

Inventory Valuation Adjustments Greatly Influence Corporate Earnings

By Robert Christian, Jr.

CHART 1

HISTORICALLY, THE AFTER-TAX CORPORATE PROFIT SHARE OF GNP FALLS DURING RECESSIONARY PERIODS. HOWEVER, THE CURRENT DOWNTURN APPEARS TO BE BUCKING THIS TREND . . .

Percentage Points

2

Change in Ratio of After-Tax Corporate Profits to GNP

1

0

-1

-2

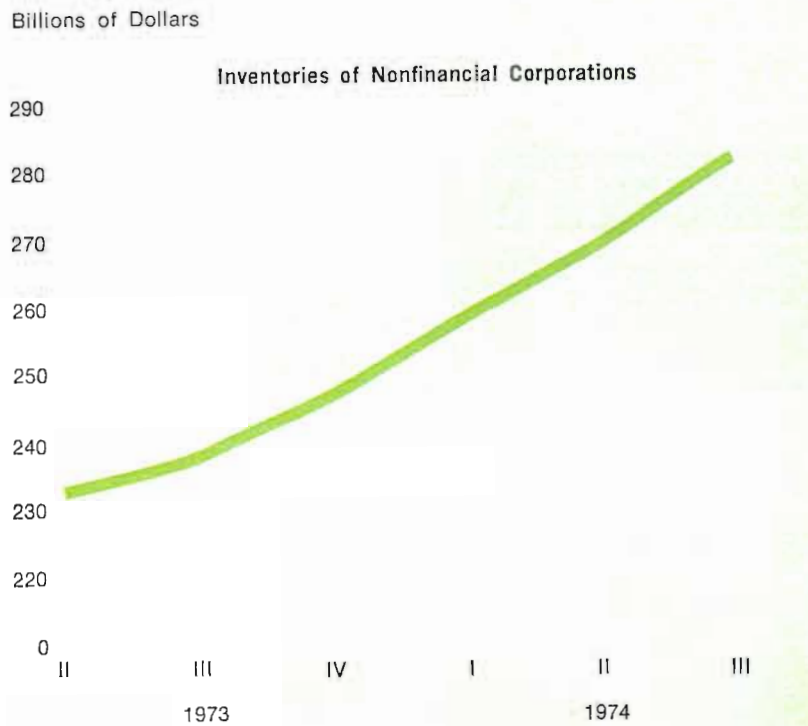
IV '48	II '53	III '57	II '60	IV '69	IV '73
to	to	to	to	to	to
II '49	II '54	I '58	I '61	IV '70	IV '74

Recessions
(Defined by Quarters)

SOURCE: U. S. Department of Commerce.

CHART 2

THIS SEEMING CONTRADICTION IS THE RESULT OF THE DRAMATIC INCREASES THAT INFLATION HAS PRODUCED IN THE VALUE OF BUSINESS INVENTORIES.

