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RESEARCH REPORTS

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Restoring Economic Order?

President Nixon sent a message to Congress on March 26 outlining what he believes is needed for restoring order in the Nation's "economic house." His comments provide clues about the extent to which he and his economic advisers understand some of the economic problems confronting the Nation.

An encouraging aspect of the President's message is the Administration's announced intention to achieve a "strong surplus" in the Federal budget for fiscal year 1970. The President wrote:

"The prospect of a thin budget surplus or a return to deficits would again nudge monetary policy off course. The result as always, would be further increases in interest rates, a dangerously overheated economic engine, and the threat of accelerating the advance of the price level. Because the problem of inflation was neglected far too long, we cannot risk even a neutral budget policy of narrow balance.

"Only a combined policy of a strong budget surplus and monetary restraint can now be effective in cooling inflation, and in ultimately reducing the restrictive interest rates forced on us by past policies. This is fundamental economics, and we intend to deal with fundamentals."

Officials of the new Administration thus have repudiated the extremely irresponsible policy of their predecessors of incurring large budget deficits during a period of unprecedented prosperity. The intention to pursue a responsible fiscal policy is encouraging. However, the apparent lack of understanding by Administration officials of other economic problems is not.

The President announced that a large budget surplus in fiscal year 1970 would be sought by reducing expenditures "while maintaining revenues." He wrote that he would submit revisions to the budget for fiscal year 1970 announced last January by his predecessor that would reduce Federal Government spending "significantly" from the amount then recommended. Such spending presumably still would exceed that during fiscal year 1969. Thus, the Administration will seek to restrict the *increase* in Government spending but will not *reduce* such spending.

In order to increase (not merely maintain) revenues needed for increasing spending without borrowing, the President requested that Congress extend the 10-percent income tax surcharge for another year through June 30, 1970, postpone scheduled reductions in telephone and passenger car excise taxes, and impose user charges recommended in the budget.

Projected revenues for fiscal year 1970 presumably are based on the assumption that business activity will continue to expand through mid-1970. Such an assumption is highly questionable, in view of apparent cyclical expansion of only half of the primary leading indicators of business-cycle changes. If a cyclical contraction of business activity occurs during the next 15 months, Federal revenues during fiscal year 1970 would be less than the projected amount, and a substantial Federal budget deficit might occur.

Another vulnerable aspect of the Federal Government's fiscal situation not mentioned by the President is the large increase during recent years in the amount of short-term, privately-held Government debt. The amount of such debt that must be refunded by the Treasury this year averages $5.5 billion per quarter, in contrast with an average of $3 billion per quarter during 1965. If private holders do not purchase all of the new securities issued to replace the maturing ones (as they did not when a refunding occurred last February), the banking system would be forced to purchase the new securities rejected by private investors. Thus, a substantial amount of Government debt might be monetized, and further inflating could occur, *even if Government revenues exceed expenditures.*

President Nixon stated that inflation (by which he meant a general increase in prices) "has been allowed to run into its fourth year." This comment is highly misleading, because it implied that such an increase had not occurred previously. In fact, both commodity and consumer prices had more than doubled during the 25 years prior to 1965.

As was noted above, the President stated that "we intend to deal with fundamentals." Yet neither he nor his economic advisers have indicated any understanding of the fundamental problem that accounts for the prolonged general increase in prices. Readers of these reports presumably understand that the fundamental problem is the failure to practice sound commercial banking. For several decades, unsound banking has resulted in inflating, i.e., creating purchasing media in excess of the amount needed for representing the gold-exchange value of things offered in the markets; the general increase in prices is a consequence of this process.

The President noted that an underestimate last January of farm price support payments had resulted in an overestimate of budget surpluses for fiscal years 1969 and 1970. Administration officials have given little indication that they "intend to deal with fundamentals" of economically unsound farm price supports that involve Government expenditures of several billion dollars annually.*

*A detailed analysis of the farm problem is presented in the forthcoming Institute booklet *CAN OUR REPUBLIC SURVIVE? Twentieth Century Common Sense and the American Crisis.* The booklet will be sent to Annual Sustaining Members within the next few weeks.

