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RESEARCH REPORTS

Coming Effects of Current Events

If it may be assumed that the recent remarks of administration leaders reflect their honest convictions and are not merely an attempt to bolster business confidence with more words, prospects for the future have materially brightened. Mr. Richberg has stated that he favors clarification of section 7A, NRA (presumably in a manner which will discourage extravagant demands by the A. F. of L.); that he is opposed to drastic changes in work hours, such as the 30-hour week we suppose; and that he favors a minimum of government control over industry.

Of equally great significance is the conversion of Mr. Moley who is apparently still highly regarded at the White House. He is opposed to Mr. Keynes' spending spree theory of recovery. It is refreshing to learn that an ex-brain trust member holds views which indicate an approach to sanity.

We have grown accustomed to leadership which chases economic will-of-the-wisps in an effort to find Utopia somewhere in the swamps of depression. It is safe to assert that straightforward action along sound lines would have an electrifying effect on the recovery process. Of course, to have this effect, such action must be the outward evidence of inner convictions and not a merely temporary concession to expediency.

In this connection, it will be well to remember that sending up "trial balloons" has become a favorite political sport. Even when Mr. Roosevelt appears to speak plainly it is best to accept what is said with reservations. We have already seen that what many people thought were definite promises in 1932 were really something else in the minds of Administration leaders. Perhaps it is wiser to ignore political headlines altogether for the time being and wait for later action to give the clue to the future.

The Budget Again

Most of us have found that it is difficult as well as unpleasant to forego expenditures considered normal during better times. In government it is even more difficult, as the necessity for keeping outgo less than income is less immediate than it is in the case of an individual.

The National Economy League has drawn up a tentative budget which, by increasing tax revenues $935,000,000, would make possible a balanced budget for the fiscal year beginning July 1, 1935. Is there any probability that the League's suggestions will be accepted?

While the President has expressed himself as desiring to limit relief expenditures to a minimum he will probably find that Congress will endeavor to increase these expenditures. Compromises will have to be effected. Although members of Congress have many elaborate plans for spending money, it is already evident that there is a general opposition to increasing the present burden of taxes.

Under these circumstances, it seems highly improbable that a balance between Federal income and outgo will be reached in the next fiscal year. The importance of this matter is difficult to overemphasize, and the progress which is made toward bringing the budget into balance will provide a clue as to the probable extent of inflation.

Bank Balances

While Federal spending has not stimulated business activity to the extent that was hoped, it has caused important changes in the deposit balances at the commercial banks. Since November, 1933, there has been an estimated total increase in checking account balances amounting to $3,500,000,000. When it is considered that this increase of 27% has occurred during the past twelve months, it may seem strange that there has not been a similar increase in business activity.

A study made by the Federal Reserve Bank of New York concerning velocity of bank deposits throws some light on the matter. This study shows that while deposits in checking accounts rose very rapidly during the past year, bank debits, or the writing of checks against these accounts, have followed a normal seasonal trend typical of a period of depressed business activity.

The velocity, or ratio between the amount of demand deposits and debits to individual accounts, has sunk to a low point for the depression. This cannot be taken to mean that business in the fall of this year was at the depression low. It merely signifies that there has been an accumulation of funds in checking accounts which are temporarily inactive. It is probable that individuals and small businesses which have been operating on greatly decreased balances, or none at all, have been enabled to accumulate enough over current expenses to build up their permanent balances.

Commercial Loans

The accumulation of checking account balances in commercial banks has added another factor to the potentialities of a coming credit inflation. It is well known that commercial banks will extend lines of credit more

(over)

readily to customers who have substantial balances in their checking accounts.

Commercial borrowings, which showed a tendency to increase between last summer and the early fall, are now declining. This decline is seasonal in nature and should be reversed within the next two months if the usual seasonal rise in business next spring is to occur.

It is reported by many bankers that there has been a steady liquidation of old loans for several months past. When the season is favorable to new borrowings the volume of commercial loans can increase very rapidly.

Are There "Bulwarks Against Inflation"?

