AMERICAN INSTITUTE
for ECONOMIC RESEARCH
GREAT BARRINGTON MASSACHUSETTS

WEEKLY
BULLETIN
May 16
1949

# RESEARCH REPORTS

## COMING EFFECTS OF CURRENT EVENTS

### *A Free Gold Market*

In last week's bulletin we mentioned a bill recently introduced in the Senate that would authorize the purchase and sale of gold in any form in the open markets of this country or outlying possessions. Because of the widespread interest in the so-called "free gold market" bill, a brief analysis of it is desirable.[1]

The experiences of the United States and other countries provide clues as to the results that probably would follow establishment of a "free" gold market. The proponents of the bill apparently believe that in a "free" gold market the price of gold eventually would be stabilized at a level determined by the demand-supply factors in the market. In France recently, in the United States during and after the Civil War, and at other times in many places, "free" gold markets for paper currencies divorced from gold have been anything but stable. Inasmuch as the present gold stocks of the Government would be frozen by the terms of the bill, the supply of gold would be limited to that obtained from the country's mines and imports. Demand, on the other hand, might be large in relation to the relatively small supply; consequently, rapidly rising prices for gold accompanied by increasing speculative activity would be a logical expectation for which there is ample precedent.

Speculation in gold initiated by individuals seeking gain might ultimately be pushed to extremes by many more individuals motivated by both the desire for gain and fear. In the recent past the rise that occurred in the prices of commodities appears to have been a more important consideration to the public than the decline in the value of the dollar. Because the dollar is defined in terms of gold, a rise in the price of gold presumably would tend to turn attention to the depreciating dollar. The resulting speculation induced by fear would in effect be a flight from the dollar; that is, the public, fearful that savings invested in bonds, life insurance, and savings deposits would become worthless, would attempt to hoard gold. In the past, similar flights from depreciating currencies have been reflected in the prices of other commodities as well as gold.

*Judging from this aspect of the situation alone, the possibility of a stable "free" market for gold appears to be rather remote. We have concluded that, instead of being a step toward resumption of a full gold standard in this country, as the proponents of the bill claim, a "free" gold market would be a step away from the gold standard and would destroy the degree of stability now provided by the present modified gold standard.*

[1]The basic problem has been somewhat confused by the claim of proponents that the bill would establish a "free" gold market in the sense that a free gold market is part of the complete gold standard. However, the gold standard provides for free availability of gold at the specified gold weight of the dollar on demand of holders of currency or bank deposits. In other words, the gold standard includes free convertibility of all currency into gold but does not provide for a fluctuating definition of the dollar in accordance with the vagaries of speculative markets.

## SUPPLY

### *Industrial Production*

Steel-ingot production, scheduled at 96.2 percent of capacity for the week ended May 14, 1949, was 1 percent less than production in the preceding week but was nearly 5 percent more than that in the corresponding week last year. Output has decreased 6 percent since the all-time high reported for the week ended March 19, 1949.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| Percent of Capacity† | 97 | 25 | 92 | 31 | 94 | 96p |
| Weekly Cap. (Million Tons) | 1.38 | 1.52 | 1.51 | 1.54 | 1.80 | 1.84 |
| Production (Million Tons) | 1.34 | .38 | 1.39 | .48 | 1.69 | 1.77 |

Automobile and truck production during the week ended May 7, 1949, in the United States and Canada was estimated at 128,185 vehicles, compared with a revised total of 136,433 vehicles reported for the previous week. Operations during the past several weeks have been hampered by strikes in many assembly and parts plants. Output is expected to be even less next week, when Ford's branch assembly plants begin to shut down.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| Vehicles (000 omitted)† | 138 | 44 | 140 | 53 | 85 | 128p |

