

ECONOMIC INDICATORS

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DR. KRESS: Admiral Hague, General Niblo, Miss Boutelle, Gentlemen: We are getting ready our month's procedure this morning. This afternoon we have movies developed by the Committee for Economic Development and they show the general background of the industrial curve of the United States. I am sure you will find them most interesting. Certainly I recommend them to you.

Our speaker this morning is the Chief Economist of the National Industrial Conference Board (NICB). I am sure that you do not need to be reminded of what that institution is. The NICB is the oldest research and educational institution for cooperative study of the economic and administrative problems of American business by economists and businessmen. It was founded in 1916 by associations representing 12 branches of industry. Its founders believed that the American voluntary competitive economy, founded on private property and individual liberty, is the one best suited to promote enduring human welfare, and that impartial factfinding and education will keep that system sound and healthy. These principles have been the basis of all the activities of the NICB for 38 years.

I think it is safe to say the NICB is really the father in one form or another of these economic indicators that we are to take up this morning, and there is no one who knows more about them than does our speaker. His biography doesn't show that he is also an adjunct professor of economics at New York University, which makes him doubly welcome for our purpose.

The NICB holds several meetings each year, and it is customary for our people, including our Commandants, to attend their conferences. Today we have the position reversed. We have the NICB member attending our conference.

It is a pleasure, Professor Gainsbrugh, to welcome you to this platform.

PROFESSOR GAINSBROUGH: I am going to spend my allotted time discussing with you the trends shown in the document that you have been asked to take up this morning. I am giving you some prefatory comments, therefore will you take out of your files a copy of the

"Economic Indicators" for August 1954. Without it both you and I will be hopelessly lost.

An economist is more frequently described than I would wish, for my own personal comfort, as a fellow who is never in doubt but frequently wrong. I want to share with you my doubts as well as my convictions about the current status of the economy and its longer-term prospects. I want to do that on the basis of the best document that has yet been developed to assist you, as well as the economic fraternity, in interpreting economic trends. I think the best buy in this country for two dollars a year is this little document, "Economic Indicators"; the synthesis of "what we think we know" about the current health and prospective trends within our Nation.

I wonder if any of you are at all acquainted with the origin of "Economic Indicators." When the Council of Economic Advisors was established about eight years ago, there began to be circulated within the Council a series of charts that were studied intensively by members of the Council of Economic Advisors in arriving at their own appraisal of how the economy stood. As this was developed it was moved into the President's office and supplied to him each week and each month. The word slowly filtered out that there was such a document, and Members of Congress then began to ask to be placed on the list for this monthly report. Shortly thereafter they felt it was so important that they asked that it be made a public document. It has subsequently become the most sought-after document, I think, on the current status of the economy of any document available in Washington.

You are all busy men; yet each of you has an immediate and direct concern in trying to understand where the economy is and where it may be going. I recommend to you that a half-hour's study each month of the charts and the two or three sentences of interpretation will do more to assist you in understanding current economic trends than any other amount of required reading.

In my presentation this morning I am going to leave for Dr. Kress the interpretation of trends in national accounts, a key set of charts contained in "Economic Indicators." Perhaps the greatest single contribution, the greatest invention, by my fraternity during the past quarter of a century was the development of a system of national accounts.

I will be dealing largely with the remaining economic indicators. There are some 32 major economic indicators whose course is traced in the document before you. All I have to do is deal with 24 of them and leave 8 of them to Dr. Kress.

Now, let me give you the central framework around which my comments are based. There are various types of economic indicators. Some of them are best described as thermometers. They indicate where we are and throw light, too, on how we got where we are. Others we have found as a result of study over more than one-third of a century are not only significant as thermometers but even more so as barometers. You see you can use economic indicators (a) for diagnosis and (b) increasingly, I am convinced, not only for purposes of diagnosis but also for purposes of prognosis. We will study both thermometers and barometers not only for diagnosis but to throw some light on prognosis. We will deal basically with two questions--the first, looking at economic indicators, where we are and how we got where we are; second--a most hazardous pursuit, let me assure you, on the basis of the knowledge of where we are and how we got where we are--looking at the question of where we may be going. We shall look particularly at a series of economic indicators which, in cycle after cycle in the past, have thrown some light on the probable future course of business activity.

So much then by way of preface--and now to work. First, dealing with the basic questions of where we are, let us start with our first economic indicator. This deals with changes in physical output, the total unit production of goods, for the most volatile sectors of the economy, manufacturing and mining.

