

# AMERICAN INSTITUTE for ECONOMIC RESEARCH

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## R E S E A R C H R E P O R T S

### COMING EFFECTS OF CURRENT EVENTS

#### *The Steel Shortage*

The public has recently been reading reports in the press that one or another project for producing experimental types of war machines or transportation equipment cannot be immediately undertaken because of insufficient steel supplies. These accounts tend to minimize the truly great achievements of the industry that has supplied and will continue to furnish the major essential for victory in mechanized warfare.

The efficient use of the weapons, supplies, and personnel provided by nations at war affords problems for their military leaders, but, assuming that these leaders can employ the resources at their command as ably as can their enemies, the outcome will be decided by the magnitude of the opposing armament. In this respect, our position is definitely encouraging.

Last year the United States produced 83,600,000 tons of steel-ingots and castings (the basic measure for gauging the industry's accomplishment), and output this year is expected to be approximately 86,000,000 tons. From time to time the industry's output has suffered to a slight degree because of the lack of adequate supplies of steel scrap. However, manufacturers of finished steel commodities have been maintaining capacity operations for some time now, and supplies of industrial scrap, normally the major source, will be steadily available as a by-product of these operations. The emergency collection systems that are now being established throughout the country should provide the means for obtaining the remaining necessary supplies of scrap.

Russia's production of about 10,000,000 tons and the United Kingdom's production of 15,000,000 tons, together with the capacities of our other associates in the war, result in adding 30,000,000 tons to the United States' output, making a total of more than 115,000,000 tons of steel for the United Nations. Virtually all of this will be employed, either directly or indirectly, for the prosecution of the war.

Japan's estimated annual capacity of about 7,000,000 tons appears negligible in comparison with ours, and there seems to be no way by which that nation can appreciably alter that ratio. Next to the United States, Germany has for several decades been the greatest steel producer among the nations. Her conquests have increased this capacity to a formidable total. Such records and estimates as are available appear to indicate that the steel tonnage produced within the orbit of the

Reich is substantially smaller than that produced by the same plants under peacetime conditions. Therefore, it is extremely doubtful whether Germany can command an annual basic steel output of 50,000,000 tons.

The rate of Russian steel output has also probably been impaired by the war and may suffer further loss. On the other hand, the United States is not only the greatest steel-producing nation, but it is also the only major producer that is in a position virtually invulnerable to disruption by either land or air invasion. This situation appears to guarantee the United Nations at least a two-to-one superiority in steel production over that of our enemies.

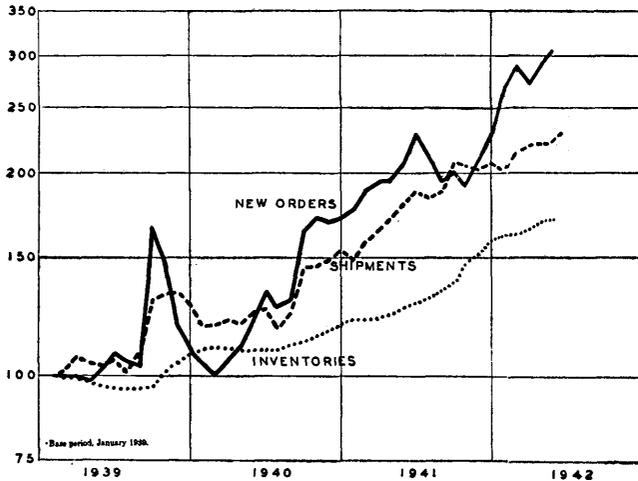
Unfortunately, the influence of this great weight of metal on our side cannot immediately be made effective. Our enemies have the advantage of earlier preparation and the superior position that this has enabled them to seize. Our communication lines are almost literally built of steel, and the greatly extended lines of the United Nations require the initial absorption of great quantities of this essential metal. However, once these lines are established by virtue of our industrial superiority, they will ultimately be the means for bringing this advantage into full play against the enemy.

