AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

MONTHLY BULLETIN

July 26 1943

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Third War Loan Drive vs. Inflation

The Treasury last week announced that $15,000,000,000 will be sought during the Third War Loan drive that is scheduled to start September 9. The magnitude of the prospective operation is similar to that of the First and Second War Loan drives, when about $13,000,000,000 was raised in December 1942 and more than $18,000,000,000 in April 1943 The Third War Loan drive will differ essentially from the first two in that the entire loan is to be financed, if possible, from nonbanking sources.

After the results of the Second War Loan drive were announced, we commented as follows in the Research Report bulletins:[1] "The Treasury sought $13,000,000,000, not more than $5,000,000,000 of which would come from banking sources that involve the creation of inflationary purchasing media. Inasmuch as total subscriptions exceeded $18,000,000,000, the whole $13,000,000,000 originally sought was in effect obtained from nonbanking sources." Treasury officials have evidently been encouraged by the results of the Second War Loan drive and believe that there is a favorable chance that the deficits that will be incurred during the remainder of the war period can be financed without resorting to the creation of inflationary purchasing media by selling new Government issues to the commercial banks.

The Treasury admits that the task of obtaining the huge sum of $15,000,000,000 without recourse to aid from the commercial banks is a formidable task. It is probable that, measured by dollars, the bulk of the sales will be made to large institutional investors, such as is represented by the industrial and other business corporations, insurance companies, and savings banks. There will be a determined attempt to tap the incomes of war workers by means of a carefully organized house-to-house canvass. This will be conducted under the direction of war finance committees in each state, and subscriptions will be taken by several hundred thousand experienced volunteer salesmen.

If the plan is successful and if the operation can be repeated whenever it is necessary for the Treasury to obtain more funds for financing its deficits, the Government can at last be credited with a significant attack on inflation at its source. If an actual halt is made to the expansion of inflationary purchasing media available to the public, there is the possibility that the inflationary progression that is lifting the general commodity price level will also be stopped. However, this cannot be taken for granted. The excess volume of purchasing media already created through the expansion of commercial-bank credit will continue to exist until the Federal budget is balanced or Government securities are purchased out of savings in values exceeding the periodic deficits. Neither of these two circumstances is likely to occur as long as the war lasts.

Whenever the Government has previously announced one of its numerous programs for the "control" of inflation, we have pointed out that such palliatives that treat the symptoms rather than the malady can only postpone but cannot permanently prevent inflation from raising prices. Studies of the average prices of commodities subject to control and of uncontrolled commodities made by the United States Department of Commerce tend to show that the efforts of the Office of Price Administration have retarded the wartime price advance. It is thus apparent that the force of inflation has been only partially exerted against the price strueture.

Unless the wartime controls imposed on the public by the Government are continued indefinitely after the emergency has passed, there will come a time when this restraining influence no longer exists. Probably the Government will wish to maintain its controls over prices indefinitely (of course, without admitting that these are anything but temporary expedients). However, this may be difficult to accomplish in view of the accumulation of popular resentment against wartime controls that will inevitably find expression after peace returns.

In summary, we can say that the Treasury's program for financing its War Loan drives entirely from noncommercial-banking sources affords hope that the Government has belatedly recognized the only feasible method of attacking the problem of the "inflationary gap." Even if the Treasury's program is successful, the danger of a runaway inflation after the war will not be removed. It may be significant that the explosive stage of inflation in France did not come until a full year after the national budget was finally balanced.

THE FUNDAMENTALS

Industrial Production

The Institute's indexes of industrial production for recent months have been revised in accordance with

[1] Weekly Bulletin May 10, 1943, page 76.

changes made in the Federal Reserve Index, on which the Institute's index is based. In earlier instances, in which revisions have been made during the war period, a higher rate of production has been indicated than was previously evident. However, the present revision indicates that the average rate of industrial operations has been somewhat lower than was shown by the preliminary data. The revisions made in the indexes for the first half of 1943 are not extensive and can be observed by comparing the chart on page 119 of this bulletin with the chart on page 103 of the June 28, 1943 monthly bulletin. The revised figures are shown in the statistical summary at the bottom of page 120 of this issue. The Institute's revised index of industrial production for June is 179.0, and the preliminary index for July is 179.5.

