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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Significance of the Stock-Market Trend

On several occasions, we have pointed out that for decades the trend of industrial stock prices has been one of the more consistent leading indicators of business-cycle changes. Therefore, although the trend of stock prices apparently is of little use in forecasting its own future, it is of interest to those who are attempting to foresee the future of business activity.

The marked upsurge of prices and activity in the stock market that has occurred in the days since the elections presumably is of more than casual significance. Unless an early and marked reversal occurs, the average prices during November will have continued the general upward trend that began in October 1953. This might well be an important clue to the future of business activity and would reinforce our belief that the upturn of business now in progress probably will be sufficiently great in magnitude and duration to be classified ultimately as a cyclical recovery.

In some respects, as *The Wall Street Journal* (of November 8) has pointed out, the situation seems similar to that of late 1924. A minor cyclical recession had been under way thirty years ago, and one of the more emphatic indications that the recession had ended was the upward surge of stock prices following the elections in that year. Prices of most stocks continued to advance on large volume through the remaining weeks of November and all of December 1924.¹

Rather than a comparison in detail with 1924, however, we believe that consideration of the parallel between post-World War I and post-World War II may be more illuminating. For the purposes of such a comparison, we divide the postwar periods into three major parts as follows: (1) initial readjustments, (2) expanding prosperity, (3) the major business and speculative boom.

After the Armistice in November 1918, there was about a year of extreme prosperity followed by a severe but brief recession, which in turn was followed by a

¹Lest this be misinterpreted as a prediction of stock-market action we should explain once more that, as far as we can discover, no scientifically grounded basis for predicting stock-market trends has yet been discovered. One can only say that what has happened at least once can happen again, although some variations rather than an exact parallel would seem to be a more logical expectation.

period of readjustment that continued through 1923. After the Armistice with Germany in the spring of 1945, there was an initial marked decrease in business activity followed by recovery during a period of readjustment that continued through early 1949. In each instance, the initial postwar readjustment period lasted about 4½ years.

The second period, that of expanding prosperity, began after World War I late in 1924 and continued nearly 4 years. The easy-money policy of the Federal Reserve System, especially the large open-market purchases in 1924, no doubt facilitated the expansion of business activity. The corresponding period after World War II began in late 1949 and continued nearly 4 years. An easy-money policy facilitated the expansion of business activity, which was further augmented by the Korean War and the rearmament program.

The third period, that of a major business and speculative boom, began after World War I in late 1927 and continued for 2 years. The easy-money policy of the Federal Reserve System, which was made effective by large purchases of Government securities in the open market during 1927, again presumably was an important influence. And in 1953-54, the Federal Reserve System once again intervened with its easy-money policy. Present indications are that a third stage of the post-World War II period has begun.²

The trends of industrial stock prices during the periods discussed above also are of interest. In the initial readjustment phase after World War I, industrial stocks first rose about 35 percent, then declined an equal amount and ended the 4½-year period only about 10 percent above the Armistice Day level. Similarly in the post-World War II period, stock prices rose about 25 percent, then declined a like amount, and ended the 4½-year period nearly at their Armistice Day level.

In the second period after World War I, stock prices first rose 75 percent, then declined 15 percent before beginning the next prolonged rise, which was under way well before the 1927 business recession ended. Similarly, from late 1949 through early 1953 prices of industrial stocks rose more than 80 percent, then declined less than 20 percent before beginning a rise that is still

²For more detailed discussion of Federal Reserve policy in this connection see the article, "Can We Do It Again?" *Research Reports*, August 2, 1954, and "Will the Boom Be Resumed?" November 2, 1953.

in progress and was under way well before the 1953-54 recession ended.

Industrial stock prices rose another 75 percent during 1928 from the low point of a late-1927 reaction of roughly 10 percent. From the lows of the late-1954 reaction, reached just before the elections (a reaction of roughly 3 percent), an upward surge of prices began following the elections. In 1929, the peak reached by the average prices of industrial stocks was more than double the late-1927 lows. We assume that the Federal Reserve authorities would become seriously concerned and take decisive action long before prices of industrial stocks reach a peak double the pre-election levels, if the parallel with the earlier period continues.

