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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

*The Aftermath of the Treasury's 1953 Dilemma**

Many readers may recall that in the issue of June 22, 1953, we discussed "*The Treasury's Dilemma.*" After pointing out the magnitude of the Treasury deficit to be expected in the latter part of that year and the large volume of refunding made necessary by maturing issues, we explained that there obviously were two extreme choices, the traditional two horns of the dilemma. We then concluded as follows:

"We do not doubt that great wisdom will be applied in handling this difficult situation. Presumably, further tightening of money rates will be one result. To place the entire burden on the Federal Reserve banks by inducing them to adopt an 'easy money' policy again would be to encourage expansion of the already huge volume of consumer lending and of municipal and corporate investment with even more inflation resulting; but to go to the other extreme probably would force an increase in money rates to panic levels.

"The final outcome may range from the possibility of further marked inflation with resulting extension of the present boom to a severe crisis in the money market. Although we hope that the probability of the latter is *very small*, we believe that it should not be wholly disregarded.

"We realize that many observers have long since been convinced that, to the Federal Government, nearly anything is possible. The Treasury's purse is quite generally visualized, even by shrewd men of experience in business and finance, as an inexhausible source of funds. Apparently the gigantic spending, borrowing, and buying of the past two decades not only has resulted in the situation now at hand but also accounts for the widespread belief in the Treasury's financial omnipotence. This is not the first time that a spendthrift has stimulated delusions of his financial grandeur while his capital and credit lasted, but it apparently is the first time that the job has been done on such a colossal scale.

"*Under such unprecedented circumstances, to predict the outcome would be to claim virtual omniscience. We shall observe developments of the next few months with unusual interest.*"

As we now know, the course of action chosen was to put virtually all the burden on the money-credit system. Shortly after the article was published the Federal Reserve Board reduced reserve requirements substantially and within the next several weeks purchased Government securities on a large scale. Again in the summer of 1954 the process was repeated in part. (We had not thought that the Federal Reserve Board would be willing to repeat, virtually on the same scale, the easy-money blunders of the 1920's.) The net effect of these actions was to facilitate the inflationary financing of the Government deficits and encourage the continued expansion of real-estate and consumer loans.

In short, the Administration chose the horn of the dilemma that involved more inflation. The extent of the additional inflation is clearly shown by the rise of our index of inflation from 160 to 190 (March 1953 to December 1954). As in 1949 (and likewise in 1924 and 1927) an easy-money policy fostered enough inflation to cut short a corrective recession and limit its principal effects to the liquidation of speculative inventories.

Now that a cyclical recovery of business is well under way and optimism is widespread, many observers may believe that the Treasury chose wisely in resolving its dilemma. Certainly, if the Administration had not selected the seemingly easy way out, if deflation rather than inflation had been chosen (or if deflation had been forced by circumstances beyond the Administration's control, as it might have been), the 1953-54 recession would have been much more severe.

Before attempting to pass final judgment on the wisdom of the choice made, however, it may be well to wait until the costs of the decision made can be more accurately estimated. Trouble postponed is not necessarily trouble avoided. Sometimes postponement results in trouble greatly magnified to critical proportions.

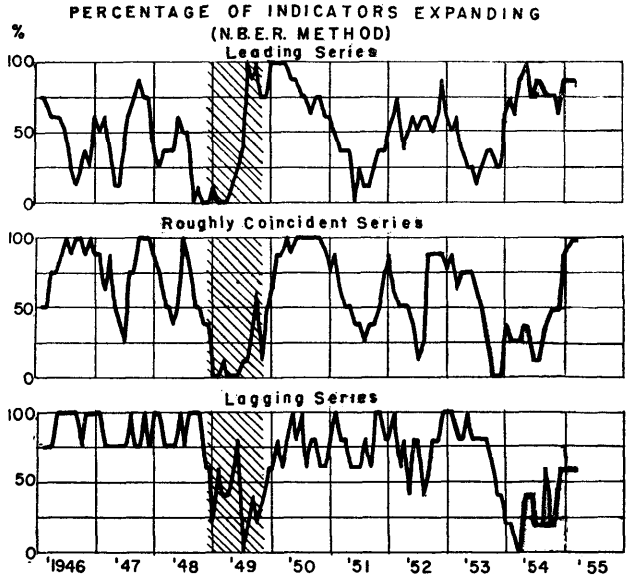
As we have pointed out elsewhere, continued inflation has maintained prices generally in the United States at such a high level that foreign nations have taken more demand claims on our gold in preference to our goods. Thus, as the superstructure of debt and credit expands, the gold base on which the inverted pyramid rests continues to shrink. Stimulated by easy money, new residences have been built at a rate that bodes ill for a prompt resumption of residential building during the next depression. In a similar manner, other types of construction may prove to be in excess of deflated needs.