Industrial production during the first half of July (on the basis of which the Institute's preliminary index of industrial production is shown) was at a somewhat higher level than was indicated by reports for June. This was primarily attributable to the resumption of work by the coal miners that in turn made possible a higher rate of production in the basic steel industry.

Members of the War Production Board are obviously concerned about the morale of employees engaged in the output of war materials. Public charges by Government officials are growing in frequency regarding the tendency for workers to relax their efforts on the supposition that the war is all but won. Even if such a tendency were not observable, it seems probable that the stage has been reached when there will no longer be substantial gains in the physical volume of industrial production in this country. Fortunately, we should be in a position to turn out the requisite mass of supplies to assure victory. Now that the toll of shipping exacted by enemy submarines has been greatly reduced, it is no longer necessary to produce much more war equipment than is needed for actual military operations, whereas formerly much of the equipment produced failed to reach its destination. Estimates, published last week, that the production of airplanes by the United Nations is currently at a rate three times that of the Axis Powers, are perhaps typical of the general war-supply situation.

The steel-ingot production rate was unchanged at 98 per cent of theoretical capacity last week. The same rate also prevailed during the corresponding week of 1942, but there has been an improvement in producing facilities during the past twelve months.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Per Cent of Capacity	95.5	22.0	82.0	37.0	98.0	98.0

(Latest 1943 weekly data; corresponding week earlier years)

Last week, there was a substantial increase in electric-power output, and reports indicated that a new high record was made in the number of kilowatt-hours generated. The Pacific Coast and West Central regions made the most favorable comparisons with output a year ago.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Billion Kilowatt-Hours	1.73	1.44	2.26	2.09	3.57	4.18

Although shipments and orders reported by the lumber industry last week were larger than they were in the preceding week or in the corresponding week of 1942, the production record was less favorable. The seasonally adjusted production index declined from 102.2 to 99.9 per cent of the 1935–1939 level.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
New York Times Index	128.1	36.9	87.0	67.3	117.7	99.9

The Harwood Index of Inflation

The preliminary Index of Inflation in ratio form for July (based on data for July 14) is 168.1, nearly seven points higher than the revised Index of 161.2 for June. The chart on page 119 shows the Index of Inflation 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 the chart shows the actual totals of inflationary purchasing media.

Following the four-point decline in the Index from the May level of 165.3 to the June level of 161.2, the Index advanced in July to the highest level to be recorded. The high rate of Federal expenditures involves the outpouring of about $8,000,000,000 into the hands of the public each month. Part of this is returned to the Treasury through taxes and part by the purchase of War Bonds from the people's savings. However, Federal taxes plus savings is falling short of meeting all expenditures, and the difference is met by the funding of Federal debt by the commercial banking system. This process is inflationary at a time such as this, when the commercial banks are not receiving any substantial volume of new savings deposits.

It is this portion of the Treasury's deficits that cannot be financed through savings that the Government authorities refer to as the "inflationary gap." It is through this gap that is pouring the newly created purchasing media which, when used by the public, appear in the markets as active demand for consumer goods and thus bring pressure to bear tending to raise prices.

