

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Major Economic Influences to Observe

It is the primary responsibility of economic advisers to analyze the factors determining the Nation's fundamental condition and to appraise as far as possible how these factors will affect our lives during the future. It will be especially essential to weigh the effects of developments during the critical months ahead on our mode of life in the postwar period. The following is a brief outline of the economic influences that we believe it is most important to watch at the present time.

1. The duration of the war is a consideration of paramount importance at the present time. The more prolonged is the conflict, the greater will be the damage inflicted on our economic mechanism. During a long war, the personnel required for the armed forces and for the maintenance of supply must adapt themselves to existences that are under ordinary circumstances viewed as undesirable. When this work force constitutes a preponderant segment of the population, as it does at present, problems incident to reorientation after the war will be grave. The end of the war in both major theaters may come without adequate warning, but at least we may observe the symptoms of disintegration that are now evident in Germany in order to form a judgment concerning the differences in opinion expressed by high-placed officials.

2. Money-credit trends are probably second only to the progress of the war as a potential influence on the Nation's future. We can measure the degree of inflation that now exists, and, as the chart on page 139 shows, we know it to be formidable. Much of the inflationary purchasing media now available to the public is being hoarded in the form of currency or checking-account deposits. Presumably, a dehoarding movement will start after the war is over, if it does not develop before that time. Its effects on the price structure can be determined only after it starts. However, there are indicators that may give forewarning of a large-scale movement, such as are available in our charts showing currency in circulation and hoarded currency and bank debits (which show the activity of checking-account deposits) that are presented from time to time in the Research Report bulletins.

3. The trend of political thought in the United States during the coming year will be of primary importance in its effect on the Nation's future. During the past decade, the Administration has maintained itself

in power through the encouragement of class conflict. It has taught its supporters that the Government can create wealth by the simple method of creating new purchasing media. It has also supported the thesis that holders of more property than the Government considers reasonable can be deprived of their holdings without threatening destruction to the property of the thrifty middle class that has provided the driving force for the creation of the United States as we know it. There are now signs of an increase in skepticism regarding New Deal theories. The strength of this trend will be revealed as the Presidential campaign develops between now and the fall of 1944.

4. The relation of the United States with the rest of the world during coming years may be of greater consequence to us than at any other time in the Nation's history. It is unfortunate that we have given the peoples of many foreign lands the idea that the United States can and will relieve them of their economic burdens. Ultimately, they must learn that this is not so, and in consequence we are likely to incur their enmity. There are today advocates of international relations that envisage the exchange of goods on a natural basis of reciprocal advantage. The Government's attitude towards world affairs will be watched with keen interest as peace problems are substituted for those of war.

How these influences will be exerted during the next few years cannot be wholly determined now but will gradually be revealed to the informed observer so that he may arrange his affairs to take advantage of the new circumstances that are developing.

THE FUNDAMENTALS

Industrial Production

Preliminary data indicate that industrial output of war materials during the first three weeks of August increased slightly from the July level, although there was some contraction in the volume of output of the consumer goods industries. The Institute's preliminary index of industrial production for August is 179.0, about the same as the revised index of 179.2 for July.

The Institute's index of industrial production is adjusted for long-term trend as well as for seasonal variations. The bar diagram in the lower left-hand corner of the industrial production chart on page 139 shows the volume of industrial production (not adjusted) for significant periods from 1900 to date. The physical volume of goods now being produced is

shown to be substantially greater than it has been at any other time in the Nation's history. The Institute's production index, adjusted for long-term trend, also shows that the present rate of manufacturing activity is substantially higher than the peak levels reached either in the first World War or in the New Era boom culminating in 1929.

The Federal Reserve index of industrial production, from which the Institute's index is calculated, is based on the combined data for eighty-three separate industries. Of these, twenty are classified as durable manufactures, virtually all of which are now primarily devoted to the production of war materials. The Federal Reserve index of durable manufactures has advanced about 45 per cent since we entered the war in December 1941, whereas the nondurable goods index is at about the same level that existed at the time of Japan's attack on Pearl Harbor.

