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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Stock Market Boom and the Economy

We believe that readers will be interested in our reply to the questionnaire sent to us and to many others by the Senate Banking and Currency Committee, preparatory to its study of the stock market. The questions and our answers follow:

1. Q. What in your opinion were the principal factors causing the stock market rise beginning in the fall of 1953?

1. A. The factors in the order of their importance are believed to have been as follows:

a. The drastic action taken by the Federal Reserve Board to ease the money market, especially the substantial reduction in reserve requirements effective in the summer of 1953 and the large-scale open-market purchases of Government securities in the late spring, summer, and fall of 1953. This practically assured that more inflation rather than deflation would follow for many months. (See our *Research Reports*, January 31, 1955, especially our index of inflation chart therein.)

b. The accumulating evidence during the fall of 1953 and early 1954 suggesting that the recession then under way in business would *not* be severe. This evidence included:

(1) A leveling off rather than a marked downward trend of commodity prices.

(2) Substantial decreases in the liabilities of business failures during the spring of 1954.

(3) Upturns in various other leading indicators of business cycle revivals. (See the charts and discussion in the bulletin referred to above.)

c. By the summer and fall of 1954, increasing evidence that a cyclical recovery of business activity either had begun or soon would begin. (See the bulletin referred to above.)

2. Q. Why was the rate of rise stepped up in the last month of 1954?

2. A. Probably at least three factors in addition to those listed above were responsible for the increase in the rate of rise in November and December, 1954. (Measured by the S.E.C. comprehensive index of 265 common stocks, the increase in November 1954 was 9 percent and in December 1954 was 5 percent, compared with an average monthly increase of 2 percent (cumulatively compounded) from October 1953 to October 1954. It will be noted that the November increase substantially exceeded that of December.) We

have no basis for estimating the relative importance of the following factors:

a. The election outcome, which had these effects:

(1) Removed the uncertainties that had retarded the advance in prices during September-October, 1954.

(2) Aroused in the minds of many investors fears of more inflation and of further depreciation of the dollar in the long run, especially in view of the fact that no action had been taken by the Congress on the bills to resume specie payments.

(3) Gave to other investors, who had feared a Democratic landslide, confidence that the tax and business policies of the Administration would not be reversed. Note: It should be observed that both fears of more inflation with resulting depreciation of the dollar on the part of some investors and hopes of policies favorable to business on the part of other investors would be reflected in a desire to buy stocks.

b. The evidence in the form of quarterly reports of numerous corporations, issued during October and November, revealing that profit margins had been relatively well maintained even during the summer months when operations were at a low rate. (This was especially true of the steel companies, a basic industry.) The obvious implication was that earnings would increase greatly with increased business.

c. The substantial capital gains tax, which inclined many investors and speculators to postpone taking profits until after December 31, 1954, thereby delaying their tax payments a full year. There are many indications that much delayed profit taking occurred during January 1955. (In this connection, see Lawrence H. Selzer, *The Nature and Treatment of Capital Gains and Losses*, National Bureau of Economic Research, Inc., New York, 1951. See also the *Reprint Supplement* enclosed.) Possibly of some significance is the fact that the rate of rise in stock prices from August 1954 to January 31, 1955, was at the rate of 3 percent per month. Thus it would appear that part of the November-December rise merely made up for the retardation during September-October, and part reflected the postponement of profit taking to 1955. The total rise from August through January did not greatly exceed the earlier rate of rise.

3. Q. Do you think there are significant similarities between the market situation now and that which prevailed in 1928-29?

3. A. Yes, see the *Reprint Supplement*, also the *Research Reports* dated December 13, 1954, both enclosed.

4. Q. Are there any dangers to the economy inherent in the (a) present market levels, (b) present market activity or (c) amount of credit on securities?

4. A. The dangers to the economy are not inherent in any of the factors indicated in the question but in the underlying developments that have recreated a situation comparable in many respects to that of 1928. See "Our Estimate of the Situation," *Research Reports*, February 14, 1955, copy enclosed.

5. Q. If the rate of increase in stock market prices between September 1, 1953 and January 1, 1955 should continue for another year, would there be any danger to the national economy?

