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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Inflation Prospects

It is an interesting fact that some of the most powerful influences tending to foster a serious, perhaps uncontrollable, inflation in this country will require several years, in one instance decades, to produce their maximum effects. On the other hand, the means available to the Government for controlling the degree of inflation are practically all of the short-run variety; that is, most of them will hardly be effective for more than two or three years at most.

Many financial problems require solutions that will serve for the long term, as long as three or four decades. Included among these problems are individuals' life insurance and retirement plans. However, most business men and investors habitually deal with problems that are usually considered to be of much shorter duration. It follows that both the long-term and short-term prospects of inflation are of real importance. For that reason, we shall deal with these two aspects of the problem separately, insofar as they lend themselves to such treatment. Because the factors that will influence the situation most in the long run will nevertheless be operative and to some extent effective during the short run, they will be discussed first in the later articles of this series.

For more detailed information on inflation's progress during the past week and month, it is suggested the readers refer to the discussion under the heading "The Harwood Index of Inflation."

THE FUNDAMENTALS

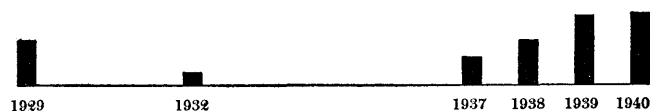
Industrial Production

Industrial activity increased further during the latter part of October, and the Institute's preliminary Index of Industrial Production for that month has been revised from 109.0 to 111.0. The preliminary index for November is 113.0. The November preliminary index is slightly higher than indexes for the postdepression peak months of March 1937 and December 1939. The bar diagram shown in the lower left-hand corner of the Industrial Production chart on page 201 indicates that the volume of industrial production (not adjusted) in November was greater than the average for 1929. However, the Institute's index, which is adjusted for long-

term trend, was substantially below the record made in the summer of 1929.

The steel-ingot production rate increased slightly during November, but total tonnage produced during the month may not exceed the tonnage for October because there were fewer working days in November. The steel industry produced 6,462,000 short tons of steel ingots in October, a new high record; the preceding monthly high was made in November 1939 when the ingot tonnage was 6,148,000 short tons. The accompanying bar chart illustrates the magnitude of steel-ingot production in November 1940 in relation to production in November during other significant years.

STEEL-INGOT PRODUCTION



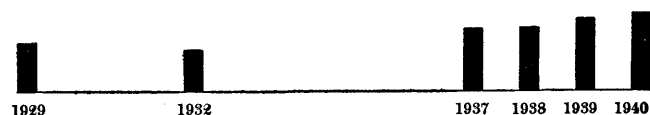
Last week the steel-ingot production rate increased from 96 to 97 per cent of theoretical capacity. The *Iron Age* expressed the opinion that the present activity will continue for several months at least. "Total sales are in such volume that steel mills will be booked through the first quarter on most products within thirty days or less, and some orders are now being received, unsolicited, for the second quarter. These are being accepted on the basis of price in effect at the time of shipment."

	1929	1932	1937	1938	1939	1940
Per Cent of Capacity	71.0	18.0	35.0	63.0	93.5	97.0

(Latest 1940 weekly data; corresponding week earlier years.)

Average weekly production of electric power during November was greater than the weekly average for October. Therefore, the comparison with output in November 1939 when industrial production was increasing rapidly remained as favorable as it was in October. The bar charts show that the industry has made steady progress during the past few years.

ELECTRIC POWER OUTPUT



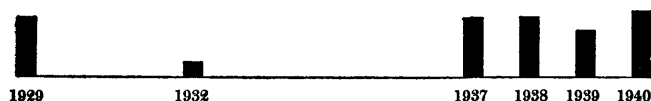
Electric power production increased from 2,719,501,000 to 2,751,528,000 kilowatt hours last week. The *New*

York Times estimated that output was 10 per cent greater than normal.

	1929	1932	1937	1938	1939	1940
Billion Kilowatt Hours	1.84	1.53	2.22	2.27	2.51	2.75

The automobile industry established a production record for the month of November for the years shown on the bar chart. The relatively unfavorable showing in November 1939 was caused by a strike against the Chrysler Corporation that eliminated production by one of the largest companies in the industry.