In a news conference recently, President Eisenhower expressed great concern for those who have had neither capital for speculative uses nor big unions to aid them in obtaining more income as the dollar has depreciated.

*This is the third 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.

But will not the Treasury's 1953 choice simply lead to another devaluation of the dollar? With half the Nation's gold reserves already payable on demand to foreign Governments and central banks, will any be left if continuing inflation is chosen as the means of maintaining prices and wages at present or even higher levels? And when only a quarter rather than half our gold reserve is left, or an eighth, or none, what then? And if all confidence in claims on dollars is lost, would not a flight from the dollar constitute irretrievable disaster for all those about whom President Eisenhower expresses great concern?

We are well aware that many supposedly qualified economists as well as many laymen are inclined to shrug off such questions with some such reply as, "It can't happen here." Nevertheless, we should feel much less concern if there were more indications that the money authorities were thinking "It might happen here." In our opinion, complacent confidence in an inflation-induced prosperity and a willingness to continue giving the economy the inflation "medicine" probably will insure that "it" (a money-credit disaster of major proportions) will happen here within the next several years.



What the Indicators Say

The percentages of statistical indicators expanding, as measured by a method of the National Bureau of Economic Research, are unchanged from those of last month.† The percentages are 87½, 100, and 60 for the leading, roughly coincident, and lagging indicators, respectively.

Nonagricultural employment in February, seasonally adjusted, was reported unchanged from that of January.

The *Iron Age* composite price of No. 1 heavy-melting steel scrap for March 22 was $37.50, unchanged from that for March 15.

The stability of the accompanying curves at levels above the 50-percent line supports our expectation of further business improvement.

†This method of summarizing the cyclical status of each of the three groups of indicators was outlined in *Research Reports* for March 1, 1954. The curves reflect the latest data available for the respective indicators. The latest data are, therefore, necessarily, not all for the same period and include preliminary or estimated data.

DEMAND

Department-Store Sales

We estimate that department-store sales, seasonally adjusted, increased 10 percent in March to a total nearly 12 percent more than in March 1954.§ Sales in the first quarter of 1955 exceeded those in the first quarter of 1954 by nearly 8 percent and those in the first quarter of record 1953 by nearly 3 percent. Should the first-quarter rate of sales be maintained through the second quarter, sales in the first half of 1955 would exceed those of the first half of 1954 by twice the earlier, seemingly optimistic, forecasts of 3 to 4 percent.

