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WE ANTICIPATE . . . that

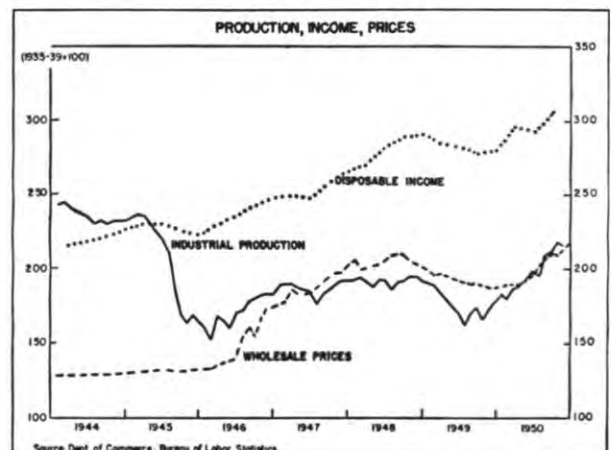
- (1) employment will continue at high levels. Conversion dislocation has not developed to any great extent yet, but will become more important within the next two or three months. **HOWEVER . . .**
 - such dislocations will be temporary. All employees will not be laid off and many of those who are will be absorbed elsewhere.
- (2) prices and wages will show further gains, despite Government action. Early controls are a delaying action and the real structure of price controls under which business will operate will develop during the next six months. **EXPECT . . .**
 - income to advance further. Disposable income has been rising, despite the increase in taxes. Inflationary pressure will be more powerful later in the year.
- (3) international agreements fixing the price and allocating the supply of world commodities will not be reached easily or quickly. Very little progress can be reported to date.
 - foreign countries need dollars. The U.S. does not have control of the shipping and has too many political problems to press too hard for international price agreements. Prices of items these countries purchase from the U.S. have also been rising.

"CEASE FIRE"

Rumors of a "cease fire" in Korea have been persistent. They may not be entirely groundless. Are we to conclude, therefore, that the aims of Communist countries, particularly China and Russia, have been modified, or that these aims were previously misjudged?

Any such development as a "cease fire" in Korea would be a tactical maneuver. From the viewpoint of longer-term strategy, and U.S. defense problems, it would be meaningless. It would not even assure a settlement in Korea, although our military activity in that area would be temporarily halted.

Nevertheless, such a move might have psychological effects, and might cause declines in some of the speculative markets. An ebb and flow of inflationary feeling and price action, however, should be expected in any event. After a period of panic sales at retail there is always a lull. And in most markets supplies are still sufficiently large so that any big increase in new orders is automatically followed by a decline.



COMMENT: Inflationary factors will continue despite action on price control.

CONTROLLING INFLATION

The battle against inflation has been a losing one so far. Price control action, now developing, will interrupt temporarily the advance of prices to higher levels. Creeping inflation will nevertheless continue, and price control problems later this year will again be acute.

Clients are justified in expecting a continued rise in prices generally, but a much more diverse movement of individual commodities.

Price control action will produce a period of great confusion in most markets. Volume of sales will drop temporarily, some buyers being unwilling to buy and some sellers unwilling to sell.

General action on prices will have to be followed up quickly by selective controls.

No solution has been found yet for *farm products*, which ESA is afraid to touch even when they are above parity, and *imported commodities*, which have so far led the advance.

Basic Cause of Inflation

The first inflation of prices reflected heavy buying by businessmen and consumers, rather than any marked expansion in Government expenditures.

The first buying wave came in the third quarter of last year. Appliances, automobiles, soap, sugar and a few textile items showed big sales increases, as consumers were reminded of the last war's shortages. New orders exceeded manufacturers' shipments substantially during this period.

In the fourth quarter, this first buying wave died down. Restrictions on credit were among the factors reducing the demand for durable goods at the retail level.

Government finances even now are not inflationary. Taxes were increased and Treasury revenues will exceed Treasury spending during the first quarter of this year.