AUTOMOBILE PRODUCTION

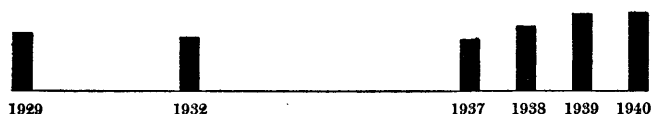


Last week motor-car assemblies increased from 120,948 cars and trucks to 121,943 units. Retail sales of cars and trucks in October were 41 per cent more than the total for October 1939.

	1929	1932	1937	1938	1939	1940
Units (000 omitted)	38	16	86	96	87	122

Cotton-mill activity during November was greater than in any preceding November of the years shown on the bar chart, although the gain over the rate in November 1939 was small. The industry has operated at a relatively high rate during the past two years, the most protracted period of prosperity for the industry since the decade of the 1920s.

COTTON PRODUCTION

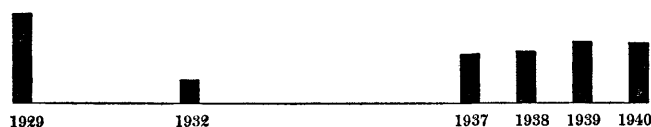


Last week, cotton-mill activity decreased slightly from the level of the preceding week. A seasonal advance was expected, and the adjusted index declined from 144.6 to 134.8.

	1929	1932	1937	1938	1939	1940
<i>New York Times</i> Index	108.3	104.9	99.5	118.7	137.9	134.8

Lumber output decreased during November from the October level and was slightly lower than production in November 1939. The trend of the industry is less favorable than any of the others shown in the bar charts.

LUMBER PRODUCTION



Lumber output declined less than seasonally last week and the adjusted index advanced from 84.6 to 86.3.

	1929	1932	1937	1938	1939	1940
<i>New York Times</i> Index	115.3	33.4	65.2	68.4	91.2	86.3

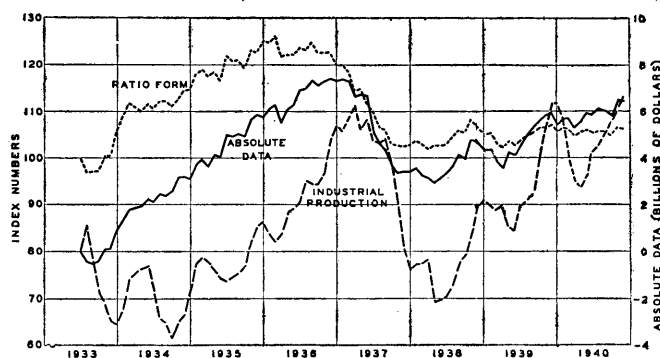
The Harwood Index of Inflation

There was a slight decline in the Index of Inflation during November from 106.3 (revised) for October to 106.2 (preliminary). As the chart on page 201 shows, the Index in ratio form is in the upper portion of the range in which it has fluctuated during 1940. Although there was an increase of approximately \$150,000,000 in

the commercial banks' investment-type assets last month, this was more than offset by a combination of two factors. First, time deposits with the commercial banks increased approximately \$100,000,000, thus increasing the savings-type liabilities of the banking system; second, about \$100,000,000 was withdrawn from the purchasing media available to the public as the Government increased its deposits with the commercial banks and the Federal Reserve Banks. Changes in other items last month were minor.

The accompanying chart presents the Harwood Index of Inflation in ratio form, the absolute data for the Index of Inflation, and the Institute's Industrial Production Index. The absolute data for the Index of Inflation are the actual amounts of inflationary purchasing media in circulation. The ratio form of the Index is intended to show the relative importance of the absolute data. The method used was described briefly in the October 28, 1940 Monthly Bulletin, page 186.

