AMERICAN INSTITUTE for ECONOMIC RESEARCH

GREAT BARRINGTON MASSACHUSETTS

WEEKLY BULLETIN

January 9 1956

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The State of the Union

The "State of the Union" message in recent years has become relatively less important, because it is confined largely to generalities. The subsequent special messages during the early weeks of the new Congressional session present specific recommendations that can be analyzed more effectively.

If President Eisenhower has any idea how the Nation has reached its present position in the upper reaches of a major boom, he chose not to reveal his knowledge.‡ Apparently because he lacks that knowledge or has accepted other more comforting explanations of developments, he was more complacent about the Nation's economic situation than we should consider the facts warrant.

Although he proposed no tax reductions at this time, we assume that he will hesitate to veto tax reductions this year. In any event, he revealed no determination to resist a tax reduction.

The suggestion that foreign aid be increased presumably will be set forth in detail in a later message. Consequently, we postpone any comment other than to repeat our belief that alternative ways of using the funds within the United States would, in our opinion, promise much more return on the money in terms of national security and progress.

Interest Rates

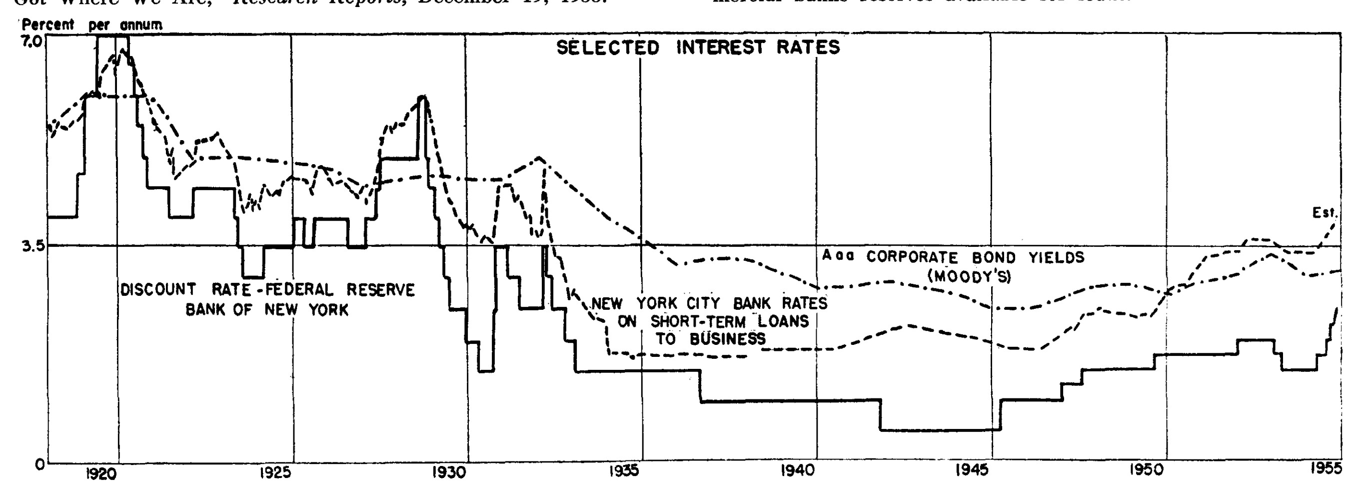
A demand for funds increasing faster than the rate of savings, in the absence of a central-bank policy of manufacturing funds through the banking system (the modern counterpart of printing paper currency), has raised the general level of interest rates to the highest level, except for a brief period in 1953, in more than 20 years.* Moreover, the four (although small) increases in the Federal Reserve discount rate during 1955 indicate that the Federal Reserve Board is using the discount rate as an instrument of monetary policy more aggressively than it has been used since 1929. (The rate was changed only six times in the 7 years preceding the first increase this year.) Thus, as long as the business boom is held in check and its collapse is avoided, interest rates may move toward the levels that prevailed prior to the era of easy money, which dates from the devaluation of the dollar in 1934. In commenting on the Federal Reserve's use of the discount rate, the First National City Bank *Monthly Letter of Business and Economic Conditions* for December 1955 says: "It has been the clear intention of the authorities to convert the discount rate from a symbol of policy to a ready weapon."

As indicators of the general pattern and levels of interest rates we show on the accompanying chart (1) the discount rate of the Federal Reserve Bank of New York, (2) the rate of New York City banks for short-term loans to business, (3) the yield (rate) on Aaa corporate bonds.

