The Business Situation

The growth of business activity moderated somewhat further in recent weeks. Severe snowstorms throughout the Midwest and Northeast during late January and early February adversely affected production and sales. These storms, moreover, have greatly complicated the assessment of underlying business trends—a task already made difficult by the many crosscurrents developing in both the financial markets and the markets for goods and services.

But, taking all factors into consideration, the economy still is moving ahead. Indicators of current strength include the high backlogs of unfilled orders on the books of durables manufacturers, the continuing large gains in employment and personal income, and the steady climb of both defense outlays and spending by state and local governments. While the likelihood of a sizable downward adjustment of inventory spending continues to cloud the outlook for total spending in the coming months, new information indicates more potential strength in some other important areas of private activity than many observers have been anticipating.

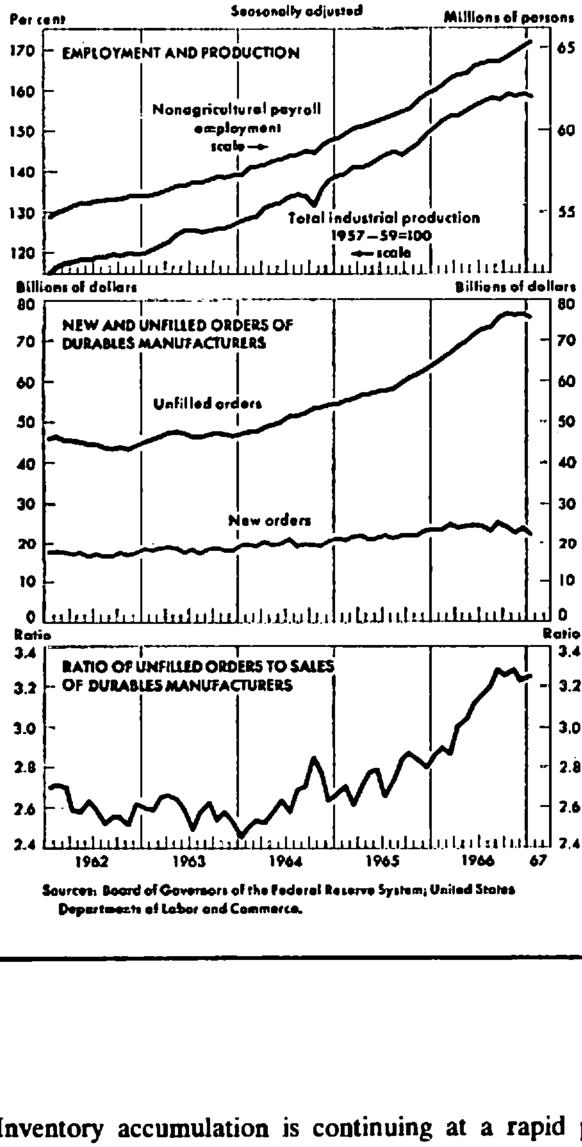
RECENT MONTHLY INDICATORS

Due in part to the severe snowstorms that disrupted production in much of the northeastern and midwestern regions of the country late in the month, industrial output in January declined substantially from the December level. The Federal Reserve Board's index of industrial production fell by 1.0 percentage point (or 0.6 per cent), after having risen by 0.3 percentage point from November to December. At 157.9 per cent of the 1957-59 average, the January production index was back down to the level of last August (see Chart I). The largest January declines occurred in durable consumer goods and durable materials. Automobile assemblies fell by 15 per cent to a seasonally adjusted annual rate of 7¼ million units. Because of production stoppages caused by the heavy snows, this rate of output was lower than had been scheduled. Iron and steel production, also affected by weather conditions, declined by 6 per cent in January, for a total reduction of 14 per cent from last July's high. Business equipment production, which had risen sharply month after month in 1966, leveled off in January, but defense equipment production continued to expand strongly.

The volume of new orders received by durables manufacturers fell by a sizable $1.6 billion in January, and the seasonally adjusted level of $22.4 billion was the lowest in more than a year (see Chart I). Contrary to the experience of earlier months, when fluctuations in new orders centered in defense-related businesses, the January decline reflected lower orders in a wide range of industries. Because shipments by durables manufacturers remained strong—the seasonally adjusted volume of $23.3 billion in January was exceeded only twice—the backlog of unfilled orders was reduced by $0.9 billion. However, the $75.5 billion of orders on the books of durables manufacturers at the end of the month was still equivalent to 3¼ months of shipments at current sales rates (see Chart I).

Chart I

INDICATORS OF BUSINESS ACTIVITY



Sources: Board of Governors of the Federal Reserve System; United States Departments of Labor and Commerce.