President Nixon asserted that "we are determined to keep faith with America's wage earners, farmers and businessmen. We are committed to take every necessary action to protect every American's savings and real income from further loss to inflation." However, the actions outlined in the President's recent message to Congress will not stop such loss. Even if a large Federal budget surplus is achieved, further inflating will not be prevented as long as the banking system is able to monetize refunded Government debt or more private noncommercial debt.

Achievement of a large Federal budget surplus would be highly desirable, although the monetary effects of such a development would depend on what holdings of Government debt were retired. If current monetary policy reduces the rapid rate of inflating of recent years, such policy would be an improvement in relation to previous irresponsible monetary policy. The steps outlined by the President are in the right direction, and they might prevent worse economic disorder. However, these steps will not result in restoring order in "our economic house;" that objective will not be achieved until sound commercial banking and sound money are restored to the Nation.

Statistical Indicators of Cyclical Trends

Among the primary leading indicators, nonagricultural placements and price per unit of labor cost increased, but contracts and orders for plant and equipment decreased, during February. Net business formation decreased in January.

Among the lagging indicators, labor cost per unit of output increased during February.

Cyclical statuses of these indicators were not affected by these new data.

Apparent cyclical expansion of only half of the primary leading indicators does not justify optimism about the future trend of business activity.

DEMAND

The Harwood Index of Inflation

We estimate that the Harwood Index of Inflation for March will be 225, or 3 points less than the revised index for February. At this level the index would be 3 points more than that for March 1968.

During February net investment-type assets of the commercial banking system decreased $2.0 billion to a total of $348.8 billion, which was 10 percent more than that of a year earlier.

Additional inflationary purchasing media are created when the commercial banking system increases its investment-type assets (investments in securities and mortgage, security, or installment loans) by a larger amount than the increases during the same period in its savings-type liabilities (savings or time deposits and capital accounts). Deflation (withdrawal of some inflationary purchasing media from circulation) occurs when the process just described is reversed; that is, when increases in investment-type assets are less than the increases in savings-type liabilities.

Savings-type liabilities of the commercial banking system increased $1.1 billion during February to $245.9 billion, which was 10 percent more than the total at the end of February 1968.

The net result of these changes in investment-type assets and savings-type liabilities in February was a decrease of $3.1 billion in inflationary purchasing media in use to an amount 10 percent more than that at the end of February last year. The effect on the index of the month's decrease in inflationary purchasing media in use was augmented by an increase of $0.9 billion in noninflationary purchasing media. (The index is the ratio of all active purchasing media to all noninflationary purchasing media.)

The decrease in investment-type assets during February reflected sales of a large amount of Government securities by commercial banks, particularly during the final 2 weeks of that month. The less expansionary monetary policy adopted last December apparently forced some commercial banks to reduce their investments in relation to their savings-type liabilities during February. However, the rapid upward trend of bank lending to private borrowers for purchasing consumer goods and capital equipment had not diminished through February.

