. The distribution of power in the central regions of the country was well sustained, but consumption in New

Notice to Annual Sustaining Members: A copy of the new publication "What Will Inflation and Devaluation Mean to You?" was mailed to you last week. If you did not receive it, please let us know. This is an omnibus edition that includes parts of earlier publications brought up to date and has much new material.

England and on the Pacific coast compared less favorably with output during the corresponding week in 1939.

	1929	1932	1937	1938	1939	1940
Billion Kilowatt Hours	1.73	1.42	2.30	2.13	2.33	2.59

Output of the automobile industry decreased from 17,373 units to 11,635 units last week. The New York automobile show has been scheduled for a week earlier this year than last, and manufacturers will presumably endeavor to expedite production of the new models in order to assure dealers of supplies when required.

	1929	1932	1937	1938	1939	1940
Units (000 omitted)	112	21	103	14	26	12

Cotton-mill activity remained unchanged last week when a seasonal expansion was expected. In consequence, the adjusted index declined from 131.7 to 129.9.

	1929	1932	1937	1938	1939	1940
New York Times Index	107.8	80.3	131.5	120.7	124.9	129.9

There was a greater-than-seasonal increase in lumber production last week and the seasonally adjusted index advanced from 83.7 to 87.2.

	1929	1932	1937	1938	1939	1940
New York Times Index	130.7	35.8	92.4	69.3	76.9	87.2

Demand

Retail trade improved in most sections of the country last week. The department-store volume was estimated as about five per cent greater than it was in the preceding week. Our entrance into the World War in 1917 apparently affected the physical volume of retail trade adversely. The Federal Reserve Department-Store Index does not cover the World War period, but Amos Parrish & Company, Inc. has recently compiled data from questionnaires sent to the stores. According to this survey, there was an increase of 13 per cent in the dollar volume of retail trade in 1917 from that in 1916, but it is estimated that the price of merchandise increased about 19 per cent. In 1918 the average sales gain was 16 per cent, and prices were believed to have increased 30 per cent. The fact that several million men were subject to compulsory military service during the period indicated, probably contributed to the decrease in the physical volume of goods sold at retail, but the rapid rise in prices may have been an even more important influence, although it is not possible to determine the extent to which trade was affected by these factors.

Prices

The sensitive wholesale commodity price indexes last week continued the gradually declining trend followed since early in July. Moody's Spot Commodity Price Index was 150.5 on August 8 and 150.3 on August 15. The Dow-Jones Index of Commodity Futures closed at 50.44 on August 8 and 49.66 on August 15.

FINANCE

New Capital Issues

There was an increase in the flow of new capital to industry during July and new issues of corporate securities valued at \$45,000,000 compared with a total of only \$5,340,000 for June. About \$15,000,000 was borrowed by the railroads, \$11,000,000 by the public utilities, and \$15,000,000 by corporations classed as miscellaneous. The recent increase in the volume of new

capital issues represents only a portion of the potential volume that may be released when the Federal Government's corporate-tax policy is definitely determined. On the basis of applications already made for the registration of new securities, it is evident that there may be a great increase in the flow of new capital into the armament industries. Armament plants obviously may not be of great economic value if they cannot be adapted to other purposes in peace time, but experience during and after the World War period indicates that at least a considerable part of the buildings and equipment devoted to manufactures for National defense are ultimately used for peace-time production.

New corporate financing in July and in the first seven months of each year during the past fifteen years is shown in the accompanying summary.

NEW CORPORATE FINANCING IN THE UNITED STATES

Year	First	
	July	Seven Months
	(In millions of dollars)	
1926	415	2,886
1927	338	3,098
1928	272	2,957
1929	583	4,354
1930	392	3,913
1931	115	1,422
1932	63	223
1933	52	112
1934	20	119
1935	55	156
1936	63	521
1937	82	911
1938	130	492
1939	50	266
1940	45	308

Source: *Commercial and Financial Chronicle*.