The discount rates of all Federal Reserve banks were

‡We refer to the developments described in the article "How We Got Where We Are," *Research Reports*, December 19, 1955.

*A central-bank policy of manufacturing funds would be implemented through the Federal Reserve banks' open-market purchases of Government obligations or advances (discounts) to the commercial banks, either of which would provide the commercial banks reserves available for loans.



increased from the $1\frac{1}{2}$ percent to which they had been reduced in 1954 to $2\frac{1}{2}$ percent by November 1955. In terms of the rates prevailing during the past 22 years, a discount rate of $2\frac{1}{2}$ percent is high. (The highest rate during this period was 2 percent, reached in 1953.) Moreover, for nearly half of this 22-year period, including the war years when the discount rate was held at one-half of 1 percent as an aid to financing the war, the rate did not exceed 1 percent. However, compared with the rates that prevailed throughout the period 1919 to 1929, a discount rate of $2\frac{1}{2}$ percent is low, the rate at none of the 12 banks at any time during that period having fallen below 3 percent; and only for 6 months of the period was the rate as low as 3 percent (for the New York bank only). Throughout the 1920's the most common rates for the New York bank were in the 4- to 6-percent range. The highest rate reached was 7 percent, charged by the New York bank and 4 of the other 12 banks.

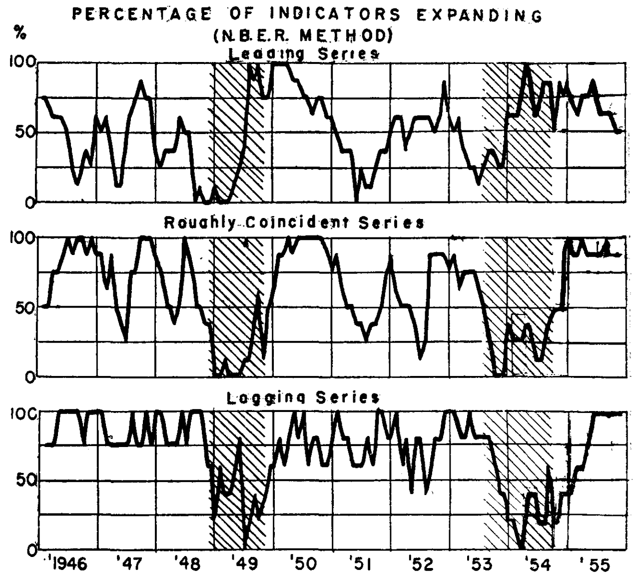
The average rate of New York banks for short-term loans to business for the fourth quarter of 1955 is estimated at 3.80 percent, compared with 3.54 percent for the third quarter of 1955 and 3.30 percent for the fourth quarter of 1954. The estimated fourth-quarter-1955 rate is the highest rate for any quarter since that for the first quarter of 1933. However, as is true of the Federal Reserve discount rate, the fourth-quarter rates on short-term loans to business are still low in relation to those prevailing prior to the early 1930's. Throughout the 1920's this rate on business loans was in excess of 4 percent. From mid-1924 to mid-1928 it ranged from about 4.1 percent to about 4.8 percent.

During 1955 the rate on business loans increased only about one-half as much as the Federal Reserve discount rate, with which it is closely associated. The failure of the rate on business loans to increase more has been ascribed to the lag in rates on long-term loans to business. Business can borrow from insurance companies at rates ranging from $3\frac{3}{4}$ to 4 percent, and bank rates higher than those now prevailing presumably would lead to increased borrowing from nonbanking sources. However, there is no assurance as to how long this source of long-term funds will be available at current levels of interest rates. Present indications are that industrial expansion and State and local government building will require large amounts of funds in 1956, and there may be further tightening in the short-term money market following a temporary and seasonal easing during the first few weeks of the year. Over the longer period higher rates in the short-term money market probably will be reflected in tighter conditions in the longer term market.

Moody's average of Aaa corporate bond yields has been increasing gradually since October 1954. The average yield for 1955 was 3.06 percent, compared with 2.90 percent for 1954 and with 3.20 percent for 1953. The smallest average for any year was 2.53 percent for 1946. During December 1955 the average fluctuated at its highest levels of the year and averaged about 3.15 percent. Not since 1938 has the annual average rate exceeded the levels reached in December.