The first series of economic indicators that we will look at are those dealing with changes in physical output--volumetric measurement, if you will. These are shown on pages 12 through 14. Turn to that highly respected economic indicator, second perhaps, only to the later innovation of gross national product and national income, the traditional measure of physical output issued by the Federal Reserve Board, on page 12, its index of industrial production.

This is an attempt, through the use of index numbers, to set forth in one single measure changes in the physical outpourings of the Nation's factories and mines. What we do here is to combine the production of steel, of textiles, of tobacco, of petroleum, and so on, into one meaningful aggregate, an index of industrial production. Now, keep in mind

the limitations of this measure. It deals only with physical output in manufacturing and mining; and yet it is labeled as an index of total industrial production. It relates to only about 20 or 25 percent therefore of the total industrial activity, rather than to 100 percent of the total industrial activity; but it relates to the most volatile form of industrial activity, namely, manufacturing and mining.

Here, very quickly, you can see a clear measure of recession--why at least some of us find justification for the label we applied to the change in business activity which began last June. If you will look at these measures on page 12, you will find that we reached a peak of 137 (with 47-49 as a base) in mid-1953. We hit that peak of 137 in May and again in July. Thereafter, the economy trended downward, at least in terms of physical output of factories and mines. And note the trough, at least as it is currently visible, was struck in March or April--from peak to trough, physical output declined about 10 percent.

This is the origin then of the phrase "the 10 percent recession" that is very frequently used to describe what has happened during the past year. On the other hand some of the measures with which you will grow familiar tomorrow will show only a 4-percent recession. The gross national product is down only 4 percent from its peak in the second quarter of 1953. This index of industrial production, however, is a more sensitive measure which reacts more violently to both the upswing and downswing of the economy, and it does show that we are turning out almost 10 percent less than we did a year ago--at least in the vital sectors of manufacturing and mining.

It shows one other thing that gives some degree of comfort, since March or April the recession is tending to saucer out--and that is another highly descriptive phrase. The bottom may have been struck in this highly sensitive index in March or April. The subsequent course has been slightly upward, 123 to 124 in May, again 124 in June. You can now enter the July figure which was not available at the time the economic indicators were issued--124 for July. If you want my guess as to what the indicators did in August, I think I would suggest that you put a slight minus figure because of the cutback in automotive production and the failure of steel to rebound. Certainly there was little indication in August of a sharp upturn in the sectors that were down the most, manufacturing and mining. And there is considerable question, at least in the minds of the business economists, as to the course of this index in the months immediately ahead. We have a highly technical

question that I can only refer to in passing--the quick changeover in car models this year, as compared with past years, and what they may do to the index of industrial production later this year.

Here then is our first indicator of where we are. In authoritative form-- a form highly respected in business because it is understood in business, a form too, that is close to the hearts of the stock analysts, if not the business analysts--the index of industrial production shows the magnitude of recession to be a 10-percent adjustment since last year. It shows a trough in March or April 1954 which gives some promise of recovery, but a recovery that has thus far been halting in character.

One virtue of this particular economic indicator is that it gives us a meaningful aggregate. Another virtue is that it permits us to analyze changes in internal components. Some of those changes are shown on pages 13 and 14. Very frequently there is an attempt to ignore off the degree of readjustment through which we are going. As I said, I am going to share my doubts with you as well as my convictions--and clearly, one of the significant changes in the composition of manufacturing is the sharp degree of correction which has taken place and which is still going on in some vital sectors of the American economy. Look, for example, on page 13, at the degree of correction experienced in the steel industry in terms of physical output as well as in terms of operating capacity. As late as last week the steel industry was still operating at 64 percent of capacity--under much expanded capacity, to be sure, to put things in proper perspective. But look at the change in terms of physical output as well as in terms of rate of capacity. Go back to the year 1953, for example, steel output then was 2.1 million net tons. It was 1.5 million tons during the week of August 14.

Not all sectors show the same downtrend. Electric power is up some 7 percent above what it was a year ago. Coal is down sharply. The automotive industry has experienced a contraction of physical output of cars and trucks now, in terms of number, some 20 to 25 percent off from the comparable position in August 1953.

You don't have the latest figure posted there. You might want to add the latest figure for the week of 14 August--116,000 as compared with an average rate of around 154,000 a year ago.

