# AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

WEEKLY BULLETIN

November 4 1940


# RESEARCH REPORTS

## COMING EFFECTS OF CURRENT EVENTS

### *Political-Economic Trends*

The purpose of this article is to analyze the election-determined economic trends that will be of major importance during the next two or three years. It is hoped that the conclusions drawn will aid subscribers in adjusting their business and investment plans when the results of the election are known.

*Spending*

There is little doubt that the rate of Government spending will have an important influence on our economic system for some time to come. Under Mr. Roosevelt's direction, Government expenditures would surely be enormous. There is no evidence of a determined effort to economize in any department, and there is every reason to believe that large-scale spending would continue, even after the Army's new equipment has been purchased.

The situation may be somewhat different if Mr. Willkie is elected. The expenditures during the next several months may be even greater if he is more successful in coördinating the rearmament program. (There is no reason to expect that Mr. Willkie would be able to carry through the national defense program at substantially *less* cost than Mr. Roosevelt could.) However, it is possible that Government expenditures thereafter, perhaps in the third year from now, would be markedly less under Mr. Willkie's direction.

*Effect on Industrial Production*

The initial effect of the great spending that has already begun will be to stimulate industrial production. Under Mr. Roosevelt, this stimulation would probably continue for a longer period than it would under Mr. Willkie. However, if the latter is elected, it is reasonable to expect that there will be a marked stimulation of private enterprise as a result of greater confidence in the continuation of our competitive-enterprise system. Long-deferred plant expansion and equipment replacement, requiring the investment of several billions of dollars, would probably be initiated. The combined effect of this expansion and that induced by the possibly more rapid progress of rearmament under Mr. Willkie's direction will mean an unprecedented boom in industrial production, presumably a greater one than that to be expected under Mr. Roosevelt.

*Inflation*

It now seems almost certain that the degree of inflation will increase substantially during the next year or two, regardless of the election outcome. However, and probably in contrast with the expectations of many individuals, we believe that the degree of inflation will increase more rapidly during the next few months if Mr. Willkie is elected than if Mr. Roosevelt is successful. Our reasons for this belief are as follows:

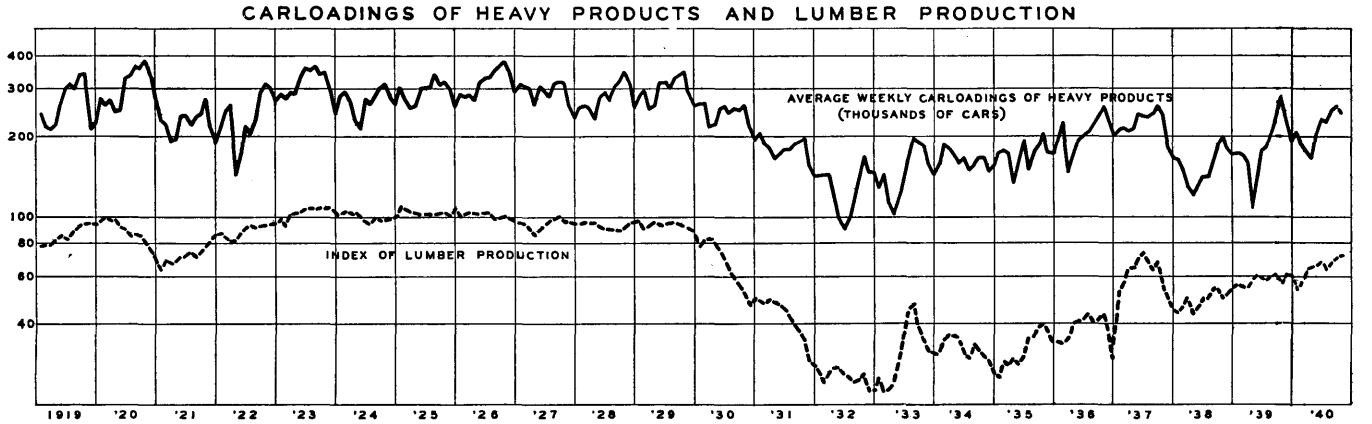
1. If Mr. Roosevelt is elected, the Federal deficits will be financed in part by the creation of new and inflationary bank credit and in part by the absorption of savings that would formerly (pre-1929) have been invested in the new capital equipment of our expanding economy. As in the past few years, timid investors will buy Government bonds rather than assume business risks. On the other hand, if Mr. Willkie is elected, investors will presumably be more eager to assume business risks; a smaller proportion of current savings will be used for the purchase of Government bonds; therefore, a greater proportion of the possibly somewhat larger deficits (larger if Mr. Willkie succeeds in speeding the rearmament program) will be financed by the creation of inflationary bank credit.

