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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Stock Market and the War

The issues that were most heavily sold in last week's stock-market decline were those of companies believed to have benefited from war orders, and the selling wave was clearly defined as a peace panic. Symptomatic of the attitude of speculators and investors was the story circulated in financial circles last Monday that the Nazis had already capitulated but that the news was being withheld. Last week's episode indicates that many security holders, especially those having speculative commitments, cherish convictions that may be erroneous.

The first set of convictions appear to include the belief that (1) the war in Europe will come to a sudden end, probably in the near future and that (2) news of the break up in Germany will be withheld by those in authority as long as possible. Such opinions as to future developments are not entirely fanciful. The disintegration of the Kaiser's empire was clearly observable months before the final surrender occurred, but the Armistice came while the Allied Governments were preparing for, as well as warning of, severe struggles to come. There are now clear evidences of disintegration within the Reich. The existence of these is admitted by responsible British and United States leaders, but we are warned against placing too much reliance on them. The fact that the news of Italy's withdrawal from the present conflict was held secret for a time lends plausibility to rumors that a similar situation may exist with respect to Germany.

The most widely held and basic conviction in the minds of most investors and speculators is that the end of the war in Europe will be disastrous to the earning power of leading corporations. It is held that only a fraction of the present huge volume of war orders will be needed to prosecute the war against Japan. Consequently, most of the orders on the books of the large companies, whose securities form the most important part of the Nation's investment media, will be canceled and profits will cease. This argument is not unreasonable. A substantial decrease in industrial activity will probably follow the end of major hostilities in Europe; however, there are grounds for believing that the slump will have a short duration.

The leading American corporations have grown to their present size because they have been capably managed and because they provide products that are essential to our mode of living. They have achieved an extra-

ordinary record in turning their capacities to war work. The same characteristics that made this possible should insure a successful transition to peacetime activities.

The railroad, oil, machinery, and chemical industries, to mention specific examples, are certain to benefit from the prosperity and future growth of our economy. They are playing an essential part in time of war, as a matter of course, and they will likewise participate in meeting the active consumer demand that is virtually certain to develop when peace is restored. For example, the leading automotive manufacturers are doing a tremendous war business, but there is every reason to believe that the demand for their peacetime products will be substantially as great, at least for some time to come.

There are industries, such as the aircraft manufacturing and the shipbuilding, that will certainly experience greatly decreased demand after the war. A review of the companies listed on the New York Stock Exchange indicates that these are relatively few. On the other hand, there are industries, such as the food-processing companies, that will probably benefit by the return of peace when supplies will become more ample and when Government-imposed restrictions will gradually be removed.

Of course, the volume of business obtained by manufacturing companies is normally the major determinant of their opportunity for profit, and their earnings are in turn the primary factor that establishes their value in the market. There are other considerations that are influential in determining security prices, especially at the present time. Earnings available for dividend distributions have been limited by heavy war taxes, and the freedom of management has been curtailed by numerous Government restrictions on both corporate policies and manufacturing operations.

Taxes will probably remain heavy after the war, but there is at least a good chance that corporate tax rates will be somewhat reduced when the Government is no longer forced to supply two theaters of military operation. The public is accepting close Government control over private industry as a wartime necessity but may not support such a policy when the need for it is no longer apparent.

BUSINESS

The Trend of Commercial Failures

There was an increase during October in both the number and the liabilities involved in commercial

failures compared with those in September. Nevertheless, the liabilities were only about half of the total recorded in October 1942, and the number was only a quarter as large as the number reported in the corresponding month last year. On the whole, failures this year have been almost negligible in seriousness in comparison with those normally experienced in the past. The trend of the record of failures has been downward during the war period. The monthly average of the number of commercial failures in 1939 was four times as great as the monthly average for the first ten months of 1943, and the difference in liabilities involved was nearly as great.

