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GREAT BARRINGTON

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Our Estimate of the Situation

Recent communications from the President to Congress, including his state-of-the-Union message and the Economic Report, have well described certain aspects of the Nation's present situation, its relation to the recent past, and to the future. We refer particularly to the description of the 1953-54 recession, the cyclical recovery well under way, and the prospects for long-term growth. However, we believe that, in focusing attention on those aspects of the over-all situation, other likewise important, perhaps more important, aspects have been overlooked.

In this 55th year of the twentieth century, the United States moves forward, as it has for several decades, in the forward echelon of an advancing civilization. Although one may question whether other nations of Western Civilization have not already begun the retrogression that marks the initial stages of a civilization's downfall, there are many indications that the advance may continue in our country for some decades to come.

Since the frontier was closed in the late 1800's and vast tracts of free land no longer have been available, there have been discernible in our own country some of the trends long evident in Europe. By the early years of the present century, the tendency for the takings of privately held monopoly privileges to coagulate, so to speak, in great aggregations of wealth had become obvious, with resulting loss of opportunity and economic freedom to the disinherited underprivileged of our land. Then there seemed to be under way here the same relentless pressure on the masses of the population that had resulted in the widespread poverty and lack of opportunity that characterized the England of Dickens' day and, as elsewhere in Europe, had divided society into castes or classes.

Fortunately for the United States, the technological advance in industry was far enough along to counteract, in part, the tendencies mentioned above. For the frontier where land had been available for the taking, the many frontiers being explored by science were substituted with a resulting development of new opportunities. Probably this development, together with the fact that the natural resources of the Nation were still widely held rather than concentrated in the hands of a few, as in England and Europe generally, accounted for the relatively much better conditions for the average man here in the United States.

Other factors also have modified the effects of institutional devices here that are similar to those of Western Europe. The "progressive" income tax has somewhat lessened the takings of the holders of special privileges, although it unfortunately has indiscriminately hamstringed the new producers who might have been the Fords and Edisons of today and tomorrow. The estate tax has tended to break up the great estates that were accumulating at such a rapid rate a few decades ago.

One of the more powerful modifying influences has been inflation and the devaluation of the dollar. Over periods of decades when a monetary unit is stable numerous arrangements such as leases for ground rents, royalty payments for mines, etc., tend to become stabilized in the form of long-term contracts. In this country, prior to 1933, few such contracts provided escalator clauses intended to offset depreciation of the dollar. One temporary result has been that the devaluation of 1934 and the subsequent great inflation with accompanying rise in prices has, in effect, greatly lessened the proportion of current output accruing to the holders of special privileges and has left a larger proportion to be distributed to others.

Of course, another effect of the great inflation has been subtly to shift wealth from the accumulated savings of the people to that available for current use. About \$160,000,000,000 has been thus "stolen" from the life-insurance, savings deposits, and other fixed dollar-value holdings of many individuals and transferred to others for current spending. This subtle and little understood shift together with the other factors mentioned above has stimulated widespread confidence in a new, "new era" as the wages of many employed individuals have increased even more than the cost of living in recent years.

As it happened, much of the inflationary purchasing media created by monetization of the Federal debt during World War II was hoarded. Some was hoarded in the form of currency and more was hoarded in the form of idle checking accounts (demand deposits) by individuals and corporations. Of course, one of the reasons for the widespread hoarding was that important items such as new automobiles, new homes, new plants and machines simply were not available during the war years. Even after the war, large sums remained hoarded, because many individuals and businessmen feared a postwar depression and decided to retain cash until the depression years.

To summarize the aspects of the present situation

overlooked in the President's reports, we note first that no adequate solution of the long-run problem confronting Western Civilization has been suggested; in fact, that there is an important problem to be solved hardly is indicated in the President's messages. Perhaps partial recognition of it may be inferred from his comment regarding restraint of monopoly and in the few words about "opportunity." However, we doubt that sufficient weight has been given to what we consider the urgent desirability of scientific investigation and appropriate action on this problem. Until a solution or solutions are found, we should expect the trends long evident in parts of Europe to exert an increasing influence here, an influence that must retard, perhaps ultimately reverse, the Nation's economic growth.

Of more immediate importance are the aspects of the present situation that reflect the great inflation of recent years. The unpleasant truth is that we have repeated, on a larger scale, the economic blunders of 1917 to 1928.

