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COMING EFFECTS OF CURRENT EVENTS

Are Commodity Prices Too High?

This is the first of a series of articles that discuss in greater detail certain features of the article, "Our Estimate of the Situation", which was published in the bulletin dated February 14, 1955. Letters from subscribers reveal so much interest in various points made that these supplementary discussions seem advisable.

The question, Are Commodity Prices Too High?, apparently is not considered worth asking by many observers. Some economists as well as others seem to believe that the maintenance of any particular level of commodity prices or changing that level is a relatively simple matter for the official money-credit managers to handle.

The significant aspect of the situation often overlooked is that prices indicate an exchange relationship between the articles concerned and gold within every nation that is using gold as its basic money and as the reserve for its money-credit system. This is the situation that prevails in all the principal industrial nations of the world.

In the past, whenever there has been substantial inflation, that is, whenever purchasing media have been created and placed in circulation at a rate that exceeded the value of goods (including gold) being produced and offered in the Nation's markets, the prices of most goods except gold have risen. As long as the monetary unit was a specified amount of gold and the currency was redeemable in gold, the exchange value of paper currency and checking accounts in terms of gold remained unchanged.

However, the costs of mining gold increase as wages and prices generally rise. During a period of inflation, therefore, gold production is discouraged. As less gold comes into the money-credit system, and as some of the gold there flows out to nations that have not inflated their purchasing media (or have not inflated as much as we have), United States' gold reserves have not increased as they would have to in order to provide a basis for the expansion of credit needed in a growing economy. Sometimes, the gold reserves have not only failed to increase but have actually decreased.

Developments such as those just described reflect a relationship between gold and other goods leading us to believe that prices generally are too high. Such is the situation that has prevailed for some years in the United States and that still exists to a marked degree. As it

happens, a somewhat similar situation exists in other leading industrial nations of the world. This fact accounts in part for our ability to continue inflation over so long a period without an even greater loss of the Nation's gold reserves than that which already has occurred.

The effects of great inflation on domestic gold production can be seen in the following figures. Gold production averaged about 4,500,000 fine ounces during the five years 1911 to 1915 inclusive; but, in 1920 when the peak for commodity prices after World War I was reached, production was only 2,307,374 fine ounces. Again, during the five years 1937 to 1941 inclusive, domestic gold production averaged about 4,540,000 fine ounces; but, in 1951 when the postwar peak for prices occurred, production was only 1,981,000 fine ounces. (The wartime restrictions on gold mining had been abandoned several years earlier.)

As readers who have studied our analyses of world gold production* presumably realize, the world situation likewise must be considered. The evidence available demonstrates conclusively (to us, at least) that commodity prices in the leading industrial nations have been far above a stable relation with gold for several years. Our estimate is that a decline of about one-third in commodity prices, perhaps more, would be necessary to restore a stable relationship between gold production and commodity prices.

One of the suggestions often made is, If prices are too high in relation to the dollar at its present weight of gold, why not simply reduce the gold in the dollar enough to restore a stable relationship and start fresh with a good resolution to abstain from inflationary follies in the future? Unfortunately, this seemingly direct and simple solution would only open another Pandora's box of troubles. For example:

1. Congressional action is required to devalue the dollar again. What would happen while Congress debated such a step? Would foreign holders of demand claims on half our gold reserves sit idly by to be cheated by a new definition of the dollar or would they demand their gold immediately?

2. Even if there were some way of avoiding Congressional debate on the matter and thus effectively cheating the foreign governments and central banks that now trust us, what would our own citizens do? Many billions of inflationary U. S. currency still are hoarded here and abroad and many more billions of U. S. savings bonds

*See *Where Are We Going?*, pages 19 to 21.

are payable on short notice. Would all holders of such assets having a fixed dollar value be content to do nothing but watch their dollars depreciate some more or would there be a flight from the dollar that would make the scare buying of July 1950 and January 1951 seem relatively insignificant? That no one knows what the answer would be only emphasizes the risks of the course that has been followed.

3. And what about all the economic distortions that result when an economy is flooded with a large volume of inflationary purchasing media for several years? Could a simple devaluation of the dollar remedy all those maladjustments?

The unfortunate fact is that a situation has been created from which there is no easy way out. Moreover, all present indications are that many more and more serious economic distortions will exist before the situation is corrected.