In commenting on the current rate of production of war materials, the official publication of the United States Department of Commerce expressed dissatisfaction with the situation. It was pointed out that industrial production gained only about four per cent during the first seven months of this year, whereas a gain of seven per cent was recorded during the comparable period a year ago "notwithstanding the slowing down due to industrial conversion to war." However, Government officials should realize that the process of expansion in any nation's manufacturing plants cannot be continued indefinitely at a high rate. In fact, a program that contemplated a continuation of industrial expansion typical of that needed during the early phase of the war would probably lead to serious losses in efficiency and, in the long run, to losses in the quantity and quality of desired war materials.

The steel-ingot production rate remained unchanged last week at 98½ per cent of theoretical capacity. Gains in activity reported from the Chicago and Cincinnati areas were offset by a moderate decline in operations in the Pittsburgh region. *The Iron Age* stated: "While raw materials have for the most part at least leveled out to permit production efficiency, the father draft is expected to leave many holes in the industrial personnel picture. Many key men have already been drafted and more are expected to go within the next six months. So far in the steel industry production has been maintained at record levels without being unduly influenced by labor shortages. The tank program is sinking towards the lowest ebb it has known since it moved into volume levels a year or so ago. Indications are that as soon as present contracts run out there will be only three plants manufacturing medium tanks against nine earlier."

	1929	1932	1937	1938	1942	1943
Per Cent of Capacity	89.0	13.0	84.0	44.0	97.5	98.5

(Latest 1943 weekly data; corresponding week earlier years)

Last week, there was a small decrease in electric-power production from the total reported in the preceding week. The Southern States area was the only one in which there was an improvement in the trend. Output for the entire country was 16.1 per cent larger than it was during the corresponding week of 1942, compared with a gain of 17.3 per cent recorded in the previous week.

	1929	1932	1937	1938	1942	1943
Billion Kilowatt-Hours	1.68	1.47	2.32	2.15	3.67	4.26

Lumber production decreased moderately last week, and the seasonally adjusted index declined from 113.5 in the preceding week to 112.4. The volume of new orders received during the week again exceeded the figures for both production and shipments.

	1929	1932	1937	1938	1942	1943
New York Times Index	130.2	35.1	81.8	75.7	120.8	112.4

The Harwood Index of Inflation

The revised Index of Inflation (ratio form) for July at 170.7 was about two and a half points higher than the preliminary Index of 168.1. The preliminary Index for August was 170.8, approximately the same as the revised Index for July. The August preliminary Index was based on data as of August 18, and the revised Index, as of the end of the month, will probably be higher.

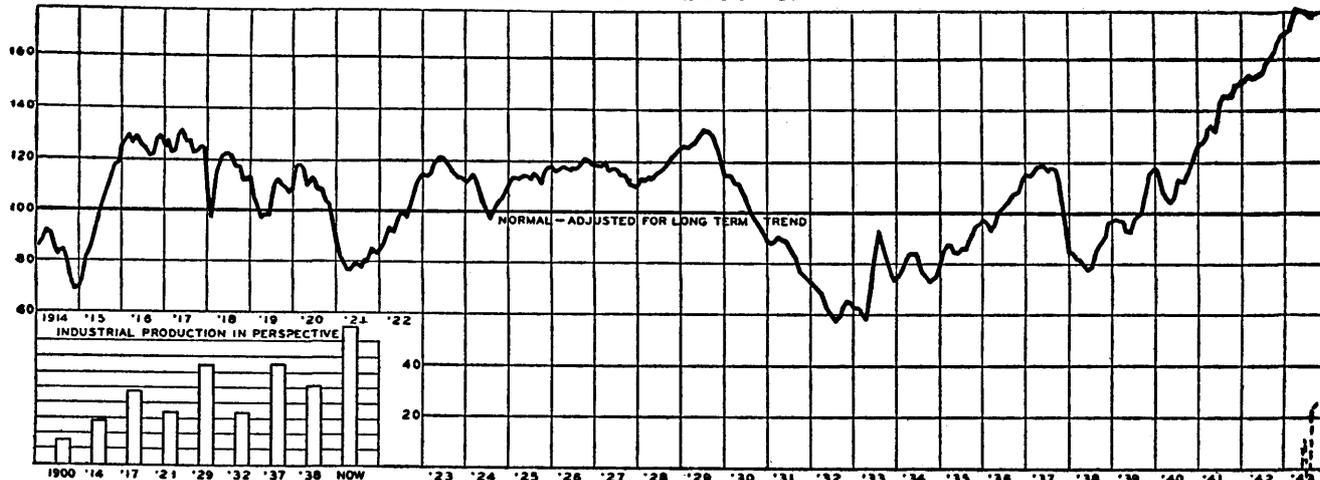
During the first three weeks of August, the commercial banks' holdings of Government securities remained substantially unchanged. The fractional increase in the Index was caused by a decrease of \$400,000,000 in Treasury bank balances. Treasury accounts are drawn on when Government disbursements exceed receipts, and this process resulted in the distribution of purchasing media to the public.