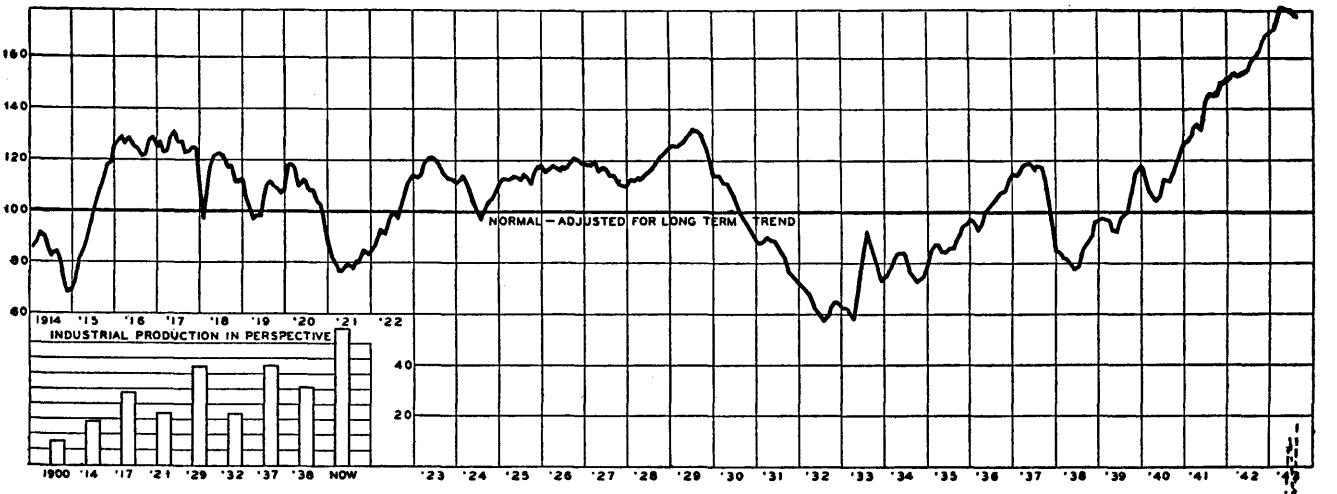
During the first half of July, the commercial banks increased their holdings of Government securities approximately $1,200,000,000, and, inasmuch as there was only a minor increase in the savings deposits of the commercial banking system, the checking-account credits created by the banks in payment for these securities became potential inflationary purchasing media in the possession of the Treasury.

Deposits in the Federal Reserve Banks and other Government depositaries to the credit of the Treasury aggregated more than $10,000,000,000, according to the latest Treasury reports. Even at the present rate of Government spending, these balances should be ample to meet Government requirements for war spending until funds are received from the September War Loan drive. It is not yet clear whether the withholding-tax payments by employers to required depositaries "within ten days after the close of each calendar month . . . of all funds withheld as taxes during that calendar month" will be considered as Treasury bank balances as soon as deposited or not until ten days following the last month of the quarter. It will be several weeks before the effects of the withholding tax on the Index of Inflation will be revealed; however, it can be assumed that it will serve as a stabilizing factor, although it is doubtful whether its influence will be sufficiently great as to stop the upward trend of the Inflation Index as long as the war continues to require the current rate of Government spending.

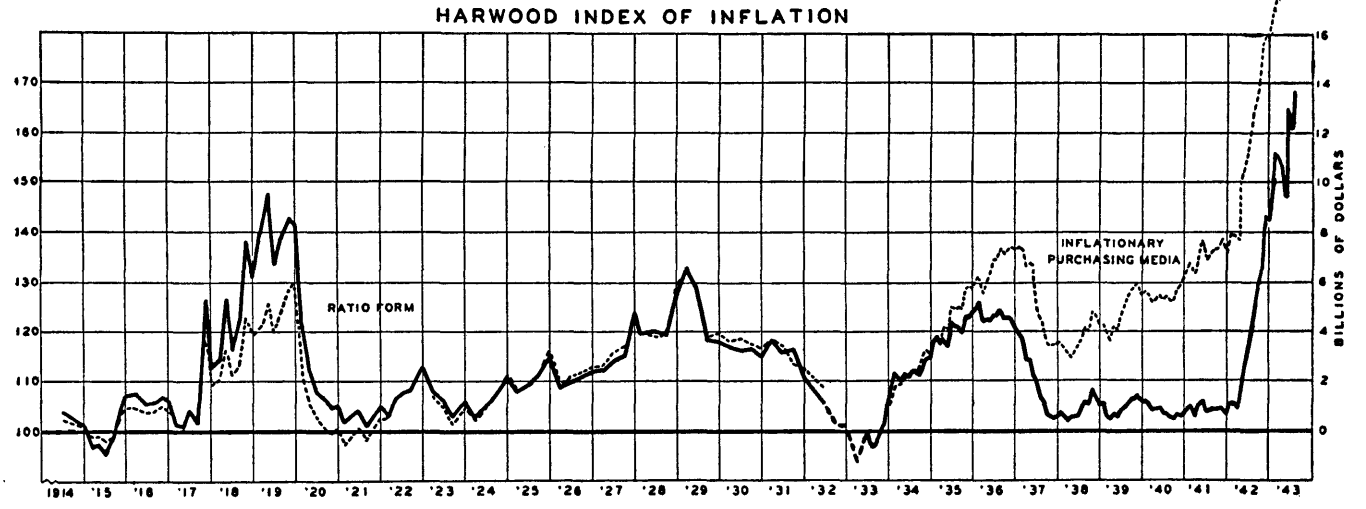
Other Demand Factors

Total income payments reported by the United States Department of Commerce remained about unchanged during the spring months. However, the index of income payments, adjusted for seasonal factors, exhibited an upward trend at a rate only moderately

