AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Protective Measures Against Inflation

During an inflationary progression, it is important for the individual to take measures for his protection that accord as closely as possible with sound policies under normal circumstances. This can be accomplished to a considerable degree by those who can look forward to many years of productive effort. They can subject their occupational equipment to a searching analysis to discover how their earning power can be improved and how their careers can best be adapted to changed circumstances. It is essential to follow current economic trends to find out the effects they will have in the post-war period.

These fortunate individuals are in a preferred position to accept the speculative risks that inflation exacts for the fullest protection of savings. However, even those who have passed the peak of their earning power can usually take the elementary precautions necessary during times such as these. It is always prudent to have the assurance of shelter that home ownership provides. As far as it is possible in war time, personal and business properties must be maintained in good condition even at the expense of extra effort and recourse to savings held in the form of cash or bank deposits. The same principle counsels the maintenance of household and business equipment. It is no longer possible to accumulate reserve food stocks, and the time is approaching when civilians cannot anticipate their future clothing requirements.

It is evident that the exigencies of the war are depriving the public of the more immediate practical safeguards against the effects of inflation that would otherwise be available. This circumstance may ultimately tend to force into other channels the pressure generated by many individuals seeking to protect themselves against inflation.

In preceding discussions of protective measures against inflation, we pointed to the possibilities for price appreciation in carefully selected common stocks, corporate bonds selling below par, and real estate. These media may all come in for speculative attention before the current inflationary progression has run its course. The Government will no doubt attempt to prevent the occurrence of such developments. In fact, the Securities and Exchange Commission has already suggested drastic steps that might be taken in the event of a stock-market boom. Past experience shows that it is impossible to control speculative movements of this kind, even though they may be temporarily halted. Whenever Government controls are established to prevent active speculation in a specific medium, such as the stock market, speculative attention may for the time being be directed elsewhere and perhaps cause rapid appreciation in real-estate values. It is thus obvious that the cardinal principle of diversification in investments should be maintained as far as practicable at the present time.

In preceding discussions we have attempted to emphasize the fact that there are as great dangers in attempting to avoid the effects of inflation through ill-considered ventures as there are in adopting no safeguards at all. This can be summed up in the warning to avoid hedging against inflation through investment media concerning which the investor is unfamiliar. This principle is especially applicable to business ventures where management responsibilities cannot be easily delegated.

The Institute's research staff has prepared material for a series of articles entitled "The Background of Investment" that will be published in the bulletins during the spring months. The discussions will include additional information with regard to protective measures against inflation.

THE FUNDAMENTALS

Industrial Production

The Institute's preliminary index for February is 172.0, fractionally higher than the revised index for January. (The index for January was revised from 171.0 to 171.6.) The industrial production chart on page 31 shows that the upward trend that has been virtually uninterrupted since April 1940 continued during the first two months of 1943, but the monthly rate of increase has become more moderate.

Some time during 1943 it may become evident that the concentration on the production of materials for the prosecution of the war has been carried too far. Any further drastic curtailment of consumer goods supplies for the civilian population will reach the point where there will be an impairment of the Nation's effective labor force. There are still possibilities of improving the efficiency of war production, but this can best be accomplished by selection. Actual combat experiences are no doubt revealing the most effective weapons for victory, and it should soon be possible to eliminate production of some types that are of relatively small value. If the War Production Board can evolve an efficient overall program, it may yet be found possible

to avoid some of the most severe hardships that the civilian population is expected to endure in order to promote the successful conclusion of the war.

There has recently been considerable criticism of absentee and slowdown tendencies developing among the Nation's labor force. Government statistical agencies have presented factual evidence to show that there is cause for alarm. It seems probable that this condition will be ameliorated when combat action by American forces becomes intensified. After the Pearl Harbor attack, there was a marked improvement in the determination of war workers to exert themselves to the utmost to achieve maximum production. This spirit gradually weakened as the effort became a protracted routine and especially since the Russian successes have encouraged the hope that our military tasks will not be so formidable as they appeared a year ago. If the American forces participate in an invasion of Europe, as promised by the President, there will probably be a renewal of the spirit that characterized the working force when we first entered the conflict.