Note: Some readers of our February 14 article apparently do not fully realize that we expect the present cyclical recovery of business activity to last for several months, at least. If the Federal Reserve Board exercises great caution in tightening money rates and no untoward developments occur elsewhere in the world, gradual resumption of the boom and continuation of it for many months, even a few years, may occur. In that event, businesses generally may be extremely profitable for some time and prices of common stocks in particular may rise much higher. In short, we were *not* predicting an early and severe decline in stock prices, commodity prices, or business activity. That such declines might quickly follow a sudden withdrawal of gold by foreign claimants or some other adverse development is probable; but even more probable, we believe, is resumption of the boom in business activity.

What the Indicators Say

This week we report the latest monthly percentage of statistical indicators expanding, as measured by the Institute method.

The percentage remains unchanged for the leading and lagging groups at 87½ and 60 percent respectively. The percentage for the roughly coincident group increased from 62½ to 87½ as gross national product and corporate profits after taxes were classified as expanding.

The latest data show that corporate profits increased in the fourth quarter of 1954; that unemployment de-

creased, and consumer installment debt increased in January.

The *Iron Age* composite price of No. 1 heavy melting scrap for the week ended March 1 at \$36.75 compares with \$37.00 for the preceding week.

Conclusion

Changes in the indicators, as reflected in the accompanying curves, do not present any warning signals and are consistent with some further improvement, which we expect in general business during the next 3 or 4 months.

SUPPLY

Industrial Production

Steel-ingot production of 2,198,000 tons during the week ended March 12, as indicated by operations scheduled at 91.1 percent of capacity, compares with 2,218,000 tons during the preceding week and 1,640,000 tons during the corresponding week last year.

The *New York Times* seasonally adjusted index of lumber production was 135.8 for the week ended February 26, compared with 137.3 a week earlier and 122.0 for the corresponding week last year.

Electric-power production of 9,727,000,000 kilowatt-hours during the week ended March 5 compares with 9,725,000,000 kilowatt-hours for the previous week and 8,590,000,000 kilowatt-hours for the corresponding week last year.

Automobile and truck production in the United States and Canada, estimated at 196,600 vehicles for the week ended March 5, compares with a total of 195,100 for the previous week and 139,800 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.	93	26	97	101	69	91 _p
Ingot prodn.—million tons	1.28	.40	1.75	1.86	1.64	2.20
<i>Lumber</i>						
<i>New York Times</i> Index	126	37	104	88	122	136
<i>Electric Power</i>						
Kilowatt-hours—billions	1.71	1.52	5.29	5.55	8.59	9.73
<i>Automobiles</i>						
Vehicles—thousands	121	35	108	118	140	197 _p

p Preliminary

DEMAND

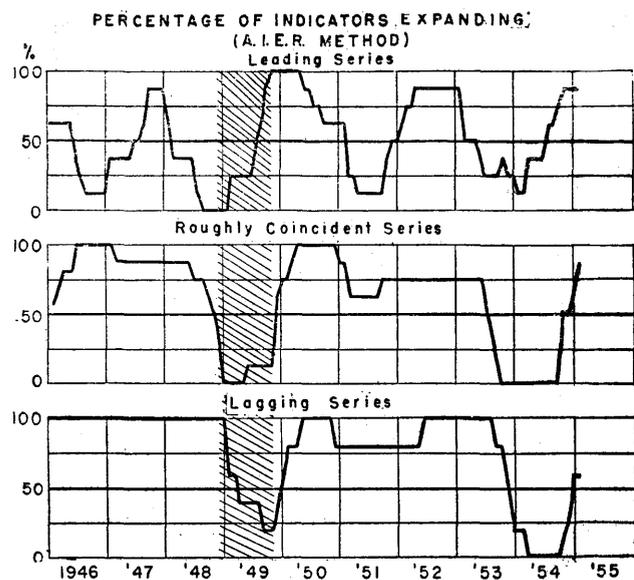
Purchasing Media

Total purchasing media at the end of February is estimated at nearly \$131,000,000,000, compared with \$132,500,000,000 (revised) for January and \$126,500,000,000 for February last year. As estimated, total purchasing media decreased about \$1,500,000,000 during February. This amount is slightly less than the average decrease during February of the preceding 8 years.

