

From the London End

Tremors and Earthquakes

The tremors of the present century have all had their origin in America and it is the situation in the U S which gives Western Europe the greatest cause for anxiety.

The sharp drop in automobile sales in the U S, the levelling of industrial production in the V K for the first time in two years and the indication that production in West Gernany can no longer be expected to increase have led to a search for appropriate counter measures.

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THE current economic situation reveals three outstanding developments:

- (1) The production of motor vehicles in the United States has fallen by 23 per cent between the first four months of 1955 and 1956;
- (2) Industrial production in the United Kingdom has levelled off for the first time in two years and is now no higher than it was a year ago; and
- (3) Industrial production in Western Germany has now reached a level where further increases can no longer be expected.

A lively controversy has been provoked in all these three countries on the need for appropriate counter measures. In the United States and Germany, the heads of the Governments concerned have disavowed the interest rate policies their respective central banks have pursued in the past two months. In Britain, the question of "trade defences" against a possible recession in the United States is being sharply raised and a debate, albeit a confused one, about the advisability of raising or lowering the bank rate is raging in and out of Parliament.

This turn in economic events has been sudden, almost unexpected. And yet economists in the United States have for some time viewed the American boom with considerable misgiving; many of them have instinctively felt that "this situation cannot last". Professor Reder of Stanford University wrote some three months ago that "a turning point in the hush cycle is suspected", and the Economic Commission for Europe in the 1955 Survey questioned the official restraints on economic activity in many of the European countries. In the United Kingdom the situation has been overshadowed by the magnitude of wage claims, yet now and then symptoms of weakness appear which point to the over-all direction of economic trends; fall in sales and

exports of motor vehicles, slump in the carpet and textile industries, etc. These pointers have of course not been taken very seriously and there is probably some justification for this attitude but the wage-price spiral cannot be regarded as lightly; it does have an over-whelming influence on economic affairs.

Commodity Markets Weakening

Although prices in general have proved to be flexible in only one direction, tendencies in the international commodity markets portray a developing situation which is in tune with the other sensitive indicators of economic activity. Thus the commodity market trend, which was beginning to emerge in the first quarter of the year, has become more clear-cut over the past two months. In 1955 industrial raw materials generally ruled firm with rubber and the major non-ferrous metals as leader. Foodstuffs and agricultural products were weak. Today the markets for industrial raw materials are very much weaker than those for foodstuffs and agricultural products. Even with regard to the latter, the price pattern is only being maintained, by the agricultural price policies of the US Administration.

It is however the situation in the United States that gives Western Europe the greatest cause for anxiety: the tremors of the present century have all had their origin in America. -And it is towards an understanding of the nature of these periodic tremors and when these tremors are likely to turn into earthquakes that, many in this part of the world direct their attention. Hence The Economist suggested that while the situation in the United States did not immediately give cause for alarm, "watchfulness" on the part of the United Kingdom would bring rewards; this journal then went on to examine the most desirable forms of "trade defences" to be adopted should the situation in America really become serious.

Soft Spots in the U S Economy

The American economy is showing two weaknesses which in the view of your correspondent are particularly infectious. There is firstly the weakness in the demand for steel and steel products and secondly the weakness in the demand for agricultural products. The "soft" spots which began showing themselves at the turn of the year are now being reflected in the fact that over 80,000 new 1950-model passenger cars and an equally substantial quantity of farm implements are in dealers' stocks with little chance of their being worked off. In other words, the rise in what the Americans term "inventories" reflects the fundamental weakness in the demand for steel. According to the US Department of Commerce Survey of Current Business "... inventories in manufacturing and in lines of trade other than new car retailing have evidenced a rather steady expansion since the Spring of 1955" and further, "the continued growth of inventories have raised book values for manufacturing, wholesale and retail trade firms combined to \$ 83½ billion at the end of last February - an increase of about \$ 6 billion over last February".

