

The Business Situation

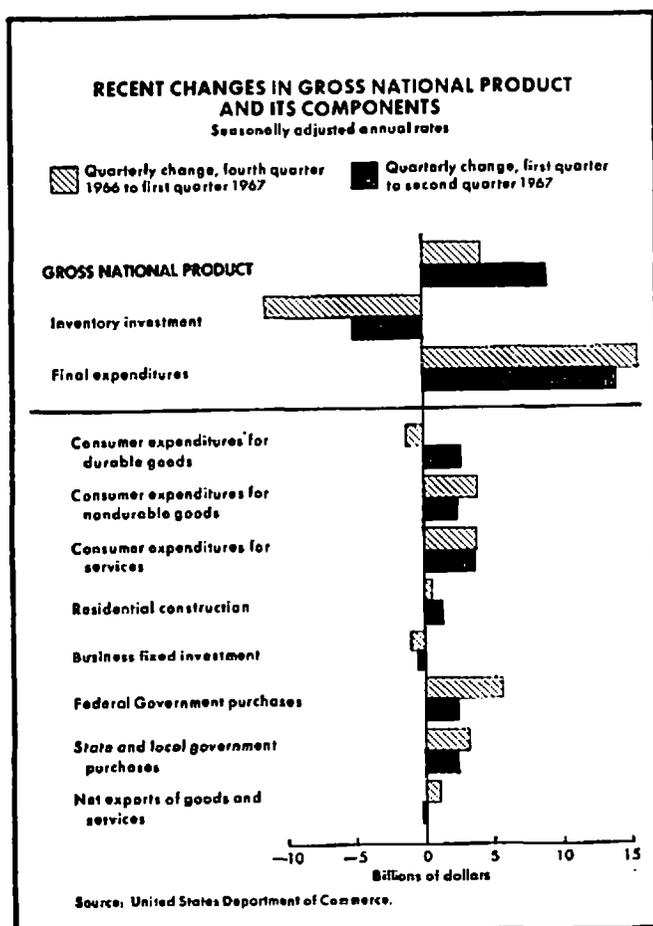
Economic activity has quickened during recent months, with the nation's real output of goods and services rising again after a slight decline in the first quarter. Consumer spending showed a large increase during the second quarter, and automobile sales in particular rose sharply. Residential construction continued to advance from the depressed level of the fourth quarter of 1966, and the latest figures on building permits and housing starts point to further gains. While business fixed investment eased again in the second quarter, surveys of business spending plans as well as new orders for business equipment point to a modest upturn in the months ahead. The reduction in the rate of inventory accumulation continued to dampen the growth of total output in the second quarter, but the effect of the inventory adjustment was considerably more moderate than in the first quarter of 1967. While further cutbacks in inventory spending are likely, it now appears that a major portion of the inventory adjustment has been completed. Government spending increased again in the second quarter and should continue to rise under the impact of mounting defense outlays. The advance in prices appears to be accelerating. Both the consumer and wholesale price in-

dexes recorded sharp rises in June, with food prices on both the retail and the wholesale levels showing large increases.

GNP IN THE SECOND QUARTER

The nation's total output of goods and services (GNP) advanced by \$9.0 billion in the second quarter (see chart) to a seasonally adjusted annual rate of \$775.3 billion, according to preliminary estimates of the Commerce Department.¹ Although the second-quarter advance was moderate when compared with quarterly GNP increases in the last three years, it represented a substantial improvement over the first quarter when total output in real terms actually showed a small decline. Of the \$9.0 billion added to GNP during the second quarter, \$4.5 billion constituted

¹ The Commerce Department's annual midyear revisions of the national income and product accounts raised GNP by \$0.7 billion in 1964, \$2.7 billion in 1965, and \$3.7 billion in 1966. For the first quarter of 1967, GNP was revised upward by \$2.6 billion to a level of \$766.3 billion.



a real increase in the production of goods and services while the remaining \$4.5 billion reflected higher prices. The average price of overall national output, as measured by the implicit GNP price deflator, continued to advance at the relatively high 2½ per cent annual rate of the first quarter. In June the consumer price index advanced by a substantial 0.4 percentage point, following increases of 0.3 percentage point in the two preceding months. Food prices at the retail level rose by a very sharp 1.2 percentage points, and other major categories also showed gains. The wholesale price index increased by 0.5 percentage point in June, as prices of food products recorded another sharp rise—pointing to more increases in the consumer price index in the near future. Preliminary wholesale price figures for July indicate a further rise in food prices and the first increase in four months in the price of industrial commodities.

The most substantial gain among the components of GNP in the April-June period was in the consumer sector where the advance in spending amounted to \$8.7 billion,

the largest increase since the first quarter of 1966. Consumer expenditures on services and nondurable commodities continued to move up, and spending on durable goods also advanced after declining for two consecutive quarters. The rise in consumer spending on durables was concentrated primarily in automobiles. Sales of new domestically produced cars accelerated during the second quarter, and by June reached a seasonally adjusted annual rate of 8½ million units. According to preliminary estimates, total retail sales showed a small gain in June, the fourth consecutive month of increase. The rise in sales was concentrated in durables, with automobiles accounting for most of the advance. Automobile sales in July held at the June rate.