It will be mid-year before any substantial deficit begins to develop in current Treasury operations.

Even this deficit can probably be financed on time by non-inflationary means—sales of Government bonds to non-bank investors, such as individuals, insurance companies and other institutions.

The fiscal picture nevertheless is an inflationary one, even though its full effects will not be felt until later.

- it is extremely unlikely that Congress will vote more than \$8 to \$12 billion in new taxes, against the President's request for \$17 billion, and
- it will not be long after mid-year before the Treasury will again have to engage in inflationary deficit financing—sales of its obligations to commercial banks.

Steps Against Inflation

Restrictions on credit undoubtedly prevent the demand for new homes, automobiles, appliances and other durable goods from being as high as they would be otherwise.

The fact remains, however, that

- income is increasing steadily. The gain from the third to the fourth quarter was about \$6 billion, even after allowance is made for higher taxes, and
- many consumers still have large savings that they can draw on.

Credit restrictions, in short, do not succeed in reducing

demand to the supply level in a period when durable goods production for civilian purposes is being reduced.

Credit restrictions were also tightened for banks. This tightening took two forms.

- requests that banks voluntarily limit loans, as far as possible, to non-inflationary purposes; and
- an increase in reserve requirements.

However, banks are under pressure to maintain their earning power, and are in no position to police all loans as to their ultimate purpose, or to draw the final line between non-inflationary and other results. The increase in reserve requirements is also ineffective, since it is small and since banks can create new reserves by selling governments.

In the credit field, the Federal Reserve Board, during a good part of last year, caused a rise in short-term interest rates through its open market policies. Anti-inflationary policies by the Federal Reserve Board, however, require the cooperation of the Treasury. And the Treasury has just made it plain

- that its own financing operations come first, and
- that the interest rates will be kept low, without regard to what impact that has on inflationary trends.

Taxes, as pointed out above, have been raised once without preventing a further rise in sales and prices; and there is little prospect that taxes will keep up with increased Government spending.

Price control therefore becomes a last resort. The marked expansion in consumer and business demand surprised the Administration, and efforts to defer price control while production was being increased have been a failure.

Price control, however, will not be a final solution.

For imported commodities, the Administration has not succeeded in reaching international agreements, which would stabilize the price, and is not ready to subsidize imports.

On farm commodities, great reluctance is shown about placing price controls, even in those cases—like cotton and meat—where prices are far above parity.

The general price level is therefore likely to increase further, perhaps another 10 percent in the next 12 months, regardless of price control action. How much the advance will be slowed down thereafter depends greatly on policies with regard to agricultural commodities and imported materials.

AUTOMOBILES

How Many in 1951?

More estimates and predictions are flying around as regards total automobile output in 1951 than deal with any other major commodity; and the variation among the estimates sometimes seems to be very confused.

On a rational basis, there are two salient facts about the outlook for automobile and truck production in 1951 to keep in mind:

1. **There is no question whatsoever that production cutbacks of a significant nature are taking place, and will continue to increase this year.**

These cutbacks are based on two major factors; one, a growing restriction on use and supply of a key number of materials, especially steel and non-ferrous metals, for non-defense purposes; two, a growing re-conversion (it might be even better described as a re-reconversion) to output of products required by the military.

AUTO PRODUCTION
(Millions)

	Passenger Cars	Trucks	Total*
1929	4.6	.8	5.4
1941	3.8	1.1	4.8
1947	3.6	1.2	4.8
1948	3.9	1.4	5.3
1949	5.1	1.1	6.2
1950	6.7	1.3	8.0

* May not add because of rounding.
SOURCE: Automobile Manufacturers Association and Automotive News.

The level of production of major military products by the automotive industry is still a very considerable distance from the peak that it will achieve in the next two-year period; while the rate of defense planning and spending is increasing, there is still a time lag between these two things and actual production or conversion to military production.