Viewing the two post-World War periods in their longer ranges, they seem to have much in common. Each has reflected a great wartime inflation followed by more inflation in peacetime. Each apparently has been maintained by that great "engine of inflation," the Federal Reserve System. Will the outcome in the long run, the depression aftermath, be much different? Before that question will be answered, however, recent stock-market trends suggest that we shall first experience what may prove to be the third and major boom phase of the post-World War II period.³

What the Indicators Say

Personal income expressed as an annual rate, adjusted for seasonal variation, increased about \$2,000,000,000 during September to a rate only one-tenth of 1 percent less than that of September 1953 and about two-tenths of 1 percent less than the peak rate of July 1953.

The *Iron Age* weekly composite price for steel scrap, not included among the indicators, averaged about 10 percent more in October than in September. The October average was the highest for any month this year. At the beginning of November the *Iron Age* composite price increased about 2 percent further.

These developments are further indications that a recovery is under way.

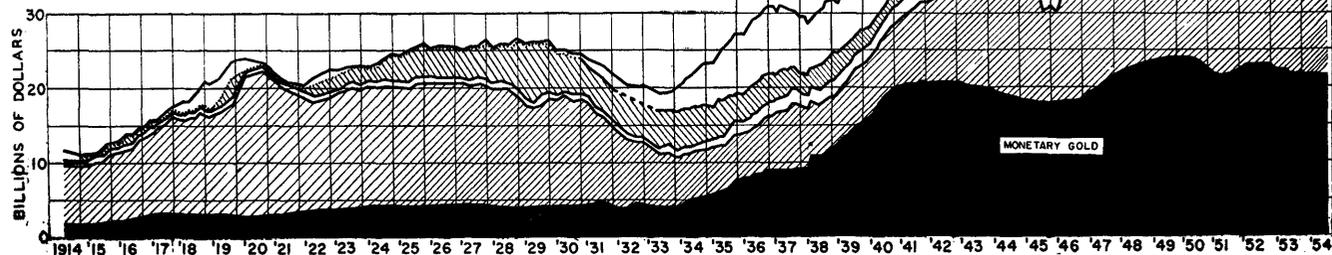
SUPPLY

Industrial Production

Steel-ingot production of 1,842,000 tons during the week ended November 13, as indicated by operations scheduled at 77.2 percent of capacity, compares with 1,822,000 tons during the preceding week and 2,060,000 tons during the corresponding week last year.

The *New York Times* seasonally adjusted index of lumber production was 124.5 for the week ended October 30, compared with 121.4 a week earlier and 118.7 for the corresponding week last year.

³In this discussion we have discussed similarities between the post-World War I and post-World War II situations. In a future article, we shall discuss the more important differences.



Electric-power production of 9,357,000,000 kilowatt-hours during the week ended November 6 compares with 9,152,000,000 kilowatt-hours for the previous week and 8,400,000,000 kilowatt-hours for the corresponding week last year.

Automobile and truck production in the United States and Canada, estimated at 123,100 vehicles for the week ended November 6, compares with a total of 90,700 for the previous week and 133,800 for the corresponding week last year.

These data compare with those for corresponding weeks of earlier years as follows:

	1929	1932	1948	1949	1953	1954
<i>Steel</i>						
Operating rate—percent cap.	73*	19*	99*	21	92	77 ^p
Ingot prodn.—million tons	1.01	.29	1.78	.39	2.06	1.84
<i>Lumber</i>						
<i>New York Times</i> Index	127	38	99	97	119	124
<i>Electric Power</i>						
Kilowatt-hours—billions	1.80	1.53	5.56	5.43	8.40	9.36
<i>Automobiles</i>						
Vehicles—thousands	62	10	118	117	134	123 ^p

^p Preliminary; *Holiday week

DEMAND

Purchasing Media

Total purchasing media, as measured by preliminary data, increased about \$1,100,000,000 during October to \$130,100,000,000, an amount approximately \$1,900,000,000 more than that at the end of October 1953.

