

The Business Situation

The business situation continues to show a great deal of strength. Most important monthly indicators surged further in March, and the total volume of goods and services produced in the first quarter as a whole showed the largest increase in three years. Part of the first-quarter buoyancy, of course, reflected a catching-up of output and sales lost during the automobile strikes last fall as well as inventory building due to the threatened steel strike. Nevertheless, there are few, if any, signs of an appreciable falloff in activity in any major sector. Indeed, a very recent survey suggests that business capital spending plans for 1965 may have further strengthened in the last several months. The extension of the deadline for a steel settlement for another four months has removed the threat of a strike during the current quarter and, while automobile assemblies did decline in April, current production schedules for the second quarter as a whole nearly match the pace reached in the first quarter. Retail sales were apparently about unchanged in April and consumer demand, buoyed by a high degree of consumer confidence, remains strong.

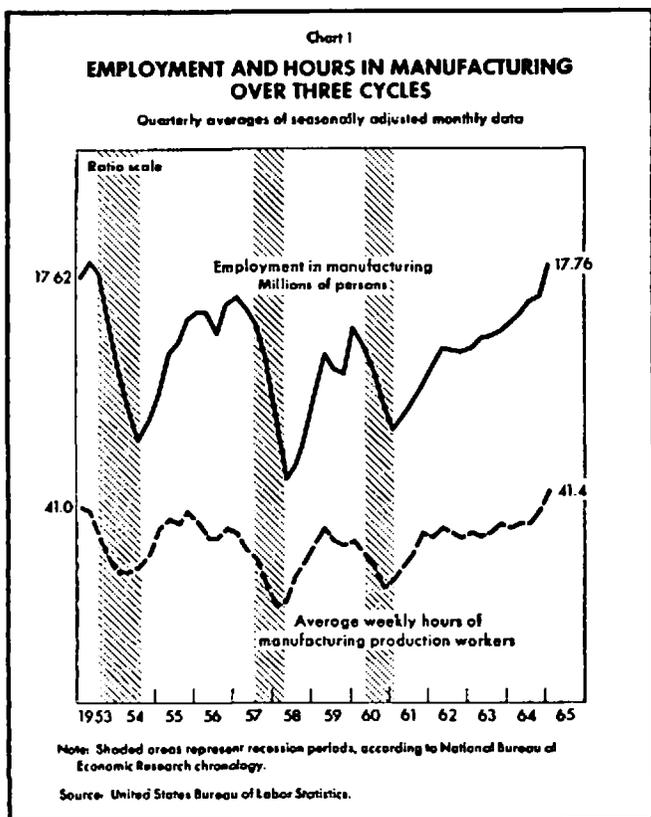
Activity in a number of sectors has clearly been moving closer to full utilization of capacity—difficult as this type of measurement is to make. Furthermore, the unemployment rate averaged 4.8 per cent in the first four months of this year, the first extended period during this business expansion in which the average was below 5 per cent. The April figure was 4.9 per cent. Signs of production bottlenecks that might put strong upward pressure on prices are still largely absent, and there are only isolated instances of labor costs outrunning productivity gains. Nevertheless, current specific price announcements are heavily weighted on the upside and there continues to be a need for very close surveillance of the price situation. The present period is marked by a round of current and upcoming labor contract negotiations in a number of key industries, including not only steel but also aluminum, paper, shipbuilding, ordnance, and aircraft. The terms of the settlements that will emerge

from these negotiations will individually, and even more in the aggregate, have an important bearing on future cost stability. In addition, significant upward price pressures have developed in the world markets for certain raw materials, while the high level of domestic demand for many goods has led to numerous probings of markets for their degree of resistance to price increases.

As regards the immediate price situation, industrial wholesale prices apparently advanced once more in April. Such prices (seasonally adjusted) rose by 0.7 per cent in the second half of last year and are now about 1.8 per cent above the level reached in April 1963 (a month that marked the end of a general downtrend during the early phase of the current expansion). Consumer prices edged up once more in March, following a pause in February when the index was unchanged. In most recent months, however, the year-to-year increase in the consumer price index has remained slightly lower than in the preceding two years.