While laboring under the financial delusion of a great inflation, we have squandered dollars abroad like the proverbial drunken sailor with a girl in every port. So great was our early urge to spend for prosperity abroad that, although many people seem now to have forgotten it, we at first invited even Russia to participate in accepting our largess under the Marshall Plan. One development, largely attributable to our lavish giving, is that foreign nations today have demand claims on half the Nation's gold reserve.

At home, by an artificially forced easy-money policy, we have encouraged the citizens of the Nation to incur debt for new homes, new cars, etc., at higher and higher prices. And the end is not yet, because new homes and new cars are today being bought on thin equity margins in large volume at high prices.

By facilitating further inflation, even since World War II, we have made possible increasing distortions of the economy. An example is provided by the general level of commodity prices, which is reflected in the prices of all goods and services.

Commodity prices today, as measured by the U. S. Bureau of Labor's comprehensive index, are about 240 percent of the pre-World War I average and are nearly as high in relation to the pre-World War II average. No doubt, part of the increase reflects the effects of the 1934 devaluation of the dollar, to which a gradual readjustment was in process for many years. Even allowing for that change in the measuring rod, so to speak, prices today are 40 to 50 percent above the level at which they could be expected to be relatively stable without more inflation. In trying to maintain stable prices at present levels, the monetary authorities are only repeating the mistakes of the later 1920's.

Elsewhere we have discussed in greater detail the significant similarities between the present situation and that of early 1928.¹ Further brief comment on two important differences is advisable.

1. The amount of hoarded currency and demand deposits (idle checking accounts) apparently much exceeds the corresponding amounts for 1928, both in dollar totals and in relation to the purchasing media in use. If substantial amounts of this hoarded purchasing media

are used for speculation in stocks, for investments generally, or for any other purchases, such as new homes, that bring the funds into the channels of trade, further stimulation of business activity could result more or less comparable to that which was facilitated by the great speculation in stocks during 1928-29. Only a drastic deflationary policy on the part of the Federal Reserve Board could offset the use of such hoarded, inflationary purchasing media. (Most of the hoarded purchasing media originally was created by the monetization of Government debt during World War II.)

2. In 1928, the demand claims of foreign governments and central banks on U. S. gold reserves were relatively small compared with such claims today. If the total continues to increase beyond the half-way point in the months ahead, the situation may become more critical. Any unfavorable development, such for example as our involvement in an Asian war, a further boom and collapse in stocks reminiscent of 1929, or monetary stringency abroad, could precipitate large withdrawals, a run on our gold. What the reaction of other nations and our own citizens would be cannot be predicted, but a severe financial panic might be one result, possibly followed by another devaluation of the dollar.

Conclusions

In view of the foregoing and other considerations already discussed in these bulletins from time to time, we conclude as follows:

a. *Unfortunately, the economic situation in the United States today is not fundamentally sound, although a cyclical recovery of business that may continue for many months is well under way.*

b. *A sudden demand of foreign claimants on United States gold reserves may cut short the period of prosperity and precipitate a financial panic of serious proportions, or may aggravate a later collapse following any speculative boom.*

c. *In the absence of such a panic the cyclical recovery may continue; and, stimulated by the use of purchasing media now hoarded, business activity may increase to boom proportions. A subsequent severe recession would be highly probable.*

d. *Conceivably, by the exercise of wisdom and with great good fortune, the Federal Reserve Board and the Administration may be able to effect a gradual transition to a more sound position. A downward trend of prices rather than maintenance of present levels and continued gradual deflation would be necessary over a period of several years.*

e. *Our present expectation is that the Federal Reserve authorities will fail to act with sufficient promptness and vigor, just as they failed in 1928-29. Consequently, although we consider resumption of the boom the most probable development of the next several months, we have little confidence that a serious aftermath of the great 1940-54 inflation will be avoided.²*

²Perhaps we should add that the Nation, in our opinion, is fortunate in having in positions of authority such men as Mr. Dodge, Mr. Burgess, and others. We do not doubt either their intelligence or their sincerity. However, even if they analyzed all aspects of the situation in the same way that we have and reached the same conclusions, their task would be extremely difficult. On several occasions in the past, the Nation has indulged in similar inflationary follies over prolonged periods, and we doubt that the end result of prolonged abuse of the money-credit system can be evaded this time in spite of the good intentions of sincere and able men.

¹See the "Reprint Supplement," December 6, 1954, and the articles referred to therein; also the article "Another Parallel, 1953-54 vs. 1927-28," *Research Reports*, December 13, 1954.

