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International Monetary Chaos Continues

When President Nixon announced on August 15 the suspension of convertibility of dollar claims into gold, existing international monetary arrangements were effectively destroyed. Since then authorities of major industrial nations have not been able to agree on a new arrangement for international monetary transactions.

On September 10 the Executive Commission of the European Economic Community (the Common Market) submitted to that organization's Council of Finance Ministers proposals for reforming the international monetary system. The communique containing the proposals stated that satisfactory equilibrium in international monetary transactions could be established only by realigning parities of major currencies, and it added that "such a realignment should include the currencies of all the countries concerned, including the dollar." The communique also stated that "international liquidity should continue to be based on gold and, for an increasing part, on reserve assets collectively created and managed on an international scale."

On September 13 Common Market Finance Ministers considered the proposals of the Executive Commission and announced that they had reached agreement on some actions that they deemed essential to reform the international monetary system. These ministers called for a formal devaluation of the dollar (a reduction of its gold content or an increase in the U.S. "official" price of gold) and removal of the 10-percent surcharge on U.S. imports, as part of an agreement to realign parities of major currencies. They agreed that gold should remain the primary monetary reserve asset; that the use of dollar claims as monetary reserves should be reduced and eventually discontinued; and that such claims should be replaced by an internationally agreed-upon "standard" that would not be linked to the currency of any one country. The ministers appealed for a return to fixed parities for major currencies but with more flexible exchange rates to "forestall speculation." They declared that "in the future, all countries or blocs of countries must respect without exception the obligations and constraints in the balance-of-payments adjustment process and take appropriate internal measures."

On September 15 and 16, finance ministers of the Group of Ten major industrial nations met in London to discuss the international monetary situation. U.S. Treasury Secretary John B. Connally told the other participants that they must help produce a $13-billion improvement in the international payments of the United States (which would result in a surplus). Treasury Under Secretary Paul A. Volcker subsequently said that such an improvement is needed over "the next year or two." Italian Finance Minister Mario Ferrari-Aggradi, who is Chairman of the Common Market Finance Ministers, said that such a marked improvement in U.S. international payments would disrupt the economies of other countries if achieved too quickly.

U.S. authorities have demanded that authorities of other major nations help to eliminate the U.S. balance-of-payments deficit by revaluing their currencies upward in relation to the dollar, by reducing trade restrictions, and by paying a larger share of the cost of free-world defense commitments. For example, these authorities reportedly have demanded that West German authorities revalue the mark by 15 percent and that the Japanese revalue the yen even more. Treasury Secretary Connally reportedly said at the Group of Ten meeting that the United States is "broke" and demanded that representatives of other countries "tell us what they are willing to do about it." He also said that "we will not change our position one iota." French Finance Minister Valery Giscard d'Estaing said after the meeting that "the position of the nine [other countries in the Group] is clear. There will be no realignment [of currency parities] without the dollar. All illusions in this respect are removed." Apparently, no agreement on how to solve the monetary crisis was reached at the meeting.

The Administration's demand that other major nations assume a greater share of the cost of defending the free world seems to us to be economically sound. Maintaining U.S. military forces abroad partly to defend other nations has contributed to this Nation's imbalance of international payments. Also economically sound is the demand that other major nations reduce restrictions against imports of U.S. products. That unrestricted trade among nations is mutually beneficial was demonstrated conclusively long ago.

What is unsound is the demand that other major nations revalue their currencies in order to eliminate the international payments deficit of the United States. For many years Americans have realized that many foreign products (such as small cars, for example) were a better bargain than products made domestically. As a result, U.S. imports and payments to foreigners were augmented. Similarly, foreigners have found that many products made in USA were no longer a bargain, with the result that U.S. exports and payments from foreigners were restricted.

Augmented U.S. imports and restricted exports resulted in an imbalance of U.S. foreign trade and payments. (The imbalance of trade until recently was obscured by inclusion of the value of U.S. foreign aid grants in the value of exports, for which payment was not made to the United States.) In effect, foreigners exchanged their products of greater value for U.S. products of lesser value plus U.S. gold or claims on it. The transfer of gold equal in value to the payments deficit long had been the method used for settling such a deficit.

On August 15 President Nixon told foreigners that they

no longer could obtain the gold to which they were entitled. He also imposed a 10-percent surcharge on most imports, in an attempt to restrict them by increasing their prices. The demand of Administration authorities that major foreign nations revalue their currencies can be translated into plain language as follows: "Many U.S. processors no longer can compete with you foreigners. We demand that you solve their problem by taking action to raise prices of things that you sell in the United States and to reduce prices of things that U.S. processors sell abroad. This will discourage U.S. imports, encourage U.S. exports, and restore equilibrium in U.S. foreign trade and payments. We do not care if this puts the burden of restoring such equilibrium on foreign citizens, by reducing markets for their products and therefore reducing their income and employment. We want to spare U.S. processors the hard effort of becoming competitive and to spare U.S. citizens from unemployment.