5. A. The danger would result *not* from the stock market's movements but from the underlying causes thereof. See the answer to 4, above.

6. Q. If the rate of increase in stock market prices between November 1, 1954 and January 1, 1955 should continue for another year, would there be any danger to the national economy?

6. A. Same as the answer to 5, above.

7. Q. If you believe there would be any danger to the national economy in a continuation of the stock market rise at the rate of rise between September 1, 1953 and January 1, 1955 or at the rate of rise between November 1, 1954 and January 1, 1955, what are your suggestions for avoiding this danger?

7. A. See the answer to 5, above, especially subparagraph d. of the conclusions of our estimate of the situation, which is as follows: "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."

8. Q. Is there any evidence that present government regulation of the exchange and over-the-counter security markets are inadequate? If so, explain and suggest how this can be corrected.

8. A. No.

9. Q. To what extent do fluctuations in the stock market bring about changes in general business conditions? To what extent do changes in general business conditions influence the stock market?

9. A. Except on rare occasions, as in 1928-29, fluctuations in the stock market reflect changes and expected changes in business activity. Only when a major speculative movement is centered in stocks do fluctuations in stock prices markedly affect business activity. In this connection, see the *Reprint Supplement* enclosed, especially the left-hand column of page 215.

What the Indicators Say

The latest data for the Statistical Indicators reveal that:

1. The Federal Reserve Board Index of Industrial Production increased 1 point in January to 131.
2. The daily average of the Dow-Jones index of 30 industrial stock prices increased about 1 percent during January.
3. The daily average of the Bureau of Labor Statistics index of wholesale prices of 22 commodities likewise increased 1 percent in January.
4. Manufacturers' new orders for durable goods in-

creased more than seasonally in December.

5. Manufacturers' inventories at the end of December were unchanged from those at the end of November.

6. Gross national product in the fourth quarter increased to an annual rate of \$362,000,000,000.

The *Iron Age* weekly composite price of No. 1 heavy melting steel scrap for the week ended February 8 was \$35.83, compared with \$35.50 for the preceding week.

The foregoing and other data previously reported apparently reflect a solidly based business recovery.

SUPPLY

Industrial Production

Steel-ingot production of 2,129,000 tons during the week ended February 19, as indicated by operations scheduled at 88.2 percent of capacity, compares with 2,095,000 tons during the preceding week and 1,780,000 tons during the corresponding week last year.

The *New York Times* seasonally adjusted index of lumber production was 141.6 for the week ended February 5, compared with 145.5 a week earlier and 123.0 for the corresponding week last year.

Electric-power production of 9,922,000,000 kilowatt-hours during the week ended February 12 compares with 10,047,000,000 kilowatt-hours for the previous week and 8,680,000,000 kilowatt-hours for the corresponding week last year.

Automobile and truck production in the United States and Canada, estimated at 190,300 vehicles for the week ended February 12, compares with a total of 190,000 for the previous week and 142,100 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
Steel						
Operating rate--percent cap.	87	25	92	100	75	88 _p
Ingot prodn.--million tons	1.20	.38	1.66	1.84	1.78	2.13
Lumber						
<i>New York Times</i> Index	137	37	110	90	123	142
Electric Power						
Kilowatt-hours--billions	1.73	1.58	5.38	5.72	8.68	9.92
Automobiles						
Vehicles--thousands	116	33	84	109	142	190 _p

p Preliminary

DEMAND

Mail-Order and Chain-Store Sales

Sales of 41 reporting mail-order and chain-store companies during January were 8.8 percent more than sales in January 1954. Data compiled by *The New York Times* are given below.

PERCENTAGE CHANGE OF TOTAL SALES January 1955 vs.