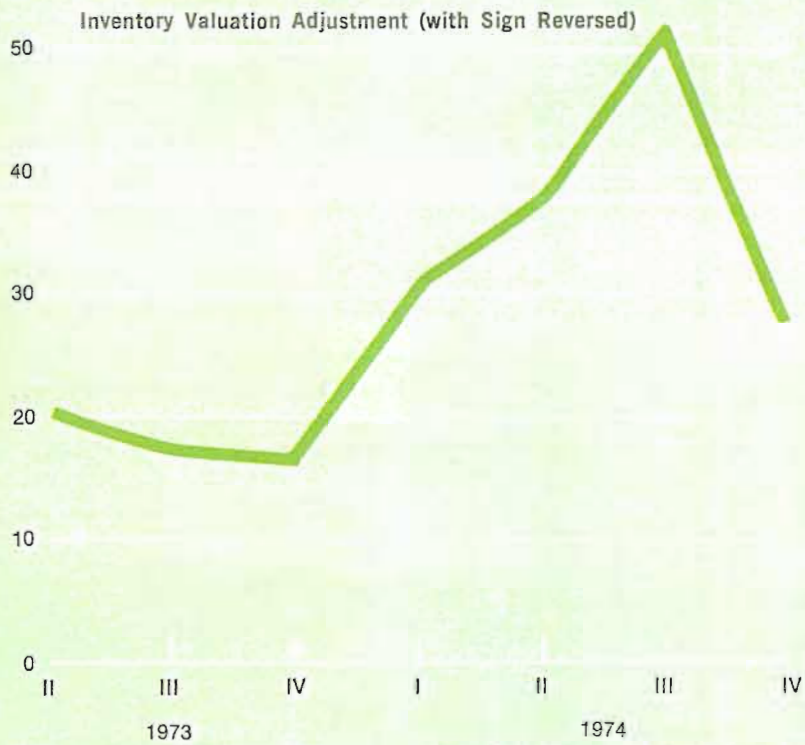


SOURCE: Securities and Exchange Commission.

CHART 3

TO ANALYZE BETTER THE OPERATING PROFITABILITY OF U.S. CORPORATIONS AN ADJUSTMENT MUST BE MADE TO REFLECT THE IMPACT THAT INFLATION-CAUSED INVENTORY PROFITS HAVE HAD ON OVERALL CORPORATE PROFITS.*

Billions of Dollars (Seasonally Adjusted at Annual Rates)

