AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

WEEKLY BULLETIN

December 15 1941

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Facing a New Life

The trend toward complete involvement in the world conflict, which was evident for many months before Japan struck, failed to prepare us for the manner in which war came. We have scarcely begun to reorient our way of living to war, but profound changes are in store for us. The achievement of national unity, that is, the subordination of all other considerations to successful defense, must and will be proved by actions as well as by words.

The movement of opposing forces is now on so vast a scale as to make the conflict of a quarter of a century ago seem a localized affair. The great distances involved and the long and vulnerable supply lines emphasize the probability of a protracted struggle. Although there are signs of weakness developing in the Reich, even more definite evidence would not justify us in failing to prepare for a long and bitter war against powerfully equipped, fanatical enemies.

Although the spectacular day-to-day news will come from the fighting fronts, it is generally realized that the final outcome of the conflict will be dictated by economic factors. We can sustain great material losses. We can mistake the type of weapons that will be effective. We can even make strategic blunders in the field of operations. But, as long as we have the producing facilities, the raw materials, the machine tools, and the skilled personnel, we can still triumph.

In his first address to the Nation after the war started the President gave only a skeleton outline of the probable course of wartime events. However, the economic character of the war was indicated by his announcement that the Government has decided on two broad policies:

"The first is to speed up all existing production by working on a seven-day-week basis in every war industry, including the production of essential war materials.

"The second policy, now being put into form, is to rush additions to the capacity of production by building more new plants, by adding to old plants, and by using the many smaller plants for war needs."

As the war develops, we shall gradually be able to make more accurate appraisals of the demands that will have to be made on our economy to assure ultimate victory. The extent to which consumers will be affected by the war was suggested by the President's statement:

"At present we shall not have to curtail the normal articles of food. There is enough food for all of us and enough left over to send to those who are fighting on the same side with us.

"There will be a clear and definite shortage of metals of many kinds for civilian use for the very good reason that in our increased program we shall need for war purposes more than half of that portion of the principal metals which during the past year have gone into articles for civilian use. We shall have to give up many things entirely."

We do not now know how far normal civilian consumption will be restricted by the war, but the extent will obviously depend primarily on the war's duration. Even with our vast resources, another two years of war may result in as severe rationing here as is now in force in England; that is, we shall not only have to forego luxuries but shall be limited in the consumption of fuels, clothing, and all but necessary foods.

Until the war is won, we cannot make a final appraisal of the changes in the economic order that it will cause. However, an intelligent understanding of the possibilities involved will no doubt prove useful. During the next few months, analyses of the wartime economic trends will be features of the bulletins. The first such article, which will appear in an early issue, will review certain of the more important predictions made in our earlier study of this subject and discuss their validity under present circumstances.

Demand-Supply Ratios

The United States Department of Commerce published its revised indexes of manufacturers' new orders, shipments, and inventories for September and its preliminary figures for October last week. The chart in the upper left-hand corner on page 203 was published first in the September 13, 1941 bulletin (page 147), together with a discussion of the significance in the trends of the separate indexes. Both the new orders index and the index of shipments declined during October, although the decline in the latter was less than the decrease in the new orders index. The inventories index continued the upward trend that has been followed for the past year and a half.

The ratio of unfilled orders to inventories, shown in the next chart in the same column, was computed by dividing the backlog of orders (obtained by calculating the excess of the new orders index over the shipments index for the period shown on the chart) by the index

of inventories. The great advance in the ratio of unfilled orders to inventories from the middle of 1940 to the middle of 1941 shows that, in spite of the substantial increase in inventories during that period, they were small in relation to the volume of incoming orders. During the fall months, the index declined almost as rapidly as it advanced in the summer, and, although the index was still high in October, the downward trend continued.

The chart at the top of the next column on page 203 shows the Institute's Demand-Supply Ratio I (new orders divided by shipments times inventories) with the Institute's Index of Industrial Production, which is adjusted for long-term trend. Demand-Supply Ratio I was following a moderately downward trend from October 1940 to June 1941, primarily because the index of shipments (a supply factor) was advancing. The sharp decline in Demand-Supply Ratio I thereafter was the result of the decline in the new orders index. The Index of Industrial Production reached a new high level in October for the period shown on the chart, but the rate of the advance has been only moderate since Demand-Supply Ratio I has been declining sharply.