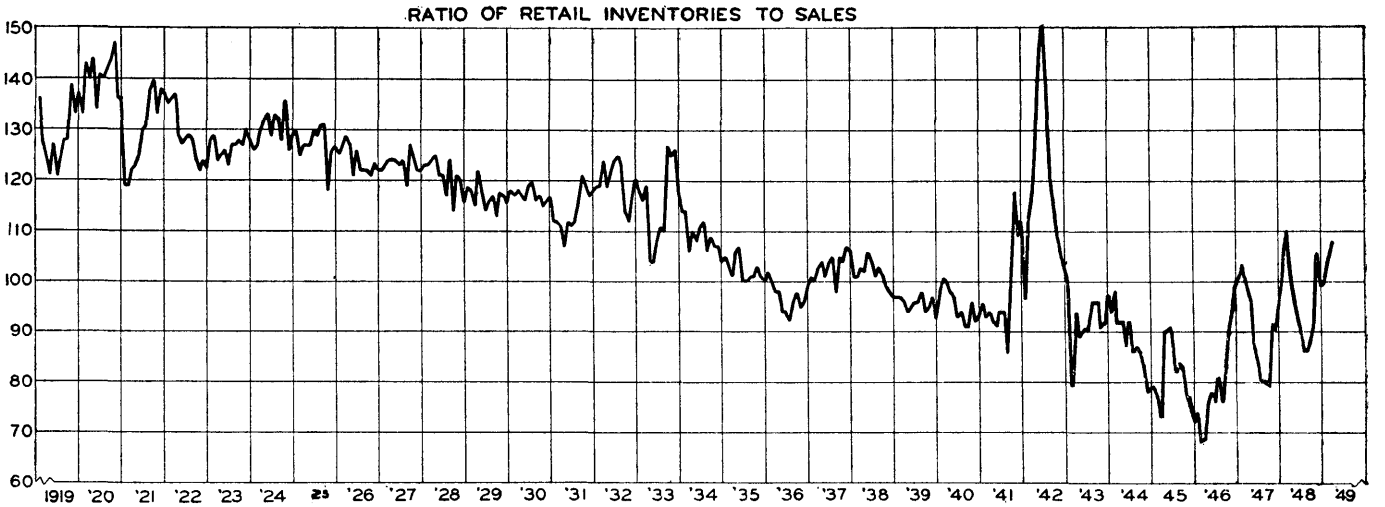
Electric-power production during the week ended May 7, 1949, decreased to 5,283,592,000 kilowatt-hours from 5,303,841,000 kilowatt-hours reported the previous week.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| Billion Kilowatt-Hours† | 1.70 | 1.43 | 2.18 | 1.94 | 5.09 | 5.28 |

Lumber production in the week ended April 30, 1949, decreased less than seasonally. *The New York Times* seasonally adjusted index was 0.3 points above the index for the previous week and was 11.6 points above that reported in the corresponding week last year.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| *The New York Times* Index† | 135 | 41 | 86 | 75 | 81 | 93 |

†Latest weekly data; corresponding weeks of earlier years
p=preliminary




## *Ratio of Retail Inventories to Sales*

The ratio of retail inventories to sales increased 3 percent during March to within 2 percent of the postwar high reached in March 1948[2]. An increase of nearly 2.5 percent in the Federal Reserve Board's seasonally adjusted index of department-store stocks together with a decrease of nearly 1 percent in the index of department-store sales accounted for the 3-percent rise in the March ratio of retail inventories to sales.

A series such as our ratio of retail inventories to sales presents an over-all picture of a significant relationship between total retail stocks and total sales. However, the movement of the over-all ratio is the resultant of many diverging and opposing trends of the inventories and sales of many types of merchandise. In turn, the relationship between inventories and sales of the individual items is influenced by several factors.

In considering the long-term trend of the ratio, readers should remember that stocks were abnormally low during the war years. (The peak reached in mid-1942 was the result of unusual circumstances attributable to World War II. The 34-percent increase in stocks from December 1941 through June 1942, while sales decreased less than 1 percent, resulted from retailers' attempts to accumulate inventories before industry converted to wartime production.) Although a long-term downward trend in the ratio of inventories to sales is indicated on the chart, this trend could not continue indefinitely because of the nature of the ratio. Probably the maximum efficiency in the turn-over of department-store stocks was approached in the late 1930's. Therefore, the extremely low levels reached in 1945 and early 1946 presumably do not represent a continuation of the long-term downward trend that prevailed from 1920 to 1936.

In view of the foregoing, the present ratio of retail inventories to sales should be compared with, say, the average for 1940 in order to judge its relation to a level not affected by unusual circumstances. However, the great change from early 1946 to date does reflect the fact that a substantial part of the great volume of production in the past 3 years has accumulated in the form of retail inventories.