2. The expansion of private enterprise, if Mr. Willkie is elected, may be on such a large scale that more than current savings plus hoarded funds will be used for the purpose. In that event, the degree of inflation may be further increased by the investment of newly created bank credits in the plant facilities of industry (precisely as part of the inflation that accounted for the 1929 boom was created).

These considerations lead us to believe that the peak of the inflation already under way may come sometime in the second year from now if Mr. Willkie is elected; but that it may come later, perhaps much later and after intermediate reactions, if Mr. Roosevelt is reëlected.

*Prices*

In analyzing the probable price trends of the future, it is first necessary to point out that the adjustment of prices to the devaluation of the dollar has not yet been completed. Such adjustments require several years anyway, and the war in Europe and the New Deal's war with business have led to hoarding and other acts that inhibit and delay the price readjustments. The election of Mr. Willkie would presumably remove some of the reasons for hoarding funds and would to that extent expedite the remaining adjustments. (Whole-




sale prices have risen 35 per cent since 1933, and a further rise of about 15 per cent is to be expected as one result of the devaluation of the dollar.)

In addition to the remaining adjustments for devaluation, the inflation under way will surely be reflected in prices. (Because of the Administration's obvious desire to avoid great price changes, it is probable that many manufacturers will attempt to conceal increases in prices by lowering quality or by changing the quantities found in familiar containers and packages.) It seems probable that, because of the greater industrial production and more inflation, the rise in prices will be somewhat more rapid during the next eighteen months if Mr. Willkie is elected.

### *Other Considerations*

There are a few other factors that should be mentioned, although they are believed to be of lesser importance because some counterbalance others. Taxes might be increased more under Mr. Willkie, assuming an honest attempt to reduce the deficits, than under Mr. Roosevelt. On the other hand, a change in the costly forty-hour week, which Mr. Willkie might advocate, would operate in the opposite direction as far as business profits are concerned.

The vested interests that are crowding at the public trough presumably would be more amply fed by Mr. Roosevelt than by Mr. Willkie. However, the inflationary effects of such additional spending as this might cause during Mr. Roosevelt's term of office might be counterbalanced by the hesitation resulting from fear that Mr. Roosevelt would involve us in war, or in fear of the outcome if we were involved.

There remains to be considered the possibility of new legislation affecting business. It now appears probable that the Democrats will have a majority in the Senate and that the Republicans will have either a majority or a very strong minority group in the House. Under such circumstances, either Mr. Roosevelt or Mr. Willkie presumably would have difficulty in obtaining legislation that would greatly alter the rules of our economic behavior.

### *Conclusions*

The conclusions that these considerations seem to justify may be summarized as follows:

1. The rearmament spending and its secondary effects on consumer demand assure something approaching boom conditions in industry for from one to two years.

2. The degree of inflation will increase and probably will be greater within the next two years if Mr. Willkie is elected than if Mr. Roosevelt is elected (unless we actually participate in the war, in which event the degree of inflation will be very great, whoever is President).

3. Commodity prices will rise somewhat farther and faster if Mr. Willkie is elected than if Mr. Roosevelt is continued in office.

4. Common-stock prices will probably rise substantially from present levels if Mr. Willkie is elected. Some gains in the event of Mr. Roosevelt's election would not be surprising, because the stock market often seems more adversely affected by uncertainty than by known bad news.

5. Prices of high-grade bonds may be close to their highs for some time to come if Mr. Willkie is elected, but there is no reason to expect a marked change in the near future if Mr. Roosevelt remains in office.