Purchasing media derived from the first source, monetary gold, decreased about \$50,000,000 during the month.

Purchasing media derived from the second source, commercial, industrial, and agricultural loans, increased about \$52,000,000 during October.

Purchasing media derived from the third source, Treasury currency, were virtually unchanged during the month.

Purchasing media derived from the fourth and fifth sources, inflationary private credit and monetized public debt, increased \$2,134,000,000 during October to a total of \$75,302,000,000. Nearly three-fifths of this increase is credited to monetized public debt.

Investment-type assets of the commercial banking system increased approximately \$3,670,000,000. About two-thirds of this gain resulted from increased holdings of United States Government obligations; the remainder resulted principally from increased loans on real estate and on securities. The increased holdings of Government obligations reflects the acquisition by the banks of a large part of the 2-year-7-month notes sold by the Treasury early in October.

Only about half of the indicated increase in Government security holdings of the commercial banking system during October resulted in additions to purchasing media. This "half" represented the amount of the new note issue forming the basis of Treasury deposits added to the supply of purchasing media by transfer to others. The other "half" represents the amount of new note issue forming the basis of increased Treasury deposits not yet added to the supply of purchasing media by transfer to others.

The supply of purchasing media is increasing about as had been expected. Further seasonal expansion of business loans, increases in the amount of currency in circulation to meet the needs of Christmas trade, and the transfer of Treasury deposits to others as the Treasury draws down its bank balances, presumably will increase the purchasing-media total to record levels by the end of the year.

BUSINESS

Ratio of Retail Inventories to Sales

The ratio of retail inventories to sales, as measured by preliminary data, decreased two-thirds of 1 percent in October to an amount nearly 2 percent less than that for October last year. The October ratio was about 1

percent more than the average ratio for 1953.

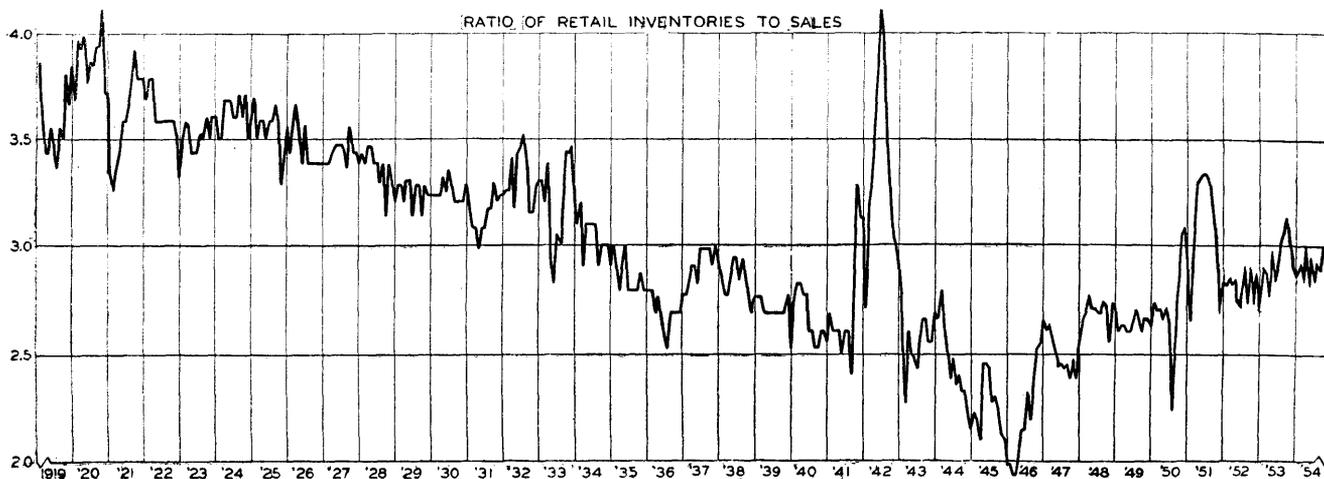
The seasonally adjusted index of department-store inventories is estimated to have increased about 2 percent during October, after having remained unchanged for 3 months through September. The October index was the highest thus far this year and was less than 1 percent below that of October last year. The seasonally adjusted index of department-store sales increased nearly 3 percent in October. Consequently, the ratio of retail inventories to sales for October decreased slightly.