The steel-ingot production rate declined a half point to 99 per cent of theoretical capacity last week. The nature of the steel industry makes it impossible for operations to be maintained at or close to 100 per cent of theoretical capacity for long. The industry has succeeded in establishing an enviable record by operating at an average rate of 98 per cent of rated capacity during the first 14 months of our participation in the war.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Per Cent of Capacity	88.5	26.5	85.0	30.5	97.5	99.0

(Latest 1943 weekly data; corresponding week earlier years)

Last week, nearly all regions improved their percentage gains in electric power production from output during the corresponding week of 1942. Last week's output for the country as a whole was 15.1 per cent greater than production in the corresponding week of 1942.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Billion Kilowatt-Hours	1.70	1.55	2.21	2.06	3.42	3.94

Last week lumber production increased more extensively than it normally does at this season, and the adjusted index advanced from 78.0 to 99.8.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
New York Times Index	126.0	37.2	80.1	57.4	136.7	99.8

The Harwood Index of Inflation

The preliminary Index of Inflation for February is 150.3, about one point higher than the January Index, which was revised to 149.2 from 147.3. The chart on page 31 shows the Index in ratio form, which is the ratio of all purchasing media available for use to the portion that is not inflationary. The dotted line on this chart shows the actual totals of inflationary purchasing media. (The scale for the ratio form is at the left side of the chart. The scale in billions of dollars for the total of purchasing media is at the right. Inflationary purchasing media have recently expanded so rapidly that it has been necessary to extend the scale for purchasing media above the chart for the ratio form.)

The preliminary Index for February was based on the latest available reports of the commercial banks representing data for the middle of the month. Therefore, the preliminary Index is probably lower than the revised Index will be, if the Treasury continues to deplete its bank balances at the rate followed during the past few weeks. During the first two weeks of February, the Treasury reduced its bank balances from $7,250,000,000 to $6,700,000,000. This decrease in the Government's bank balances indicated the distribution of purchasing media to the public of $550,000,000 during this short period.

During the first part of last month, the commercial banks were not called upon to absorb any new Government obligations and in fact were able to reduce their holdings by about $300,000,000. The banks were evidently distributing Treasury issues to their customers that they had originally purchased for their own accounts.

In the discussion of "Treasury Finance and the New Budget," published in the current issue of the *Federal Reserve Bulletin*,[1] there is a frank statement of the necessity for financing a substantial portion of Treasury deficits by inflationary means. After pointing out the desirability of raising as much of these funds as possible from current income and holding to a minimum the creation of new purchasing media by borrowing from the commercial banks, the Federal Reserve authorities continued: "To the extent, however, that banks are relied upon to purchase additional Government securities, the Federal Reserve System has assumed responsibility for providing the banks with sufficient reserves for the necessary expansion of credit." This statement emphasizes the fact that was already clear that there is virtually no check to the development of inflation in war time.

In respect to the effects that this increase in inflationary purchasing media will have, the Federal Reserve authorities expressed their opinion as follows: "So long as most of the additional bank deposits remain idle, the immediate inflationary consequences of their expansion would be negligible. If, however, depositors should endeavor to spend their funds even as actively as they did in 1942, which was not a year of exceptionally rapid turnover of deposits, the pressure on prices would be serious."