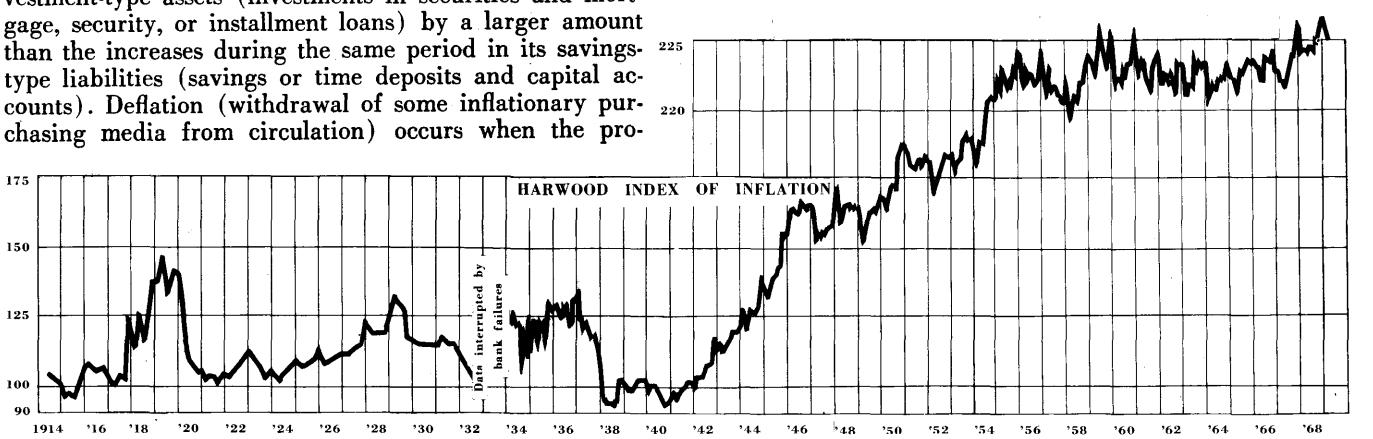
The accompanying chart of the amount of inflationary purchasing media in use reflects the marked inflating that has occurred since the spring of 1967. Since then the commercial banking system has created and placed in use about $17 billion of additional inflationary purchasing media. Late in 1966 the prolonged upward trend of inflating had been interrupted temporarily, presumably as a result of the restrictive monetary policy that was applied during much of that year. No such interruption has yet resulted from the less expansive monetary policy adopted last December.

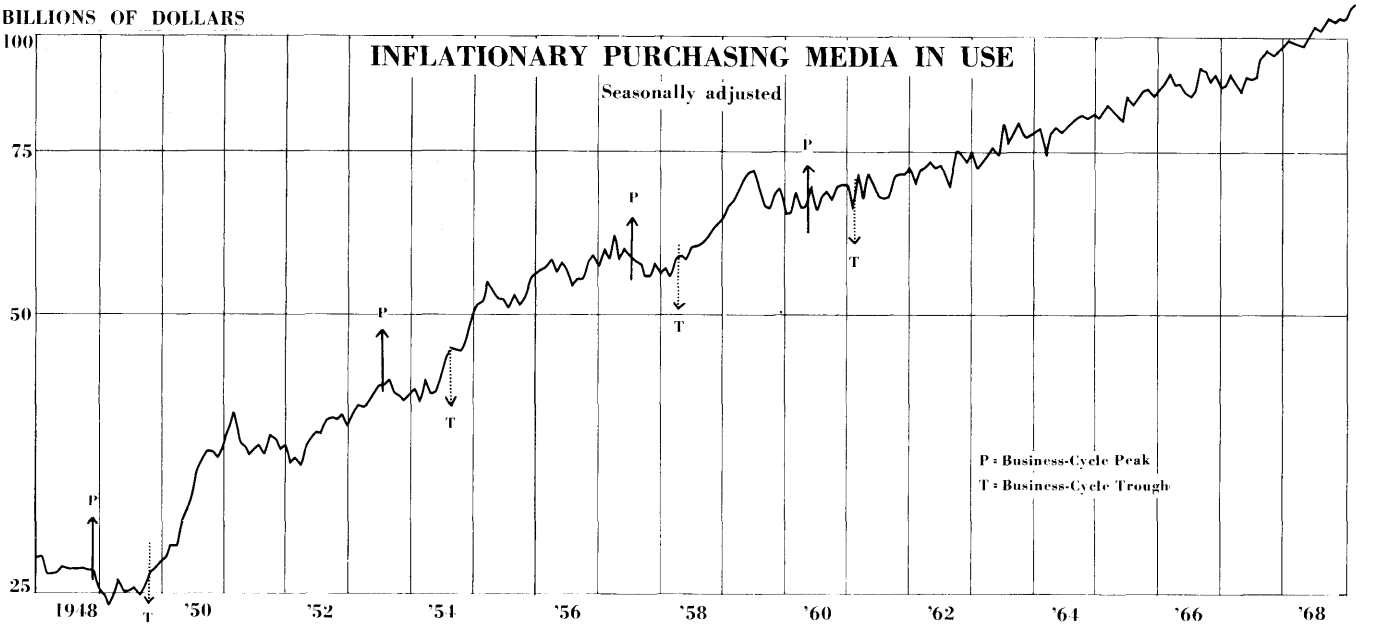
Unless commercial banks are forced to reduce both their noncommercial lending and investing in relation to savings-type liabilities, substantial deflating seems improbable.