The strong 7.2 per cent annual rate of increase in consumer purchases of goods and services during the second quarter was striking in view of the modest 5.6 per cent rise in disposable personal income. Personal income rose by \$6.0 billion in the second quarter, compared with a rise of \$11.3 billion in the first three months of 1967. The advance in April and May was well below the first-quarter average, as increases in wage and salary payments moderated, reflecting a slower growth in employment and shorter workweeks in manufacturing. In June, however, a rapid rise in employment boosted earnings, and total personal income increased by a strong \$3.7 billion.

With consumption expenditures rising more rapidly than income, consumer savings fell. Some decline in savings was not entirely unexpected in view of the fact that consumers have been saving an unusually large proportion of their incomes since the fourth quarter of 1966. While the savings ratio dropped back from the exceptionally high level of 7.3 per cent reached in the first quarter, it remained at a high 6.9 per cent in the April-June period.

A decline in the rate of inventory accumulation dampened total output in the second quarter, but the impact of the inventory adjustment on GNP was considerably less than in the first three months of 1967. While the Commerce Department estimates of GNP components are preliminary, the data available indicate that inventory spending declined by \$5.0 billion in the second quarter, compared with a drop of \$11.4 billion in the first quarter. These cutbacks have sharply reduced the rate of accumulation from the rapid 1966 pace, particularly as compared with the fourth quarter of 1966 when inventory spending rose by \$7.1 billion and accounted for more than half of the increase in GNP. The problems of inventory adjustment have been concentrated in manufacturing where the inventory-sales ratio has been particularly high. While manufacturers have been reducing the rate of inventory accumulation for several months, in June they made the first actual cutback in total inventories in three years. This cutback further

reduced the inventory-sales ratio for all manufacturing from its April peak. Nevertheless, the inventory-sales ratio in manufacturing remains above the level reached in mid-1966, when the problem of excessive inventories began to emerge. Thus, while the greatest part of the inventory adjustment appears to be over, some further cutbacks in inventory spending are likely before a rising level of economic activity brings sales into a more normal relation to inventories.

Along with the slower rate of inventory accumulation, business fixed investment eased slightly again in the second quarter as expenditures on structures, which had held steady in the first quarter, moved down. Spending on equipment, however, edged up after declining in the first three months of the year. In June, new orders for machinery and equipment rose again, suggesting further spending gains in coming months. Moreover, business surveys of capital spending plans point to increased capital investment over the second half of the year. Thus it appears that, over the balance of the year, the impact of labor cost pressures and the restoration of the investment incentives, as well as the general expectation of rising sales, are likely to offset the negative influence of currently declining utilization and profit rates on plant and equipment spending.

During the second quarter, residential building continued to move up from the depressed levels of 1966. Although residential spending in the second quarter remained considerably below the rates prevailing before the housing slump began early in 1966, June data on housing starts and permits point to a continuation of the recovery in new housing construction. The supply of mortgage funds appears to be more than adequate to support a further advance in residential building.

Total government purchases of goods and services boosted GNP again in the spring months, although the increase was smaller than the record advance of the first quarter. While Federal spending for nondefense purposes held at about the first-quarter level, defense expenditures climbed again after showing an unusually large rise in the first quarter. State and local government expenditures also continued to mount; although the April-June increase was smaller than the first quarter's record rise, it was large by historical standards.

PRODUCTION, ORDERS, AND EMPLOYMENT

Industrial output edged off slightly again in June. The Federal Reserve Board's index of industrial production declined 0.3 percentage point to 155.2 per cent of the 1957-59 average. Output of industrial equipment eased further, and production of both materials and consumer

goods was off slightly. Production of automotive products increased substantially despite the continuation of a strike in the rubber industry, which had dampened the auto index in May. Auto assemblies rose to a seasonally adjusted annual rate of 8 million units in June, after two months of production at a 7½ million unit rate. Production of other consumer goods declined, partly because a strike at a major producer of radio and television sets cut sharply into production. The output of furniture and appliances also eased off during the month. On the other hand, defense equipment production increased further, and the curtailment of supplies from the Middle East helped boost crude petroleum output.

The volume of new orders received by durables manufacturers in June advanced again, following a strong rise in May. Orders for machinery and equipment rose for the fourth consecutive month, and defense orders continued to mount. While shipments of nondurable goods eased after the May surge in sales, durables shipments rose for the second month. The increase in durables shipments, however, was smaller than the rise in new orders for durable goods. Thus, the volume of unfilled orders rose for the second successive month, reaching the highest level since the backlog began to drop last January.

Reflecting the moderate strengthening of the economy in the second quarter, the employment picture appears to be relatively good. In June, a sharp increase brought non-farm employment almost to the record level set in March. While a rise in government employment accounted for more than half of the overall increase, manufacturing employment also edged up slightly for the first time since January. The rise occurred entirely in nondurables manufacturing, since employment increases in several lines of durables production failed to offset the effects of the strike in radio and television manufacturing. Construction employment also increased in June after declining for three consecutive months. Average weekly hours of production workers showed a small increase in the nondurables sector, but continued to ease in durables industries.

The civilian labor force after seasonal adjustment showed one of its largest advances of recent years in June, following six months of virtual stability when slack economic activity discouraged many individuals from joining or remaining in the labor force. As a result, the number of unemployed rose substantially despite the large advance in total employment. The seasonally adjusted unemployment rate increased from 3.8 per cent in May to 4.0 per cent in June. Unemployment rates for most groups edged up, but the rise in the number of unemployed adult women accounted for about two thirds of the increase in total unemployment.