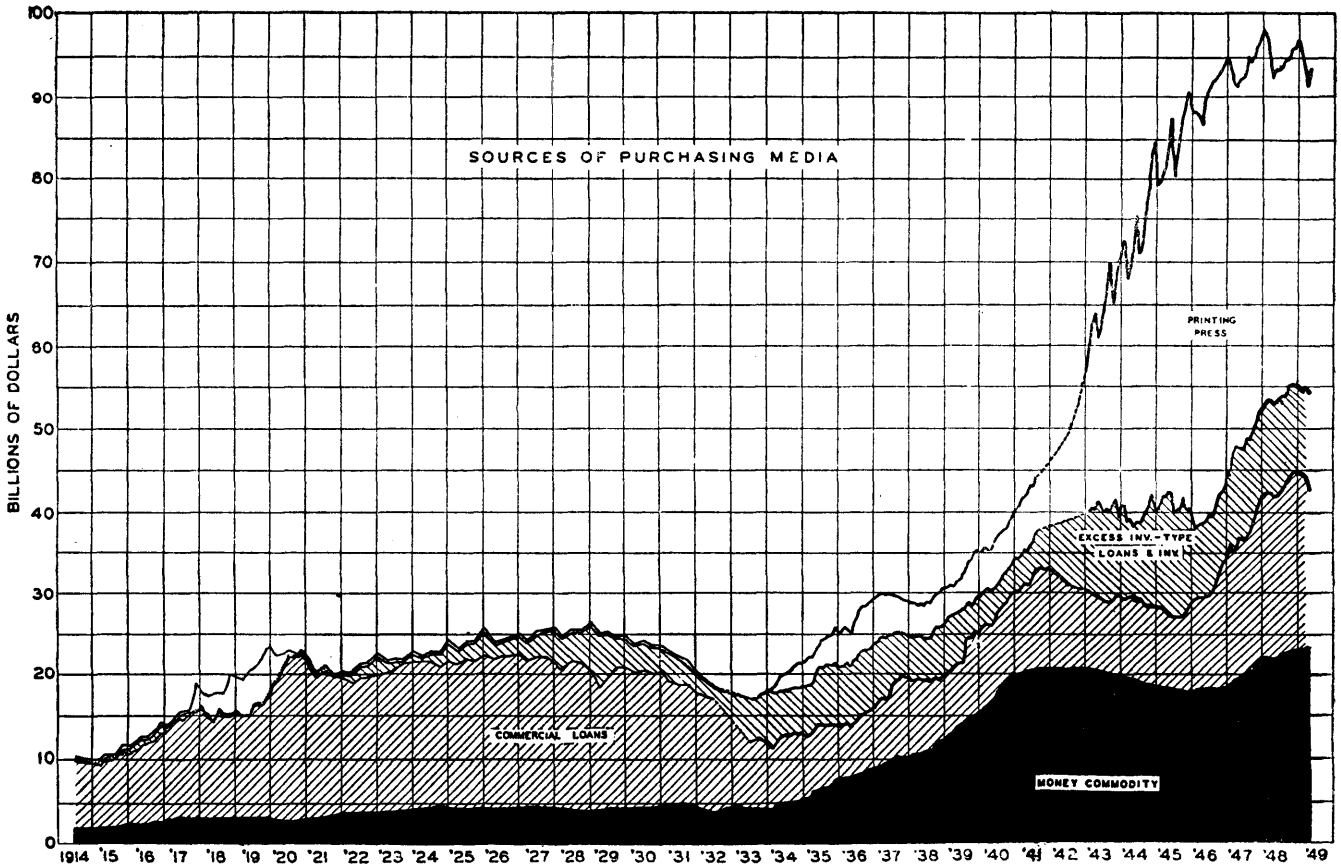
For the third time since the end of World War II the ratio of retail inventories to sales has increased markedly within a few months. The first of these great increases apparently was the result of the initial efforts to accumulate supplies of consumers' goods immediately following the war. In the spring of 1947, at the first signs of an approaching recession, retailers successfully disposed of excessive inventories. That problem was solved so quickly that department-store buyers apparently became overconfident, with the result that inventories became excessive again in the spring of 1948. Subsequent action by retailers, aided by rapidly increasing sales, temporarily reduced the inventories-to-sales ratio. However, in August 1948, sales began to decrease. Inventories have accumulated since then nearly to a postwar high in relation to sales.