The inventory structure described above follows a performance in the American economy which has been described as "breath-taking". During 1955, the seasonally adjusted GNP rose by 2½ per cent in quarterly intervals for the year as a whole it rose by 2 per cent. Such a rate of growth for a highly industrialised economy is certainly "breath-taking". It is all the more so when the increase in output has been largely the result of increased employment (and very slightly that of price increases). The Federal Reserve Board's index of industrial production recorded a rise of 11 per cent in 1955 and the gain in the second half was somewhat larger than in the first.

Breathtaking Expansion

This remarkable expansion in the American economy an expansion which tended to become cumulative as the months of 1955 rolled by—appears in retrospect, as an approach to the peak of the customary business cycle. This interpretation is not only justified by the growth of inventories and the decline of sales in the opening quarter of 1958 but also by the nature of the 1955 build-up. Personal consumption expenditure on durables in 1955 proceeded at a rate considerably higher than that on non-durables. Further, while personal consumption expenditure had increased between 1954 and 1955 by 8 per cent, the increase in gross fixed investment proceeded at a higher rate viz 12 per cent. Of the increases in fixed investment, that of house construction and producers' durable equipment was the most rapid. These features are symptomatic of the well-known building-up of activity to the peak of the business cycle when either an earthquake takes place, or, when appropriate *policy* measures are set to work, the crack-up at the peak takes the milder form of a tremor.

The Turning-Point?

The developments in the first four months of this year in the United States suggest that the turning-point has been reached. Weak spots have appeared precisely where the boom was most in evidence in 1955. Last year the smaller motor car producers were able not only to increase their share of the market but to increase their net profits as well. Now each of these small producers faces what one American commentator describes as "extinction". Further, such giants as General Motors and Fords have joined the ranks of firms calling for production holidays. Taking 1947-49 .100, the index of motor car production rose to a peak of 212 in November 1955 and has since steadily fallen to 164 in April this year. The index for the production of durable manufactures as a whole has come down in the first quarter of this year to the September 1955 level. Automobile production is now running at about 10 per cent below that of last year and major car producers have projected a more or less proportional cut for the entire year.

The slump in the US motor vehicle industry (and in the demand for farm equipment) has not yet produced an impact on steel production. As the manufacture of durables has

continued unchanged, steel output has not yet been affected.

Company Profits Decline

The Monthly Letter on business and economic conditions issued by the First National City Bank for

May 1956 contains some revealing information on company profits in the United States in the first quarter of this year. For the 777 firms reported on, net profits fell by 8 per cent between the fourth quarter of 1955 and the first quarter of 1956.

TABLE I**USA—Selected Economic Indices
(1947-49 = 100)**

Period	Industrial Production	Consumer Prices	Wholesale Prices
1952	124	113.5	111.6
1953	134	114.5	110.1
1954	125	114.8	110.3
1955	139	114.5	110.7
1955 March	135	114.3	110.0
June	139	114.4	110.3
Sept	142	114.9	111.7
Dec	144	114.7	111.3
1956 March	144	114.6	112.8

TABLE II**US Manufacturing and Trade Inventories**

	Book Values \$ Billions				Stock-Sales Ratio	
	1955		1956		1955	1956
	February	December	January	February	February	February
Manufacturers	43.3	45.9	46.3	46.8	1.75	1.72
Wholesalers	11.7	12.3	12.4	12.5	1.23	1.20
Retailers	22.4	23.9	24.1	24.2	1.51	1.58
Total	77.3	82.1	82.8	83.5	1.58	1.58

TABLE III**Construction and Employment**

Period	Commercial Construction Contracts \$ millions	Non-Farm Housing Starts 000's	Unemploy- ment 000's monthly average
	1953	1488	1104
1954	1815	1221	3230
1955	2359	1329	2654
1955 March	194	114	3176
June	228	135	2679
Sept	197	115	2149
Dec	192	76	2427
1956 March	153	76	2834

TABLE IV**Expenditure on New Plant and Equipment
By U S Business**

	\$ millions		
	1954	1955	1956 (Expected)
Manufacturing Industry	11,038	11,439	15,036
Durable Goods	5,091	5,436	7,685
Non-Durable Goods	5,948	6,003	7,351
Mining	975	957	1,141
Railways	854	923	1,307
Public Utilities	4,219	4,309	4,989
All Industries	26,827	28,701	34,893

This sharp fall may no doubt partly be due to seasonal influences, but in the case of companies in the automobile, electrical equipment and radio industries, profits have fallen compared to those in the first quarter of 1955.

