

The Business Situation

Early spring saw little change in the pace of economic activity. The readjustment in business inventories continued to have a dampening effect on production, employment, and incomes. In addition, labor disputes in the trucking industry during April apparently played some role in holding down the volume of economic activity. Taken together, the most recent data seem to indicate that, early in the second quarter, the economy remained on the high plateau which had characterized it since the start of the year. The general stability of the economy, in the face of this year's very sharp reduction in the rate of inventory accumulation, attests to the continued strength of other demand forces. Additional declines in inventory spending seem probable, perhaps resulting in some actual liquidation of aggregate stocks. However, the rate of adjustment is unlikely to be so sharp as in recent months, and the resulting reduction in spending should thus have appreciably less impact on overall production. At the same time, the prospects are for substantial further growth in other demand categories, including especially residential construction and government spending. The recent outbreak of war in the Middle East has, of course, added a substantial element of uncertainty to the outlook.

PRODUCTION, ORDERS, AND RESIDENTIAL CONSTRUCTION

Industrial output in April was slightly below the level of the preceding two months. The Federal Reserve Board's seasonally adjusted production index dropped to 155.9 per cent of the 1957-59 average, 0.5 percentage point under the reading in both February and March. The decrease put the overall index at a level 2 per cent under the record high touched last December. Modest output declines in April were widespread among manufacturing industries, the only significant exception being motor vehicle production which rose strongly for the second month in a row. The spring brought an improvement in new car sales as well as in producers' expectations regarding the sales outlook. As a result, the industry has been able to work down auto

inventories and reduce the stock-sales ratio from the exceptionally high level reached early in the year. Responding to the improved situation, automobile producers rescinded some earlier cuts in second-quarter production schedules, thus adding strength to the rise in the assembly rate. Auto output in April, seasonally adjusted, rose by nearly 10 per cent to an annual rate of about $7\frac{2}{3}$ million units, and a further increase was recorded in May.

In contrast to the renewed strength of motor vehicle output in recent months, production of other consumer durable goods has continued to slacken. Retail sales of furniture and home appliances have been weak, and significant inventory problems have developed in some lines. The market for television sets has experienced a particularly dramatic swing away from the surging growth that characterized the 1964-66 period. In April, output of television sets was fully 30 per cent below the peak reached in December.

The easing of overall industrial production in 1967 has reflected not only a sluggishness in consumer demand but also a slowdown in the growth of capital spending. The volume of business equipment output in April was almost 3 per cent under its December peak and about equal to the level of late last summer. The restoration by Congress of the tax incentives for investment that were suspended last fall should give some boost to demands for capital equipment. Even with the restoration, however, the recent easing of capacity utilization rates and the decline in profits in the first quarter suggest that 1967 will see only a modest further rise in spending on capital investment. According to the latest survey of businessmen, taken in May by the Commerce Department and Securities and Exchange Commission, total capital outlays this year will be 3 per cent above the 1966 level. This represents a modest downward revision in anticipated 1967 spending from the figure reported in the Government's February survey, with the bulk of the reduction being concentrated in the first half of the year.

The inflow of new orders for durable goods increased moderately in April and at \$22.3 billion was somewhat



trend of defense buying of durable goods. The Commerce Department's figures on new orders for defense products do not include all defense ordering of durables and, on the other hand, they do record some nondefense ordering, especially of aircraft. While new orders for defense products have been essentially stable for some months, there can be little doubt that the impact of military demands on the economy has continued to be very substantial. A revision of first-quarter gross national product (GNP) figures shows that the rise in Federal purchases of goods and services for defense purposes was \$4.2 billion at a seasonally adjusted annual rate, accounting for more than 25 per cent of the total rise in final demand, that is, GNP excluding inventory investment.

The recovery in residential construction is continuing. On a seasonally adjusted basis, the number of private nonfarm housing starts rose only slightly in April after a small March decline (see Chart I). Underlying these figures, however, is the fact that the actual number of starts succeeded in scoring the very strong March-April advance which is expected as a seasonal phenomenon and is thus allowed for in the seasonal adjustment of the data. In unadjusted terms, housing starts rose by almost 50 per cent in March and by more than 20 per cent in April. These rises occurred despite the relatively short period of time that had been available to the home-building industry to adjust to a higher rate of operations, in the wake of last year's steep decline.

The resurgence of residential building can also be seen in the trend of building permits issued by local authorities (see Chart I). In areas requiring permits, there has been a strong rise in authorizations of both single-family homes and of units in multifamily structures. (While only about 80 to 85 per cent of total starts in recent years have been covered by permits, nearly all multifamily structures are built under permit authorizations.) The slump last year in construction of multi-unit housing followed two previous years of weakness which had resulted from earlier overbuilding in some areas, especially in the West. There was no tangible decline in the national rate of vacancies in rental units until 1966, when the vacancy rate in the West, which had previously stopped rising, finally turned downward. Vacancy rates moved still lower in the first quarter of 1967, and their substantial decline in the past year or two suggests the existence of an appreciable volume of potential demand for rental housing.

EMPLOYMENT, INCOME, AND CONSUMER BUYING

Manufacturers made further reductions in both April and May in the number of production workers on their

larger than the first-quarter average. Most major industries reported orders gains for the month, including the primary metals producers whose orders had slumped quite sharply in March. The machinery and equipment industries experienced a second consecutive rise in new bookings; from last October through February, such orders had dropped month by month. Shipments of durable goods declined in April—in part, perhaps, because of labor disputes in the trucking industry. Since shipments and orders were virtually equal, the total backlog of unfilled orders showed no significant change in contrast to the substantial declines in the earlier months of the year. The backlog of primary metals producers declined significantly further in April. However, the aircraft industry's backlog grew strongly, while unfilled orders changed little in most other durables industries.