In extending our study of the ratio of retail inventories to sales we have developed a new statistical series that reflect the new orders placed by department stores. The only data theretofore available were the Federal Reserve Board's reports of outstanding (unfilled) orders of department stores at the end of each month. Because of variations in the promptness of delivering orders, fluctuations in the amount of outstanding orders do not accurately reflect changes in the current buying policies of retailers. Our new series provides a more accurate indication of retailers' demand for goods than does the record of outstanding orders.[3]

The advantage of the new-orders series may be seen from data for the first 3 months of 1949. Outstanding orders at the ends of January, February, and March 1949 were substantially less than those of the corresponding months of 1948. Moreover, outstanding orders at the end of March were 17 percent less than the total a month earlier. One might reason from these data that retailers were more cautious in their buying during 1949 than they were during 1948 and that less merchandise was ordered during March than during February. However, analysis of our new-orders data reveals that the indicated decreases in the total of outstanding orders resulted from greater promptness in delivering goods ordered. Actually, department-store new orders during

[2]Because of the different dates on which Easter occurs from year to year, there is always some question as to whether or not the seasonal adjustment of sales data in any particular year is satisfactory. Moreover, apparently no adjustment is made for the effect of Easter in the Federal Reserve Board's inventory data. Consequently, the ratio of inventories to sales for March and April may not accurately reflect the retailers' inventory situation.

[3]New orders during the month equal sales plus any gain in inventories during the month (or minus any decrease in inventories) minus the change in outstanding orders during the month.




the first quarter of 1949 were slightly greater than those of the corresponding 1948 period, and from February to March there was a 5-percent increase in new orders.

The decrease in outstanding orders at the end of March, in spite of an increase in new orders during that month, may be accounted for in part by the large number of pre-Easter rush orders that were quickly filled by manufacturers. Apparently, these rush orders were placed by retailers, originally pessimistic, who were encouraged by the early pre-Easter demand.

*Based on preliminary data, we have estimated that the April seasonally adjusted index of department-store sales was slightly higher than that of March. Moreover, additional preliminary data indicate that the seasonally adjusted index of stocks decreased during April. Consequently, the ratio of retail inventories to sales may have decreased somewhat during April. Nevertheless, the inventory situation was still unsatisfactory at the end of April. Apparently both further curtailment of production of the consumer goods sold in department stores and more active promotions, including further price reductions, will be resorted to as retailers attempt to liquidate their excessive inventories.*

## DEMAND
### *Purchasing Media*

The amount of purchasing media in circulation increased sharply in April. The preliminary figure for the end of April reflected an increase of $2,228,000,000 to $93,321,000,000, nearly the same as the amount reported in April last year. Apparently, the net deflation that occurred during the past year was almost counterbalanced by the inflation that occurred in the month of April alone.

Purchasing media derived from the first source, the money commodity, increased slightly and made the total gain since the first of the year about $50,000,000. Both imports of gold and production of gold in this country have been decreasing for several months.

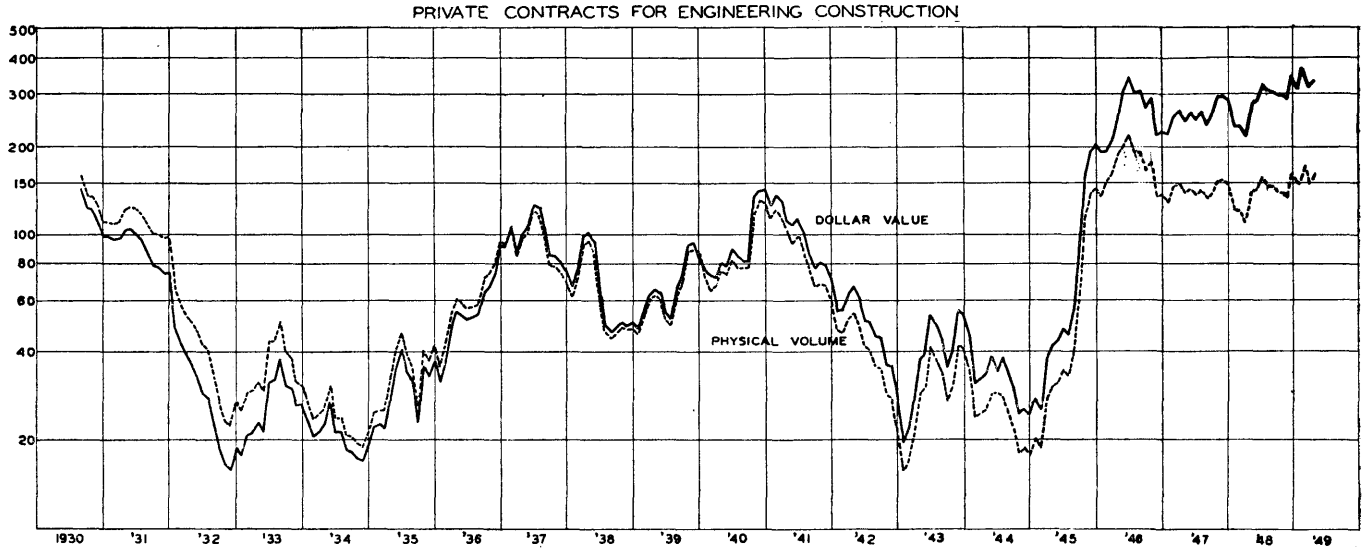
Purchasing media derived from the second source, commercial and agricultural loans, decreased for the fourth consecutive month. The amount derived from this source totaled $19,827,000,000, about $1,000,000,000 less than the total reported for March and nearly $2,000,000,000 less than the high reached at the end of last December.