The Harwood Index of Inflation is primarily a means of measuring the quantity of inflationary purchasing media available to the public. Inflation is defined as the condition arising when the banks or other agencies, such as the Treasury printing press, create purchasing media in excess of those required to represent goods produced that are currently coming to market. The chart on page 140 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 broken line on the same chart shows the absolute data, which are the inflationary purchasing media totals. (The scale for the ratio form is at the left of the chart, and the scale in billions of dollars for inflationary purchasing media is at the right.)

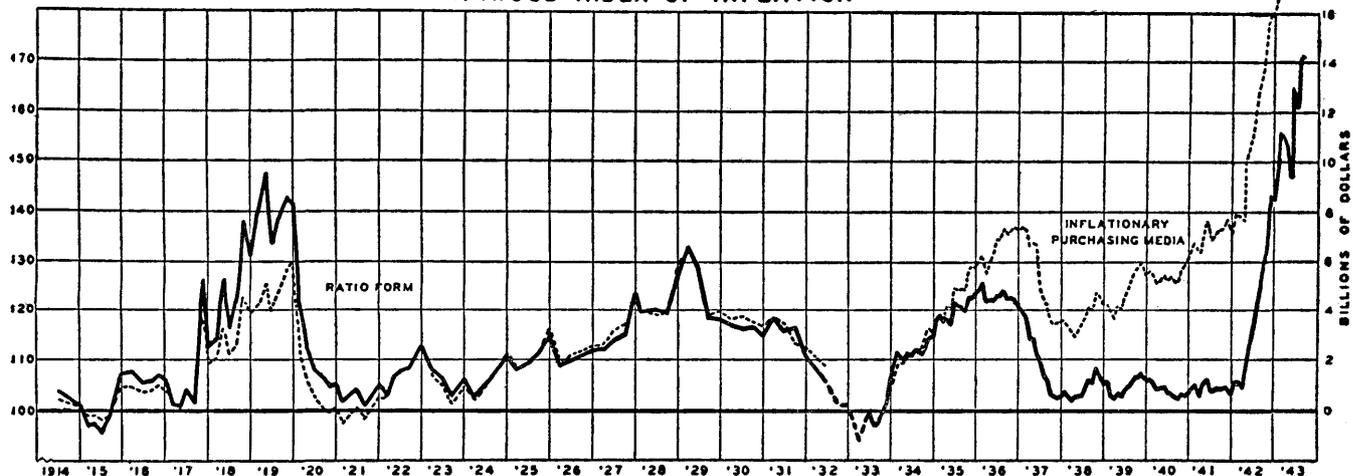
As the chart on page 140 shows, the absolute amount of inflationary purchasing media now far exceeds that available to the public at any time during the past three decades. Furthermore, the proportion of inflationary purchasing media to the total is greater than it has been at any time during the period shown. The chart below shows the two curves, the ratio form and the inflationary purchasing media (absolute data) since June 1933, together with the curve of industrial production.