On the next page--again you will find more minus signs as you analyze the subcomponents of manufacturing than you will find plus

signs, as compared with the rate of activity a year ago. The textile industry has had some recovery but is still down to 15 percent below what it was in the second quarter peak of 1953. Even some of the growth industries are well below what they were a year ago. Look at the chemical industry--we are inclined to view that as an industry with sustained growth. Here we are not talking about dollar figures--we are talking about physical output, weighted by the relative economic importance of the various components.

The minus signs still prevail, as compared with a year ago. This is one of the reasons why employment is down in manufacturing--the sharp curtailment of production in many major manufacturing industries in this recession, already a year old.

Going on with the indicators which deal with the first question, where we are and how we got where we are, let us shift now from volume to another important consideration--trends in price. Those are charted for you on pages 3 through 6. This area is of vital importance again to broad sectors of our population. Millions of wage earners have their compensation altered in accordance with the movement of one of these price indexes, the consumer price index here is a definite mechanical tie-in between wages and changes in price for some 3 to 4 million workers. That is one of the indexes we will talk about. Another is the wholesale prices on page 4. I believe this index to part of this audience, at least, is painfully familiar--escalator clauses are frequently tied to changes in wholesale prices.

On page 5 is an index which again affects the livelihood of millions of our people--prices received and prices paid by farmers insofar as they tie in with the parity ratio and with support prices.

As we move along, you will find that you have to keep in mind constantly the reservations and limitations that surround the material provided by the economists. We have an index called the index of industrial production but, as I told you, it doesn't measure the total of industrial production--only manufacturing and mining. Here we have an index called consumer prices, but it does not really measure trends in all consumer prices--it measures trends in the prices of goods and services bought by one sector of our population, the wage earning sector, because this index was set up primarily to be used in connection with collective bargaining.

Now, a bit of the background of this index--it is a fixed weight index, and that is rather important, too. The Bureau of Labor Statistics (BLS) surveys consumers, particularly wage earners, and observes what they buy during the course of a given year. From this survey they set up a market basket of items that are customarily purchased by the wage earner. From that time on the weights in the index are fixed. BLS thereafter will continue to price the same items month by month and year by year to observe changes in the cost of that particular market basket over time.

If wage earners alter their pattern of consumption after the weights have been determined, that alteration in the pattern of consumption is not given recognition in the price index. From time to time--about once a decade--we do reweight the index on the basis of changes in the market basket in the types of items purchased by the wage earner sector of our population. Food, for example, may be given a weight of let's say 30 percent. Price changes thereafter in the food sector will be multiplied by the 30 percent in arriving at a measure of change from month to month and year to year in prices paid for food by the wage earner.

Since "Economic Indicators" for August was published, the July figure has come out and it bears out the conclusion reached earlier by the Council of Economic Advisors of price stability--previously mentioned. If you want to enter the figure for July, for all items it is 115.2. I hope it is clear to all of you that that figure means that prices have increased 15.2 percent from the base period, which is 47-49. But there is no question--and this is another salient finding on where we are--that this economic indicator tells us that this recession, unlike past recessions, has been characterized by price stability.

Look back over the past year. In July 1953, the index stood at 114.7. Today the index still stands at 115 plus or minus a couple of tenths of a percentage point. There has been no sharp break in price at the retail level or as you will see from subsequent charts, at the wholesale level, or even in the highly sensitive raw-material sector.

So we are beginning to get the basis for two conclusions--(a) that physical output was cut during the past year in manufacturing and mining by about 10 percent and (b) that cut was accompanied by price stability, unlike past cyclical corrections, in which a downturn in price was one of the salient characteristics. There is some doubt within the economic fraternity as to whether price stability is to be regarded as an item of

strength, currently, or as an item of weakness. You may want to come back to that for a further discussion; but it is a fact that there has been relatively little price change so far in either the wholesale level or the retail level of prices.

This first index deals with prices at the retail level, and it takes in prices of goods, as well as prices of services. That is rather important. Perhaps it ought to be stressed. It includes not only food, apparel, and other commodities but it also includes the service trades--transportation, recreation, and personal care, as well as rents and other housing costs.

Another fleeting note, and a rather gratifying one, too--of late the rent index has begun to stabilize. That may have more than a passing significance. If you look at the rent component, you will find that it has risen rather sharply in recent years. Rent controls held rentals down for a long period of time and rents are still relatively low as compared with other prices prewar. They were predestined to move up rather sharply as decontrol was initiated; but in mid-1954 we are beginning to get stabilization in the housing and rental component of the consumer price index.