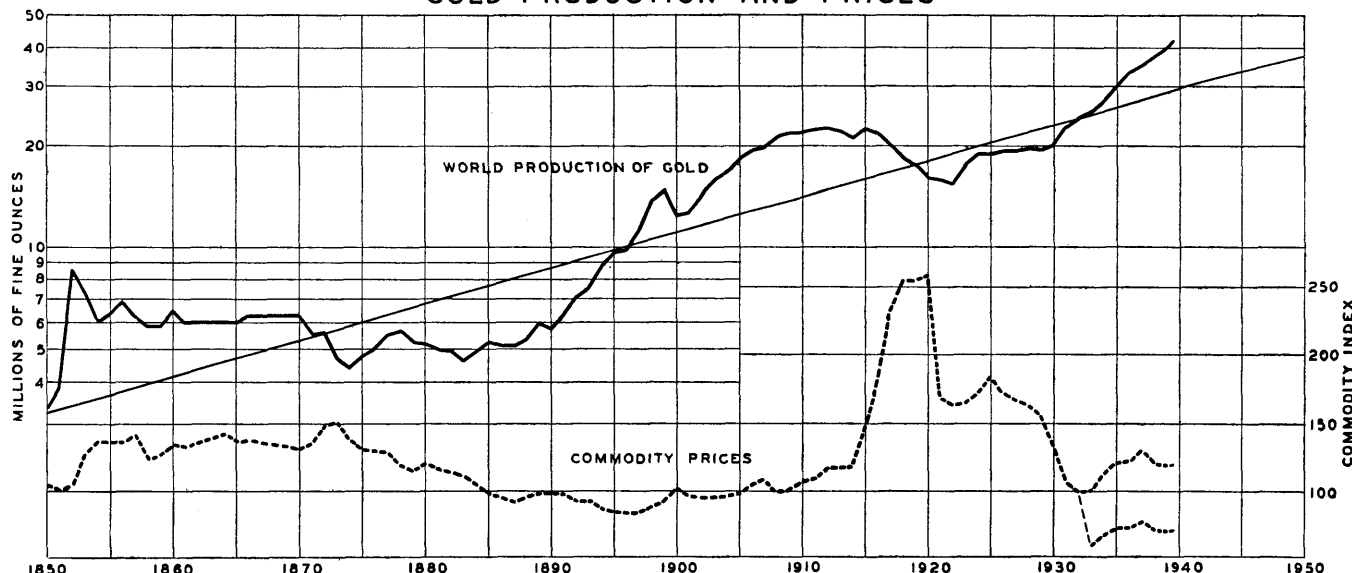
Commodity Prices and Gold Production

The amount of gold produced each year has an influence on commodity prices; because, as long as gold production continues at a higher-than-normal rate, total purchasing media increases more rapidly than the supply of goods currently being produced. On the other hand, when commodity prices rise to a level higher than normal, costs of producing gold are substantially increased, and production of the metal is consequently discouraged and annual production decreases. Because the price of gold is fixed in terms of dollars, whereas costs of producing gold usually follow commodity-price changes, gold production is stimulated when commodity prices are low and is discouraged when commodity prices are high. A detailed description of the relationships involved together with a discussion of other aspects of the money commodity was presented in the February 5, 1940 weekly bulletin (pages 21-23).

The accompanying chart shows that the rate of increase in gold production gained during 1935 and 1936 when commodity prices, although rising, were substantially below the Institute's new normal adjusted for devaluation. There is usually a lag in the effect of commodity-price changes on the volume of gold produced, and the rapid advance in the wholesale commodity-price level during the winter of 1936-1937 was followed early in 1938 by a decline in the rate at which gold production was increasing.

The decline in commodity prices beginning late in 1937 and persisting (at a declining rate) over a period of nearly two years stimulated gold production before the close of 1938. There was no substantial change in commodity prices during 1939 and the rate of increase

GOLD PRODUCTION AND PRICES



in gold production was not so great as it was in the preceding year. However, the rate of gain has increased during the first half of 1940, as the chart indicates. The recent increase in gold output is partly attributable to the British Empire's need for dollar exchange. Production in the South African mines has been increased greatly since the war began.