#### *Demand-Supply Ratios*

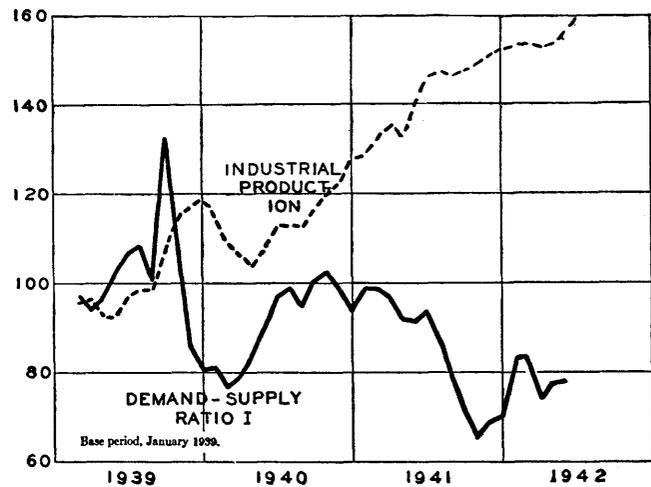
The figures published last week by the United States Department of Commerce provided the necessary data for calculating our demand-supply ratios for May 1942, and we are presenting the charts in this issue. The chart in the upper left-hand corner of page 122 shows the basic indexes from which our demand-supply relationship charts are derived.

The dollar volume of new business placed with manufacturers increased to a new high level during May. There are separate new-orders indexes for durable goods and nondurable goods on the basis January 1939 = 100. The durable goods index advanced from 449 in April to 522 in May. On the other hand, the nondurable goods index declined from 192 in April to 169 in May. It is evident that the increase in war orders, most of which fall into the durable goods category, is more than sufficient to offset the decrease in the activity of civilian consumer goods. The value of shipments of manufactured products increased in May after remaining about unchanged during the preceding two months. The advance in the shipment's index appears to indicate that the increase in deliveries of war materials is more than offsetting the decrease in shipments for consumer distribution. The index of manufacturers' inventories

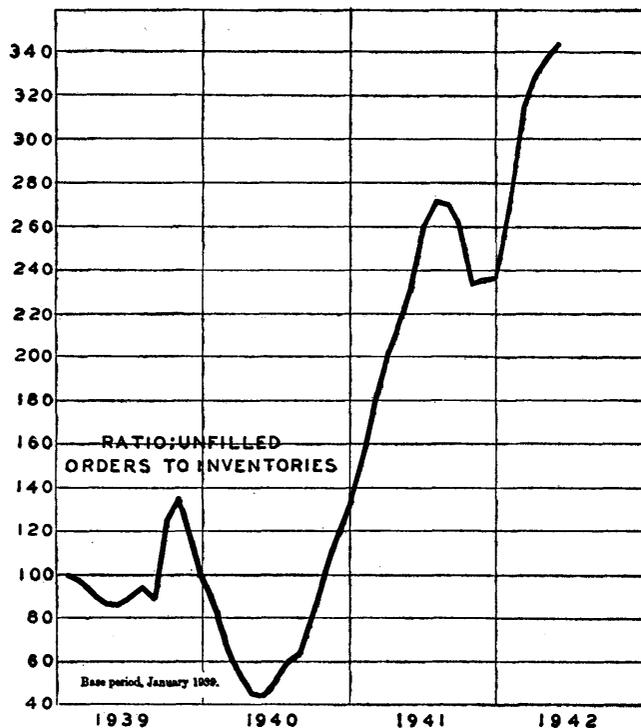
**INDEXES OF MANUFACTURERS' NEW ORDERS, SHIPMENTS, AND INVENTORIES**



