AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Inflation's Progress

The chart of the Harwood Index of Inflation on page 137, shows that the total of inflationary purchasing media now available to the public is about the same as the maximum just prior to the end of the 1936–1937 boom. The Institute's chart of industrial production on the same page shows that manufacturing activity far exceeds the former postdepression peak, which was reached in 1937. Furthermore, the consumer buying wave is also more extensive than it was five years ago. The stimulating effects of an enormous gold inflow have been added to the normal effects of the inflationary purchasing media. Although currency hoarding continues to increase (probably because of rumors that bank deposits will be taxed), the hoarding of checking-account deposits appears to be diminishing. The velocity of demand deposits in 101 leading cities (computed by dividing bank debits by total demand deposits and making adjustment for seasonal factors) advanced in May and June, and, although figures have not yet been published for July and August, the trend has apparently continued upward, because bank debits have been increasing more rapidly than have demand deposits.

Such data as are available indicate that installment credit has been expanding in recent months. Although the installment buyer borrows purchasing media from a finance company, it must be remembered that the finance company in turn obtains most of its funds from the banks. The purchasing media thus obtained may or may not be inflationary, depending on whether they represent funds already deposited with the banks and not otherwise invested or are originated by the banks. Limitations now imposed by the Board of Governors of the Federal Reserve System will probably be at least partially effective in controlling the increase in this type of credit. However, conditions requiring larger down payments are less effective when consumer incomes are increasing rapidly, and the restrictions thus far contemplated are not drastic.

In calculating the Harwood Index of Inflation, bank credits classified as commercial, industrial, and agricultural loans, are assumed to be noninflationary, but there may be an indeterminate amount of such credit that is used to carry speculative inventories, which obviously are not automatically self-liquidating. Commercial loans have increased substantially during the past year, but so have shipments of goods produced, and the proportion of these loans that are inflationary is believed to be small at present. If there is a substantially greater increase in commercial loans than in shipments of goods, allowance for this factor will be made in calculating the Index.

Whenever there is a substantial amount of inflationary purchasing media in circulation, as there is today, the situation is inherently unstable, and either of three developments may occur. These possibilities are as follows:

1. During an inflationary progression, a temporary deflation can occur if some adverse development of great importance occurs, or even as the aftermath of a temporary buyers' panic.

2. A second possibility, albeit a slight one, is that the situation may be stabilized at present levels with production and consumer purchases remaining high, but with the Government succeeding in its announced endeavor to limit the inflationary trend. This might occur, if the Government economized in relief and other nondefense expenditures, substantially increased taxes (beyond levels now contemplated), and sold more defense bonds, possibly by a compulsory saving plan. Neither the Administration nor Congress has seriously considered economy. Although broadening the tax base or a sales tax have been proposed, their political inexpediency will apparently prevent their enactment. There is no indication of an increase in the rate of voluntary purchases of defense bonds, and the opposition of organized labor to a compulsory savings program assessed against pay rolls would probably be sufficiently strong to prevent the enactment of such legislation.

3. The third possibility is that the inflationary progression will continue throughout the emergency and probably after its conclusion. The receipts from sales of savings bonds during May, June, and July averaged $350,000,000 per month. Even this rate of more than $4,000,000,000 per year will not suffice to finance the budgetary deficits that are now exceeding $1,000,000,000 per month. The officials of both the Treasury Department and the Federal Reserve System are aware of the dangers in financing budgetary deficits by the creation of excess commercial bank credit, but the Administration has done nothing to halt the inflationary progression; in fact, financial irresponsibility in Washington is so complete that even the discussions of steps that might be taken are largely concerned with price-fixing, that is, with the treatment of symptoms rather than causes.

Our conclusion is that the first is always a short run possibility, but that the third development will dominate in the long run.

THE FUNDAMENTALS

Industrial Production

The Institute's index of industrial production, shown on page 137, was revised for July from 144.9 to 148.6. The preliminary index of 148.0 for August indicates only a slight decrease in the preceding month's high rate of manufacturing activity. The Institute's index of industrial production is adjusted for long-term trend as well as for seasonal variations. The bar charts in the lower left-hand corner of the industrial-production chart show the volume of industrial production (not adjusted) at significant periods from 1900 to the present time. The solid black bar charts, included in the discussion that follows, show comparable data for each August during the years indicated. The record high level of the current index is of course the result of the Government's national defense and British-aid programs.