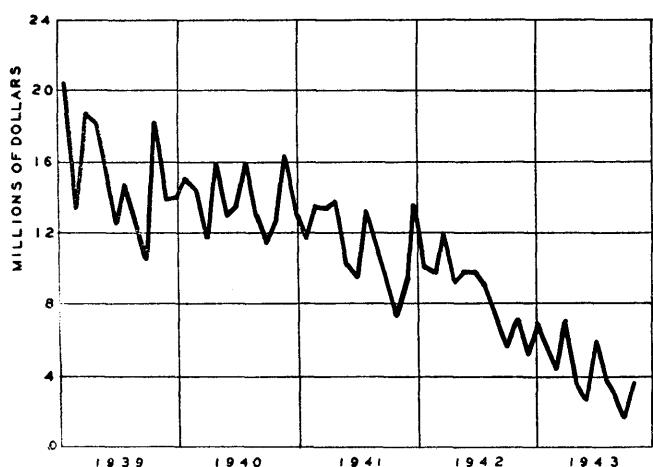
Last month's increase in the number and liabilities of commercial failures was substantial only because the figures for September were so small and probably does not indicate a change in the favorable downward trend followed by the series during the past few years. Nevertheless, further decreases from the recent levels cannot be expected because failures have been reduced close to the vanishing point.

The revised statistical series compiled by Dun & Bradstreet include, in addition to voluntary and involuntary bankruptcies, long-term discontinuance with a loss to creditors and statistics of concerns forced out of business through such action as foreclosure, attachment, or execution with insufficient assets to cover all claims. The number and liabilities of commercial failures for each month of the past two years and during the first ten months of 1943 are shown in the accompanying table.

COMMERCIAL FAILURES, NUMBER AND LIABILITY

	Number of Failures			Liabilities of Failures (000 omitted)		
	1941	1942	1943	1941	1942	1943
January	1,124	962	458	\$11,888	\$9,916	\$5,515
February	1,129	916	422	13,483	9,631	4,163
March	1,211	1,048	410	13,444	12,011	7,282
April	1,149	938	362	13,827	9,282	3,523
May	1,119	955	281	10,065	9,839	2,550
June	970	804	265	9,449	9,906	6,076
July	908	764	203	13,422	8,598	3,595
August	954	698	227	11,134	6,786	2,905
September	735	556	124	9,393	5,473	1,488
October	809	673	169	7,933	7,181	3,785
November	842	585		9,197	5,245	
December	898	506		13,469	6,960	
	11,848	9,405		\$136,104	\$100,818	

LIABILITIES OF COMMERCIAL FAILURES



The liabilities involved in commercial insolvencies afford a more significant indicator than do the number of failures. We are therefore showing the chart of the liabilities in millions of dollars each month for years that include the war period. Although there are rather wide month-to-month fluctuations, the general trend can be observed.

The Trend of Machine-Tool Output and All Industrial Output

Companies producing machine tools were one of the earliest groups of industries to receive large orders for carrying out the war program. When the United States started its rearmament program and during the first year of our participation in the hostilities, there seemed to be no limit to the demands made on these companies. However, during the winter of 1942-1943, the upward trend in the industry's production record that had proceeded with virtually no interruption throughout the war period beginning in September 1939 showed signs of leveling off.

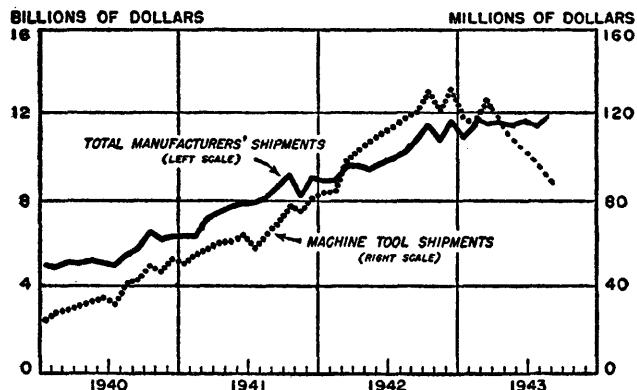
During the years 1940-1942, the accumulation of machine tools that were constructed at that time was providing the basis for the great wartime expansion in the creation of the offensive weapons that are now playing a vital part in bringing the war to a successful conclusion. Early this year, American industry had apparently completed its producers goods program for meeting wartime requirements. Old establishments had been reequipped, and new establishments were completed. Probably the Army and Navy procurement programs had become fairly well defined. The experimental stage, during which many varieties of war materials were being developed, was substantially at an end. Therefore, a falling off in the demand for machine tools might be expected.