An indication of the trend of gold production during the past several years is shown in the following summary:

WORLD GOLD PRODUCTION		
Year	Thousands of Fine Ounces	Per Cent Gain
1932	24,093
1933	25,143	4.4
1934	27,371	8.9
1935	29,743	8.7
1936	33,057	11.1
1937	34,914	5.6
1938	37,629	7.8
1939	39,743	5.6

The rate of gain in world gold production during the first half of 1940 (preliminary data) was 8.8 per cent. If this rate is maintained throughout the year, total production will be approximately 43,240,000 fine ounces. At the present rate, the curve of the world's production of gold is increasing its margin above the long-term trend line. This greater-than-normal increase in the available gold supply is evidence that commodity prices have not yet risen to the new levels that may be expected as a result of the devaluation process.

SECURITIES

Bonds

The trend of bond prices was consistently downward last week. The Dow-Jones Average of Forty Bonds declined from 88.14 on August 8 to 87.66 on August 15. The liquidation of bonds by Swiss and Portuguese holders was reported to be an important factor contributing to the decline in the market. It is feared that Germany will complete its control of Europe by taking over the governments of Portugal and Switzerland. In this event, the United States Government would probably restrict the transfer of funds held in this country to these nations. It is understood that Brazil

is at present the favorite haven for the funds of Continental citizens that are still free to be moved.

Stocks

The intensification of air-raids along the Channel Ports was evidently responsible for the decline of about five points in the Dow-Jones Industrial Stock Average last week. The fact that the London stock market appeared to reflect confidence in the outcome probably prevented the movement from continuing. The volume of transactions was not great, even when the selling was at its maximum, and has since decreased to the modest proportions that prevailed during July.

RECOMMENDED BOOKS

"Atoms in Action: The World of Creative Physics," by George Russell Harrison. William Morrow & Company, New York. (\$3.50.)

This is a thoroughly enjoyable book on modern physics that the layman can read with understanding. It is written in a nontechnical style readily comprehensible to the average man who has no technical training. A scientist's view of things to come impresses the reader with the fact that there are many unexplored frontiers and that we have only begun to make the technological advance. The economic implications are obvious.