We have been asked to discuss this subject by readers who hope that various factors will prevent the inflation which is confidently expected by this organization. Of the various influences suggested as apt to have a deterrent effect, six seem worthy of serious consideration. They are dealt with in turn below.

The President Will Oppose

It is asserted that the President is at heart a conservative, that his personal fortune is largely in bonds and similar investments, and that he does not want inflation anyway. If there was any evidence that Mr. Roosevelt had grasped the elements of monetary theory and actually knew what inflation was, this might be given some weight. However, the facts are that devaluation, silver remonetization, and a credit inflation via Treasury deficits are already here. It requires no stretching of the imagination to visualize the further operation of these already approved policies. That being the case, how can it be said that the President is opposed to any other than the more obvious method of inflation, namely, the printing press.

Do Treasury Deficits Necessarily Mean Inflation?

The argument of the optimists along this line is as follows: During 1920-1929, the bank credit of the country was increased more than $20,000,000,000. Commodity prices were not forced upward by this means. Therefore, an increase in the public debt will not inflate commodity prices. The flaw in this argument is to be found in the assertion that commodity prices did not rise during 1920-1929. It is sometimes forgotten that prices in 1920-1921 were still highly inflated, about 50% above pre-war. In the absence of the credit inflation of the last decade, prices would undoubtedly have continued their decline to or below pre-war levels instead of holding at the 150% figure, or thereabouts. At least two independent research studies confirm this viewpoint. Therefore, from 1920 to 1929 prices *were rising* with respect to a normal post-war trend.

Wise Politicians Do Not Force Up Living Costs

It is also urged that no political party would care to be responsible for a rising cost of living. But political parties in France and Germany didn't mind as long as there was money to spend. Are our politicians different?

Taxation Can Kill Inflation

This is an excellent theory, but it is difficult to imagine it being put into practice before the next presidential elections. If inflation has "taken" by that time, business will be good and prospects will be better. What a howl of protest would accompany any attempt to choke off inflation by drastically higher taxes,—and half-way measures would be useless.

Would the Banks Freeze Inflation?

It is of course true that any banking system has within itself the power to freeze inflation. However, the banking system in this country is now in the poorest possible condition to exert any such influence. It may be that the banks have learned some lessons in sound finance during the past few years but they are not yet ready to say "no" to a greedy Treasury. Until they are, the presence of government bonds in their portfolios is not a sign that they can control inflation, but the reverse.

Large Gold Reserves a Bulwark

Metallic reserves are a bulwark against inflation only if the holders of that reserve are forced to pay out on demand. Faced with that contingency, the holders dare not encourage the process which would result in a flight of gold. However, since international promises to pay on demand (including our own) are no longer taken seriously, and since gold is no longer permitted to be in the pockets of the private citizen, this bulwark is but the shadow of something which might have been.

Productive activity is showing signs of vitality. The decline in inventories which had been taking place since the latter part of the spring has apparently been overdone. Consumer demand has been better sustained than was anticipated. Unless some unlooked for factor enters into the picture we may expect a rising curve of business activity over the next few months.

Supply, Demand and Prices

Supply

The inventory situation in finished goods appears to be in a healthier condition than it has been for some time. The United States Department of Commerce reports that while department store sales in September were running 7% over the same period last year, stocks were 8½% lower. Although industrial production has been increasing during the past month, it has probably made small headway in replenishing inventories.

Demand

Higher payrolls due to increased industrial production, continued government spending, and some stimulation in the construction industry lay the foundation for increased spending this winter. Christmas goods are being advertised early and in spite of lower interest rates paid by savings banks, Christmas Club savings are reported to be larger this year than last. Lines of newspaper and magazine advertising, which are significant indexes of probable consumer demand, are running substantially higher than a year ago.

Prices

Some slight signs of recovery in the heavy industries and increasing production in the consumer industries to meet enlarged demand and consequent further expansion of payrolls and purchasing power will probably support prices during the next few months. It is expected that prices of both finished goods and commodities will be maintained at present or higher levels for some time to come.

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