Inventory accumulation is continuing at a rapid pace. While retail and wholesale trade inventories have also increased substantially, it is manufacturing stocks that have provided the main push. Indeed, the increase in manufacturers' stocks in both December and January was at a seasonally adjusted annual rate in excess of $12 billion. Durables manufacturers' inventories—especially of finished goods—increased in January at a substantially lower pace than in December, and the rise was actually the smallest since last spring, but this was offset by an extremely large inventory accumulation by manufacturers of nondurable goods.

Private nonfarm residential construction outlays (seasonally adjusted) increased in January for the first time in eight months. This increase had, of course, been foreshadowed by the earlier rises in housing starts from their October lows. Moreover, both housing starts and building permits again climbed sharply in January, thus suggesting further increases in construction outlays in the immediate future. Housing starts increased by 14 per cent, to reach a seasonally adjusted annual rate of 1.2 million units, midway between the 1966 peak rate of 1.6 million units in January and the 1966 low of 0.8 million units in October. Building permits for new private housing units also jumped by 18 per cent in January, thereby recovering almost one third of the reduction that took place between March and October of last year. But, while these developments are certainly most encouraging, it must be recognized that starts and permits are highly volatile series, and assessment of the strength of the housing recovery therefore must await developments in the coming months.

The employment situation continued very strong in January. Nonfarm payrolls again expanded sharply, increasing by 279,000 persons to a seasonally adjusted total of 65.4 million. Almost half of the gain centered in retail trade employment. Manufacturing employment also posted a good advance, but employment by all levels of government increased by less than in preceding months. The overall unemployment rate remained unchanged in January, at 3.7 per cent of the civilian labor force. (This figure was computed by the Bureau of Labor Statistics according to its new and improved definitions which conform more closely to the everyday meaning of "unemployment". The new measurement procedure apparently reduced the reported overall unemployment rate by about 0.2 percentage point.) The key unemployment rate for married men remained in January at its low November and December reading of 1.7 per cent. But, while unemployment rates were unchanged, some easing of the labor shortage is indicated by the recent slight shortening of the manufacturing workweek and by the behavior of various labor turnover rates in manufacturing.

Despite a $1.1 billion hike in the social insurance contributions of employees, personal income rose by a very large $5.4 billion in January to a seasonally adjusted annual rate of $607.2 billion. In comparison, personal income increased by $3.3 billion in December and averaged a $4.1 billion monthly gain during the second half of 1966. Wage and salary disbursements were up by $3.3 billion in January, as against $2.4 billion in December; dividend receipts rose by $1.5 billion after falling by an almost equal amount in December, and transfer payments moved up by $0.7 billion, $0.4 billion less than in the preceding month.

Despite the continued strong rise in personal income, retail sales remained sluggish in January. According to preliminary data, they were virtually unchanged from their reduced December level. However, part of the poor January performance was undoubtedly the result of heavy snowfalls which blanketed large areas of the country late in the month. There was a significant decline in auto sales during January, but this was offset by increased sales of other consumer goods. With bad weather conditions continuing into February and with new car sales down by as much as 10 per cent, retail sales are unlikely to have shown any improvement during that month.

Recent price movements have reflected the lessened demand pressures in the economy. Consumer prices, which had advanced noticeably more slowly in November and December than in earlier months, were stable in January. Prices of services again increased, but those of foods as well as of other commodities declined about in line with seasonal expectations and presumably in large part as a result of the earlier good performance of wholesale prices. The wholesale price index had declined by 0.8 per cent between August and December, under the impact of falling prices for farm products and processed foods and of only slowly rising prices for industrial commodities. In January, the wholesale index again rose by a substantial 0.3 per cent as the prices of farm products, processed foods, and industrial commodities increased, but preliminary data indicate a 0.2 per cent decline in February. In contrast to recent price developments, unit labor costs in manufacturing (which had temporarily stabilized in December) rose sharply again in January, bringing the increase since July to an annual rate of almost 8 per cent.

INDICATORS OF FUTURE CONSUMER DEMAND AND CAPITAL SPENDING

The Commerce Department's January survey of consumer buying intentions reveals little apparent change in consumer sentiment since the previous survey taken in October. In both of these two most recent surveys, the proportion of families intending to purchase a new automobile or one or more of seven big-ticket household durables within six months was lower than in the respective year-earlier survey. While the shortfall from the year-ago percentages was somewhat smaller in the January survey than in the preceding October survey (see Chart II), it should be borne in mind that the October 1966 findings did suffer by comparison with the exceptionally strong buying intentions expressed a year earlier, just prior to a sharp upsurge in auto and durables sales.