"Moreover, we do not want to increase the official U.S. 'price' of gold. This would reaffirm the importance of the monetary use of the metal. We want to eliminate such use, so that it will not hinder us in stimulating economic activity and achieving full employment by inflating the Nation's purchasing media."

That authorities of foreign nations are reluctant to accede to the demand that they revalue their currencies is not surprising. They do not wish to impose on their citizens the burden of solving an economic problem of Americans. Moreover, at least some of these authorities apparently recognize that the monetary use of gold tends to restrict inflating and therefore to avoid the destructive consequences of this process.

However, we are not encouraged by the Common Market Finance Ministers' recent advocacy of an internationally agreed-upon "standard" for use as monetary reserves. Such advocacy indicates that they do not understand that the exclusive use as monetary reserves of gold, which long has been an internationally agreed-upon and universally accepted standard of value, is the only arrangement that has ever functioned satisfactorily to prevent worldwide inflating. Until such understanding is acquired, the so-called monetary experts of the world can be expected to continue fumbling in the dark in their attempts to reform international monetary arrangements.

STATISTICAL INDICATORS

Among the primary leading indicators of business-cycle changes, data received since our preceding report indicate that both new orders for durable goods and inverted average weekly initial claims for unemployment insurance decreased during August. These series have fluctuated since early this year, and their cyclical statuses remain indeterminate. An increase during June in the index of net business formation supported our conclusion that this series has been expanding cyclically from a trough last December. With no change in the apparent cyclical status of any of these series, the percentage of leaders apparently expanding cyclically is unchanged at 50.

Among the primary roughly coincident indicators, retail sales and personal income increased during August. The latter series had decreased for the first time in 9 months during July following a marked increase during June that reflected retroactive payments of increased Social Security benefits. The percentage of this group apparently expanding cyclically remains at 86.

No new data were received for the primary lagging indicators, whose percentage apparently expanding cyclically is unaltered at 67.

That the percentage of primary leading indicators expanding cyclically recently increased to 50 is encouraging. Further increases in this percentage would justify optimism about the future trend of general business activity.

SUPPLY

INDUSTRIAL PRODUCTION

According to the preliminary report of the Federal Reserve Board, the seasonally adjusted index of industrial production decreased 0.8 percent from the second consecutive month during August to 105.1 (1967=100), which was 2.2 percent less than that a year earlier. The volume of industrial production during August was only 2.4 percent more than that last November, which was the recent trough month of such production.

Among the industry groups, decreases in production occurred during August in all categories except mining. Production of durable goods, which accounts for about one-half of total industrial output, decreased 2.0 percent during August to a volume 6.1 percent less than that a year earlier. The August decrease in production of durable goods reflected a marked 26-percent decrease in the production of iron and steel, which accounted for most of the decrease in total industrial production. However, production of lumber, clay, and glass and of furniture also decreased. Nondurable goods production, which accounts for about two-fifths of total industrial output, decreased 0.4 percent during August but was 3.5 percent more than such production a year earlier. The decrease in nondurable goods production was the third consecutive monthly decrease in this category. Mining output increased 0.5 percent during August but was 2.1 percent less than that during August 1970. Utilities output decreased 1.3 percent during August but was 2.7 percent more than such output a year earlier.

Among the market groups, production of consumer goods decreased 0.3 percent during August but was 3.5 percent more than that during August 1970. Business equipment output (excluding that for defense and space) was 0.4 percent less and 6.6 percent less, respectively, than such output a month and a year earlier. Materials output, which accounts for about three-eighths of total industrial production, decreased 1.5 percent during August to a volume 4.7 percent less than that during the similar month a year earlier.

In measuring industrial production, Federal Reserve analysts use electric power consumption data, especially compiled and adjusted, to estimate about one-third of the total monthly index. Because large quantities of electricity cannot be stored easily, changes in its production and consumption are similar. The output of electric power during the first 3 weeks ended in September was about 4 percent more than such output during the corresponding period a year earlier. This percent increase from a year earlier was small compared with increases that were evident 9 months after previous expansions of general business activity had begun.

Preliminary data indicate that steel production increased substantially early in September. If the larger rate of steel output continued later in the month, this component would not adversely affect total industrial production as it did during August.

Increases in production of steel and electric power early in September suggest that industrial production may have increased this month.