Other Demand Factors

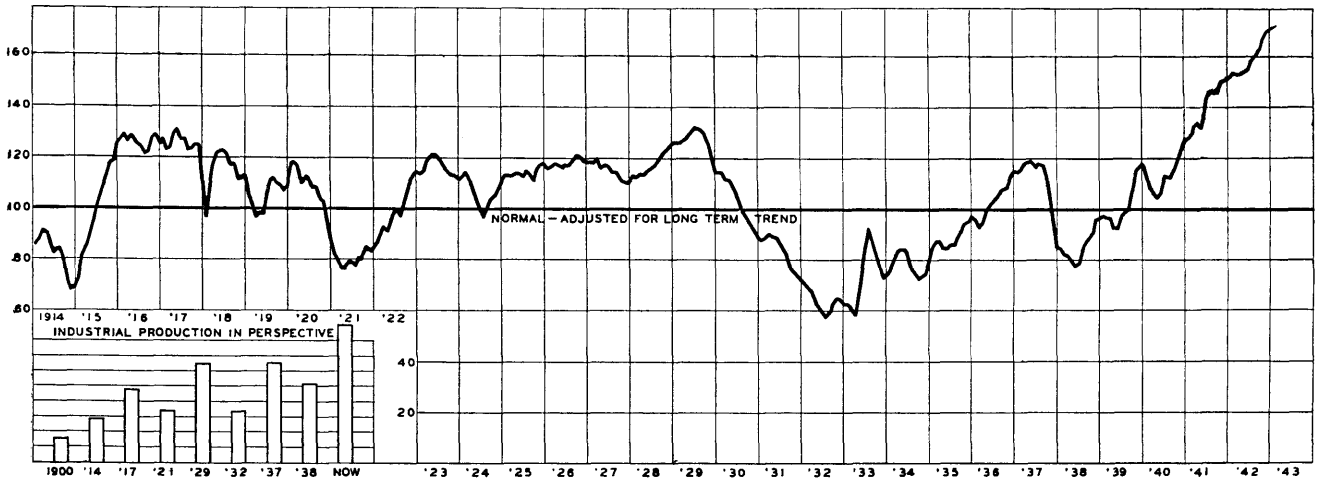
Weekly retail sales for February indicate that the dollar volume of nondurable goods sales for the month will exceed the high level reported in the corresponding month of 1942, although the index, adjusted for seasonal factors, will be somewhat lower than the peak reached last summer. The establishment of shoe rationing initiated a fresh wave of scare buying of other clothing items. Official denials that the Government contemplated clothes rationing failed to stem this movement. As long as Government officials continue to make contradictory statements about civilian supplies, the public will distrust their reassurances as well as their threats. The war has reversed the usual situation in respect to demand and supply. Normally, the former is apt to be the unknown, whereas supply can be measured with relative accuracy. Under present circumstances, it seems doubtful that the Government has made a satisfactory appraisal of the supply situation, but it is apparent that civilian demand is exerting constant pressure on the commodity-price structure.

Commodity Prices

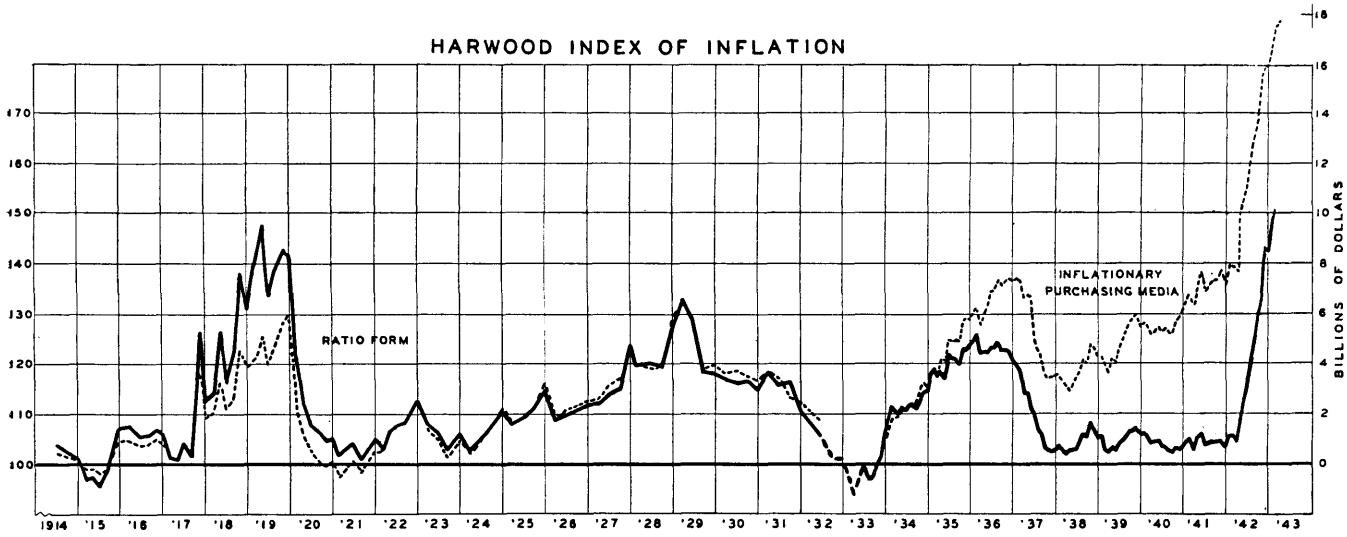
The United States Bureau of Labor Statistics' combined index of commodity prices in February at 146.1

[1] *Federal Reserve Bulletin*, February 1943, pages 111–113.