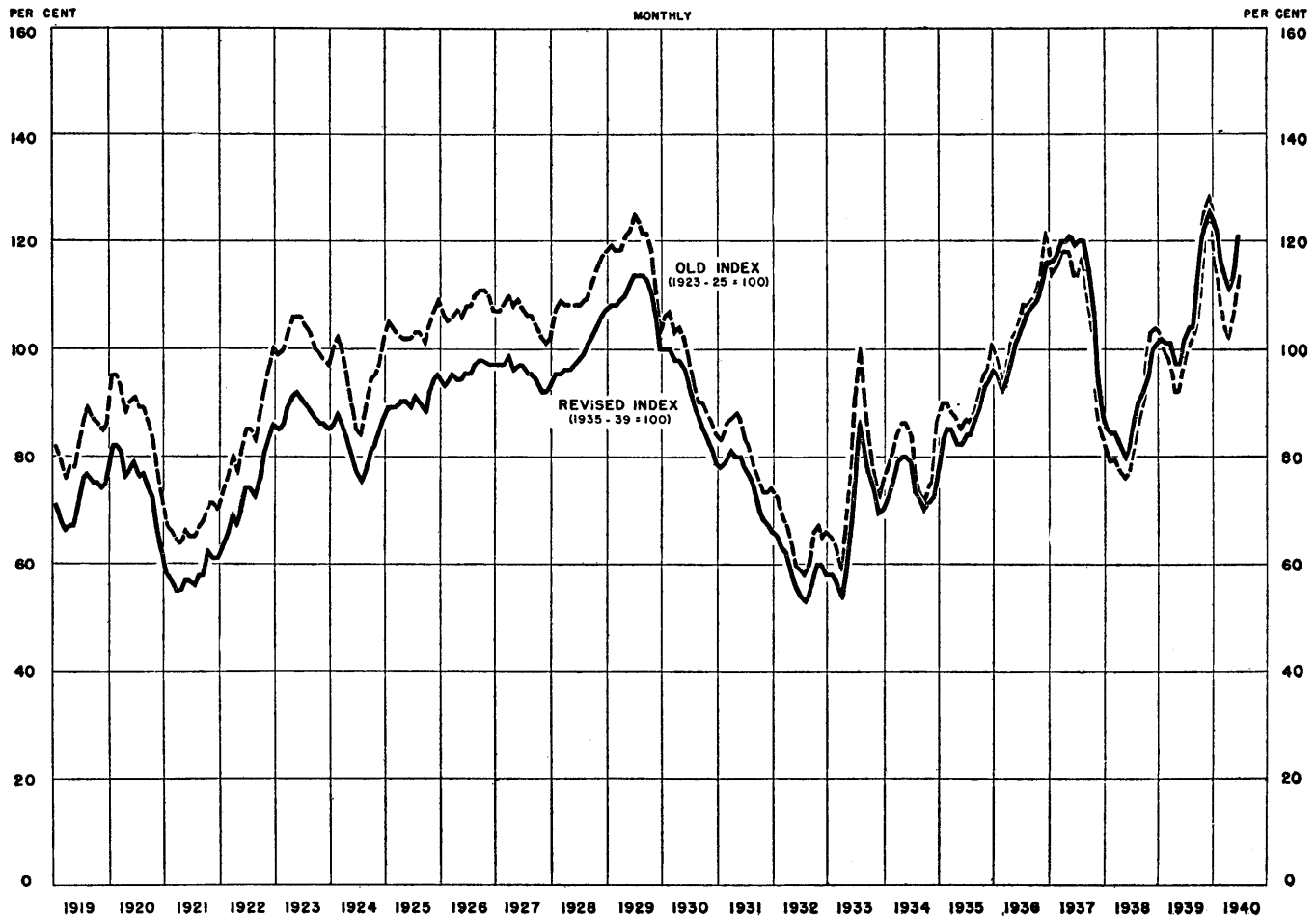
SOURCES OF BUSINESS INFORMATION

The Revised Federal Reserve Index

When we discussed "Combined Indexes of Production Activity" (May 13, 1940 bulletin and supplement, pages 84-86), we devoted only a limited space to the Federal Reserve index because the index was at that time being revised. The new index has just been published. Inasmuch as it is the most widely accepted index of measuring monthly changes in industrial activity, we believe that subscribers will be interested in the significance of the changes resulting from the revision.

As in the case of the former index, the new one has

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separate combined indexes for durable goods, non-durable goods, and minerals. The statistical "weights" given to these three subgroups were altered but not sufficiently to affect the relationship of the three curves to each other noticeably.

The methods used in compiling the new index are similar to those used in the former index. However, the base period was changed from the 1923-1925 monthly average to the 1935-1939 monthly average. Data for the individual industries were combined in calculating the index in accordance with census figures. The 1937 census figures were used in determining weights allocated to the separate industries for the past ten years, and the 1923 census data were used for weighting the previous years' indexes.

Seasonal adjustment factors were computed for the industries added to the index, and new seasonal factors were tabulated for the old series. The index is also adjusted for changes in the number of working days in each year.

The accompanying chart illustrates the difference between the old and the new index. The most obvious and significant difference is in the more favorable rate of growth indicated by the revised index. The principal reason for the more favorable growth rate shown by the revised index is the inclusion of data for industries that have become increasingly important during recent years, such as the machinery, rayon textile, manufactured food, and chemical industries. Twenty-two of the

series used in calculating the index are substantially the same as in the old index. Eighteen series were materially revised, and seventeen new series were added.

There is an extensive description of the new Federal Reserve Index of Industrial Production in the August issue of the Federal Reserve Bulletin, pages 753-763, and separate indexes for all of the industries used in computing the index are printed on pages 825-882.

The Board summarized the most important differences between the two indexes as follows: "The major cyclical movements of the two indexes are broadly similar both in timing and in degree of change. Both indexes rose gradually in the 1920's with pronounced recessions in 1921 and 1924 and smaller fluctuations in other years, reached a peak in the summer of 1929 and then declined without important interruptions to a low point in the middle of 1932. This decline was the same for both indexes, amounting to over fifty per cent. Both indexes rose, with major interruptions, from 1933 to early in 1937, but in that year the new index reached a new high level of 121, compared with a 1929 peak of 114, while the old index remained below its 1929 peak. The 1937-1938 recession and the recovery since were equally pronounced for both indexes."

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