We move on to the next indicator, which deals with wholesale prices. Again, when we say "wholesale prices" we don't mean wholesale prices. These are not measures of prices that are charged by the wholesalers but largely prices charged by the manufacturer. A more accurate label is primary-transaction prices--at the time a good first enters the commercial market.

Very quickly, the same conclusion emerges on page 4 as on page 3--price stability in the recession of the past year. Note where prices were a year ago--110.9. Note where they were as late as 3 August 1954 in your economic indicator. I can give you a figure through 24 August if you like--virtually unchanged--110. It costs the consumer no more or no less to buy his fixed market basket today than it did at the peak of the expansion in 1953. It costs the manufacturer no more and no less to buy his basic raw materials now than it did a year ago, despite the fact that some prices are down; others are up. The overall average of wholesale prices is essentially where it was a year ago. We can also break this aggregate down into some very meaningful subcomponents--farm products, processed foods, and so on.

I might direct your attention in passing to the degree of price correction which took place prior to the recession, as indicated on the chart on top of page 4. Prices had broken rather sharply before June 1953. That may be a partial explanation of why there has been so little price correction during the past year.

We have looked at prices paid by consumers and at prices paid or charged by the manufacturing and fabricating sectors. Finally, we can look perhaps at the sickest sector of the American economy at the moment--agriculture and the prices received and paid by farmers. As I have said earlier, this is an indicator that virtually dictates the economic fate of some 5 or 6 million enterprises, the largest single group of private enterprises in the Nation. Observe the degree of price correction which that particular sector has undergone. Much of this took place before the recession began--some of it has taken place since that time.

The most meaningful figure on the page in terms of public policy is the parity ratio which relates the prices received by farmers to the prices paid by farmers--in other words, what the farmer gets for the materials he sells to the urban population, and what he has to pay for the goods that are largely produced by the urban population. When the price he pays and the price he receives are in balance, we get a parity ratio of 100. As late as 1952 those prices were still in balance--we had a parity ratio of 100. Come down to the latest figure posted on your indicators and you will find the figure of 88 for the parity ratio. In some schools this is interpreted as meaning that the farmer has a 12-percent deficit when it comes to exchange of the goods he produces for the goods produced by the urban population. The index of prices paid including interest, taxes, and wage rates is particularly important in determining the parity price and hence the support price for a given farm commodity.

What is done there is to take the price prevailing for a given commodity at the moment and multiply it by the index of prices paid. This in turn is what the farmer needs to receive in order to have a balanced price relationship for a particular product. We then support it at blank percent of the price so determined.

At the present time there are only two major agricultural commodities that are selling above parity, and one of these is turning sharply downward. The first is soybeans; the second, hogs. All other major agricultural commodities are selling below parity.

What have we found out so far? To recap, first, so far as volume of output is concerned--authoritative evidence of a substantial degree of cutback. In the price sector the major evidence we have found is of price stability. Now, you can put the two together in a meaningful relationship. If you multiply volume by price, you derive an overall indication of dollar change in economic activity. The measure that you get from this approach will fit very neatly into the gross-national-product approach which you will hear about tomorrow. A decline in physical output, accompanied by price stability, gives us an overall dollar value of national output substantially below where it was last year--4 percent below for the United States as a whole. For the manufacturing and mining sector about twice that percentage--between 8 and 10 percent below where it was a year ago, since volume was cut more sharply.

We have therefore identified (a) the aggregate of recession and (b) we have had through the economic indicators some insight into the areas in which recession has been most pronounced--in durable goods, manufacturing, and in the agricultural sector.

The third battery of indexes that we will next look at, still dealing with the question of where we are and how we got where we are, relate to employment, unemployment, and earnings. These, too, are easily analyzed through the data provided in economic indicators. The charts in question begin on page 7 and run through page 11.

While you are looking at page 7, I might say that another price indicator that is shown in "Economic Indicators" appears on page 6--stock prices--but I have no competence in that particular area. I don't understand what influences the price trends in that particular sector of our economy. If you believe that is an interesting sector to observe, the basic data and the charts pertaining to it are on page 6. Employment and wage trends also give clear evidence of the contraction which has taken place over the past year.

Approaching it now from quite a different aspect--perhaps the most meaningful figure of the lot, although there is some debate on this--look first at the measure labeled unemployment page 7. Go back to a year ago and you will find that we had about 1.5 million people reported as unemployed, in the estimates of unemployment then put out by the Bureau of the Census. Come on to July 1954 which is still the last figure, and you will find that we had 3.3 million people unemployed or twice the number that we had a year ago. The trough--the peak of the unemployment figure--was reached at about the same time that we found troughs in some of our other economic indicators, in February or March.