The next chart shown in the same column presents the Institute's Demand-Supply Ratio II with the index of industrial stock prices. This ratio includes industrial production, as well as shipments and inventories in the supply factor, and it has declined more than has Demand-Supply Ratio I during the past year, largely because of the great increase in industrial production during this period. Increasing industrial activity as a depressing element in Demand-Supply Ratio II was less in evidence after June 1941, but the general downward trend continued because of the decline in the new orders index, the numerator of the ratio.

Four months ago, as a result of the trend shown by Demand-Supply Ratio II, we suggested that a pessimistic attitude toward stock prices in the near future seemed advisable. Last week's break in the stock market was obviously occasioned by the Japanese attack, and this factor appears to be unrelated to the factors on which the forecasting value of the index depends. It is possible that the large volume of sales of the past few days represented the selling climax that often comes at the end of a decline such as that of recent months. Presumably, Ratio II will turn upward in a few weeks when the orders contemplated by the so-called Victory program are placed. If this occurs, an upward movement of stock prices will follow soon afterward, judging by the record for the brief period that is available.

BUSINESS

The Trend of Commercial Failures

Both the number of business insolvencies and the liabilities involved increased moderately during November. However, failures were less serious than they were in the corresponding months of 1939 and 1940. In the December 1, 1941 bulletin, we suggested that a sustained increase in the number of business insolvencies would indicate that the national defense program is adversely affecting the smaller nondefense enterprises. The latest data appear to show that such an influence is being felt, but that it has not yet reached serious proportions.

The number and liabilities of commercial failures during each month of the past two years and during the first eleven months of 1941 are shown in the following table.

COMMERCIAL FAILURES, NUMBER AND LIABILITY

	Number of Failures			*Liabilities of Failures (In Millions of Dollars)*		
	1939	*1940*	*1941*	*1939*	*1940*	*1941*
January	1,567	1,237	1,124	20,790	15,279	11,888
February	1,202	1,042	1,129	13,582	13,472	13,483
March	1,332	1,197	1,211	19,002	11,681	13,444
April	1,331	1,291	1,149	18,579	16,247	13,827
May	1,334	1,238	1,119	15,897	13,068	10,065
June	1,119	1,114	970	12,581	13,734	9,449
July	1,153	1,175	908	14,999	16,213	13,422
August	1,126	1,128	954	12,637	12,997	11,134
September	1,043	976	735	10,545	11,397	9,393
October	1,234	1,111	809	17,464	12,715	7,333
November	1,184	1,024	842	13,201	16,572	9,197
December	1,153	1,086		13,243	13,309	
Total	14,768	13,619		182,520	166,684	

THE FUNDAMENTALS

Supply

The steel-ingot production rate was estimated at 97½ per cent of theoretical capacity last week, an advance of one-half of one per cent from the level of the preceding week. *The Iron Age* reported that plant managers are "weighing adoption of the seven-day week, the dropping in some cases of all orders except those for war goods, and the conversion of still more nondefense industrial capacity to war needs. War has already sharpened the drive to spread defense work among small metal-working plants so that the plants themselves can be saved and so that production of planes, guns, ships, tanks and other fighting equipment can be brought to victory levels. Without waiting for official requests from the government, the steel industry, for example, at midweek was already gearing for activity never before seen against obstacles which include serious shortages of such raw materials as scrap and pig iron."

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Per Cent of Capacity	64.0	15.5	28.0	58.0	96.5	97.5

(Latest 1941 weekly data; corresponding week earlier years)

Electric-power output of 3,368,870 kilowatt-hours last week established a new high level for the industry. Production exceeded that for the corresponding week of 1940 by 13.2 per cent.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Billion Kilowatt-Hours	1.84	1.56	2.22	2.32	2.98	3.37

Automobile production decreased last week from 93,495 units in the preceding week to 90,205 units. The industry will hereafter be subject to the Government's curtailment order, and, in view of the urgent need for most of the raw materials that are used by the industry, passenger car production next year will be limited to small proportions.