During the first two years of the second World War, the upward trend of industrial production preceded the upward movement of the Inflation Index. Increased demand was made possible in advance of the emission of inflationary credit purchasing media by the great volume of gold imports that was sent here by England (and to a lesser degree by France) in exchange for our supplies. The flow of new purchasing media from this source was halted as soon as Lend-Lease credit was made available to the United Nations. The credit creations required to finance the subsequent huge volume of industrial production, much of which has been shipped out of the country, were reflected in the sharp upward movements of the two money-credit curves during 1942. More recently, the Government has withdrawn purchasing media from the public by way of heavier taxation and War Loan drives. These

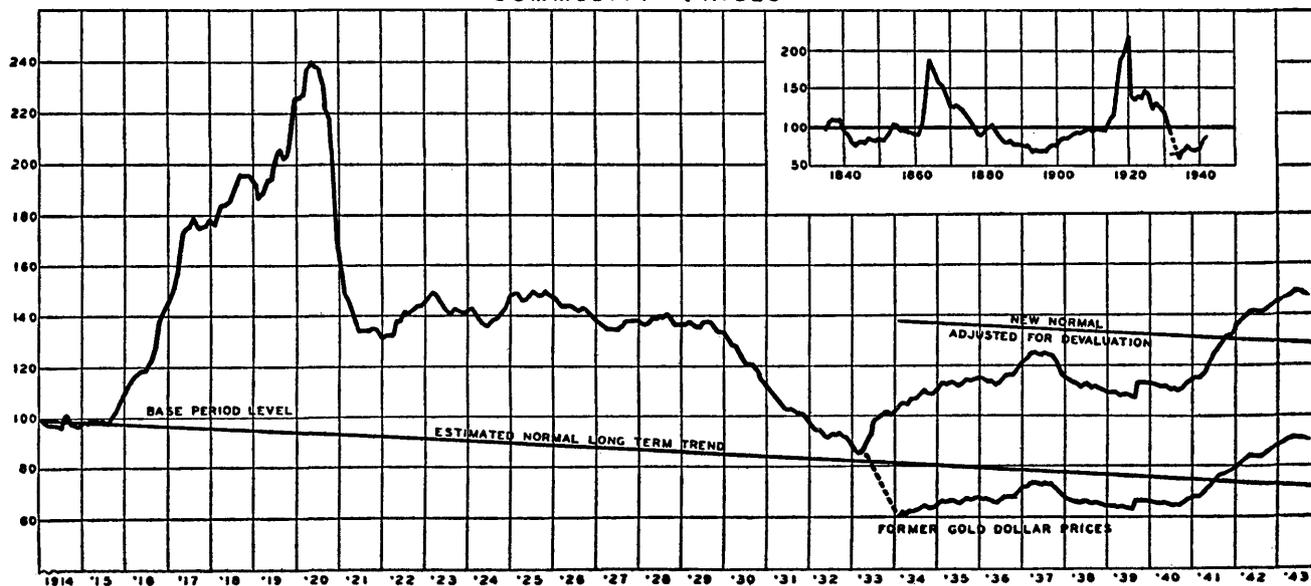
INDUSTRIAL PRODUCTION



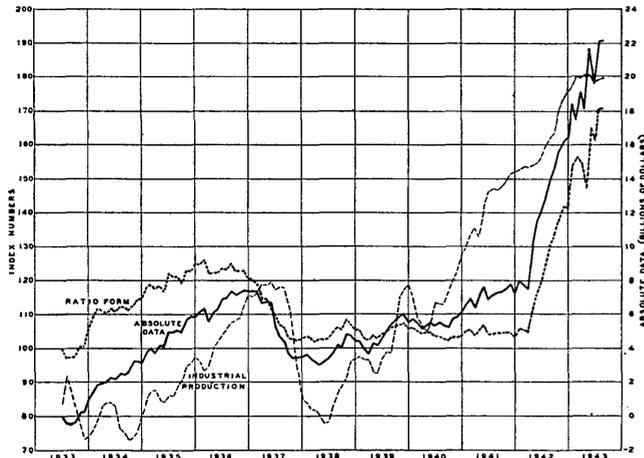
HARWOOD INDEX OF INFLATION



COMMODITY PRICES



HARWOOD INDEX OF INFLATION, RATIO FORM, ABSOLUTE DATA, AND INDUSTRIAL PRODUCTION



factors have resulted in the recent irregular movements in the money-credit curves that can be observed in the chart. It is also interesting to notice that the expansion in industrial production that continued with only minor reversals from the spring of 1940 until early this year has failed to make further progress during the past few months.

