AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

WEEKLY BULLETIN

April 19 1943

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

More Palliatives vs. Inflation

The President's executive order designed to bolster the Government's program to stabilize prices, wages, and profits is a belated acknowledgment that there were serious loopholes in the plan developed during the past two years. It is clear that the President's action was taken at a time when pressures from organized labor groups and the Farm Bloc threatened a disastrous breach of the bulwarks against the effects of inflation.

Under the new order, price ceilings are to be placed immediately on all commodities affecting the cost of living, and prices that are excessively high, unfair, or inequitable are to be reduced. No further increases in wages or salaries are to be granted except under the "Little Steel" formula and "to correct substandards of living." The order still allows for reasonable adjustments for the purpose of promotions, reclassifications, merit increases, and incentive wages. Government regulatory authorities passing on the rates of utilities and railroads are requested to disapprove of petitions for rate increases and are asked to establish rate reductions "consistent with Federal and State laws."

It seems probable that the President's action will be effective as a temporary expedient in halting the assault against the Nation's wartime price structure. More than this cannot be expected.

The Administration has constantly emphasized the means for controlling prices instead of taking action that might be effective against the forces causing the pressure on the price structure. In fact, recent policies of the Treasury, as expressed by its attitude toward Federal taxation, tend to nullify its efforts to finance its war deficits from the people's savings, instead of through the monetization of Government bonds by the banking system.

Immediately after publication of the President's "freeze" order, security prices declined sharply. This behavior supported the contention expressed in the bulletins from time to time this spring, that inflation psychology has been a potent market influence promoting the market advance. If commodity prices are stabilized for a time, as they have been for a few months following other attempts at Government price control, the inflation influence will be a less prominent feature of the security markets. However, it would be unwise to count on the market selling "ex-inflation" for an extended period while the Government continues to create more and more purchasing media.

THE BACKGROUND OF INVESTMENT

Characteristics of Major Fields of Enterprise

The companies engaged in the various distinct fields of enterprise in the modern economy usually have important characteristics in common making for strength or weakness in the group from the aspects of investment. These characteristics are probably not so important as the quality of corporate management but have a significance that must not be overlooked by individuals seeking to preserve their savings.

We have previously expressed the opinion that the Nation's industrial establishments constitute the most vital element in the economy and consequently afford the best opportunity for investment among the many economic activities. We shall therefore first discuss the characteristics common to the average companies in industry. Industrial companies may be conveniently classified into two groups: the special-industry group, and the natural-resource group.

Special Industries

The first group includes the majority of the companies that have contributed most to the improvement in the Nation's living standards during the past half-century and probably contains the names of many of the concerns that will continue the process in the post-war years. The production of improved types of durable goods has made the most important contribution to creating the physical conveniences of today.

The large corporations that produce the greater part of the goods in this field emphasize scientific research to make possible technological improvements and new developments in manufacture. Strict classification by departments of engineering cannot be drawn among the individual companies because many are engaged both in research and manufacture in widely differentiated techniques. However, for the investor's purposes, general divisions may be made.

Scientific research in the field of chemistry has been of major importance in making possible the production of many of the conveniences that we have become accustomed to think of as a necessary part of modern life. The companies engaged in this field have developed rapidly during the past few decades, and have fre-

quently proved to be extremely profitable enterprises. The capital stock of the leading companies such as Air Reduction, American Cyanamid, Dow Chemical, DuPont, Monsanto Chemical, and Union Carbide and Carbon are listed on the established stock exchanges and enjoy a wide market.

Corporations utilizing the technology of electrical and mechanical engineering in developing mass production of machinery have records almost as remarkable as those made by the chemical companies. The Nation's public utilities have been made possible by the work of such corporations as General Electric, Westinghouse Electric & Manufacturing Company, and Allis Chalmers. The Nation's transportation system has been revolutionized by such companies as Westinghouse Airbrake, American Brake Shoe and Foundry, General Motors, Sperry Corporation, and United Aircraft. Machines that perform varied vital functions in the economy have been developed by International Harvester, Caterpillar Tractor, Link Belt, Timken Roller Bearing, and other similar corporations. We have named only certain leading companies having outstanding records and having an active market in their securities. There are other companies in this field whose securities offer opportunities for the investor.

The special-industries group has some characteristics of a disadvantageous nature. Demand for its products fluctuates widely with the business cycle. The Federal Reserve indexes for durable and nondurable goods industries clearly demonstrate that the former group is more susceptible to the influence of general business activity than is the latter. Therefore, the earnings of the companies engaged in this field are not so steady as those in some fields where opportunities for long-term improvement are less favorable. Another disadvantage suffered by many of these companies included in the special-industries group is that their securities tend to sell in the market at prices affording a low yield on capital invested. The investing public frequently discounts potentialities for continued progress in the company's earnings, and the purchaser is obliged to pay a correspondingly high price for the security issues.