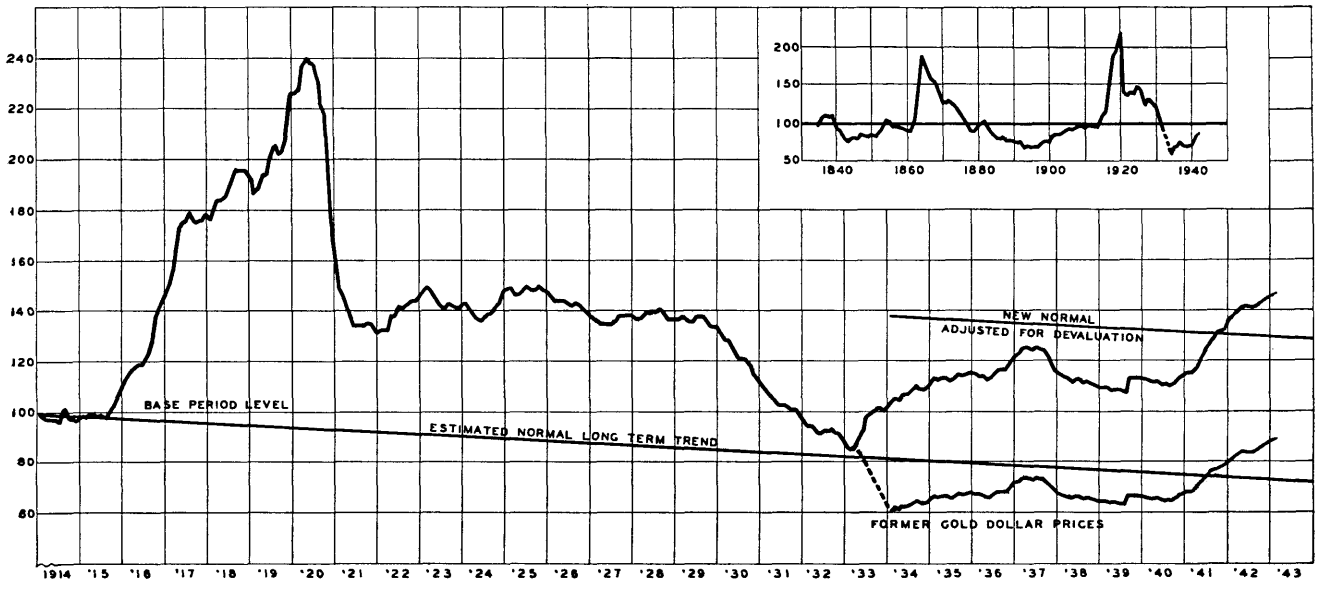
INDUSTRIAL PRODUCTION



HARWOOD INDEX OF INFLATION



COMMODITY PRICES



(preliminary) was fractionally higher than the revised January index of 145.7. Inasmuch as the preliminary index for February was based on data representing average prices before the middle of the month, the fractional increase indicates that the upward trend of the index followed during the war period is continuing at about the usual monthly rate. Since August 1939, the combined wholesale commodity price index, which includes nearly 900 separate quotations, has risen about 34 per cent. The index is shown in chart form on page 31. (Although there were fewer components in the earlier years, the index is so constructed that the data are comparable throughout the entire period.) The index is also shown on the former gold basis since January 1934, when the dollar was devalued. The estimated long-term trend line and the new long-term trend line, adjusted for devaluation, are features of the chart. The small insert in the upper left-hand corner of the commodity price chart shows changes in commodity prices during the past century on the basis of the former gold dollar.

The February indexes for the three economic classes show that raw-material prices and the prices of manufactured products advanced moderately, but there was no change in the index of semimanufactures. With the exception of farm products, changes in the commodity price classifications were minor. The majority of items remained unchanged from the January level.

The accompanying table shows changes that have occurred in the major classifications in the wholesale commodity price index. The February preliminary indexes are compared with the revised indexes of earlier significant periods.