Type of Outlet	January 1954
Mail Order	+ 14
Variety	+ 6
Grocery	+ 7
General Merchandise	+ 8
Apparel	+ 11
Shoes	+ 2
Drug	+ 4
Automotive Variety	0
Men's Wear	+ 8
41 Reporting Stores	+ 9

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 12	0
Four weeks ended February 12	+3
Year to date	+7

PRICES

Commodities at Wholesale

Index	1954		1955
	Feb. 16	Feb. 9	Feb. 16
Spot-market, 22 commodities	270	282	280
Commodity futures	362	355	347

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

Private Contracts for Engineering Construction

Our 3-month moving average of the dollar value of private awards for engineering construction (plotted at the third month) increased nearly 14 percent during January, but was still about 3 percent less than the largest monthly average of 1954 reached in September. The moving average had increased 4 percent during November.¹ The average for January was 43 percent more than that for January 1954; the average for December was about 3 percent less than that for December 1953.

Contract awards for private engineering construction averaged \$201,600,000 per week during January, compared with \$177,800,000 during December. The weekly averages for the corresponding months a year earlier were \$87,600,000 and \$179,800,000, respectively. Mass-housing contract awards decreased nearly 4 percent during the 5-week month of December, but increased 22 percent during the 4-week month of January. These awards for January were 150 percent more than those for January 1954. Commercial-building contract awards during January were 21 percent more than those during January 1954; industrial-building awards were 170 percent more than those during January 1954.

Private engineering construction contract awards for 1953 and 1954, in millions of dollars, break down as follows:

	1953 (53 weeks)	1954 (52 weeks)
Mass housing	3,464	4,232
Commercial building	1,157	1,551
Industrial building	3,178	1,876
All other	866	596
Total	8,665	8,255

The *Engineering News-Record* index of construction costs for February increased slightly, after having also increased slightly in January.

Our 3-month moving average of the physical volume of private engineering construction, which is derived by dividing the dollar value of contract awards by the construction-cost index, increased nearly 4 percent in December and 13 percent in January. The January average was 36 percent more than that for January 1954.

It is believed that the general business recovery now under way will be both reflected in and stimulated by an upward trend in private construction contract awards during the next few months, at least.

Industrial Productivity

Our index of industrial productivity increased 2.6 percent in 1954, compared with 2.4 percent in 1953.²

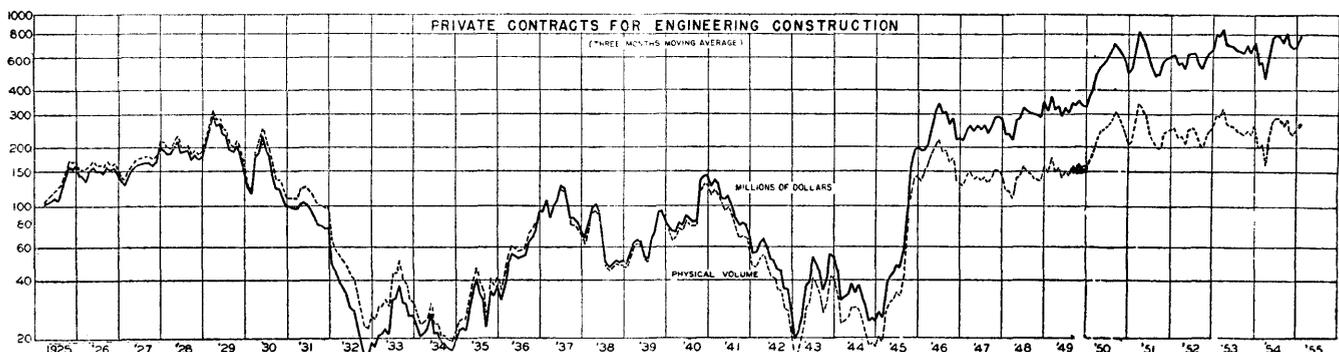
Between 1919 and 1929, a period notable for the widespread and rapid introduction of line-production methods, the rate of productivity increased about 5 percent per year. From 1930 to 1940, a period of depressed business activity, the average annual rate decreased to 2½ percent. During the wartime economy the rate of productivity decreased considerably due to the use of obsolescent equipment, inexperienced workers, and the emphasis on the unfamiliar products comprising armament production.