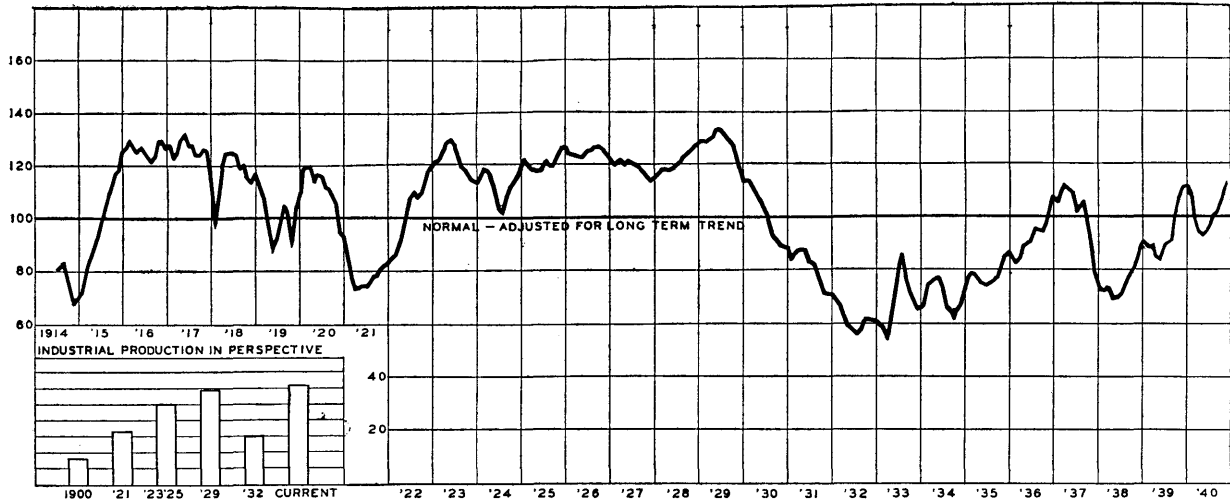
HARWOOD INDEX OF INFLATION, RATIO FORM, ABSOLUTE DATA, AND INDUSTRIAL PRODUCTION



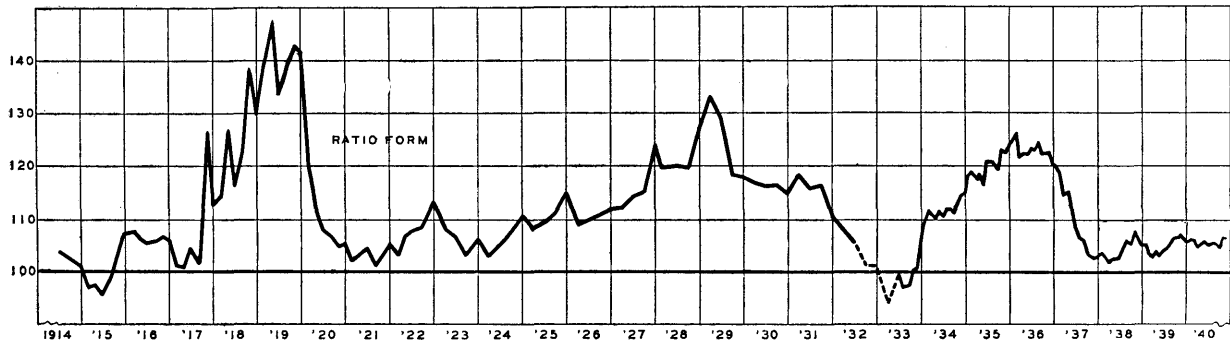
The chart shows that there has been a substantial increase in the actual amount of inflationary purchasing media available during 1940, but that the gain has been of minor importance in relation to the total. There have been marked increases in purchasing media as a result of gold imports and (especially during October) as a result of the Government's spending of purchasing media created at an earlier date and temporarily hoarded in Treasury bank accounts. During the past month, there has been no appreciable change in the money-credit situation.