Latest Weekly Data: Selected Items

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:

	1929	*1932*	*1957*	*1961*	*1970*	*1971*
Steel						
Ingots - million tons						
1 week: September 18	1.17	0.23	2.10	2.03	2.54	1.81
4 weeks: September 18	4.80	0.91	8.37	8.11	10.00	6.83
Automobiles						
Vehicles - thousands						
1 week: September 18	87	17	55	64	97	173p
4 weeks: September 18	368	72	346	300	476	657p
Electric Power						
Kilowatt-hours - billions						
1 week: September 18	1.8	1.5	12.0	15.9	30.4	32.2
4 weeks: September 18	7.0	5.8	47.8	63.4	123.8	131.1
Percent change from 4 weeks a year earlier: + 5.9						
Lumber						
Board feet - billions						
1 week: September 11	0.71	0.21	0.71	0.66	0.42	0.68
4 weeks: September 11	2.78	0.82	2.84	2.69	2.16	2.98

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NEW CONSUMER GOODS PER CAPITA

Note: All data are seasonally adjusted.

During July our index of new consumer goods per capita decreased 0.3 percent to a level 6.2 percent more than that a year earlier. Revision by the Federal Reserve Board of June consumer goods production required revision of our index of new consumer goods for that month; instead of the earlier-reported decrease of 0.3 percent during June, our index of new consumer goods per capita was unchanged during that month. After increasing during 8 consecutive months through May, our index of new consumer goods per capita was unchanged during June and decreased during July. Before adjustment for population growth, which currently is at the rate of 1.1 percent annually, production of new consumer goods decreased 0.2 percent during July but was 7.3 percent more than such production during July 1970.

Production of manufactured consumer goods, which accounts for about three-fourths of total new consumer goods output, decreased 0.3 percent during August but was 3.5 percent more than that a year earlier. Both major components of consumer goods production decreased during August; the decrease in durable consumer goods production was 1.0 percent and that in nondurable consumer goods production was 0.1 percent. Compared with the year-earlier volume, durable and nondurable consumer goods production during August was, respectively 3.8 percent more and 3.3 percent more. As a proportion of manufactured consumer goods, durable goods account for about 30 percent and nondurable goods account for 70 percent. Changes in durable goods production are more volatile than those in nondurable goods.

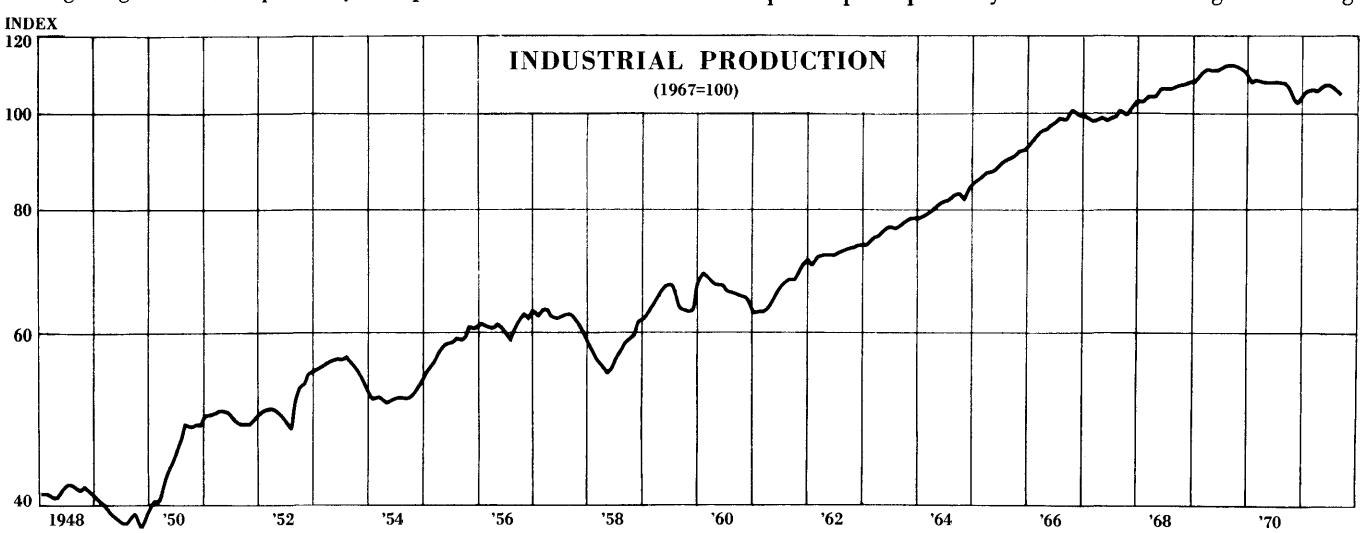
Production of consumer durable goods has decreased during each of the most recent 3 months, after increasing during each of the months December through May. These data suggest, as was suspected, that the substantial increases in consumer durable goods production earlier this year reflected primarily post-strike production in the automobile industry. However, *retail sales* of durable goods, after having decreased during May, increased during the next 3 months. Should retail sales of durable goods continue to increase during the next few months, production of durable consumer goods may increase again.