The absolute figure has some meaning, although it is surrounded with some uncertainty because of a change in tabulation. But the relative figure is perhaps one to which you will want to pay more attention. How much of our labor force, of the total number of people habitually and traditionally seeking work, is currently unemployed? That figure is shown on page 7 in percentage terms--presently, 5.1 percent. Prior to World War II there was general agreement that 5 percent unemployment was about what you would expect even in periods of high-level economic activity. This we labeled frictional unemployment--people who would be moving from one job to another, who, for various reasons, were displaced but who created in the main no great social problem, no hard core of unemployment.

I think there has been a change in the character of what the economy is willing to accept as a measure of frictional unemployment, and that sustained unemployment at the level of 5 percent may no longer be regarded as merely frictional unemployment which creates no great social problem. Various studies by the CED and other groups are inclined to view 3 to 4 percent as the measure of frictional unemployment, rather than the 5 percent which had some degree of acceptance prior to World War II.

There is some meaning, then, to be read into changes in the absolute figures of unemployment, and even more in the relative figures of unemployment. One other measure, which is not shown here reflects the duration of unemployment. That is contained in the basic document put out each month by the Bureau of the Census, called the "Monthly Report on the Labor Force." It will show that nearly a million people of the 3.3 million reported unemployed in July had been out of work for more than 15 weeks. This is at times referred to as the hard core of unemployment, as distinguished from the overall total of frictional and extended unemployed combined.

The labor force is subject to wide seasonal swings. When school ends, two or three million youngsters may enter the labor force seeking summer employment. Failing to find summer employment, they would be entered in the unemployment figure. As you see, the figure has shown no change in recent months and will, I suspect, again show no change in August, when the data are released. The reason is that we have not had the normal seasonal expansion in the labor force--people have not entered the labor force in the same magnitude as they have in past years come summer.

There is an overtone here that I will simply refer to and pass on. You may very frequently hear it said that, if we hold this plateau for any sustained period of time, we will be faced with increasing unemployment, for two reasons: (1) that each year there is a normal net increase simply through the process of young people into the labor force and (2) that we grow more efficient each year and, if we hold to the same physical volume of output for any extended period of time, it will take fewer people to turn out the same volume of goods.

That is one school of thought prevailing at the moment. There is another approach which perhaps ought to be given its day in court. That school believes our labor force was artificially swollen; first, by the extreme needs of World War II, and then again by the hyperstimulation of defense, and that currently, and in the months ahead, many of the superannuated and many of the housewives, who are supplemental wage earners, will again return to their normal peacetime pursuits. The labor force may suffer attrition rather than expansion; and hence a plateau in economic activity would not necessarily imply a very sharp increase in the total number of people unemployed during the course of the next six months or the next year.

But basically, again, the material on page 7 helps to explain (a) the process of contraction which has taken place during the past year and (b) the mildness of that contraction. Note that in July we still had 62 million people at work and in July 1953 we had 63.1 million. There is not so sharp a difference between the levels of employment a year ago and currently as many people believe. That becomes clearer as you move from materials on page 7 to the materials on page 8, which help to identify changes in the internal components.

Let me now direct specific attention to some of the pertinent figures. In durable goods manufacturing we had about 102 million people employed a year ago; in July 1954, only 8.9 million. Note the extent to which the employment had contracted in the manufacturing sector--17.4 million in June 1953; 15.7 million in July 1954.

In other areas, however, you have had stability rather than contraction--in the governmental, in the financial, in the wholesale, and in the retail sectors. The violence of the contraction has been closely confined in the manufacturing sector and in the durable goods sector within the manufacturing sector.

offsetting a good part of the loss of overtime. We heard a lot about the loss of overtime and what it would mean in diminished consumption the loss of overtime and what it would mean in diminished consumption expenditures; but here you see the figures on the size of the paycheck virtually unchanged. There would be a further offset, in the form of lower taxes in 1954 than in 1953, in terms of take-home pay as distinct from gross earnings.

Another reflection of that appears on page 10. The average earnings figure to the left of the chart on average weekly earnings is \$1.80 per hour as late as July 1954. It was \$1.77 per hour in July 1953.

I have been stressing the beneficial aspects of the flow of wages to the labor sector of our population, but the average hourly earnings' figure has significance from quite another point of view. It is also a measure of labor cost to the employer, as well as of labor income to the wage earner.