What the Indicators Say

The monthly percentage of leading indicators expanding, as measured by the Institute method, remains unchanged at 87½.³

The percentage of the roughly coincident indicators expanding increased from 50 to 62½; that of the lagging indicators increased from 40 to 60. These increases respectively reflect the inclusion of bank debits outside New York City and personal income among the indicators whose apparent recent trends are classified as up.

Conclusion

The percentage of both the roughly coincident and the lagging indicators expanding, as measured by the A. I. E. R. method, exceeds 50 percent, confirming similar developments as measured by the National Bureau of Economic Research method and reported last week. There is little doubt that general business activity is well along in a period of cyclical recovery that may continue for many months.

DEMAND

Purchasing Media

According to preliminary data, total purchasing media decreased about \$200,000,000 in January to \$135,800,000,000, nearly 4 percent more than that a year earlier. The decrease in January compares with a decrease of about \$900,000,000 in January 1954. The average January decrease of the preceding nine postwar years has been \$1,300,000,000.

Purchasing media derived from the first source, monetary gold, was practically unchanged during January.

Purchasing media derived from the second source, commercial, industrial, and agricultural loans, decreased nearly \$600,000,000 during the month.

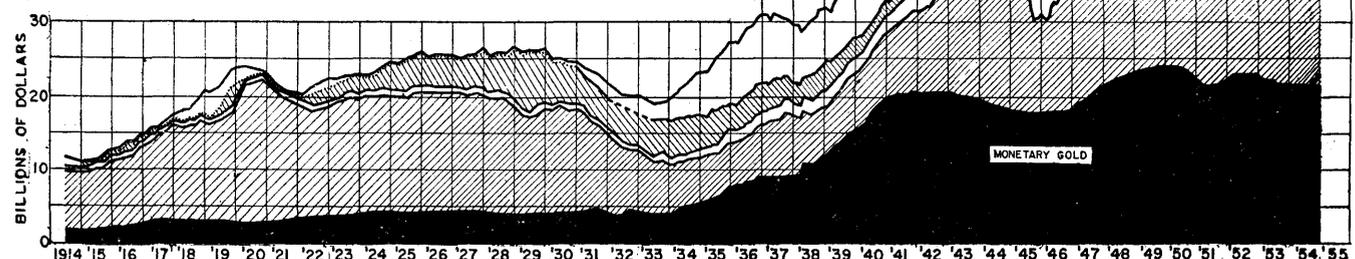
Purchasing media derived from the third source, Treasury currency, changed little during January.

Purchasing media derived from the fourth and fifth sources, inflationary private credit and monetized public debt, increased about \$300,000,000 during the month.

About half of the impact on the supply of purchasing media resulting from a \$2,000,000,000 reduction in the amount of Government securities held by the commercial and Federal Reserve banks was offset by a decrease in the amount of Treasury deposits with the banking system. The amount of purchasing media resulting from inflationary private credit is estimated to have increased about 1 percent.

The Treasury's current refunding of \$15,000,000,000 of debt will require Treasury disbursements of \$832,000,000, divided between February 15 and March 15, in payment of retired obligations not exchanged for new

³The Institute method is outlined in our weekly bulletin of March 8, 1954.



securities. Assuming that the Treasury does not increase its current borrowings to meet a part or all of this \$832,000,000, such payment will be a special factor offsetting a part of the seasonal contraction in the volume of purchasing media during the next 2 months.

The total of purchasing media is expected to contract seasonally during the next 2 or 3 months. However, the rate of contraction in the total is expected to be less and the period of contraction longer than usual, reflecting the effects of the Treasury payments mentioned above and the extension of the period of tax payments into April.

Department-Store Sales

Sales of the 325 reporting department stores compare with those of corresponding periods a year ago as follows:

Period	Percent Change
Week ended February 5	-1
Four weeks ended February 5	+7

SUPPLY

Industrial Production

Steel-ingot production of 2,110,000 tons during the week ended February 12 as indicated by operations scheduled at 87.4 percent of capacity, compares with 2,070,000 tons during the preceding week and 1,760,000 tons during the corresponding week last year.

The *New York Times* seasonally adjusted index of lumber production was 145.5 for the week ended January 29, compared with 140.2 a week earlier and 113.8 for the corresponding week last year.

Electric-power production of 10,047,000,000 kilowatt-hours during the week ended February 5 compares with 10,003,000,000 kilowatt-hours for the previous week and 8,670,000,000 kilowatt-hours for the corresponding week last year.