Natural-Resource Industries

Companies that provide the most important raw materials for the industries discussed in the foregoing section as well as serving other markets are included under our second industrial group. Typical industries in this classification are oil, copper, nickel, lead, and steel. Although many of the companies in this field have greatly improved their production methods during the period when the special-industry group was developing, this factor is less important in considering the investment position of the natural-resource industries than it is in the case of the former group.

The natural-resource industries are in an especially favorable investment position during periods of currency depreciation. It is fairly certain that a business engaged in the extraction of some natural-resource commodity will probably maintain its advantage and, in general, be assisted by inflation and devaluation.

The basic natural resources concerned should be those essential to the present industrial civilization. Furthermore, it is important to select industries producing commodities for which the trend is toward a greater per capita use in the long run. Subject to these considerations, the producing companies' situation is favorable during the period when the general trend of commodity prices is upward. Costs involved in the operation of natural-resource industries are principally for labor and capital, which means that they cannot be squeezed between rising raw-material costs and consumer resistance to higher prices. The present price ceilings established on natural-resource commodities by Government order are believed to be only temporary expedients made necessary by the war program.

There are numerous large and powerful companies operating in the petroleum industry whose securities are widely held by investors. In choosing companies in this department of the natural-resource group, it is advisable to make selections among those who are especially progressive in developing chemicals and by-products that seem destined to constitute a factor of growing importance in the industry. Among these are included Continental Oil, Phillips Petroleum, Standard Oil of New Jersey, and Texas Company.

Investments in the steel industry should be restricted to those well managed, integrated steel companies whose production is concentrated in the light steel classification. It now seems probable that demand in the postwar period will change from the present concentration of distribution on heavy steels to an emphasis on light steels. At least a sustained demand for light steels at the end of the war is practically assured. Light steel consuming industries, including the manufacturers of automobiles, refrigerators, washing machines, stoves, vacuum cleaners, and furniture, whose output either has been sharply reduced or stopped entirely, will resume volume operations. Foremost among these companies are Inland Steel and National Steel.

Among the nonferrous mining companies, Aluminum Company of America, Climax Molybdenum, International Nickel, Kennecott Copper, Phelps-Dodge, and St. Joseph Lead have production records that merit favorable investor consideration.

Disadvantages of companies in the natural-resource industries group include those that affect the special industries which they serve. In addition, competition among the industrial metals is keen, and variations in the price relationships determine in part the use of substitute metals. Moreover, consumption is affected by such factors as decreasing demand by moribund industries, technical improvements in the industrial use of metals, and the introduction of new metals. The industries included in this group are extractive ones, and profits are derived from the liquidation of their assets. This factor is, of course, taken into consideration in their accounts, but there is always the possibility of exhaustion of the company's resources that are available at profitable operating costs.

Characteristics associated with other economic fields will be discussed in a subsequent bulletin.

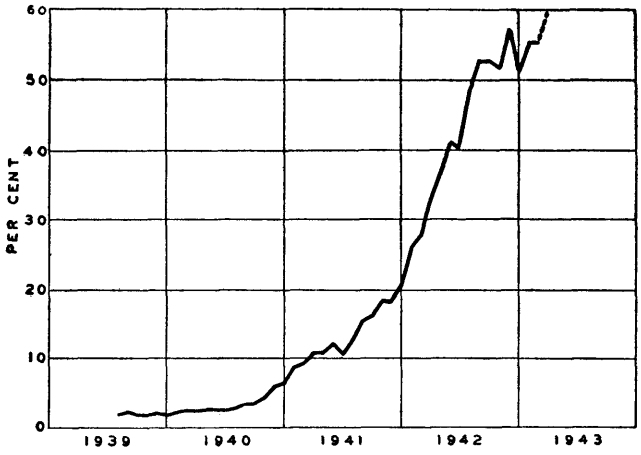
Proportion of the National Economy Devoted to War Activity

During March 1943, there was an increase of $1,000,000,000 in expenditures for war activities from the level of the preceding month, and the tremendous total of $6,744,000,000 was recorded. During the preceding four months, such expenditures remained within a relatively narrow range, indicating the possibility that the diversion of the country's economic activity to the

production of war materials had reached its practical limit. However, the latest figures show that it is possible to produce substantially more than $6,000,000,000 worth of goods and services for the war in a single month.