Although the steel industry was not able to maintain its ingot-production rate at theoretical capacity throughout August, its average rate of 99 per cent of capacity was a slight improvement over the record made in July. During July 6,822,000 tons of steel ingots and steel for castings were produced, and apparently August production will exceed 7,000,000 tons and about equal the high records made this spring.

IRON AND STEEL PRODUCTION

The steel-ingot production rate advanced from 99 to 99½ per cent of theoretical capacity last week. The *Iron Age* stated: "More study of the steel priority order by steel consumers and producers brings home the fact that most nondefense orders for steel cannot be filled for some time to come. Large consumer industry groups, such as canners, railroads, the oil industry, and jobbers are growing still more apprehensive over their ability to obtain the necessary steel. Refrigerator and washing-machine makers, grave-vault manufacturers and makers of such items as stoves, signs, bird cages, and bed springs, as well as countless other industries hitherto served fairly promptly by steel producers, are scheduled for a period of low operations."

	1929	1932	1937	1938	1940	1941
Per Cent of Capacity	90.0	13.5	88.0	42.0	90.5	99.5

(Latest 1941 weekly data; corresponding week earlier years)

Production of electric power during August exceeded the output for August 1940 by approximately 15 per cent. The comparison was slightly less favorable than it was in July when the gain was 16 per cent. The bar charts portraying electric-power output for August of the years specified reflect the favorable long-term trend of power sales.

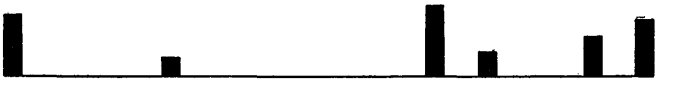
ELECTRIC-POWER OUTPUT

Electric-power output of 3,200,818,000 kilowatt hours last week was only slightly less than the record high in production reported in the final week of July. Gains were reported in all sections of the country but were greatest in the New England, Central Industrial, and Southern regions.

	1929	1932	1937	1938	1940	1941
Billion Kilowatt Hours	1.75	1.43	2.30	2.14	2.75	3.20

Automobile production in August this year was less than it was in August 1929 and 1937, although it exceeded output in any of the other corresponding months shown in the bar charts. The industry's current record is better than the statistics indicate, because the model changeover period has been advanced to an earlier date since 1937.

AUTOMOBILE PRODUCTION

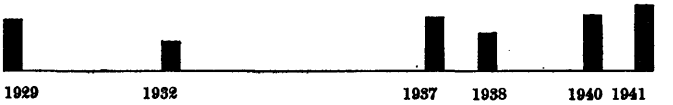


Last week, motor-car assemblies increased from 41,795 cars and trucks to 45,500 units.

	1929	1932	1937	1938	1940	1941
Units (000 omitted)	112	20	93	24	20	46

A moderate decrease in the activity of the cotton-goods industry during August was attributed to the confusion caused by the efforts to control prices of yarns that were made by the Office of Price Administration. In spite of the decrease, the level of operations in August this year compared favorably with the record for August of the other years shown by the bar charts.

COTTON-MILL PRODUCTION



Last week, cotton-mill activity decreased contraseasonally, and the adjusted index declined from 181.6 per cent of estimated normal to 174.5.

	1929	1932	1937	1938	1940	1941
New York Times Index	114.2	84.2	140.4	121.7	118.1	174.5

Lumber Production increased in August from the July level, but the volume was only about 80 per cent of that in August 1929.