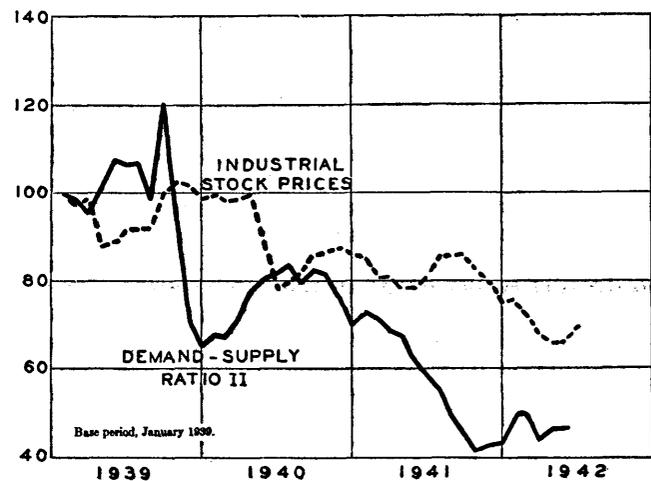
**DEMAND-SUPPLY RATIO I VS. INDUSTRIAL PRODUCTION**



**RATIO OF UNFILLED ORDERS TO INVENTORIES**



**DEMAND-SUPPLY RATIO II VS. INDUSTRIAL STOCK PRICES**



increased during May at about the same rate that has prevailed throughout most of the year.

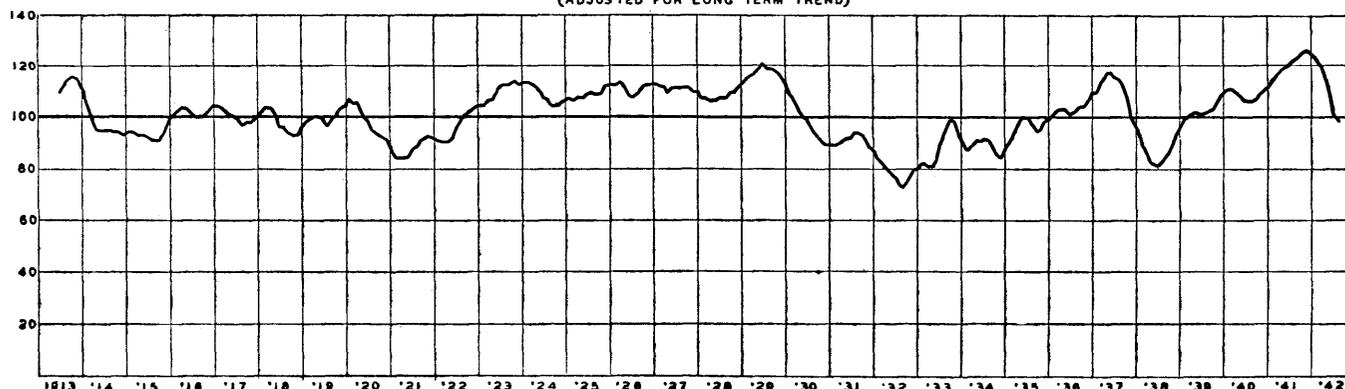
The ratio of unfilled orders to inventories shown in the next chart in the same column, was computed by dividing the backlog of orders (obtained by calculating the excess of the new-orders index over the shipments index for the period shown on the chart) by the index of inventories. This ratio follows an upward trend when the volume of incoming orders is larger than the volume of shipments. This has been the situation throughout the first five months of 1942, but the excess of orders over shipments was greater during the early months of the year than during the more recent months. At the present time, the inventory factor entering into the calculation of the ratio does not appreciably affect the

month-to-month changes because the inventories index has been advancing at a relatively moderate rate.

The chart at the top of this column 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 has improved its position in relation to the base period since October 1941 when a low point for the period shown on the chart was recorded. However, the increase has not been great, and, although there was a small advance in the ratio during May 1942, it remains below the year's best level shown in February. The index of industrial production reached a new high level in June for the period shown on the chart (more recent figures are available for industrial production than for the demand-supply ratio), but the rate of advance has been relatively moderate during 1942.