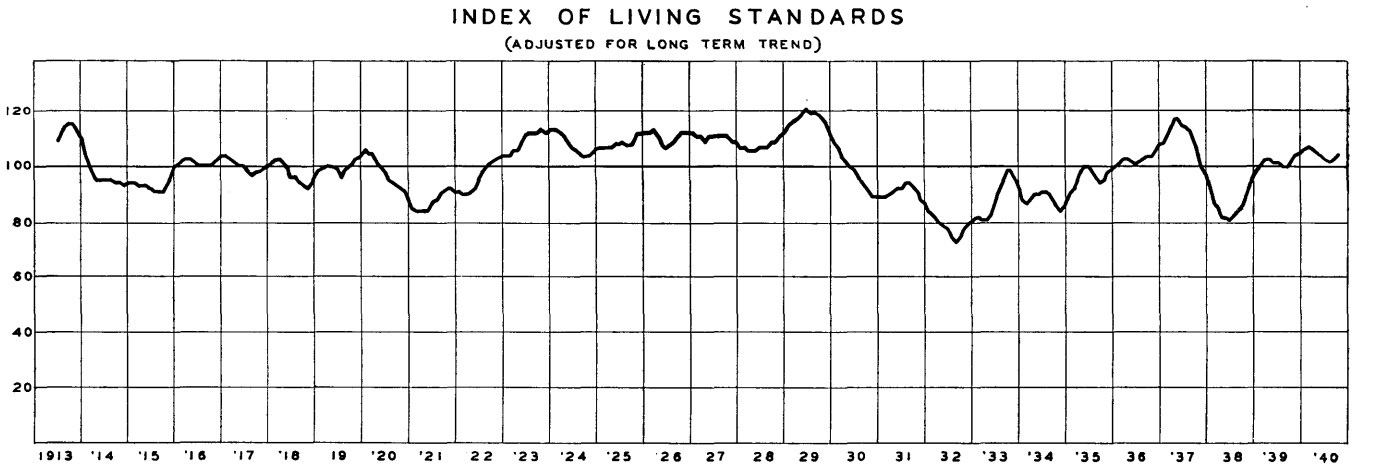
## *Carloadings and Lumber Production*

The chart showing carloadings of heavy products and lumber production presents two series of data that reflect changes primarily in the activity of the heavy industries (which are large consumers of bituminous coal) and the construction industry.

### *The Carloadings Record*

Freight carloadings of heavy products include coal and coke, ore, and forest products. The carloadings record is greatly influenced by changes in shipments of coal and coke, inasmuch as carloadings of these materials account for about two-thirds of the total shown.

The sharp decline in carloadings for April 1939 was caused by a widespread strike of bituminous coal miners. After the settlement of the strike, the tonnage of bituminous coal moved by rail increased substantially, and this trend was accelerated by the increase in manufacturing activity following the outbreak of war. However, manufacturers accumulated an oversupply of raw materials and fuels during the fall of 1939, and shipments of heavy products were reduced while the materials were being used by industry. The change to an upward trend in the chart coincided with the resumption of industrial recovery in May. The trend of the carloadings chart was upward from April through September, but there was a moderate decrease in carloadings of heavy products in October (preliminary data). The upward trend will probably be resumed within the next few months as production of heavy materials for the national defense program increases.




*Lumber Production*

Although the residential-construction industry is the most important consumer of lumber, large quantities of lumber are used for forms and scaffoldings for commercial and industrial buildings and for engineering construction.

The trend of lumber production has been steadily although gradually upward since early in 1938. Producers have evidently maintained a close control over output with respect to demand, because the violent fluctuations that characterize the lumber-production curve during the years 1933–1937 have been absent.

The demand for lumber for cantonment construction will undoubtedly be large, but it is not certain that this will have an important effect on the total demand for lumber. After our entry into the World War, the Government consumed great quantities of lumber in war preparations, but increased building costs brought the residential construction industry almost to a standstill, and, although lumber prices advanced, demand for the better grades of hardwood lumber decreased. However, unless lumber prices advance more than they have during the past year, the trend of production should be at least as favorable during the next few months as it has been during the past two or three years.