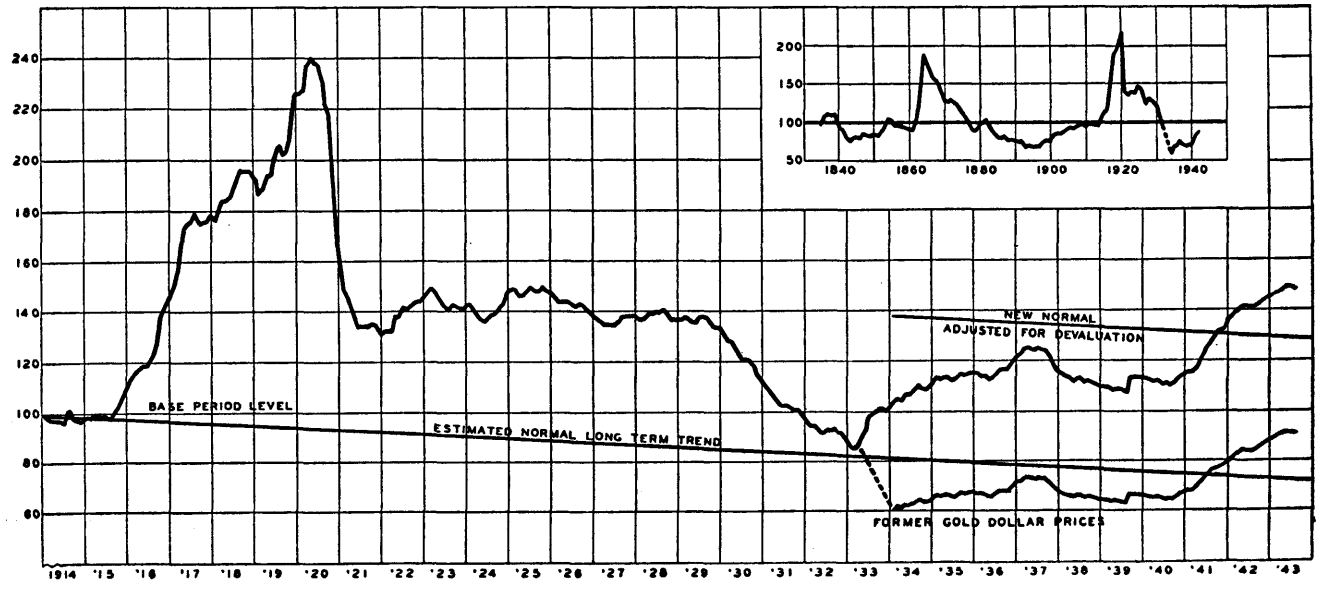
INDUSTRIAL PRODUCTION



HARWOOD INDEX OF INFLATION



COMMODITY PRICES



less than that followed a year ago. Nevertheless, it is inevitable that the steady gains in income payments that have been reported during nearly the entire war period will be halted when industrial employment becomes stabilized. When industrial pay rolls no longer continue to increase in size, consumer demand in the retail markets will no doubt be adversely affected. This influence will be important only if wage and salary earners continue to hoard a substantial portion of their increased incomes in the form of cash and checking-account balances.

Commodity Prices

The combined wholesale commodity price index, compiled by the United States Bureau of Labor Statistics, experienced a decline during the second half of June and during the first two weeks of July. This was the first decrease recorded since June 1942 The preliminary index for July was 147.6, only slightly lower than the revised index for June of 147.7. However, the revised June index was one full point lower than the index of 148.7 for May.