2. The second fact is that the level of production of civilian cars and trucks during 1951 as a whole will be relatively high, and will add up to a level that will be within the range of what is considered to be a good production year under normal peacetime conditions.

Total production of cars and trucks during 1950 exceeded 8 million units for an all-time record. It will be a long time before a similar level is seen again. However, more important than the question of holding to that level is the fact that a cutback of 25% to 30% this year would still result in a total production of between 5.6 million and 6 million cars and trucks. Even a drop of as much as 37.5 percent would mean a level of 5 million units.

- As shown by the accompanying table, it was not until 1948 that the 1929 record was surpassed. Thus, in relation to production in earlier years, total output during 1951 of between 5 and 6 million units would still constitute a good production total.

The latest order affecting priorities in the steel industry, which raises the maximum percentages that producers are required to set aside in meeting defense orders does not represent a major change in the supply picture for the industry; presently, a tighter pinch is being felt in the field of key non-ferrous metals.

Of perhaps greater importance in determining the level of car output during the coming year is whether a maximum production limit will be imposed on the industry by NPA in an effort to conserve key materials even further. Such limits would of course lay a much different basis for evaluating the level of 1951 production, and would probably result in a lower level than that estimated above.

Barring such an order, outlook for production in the first half of this year remains fairly good; thus, in the latest week, annual rate of production of cars and trucks came close to the 8 million level. This is a rate which to many would have seemed impossible of achieving some months ago. Continuation of production anywhere near that level will more than offset more severe cuts in the second half of the year.

ELECTRIC UTILITIES

Seven Billion KWH Weekly

In one of the last weeks in December of last year, the country's electric light and power industry achieved a total distribution of electric energy that exceeded 7 billion kilowatt-hours of energy.

More important than the achievement of the 7 billion KWH weekly output in one week of 1950 is the fact that this level will be seen and exceeded, many times during 1951. In one sense, it becomes the new base by which to judge activities of the electric light and power industry during the period of increased mobilization of resources in line with a vastly expanded, and expanding, defense program.

Production and Capacity

Total output of electrical energy during 1950 is estimated to be about 328 billion kilowatt-hours, in itself an annual record; 1950's total was 100 billion KWH above the World War II peak; on a percentage basis, the increase was about 44 percent.

The increase in output during 1950 from the previous year's total amounted to about 35 billion KWH; a similar increase during the present year would bring the total to over-360 billion KWH, a total output that seems fairly likely for the year, in view of the steadily increasing requirements that will be made during the year, especially by the heavy consuming industries.

At the beginning of 1950, generating capacity of the country's electric light and power industry amounted to 62.7 million KWH (the figures cited above do not include output of private plants, which amounted to about 58 billion KWH of energy during 1950). By the end of 1950, capacity, in terms of name plate rating, amounted to about 68.5 million kw, for a gain of about 6.0 million kw during the year.

As industry plans stand at present, the next three year period will see a considerable further growth in capacity installation; increases during 1951 alone will probably be around the 7 million kw level.

In part, the ability of the power industry to achieve these goals will depend on materials availability, on a relatively long-term basis. So far, Administration sources give evidences of placing increased power output high on the list of priorities; should there be a Controlled Materials Plan later this year, and such action seems to be growing ever more likely, the electric light and power industry would most probably benefit in terms of guarantees of required materials and parts.

- This also applies to transmitting and distribution equipment; the order cutting back aluminum use made specific exemptions in relation to use of aluminum for such purposes, at least on a temporary basis.

All in all, it seems likely that additions to power generating capacity will keep pace with the growth in demand for energy, especially by heavy industry. During 1951, there may be occasions where simultaneous demand for power may create operating difficulties and spot shortages; these however, should be relatively rare, and confined to a very few areas.