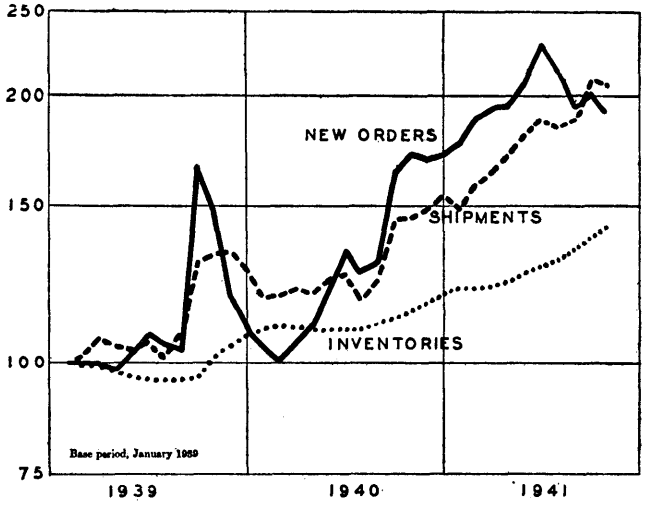
	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Units (000 omitted)	33	22	86	101	130	90

Aggregate cotton-mill activity increased last week, and there was a more substantial advance in the adjusted index than was reported since midsummer.

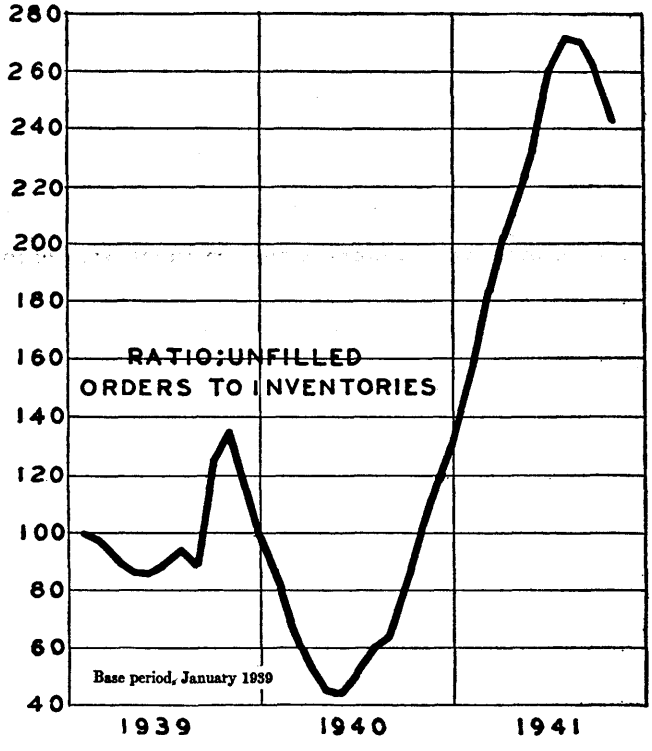
	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	105.6	101.5	104.4	130.5	139.3	161.6

Lumber production decreased slightly last week when a greater decrease was seasonal. Consequently