The next chart shown in this 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. During recent months when the industrial production index has remained within a relatively

INDEX OF LIVING STANDARDS  
(ADJUSTED FOR LONG TERM TREND)



narrow range, Demand-Supply Ratio II has followed a course somewhat similar to that traced by Demand-Supply Ratio I, although the fluctuations have been more moderate. The current picture presented by Demand-Supply Ratio II, that of advancing moderately from a low level, suggests that the risks of holding common stocks are not great at the present time. If the ratio continues to advance during the next few months, it will give support to the contention of the market analysts who have proclaimed a change has been established in the market's basic trend.

**BUSINESS**

*Index of Living Standards*

The Index shown in the chart at the top of this page reflects the physical volume of consumer goods produced and distributed per capita in the United States. It is adjusted for long-term trend by adapting "weights" given to the component series of the index each year, so that each item has an influence proportional to the year's production. The normal time required for consumer goods to reach the hands of the public is about six months.

The rise of the index at the end of 1941 to the highest level above normal recorded during the thirty-year period shown was made possible by the boom in consumer durable goods that occurred after the national defense program had begun to augment industrial payrolls, but before the program had seriously interfered with the production of materials not essential for war. The production of durable consumer goods was being curtailed during the second half of 1941 when materials were requisitioned for national defense, but a large stock of supplies had been accumulated and was being distributed to the public during the latter part of the year.

The war has of course distorted the normal pattern of the Nation's system of production and trade. The production of consumer durable goods this summer has fallen to about one-third of the volume produced in the summer of 1941 (when the industries manufacturing these commodities were unusually active). On the other hand, production of consumer nondurable goods is fairly well sustained because restrictions on the production and sale of most foods, clothing, and other consumer nondurable goods have been relatively light, and partly because the demand for this class of goods by the armed forces is greater per capita than from the civilian population.

The Institute's Index of Living Standards for July 1942 declined below normal for the first time since the war began in Europe in 1939. The latest decline was somewhat less precipitous than it was during the preceding three months, but it does not appear probable that this indicates an early reversal in the downward trend. In fact, the civilian population must be prepared to make further sacrifices in their living standards for the duration of the war.

**FUNDAMENTALS**

*Supply*

The steel ingot production rate last week declined from 98 to 97½ per cent of theoretical capacity. The one-half point decrease was caused by temporary plant shutdowns for repairs. *The Iron Age* expressed in the following words its confidence that the steel supply situation will be improved by better control methods. "Of particular significance is that for some months lend-lease shipments of steel have taken really terrific bites out of output but now export is being severely pared down to more digestible levels. The critical domestic tightness in semi-finished steel and bars should quickly reflect this action. Moreover, the current widespread and very vocal fears of many steel users regarding their supply position should within a fortnight sink to whispers as the unlamented priorities set-up is blanketed by what the War Production Board designates as production directives, but what many others insist on calling the quota system. A strict, sensitive and flexible statistical control over steel usage has long been overdue to kill off careless treatment of delivery dates, poor timing of deliveries and growth of unbalanced stocks."

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	96.0	14.5	85.0	38.0	99.0	97.5

(Latest 1942 weekly data; corresponding week earlier years)

Electric power production increased substantially last week. Output was 12.6 per cent greater than that in the corresponding week last year when new high records were also being made. The most favorable reports were received from the Southern States and the Pacific Coast region. The electric power industry is demonstrating its ability to provide all of the power needed for the extraordinarily high rate of industrial operations required by the war without curtailing the use of current by civilians.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.73	1.44	2.26	2.09	3.22	3.63

There was a greater-than-seasonal increase in lumber production last week, and the adjusted index advanced from 117.7 to 123.2 per cent of the 1935-1939 monthly average. A downward trend in the industry's activities that generally prevailed during the first half of the year has apparently been halted. The volume of incoming orders has been consistently exceeding the production volume.

	1929	1932	1937	1938	1941	1942
New York Times Index	128.1	36.9	87.0	67.3	124.6	123.2

### Demand

Last week's gain in the Federal Reserve index of department-store sales from the figure reported for the corresponding week of 1941 was five per cent. Retail-store inventories are high even when adjusted for price increases. Authoritative comprehensive data for last month are not yet available, but reports indicate that some progress is being made in reducing retail inventories. In the meantime, demand in the wholesale markets has been greatly reduced.