This then is a recession characterized by an increase in labor cost rigidity may be one of the reasons for price stability. This labor cost rigidity may be one of the reasons for price stability. This recession as compared with price correction in some of the recessions.

in your own minds how desirable price correction downward is in your book would you put price stability? Would you view it not of strength or as an item of weakness currently? As you would all say price correction downward is contributing toward expansion. But view it not as a cost in the market place but also from the point of view of what it would do to your balance sheet, as your operating statement.

action I have drawn over the years is that changes locked within the operating when the business contraction invades action begins to affect capital values,

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tried to raise with you a counterquestion. Are we prepared to pay the price of sharply lower prices? One other observation in that connection is pertinent to this group. Every great war in this Nation's history, and you have had intimate experience with this background, has been accompanied by drastic inflation. If we had a price chart you would see this very clearly portrayed, no matter what mechanics of presentation were employed.

We had inflation in and after World War II. That can be ascribed to the methods used to finance the war. The chart book which we recently put out, titled "Costs, Prices and Wages," shows clearly that the inflation of World War II was as marked as, if not more marked than, any past inflation. Prices have undergone a mild correction over the past year and they are still above the zenith of any past inflation. The dollar was never worth less than it has been in recent years.

You are also familiar with the second part of that historic pattern. On the average in the decade immediately following every great war, we have had drastic, destructive, devastating deflation. That process can be as unstabilizing to the economy as inflation was in this stimulation.

Thus far we have avoided the vital parallel which is clearly found in price history. All this is by way of explanation, of why in my book I put price stability as a great item of strength during the past year. In many instances this reflected a deliberate policy pursued by industry because of the strong balance-sheet position in which it found itself.

There are two courses that could have been pursued during the past year. One was to cut prices violently and to hope that increases in volume would enable some modicum of recovery and profit to emerge from that. The other was to recognize the inventory imbalance existing during the past year, to shed as quickly as one could the excessive inventory, but not to unstabilize the existing price structure; to cut back on production rather than price; to take the licking on inventories and hope through the preservation of price stability for a quick, healthy recovery. This is a pattern that has not prevailed in past recessions-- in part it reflects the healthy, balance-sheet position of consumers business and agriculture. This is why some of us believe that recovery could begin soon, as the inventory overhang is cleared up.

So much, then, by way of comments under my first topical heading, where we are and how we got where we are. I suspect that this is all

pedestrian to many of you, and that your primary interest is not in where we are and how we got where we are but much more in terms of where we are going.

So I turn next to some of the barometric indicators of what may lie ahead, as distinguished from the business thermometers we have thus far examined. Within my lifetime and yours, we have seen a great change in our battery of economic indicators, with increased emphasis on current statistics for better public policy formation. Most of the economic tools I have been talking about were not in existence during World War I. They were brought into being between World Wars I and II. That void of pertinent economic data led to the formation of the National Industrial Conference Board, the Brookings Institution, the National Bureau of Economic Research, among other economic research agencies--a recognition that business and Government lacked tools that would at least provide better insight on the current position of business.

About all we had were dead statistics of the past, until the end of World War I. The second step was the improvement of statistics on current position; that came between World Wars I and II. Thereafter, our efforts have been increasingly devoted to the third stage, which I have elsewhere labeled as the development of foreshadowing statistics, of data that might throw light on future performance of the economy.

Some progress has already been made on this. Some of the charts, beginning on page 15, have foreshadowing overtones--they hint at what may lie ahead, they tell us the size of the woodpile, as it were, of American industry. Look, for example, at the material on page 15, Gross Private Domestic Investment.

The economy grows increasingly insecure as private investment begins to collapse. Note what happened to the private investment sector during the past year and what is continuing to happen--on page 15. Construction expenditures instead of moving in conjunction with and turning down with the reaction in manufacturing, moved up to even higher levels than in 1953. See where we were in the second quarter--25.9 billion dollars, annual rate. We are up now to the rate of 27 million dollars of new construction--new private construction, excluding public capital formation. Expenditures for machine tools, turbines, lathes, and other producers' durable equipment have also been well maintained. The only change of great significance in terms of investment was confined to the one sector to which I have already directed your attention,

the inventory policy of industry. This is particularly important as it relates to mobilization programs. Recall the rush to climb aboard the inventory train when it was believed goods would be scarce in 1951. This is clearly evident in the change of business inventories, shown by the figures in the last column. Conversely, when business finds itself in a period in which its inventories are excessive or out of balance, it can then proceed to fill orders off the shelf rather than from new production. That has been the salient characteristic of our economy since mid-1953.