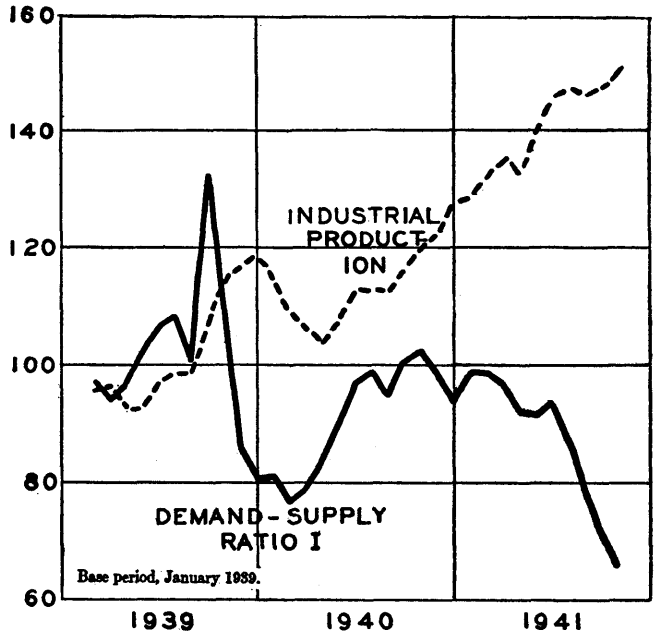
INDEXES OF MANUFACTURERS' NEW ORDERS, SHIPMENTS, AND INVENTORIES



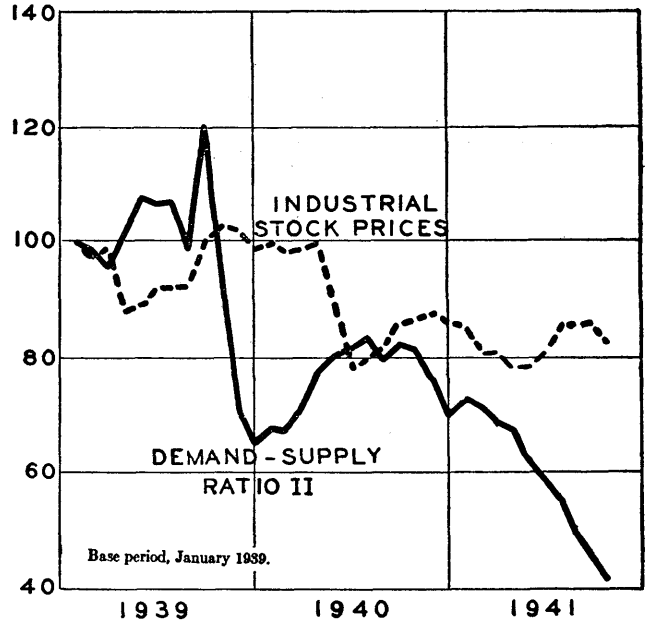
RATIO OF UNFILLED ORDERS TO INVENTORIES



DEMAND-SUPPLY RATIO I VS. INDUSTRIAL PRODUCTION



DEMAND-SUPPLY RATIO II VS. INDUSTRIAL STOCK PRICES



the adjusted index advanced from 130.5 to 132.0 per cent of the 1935–1939 monthly average.

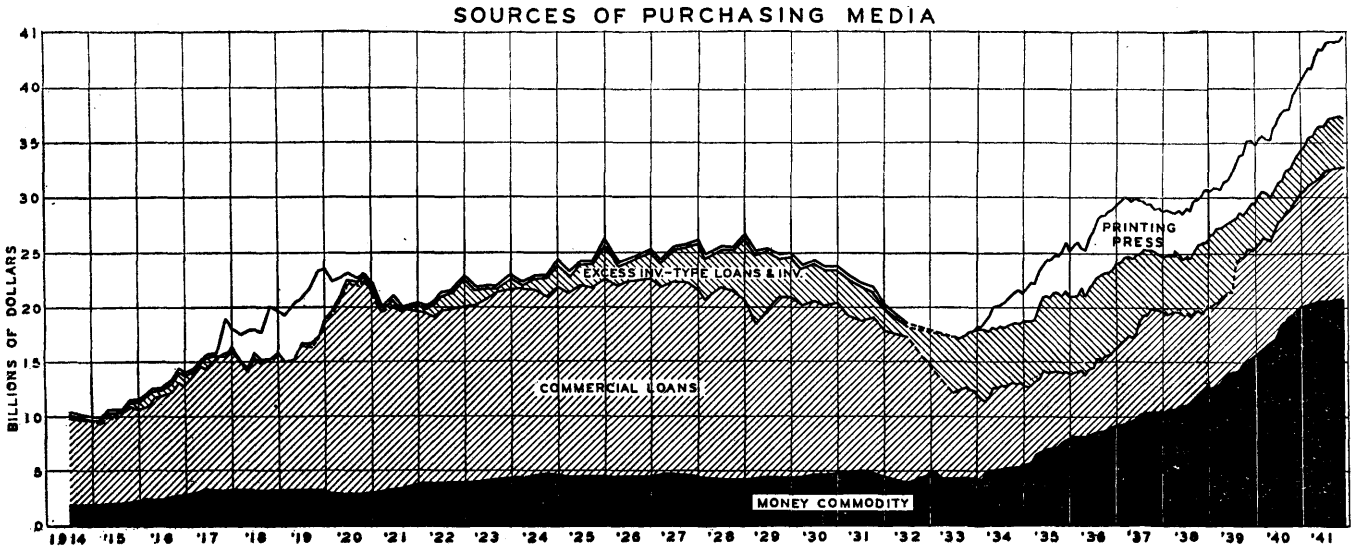
	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	124.2	34.5	56.5	72.7	133.8	132.0