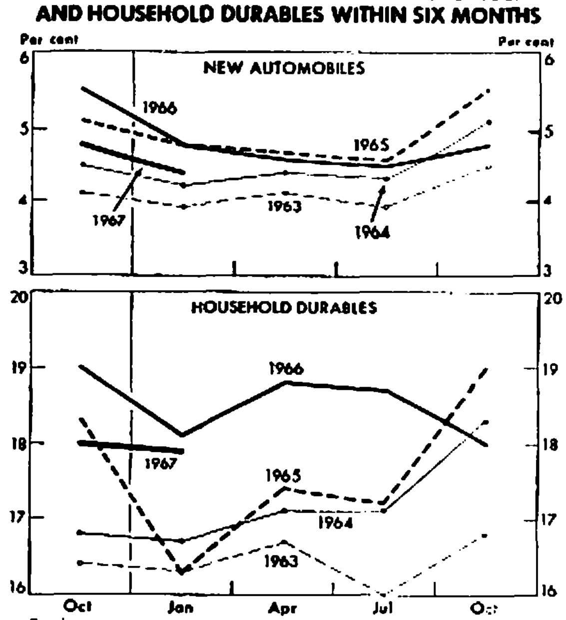
The proportion of families intending to buy one or more household appliances was only 0.2 percentage point lower in January 1967 than in January 1966 — considerably smaller than the 1.0 percentage point drop between October 1965 and October 1966. Moreover, the January 1967 reading was among the highest recorded for a January survey. Last fall, the main weakness had been in plans to purchase household durables three to six months in the future or at some indefinite time within six months. This pattern was interpreted as reflecting considerable unease with regard to the economic outlook and the size of a possible tax increase. The latest survey apparently reflects a reduction in this feeling of uneasiness, as it shows a considerable narrowing of the earlier discrepancy between shorter and longer run buying plans.

The survey indicated continued weakness in plans to buy a car within six months, with the proportion of families planning such a purchase smaller than in either of the preceding two years. Here again, however, the decline from the year-earlier reading was less in January than it was last October. This relative improvement centered in the longer term or less definite plans.

The latest Department of Commerce survey also showed

Chart II

CONSUMER INTENTIONS TO BUY NEW AUTOMOBILES AND HOUSEHOLD DURABLES WITHIN SIX MONTHS



Note: Buying plans are expressed as the ratio of the number of families who indicate they intend to buy to the total number of families in the survey.

Source: United States Department of Commerce, Bureau of the Census.

that 27 per cent of the interviewed families expected their incomes to increase in the coming year—a higher proportion than in any of the earlier January surveys. The discrepancy between households' very strong view of their future financial situation and their conservative buying intentions suggests that consumers are presently contemplating a continued high rate of savings.

A special survey of plant and equipment expenditure plans taken in January by McGraw-Hill implies more strength in the capital investment area than was generally thought to exist. To be sure, the $64.4 billion of outlays planned at this stage for 1967 would amount to a much smaller year-to-year increase than in the preceding three years when the gains ranged between 14.5 per cent and 16.6 per cent. Nevertheless, the planned 6.3 per cent rise indicated by the special McGraw-Hill survey would be quite respectable by historical standards. Another indication that businessmen generally view the economy's future with confidence is their anticipation, indicated by another recent McGraw-Hill survey, that profits before taxes in 1967 will be 4 per cent higher than last year.

The McGraw-Hill survey shows that manufacturing industries are now planning to increase capital spending in 1967 by 8 per cent, with durables manufacturers looking forward to an 11 per cent advance over 1966. Particularly large increases are being contemplated by the electrical machinery, iron and steel, nonferrous metals, and fabricated metals and instruments industries. Nondurable goods producers, however, intend to up their outlays by a more modest 5 per cent. Outside manufacturing, electric and gas utilities and airlines and mining companies are planning for major increases in plant and equipment expenditures, while railroads anticipate a considerable cutback. Other transportation and communications industries, as well as commercial enterprises, are projecting little change in capital spending from 1966 levels.

The National Industrial Conference Board's survey of the capital appropriations of the 1,000 largest manufacturers during the fourth quarter of 1966 supports the present indications of strength in business fixed investment plans. Seasonally adjusted, net new appropriations rose by 2 per cent during the fourth quarter and, although still considerably below the levels reached between the fall of 1965 and the summer of 1966, they were well ahead of the figures reported for any but these three quarters. The net new appropriations of these large firms exceeded their capital expenditures during the final quarter of 1966, and closing backlogs rose further. Backlogs at the start of 1967 were equal to almost a full year of capital spending at the fourth-quarter rate.