The accompanying chart, presented as a rough measure of our war effort, was published in the March 22 1943 bulletin and was accompanied by a description of the data used. Expenditures for war activities are expressed as a per cent of all income payments, which include payments for war activities in their total.

PER CENT OF TOTAL INCOME FOR WAR ACTIVITIES



Since the chart was published before, figures have been released showing expenditures for war activities for March and revised income payments data for January and February. A substantial increase in income payments from the February to the March level has usually been recorded. An important factor in this seasonal increase is the excess of working days in March over the number in February. When expenditures for war activities are increased greatly, there is also a great increase in industrial pay rolls, which constitute a substantial proportion of the income payments total. Nevertheless, the proportionate increase in expenditures for war activities was greater than the increase in income payments, and the per cent of total income for war activities shown on the chart increased to a new high level.

The following statistical summary shows the expenditures for war activities for each month in 1942 and for the first three months of 1943, together with the income payments for the corresponding period. The income-payment figure for March 1943 is a preliminary estimate.

	Expenditures for War Activities	*Income Payments*
1942	*(In Billions of Dollars)*	
January	2,101	8,411
February	2,201	8,026
March	2,797	8,714
April	3,231	8,811
May	3,553	8,670
June	3,823	9,647
July	4,494	9,508
August	4,882	9,357
September	5,384	10,243
October	5,481	10,603
November	6,042	10,430
December	5,825	11,524
1943		
January	5,947	10,725
February	5,770	10,428
March	6,744 (Est.)	11,300

THE FUNDAMENTALS

Supply

The steel-ingot production rate was estimated to be 98½ per cent of theoretical capacity last week. This was one point lower than the revised rate of 99½ per cent for the preceding week. The decrease in operations was attributed to labor disputes. *The Iron Age* summarized the current situation in the industry as follows: "The oil industry and the railroads are two of the industries whose need for steel is becoming more critical rapidly. . . . The oil industry in the first quarter was allowed about 140,000 tons of steel but actually received no more than about 75,000 tons. . . . The problem of obtaining more rolling stock for the railroads has been becoming more acute, and now frantic efforts are being made at Washington to avert a threatened national disaster caused by faulty War Production Board estimates last November. The steel industry itself is worried over the outlook for transcontinental transportation."

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Per Cent of Capacity	96.0	22.0	91.5	32.5	98.5	98.5

(Latest 1943 weekly data; corresponding week earlier years)

Electric power production last week was slightly less than it was in the preceding week and followed the downward trend seasonably normal at this time. Output was 16.9 per cent greater than that in the corresponding week of 1942, compared with a gain of 16.2 per cent in the preceding week.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Billion Kilowatt-Hours	1.70	1.48	2.17	1.96	3.32	3.88

There was a greater-than-seasonal decrease in lumber production last week, and the adjusted index declined from 107.0 in the preceding week to 104.5 per cent of the 1935–39 monthly average.

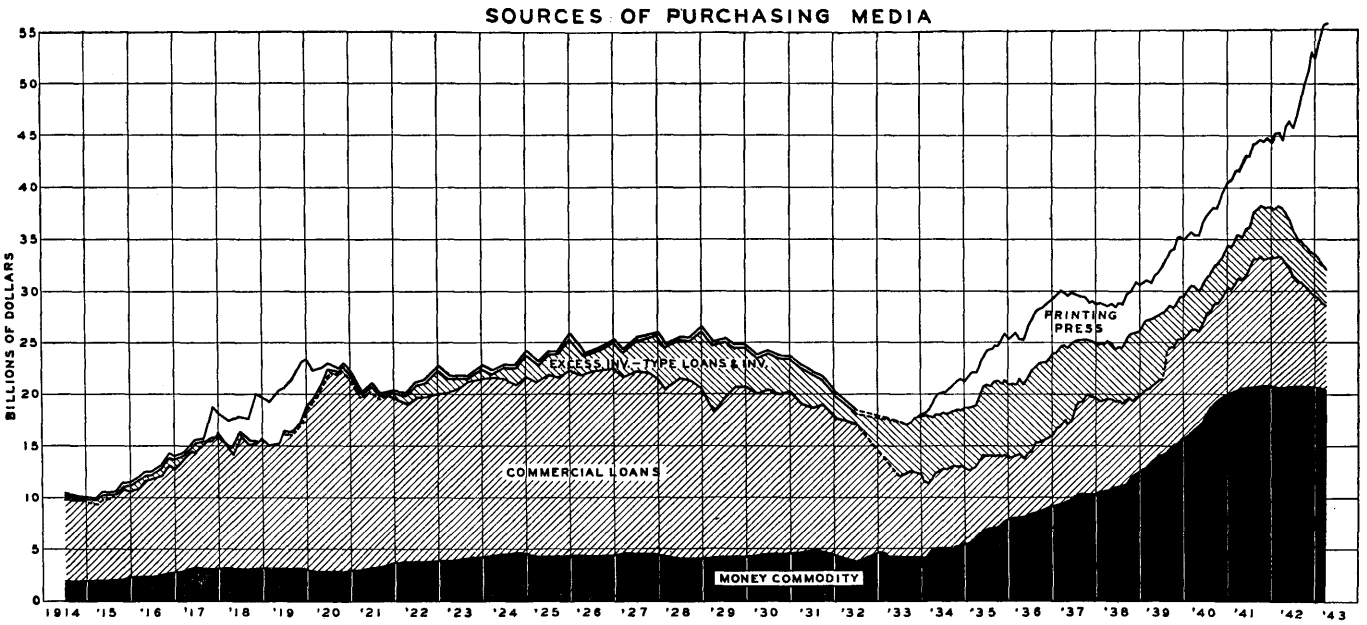
	1929	*1932*	*1937*	*1938*	*1942*	*1943*
New York Times Index	135.2	41.6	84.4	61.0	121.5	104.5