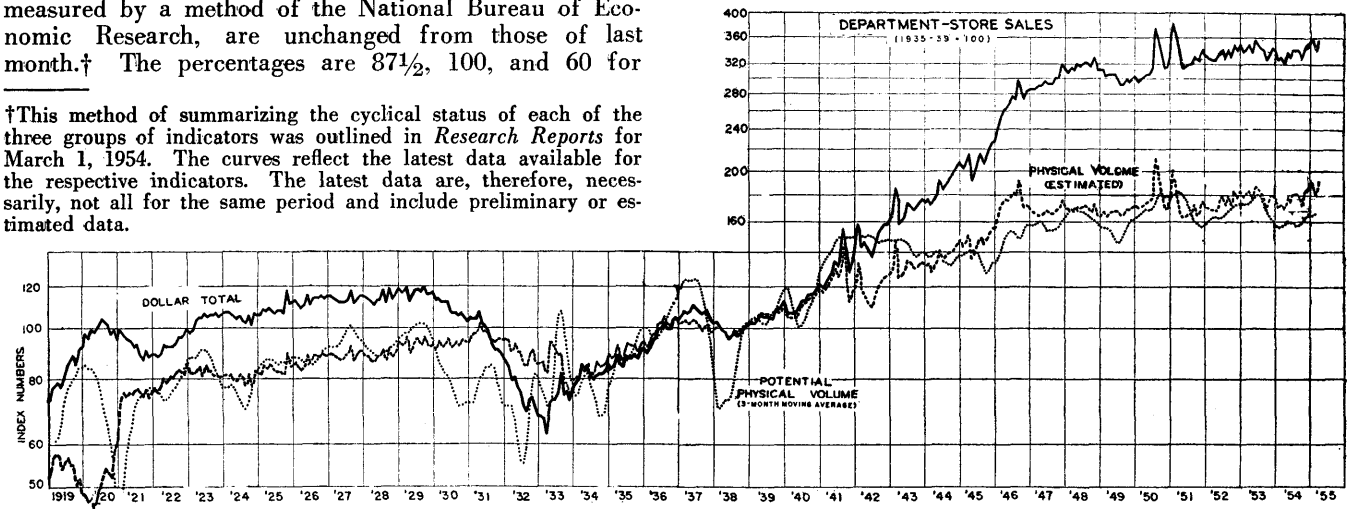
In comparing first-quarter sales of 1955 with first-quarter sales of the preceding 2 years, it should be pointed out that, in both 1954 and 1953, sales seasonally adjusted were smaller in the first quarter than in the second. Thus the larger sales in the second quarter of each of the preceding years makes more unlikely a continuation this year of the first-quarter rates of sales gains relative to the corresponding quarters of the earlier years.

Prices in March of goods sold in department stores were reported practically unchanged from those in February but 1.4 percent below prices in March 1954. The physical volume of department-store sales increased 4 percent during March to a level 13 percent larger than that in March 1954, indicating that about one-eighth more merchandise moved through the stores into customers' hands than in March last year.

The potential volume of department-store sales, which reflects production of goods sold through department stores, increased less than 1 percent during February.

The recent tendency of the physical volume of sales to increase at a rate somewhat faster than that at which po-

§In estimating seasonally adjusted sales for March, allowance was made for the effect of the earlier date of Easter this year as compared with last.



tential volume has increased suggests that merchandise is being sold at a rate faster than it is being produced. Thus it appears that the aggregate inventories of goods sold by department stores, which inventories include those in the hands of manufacturers and distributors, are tending to decrease.

The upward trend of department-store sales that began in the third quarter of 1954 received added impetus during March. There is evidence that customers are more disposed to spend and are less hesitant to use their savings as well as their credit. We believe, therefore, that the record level of department-store sales achieved in the first half of 1953 will be slightly exceeded in the first half of 1955.

Latest Weekly Data

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

Period	*Percent Change*
Week ended March 26	+ 2
Third week before Easter‡	− 1
Four weeks ended March 26	+10
Year to date	+ 7

SUPPLY

Industrial Production

Steel-ingot production of 2,258,000 tons during the week ended April 2, as indicated by operations scheduled at 93.6 percent of capacity, compares with 2,262,000 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 119.5 for the week ended March 19, compared with 125.8 a week earlier and 118.3 for the corresponding week last year.

Electric-power production of 9,907,000,000 kilowatt-hours during the week ended March 26 compares with 9,814,000,000 kilowatt-hours for the previous week and 8,490,000,000 kilowatt-hours for the corresponding week last year.

Automobile and truck production in the United States and Canada, estimated at 216,800 vehicles for the week ended March 26, compares with a total of 212,800 for the previous week and 149,600 for the corresponding week last year.