### Prices

The sensitive wholesale commodity price indexes were moderately lower last week than they were in the preceding week. Moody's Spot Commodity Price Index was 231.1 on July 23 and 230.4 on July 30. The Dow-Jones Index of Commodity Futures closed at 85.35 on July 23 and at 84.60 on July 30.

The spot commodity price index has for the past three months remained substantially unchanged at a level about 60 per cent higher than it was at the end of August 1939, just before the war started the price advance. The future's index has also remained about unchanged during the same period at a level nearly 80 per cent higher than it was at the end of August 1939.

## FINANCE

### Currency, Hoarded and in Circulation

The currency reported to be in circulation by the United States Treasury has nearly doubled during the past four years, and there is no indication that this trend toward expansion is changing. The Treasury

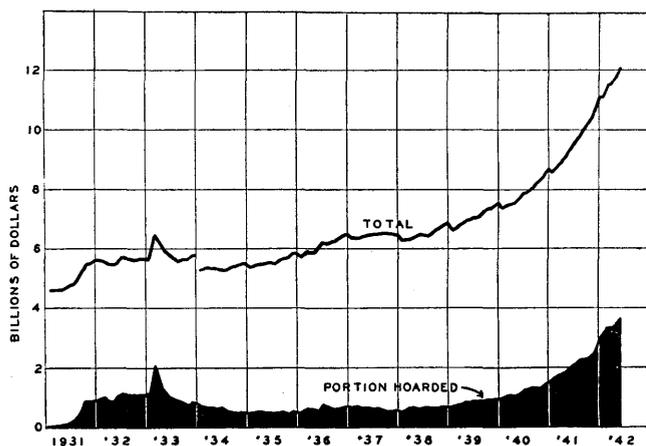
reports of currency in circulation include all of the currency outstanding that is not held by the Treasury and by the Federal Reserve banks, and therefore do not take into consideration the considerable proportion of the total, that, instead of being actually in circulation as the reports indicate, remains in safety-deposit boxes and other repositories deemed to be safe by its holders.

The foregoing chart presents the monthly record of total currency in circulation during the past eleven and a half years. The shaded section of the chart indicates the amount of currency estimated as hoarded during each month of the period shown. The vertical distance between the top of the shaded portion and the line indicating the total currency in circulation affords a more accurate measure of circulating currency than the Treasury reports, because the hoarded currency does not actually appear as a demand in the markets. The use of this guide reveals that, although there has been a considerable increase in currency outstanding during the past few years, somewhat more than half of the increase in total currency reported in circulation by the Treasury has been hoarded.

Questions from some of our clients indicate that there may be a general impression that currency hoarding is an inflationary process. This is a misconception that may have been encouraged by participants in the campaign to sell War Bonds. Appeals have been made to the public to invest its hoarded currency in these Government issues, and one argument used is that such action would help to avert inflation.

It is true that hoarded currency constitutes an inflationary potential that would become dangerous if there were a concerted movement on the part of hoarders to buy goods with this currency. However, as we pointed out more than a year ago<sup>1</sup> when the Treasury first offered its Defense Savings Bonds (forerunners of the present War Savings Bonds), their call redemption features injected an unusual risk in connection with this type of financing. Unless the Treasury repudiates its redemption promise, the bonds will constitute just as effective an inflationary potential as hoarded currency and could appear as active demand in the market in as short a time as the formalities required for presenting the securities for redemption could be completed.

CURRENCY IN CIRCULATION AND PORTION HOARDED



Gold coin omitted from reports beginning January 1934.

## SECURITIES

### Bonds

Bond prices remained about unchanged last week. The Dow-Jones Average of 40 Bonds was 89.14 on July 23 and 89.19 on July 30.

### Stocks

The trend toward recovery in the stock market was interrupted last week. However, price declines as a rule were moderate, and the volume of transactions was extremely low.

<sup>1</sup> Weekly Research Report Bulletin, May 12, 1941, page 75.

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