Presumably the downward trend in commercial and agricultural loans and a similar trend in other types of loans were among the factors considered by the Federal Reserve Board prior to the recent change in reserve requirements and the relaxation of controls on installment lending. Thus far there is no indication of the effect the lower reserve requirements may have on the trend of commercial and agricultural loans.

On the other hand, the changed policies of the Federal Reserve Board apparently have affected certain other types of credit that are inflationary in character. For example, purchasing media derived from both the third and fourth sources increased greatly during April. The third source is largely installment credit and bank credit based on real estate and securities.

Purchasing media derived from the last two sources, both of which are inflationary, increased $3,250,000,000 during April. The gain in the media derived from the fourth source was the first increase since December.

Installment credit, particularly that used for the purchase of automobiles, has increased substantially since the Federal Reserve Board lowered requirements on in-




stallment credit. Similarly, lowering the margin requirements apparently has encouraged the purchase of securities on credit in recent weeks. However, installment credit for the purchase of household appliances, real-estate loans, and certain other personal loans have decreased further.

*In the last 7 months of 1948 the Nation's gold holdings increased nearly* $1,000,000,000, *commercial and agricultural loans increased* $2,000,000,000, *and inflationary credit extensions (largely real-estate and installment loans) increased more than* $1,000,000,000. *Present indications are that the additional purchasing media derived from these sources in the remaining months of 1949 will be much less: not more than* $150,000,000 *from gold; probably less than* $1,000,000,000 *from commercial and agricultural loans; and substantially less than* $1,000,000,000 *from real-estate and installment loans. Consequently, we do not expect the amount of purchasing media in circulation to increase much more this year.*

## *Department Store Sales*

Department-store sales for the week ended May 7, 1949, were 16 percent more than sales for the previous week and were 1 percent more than sales in the corresponding week last year.

# PRICES

## *Commodities at Wholesale*

| (August 1939=100) | *1948* *May 12* | *1949* *May 5* | *May 12* |
|---|---|---|---|
| Spot-Market rices (28 basic raw materials) | 321 | 245 | 244 |
| Commodity Futures Prices (Dow-Jones Daily Index) | 310 | 262 | 264 |

# BUSINESS

## *Private Contracts for Engineer Construction*

The 3-month moving average of private contract awards for heavy engineering construction increased 5 percent during April after having decreased 15 percent during March. The April average was 18 percent greater than that of April 1948.

Construction costs, which have been leveling off since July, decreased slightly during March. *The Engineering News-Record* index of costs was nearly 2 percent below the postwar high reached in September 1948. Preliminary data indicate that the downward trend continued during April.

As a result of the increased dollar volume of construction and decrease in costs, the 3-month moving average of the physical volume of engineer construction rose 9 percent during April. The average was 16 percent greater than that of April 1948.

Private contracts for engineering construction include contracts for the building of large industrial projects and apartment housing. Although a pronounced seasonal variation occurs and figures of monthly volume are calculated by adding weekly reports, our 3-month moving average reduces the magnitude of the seasonal changes and almost eliminates variations resulting from 4- and 5-week months.

An analysis of average weekly contract awards during each of the first 4 months of 1949 reveals that the maximum gain over the corresponding month of 1948 occurred in February, when the increase was 65 percent. In March the percentage gain was only 24 percent, and in April the average weekly figure was 14 percent less than the corresponding figure for April 1948. Unless a marked reversal of this relative trend occurs in May, the 3-month moving average for that month (which will exclude the large gain in February) will be nearly 20 percent less than the April 1949 average.

*A recent survey by the Asset Realization Company of 2,486 concerns throughout the United States revealed that 88 percent of them are not contemplating plant expansion now or in the discernible future. If the results of this survey are representative and if the trend of recent weeks continues, private contract awards for engineering construction will be below the levels of recent years before the end of 1949.*

---