The other depressed area of the economy, agriculture, has been in the doldrums for some months. In February this year incomes of farmers at a level of \$1,839 billion were some \$60 billion less than a year ago. The short and quickest answer to the troubles of the American farmers (in this election year) has been the Agriculture Act of 1950 which by the time it has been through the processes of legislation has become so repugnant to the Administration that President Eisenhower has vetoed it, only to announce equally rigid high price supports for a number of commodities in the coming crop year. The uneconomic and opportunist remedies to the problems of American farming do nothing more than either postpone the collapse of American agriculture or imperil the international market for the commodities of other agricultural countries. The US policy of funneling farm surplus to countries abroad under the Mutual Security Act has caused more than consternation in Australia and Canada,

Next to automobiles and farming, house construction has become the main cause for concern. Up to September last, the number of private house constructions started was about 17 per cent above that for the corresponding months of 1954. A seasonal slump set in after that; it has however continued into the new year. Probably this continuation in the decline in housing has been the result of a tightening of mortgage lending terms by agencies of the Federal Government. In any event, the pressure for work by building contractors forced the Government at the end of January 1956 to rescind its tighter lending policy and yet new private construction expenditure on dwellings was some \$20 million less in February 1956 than in February 1955. Many informed Americans believe that the post-war housing shortage has been overcome and that the current recession in house construction is likely to develop into a serious slump.

The one important but unpredictable factor likely to have a marked influence on developments is investment in durable producers' equipment.

According to the First National City Bank Monthly Letter this "key item in business change" reflected an increase (in expenditure) of \$iv> billion between the fourth quarter of 1955 and the first quarter of 1956. Business plant and equipment expenditures are scheduled, it says, to total \$35 billion in 1956, exceeding 1955 by 22 per cent. This optimistic forecast is repeated by a McGraw-Hill survey which found 1956 business investment plans amount to \$33A billion or 13 per cent above that of 1955. By the look of things in the United States, this "key item" will determine whether "It" is to be a tremor or an earthquake.

The doubts about the course of the American economy which are widely held even in the United States should have suggested to the monetary authorities a more liberal financial policy. And yet as late as

April last, another round of discount rate advance was announced by the twelve Federal Reserve banks. Simultaneously the Federal Reserve authorities jointly conducted open market operations by selling Government securities, thereby adding pressure on the banks to borrow. Member bank borrowings from the Federal Reserve averaged \$1.1 billion during April, higher than in the first quarter of the year and slightly above the billion dollar peak of November last. In this situation the major banks adjusted their rates, forcing up Treasury bill yields to 2¾ per cent from 2.17 per cent previously. Stock and share prices fell correspondingly and the Stock Exchange in New York remains in the doldrums.

For some reason Federal Government expenditure has been showing a decline of about 2 per cent every quarter since the beginning of 1955. This decline has occurred on both defence and other expenditure items. On the other hand, Federal receipts have been running about 11 per cent higher in the first five months of the 1956 fiscal year compared with the corresponding period of 1955.

Against these positively deflationary features in the American economy (except the hoped-for intentions in business investment), the wage-price structure continues its upward trend. Wage demands have received official support this Spring minimum wages are generally increased by a third as well as the support of collective bargaining pressure. Prices for industrial products have risen by 0.5 per cent per month since June 1955 and the overall wholesale price index has been rising at an annual rate of 3½ per cent in the same period.

The United States economy, possessing as it does a number of deflationary elements and one or two inflationary ones, appears to be precariously poised at a very high level of income and employment. It is to the buoyancy of the capital goods sector and the "possibility of heavier government spending on public works and defence", that one has to look hopefully for countering the depressive influences emanating from automobiles, farming and housing. In this uncertain, precariously-balanced position, the American economy is most vulnerable to shock or downward pressure from any quarter. And should the hopes placed on business investment be not realised, the tremor may become more serious.

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