Department-Store Sales

Sales of department stores reporting to the Bureau of the Census compare with those of corresponding periods a year earlier as follows:

Period	*Percent Change*
Week ended March 29	+ 3
Four weeks ended March 29	+ 5





SUPPLY

Industrial Production

Production of steel, automobiles, electric power, and lumber (1) in the 1-and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

Steel	*1929*	*1932*	*1957*	*1961*	*1968*	*1969*
Ingots, etc.—million tons						
1 week: March 29	1.31	0.36	2.36	1.63	2.88	2.83
4 weeks: March 29	5.20	1.55	9.57	6.38	11.45	11.19
Automobiles						
Vehicles—thousands						
1 week: March 29	112	29	133	102	192	183
4 weeks: March 29	436	110	549	355	757	726
Electric Power						
Kilowatt-hours—billions						
1 week: March 29	1.7	1.5	11.7	14.2	23.6	26.1
4 weeks: March 29	6.8	6.1	46.9	57.1	96.3	106.3
Lumber						
Board feet—billions						
1 week: March 22	0.71	0.20	0.67	0.60	0.68	0.70
4 weeks: March 22	2.88	0.81	2.68	2.40	2.75	2.83

p Preliminary

PRICES

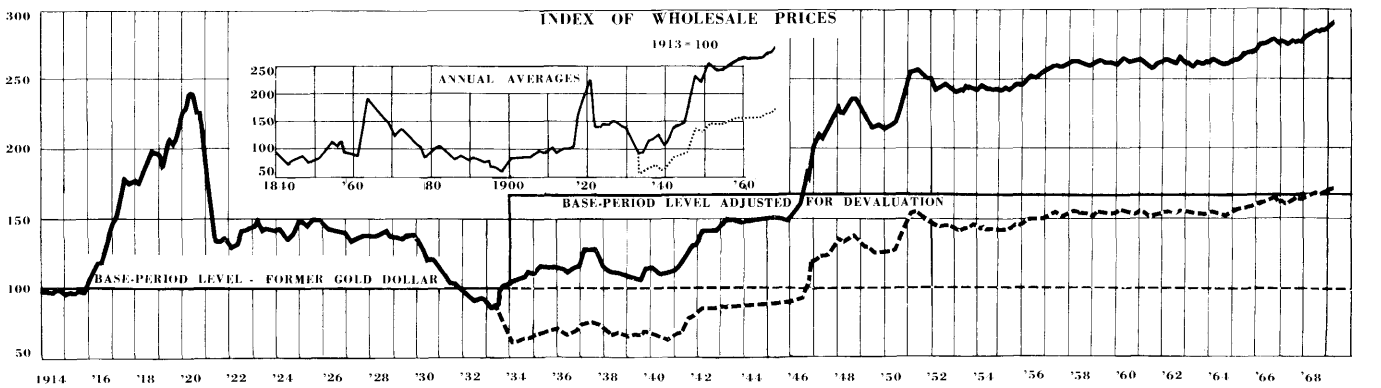
Commodities at Wholesale

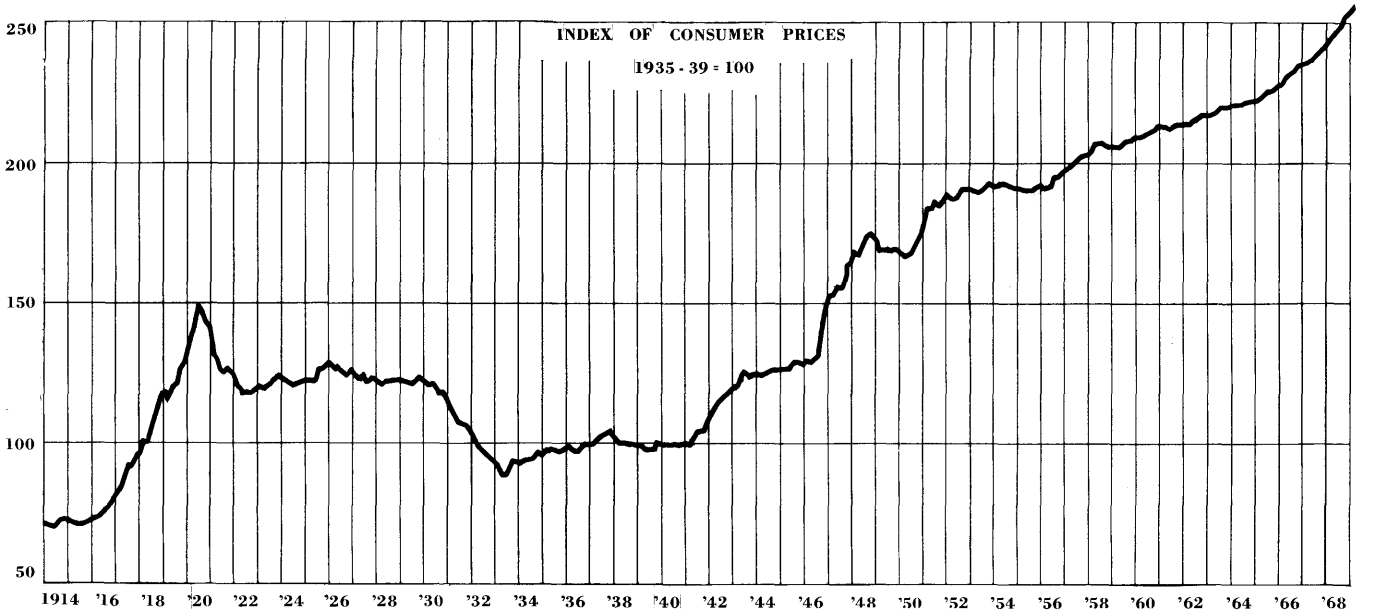
The Index of Wholesale Prices increased during March for the fifth consecutive month to 292, converted to the 1913 base and rounded to the nearest whole number, according to Bureau of Labor Statistics' preliminary data. The March estimate was 0.5 percent more than the index for February and 3.2 percent more than that for March last year. The Labor Department's index for March was 111.7 (1957-59=100), compared to 111.1 for February and 108.1 for March 1968.

Wholesale prices of industrial commodities included in the estimate increased 0.4 percent during March and were 3.4 percent more than those of a year earlier. The combined index of prices for farm products and processed foods and feeds increased 0.6 percent from February to March to a level 3.6 percent more than that in March 1968. Separate indexes of farm and food prices in March have not yet been received.

The Bureau's daily index of spot-market prices of 22 commodities was 0.8 percent more in mid-March than it was a month earlier. The most recent index was about 7 percent greater than that of a year earlier. The 13 industrial raw materials component of the index, which is a leading indicator of business-cycle changes, also was 0.8 percent more in mid-March than it was a month earlier and was 6.4 percent more than that in mid-March 1968. The Dow-Jones index of commodity-futures was 1.3 percent less at the end of March than it was at the end of February and was almost 1 percent less than that of a year earlier.