United States Bureau of Labor Statistics
Wholesale Commodity Price Index
(*Monthly Average 1913 = 100*)

	Feb. 1929	*Feb. 1932*	*Feb. 1942*	*Jan. 1943*	*Feb.* 1943*
Farm Products	147.4	70.8	141.7	163.9	165.3
Foods	152.8	97.4	147.4	163.2	163.7
Hides and Leather	159.9	115.0	169.3	173.9	173.9
Textile Products	161.1	104.4	166.1	168.9	168.9
Fuel and Light	135.2	111.4	127.2	130.7	131.2
Metals and Products	110.8	89.1	114.1	114.4	114.4
Building Materials	169.1	129.5	194.2	194.0	194.2
Chemicals	125.8	100.7	120.9	124.1	124.1
House Furnishings	166.6	137.7	182.1	184.9	184.9
Miscellaneous	118.5	92.3	127.9	129.7	129.7
Raw Materials	142.6	82.7	141.0	157.0	157.8
Semimanufactures	126.3	82.6	122.8	123.5	123.5
Manufactured Products	135.9	102.9	139.8	144.5	144.7
All Commodities	136.7	95.0	138.5	145.7	146.1

* Preliminary Estimate.

The foregoing table makes possible comparisons between the current level of wholesale commodity prices and those existing in 1929 at the height of the New Era inflationary price advance. In February this year the combined index was seven per cent higher than it was in the corresponding month of 1929. Of the ten major classifications (that precede the three economic classes shown in the table) eight are currently higher than they were in the preceding boom period, and two are lower. Meats and dairy products led the advance in the farm products and food items, whereas cereal products and fruit and vegetables have only slightly exceeded price parity with the 1929 level. In the case of hides and leather, the increase was attributable to higher prices for hides and skins. Finished leather prices are at present about ten per cent below the 1929 level. The textile products index advanced about five per cent during the past thirteen years as a result of higher prices for cotton and woolen goods, the latter having advanced more extensively than the former. On the other hand, the prices of rayon fabrics have been more than halved during the period, and their quality has been improved.

The favorable comparison made by the fuel and light item, which shows a three per cent decrease from the 1929 level is primarily attributable to lower rates for electricity and lower prices for petroleum products. The electric-power and oil industries have been able to achieve this record in spite of special taxation levied on their products. The metals and metal products classification includes machinery as well as semifinished metals, and this has helped to maintain the price level at about that in 1929. However, there have been improvements in the method of producing nonferrous metals, reflected in lower prices for these products.

The increase of 15 per cent in the building materials classification from the 1929 level was the largest recorded by the major components of the combined index. The increase was primarily attributable to an advance of 42 per cent in lumber prices. This is apparently attributable to the industry's higher costs of operations, inasmuch as there has been no appreciable increase in timber prices. The average price of chemicals has been reduced somewhat from the 1929 level, evidently reflecting improved methods of manufacture. This trend would have been more evident in the group index if drugs and pharmaceuticals were not included. The prices of these products have more than doubled from the 1929 level. Many of these are imported products, and the price advance has been accelerated since the war disrupted international commerce. Price advances have been about equal in the two classifications of the house furnishings group shown separately under the titles furnishings and furniture. The price movements of the miscellaneous group are less significant than are those of the other classes, inasmuch as it includes such distantly related products as automobile tires and paper and pulp.

The sensitive wholesale commodity price indexes moved upward last week after about a month of minor fluctuations. Moody's Spot Commodity Price Index was 244.8 on February 11 and 245.6 on February 18. The Dow-Jones Index of Commodity Futures closed at 89.22 on February 11 and at 89.92 on February 18.

Statistical Summary; Production, Purchasing Media, and Prices

	1942											1943	
	Feb.	*Mar.*	*Apr.*	*May*	*June*	*July*	*Aug.*	*Sept.*	*Oct.*	*Nov.*	*Dec.*	*Jan.*	**Feb.*
Index of Industrial Production.	153.4	153.2	153.9	155.4	156.0	159.3	161.8	163.3	166.5	168.1	169.9	171.6	172.0
Index of Inflation (Ratio Form)	105.3	104.8	111.0	116.1	119.7	125.1	130.8	133.6	140.7	143.5	142.7	149.2	150.3
Commodity Price Index.....	138.5	139.8	141.4	141.5	141.3	141.4	142.1	142.3	142.8	143.4	144.4	145.7	146.1
Commodity Price Index.....	82.0	82.7	83.7	83.7	83.6	83.7	84.1	84.2	84.5	84.9	85.4	86.2	86.4

(In terms of former gold dollar) ***Preliminary Estimate.**