Since the inflationary progression that was initiated in 1933 and collapsed in 1936 and 1937 (following the action of the Board of Governors of the Federal Reserve System in drastically raising bank reserve requirements), there have been no alarming indications that inflation was being resumed, although the Index advanced for a few consecutive months in 1938 and again in 1939. The effects of continued Federal budget deficits have been partly counteracted during the past three years by deflationary factors. The most important of these has been the investment of a substantial proportion of the Nation's available annual savings in Government securities. Another important factor has been the hoarding of currency. According to our latest estimates, \$1,337,000,000 is now being hoarded compared with \$553,000,000 three years ago. More recently, a factor counteracting inflation has been the reduction of Government security holdings by the Federal Reserve System. During the past year, these have been reduced \$570,-

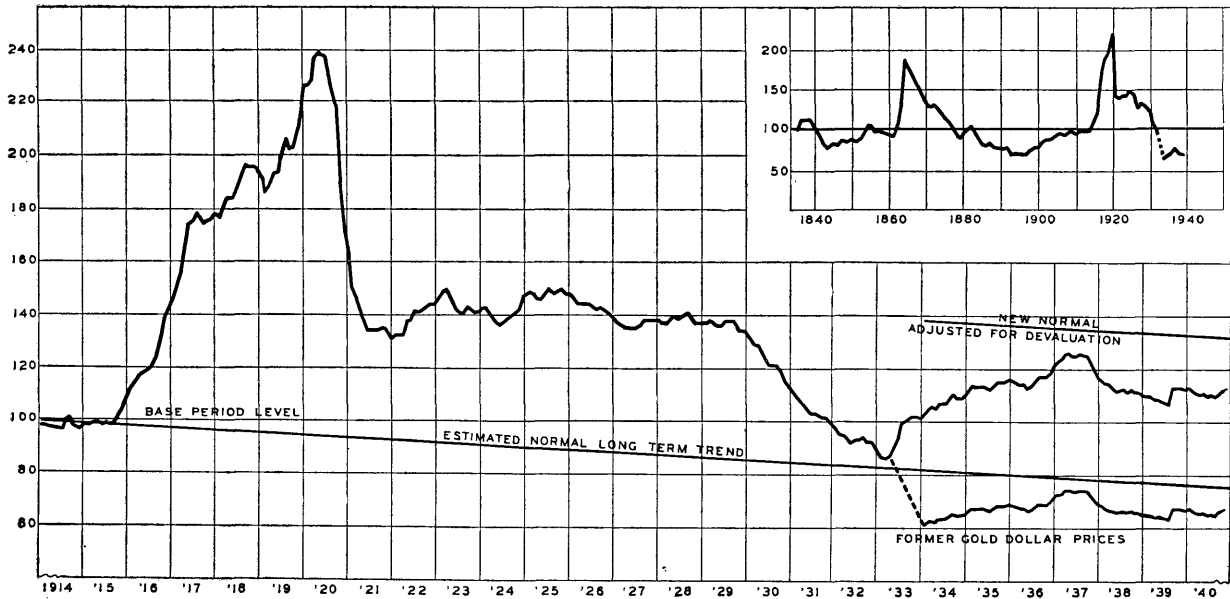
INDUSTRIAL PRODUCTION



HARWOOD INDEX OF INFLATION



COMMODITY PRICES



000,000, or about 20 per cent. (This was discussed in the November 11, 1940 Weekly Bulletin on page 194.)

We have recently received inquiries from subscribers asking if the Government can prevent inflation from accompanying the great increase in spending for national defense. We believe that other subscribers may be interested in a brief discussion of the subject.

Although the Government possesses powers which, if exerted, could postpone the development of an inflationary progression for a time at least, the probable results of exerting such powers may prevent their use. First, inflation could be prevented if the Government financed the national defense expenditures, together with the regular Government expenditures, entirely through taxation. Such action does not appear to be feasible in view of the great expenditures already authorized by Congress, and does not even appear to be contemplated by the Administration. Second, an increase in reserve requirements, such as that which checked inflation in 1937, could be imposed by the Board of Governors of the Federal Reserve System acting under pressure from the Government. However, this would, as it did in 1937, precipitate sales of Government securities by the banks at a time when new funds must be borrowed by the Treasury. Our guess is that the Administration will continue its easy-money policy and will resort to deficit financing with resulting bank credit expansion insofar as Treasury requirements exceed savings available for investment in Government securities.