During the 6 months ended in February, prices of commodities at wholesale increased at an annual rate of 4.5 percent. This rate was much greater than the 1.2-percent annual rate of increase during the preceding 6 months. If the estimated March increase in the Department of Labor's Index of Wholesale Prices proves to have been correct, the annual rate of increase last month would





have been 6.6 percent.

The recent rapid increase in the prices of things, both at wholesale and at retail, is one of the consequences of marked inflating during recent years. President Nixon's Administration has pledged to curtail the rate of increase in prices, and the monetary authorities have sought to do so by following a less expansionary monetary policy since last December. This policy, however, had not prevented further inflating through February. On past occasions when inflating had been stopped temporarily, the effect on prices did not become apparent until several months later. Thus, even if inflating is stopped, prices probably will continue to increase for several more months, at least.

Further increases in wholesale prices of industrial commodities seem probable during the next few months.

Latest Indexes

Index	*1968* *Mar. 31*	*1969* *Mar. 24*	*1969* *Mar. 31*
Spot-market, 22 commodities	257	276*	n.a.
Commodity-futures	290	288	290
Steel-scrap	$27.17	$26.17	$26.17

*For the preceding Tuesday. n.a. Not available.

Consumer Prices

Consumer prices continued to increase during February despite efforts of the monetary authorities to curtail excess demand by following less expansive monetary policies. The Consumer Price Index increased 0.4 percent during February to 255.7 on the 1935-39 base, which was 4.7 percent more than that of a year earlier. This increase was the twenty-fifth in as many months and was of about the same magnitude as the average monthly increase during 1968.

Among the major components of the Consumer Price Index, all but one increased during February. Prices of housing increased 0.5 percent and were 5.5 percent more than those in February 1968. Prices of health and recreation increased 0.3 percent and were almost 5 percent more than those of a year earlier. Prices of transportation increased 1.1 percent and were nearly 3 percent more than those of a year earlier. Prices of apparel and upkeep increased 0.4 percent and were about 6 percent more than those in February 1968. Food prices decreased 0.1 percent to a level nearly 4 percent more than those in February 1968.

Increases in prices of housing, transportation, and clothing were the main factors in the February increase in the composite index. Homeowners had to pay more for everything, including interest rates, taxes and insurance, maintenance and repair, furniture, household textiles, and service charges such as laundry fees, moving expenses, and baby sitter fees. The increase in transportation costs was attributable largely to a 6.1-percent increase in used car prices; prices of new cars remained unchanged. Medical care costs increased 0.7 percent.

Average weekly earnings after taxes for a factory worker with three dependents increased 0.3 percent during February to $97.25. Although these earnings exceeded those of a year earlier by 4.6 percent, the purchasing power of such earnings was slightly smaller than that of year-earlier earnings because of the increase in consumer prices.

The purchasing power of the consumer dollar in February was 39.1 percent of that during the 1935-39 period. The most recent level of the Consumer Price Index indicates that urban wage earners and clerical workers paid $12.46 for goods and services that cost them $10 during the period 1957-59. Such workers paid $25.57 for goods and services that cost them $10 during the period 1935-39.

Further large increases in consumer prices seem probable during the next few months.

Indexes of Production, Inflation, and Prices

	1968										*1969*		
	Mar.	*Apr.*	*May*	*June*	*Jul.*	*Aug.*	*Sept.*	*Oct.*	*Nov.*	*Dec.*	*Jan.*	*Feb.*	*Mar.*
Industrial Production†	133	133	134	135	134	133	133	133	134	135	135*	135*	135*
Harwood Index of Inflation	222	222	219	223	223*	220*	226*	224*	228*	232*	233*	228*	225*
Commodities at Wholesale	283	284	284	284	286	284	286	286	287	287	290*	291*	292*
Commodities at Wholesale§	168	168	168	168	169	168	169	169	170	170	172*	172*	173*

†FRB index adjusted by the Institute for long-term trend. *Preliminary. §In terms of former gold dollars.