The dollar value of new orders placed by department stores during September (more recent data are not available) was about 30 percent more than that for August and was the greatest for any month this year. September new orders totaled \$513,000,000, compared with \$460,000,000 in September 1953. The dollar value of new orders has increased during September in 8 of the 10 years since the end of World War II. The increase was 27 and 31 percent in September 1953 and 1952, respectively. The average increase during September of the eight post-World War II years has been 24 percent. Thus, the September increase in new orders appears to be about that seasonally expected.

The dollar value of outstanding orders of department stores increased 6 percent in September, compared with increases of 2 and 10 percent in September 1953 and 1952, respectively. The increase was in line with that expected. Outstanding orders, reflecting orders for Christmas trade, were the largest at the end of September they have been thus far this year and were approximately 3 percent less than those at the end of September 1953.

The dollar value of goods received by department stores increased about 20 percent in September, compared with increases of 14 and 24 percent in September 1953 and 1952, respectively. The increase seems to be about seasonal.

New orders placed by department stores during September were larger than those placed during the corresponding month of 1953 for the second consecutive month, and department-store sales during September exceeded those of the corresponding month a year earlier for the fourth consecutive month. Thus, increased new orders seem to have been placed because of increased sales rather than for the purpose of rebuilding inventories. Our expectation is that caution in buying will continue during the next several months. If department-store sales continue at their present rate, slightly above



that of the last quarter of 1953, a leveling-off or even a moderate decrease in the ratio of inventories to sales during the remainder of the year is more probable than an increase.

Railroad Freight Ton-Miles vs. Industrial Production

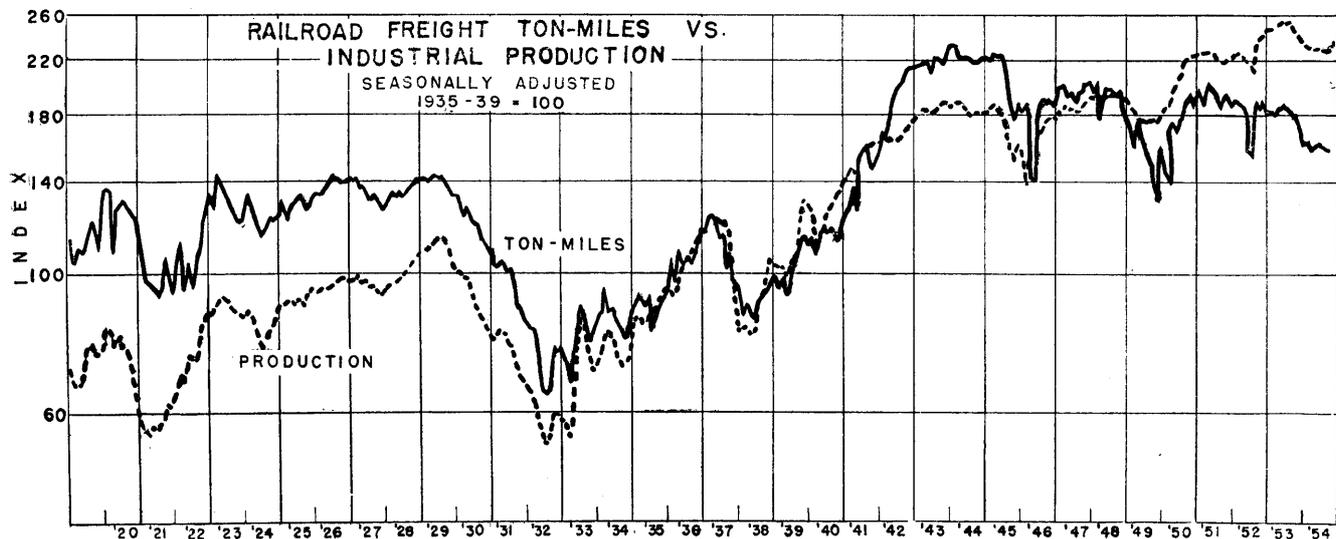
Our preliminary seasonally adjusted index of railroad freight ton-miles, which is a 3-month moving average, centered, decreased during each of the 3 months through September.⁴ The decreases were 2.0, 0.4, and 0.2 percent during July, August, and September, respectively. The September average was 13 percent less than that of the corresponding month last year and 17 percent less than the 1953 peak reached in June. The decrease of about 2 percent in the index during the third quarter of this year compares with an increase of about 1 percent during the second quarter of the year.