ELECTRIC POWER

	Generation (Billions of KWH)	Capacity* (Millions of KW)
1939	127.6	38.9
1944	228.2	49.2
1948	282.7	56.6
1949	291.0	62.7
1950	328.0	68.5

* End-of-year.
e—Estimated.
SOURCE: Edison Electric Institute.

WASHINGTON INTERPRETER

Dynamic

Politicians love to emit sonorous noises about this country's economy. In all truth, many of them don't know how dynamic it actually is.

Price control is a case in point.

The belief that controls of this sort could be put off until much later was quite sincere. It found support in the statistical background, which even now indicates that defense spending twelve months hence will account for no more than 12 percent of the gross national product. *All that was ignored was the basic source of dynamics, the human reaction of businessmen and consumers to repeated statements of emergency.*

Defense spending is still very low. New orders have increased sharply and defense production is beginning to rise slowly, but actual *defense spending* is very little greater than it was a month ago, or than it was before Korea was invaded. The Treasury, in fact, is taking in more money than it is paying out.

The public at large, however, has been way ahead of the Administration. It knows this situation will not last. However much the Administration is willing and anxious to wait until later, the public, which the Administration has left to fend for itself, has been taking care of itself as best as it can by buying ahead.

Premature

Nevertheless, general price action at this time is premature.

Not because it is not needed, but because ESA is not organized or equipped to administer such controls; and because the agency is even less prepared to cope with problems of rationing, which its action on prices will probably make more immediate.

Its first actions, therefore, can be regarded as no more than preliminary.

They may in some cases establish a pattern, which will be helpful in estimating what will come later. But the real problems of price control are still unsolved and the job is hardly begun.

More Victims

Price Administrators have been very hard to obtain. Neither Valentine nor DiSalle were the first to whom their jobs were offered; and neither, if the truth were known, is likely to have accepted the appointment without a great deal of doubt and misgiving.

It is pointless to argue Valentine's merits or demerits as ESA Administrator. However great his merits were, the first appointee to this office was almost certain to be an early casualty; and the first casualty will not be the last.

The last war was a long and costly war. A really successful price control, however, requires such extremes of austerity, and such intensive control over all civilian activity, that they are politically impossible in this country unless the foreign threat is much more apparent and much closer to home than it was last time.

A succession of stabilization administrators, it seems likely, will fall victim to these circumstances.

Renegotiation

Price controls and rising costs will cut profits on both civilian and military work. A new renegotiation act will soon apply to war contracts, making possible a later recovery of any "excessive" profits that do slip through on war work.

Mildness of the present excess profits tax is one reason for the haste in speeding renegotiation policy.

One of the legitimate criticisms of renegotiation during the last war is that a substantial part of the recovery in funds would have been claimed in any event under the stiffer excess profits taxes of that period. Now the excess profits tax is milder and renegotiation policies are likely to be tougher.

Mobilization

Defense mobilization, however, is an easier problem. Unbelievable feats of production are a matter of pride, and the severe regulation of materials that they make necessary is accepted without much question.

Organization of materials control, however, is not a simple problem, even though it does not encounter the same political and psychological obstacles as price control. Early efforts to organize material controls during the last war were unsuccessful, the mobilization agencies had many anxious and critical days and it was not until after many mistakes that workable methods were devised.

Wilson has the advantage at this time of his experience as an industrialist, of his experience in Washington during the last war, and of the then Senator Truman's activities as an investigator of the war efforts.

Senator Truman had pointed out, quite logically and quite intelligently, that one handicap to war mobilization at that time had been the incomplete authority granted to the chief war mobilizer.

Wilson's grant of power, we have pointed out, gives him more authority over the economy than has ever before been held by any one man, excepting wartime Presidents. In a sense, however, this puts Wilson on a spot.

Moreover, some of this former business associates and competitors seem to feel, since Wilson is a representative of "big business," that business itself is on a spot. They are all too afraid that any difficulties or failures, if not attributed to Wilson personally, will be attributed to lack of "business" cooperation.

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