The chart on page 183 shows the trend of machine-tool shipments and the trend of all industrial shipments during the war period. During the first three years covered by the chart the upward trend of machine-tool output available for delivery proceeded at a higher rate than was achieved by aggregate industrial production. The curve of machine-tool shipments reached its highest point in December 1942, and, although there were heavy shipments in March 1943, the general trend this year has been downward. Since March, the month-to-month decline has been consistent and has proceeded at a somewhat steeper rate than was experienced during the advance.

The upward trend in the curve showing total manufacturers' shipments began to level off at about the same time as did the curve of machine-tool shipments; but, whereas the latter has followed a distinctly downward course this year, the former has fluctuated within a narrow range and, according to the most recent data available, is now higher than the average for this year.

The activity of the machine-tool industry has for many years been observed for the purpose of forecasting the general rate of industrial activity. Before the war, the Institute's Research Division made a special survey of data representing industrial trends in order to select statistical series that would point the way to future major economic changes. The series representing machine-tool orders was then available over an extended period of years, and it was found that an increase in these orders was frequently followed by expansion in

TREND OF MACHINE-TOOL AND ALL INDUSTRIAL OUTPUT



the volume of general industrial production. Data are no longer available showing the volume of machine-tool orders, but the figures for machine-tool shipments have a similar significance, except that changes in the trend are not revealed so promptly.

The downward trend now observable in the curve of machine-tool shipments probably forecasts a downward trend in total manufacturers' shipments that will occur after the cessation of major hostilities in Europe. This is of course to be expected, but how extensive will be the decline before it is arrested by the resumption of demand for civilian production is an important consideration to be determined.

If the present downward trend in machine-tool shipments is arrested during the next few months, it can be assumed with a reasonable degree of confidence that the general downturn of economic activity in the country will not have an extensive duration. We believe that it is advisable to observe the month-to-month changes in machine-tool shipments in order to take advantage of any information that may be useful in shaping plans for the postwar period.

THE FUNDAMENTALS

Supply

There was a decrease in the steel-ingot production rate last week from 99½ to 99 per cent of theoretical capacity. The reduction in operations was a direct result of the general coal-mine strike. Although this labor dispute appears to be settled, the reduction of fuel supplies that it occasioned is not expected to be retrieved while demand for steel remains as urgent as it is at present. It was reported that the coal strike affected the steel-scrap situation adversely. Pig-iron production was reduced and steel companies were forced to use steel scrap that was available to replace deficiencies in the supply of pig iron. However, steel-company executives expressed the opinion that steel-scrap supplies for the winter months will suffice to maintain the current steel production rate, unless heavy snowfalls interfere with transportation.

	1929	1932	1937	1938	1942	1943
Per Cent of Capacity	73.0	19.0	37.0	62.5	99.5	99.0

(Latest 1943 weekly data; corresponding week earlier years)

Although there were gains in the volume of electric-power production in the West and South regions of the country, these were more than offset by decreases in output in the New England, Middle Atlantic, and Cen-

tral Industrial States. The net result was a less favorable comparison between total current production with all output in the corresponding week of 1942. The gain was 17.3 per cent, compared with an increase of 18 per cent reported in the preceding week.

