ENCYCLOPEDIA

OF

BANKING AND FINANCE

A REFERENCE BOOK COMPRISING OVER 3,000 TERMS RELATING TO MONEY; CREDIT; BANKING PRACTICE, HISTORY, LAW, ACCOUNTING AND ORGANIZATION; FOREIGN EXCHANGE; TRUSTS; INVESTMENTS; SPECULATION; MARKETS; AND BROKERAGE

BY

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7. Gold movements.
8. Gold production.
9. Excess bank reserves.

INVESTMENT BAROMETERS

1. Money rates.
2. Average bond prices.
3. Average stock prices.
4. Municipal bond sales.
5. Activity of the New York Stock Exchange.
6. New capital issues.
7. Refunding issues.

(See Business Cycle, Business Forecasting Services, Fundamental Conditions, Investment, Market Sentiment, Speculative Cycle.)

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Business Cycle

An interval which embraces alternating periods of business prosperity and depression. It is one of the most significant phenomena of the capitalistic regime and appears to be an outgrowth of our modern credit system in which production takes place in advance of consumption. Business volume and commodity prices do not remain constant, but are subject not only to seasonal variation, but to long-term fluctuations. In other words, business travels in waves, and excesses of activity appear to be counteracted by excesses of depression. Borrowing from the physical sciences, Mr. R. W. Babson, one of the best-known business forecasters, constructs his theory of the business cycle on the principle that action and reaction are equal, or that periods of business prosperity in so far as they are in excess of normality, are compensated for by periods of depression.

According to this last authority the business cycle comprises four distinct phases which are called the period of: (1) prosperity, (2) decline, (3) depression, and (4) improvement. S. S. Huebner in his book entitled "The Stock Market," divides the cycle into five periods as follows: (1) business depression, (2) reviving business, (3) new enterprises, (4) intense prosperity, and (5) violent liquidation in security markets.

The author divides the business cycle into more or less distinct periods, enumerated and described as follows:

(1) Crisis—This is the turning point or decisive moment which marks the collapse of the period of prosperity, inflation, extravagance and high prices. It is usually initiated by a buyers' strike as a reaction from high prices. Before the inauguration of the Federal Reserve System a crisis was likely to be followed by a panic. This is primarily a financial phenomenon characterized by a collapse of the credit structure, universal demand for money payments, lack of confidence in the ability of debtors to pay debts, and usually by a series of important business, brokerage and banking failures. Banks are the storm centers of panics, since everyone is experiencing difficulty in securing an adequate supply of cash. If important failures occur, "runs" are likely to be made upon the banks, and a great strain is placed upon the banking system. Since no panics have occurred subsequent to the establishment of the Federal Reserve System, and since reserves are concentrated and mobile, and hand-to-mouth currency readily available through rediscounting, it is believed that the country is now panic-proof.

(2) Emergency Liquidation — Following the crisis (and panic if there is one) comes a period of emergency liquidation. During the previous period of prosperity production has been at a high rate, leading to an overstocking of goods at high prices. When the crisis announces the end of the period of high prices, businesses are eager to unload or to "get out from under" before prices decline further. There is, moreover, an oversupply of goods and a shortage of cash. Quantities of goods are, therefore, placed on the market for what they will bring.

(3) Depression—This is a period of "hard times" in which the disturbance in the normal equilibrium between supply and demand is still felt. Prices are low and efforts are made to work off the excess of goods. There is a drastic curtailment of production, resulting in widespread unemployment, reduction or elimination of profits, accumulation of money supply through the deflation of credit, and a general practice of economy. There is a constant "feeling for the bottom" in the price movement.

(4) Readjustment—When the bottom of the price movement has been struck, the period of readjustment begins. It is characterized by irregular and uneven price movements which are in process of stabiliza-

tion and harmonization; also by sharp competition, lower production costs, elimination of the inefficient (numerous business failures) but with the return of more cheerful sentiment.

(5) Recuperation or revival—The period of readjustment blends so imperceptibly into the recuperative phase that the latter is not easy of detection. By this time the deflation process has been completed, bank reserves are high and interest rates are low. Lower prices begin to stimulate demand, first noticed at the retail stores. Recuperation may be hastened by such propitious events as bumper crops, increase in foreign trade, or a boom in building. The increase in retail demand communicates itself to the wholesaler, jobber and manufacturer, until normal conditions reappear.

(6) Prosperity — The economic forces which account for the revival also account for prosperity except that they act more intensely. As the demand for goods increases industry picks up, more labor and capital are employed, as a result of which purchasing power is increased. This, in turn, stimulates demand, and because stocks have become depleted production and deliveries lag behind orders. This condition leads to increased production costs and contract renewals at higher rates. As costs advance, prices, wages, rents and interest rates rise. A large volume of business is being done on a rising market and business men are making large profits and laborers high wages. For a time, at least, the prosperity is cumulative, since purchasing power increases in proportion.

(7) Over-extension and speculation—Unfortunately the period of prosperity does not last. It contains elements of danger. Sooner or later businesses find existing facilities inadequate to supply the demand. This leads to an expansion of facilities acquired at high costs. Output is increased, but also at higher costs. The program of expansion has tightened credit and raised interest rates, but the lure of profits, due to rising markets, provides a powerful incentive for businesses to produce at the maximum. Prices rise, profiteering sets in, extravagance in consumption appears, and credit becomes inflated. In the final stages, costs rise more than selling prices, due to the decline in the efficiency in labor, rising raw material prices, and higher interest rates. Speculation for further rise in prices tends to make prices rise higher than warranted, finally resulting in a buyers' strike. This leads to a crisis.

While a business cycle is a rhythmical phenomenon, it has no definite periodicity, *e. g.*, three years, seven years, or twenty years. No two business cycles are alike, but rather consist of a different combination of factors. The accompanying chart, published by the Standard Statistics Company (New York City), shows the business cycles that have occurred in the United States since 1901. The business line in this chart is to be correlated with the curve of stock prices and money supply. It will be noted that the money supply line is the basis, or signal, upon which the other two lines take their cue. Just as the money supply line precedes the movement of the line of stock prices (though in opposite direction), so the line of stock prices precedes the business line in both the upward and downward swings. (See Business Barometers, Business Forecasting Services, Speculative Cycle.)

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Business Failures

See Failures.

Business Forecasting Services

If cyclic movements of prices in commodities, securities and money actually occur, as explained under the term *Business Cycle* (q. v.), and business conditions and price movements are subject to analysis and interpretation as explained under the term *Business Barometers* (q. v.), then price movements become, in part at least, amenable to scientific forecast. While most business men recognize the validity of the principles underlying the business cycle and the importance of watching business barometers, few regard themselves as capable of analyzing and interpreting available data first