Other Demand Factors

The dollar volume of department-store sales last week was 15 per cent larger than it was in the corresponding week of 1942, according to reports made by the Federal Reserve System. A study of sales at wholesale, just completed by the United States Bureau of Foreign and Domestic Commerce, shows that during 1941 the trend of sales by wholesalers was more steeply upward than the trend of sales of retail establishments, indicating the accumulation of inventories by retail merchants. During the past year and a half, retail sales have increased more extensively than have sales by wholesalers, and the stocks on the shelves of retail merchants have been reduced.

Commodity Prices

The United States Bureau of Labor Statistics' combined index of commodity prices changed only fractionally last month. The index was 147.4 per cent of the 1913 monthly average in July and was 147.1 per cent (preliminary) in August. Wholesale prices have been stabilized for about three months according to the official figures. As the chart on page 139 shows, the wholesale price index has advanced with only minor interruptions since the summer of 1940. A temporary

reaction in an upward movement so extensive would not be surprising under any circumstances.

At a time when the wholesale commodity price average is at least temporarily stabilized, it seems appropriate to observe the situation with respect to the price level prevailing in preceding periods. The present level is somewhat higher than that existing during the period 1921-1929 after the first World War price advance had been partially liquidated. However, the current level is substantially higher in relation to the long-term trend line shown in the chart on page 139 than it was during the decade of the 1920's, and it has advanced substantially beyond the new normal line adjusted for devaluation. It is therefore apparent that the consumer has lost his advantage of lower prices gained during the past two decades through the improvement of manufacturing technique resulting in savings in production costs. Price changes have not been uniform in the various price groups, but nearly all are higher than they were in 1929.

The accompanying table shows changes that have occurred in the major classifications of the index. The August 1943 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)

	Aug. 1929	Aug. 1932	Aug. 1942	July 1943	Aug.* 1943
Farm Products	150.4	68.7	148.4	174.5	171.9
Foods	161.2	96.3	157.0	165.9	163.7
Hides and Leather	160.8	102.4	173.6	173.9	173.9
Textile Products	156.7	94.2	169.8	169.1	169.1
Fuel and Light	134.0	117.6	128.9	133.3	133.3
Metals and Products	110.6	88.2	114.3	114.3	114.3
Building Materials	167.9	122.7	194.5	195.2	197.7
Chemicals	125.8	100.1	120.0	124.8	124.9
House Furnishings	167.5	130.7	182.4	185.3	185.1
Miscellaneous	118.6	92.6	127.4	132.4	132.4
Raw Materials	144.1	81.0	147.1	164.7	163.2
Semimanufactures	124.9	77.3	123.8	123.8	123.9
Manufactured Products	137.1	101.9	142.5	143.8	144.1
All Commodities	137.9	93.4	142.1	147.4	147.1

* Preliminary Estimate.

Last month, important changes in the separate classifications shown in the table were confined to the farm products and foods groups, the indexes for both of which declined. Among the three economic classes, raw materials, semimanufactures, and finished goods, the first declined about two per cent; the second remained about unchanged; and the last advanced fractionally.

The sensitive wholesale commodity price indexes were firmer last week than they have been in recent earlier sessions. Moody's Spot Commodity Price Index was 225.2 on August 19 and 246.3 on August 26. The Dow-Jones Index of Commodity Futures closed at 92.55 on August 19 and at 93.04 on August 26.

Statistical Summary; Production, Purchasing Media, and Prices

	1942					1943							
	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.*
Index of Industrial Production.	161.8	167.0	170.4	173.7	176.2	177.5	180.2	179.9	180.6	180.3	178.2	179.2	179.0
Index of Inflation (Ratio Form)	130.8	133.6	140.7	143.5	142.7	154.2	156.1	154.7	147.2	165.3	161.2	170.7	170.8
Commodity Price Index.....	142.1	142.3	142.8	143.4	144.4	145.7	146.7	147.9	148.1	148.7	147.7	147.4	147.1
Commodity Price Index.....	84.1	84.2	84.5	84.9	85.4	86.2	86.8	87.5	87.6	88.0	87.4	87.2	87.0

(In terms of former gold dollar)

*Preliminary Estimate.