LUMBER PRODUCTION

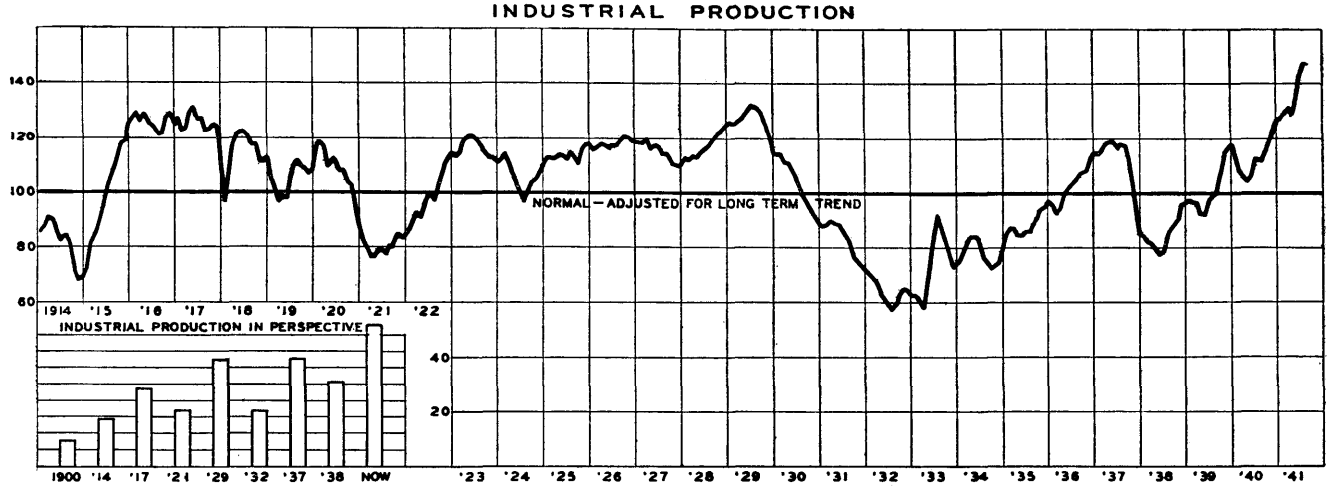
Lumber production increased last week and the adjusted index advanced from 130.0 to 131.1.

	1929	1932	1937	1938	1940	1941
New York Times Index	128.9	35.4	84.8	73.5	115.4	131.1

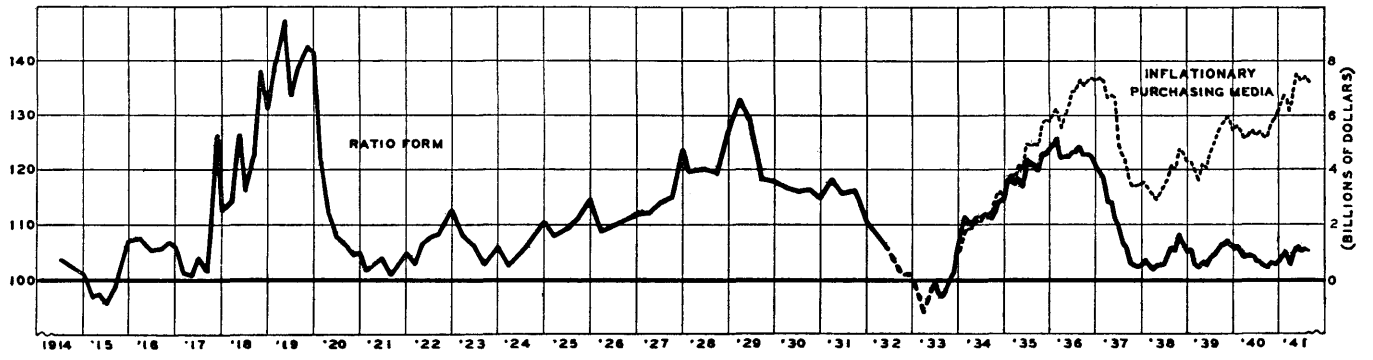
The Harwood Index of Inflation

The preliminary Index of Inflation (ratio form) for August at 105.3 was fractionally lower than the revised July Index, which was 105.7. During the past month, we have made the usual quarterly revision based on the more comprehensive data provided by the bank call for all member banks of the Federal Reserve System. The revised Index follows the same general pattern as did the preliminary data, but at a slightly lower level, because of the divergent policies of the city and country banks. The decline in the preliminary Index for August