## *What Next?*

The latest available information regarding the more significant indicators of future trends is summarized in the following table. A plus sign indicates an advance in the indicator; a minus sign, a decline; and a zero, an unchanged position.

| | *Latest Indication* |
|---|---|
| Private Engineering Contracts (October) | + |
| Machine-Tool Activity (September) | + |
| Orders for Steel Boilers (August) | − |
| Capital Goods' Stock Prices (Last Week) | + |
| Durable Goods' Employment (September) | + |
| Steel-Ingot Production (Last Week) | + |
| Prices of Metals and Metal Products (Last Week) | 0 |
| New Capital Issues of Corporate Securities (September) | 0 |
| Velocity of Purchasing Media (September) | + |
| Carloadings of Heavy Products (Last Week) | − |
| Lumber Production (Last Week) | + |
| Harwood Index of Inflation (October Preliminary) | + |

The proportion of favorable to unfavorable indicators of cyclical trends increased slightly since the summary was published a month ago. Then there were eight pluses, three minuses, and one zero. In this summary, there are eight pluses, two minuses, and two zeros.

# BUSINESS

## *Index of Living Standards*

The Institute's Index of Living Standards, described on page 172 of the October 7, 1940, Research Report Bulletin, advanced from 102.0 per cent of normal in September to 103.3 per cent in October. The Index has not been below normal since January 1939 although it declined to normal in August 1939 and again to one per cent above normal in August 1940. If the rate at which the consumers' goods are now being produced remains unchanged, the Index will continue well above normal during the remainder of the year, and any increase will result in substantially improved living standards.

Unless the United States actually becomes involved in the war, the demand arising from the need for equipping our forces should not curtail the supply required by the civilian population. Our productive capacity for most consumers' goods has been only partially utilized within recent years. If the rearmament program were financed entirely through taxation, the public's capacity to buy would undoubtedly be impaired, and living standards would be lowered. Presumably the Government will continue its policy of financing a substantial portion of its expenditures by means of budgetary deficits, thus expanding instead of contracting the Nation's total available purchasing media. Therefore, until the Government adopts a policy of deflation, the living standards at present enjoyed should not be jeopardized by the armament program.

## *Principal Exports in September*

The Department of Commerce has just published figures revealing the value of exports in September divided by commodity classes, although the data by destinations are not yet available. The accompanying table summarizes the value of exports for that month by leading commodities in 1939 and 1940 and also shows the per cent increase or decrease from exports in the earlier period.

The total value of exports in September was substantially below the value in August, and the increase in comparison with exports in September 1939 was only 1.4 per cent, compared with an increase of 39.9 per cent in August. The radical change in the export trade comparison was partly attributable to the fact that exports increased greatly in September 1939, the first year of the war. A more important factor was an absolute decrease in the volume of our exports in September 1940, appar-

UNITED STATES EXPORTS

| Commodity | September 1939 (In Millions of Dollars) | September 1940 (In Millions of Dollars) | Per Cent Increase |
|---|---|---|---|
| Unmanufactured Cotton | 35.4 | 5.1 | *85.6** |
| Unmanufactured Tobacco | 9.9 | 1.5 | *84.9** |
| Manufactured Foodstuffs | 21.3 | 10.4 | *51.2** |
| Iron and Steel Semimanufactures | 14.8 | 39.7 | 168.2 |
| Steel-mill Manufactures | 5.6 | 14.3 | 155.4 |
| Copper Ingots, Plates, Rods | 7.8 | 2.9 | *62.8** |
| Lubricating Oil | 7.6 | 3.5 | *53.9** |
| Industrial Machinery | 23.2 | 36.9 | 59.1 |
| Electrical Machinery | 8.2 | 9.2 | 12.2 |
| Metal-working Machinery | 9.8 | 23.2 | 136.7 |
| Motor Trucks | 2.5 | 5.0 | 100.0 |
| Passenger Cars | 2.8 | 1.7 | *39.3** |
| Aircraft | 8.8 | 22.9 | 160.2 |
| All Other | 126.7 | 112.0 | *11.6** |
| | 284.4 | 288.3 | 1.4 |

* Decrease

ently because of difficulty experienced by foreign nations in obtaining dollar exchange.

More than one-half of the value of all exports in September was concentrated in a few commodity classifications: iron and steel semimanufactures; steel-mill manufactures; industrial, electrical, and metal-working machinery; and aircraft. These are obviously materials intended only for warfare. Our largest customers, the United Kingdom and Canada, are expending a progressively larger proportion of their national incomes for military purposes and are curtailing purchases of all consumer nonessentials. The Latin American nations that are making no war efforts are nevertheless affected by the war. They have lost most of their European markets and are unable to dispose of enough merchandise in this country to obtain the dollar exchange needed to buy here the materials that they require and had previously purchased from European sources.