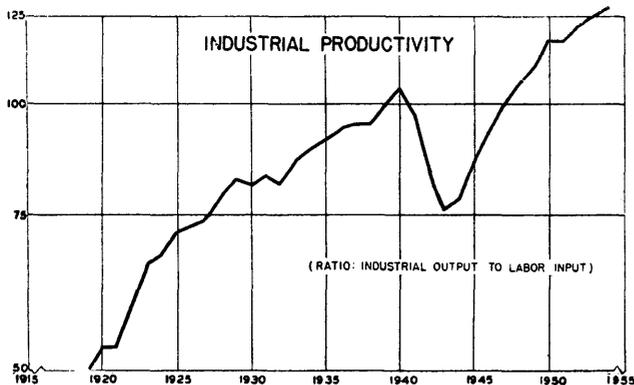
The ratio of 1940 was not again reached until 1948. With the exception of the Korean war year of 1951, when armaments again took precedence, the index has each year reached a new record although not at the rate of the decade beginning 1919.

There are many factors contributing to the increased productivity. Large expenditures for scientific research are continually yielding results, notably in the fields of electronics and chemistry.³ Moreover, the know-how of American industry has quickly adapted

²The index is derived by dividing the index of industrial production by the index of industrial employment, adjusted to allow for variations in length of the workweeks.

³It is estimated that private industrial corporations spent about \$1,500,000,000 for scientific research in 1954 as compared with about \$500,000,000 in 1941.





itself to new developments, labor has responded with a flexibility enabling it readily to move into new areas of activity, and ample funds have been readily available to provide the improvements and equipment needed to exploit technical innovations. The year 1954 was relatively free of industrial disputes and losses in productivity incidental to strike-interrupted operations.

We believe that the index of industrial productivity will continue to increase at recent or even greater rates. Moreover, the peacetime utilization of atomic energy looms on the horizon as a special development promising increased industrial productivity. Given world conditions and management-labor understanding that will provide a climate conducive to a full utilization of technological developments, industrial productivity of the next several years may well increase at rates approximating those of the 1920's.

Ratio of Retail Inventories to Sales

The ratio of inventories to sales of the 325 department stores reporting to the Federal Reserve Board is estimated to have decreased 1 percent during January after having decreased 5 percent (revised) in December. The January index is 8 percent smaller than that of January 1954 and is almost as small as that of January 1951, when the consumer scare buying of the Korean war unexpectedly depleted stocks of department stores.

The smaller ratio in January is due largely to an increased volume of sales. The adjusted index of department-store sales, which increased 5 percent in December, increased 1 percent more in January. In no other January (except 1951) has this index exceeded that of the preceding December.

Inventories of the 325 department stores were turned

4.29 times in 1954 as compared with 4.18 times in 1953 and 4.34 times in 1952. This rate of turnover is derived by dividing the year's total net sales by the average of the monthly inventories.

The seasonally adjusted index of department-store stocks, which index had changed less than 1 percent during the last half of 1954, remained unchanged from its December level. The stability of this index on the one hand and the increasing rate of sales on the other suggest effective inventory control. The average monthly index of stocks for 1954 was 3 percent smaller than that of 1953.

Department stores received more goods in December than in any previous December, and 13 percent more than in December 1953.

New orders in December were 11 percent more than those in December 1953; total purchases of \$398,000,000 comprised the largest December total in department-store history.

Outstanding orders decreased 25 percent during December but were 3 percent larger than at the end of 1953. The relatively small total of orders outstanding at the end of December, in view of the high level of December sales, appears to be explained by the desire of executives to keep their buying at a minimum in December in order to reduce inventories by clearances in January, thereby reporting more acceptable figures on annual statements.⁴

The influence of the sales trend, which was up in 1952-53 and down in 1953-54, on new orders placed in January is apparent in the following table of new orders:

	1952-53	1953-54	1954-55
	(millions of dollars)		
December	383	358	398
January	428	363	480 est.

The estimate of \$480,000,000 for January 1955 is based on purchases required to maintain the basic stocks of the reporting department stores with no allowance for increased inventories.

If department-store sales continue to increase at the rate of December and January, the ratio of inventories to sales is expected to remain relatively small. If sales increase only slightly, the ratio will still be smaller than that of 1954. Although department-store inventories appear to be relatively small, it is expected that the stores will continue to place new orders cautiously.

⁴The fiscal year of most large retail organizations ends on January 31.