Within the consumer durable goods category, output of automotive products increased 0.5 percent during August to a volume 8.6 percent greater than that during the year-earlier August. Automobile production increased 0.6 percent during August and was 4.4 percent more than the year-earlier volume. Spokesmen for U.S. automobile manufacturers said that President Nixon's new economic policies have not altered their automobile production plans for the near future. Automobile production accounts for about two-thirds of automotive products output. The remaining one-third is accounted for by production of automotive parts and allied products, which increased 0.2 percent during August to an amount 15 percent more than that a year earlier.

The other component of consumer durable goods production, home goods production, decreased a marked 2.0 percent during August but was 0.8 percent more than the year-earlier volume. Home goods production has fluctuated substantially during recent months.

Within the consumer nondurable goods category, output of consumer staples was 0.1 percent more and 3.6 percent more, respectively, than that a month and a year earlier.

Data on residential construction put in place, which accounts for about one-quarter of total new consumer goods production, are available only through June. Our estimate of such construction (in terms of 1957-59 dollars) during July is 1.2 percent less than such construction during June but 36 percent more than the year-earlier volume. Although residential construction put in place decreased during both June and July, apparent cyclical expansion of housing permits and the number of houses started suggests that residential construction put in place probably will increase during the coming



months.

Unless manufactured consumer durable goods output stops decreasing, probable increases in residential construction put in place may not be sufficient to increase total production of new consumer goods per capita during the next few months.

DEMAND

THE HARWOOD INDEX OF INFLATING

The seasonally adjusted index of inflating decreased markedly, by 6 percent, during August but was 2 percent more than that a year earlier.

Inflating occurs when either a commercial or Federal Reserve bank creates purchasing media, not for representing consumable things offered in the markets, but instead for acquiring investment-type assets. Such assets include Government or other securities; they also include loans to borrowers for buying such securities or for buying consumable things that are represented by purchasing media that *already have been created.*

Deflating occurs when a commercial bank sells investment-type assets or acquires them less rapidly than it receives purchasing media through time deposits, capital funds, or other savings-type liabilities. Deflating also occurs when a Federal Reserve bank sells assets other than gold certificates, such as Government securities, or acquires such assets less rapidly than it receives capital funds. This process reduces the amount of excess or inflationary purchasing media in use.

Investment-type assets of the commercial banking system increased $3 billion during August to nearly $490 billion. This amount was almost $52 billion more than that a year earlier. Savings-type liabilities increased $5.5 billion during August to about $346 billion, which was nearly $40 billion more than that a year earlier.

The net result of these changes during August was a decrease of $2.5 billion in inflationary purchasing media in use to about $146 billion late in that month, which was about $12 billion more than that a year earlier. The amount of noninflationary purchasing media increased $1 billion during August to $73 billion. (The index is the ratio of total purchasing media in use to the portion that is *non*inflationary.)

A marked increase in the seasonally adjusted index of inflating during June was followed by a substantial decrease during July and a marked decrease during August. The index last month was the lowest thus far this year. However, part of the marked decrease during August apparently was attributable to a temporary development associated with the international monetary crisis. Purchases of more than $3 billion of nonmarketable U.S. Treasury securities by foreign official institutions last month apparently augmented the Treasury's deposits in commercial banks and therefore the savings-type liabilities of such banks; this reduced the amount of inflationary purchasing media in use, but probably only temporarily.

Both the seasonally adjusted index of inflating and the adjusted amount of inflationary purchasing media in use have fluctuated widely during recent months. This amount late in August was somewhat greater than that late last January, which suggests that some inflating occurred during that period. However, substantial inflating has not been apparent, in spite of the extraordinarily expansive monetary policy that has been followed.

The President's new economic program is expected to increase the already large deficit in the Federal budget during fiscal year 1972. This program thus would increase the probability, which already is large, that substantial inflating will occur.

RETAIL SALES

Estimates of retail sales for the most recent week and 4 weeks compare with such sales during the corresponding periods a year earlier as follows:

Period	*Percent change*
Week ended September 18	+ 7
Four weeks ended September 18	+ 7

PRICES

COMMODITY PRICES

	1970	*1971*	
Index	*Sept. 13*	*Sept. 6*	*Sept. 13*
Spot-market, 22 commodities*	295	282	282
Commodity-futures	310	298	294
Steel-scrap	$42.50	$33.17	$33.17

*For the preceding Tuesday.

Note: The indexes are, respectively, those of the U.S. Bureau of Labor Statistics, Dow-Jones, and *Iron Age.* The spot-market and futures indexes are converted so that their August 1939 daily averages equal 100. The steel-scrap index is a composite price for No. 1 heavy melting scrap.