Other Demand Factors

There was no marked change in demand for goods at retail last week. The failure of consumer buying to keep pace with the increase in manufacturing activity is partly attributable to the fact that farm incomes have not increased as have industrial pay rolls. This situation will probably have political repercussions before the winter is over.

Commodity Prices

The wholesale commodity price index advanced from 112.2 (revised) in October to 112.9 (preliminary) in November. The increase in the composite index was primarily the result of higher raw-material and semi-manufactured goods' prices. Finished goods' prices rose to a lesser extent. Prices of all the commodity groups classified separately as the principal subdivisions of the United States Bureau of Labor Statistics' Wholesale Commodity Price Index advanced last month, but none acted in such a manner as to suggest panic buying.

The accompanying table shows changes that have occurred in the major classifications of the Wholesale Commodity Price Index. The November 1940 preliminary indexes are compared with the revised indexes of earlier significant periods.

UNITED STATES BUREAU OF LABOR STATISTICS WHOLESALE COMMODITY PRICE INDEX

(Monthly Average 1913=100)

	Nov. 1929	Nov. 1932	Nov. 1939	Oct. 1940	Nov.* 1940
Farm Products	141.4	65.3	94.1	92.9	94.0
Foods	154.0	94.4	112.6	110.4	111.7
Hides and Leathers	159.1	104.9	152.7	148.3	150.4
Textile Products	154.6	94.1	133.3	127.7	129.0
Fuel and Light	135.7	116.5	120.9	117.9	118.3
Metals and Products	108.7	87.7	105.7	106.7	107.3
Building Materials	166.5	124.7	164.0	168.3	169.8
Chemicals	†	†	106.2	95.9	96.3
House Furnishings	168.0	130.9	157.0	159.9	160.0
Miscellaneous	118.1	91.3	110.3	109.9	110.5
Raw Materials	137.8	78.8	105.2	103.2	104.1
Semimanufactures	124.3	78.6	109.6	105.9	107.1
Finished Goods	133.9	99.9	118.2	118.0	118.7
All Commodities	134.0	91.5	113.5	112.2	112.9

* Preliminary Estimate

† In process of revision

Statements by Administration officials that the Government will act to prevent increases in living costs are reminiscent of similar statements made during the World War after commodity prices had started their meteoric rise. Today there are more ample stocks of most commodities than existed twenty-five years ago, and these should postpone, if not prevent, another uncontrolled price advance. Nevertheless, higher prices are virtually certain to accompany the expansion of the national defense program. Even if no serious commodity scarcities develop, the bidding for skilled labor and the mandatory shortening of the work week will tend gradually to raise the general wage level and consequently production costs that must be passed on to consumers.

To a limited extent, price increases can be temporarily masked by lowering the quality of goods and decreasing the quantities in familiar packages. Both the United States Bureau of Labor Statistics and the National Industrial Conference Board have established definite quantitative and qualitative standards for compiling their price data, and the true situation will presumably be revealed by the Wholesale Commodity Price Index and by the Cost of Living Index compiled by these organizations.

Last week the sensitive wholesale commodity price indexes advanced only moderately. Moody's Spot Commodity Price Index was 167.9 on November 13 and 167.4 on November 20. The Dow-Jones Index of Commodity Futures closed at 57.19 on November 13 and at 56.39 on November 20.

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Statistical Summary; Production, Purchasing Power, and Prices

	1939			1940									
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.*
Index of Industrial Production . .	111.8	112.1	109.0	100.9	95.5	93.4	96.1	100.5	102.2	105.2	109.0	111.0	113.0
Index of Inflation (ratio form) . .	107.3	105.5	106.5	106.2	104.4	105.4	106.0	105.2	105.8	105.6	104.8	106.3	106.2
Commodity Price Index	113.6	113.5	113.8	112.8	112.3	111.9	112.3	111.0	111.2	110.9	111.7	112.2	112.9
Commodity Price Index	67.2	67.2	67.3	66.7	66.4	66.2	66.5	65.7	65.8	65.6	66.1	66.4	66.8

(In terms of former gold dollar)

*Preliminary Estimate.