At the end of February, total purchasing media was divided between noninflationary and inflationary in the ratio of 2 to 3, and in the neighborhood of 30 percent of this total was idle or hoarded.

Noninflationary Purchasing Media

Noninflationary purchasing media, derived from gold and commercial, industrial, and agricultural loans, totaled approximately \$52,400,000,000 at the end of February. This amount is substantially the same as that a year earlier. Purchasing media derived from gold amounted to \$21,700,000,000 at the end of February compared with nearly \$22,000,000,000 a year earlier.



Purchasing media derived from commercial, industrial, and agricultural loans increased about 1 percent during February to approximately \$30,700,000,000, which compares with \$30,000,000,000 at the end of February 1954.†

Inflationary Purchasing Media

Inflationary purchasing media are those purchasing media derived entirely from credit other than commercial, industrial, and agricultural loans or based on the silver holdings of the Treasury valued at \$2,440,000,000 at the end of February. The total of such purchasing media at the end of February was \$78,600,000,000. This amount compares with \$80,400,000,000, at the end of January and \$74,100,000,000 a year ago.

Purchasing media based on the credit of the United States, or on silver, and circulating as Treasury currency totaled about \$4,100,000,000 at the end of February, nearly \$100,000,000 more than that of a year earlier. Purchasing media based only on the general credit of the United States (Government securities) and monetized through demand deposits of commercial banks and Federal Reserve notes are estimated at \$47,800,000,000 at the end of February, compared with \$50,200,000,000 at the end of January and \$47,600,000,000 at the end of February 1954.

Purchasing media derived from all other sources of credit and monetized through demand deposits of commercial banks are estimated at \$26,800,000,000 at the end of February.‡ This amount compares with \$26,000,000,000 a month earlier and \$22,500,000,000 a year ago.

Conclusion

Although the extension of the period of tax payments into April is a factor tending to retard the seasonal rate of contraction in purchasing media, the decrease to-date this year has been closely comparable to that of preceding years. This fact is explained by a somewhat greater reduction in bank holdings of Government securities in January and February than has been common in these months during recent years.

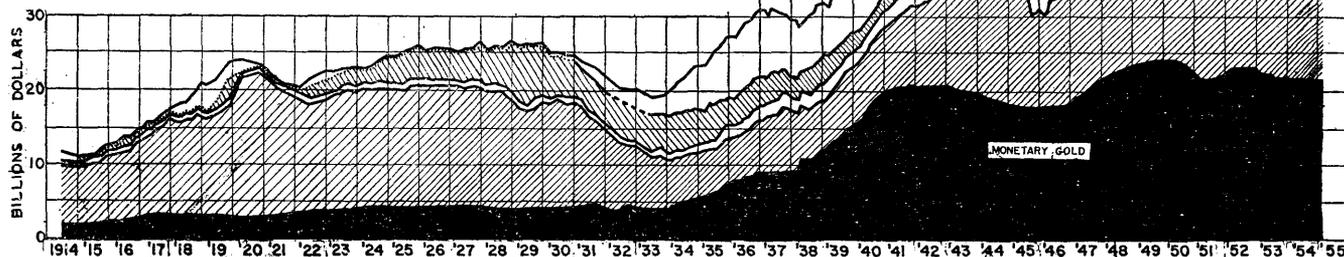
Department-Store Sales

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

Period	Percent Change
Week ended March 5	+15
Four weeks ended March 5	+6
Year to date	+7

†In a monetary system based and operating on strictly commercial banking principles seasonal and cyclical changes in the economy's need for purchasing media would be met by changes in purchasing media derived from this source.

‡This credit is represented by commercial bank holdings of (1) notes taken in exchange for all loans other than commercial, industrial, and agricultural loans and (2) bonds and other forms of indebtedness, excepting that of the United States Government.



PRICES

Commodities at Wholesale

Index	1954		1955
	Mar. 9	Mar. 2	Mar. 9
Spot-market, 22 commodities	273	275	272
Commodity futures	376	336	331

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

New orders received by manufacturers during January, seasonally adjusted, continued at the high levels of November and December, with orders for durable goods registering the greater gains. New orders received by all manufacturers during January, the second successive month of increasing sales, were 21 percent greater than those in January 1954; new orders received by durable-goods manufacturers were 49 percent greater than those in January 1954. Although steel and autos led in amount of gain, all components of the durable-goods index reflected gains. New orders, seasonally adjusted, totaled \$25,100,000,000 in January compared with \$25,300,000,000 in December, the largest total since May 1953, and with \$20,700,000,000 in January 1954.