Demand

Public demand for many types of nondurable consumer goods, as well as for most durable consumer goods, can no longer be met by retail merchants. The situation is reported to be more stringent in the wholesale markets, where demand from retail distributors is actively seeking the goods needed to sustain future sales volume. The character of store displays has undergone a considerable change since a year ago, but there are still ample stocks of most apparel lines, although the selections offered are becoming more limited.

Prices

The sensitive wholesale commodity price indexes were reactionary early last week but tended to recover during later sessions. Moody's Spot Commodity Price Index was 248.8 on April 8 and 246.6 on April 15. The Dow-Jones Index of Commodity Futures closed at 91.31 on April 8 and at 91.11 on April 15.



FINANCE

Sources of Purchasing Media

This Institute has developed two tests of the functioning of the money-credit-production relationship. The first is the Harwood Index of Inflation, which is an important instrument for measuring the degree of inflation that exists at any time. A chart of the Index of Inflation is shown in the bulletin published on the last Monday of each month. The second qualitative test is the analysis of sources of purchasing media, which is also published monthly, as soon as the revised data are available. Purchasing media available to the public consist of currency in circulation, plus checking-account deposits. The chart shows the total purchasing media in use during each month of the twenty-nine-year period and indicates the sources from which the purchasing media were derived.

Purchasing media originating from the money commodity (gold) are not inflationary, because they represent the metal itself that, in effect, is being offered in the markets by those who use such purchasing media. Purchasing media created by commercial loans are not 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 constitute bank credit or Government currency that does not represent goods being offered in the markets.

There was a small increase in the total purchasing media available to the public during March. This occurred in spite of the transfer of private checking-account bank balances to Government accounts incident to the payment of the first installment of the Federal income tax and in spite of moderate reductions in purchasing media from sources other than the "printing press."

Purchasing media from the money-commodity source decreased about $70,000,000 during March. Since October 1941, when the Nation's monetary gold stocks reached an all-time high, changes have generally been confined to relatively small monthly reductions. The total decrease has been only $220,000,000, a small amount in relation to the aggregate at the end of March 1943 of $20,631,000,000. The net gold export has apparently been caused by credits granted to countries sympathetic to the cause of the United Nations or through other employment of the metal as a weapon in the prosecution of the war.

There was a small decrease in purchasing media derived from commercial loans last month. This type of bank credit contributed substantially to available purchasing media during most of 1941, but after March 1942 there has been an uninterrupted trend toward contraction.

During March, there was a moderate decrease in 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). The commercial banks sold a small proportion of their holdings of both Government-guaranteed and "other" securities.

Income-tax collections last month aggregated more than $4,700,000,000 and were about $1,600,000,000 larger than the previous record of March 1942. These Treasury receipts were supplemented by about $500,000,000 of other revenues and by the sale of Savings Bonds and tax-saving notes that together totaled about $1,500,000,000. Nevertheless, the rate of disbursement was so great (total expenditures for the month were $7,350,000,000) that Government bank deposits were reduced from $3,600,000,000 at the end of February to $2,840,000,000 at the end of March. This reflected the distribution of funds, a portion of which had previously been created by inflationary means.

To an increasing degree since the early 1930's and especially now that the Nation is at war, money-credit trends are dominated by the Federal Government's policies. The trends of the money-credit curves during April will be determined by the Treasury's ambitious financing program that contemplates the sale of at least $13,000,000,000 of Government securities. If a considerable proportion of the total is purchased out of the people's savings, there will be a temporary decrease in purchasing media available to the public.