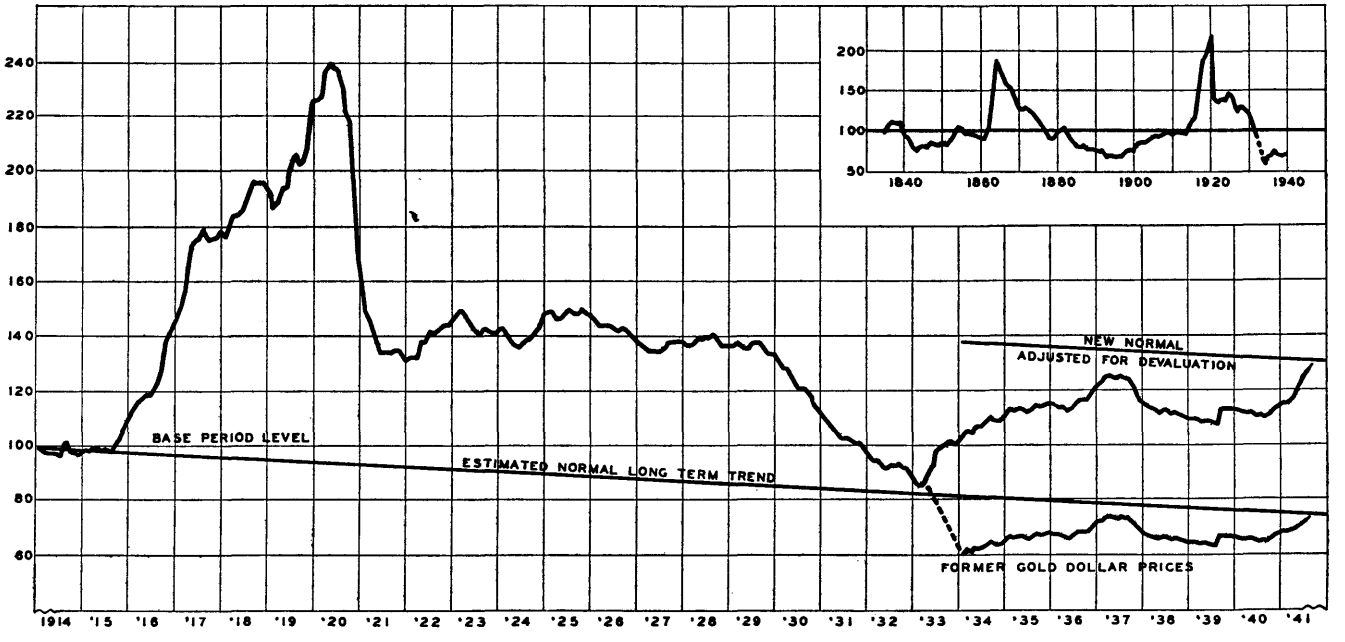
INDUSTRIAL PRODUCTION



HARWOOD INDEX OF INFLATION



COMMODITY PRICES



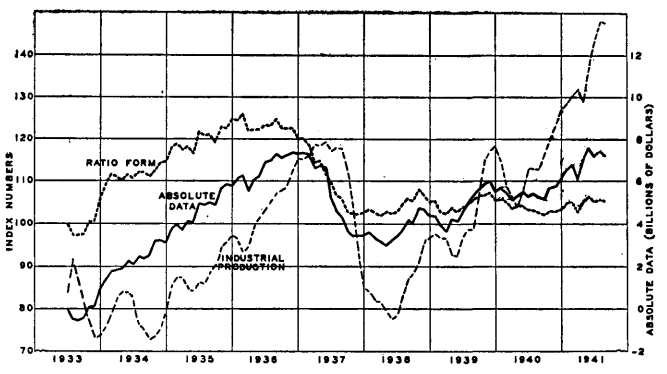
was caused largely by the withdrawal of purchasing media from private checking accounts for the payment of Social Security and other taxes and the purchase of defense bonds.