At the bottom of the page, see the minus signs commencing in the fourth quarter, 1953. Business was adding to its inventory at an annual rate of 5.4 billion dollars in the second quarter of 1953; it was still adding in the third quarter of 1953. In the first quarter of 1954, it began to whittle down those inventories and is still engaged in that process, in part because of the reduction of lead time. The steel industry has found it possible to fill much more of its orders out of past production. Lead time has been changed from three to six months, which it was a year ago, to three to six weeks currently. That has also altered inventory-sales ratios drastically from what we thought were normal under the influence of artificially tight supply of the past decade.

The barometric implications of this chart are that end-product demand for private investment has been well maintained during this recession, unlike past recessions, giving high promise of automatic recovery. Depression takes place when you get not only a shift in inventory policy but also a violent contraction in the rate of construction, in the rate of investment in private areas. This time expenditures for construction rose and sustained private investment. With high end-product demand pointing in that direction, if we correct the inventory overhang, it is quite likely that we will move into the expansion phase in the next quarter.

There are other foreshadowing statistics on page 16. These test the psychological temper of American industry. Have they altered their expansion program as a result of the recession of the past year? What do they intend to spend for plant and equipment in the weeks and months ahead? There is little, if any, evidence that the recession is leading to any sharp curtailment in the private-investment programs. Instead, there is growing evidence that tax relief and tax reform may be highly stimulating to both construction and the investment program of American industry.

True, the figures for the third quarter for anticipated capital investment are lower. But figures for the fourth quarter and early 1955, supplied by McGraw-Hill suggest little, if any, further decline.

We can also test the psychological temper of American consumers, as we have annually ever since the end of the war. George Katonah in a survey completed as late as June or July of this year found that consumers expected to spend more freely in the second half of 1954 and the first months of 1955 than they did in the past year.

The psychological temper is high in industry. The psychological temper is high among consumers.

Another foreshadowing statistic which I have referred to before is the construction activity and what that implies in terms of subsequent demands by consumers and by industry for capital goods to be used in such new structures. Construction awards are some 20 to 25 percent higher in August 1954 than in August 1953. There is the same general picture again on page 18 for new housing starts, substantially above expectations in 1954. The July figure, not posted here, is 112,000. That is somewhat below the June figure, but still it is a very high rate. The annual rate is 1.15 million--above last year.

We could well spend the rest of the day on the inventory, sales, and the new order data on page 19. That's the clearest picture of what I mean by foreshadowing statistics. If you were running your own shop, you would relate your backlog of new orders to your current rate of activity and that would pretty much tell you how much work lay ahead of you. Your backlog related to your current rate of activity would tell you how many months of future work were already committed for, in terms of, you hope, firm orders.

So much emerges from the figures on page 19. The new orders figure for July, if you want to post it, is a little disappointing--22.6 billion as compared with 22.9 billion dollars for June. This came as a surprise. We thought the new orders for defense items would pick it up. It may still be reflecting the summer doldrums.

The inventory picture that I referred to earlier is more clearly portrayed here than by any other set of accounts. Visualize the magnitude of inventories in the hands of American industry. Retail, manufacturing, and wholesale trade--just those three sectors alone--had inventories in excess of 80 billion dollars last year. The inventory was

still piling up as late as last September, 82 billion dollars of inventories, although sales had already begun to turn down in May and June.

You begin to see evidence of the inventory correction--gratifying, in the total amount--down from 82 billion to 79 billion dollars. But that is only three billion on a 79-billion base. We may expect to have more inventory correction before full-scale expansion is under way. But for each sector of American industry we are beginning to have basic data that will enable members of industry to observe inventories within industry, among their customers, and among their suppliers--and with better data, perhaps we can do a better job of controlling inventories.

The key figure to watch in the sharp, severe, but short-lived recession is the inventory figure. More and more we believe this imbalance in inventory is the major cause of sharp, short-lived recession. The subsequent upturn should be clearly portrayed in an improved inventory position. The better knowledge we have of the inventory position, the greater contribution industry itself can make, through its own private mechanism, towards minimizing the amplitudes of the imposed business cycle and maintaining economic stability.

I must move on. The figures for merchandise exports and imports on page 20 are some sourer than they were in June. If you want to post the figures for July, they are, 1,291 million dollars for exports; 832 million dollars for imports.