The volume of new orders for defense products rose in April, returning to the February level. This series, which tends to be heavily influenced by swings in orders for aircraft, can give only a rough approximation of the actual

payrolls. A large part of the May decline was attributable to the effects of strikes in the rubber industry. Employment expanded in most other sectors of the nonfarm economy, with government continuing to show a particularly strong uptrend, but the total number of persons on non-agricultural payrolls nevertheless declined in both months. The May cutback in manufacturing employment was the fourth in a row and, at the same time, the average length of the workweek dropped back to the February figure following two small increases. Average weekly hours in durables manufacturing have been essentially unchanged since February, but in nondurables the workweek lengthened slightly in March and April and then fell back in May. Having made a very sharp reduction in the workweek during the winter months, manufacturers in the spring were apparently making further adjustments to slower production largely by way of cuts in employment.

The rate of unemployment in the civilian labor force

edged back up in April to the 3.7 per cent figure that had prevailed from December through February, and moved to 3.8 per cent in May (see Chart II). Thus, the unemployment rate has changed but little this year despite a definite slowing in the economy. In part, the fact that the rate has been so nearly stable is the result of a reduction in average output per worker. This reduction, in turn, is attributable to the combined effects of a cut in workers' average weekly hours and a halt to the growth of productivity, that is, output per man-hour.

Moreover, in periods when there is a slowing in economic activity and in the growth of job openings, it is quite common for some women to withdraw from—or to refrain from entering—the labor force. This is often true of teen-agers as well. There has been some evidence of such a development in recent months. In 1966, when the economy was growing very rapidly and demands for labor were very strong, there was a vigorous expansion in the number of women in the labor force, with virtually all the growth representing an advance in the number of women employed. During the first five months of this year, in contrast, the average number of women in the labor force was only very slightly larger than in the preceding five months, and the average number of women employed declined. Largely as a consequence, overall labor force growth has slowed during the early months of 1967.

The April cutbacks in manufacturing employment and overtime were accompanied by a drop in total wage and salary payments in that sector, which in turn held down the growth of personal income. Also working to hold back the expansion of income in April was the fact that accelerated payments of dividends on veterans' life insurance had temporarily swelled personal income in February and March; this buoying influence then disappeared in April. Altogether, the rise in personal income for the month was the smallest in well over a year.

Since the closing months of 1966, consumers have sharply stepped up the proportion of their after-tax incomes allocated to savings. Over the same period, aggregate retail sales volume has been virtually stable and consumption spending on goods and services has contributed only modestly to overall GNP expansion. According to recent revisions of GNP figures, personal consumption expenditures grew by \$5.8 billion in the first quarter, at a seasonally adjusted annual rate,¹ rather than the \$8.1 billion indicated



¹ With various other components also revised, the net effect of the revisions was to reduce total first-quarter GNP by \$0.6 billion to \$763.7 billion.

by the preliminary estimate and reported last month in this *Review*. The downward revision was largely in purchases of nondurable goods, and was chiefly due to the fact that preliminary estimates had overstated retail sales in February and March. With consumption spending revised downward, the ratio of savings to disposable income was revised upward to 6.5 per cent, compared with 5.9 per cent in the fourth quarter and a quite low 4.8 per cent in the third quarter.

As a concomitant of the recent vigorous growth of savings, there has been a strong buildup in consumers' holdings of liquid assets, such as savings deposits. This trend suggests that a favorable basis is being established for the development of renewed vigor in the expansion of consumer spending. Preliminary April data, however, provided little evidence of any appreciable strengthening in the behavior of overall retail sales. Sales of nondurables increased by about 1 per cent, and outlets dealing in motor vehicles and related goods also registered a gain in dollar volume. Sales declined at other durables stores, however. Total April sales were estimated as being up by less than 1 per cent, following a slightly stronger rise in March.

Sales of new automobiles made a relatively good showing in both March and April. A rise of about 5½ per cent in the latter month brought sales to a seasonally adjusted annual rate of 7.6 million units. May sales held very close to the April pace. While the current selling rate is low, relative to the experience of the last few years, the improvement during the spring has buoyed manufacturers' expectations regarding the sales outlook.

COST AND PRICE DEVELOPMENTS

The general stability of output in recent months has been accompanied by a cessation of growth in overall output per man-hour, with some sectors of the economy apparently recording actual declines. Hourly compensation has shown a strong rise, and labor costs per unit of output have continued to increase at a significant rate. Non-financial corporations, whose activities generate well over half of total GNP, experienced a first-quarter rise in unit labor costs equal to almost 10 per cent at an annual rate. The quarter's increase for manufacturing firms alone was of nearly the same magnitude. The pressure of rising unit costs was clearly a factor behind the first-quarter drop in corporate profits, and price increases aimed at protecting profit margins could well become more common over the months ahead.

According to preliminary figures, the wholesale price index rose in May, following three months of decline. There has been no change since February in the average level of industrial commodity prices. Thus, the behavior of the overall index has been dominated by agricultural prices, which trended downward through April but then rose rather sharply in May, largely as the result of an upturn for livestock and meats. This recent advance in wholesale food prices may well be followed by a renewed rise at the consumer level. In April, however, the consumer food price index continued to decline, but increases for other goods as well as for services pushed the total consumer price index up by 0.3 percentage point—the largest advance since last October.