The index, which is shown in chart form on page 119, is a weighted average of nearly 900 commodities, adjusted so that the 1913 monthly average = 100 (also shown on the former gold basis since January 1934, when the dollar was devalued). The estimated normal long-term trend line and the new normal long-term trend line, adjusted for devaluation, are features of the chart. The chart in the upper right-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 declines in the combined wholesale commodity price index during the past few weeks were primarily attributable to decreases in the cost of farm products and foods. Average prices of other groups either remained unchanged or changed only fractionally. The farm products and food items that have recently recorded declines were in the foreground of the price advance during the past year, and, in spite of the moderate setback, the farm products index advanced 20 per cent during the past twelve months and the food index, eight per cent; whereas, the combined index has advanced four per cent during this period.

The accompanying table shows changes that have occurred in the major classifications of the wholesale commodity price indexes and in the combined index of all commodities. The July 1943 preliminary indexes are compared with the revised indexes for earlier significant periods.

The sensitive wholesale commodity price indexes were about unchanged last week. Moody's Spot Commodity Price Index was 244.1 on July 15 and was at the same level on July 22. The Dow-Jones Index of Commodity Futures closed at 92.87 on July 15 and at 92.99 on July 22.

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

	July 1929	*July 1932*	*July 1942*	*June 1943*	*July* 1943*
Farm Products	150.5	67.0	147.3	177.6	176.2
Foods	160.3	94.9	154.5	169.0	167.1
Hides and Leather	160.3	100.7	173.6	173.9	173.9
Textile Products	156.4	92.0	169.5	169.1	169.1
Fuel and Light	135.9	118.0	128.9	132.8	133.0
Metals and Products	111.2	87.2	114.3	114.4	114.3
Building Materials	167.8	123.0	194.5	194.7	194.9
Chemicals	125.8	100.7	120.6	124.9	124.8
House Furnishings	167.5	131.5	182.6	185.3	185.3
Miscellaneous	118.6	92.1	128.7	131.4	131.2
Raw Materials	144.0	79.5	145.5	166.3	165.7
Semimanufactures	124.7	74.1	123.9	123.9	123.8
Manufactured Products	137.7	101.6	142.1	143.9	143.5
All Commodities	138.2	92.4	141.4	147.7	147.6

* Preliminary Estimate.

FINANCE

New Capital Issues

The volume of new capital issues of corporate securities during June this year aggregated $30,000,000. This was about the same as the preceding months' total of $29,000,000, but was much smaller than the aggregate of $77,000,000 issued during June 1942. Nearly all of the new capital issues last month represented borrowings by industrial concerns. Both the railroads and the public utilities entered the market for new securities but each group sought slightly less than $1,000,000. The $150,000,000 borrowed during the first half of the year was divided as follows: 20 per cent by the railroads; nine per cent by the public utilities; and 71 per cent by industrial companies.

New corporate financing in June and in the first six months of each year during the past seventeen years is shown in the accompanying summary.

New Corporate Financing in the United States

Year	*June* (*In millions of dollars*)	*First Six Months*	*Year*	*June* (*In millions of dollars*)	*First Six Months*
1926	273	2,471	1935	14	101
1927	520	2,760	1936	152	458
1928	582	2,685	1937	276	829
1929	553	3,771	1938	202	362
1930	441	3,521	1939	31	218
1931	131	1,307	1940	10	270
1932	4	160	1941	91	380
1933	12	60	1942	77	484
1934	9	99	1943	30	150

Source: *Commercial and Financial Chronicle.*

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

Statistical Summary; Production, Purchasing Media, and Prices

	1942						1943						
	July	*Aug.*	*Sept.*	*Oct.*	*Nov.*	*Dec.*	*Jan.*	*Feb.*	*Mar.*	*Apr.*	*May*	*June*	*July**
Index of Industrial Production.	159.3	161.8	167.0	170.4	173.7	176.2	177.5	180.2	179.9	180.6	180.3	179.0	179.5
Index of Inflation (Ratio Form)	125.1	130.8	133.6	140.7	143.5	142.7	154.2	156.1	154.7	147.2	165.3	161.2	168.1
Commodity Price Index.....	141.4	142.1	142.3	142.8	143.4	144.4	145.7	146.7	147.9	148.1	148.7	147.7	147.6
Commodity Price Index..... (In terms of former gold dollar)	83.7	84.1	84.2	84.5	84.9	85.4	86.2	86.8	87.5	87.6	88.0	87.4	87.3

*Preliminary Estimate.