The course of interest rates during the next year or more will depend not only on the course of business activity but also on the monetary policy of the Federal Reserve Board. However, if the Board succeeds in preventing a more extreme boom and a "bust," interest rates probably will advance gradually toward the levels that prevailed prior to the era of easy money.

What the Indicators Say



The percentages of indicators expanding during November, measured according to a method developed by the National Bureau of Economic Research, are 50 for the leading indicators, $87\frac{1}{2}$ for the roughly coincident indicators, and 100 for the lagging indicators.†

Latest data reveal that during November new orders for durable goods increased $3\frac{1}{2}$ percent and manufacturers' inventories increased one-half of 1 percent. During December the average of the Dow-Jones daily index of common-stock prices of 30 industrials increased $1\frac{1}{2}$ percent and the average of the Bureau of Labor Statistics daily index of wholesale prices of 22 basic commodities increased 1 percent.

The *Iron Age* composite price of No. 1 heavy melting steel scrap for January 3 was $53.33. The price for December 27 was $53.00; the price for the corresponding Tuesday a year earlier was $34.17. The average is currently at its alltime high.

The decline in the percentage of indicators expanding to 50 percent could be the beginning of a trend that will bring the percentage below 50. Such a change would suggest that a downturn in general business activity might soon begin.

SUPPLY

Industrial Production

Steel-ingot production of 2,370,000 tons during the week ended January 7, as indicated by operations scheduled at 96.4 percent of capacity, compares with 2,310,000 tons during the preceding week and 1,950,000 tons during the corresponding week last year.

The *New York Times* seasonally adjusted index of lumber production was 124.9 for the week ended December 24, compared with 138.7 a week earlier and 143.0 for the corresponding week last year.

Electric-power production of 10,751,000,000 kilowatt-hours during the week ended December 31 compares with 11,614,000,000 kilowatt-hours for the previous week

†This method of summarizing the cyclical status of each of the three groups of indicators was outlined in *Research Reports*, March 1, 1954. All the indicators are seasonally adjusted except corporate profits, bank rates, and the three price series.

and 9,400,000,000 kilowatt-hours for the corresponding week last year.

Automobile and truck production in the United States and Canada, estimated at 121,660 vehicles for the week ended December 31, compares with a total of 177,250 for the previous week and 148,400 for the corresponding week last year.

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

	1929	*1932*	*1948*	*1949*	*1955*	*1956*
Steel						
Operating rate—percent cap.	62*	25	98	98	81	96*p*
Ingot prodn.—million tons	,86	.38	1.76	1.80	1.95	2.37
	1929	*1932*	*1948*	*1949*	*1954*	*1955*
Lumber						
New York Times Index	123	30	99	115	143*	125
Electric power						
Kilowatt-hours—billions	1.64*	1.42*	5.47*	5.49	9.40*	10.75*
Automobiles						
Vehicles—thousands	24*	28*	82	113*	148*	122p*

p Preliminary; * Holiday week

DEMAND

Retail Sales

We estimate that retail sales in 1955 totaled $186,-000,000,000 compared with $171,000,000,000 in 1954 and in 1953. Thus, for the entire year, sales exceeded those of 1954 by nearly 9 percent. Because of the small change in the prices of items sold at retail last year these figures are a fairly good indication of increases in the physical volume of merchandise sold at retail during 1955.

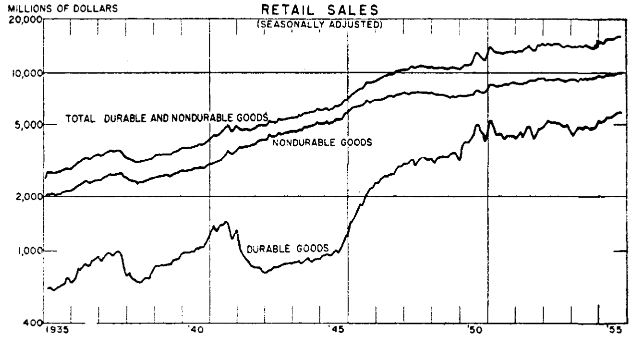
Sales of durable goods, which characteristically fluctuate more than sales of nondurable goods, increased 15 percent in 1955; sales of nondurable goods increased a little more than 5 percent. Automobile sales, which comprised nearly three-fifths of all consumers' durable goods sales last year, were nearly 21 percent larger than those in 1954. Sales of furniture and appliances, which ranked next to automobile sales in size of gain, increased nearly 11 percent. The 5 percent increase in sales of nondurable goods was somewhat greater than twice the rate of population growth. Sales of gasoline service stations, which account for about one-twelfth of all nondurable goods sales increased 9 percent in 1955.