PRODUCTION, ORDERS, AND EMPLOYMENT

Industrial output advanced on a broad front in March, and the Federal Reserve Board's seasonally adjusted index rose by 1.2 percentage points to 140.1 per cent of the 1957-59 average. The increase was paced by a very large gain in automobile assemblies and received additional strength from another rise in iron and steel production. Outside these two industries, however, production gains were also larger in March than in February. Prospects for further near-term strength in production were bolstered by the further advance in March of new orders received by durable goods manufacturers. New orders booked by steel producers fell a bit in March, following the bulge in orders earlier in the year—many of which were for delivery several months in the future. On the other hand, the overall volume of orders in other durable goods industries increased. Data at hand for April show that auto production slipped back from the extraordinary 10 million unit



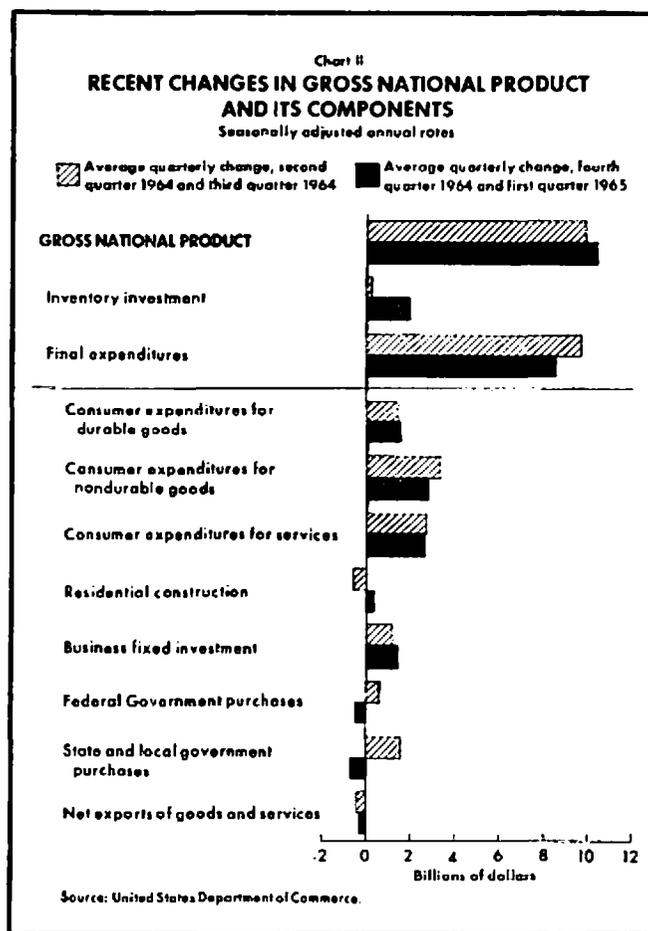
tries, lengthened the average workweek of all manufacturing production workers to 41.5 hours, a postwar record.

RECENT PATTERNS OF DEMAND

The strength of the economy in March capped off a first quarter that, as had been widely expected, showed an exceptionally large gain in over-all activity. According to the Commerce Department's preliminary estimates, gross national product rose to a seasonally adjusted annual rate of \$649 billion in the first three months of 1965, up by \$14.4 billion from the preceding quarter when strikes in the automobile industry had curtailed output. To be sure, some of the first-quarter surge reflected a recovery of the losses suffered during the auto strikes last fall. One way of making a rough allowance for this special circumstance is to focus on the average increase in GNP in the past two quarters combined. Such a calculation shows that the

annual rate reached in March. For the second quarter as a whole, however, current schedules call for a seasonally adjusted assembly rate of around 9.4 million units, virtually the same as that turned in during the first quarter. According to trade reports, producers foresee the continuation of extra shifts and six-day weeks well into the summer. In the steel industry, ingot production (seasonally adjusted) rose once again in April.

Nonfarm payroll employment also scored another sizable advance in March, with virtually all sectors sharing in the expansion. Reflecting the continued growth of factory output, especially in the metal-producing and metal-using industries, the number of persons at work in manufacturing reached the highest monthly reading since early 1944. On a quarterly basis, manufacturing employment over the first three months of 1965 was very nearly equal to the postwar quarterly record reached twelve years earlier (see Chart I). Over-the-year gains in such employment in early 1965 have amounted to some 600,000 persons, in contrast to the over-the-year gains of only about 200,000 persons in early 1964. Extensive use of overtime in March, especially in the durable goods indus-



average increase in the annual rate of GNP in the two most recent quarters—i.e., 1964-IV and 1965-I—amounted to \$10.3 billion, compared with \$9.8 billion in the second quarter and again in the third quarter of 1964 (see Chart II). It is noteworthy that, even on this smoothed-out basis, the average GNP gain over the past two quarters has exceeded the increases registered in all but one of the quarters since the pace of expansion speeded up in mid-1963.