The Harwood Index of Inflation is primarily a means of measuring the quantity of inflationary purchasing media made available to the public. Inflation is defined as the condition arising when the banks or other agencies, such as the Treasury printing press, have created purchasing media in excess of that required to represent goods produced that are currently coming to market. The chart on page 137 shows the Index in ratio form, which is the ratio of all purchasing media available for use to the portion that is not inflationary. Beginning in 1934, the absolute data, that is, the inflationary purchasing media totals are also shown. (The scale for the ratio form is at the left side of the chart, and the scale in billions of dollars for the inflationary purchasing media is at the right.)

It will be observed that, although the ratio of all purchasing media to that which would have been in circulation in the absence of inflation has remained virtually unchanged during the past four years and is well below the peak reached in the inflationary boom of 1936, the total amount of inflationary purchasing media has increased greatly during the past four years and is now near the 1936 peak. The available purchasing media have been augmented by the arrival of several billion dollars worth of gold from Europe. New additions of gold to the Nation's monetary stock increase the available purchasing media, but these additions are not inflationary because they represent the gold itself in the market. As a result of the gold imports, the purchasing media total has increased so much that the inflationary portion, although likewise increasing, has remained in about the same relation to the total.

The chart below shows the two curves, the ratio form and the inflationary purchasing media (absolute data), since June 1933, together with the curve of industrial production.

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



During most of the period shown on the chart, major turning points in the industrial-production trend were preceded by changes in the inflation indexes. However, the upward trend of industrial production in 1940 preceded the upward movement of the inflation indexes. Apparently, increased demand in advance of the emission of inflationary credit purchasing media was made possible by the inward flow of gold, much of which was used for the purchase of war materials in American markets.

Other Demand Factors

The hosiery-buying stampede was only partly responsible for the sensational increase in retail trade volume during August. Gains in department-store sales, compared with the dollar volume in August 1940, exceeded 60 per cent in some areas. Part of the increase (about 7 per cent) is attributable to higher prices. Even the fear of scarcities and higher prices in prospect could not have created the present buying wave had there not been an increase in the purchasing media available to consumers. This increase has of course been provided in large part by the Government's latest spending spree. The index of income payments, compiled by the United States Department of Commerce, was five per cent higher in June than it was in the best month of 1929.

Commodity Prices

The United States Bureau of Labor Statistics' combined index of wholesale commodity prices advanced from 126.6 in July to 128.4 (preliminary) in August. This index, which is shown in chart form on page 137, is a weighted average of 813 commodities, adjusted so that the 1913 monthly average equals 100 (also shown on the former gold basis since January 1934, when the dollar was devalued). The estimated normal long-term trend line and the new normal long-term trend line, adjusted for devaluation, are valuable features of the chart. The small chart in the upper right-hand corner of the commodity-price chart shows changes in commodity prices during the past century on the basis of the former gold dollar. The advance in the combined index during the past twelve months has raised it above the previous postdepression peak in 1937, and it is now near the level estimated to be normal since devaluation of the dollar.

All of the three major economic classes, raw materials, semimanufactures, and finished goods, participated in the advance during August. The metal and metal-products group was the only one of the principal subdivisions of the wholesale commodity price index that resisted the upward trend.

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Statistical Summary; Production, Purchasing Media, and Prices

	1940					1941							
	Aug.	*Sept.*	*Oct.*	*Nov.*	*Dec.*	*Jan.*	*Feb.*	*Mar.*	*Apr.*	*May*	*June*	*July*	*Aug.**
Index of Industrial Production..	112.8	116.3	119.8	122.6	127.0	128.5	130.2	131.8	128.9	138.8	144.0	148.6	148.0
Index of Inflation(ratio form)...	102.8	102.3	103.2	103.0	103.6	105.1	105.2	102.8	105.2	106.6	105.3	105.7	105.3
Commodity Price Index.....	110.9	111.7	112.8	114.3	114.6	115.8	115.5	116.8	119.2	121.6	124.2	126.6	128.4
Commodity Price Index.....	65.6	66.1	66.7	67.6	67.8	68.5	68.3	69.1	70.5	72.0	73.5	74.9	76.0

(In terms of former gold dollar) * Preliminary Estimate.