After reaching a peak in July 1953, the Federal Reserve Board's Index of Industrial Production decreased a little more than 10 percent through July 1954 and remained about 1 point above its July level in August and September. The index is expected to increase moderately during the remainder of the year.

The index of railroad freight ton-miles is expected to decrease further during the last quarter of 1954. A forecast published recently by the Association of American Railroads, based on information compiled by thirteen Regional Shippers Advisory Boards, indicates that freight carloadings during the fourth quarter will be nearly 9 percent less than the shrinking volume of carloadings of the last quarter of 1953. Although this year's earlier forecasts of the group were somewhat optimistic, carloadings of miscellaneous freight during recent weeks have been only about 6 percent less than those of the corresponding weeks last year.

The continuing decrease in railroad freight traffic can be only partly attributed to the contraction of general business activity. Manufacturing and mining, as measured by the Federal Reserve Board's Index of Industrial Production, are at present less than 10 percent below the peak level of July 1953. Construction activity, as meas-

⁴The index reflects the number of tons of revenue freight handled multiplied by the number of miles each ton is carried. The 1935-39 monthly average of this series is the index base, 100. Data for the latest 3 months are estimated on the basis of carloadings.



ured by expenditures for new construction (i. e., expenditures on labor and materials put in place) published by the Department of Commerce, in the aggregate was this year at least equal to if not greater than that of the corresponding period of 1953. And total farm output this year is expected to be about 2 percent greater than that of 1953, according to estimates of the Department of Agriculture. Apparently, at least a part of the decrease in railroad freight ton-miles can be explained only in terms of traffic lost to other freight carriers since the winter of 1943-44, when an alltime record in railroad freight traffic was reached.

During 1953 and 1954, for which years complete data are not available, this trend from the railroads to other carriers continued. Intercity tonnage transported by motor carriers increased 9 percent in 1953; in that year the proportion carried by inland waterways (except Great Lakes) increased to about 6 percent. In the first half of 1954 there was a decrease of 4 percent in intercity tonnage transported by trucks as compared with the corresponding period a year ago. This figure compares with a decrease of nearly 13 percent in railroad freight ton-miles during the first two quarters of 1954.

The unfavorable situation of the Nation's railways induced the President to direct the Secretary of Commerce in July to appoint a Cabinet working group to study the situation of the railroads and to report the recommendations of the group before December 1.

The gap between the indices of freight ton-miles and industrial production is still increasing, albeit slowly, indicating that the relative share of the Nation's railroads in the transportation of freight has decreased further. Optimistic reports have appeared regarding the new "piggy-back" railroad-trucking combination; but the experiment of hauling trailer-truck bodies on railroad cars has not yet proven that the railroads can regain much of the lost traffic.

PRICES

Commodities at Wholesale

	1953		1954
	Nov. 10	Nov. 4	Nov. 10
(August 1939=100)			
Spot-Market Prices (22 basic raw materials)	267	278	282
Commodity Futures Prices (Dow-Jones Daily Index)	336	364	365