Manufacturers' sales, seasonally adjusted, continued to be the largest since the fall of 1953. Compared with those of a year ago sales of durable goods were 6 percent larger, sales of nondurable goods 2½ percent larger.

Unfilled orders, not seasonally adjusted, increased slightly from those of December but were considerably less than those of the spring months of either 1954 or 1953.

Manufacturers' inventories, which include goods in process, raw materials in storage, and finished goods awaiting shipment, were unchanged seasonally from their December level, but were 6 percent less than those of a year ago. Inventories of durable goods were reported at 8 percent less than those of a year earlier. Combined inventories of all manufacturers are smaller than they have been at any time since 1952.

The ratio of manufacturers' inventories to sales, both seasonally adjusted, was 1.76, unchanged from the December ratio, which was the smallest since the spring of 1953. The January ratio for durable-goods industries is 2.03, compared with 1.53 for the nondurable-goods industries. In January last year these ratios were 2.28 and 1.61, respectively. The ratio for the durable-goods industries is the smallest since the spring of 1953.

Periods of greatest business activity usually are associated with relatively great activity in the durable-goods industries. The accompanying table shows that manufacturers' sales were larger in 1954 than in any of the years 1949-54 excepting 1953, and that durable goods accounted for a larger percentage of manufacturers' sales in 1954 than in 1949, 1950, or 1951. In the 4 months ending with January 1955 manufacturers' sales of durable goods averaged 48 percent of all manufacturers' sales.

MANUFACTURERS' SALES
1949-1954

Year	Total (Millions)	Percent of Total	
		Durable Goods	Nondurable Goods
1949	\$197.0	43.1	56.9
1950	231.4	45.6	54.4
1951	266.5	46.9	53.1
1952	276.5	48.6	51.4
1953	303.4	50.3	49.7
1954	287.8	47.3	52.7

The relatively level trend of manufacturers' unfilled orders for 5 months following a declining trend for nearly 2 years, new orders at near-record levels, and the smallest sales-inventory ratio since the spring of 1953 reflect the generally favorable position of manufacturers. We believe that new orders will be sufficiently

large during the next several months to enable manufacturers to maintain and possibly improve their present satisfactory position.

The Trend of Business Failures

Our 3-month moving average of liabilities of business failures for December increased 9 percent to an amount 3 percent more than that for December 1953. The average is 23 percent less than the post-World War II record of March 1954.

The monthly total of failure liabilities in January was \$37,872,000, compared with \$40,103,000 in December and \$29,592,000 in January 1954. With the exception of those for December, the failure liabilities for January were the largest since those of June 1954. Although failures involving less than \$5,000 and those involving \$100,000 or more were not so numerous in January as they were in December, the number of failures involving liabilities of \$5,000 to \$25,000 increased. There were 939 failures in January, compared with 917 in December and 867 in January 1954. Average liabilities of \$40,332 per failure in January compare with \$43,800 in December and \$34,131 in January 1954.

The direction of change in number and liabilities of failures by industry classification in January was as follows:

	Number	Liabilities
Mining and Manufacturing	Decrease	Decrease
Wholesale Trade	Increase	Decrease
Retail Trade	Increase	Increase
Construction	Decrease	Increase
Commercial Services	Increase	Increase

The percentage of all failure liabilities accounted for by the several industry groups changed from December to January, as follows: mining and manufacturing, from 43 to 31; wholesale trade, from 16 to 12; retail trade, from 21 to 25; construction, from 15 to 24; commercial services, from 5 to 8.

The number of failures reported by Dun & Bradstreet for the 4 weeks ended March 3 was 843, compared with 984 for the preceding 4 weeks.

The latest increase in the moving average reflects monthly increases in failure liabilities in November and December following a relatively small total in October. Consequently, this increase in the monthly average is only the delayed reflection of random interruptions in what appears to be a slightly downward trend in failure liabilities.

§The average is based on data reported by Dun & Bradstreet and is plotted at the midmonth; the monthly figures are as reported by Dun & Bradstreet. The reported liabilities exclude long-term debt publicly held.