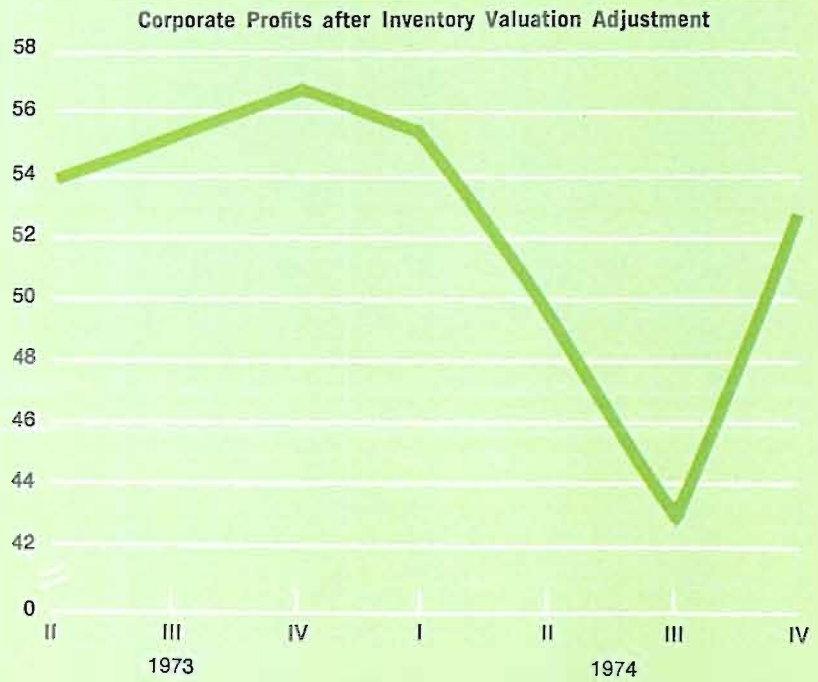


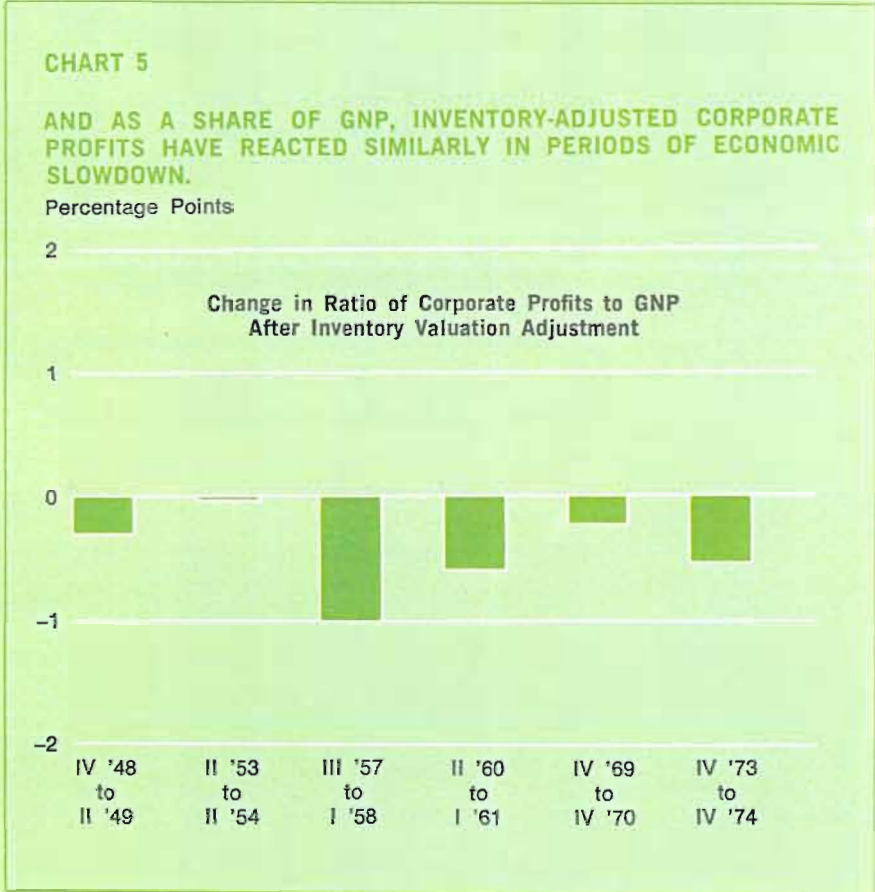
* When prices are rising, firms that use the cost of the oldest and cheapest units of their inventory as the basis for their production expenses (FIFO) will systematically show more profit than those using current replacement costs to calculate their operating profits (LIFO).

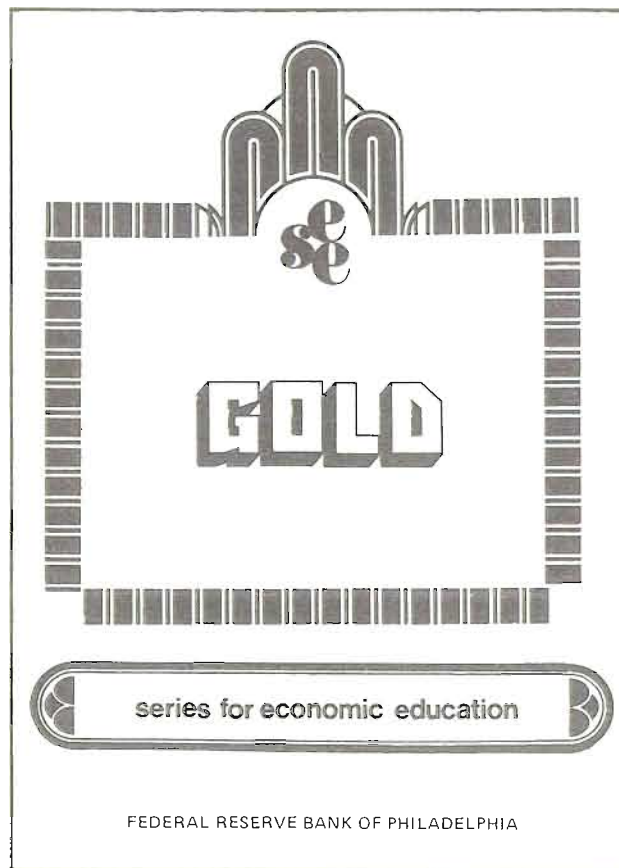
CHART 4

WHEN THIS VALUATION ADJUSTMENT IS ADDED TO AFTER-TAX CORPORATE EARNINGS, IT BECOMES CLEAR THAT PROFITS HAVE DECLINED SIGNIFICANTLY.

Billions of Dollars (Seasonally Adjusted at Annual Rates)







On December 31, 1974, Americans were permitted to buy and sell gold for the first time in some 40 years. Since then questions have been raised about the once-hallowed, almighty metal's worth and importance. For example, has its status in the United States and in the international monetary system changed? If so, in what manner? A pamphlet recently produced by the Philadelphia Fed's Department of Public Information considers the role of gold—past, present, future.

Copies are available free of charge. Please address all requests to Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, PA 19105.