‡Because of the influence of Easter on department-store sales, comparisons are more significant if made for corresponding weeks before Easter. Thus we compare under "Third week before Easter," sales of the week ended March 26, 1955, with sales of the week ended April 3, 1954.

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

	1929	*1932*	*1948*	*1949*	*1954*	*1955*
Steel						
Operating rate—percent cap.	95	22	88	100	69	94*p*
Ingot prodn.—million tons	1.31	.33	1.58	1.84	1.64	2.26
Lumber						
New York Times index	125	40	100	88	118	120
Electric Power						
Kilowatt-hours—billions	1.68	1.52	5.06	5.40	8.49	9.91
Automobiles						
Vehicles—thousands	126	37	107	121	150	217*p*

p Preliminary

PRICES

Consumers' Prices

Prices of goods and services bought by moderate-income city families, as measured by the United States Bureau of Labor Statistics index of consumer prices, were virtually unchanged during the month ended February 15 for the second successive month. The February index was about one-half of 1 percent less than that of February 1954.

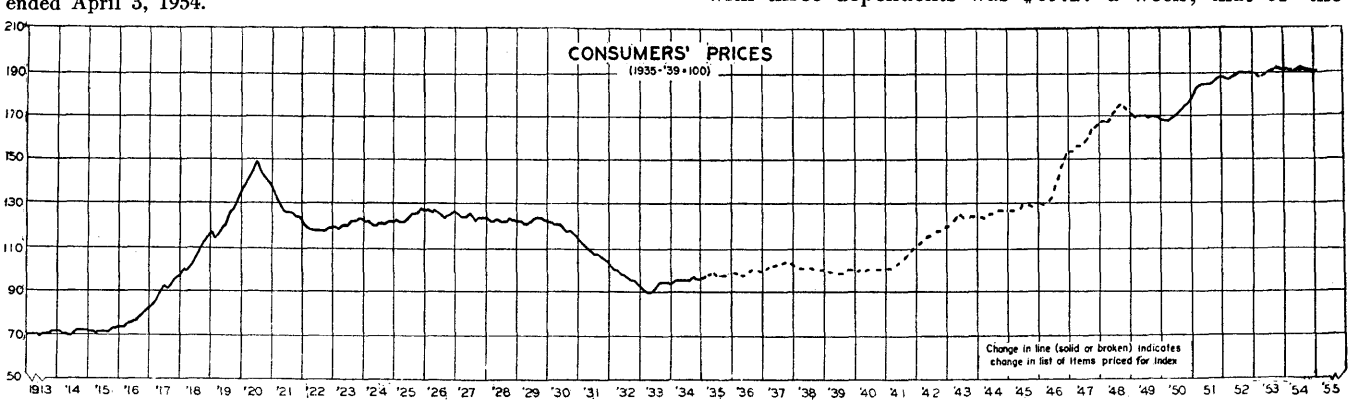
Slight increases were reported for food, apparel, and medical care; slight decreases were reported for transportation, personal care, reading and recreation, and other goods and services. The housing component was unchanged.

The increase in food prices did not extend to either all cities or all foods. Egg prices were higher, but meat prices, especially those of pork, were slightly lower. Prices for poultry were higher, but coffee prices averaged lower during the month ended February 15 than they had been during the previous month. The small increase in apparel prices was attributable primarily to the change from January sales to regular prices for men's suits. The increase in costs for medical care was attributable to higher premiums for group hospitalization in certain cities.

The decrease in transportation costs reflected lower prices for used cars and greater price concessions on new cars. Concerning automobile prices, *The Wall Street Journal* writes: "Car prices have perhaps never been more subject to dickering." The decrease in the component reading and recreation reflected sales prices for toys and sporting equipment.

In the housing component of the index, lower ownership costs, attributable to lower interest rates on mortgages and lower costs for fire insurance, were offset by higher rents and higher prices for housefurnishings, gas and electricity, coal, and fuel oil.

The Bureau of Labor Statistics reported that in February the take-home pay of the average factory worker with three dependents was $69.17 a week; that of the



average factory worker with no dependents was $61.91. During the past year the purchasing power of the average factory worker increased 5 percent because of more take-home pay and the slightly lower cost of living.