Automobile and truck production in the United States and Canada, estimated at 190,800 vehicles for the week ended February 5, compares with a total of 190,500 for the previous week and 139,300 for the corresponding week last year.

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

	1929	1932	1948	1949	1954	1955
<i>Steel</i>						
Operating rate—percent. cap.	86	27	93	100	74	87 _p
Ingot prodn.—million tons	1.19	.41	1.67	1.84	1.76	2.11
<i>Lumber</i>						
<i>New York Times</i> Index	144	38	114	82	114	146
<i>Electric Power</i>						
Kilowatt-hours—billions	1.73	1.59	5.41	5.78	8.67	10.05
<i>Automobiles</i>						
Vehicles—thousands	109	30	83	103	139	191

p Preliminary

New Consumer Goods Per Capita

Our index of new consumer goods per capita increased 4 percent during December from the revised figure for November. For the first time since 1951 the trend of the 3-month moving average plotted at the third month reflects a sharp increase. The index was 4 percent more than that of December 1953.

The monthly index of production on which the per capita index is based reveals that manufacturers' output of consumer goods in December 1954 was 14 percent more than it was in December 1953 and about 11 percent more than it was during October 1954, when the uptrend started.

The textile and shoe components, which account for 25 percent of the index, increased 3 percent during December and 13 percent during 1954.

The food and tobacco components, which account for 46 percent of the index, continued close to their high levels of recent years. Because of the nature of the demand for these products they are a stabilizing factor in the index.

The automotive component, which is 13 percent of the index, probably will remain large for several months. Present indications are that automobile output in the first quarter of 1955 will be 44 percent more than that of the same record period for 1954.

The housing component, which accounts for 8 percent of the index, increased further in December. Work was begun on 91,000 new dwellings in December, a new high for the month, and it is estimated that the number of new nonfarm dwellings started in January will approximate the December record.

Because the October production figure will be replaced by a larger January figure in the 3-month moving average on which our index of new consumer goods per capita is based, the January index probably will increase 4 percent or more. Although this rate of increase is expected to diminish, we believe that the index will trend upward. Under present conditions there are few

shortages in basic raw materials, and this fact coupled with the expanding consumer credit and a rising personal income suggests that the level of the index may remain high for several months.

PRICES

Commodities at Wholesale

<i>Index</i>	1954		1955	
	Feb. 9	Feb. 2	Feb. 9	
Spot-market, 22 commodities	271	283	282	
Commodity futures	360	359	355	

Note: The indexes are respectively those of the United States Bureau of Labor Statistics and Dow Jones. Both indexes are converted so that their August 1939 daily averages equal 100.

BUSINESS

Manufacturers' Orders, Sales, and Inventories

Manufacturers' new orders during December (seasonally adjusted) increased nearly 4 percent from those of November and were about 13 percent more than those of December 1953. The seasonally adjusted total of new orders for December is \$25,300,000,000.

New orders for durable goods increased 7 percent during December to an amount \$800,000,000 more than the revised figure for November and \$2,700,000,000 more than that for December 1953.⁴ New orders for nondurable goods increased about 2 percent during December to an amount \$300,000,000 more than the figure for November and \$600,000,000 more than that for December 1953. The major increase in new orders was in the primary-metals and transportation-equipment industries.

Manufacturers' sales (seasonally adjusted) increased 2 percent during December compared with the revised figure for November, after having increased nearly 6 percent during November. Shipments of durable goods increased nearly 4 percent in December; shipments of nondurable goods were virtually unchanged. Total sales of manufacturers in 1954 were 5 percent less than those in 1953.

Manufacturers' unfilled orders (not seasonally adjusted) decreased slightly in December, with the decrease occurring in the unfilled orders for durable goods. Unfilled orders for nondurable goods increased slightly during the month.

Manufacturers' aggregate inventories of purchased materials, goods-in-process, and finished goods at the end of December (seasonally adjusted) were virtually unchanged from those at the end of November.

The ratio of manufacturers' inventories to sales (both series seasonally adjusted) was 1.76 for December, compared with 1.80 (revised) for November and 1.94 for December 1953. This was the lowest it has been since July 1953. The ratio for durable goods decreased nearly 3 percent during December; the ratio for nondurable goods was unchanged during December from the revised ratio for November.

In view of the substantial increase in manufacturers' orders for durable goods and other favorable developments among indicators of business-cycle changes, we believe that manufacturers' orders, sales, and inventories will trend upward during the next several months.

⁴This seasonally adjusted series is one of the eight leading statistical indicators.