	1929	1932	1937	1938	1942	1943
Billion Kilowatt-Hours	1.79	1.52	2.18	2.21	3.76	4.41

Lumber operations were curtailed more than seasonally last week, and the adjusted index declined from 107.1 per cent of the 1935-1939 monthly average in the preceding week to 104.7 per cent. Demand for some types of hardwood now seems to be decreasing, as indicated by figures published by the United States Department of Commerce that show a smaller volume of orders unfilled at the end of the month than was reported a year ago. On the other hand, demand remains urgent for soft woods, and the volume of orders unfilled at the end of the month for the latest period shown is at a higher level than that of a year ago.

	1929	1932	1937	1938	1942	1943
New York Times Index	127.2	36.7	65.7	65.8	120.7	104.7

Demand

Developments in Europe during the next few months will probably have an important effect on civilian demand in this country's retail markets. If the United States forces participate in an onslaught against the northern bastions of Hitler's Europe, such an event will absorb the people's interest. War Bond sales will be greatly increased, and the public will be less inclined to indulge in personal extravagances. On the other hand, if there is an internal collapse in Germany that indicates the conclusion of major hostilities in the European war theater, the public may celebrate with a buying spree. Industrial pay rolls will not immediately be cut severely, and more people have liquid funds today than they have ever before had in the country's history. The second situation might well result in breaking through the restraints that have so far held the inflationary progression to a relatively moderate pace.

Prices

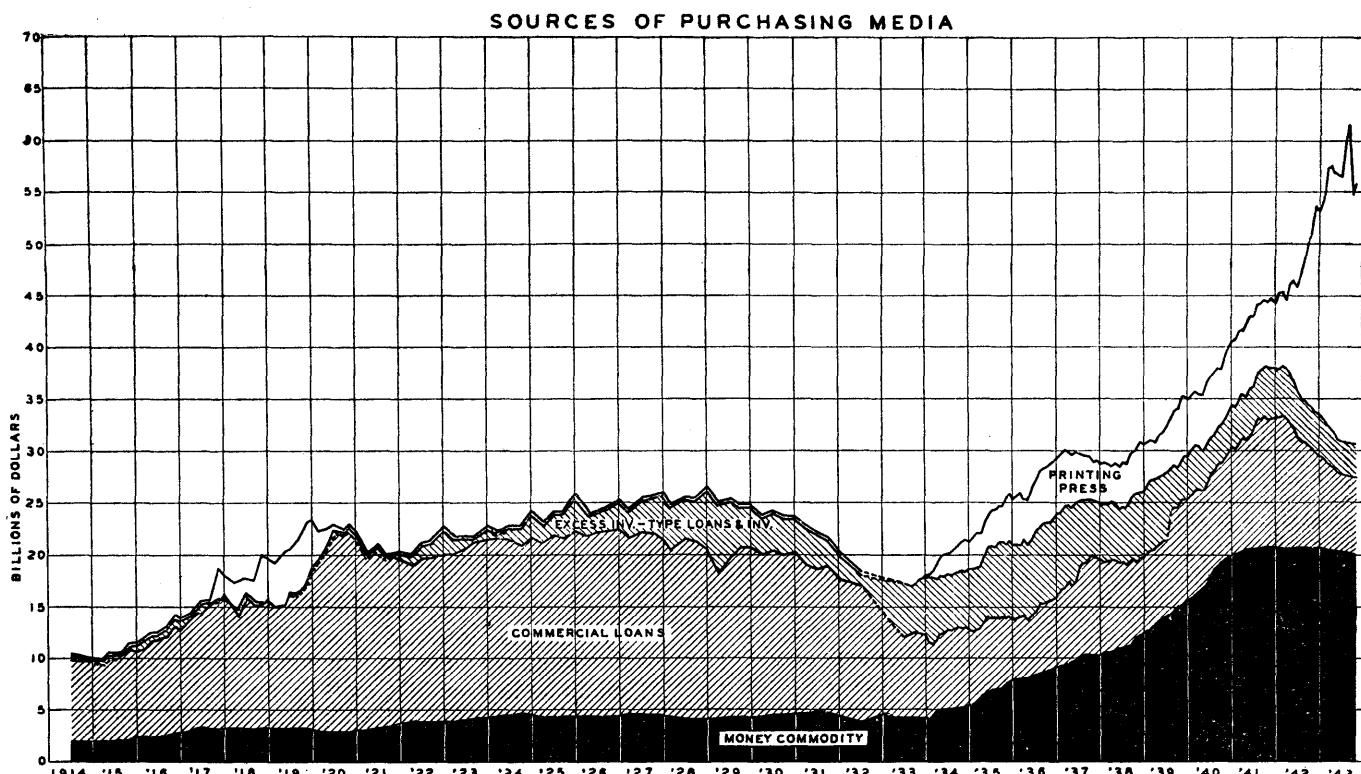
Since the middle of October, spot commodity prices have followed a downward trend that was accelerated during the first ten days of November. On the other hand, prices in the futures market have remained generally firm, and average losses for the past month have been slight. Moody's Spot Commodity Price Index was 244.3 on November 4 and 243.0 on November 10. The Dow-Jones Index of Commodity Futures closed at 93.94 on November 4 and at 93.78 on November 10.