Moving along, so that it cannot be said I discussed the economic scene without any consideration at all of credit and monetary aspects--there are a series of charts beginning on page 27 devoted solely to such changes. As page 27 shows, reaffirmed by some subsequent charts, unlike past recessions, this recession has been accompanied by an expansion rather than a contraction in the money supply. Go back to June of last year and you will find a total of 138 billion dollars bank loans on investments; today it is 146 billion. There has, however, been no significant rise in bank loans so far this year.

I will reserve major comment on consumer credit for some later time and direct attention now solely to the fact that this measure is in "Economic Indicators," page 28. Much of our mass market for durables is created by consumer credit. I recommend that you think of consumer credit not only in terms of absolute but in terms of amounts.

And relate changes to it to changes in the incomes and the assets of our people. Thereby you may get a more meaningful perspective of consumer credit supply through looking at the 5.7 billion dollars of consumer credit outstanding in 1945 and the 28 billion outstanding in 1954 and concluding that it is too high. That quick, curbstone conclusion that is frequently presented to lay audiences may be completely unwarranted--on a relative basis.

On page 30 there is further confirmation of my earlier point on the expansion of the money supply, that is, the total amount of money outstanding in the banks, held by business, consumers, and so on. There has been nearly the same rate of expansion in the money supply, during the recession as before it and a greater resort to easy money as a countercyclical policy than in any past period of recession.

Last, on page 31 you will see total expenditures for national security--cumulative by months. We came down here a month and one-half ago to be briefed by one of the Department of Defense experts on the budgetary outlook for the Defense Department for fiscal year 1955. We carried home to our various associates the message that defense contract placement, which had tended to be very low in the first and second quarters of the calendar year, would be sharply accelerated in the third and fourth quarters of calendar 1954. That in turn had some stimulating impact upon business planning for the second half. We find, despite an intensive search, no indication of intensification of defense contracts thus far in the third quarter of calendar 1954. I hope some of you may be induced to comment on that during the discussion period. What happened to the doubling of defense contracts that was required if we were to live up to the budget defense expenditures in fiscal 1955?

Let me recap very hastily what our examination of "Economic Indicators" has revealed. It clearly confirms that we have experienced a recession of considerable magnitude, particularly in vital sectors of manufacture. If you don't believe it, look at the economies of South Bend, Pittsburgh, Fall River, Scranton, Detroit, and others--there has been more than a 4 percent recession in all of those particular areas. It is an economy that has been characterized by (a) a cutback in physical production but also (b) stability in price, contributing, at least in my analysis, toward the mildness of the recession and giving considerable hope of quick, automatic recovery.

The foreshadowing statistics--and there are many more than I was able to present to you--show a high psychological tone in American industry. We have completed a survey in our shop that we will announce next week. Our associates in the manufacturing sector believe the second half of 1954 will be better in terms of sales and in employment than the first half. As I have indicated, consumers kept their demand high in the first half and indicated they plan to spend even more freely in the second half. In the main, the economic outlook seems to be better for the second half than for the first half--at least it appears so to the Administration's economists.

I must in all fairness tell you that so far as many business economists are concerned, they do not see clearly those forces that will move us toward higher levels in the months immediately ahead than the levels that prevailed in the second quarter of 1953. Recovery may take a little longer than is generally believed--at least according to the business economists. They do not see the expansionary forces that will bring us quickly into high ground.

Will private industry spend more for capital investment than it has in the past months, particularly with capacity already too large in many instances? Will Government spend more than it has in the immediate past, keeping in mind the fact that defense spending will be lower in the next than it has been in the past fiscal year. Will consumers spend more in the aggregate for hard goods, soft goods, and services than they have spent in the restocking period of the past three, four, or five years.

Basically, have the misallocation of resources arising from the inflation of World War II and the artificial stimuli of Korea all been corrected in so short a period of time that we can and ought to move on to higher ground in the months immediately ahead?

And yet business expectations are high. The current figure of the Federal Reserve index of industrial production is around 124. It should be more than 124 or 125 in the next calendar year--perhaps by late 1954, or at worst the early months of 1955. The gross-national-product figure for the next calendar year is also expected to be somewhat higher, but still below the gross national product for 1953.

I think that through "Economic Indicators" you have seen that the woods are full of strong, sustaining forces currently. If it takes us a little longer than is generally believed to correct for the misallocation

of resources of the last 5 or 10 years, there should be no great basic damage wrought to our economic structure in the interim.

DR. KRESS: Professor Gainsbrugh, you have given us an excellent lecture. Thank you very much.

(16 Dec 1954--250)S/en