Demand

During the week immediately preceding our entrance into the war, the Federal Reserve index of department-store sales was nine per cent higher than it was in the corresponding week of 1940. There is no immediate evidence that the war will have a seriously adverse effect on the volume of holiday buying. With income payments at a new high level, the public has the wherewithal to make generous purchases. Civilian purchases may be stimulated by the feeling that consumer supplies may be curtailed soon, but this factor may be offset to some extent by the feeling that "we should make less of Christmas this year."

Prices

The commodity markets exhibited the "orthodox" response to war last week by rising sharply. This movement was halted by Government action to control speculation. Moody's Spot Commodity Price Index was 211.4 on December 4 and 217.1 on December 11. The Dow-Jones Index of Commodity Futures closed at 82.65 on December 4 and at 84.60 on December 11.



FINANCE

Sources of Purchasing Media

Purchasing media available to the public consist of currency in circulation plus checking-account deposits. The chart at the top of this page shows the total purchasing media in use during each month of the 27-year period and indicates the source from which the purchasing media were derived. Purchasing media derived from the money commodity (gold) are not inflationary because they represent the metal itself, which, in effect, is being offered in the market by those who use such purchasing media. Purchasing media created by commercial loans are not usually inflationary because they normally represent the value of goods that are currently being produced and are on the way to the market. The remainder of the purchasing media are inflationary because they represent bank credit or Government currency issues that do not represent goods being offered in the market.

Following a period of three months during which aggregate purchasing media remained substantially unchanged, the upward trend that has been followed since the middle of 1938 was resumed in November. The total at the end of November was approximately $300,000,000 greater than it was at the end of October.

For the first time since December 1937, there was a decrease in purchasing media from the money-commodity source. The decrease in the Nation's monetary gold stock was only $15,000,000 and may have been caused by the earmarking of gold for Latin American accounts as a result of the extension of Government credit to these nations. Monetary gold earmarked for foreign accounts is of course removed from the Nation's monetary gold stock just as effectively as if it were exported.

There was a small increase in purchasing media derived from commercial loans last month, but this source has not contributed greatly to the expansion of total purchasing media since last July.

Purchasing media derived from the third source (an excess of investment-type assets representing tangible property with respect to the savings available to the banking system) decreased during November. The decrease from this source was caused by bank sales of both fully guaranteed issues and "other securities." This trend probably will continue, inasmuch as managers of the commercial banks will be expected to purchase Government securities to finance the war effort.

The substantial increase in purchasing media from the fourth source was caused by the Treasury's spending funds previously obtained by inflationary means. The Government's bank deposits were augmented by the sale of bonds to the commercial banks when there was virtually no increase in savings deposited with the banks. This results in the creation of inflationary purchasing media, which appear as demand in the markets when distributed through Government spending.

SECURITIES

Bonds

After two days of precipitate decline that carried average bond prices down three per cent last week, the market appeared to become stabilized. The Dow-Jones average of 40 bonds was 90.76 on December 4 and 87.70 on December 11.

Stocks

The selling wave in the stock market apparently reached a climax on the second trading day after war was announced. The future behavior of the market will probably be more than ever dependent on news from combat areas. After our entrance into the war in 1917, there was an irregular decline in stock prices over a nine-month period, which was thereafter followed by a substantial recovery that continued for the duration of the war.

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