The most notable added boost to over-all demand in the latest six-month period, compared with the preceding six months, came from business decisions to build up inventories. After a very modest accumulation through most of 1964, stock building (at an annual rate) jumped by \$2.9 billion in the fourth quarter and by an additional \$0.8 billion in the first quarter of 1965. To a considerable extent, of course, the fourth-quarter spurt reflected the onset of widespread steel stockpiling. It is estimated that manufacturers and wholesalers laid in 2.9 million tons of finished steel during the fourth quarter of last year, an accumulation rate almost five times as large as in the preceding three months. Steel stockpiling continued in the first quarter of this year, though at the reduced rate of 2.1 million tons, while auto dealers were at the same time adding heavily to their strike-depleted stocks in an effort to meet the booming demand for new cars. While there are obvious potential dangers associated with a rapid rate of inventory building, it should be noted that, even with the recent run-up in stocks, inventory-sales ratios in most lines of business have risen little, if at all, in recent months. Moreover, despite the near-record number of automobiles in dealer stockpiles, some fast-selling models reportedly continue to be in short supply.

Although consumer spending showed significantly more strength in the first quarter of 1965 than in the preceding three months, the average gain in the two quarters combined was about the same as in the previous two quarters. The main factor in the first-quarter surge was, of course, the boom in auto sales, following their strike-caused slowdown late in 1964, but spending on nondurables also showed a sizable gain. Auto sales in March and again in April moved down from the extremely high level of the first two months of the year but, at an annual rate of 8.2 million units in April, remained well above the pace of 7¾ million units set during the first nine months of 1964. In recent months, consumers have also been heavy buyers of color television sets and demand for nondurable goods has picked up new vigor. Total retail sales were apparently unchanged in April, following the slight dip in March. Prospects for further gains remain strong. Michigan University's Survey Research Center reported that consumer

confidence in the January-March period had risen to a very high level, and that the proportion of families planning to purchase new cars was larger than a year and two years earlier.

Outlays for residential construction in the initial quarter of 1965 were up for the first time in a year, and the new level was about maintained in April. While this level remains below the year-earlier reading, a number of observers have expressed the view that the recent weakening may well have bottomed out. Contributing to this more optimistic appraisal is the rebound in March in the number of housing units started as well as in the number of new building permits issued, following considerable declines in February. Moreover, the value of residential construction contract awards also registered a substantial increase in March.

Business outlays for new plant and equipment also expanded in the first quarter, with the large size of the gain to some extent reflecting the effects of delayed business spending for automobiles and trucks. Future spending plans, moreover, continue to show strength. Thus, McGraw-Hill's latest survey of business spending plans for 1965, taken in March and early April, points to total outlays this year of \$51.7 billion, or 15 per cent more than in 1964. As has been generally true in other years of over-all economic expansion, this year's McGraw-Hill spring survey suggests a larger rise in capital spending than the 12 per cent increase indicated in the survey taken in February by the Commerce Department and the Securities and Exchange Commission. In part, the difference between the results of the two surveys may reflect the greater concentration of large firms in the McGraw-Hill sample. In the past several years, such firms have tended to show above-average percentage gains in capital spending. Yet, the fact that the size of the over-all differential between the two surveys is somewhat larger this year than in the past several years suggests that some businessmen probably have upgraded their spending plans, as sentiment regarding the business outlook has become more optimistic.

Government purchases of goods and services have recently given little push to over-all GNP. Indeed, the total volume of such purchases by all levels of government was unchanged in the first quarter, following a very small rise in the final quarter last year. Federal outlays declined in both quarters, while the rate of increase in state and local government purchases slowed somewhat from the pace set earlier in 1964. It is interesting to note that state and local government outlays for goods and services in the first quarter of 1965 exceeded those of the Federal Government for the first time since mid-1950, when defense spending began to accelerate after the out-

break of the Korean conflict. Total government spending, of course, also includes sizable outlays for social welfare, interest on the debt, etc. Since these government "transfer" expenditures are not purchases of goods or services, they are not counted directly in GNP. (They do, of course, affect GNP indirectly since they constitute income for the recipients of the transfers, who are then able to purchase goods and services.) Such expenditures, which have been growing more rapidly than government purchases of goods and services, make up a considerably larger proportion of total Federal spending than of total spending at the non-Federal level. As regards government purchases of

goods and services alone, the total at all levels of government accounted for about 14 per cent of GNP in 1950, with outlays at the state and local level very slightly larger than those of the Federal Government. By the end of 1953 Federal purchases had grown to more than twice the size of state and local purchases, and combined government demand accounted for some 23 per cent of GNP. Since that time, the share in GNP of outlays for goods and services by all levels of government combined has been nearly constant at about 20 per cent, but such spending has grown more rapidly at the state and local than at the Federal level.