FINANCE

Sources of Purchasing Media

There was an increase in purchasing media available to the public last month, but it was relatively small in comparison with the decrease that occurred in September as a consequence of the Third War Loan drive. Purchasing media available to the public consist of currency in circulation plus checking-account deposits. The chart at the top of page 184 shows the purchasing media in use during each month of the twenty-nine year period and indicates the sources from which the purchasing media were derived.

The volume of purchasing media from the money-



commodity source was reduced somewhat further last month, following the trend that has generally prevailed this year. The decrease during October was only about \$40,000,000, which is small relative to the Nation's total monetary gold stock of more than \$20,000,000,000. The total decrease since we entered the war has been \$650,000,000. The net gold export has apparently been attributable to the granting of credits to countries sympathetic to the cause of the United Nations or by other employment of the metal as a weapon in the prosecution of the war. Probably gold exports have exceeded the total indicated by the decrease in the Nation's monetary gold stock, because domestic gold production has not entirely stopped, although mining operations have been limited by Government prohibitions.

Purchasing media derived from commercial loans remained about unchanged during October. The type of credit from which these purchasing media originated was augmented to finance the increased manufacturers' inventories representing materials for the armament program in 1941. Soon after we entered the war, this volume of credit was reduced. The Government pursued a policy of insisting on the reduction of inventories that were considerably larger than those carried by corporations during the prewar period and were therefore considered to be excessive. There will probably be no substantial change in the volume of commercial loans under present war conditions, and consequently the purchasing media from this source will represent a minor part of the total. The chart shows that, during the period preceding 1933, purchasing media originated from commercial loans represented the most substantial part of the total.

There was no observable change last month in purchasing media from the third source (credit resulting from the banks' acquirement of investment-type assets

that represent tangible property in excess of the savings available to the banking system). The commercial banks made only minor changes in holdings of securities other than direct Government obligations.

The partial recovery in the curve showing total purchasing media last month was entirely attributable to an increase in purchasing media from the fourth source. The volume of direct Government obligations held by the commercial banks increased about \$1,500,000,000 during the month. The Treasury was able to maintain its bank accounts at a high level during October. There was a budgetary deficit of \$5,400,000,000, which ordinarily would have necessitated substantial reductions in the Treasury's balances with the Federal Reserve Banks or with other depositaries. However, this was avoided by the Treasury through the sale of bills and certificates of indebtedness of approximately the same amount as the month's deficit.

The Government will probably incur large deficits during the next few months, and it is reported that the Treasury does not contemplate any new borrowings until another War Bond drive is undertaken sometime next year. Consequently, the Treasury's bank balances, which are large at the present time, will be drawn upon to meet the excess of expenditures over receipts from taxes and from regular monthly War Bond sales. The volume of purchasing media available to the public will increase and may exceed the level attained in August 1943 before another War Bond campaign again results in replenishing the Treasury's bank balances at the expense of private accounts.

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