In 1955 retail sales equaled 69 percent of consumer disposable income. In 1954 and 1953 the corresponding percentages were 67 and 68 respectively.

Retail sales in 1955 were benefited by large expenditures for Christmas gifts. Total retail sales for December have been estimated at $20,000,000,000 compared with $17,900,000,000 in December 1954, the previous record month. Toys, and particularly the more expensive toys are reported to have sold well. Reflecting the large Christmas sales, retail inventories were reported at exceptionally low levels at the year end.

Spot checks indicate that in general retailers improved their operating efficiency last year and increased their earnings records.

Widely quoted estimates indicate that retail sales in the first half of 1956 are expected to exceed those of the first half of 1955 by amounts ranging from 4 to 6 percent. Many observers expect sales of nondurable goods to make a relatively better showing than sales of durable goods in 1956. However, installment selling will be emphasized by many department stores this year in an effort to maintain the recent high sales levels of home appliances and other items commonly sold on the installment plan.



Philip M. Talbott, president of Woodward and Lothrop (Washington, D. C) and president of the National Retail Dry-Goods Association has said, "I do not feel there will be any significant increases in prices in 1956," and "a powerful force to check any price increase trend is the intense but healthy competition that will prevail."

Mr. Talbott, whose own store has opened suburban branches, also has predicted, "The renaissance of downtown areas will be the dominating factor in the merchandising scene this coming year."

In the absence of further large increases in the amount of installment credit in use, retail sales during the next few months are expected to exceed those of the corresponding months of 1955 by 3 to 5 percent. If, however, the use of installment credit continues to increase at recent rates the rate of increase in retail sales may be somewhat greater.

Department-Store Sales

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

Period	*Percent Change*
Week ended December 31	+11
Four weeks ended December 31	+10
Year to date	+ 7

PRICES

Commodities at Wholesale

Index	*1955 Jan. 4*	*1955 Dec. 28*	*1956 Jan. 4*
Spot-market, 22 commodities	279	276	278
Commodity futures	360	320	323

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.

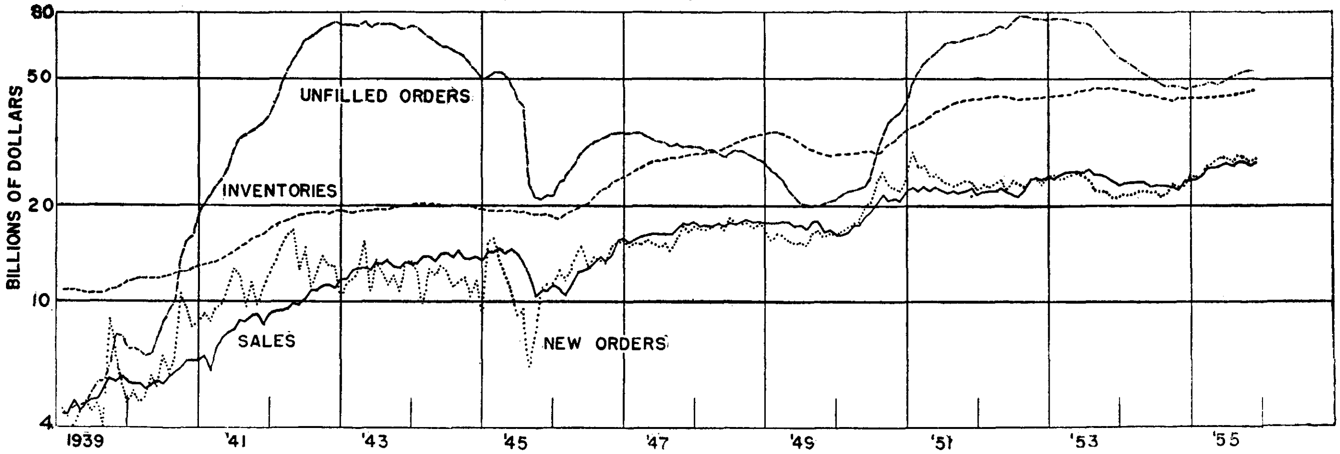
BUSINESS

Manufacturers' Orders, Sales, and Inventories

Note: All data used for this article are seasonally adjusted except those for unfilled orders.