## THE FUNDAMENTALS

### *Supply*

The steel-ingot production rate increased from 95½ to 96 per cent of theoretical capacity last week. Although further gains will obviously be limited, the industry will probably operate at a high rate during the next few months. The *Iron Age* stated: "October business has been the largest for any month this year. A few companies have doubled their September volume, while others gained from 15 to 30 per cent. Some companies have thus far in 1940 booked as much business as in all of 1939, not forgetting the heavy ordering in September and October of last year."

| | *1929* | *1932* | *1937* | *1938* | *1939* | *1940* |
|---|---|---|---|---|---|---|
| Per Cent of Capacity | 80.0 | 20.0 | 55.0 | 57.5 | 93.0 | 96.0 |

(Latest 1940 weekly data; corresponding week earlier years)

Electric-power companies generated 2,711,282 kilowatt hours last week, thus recording an all-time high in output. The distribution of power in industrial regions accounted for the increase, but the Rocky Mountain region was the only one in which the trend was unfavorable.

| | *1929* | *1932* | *1937* | *1938* | *1939* | *1940* |
|---|---|---|---|---|---|---|
| Billion Kilowatt Hours | 1.82 | 1.53 | 2.26 | 2.23 | 2.54 | 2.71 |

In spite of a slight decrease in production by Chrysler Corporation, total output of the automobile industry increased from 114,672 to 117,080 units last week. The gain was primarily attributable to a substantial increase in General Motors' production.

| | *1929* | *1932* | *1937* | *1938* | *1939* | *1940* |
|---|---|---|---|---|---|---|
| Units (000 omitted) | 77 | 11 | 90 | 72 | 78 | 117 |

Cotton-goods production increased last week, and the adjusted index advanced to the best level recorded by the series since it was started in 1929. The weekly index is adjusted for seasonal variations and is expressed as a per cent of estimated normal. Last week's index was 150.9 and compares with the preceding high of 148.7 for the week ended December 16, 1939.

| | *1929* | *1932* | *1937* | *1938* | *1939* | *1940* |
|---|---|---|---|---|---|---|
| *New York Times* Index | 119.9 | 105.9 | 110.8 | 116.7 | 133.0 | 150.9 |

Lumber production decreased less than seasonally last week and the adjusted index advanced from 85.6 to 87.9.

| | *1929* | *1932* | *1937* | *1938* | *1939* | *1940* |
|---|---|---|---|---|---|---|
| *New York Times* Index | 126.9 | 37.5 | 70.9 | 71.6 | 84.0 | 87.9 |

### *Demand*

Last week department-store sales were about six per cent greater than the volume last year. This record is favorable because consumers' goods were being distributed in substantial volume during the final quarter of 1939. The new orders' index compiled by the National Industrial Conference Board reached a new high for the year in September. The September index has been exceeded only once (in December 1936) since the series was started in January 1933.

### *Prices*

The sensitive wholesale commodity price indexes remained substantially unchanged last week. Moody's Spot Commodity Price Index was 165.0 on October 24 and 164.9 on October 31. The Dow-Jones Index of Commodity Futures closed at 55.68 on October 24 and at 55.07 on October 31.

## FINANCE

### *The Harwood Index of Inflation*

There was a fractional advance in the Index of Inflation in ratio form from 105.5 for the week ending October 16 to 105.8 for the week ending October 23. Although there was a decrease of $32,000,000 in Government securities held by the Federal Reserve Banks, this was more than offset by an increase of $119,000,000 in the commercial banks security holdings. A more important cause of the advance in the Index was a decrease of more than $100,000,000 in the Treasury's bank deposits and gold in the working balance of its general fund. This represented distribution to the public of funds previously hoarded, in effect, by the Government.

The advance in the ratio form of the Index would have been greater had there not been a marked increase in total purchasing media available to the public. The gain in circulating purchasing media was approximately $400,000,000. This was caused by gold imports in addition to increased bank credit and the distribution of Government deposits.

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