Present indications are that the trend of consumer prices in the coming months will continue gradually downward.

Commodities at Wholesale

Index	1954 Mar. 30	1955 Mar. 23	1955 Mar. 30
Spot-market, 22 commodities	282	275	275
Commodity futures	379	327	325

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

BUSINESS

The Trend of Business Failures

Our 3-month moving average of liabilities of business failures increased to $40,000,000 for January, compared with $37,700,000 for December and $40,400,000 for January 1954.||

The monthly total of liabilities of business failures was $42,100,000 for February, compared with $37,900,000 for January and $47,800,000 for February last year. Although the liabilities of business failures increased nearly 11 percent in February, the number of failures decreased nearly 6 percent to 877, compared with 926 in February 1954. Liabilities averaging $48,000 per failure in February compare with $40,300 in January and $51,600 in February last year. The number of failures in February was unchanged or decreased in all size groups except in the $100,000 to $1,000,000 group, for which the number was 70 compared with 62 for January.

The percentage of all failure liabilities accounted for by the several industry groups changed from January to February as follows: mining and manufacturing, from 31 to 45; wholesale trade 12 to 10; retail trade 25 to 22; construction 24 to 18; commercial services 8 to 5.

Business failures in February were at an annual rate of 39 per 10,000 enterprises listed in Dun & Bradstreet's *Reference Book.* This annual rate compares with 41 in February 1954 and 58 in prewar 1940.

The number and liabilities of failures by industry classification in the first 2 months of the year compare with those of the corresponding period of 1954 as follows:

	Number First 2 Months 1954	Number First 2 Months 1955	Liabilities¶ First 2 Months 1954	Liabilities¶ First 2 Months 1955
Mining and manufacturing	399	383	34.5	30.6
Wholesale trade	166	218	7.8	8.7
Retail trade	899	868	20.4	18.6
Construction	195	200	7.2	16.7
Commercial services	134	147	7.5	5.4
Total	1,793	1,816	77.4	80.0

Perhaps the most noteworthy change revealed in this breakdown of the data is the sharp increase this year in the failure liabilities of construction firms. Although the number of failures among this group increased only 2½ percent, liabilities increased 132 percent and averaged $83,000 per failure, compared with $38,000 in the like period last year.

Of all business failures in 1954, inexperience is reported as accounting for nine out of ten. Other causes of failure, in order of importance, are listed as neglect, fraud, and disaster, with the last accounting for less than 2 percent. Of the failures attributable to inexperience, slightly more than half were reported as due to inadequate sales experience.

Failures reported in the 4 weeks ended March 24 total 937, compared with 972 in the corresponding weeks last year.

Because business-failure liabilities are one of the most reliable leading indicators of business-cycle changes and as such have had a record lead averaging more than 10 months, this series could be warning of a downturn in general business activity late this year or early next. However, more time is required to determine whether the successive increases in the average for its four latest months indicate a reversal of the cyclical trend or reflect only random movements.

BUSINESS FAILURES: NUMBER AND LIABILITIES

Month	Number 1953	Number 1954	Number 1955	Liabilities (000 omitted) 1953	Liabilities (000 omitted) 1954	Liabilities (000 omitted) 1955
January	647	867	939	$23,309	$29,592	$37,872
February	691	926	877	27,273	47,774	42,056
March	739	1,102		31,082	57,280	
April	693	975		27,520	42,512	
May	697	943		32,789	38,494	
June	817	965		32,379	41,613	
July	724	856		39,830	32,230	
August	700	912		28,529	32,582	
September	686	819		33,817	36,381	
October	840	871		37,076	29,000	
November	815	933		36,795	35,067	
December	813	917		43,754	40,103	
Total	8,862	11,086		$394,153	$462,628	

||The average, as is the entire article, is based on data reported by Dun and Bradstreet. The average is plotted at the mid-month. Reported liabilities exclude long-term debt publicly held.

¶Millions of dollars.