Manufacturers' sales (shipments) increased 2½ percent during November to $27,400,000,000, a total 14 percent larger than that for November 1954. Without seasonal adjustment, sales decreased in November, but the decrease was less than is expected at that time of year. Primarily responsible for the increase on a seasonally adjusted basis were larger sales of durable goods, especially of automobiles. Shipments of durable and nondurable goods were 22 and 8 percent, respectively, larger than those in November 1954.

MANUFACTURERS' ORDERS, SALES AND INVENTORIES



Manufacturers' inventories increased one-half of 1 percent during November to $45,600,000,000, a total 5 percent larger than that for November 1954 and only one-half of 1 percent smaller than the alltime record total of inventories for August and September 1953. The November increase was accounted for entirely by larger inventories of durable goods.

The ratio of manufacturers' inventories to sales decreased from 1.70 (revised) for October to 1.66 for November; the ratio for durable goods decreased from 1.92 to 1.88, and that for nondurable goods decreased from 1.47 to 1.45. In November 1954, manufacturers' inventories were 1.79 of sales.

New orders received by manufacturers during November totaled $28,100,000,000, 2 percent more than those received during October and nearly 22 percent more than those received during November 1954. Most of the increase was in new orders received for durable goods.

Manufacturers' unfilled orders increased nearly 1 percent during November to a total nearly 16 percent larger than that for November 1954. Unfilled orders for nondurable goods increased more than those for durable goods and were nearly 31 percent larger than they were in November 1954. The backlog of orders for durable goods was 15 percent larger than it was in November 1954.

Small inventories in the hands of retailers are reported as causing buyers to make trips to buying centers earlier this year than is usual.

The increase in new orders, especially new orders for durable goods, and the further increase in unfilled orders strengthen optimism regarding the business outlook for the next few months.

Business Failures: Number and Liabilities
By Months, 1953–1955

Month	*Number*			*Liabilities (000 omitted)*		
	1953	*1954*	*1955*	*1953*	*1954*	*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	1,038	31,082	57,280	41,209
April	693	975	903	27,520	42,512	35,968
May	697	943	955	32,789	38,494	34,714
June	817	965	914	32,379	41,613	36,667
July	724	856	861	39,830	32,230	32,543
August	700	912	888	28,529	32,582	36,028
September	686	819	822	33,817	36,381	33,120
October	840	871	919	37,076	29,000	34,777
November	815	933	945	36,795	35,067	42,783
December	813	917		43,754	40,103	
Total	8,862	11,086		$394,153	$462,628	

BOOK REVIEWS

Statistical Methods (Third Edition) by Frederick C. Mills

Henry Holt and Company, 383 Madison avenue, New York 17, New York ($6.75)

This is the third edition of a book that has served as a standard text and reference work for many years.

In the 17 years that have elapsed following the second edition, the tools of statistical techniques have been improved and sharpened, and new methods of their use introduced. For example, what the author terms "the art of sample surveys" has developed largely in this period, and as a guide in using this technique, the author devotes the last chapter of the book to sampling and surveys.

Economic Developments in the Middle East, 1945 to 1954, Department of Economic and Social Affairs, United Nations

Columbia University Press, 2960 Broadway, New York 27, New York ($2.50)

This is a supplement to the *World Economic Report, 1953-1954*, prepared by the Secretariat of the United Nations. Besides the introduction, which presents an overall view of economic conditions in the Middle East, the report contains a chapter on each of seven countries: Egypt, Iran, Iraq, Israel, Lebanon, Syria, and Turkey. Discussions are included on such topics as agriculture, industry and mining, foreign trade, monetary policy and prices, and land reform.

Industrial and Commercial Geography (Fourth Edition), by J. Russell Smith, M. Ogden Phillips, and Thomas R. Smith

Henry Holt and Company, 257 Fourth Avenue, New York 10, New York ($6.95)

The authors of this volume had the perspicacity to note that the backwardness of the underdeveloped (industrially) areas of the world is largely attributable to political and other social factors not strictly economic. The common error of attributing backwardness of industrial development to lack or relative lack of resources such as coal, iron ore, and other raw materials of an industrial civilization is avoided. More extensive discussion of the potential availability of natural resources in the various continental areas, based on geological and related considerations, would have been enlightening to many readers and would have strengthened the authors' conclusions regarding the reasons for the backwardness of some nations.