The Business Situation

The advance in business activity strengthened on a broad front during the summer. In August, industrial production increased again and residential construction activity continued to improve, while employment and personal income also rose strongly. Moreover, preliminary figures indicate that retail sales, which have shown renewed vigor in recent months, registered another large advance in August. The latest Government survey of capital spending plans confirms that business is stepping up outlays on plant and equipment in the second half, and two recent private surveys indicate further gains in these outlays in 1968. Thus, virtually all indicators are now pointing to a resumption of rapid growth in the private economy at a time when the Federal and state and local governments are claiming a large share of the increases in the nation's output of goods and services. The automobile strike of course dampened the pace of economic activity in September. Barring a prolonged strike, however, the effect on the overall economy is not expected to be large, and a surge in production will undoubtedly follow the eventual settlement. Meanwhile, price pressures are mounting. In the past five months the consumer price index has risen at an annual rate of 4 per cent, and industrial wholesale prices, which had remained stable throughout the first half of 1967, have increased substantially in the last two months.

PRODUCTION, INVENTORIES, AND NEW ORDERS

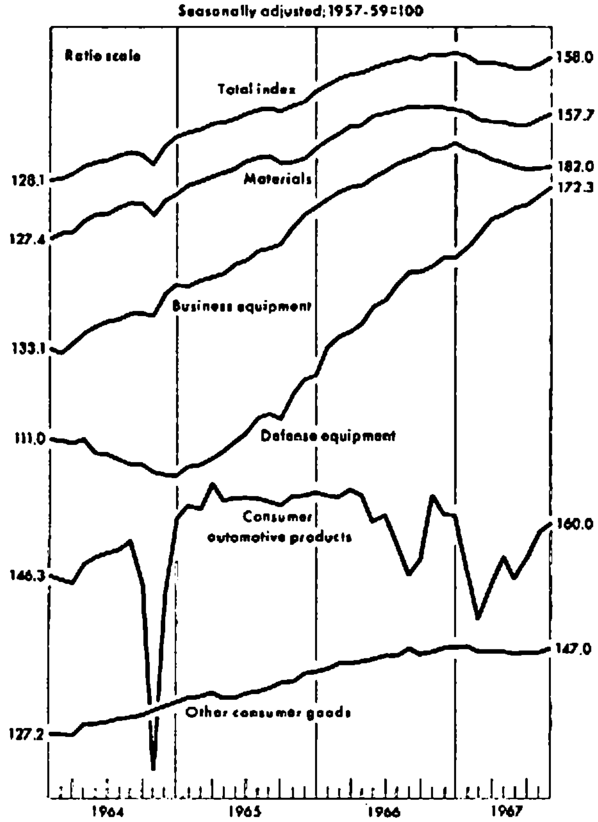
The nation's industrial production moved up strongly in August, marking the second consecutive month of increase, though special factors were again responsible for much of the rise. With output of materials, equipment, and consumer goods all registering gains, the Federal Reserve Board's seasonally adjusted production index rose by 1.3 percentage points to 158.0 per cent of the 1957-59 average (see Chart I). The August improvement came after an almost equally strong gain in July, following six months during which the production index had generally declined. The July-August advance, totaling 2.5 percentage points, brought the index to a level only 1.0 percentage point below the record high reached last December. In September, however, the automobile strike had a dampening effect on industrial activity, and it is likely that any further sizable advances in the overall production index will be delayed until after a settlement in the auto industry.

The August rise in industrial production was broadly based, though a substantial part of the strength was due to

Chart I

INDUSTRIAL PRODUCTION

Seasonally adjusted; 1957-59=100



Note: Indexes for defense equipment and nonautomotive consumer goods were calculated at the Federal Reserve Bank of New York from data published by the Board of Governors of the Federal Reserve System.

Source: Board of Governors of the Federal Reserve System.

special factors. These included the further recovery of production in the rubber industry from the strike that was settled in mid-July and another boost in crude oil output in response to the curtailment of supplies from the Middle East. The special factors affecting oil and rubber output contributed to the strong rise in the index of materials production, although an increase in iron and steel output also figured in the advance. In September, on the other hand, a truckers' strike apparently dampened iron and steel output, while at the same time the Texas authorities cut back allowable oil production because of a resumption of shipments from the Middle East.

Production of equipment moved up again in August on the strength of a 1½ per cent rise in the defense component. At the same time, the slackening in business equipment output appears to be leveling off. Following six months of uninterrupted declines, production of business equipment edged up in July and then held steady in August, at a level about even with that of a year ago.

Consumer goods production was boosted in August by an extremely sharp jump in the output of television sets, which reflected both an improved sales outlook and the settlement of a strike at a major producer. That strike had followed six months of industry-wide cutbacks which were made because of a substantial gap between actual and projected consumer buying. In anticipation of a continuing improvement in overall consumer demand, production of television sets and other consumer goods is now apparently on the upswing. Another sizable gain was registered in August by the automotive industries, as the pace of auto assembly operations increased once more, reaching a seasonally adjusted annual rate of 8.3 million units—the highest this year. The industry's original production schedules for September had pointed to another sharp rise in the assembly rate, but the strike at the Ford Motor Company of course meant that the original schedules were not met. Preliminary figures indicate that September output fell about 20 per cent to an annual rate of less than 7 million units.

The upturn of industrial activity in recent months has been helped by the much improved inventory situation. During the first half of 1967, the overall rate of business inventory accumulation was cut back sharply. For several months, stocks were actually reduced in the trade sector, and June saw a decumulation in manufacturing as well. In both July and August, manufacturers' inventories rose, with the increase occurring entirely in durables manufacturing. Total accumulation was centered in stocks of goods in process, although in August materials inventories also rose. Shipments made by manufacturers increased during the summer. In July the rise was larger than the increase in inventories, thus reducing the inventory-shipments ratio for the third consecutive month. In August, however, inventory accumulation exceeded the gain in shipments, and the ratio rose.

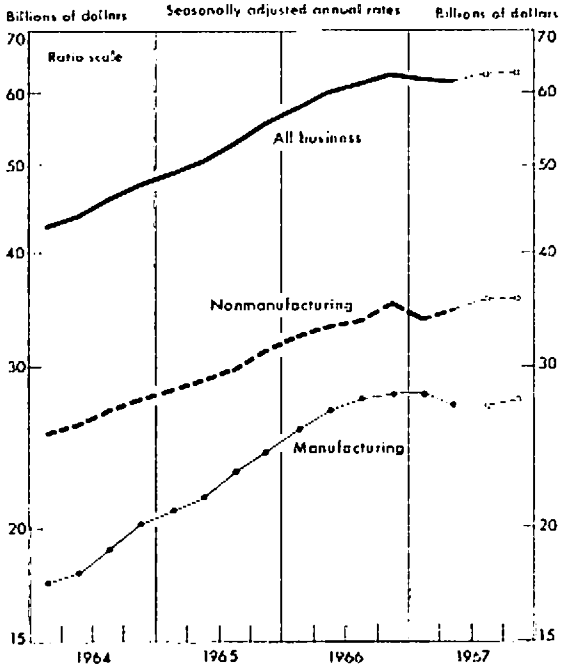
Recent information on manufacturers' expectations regarding inventories and shipments indicates that producers anticipate an accelerating rate of inventory accumulation. According to the Commerce Department's latest quarterly survey, taken in August, manufacturers were expecting to continue a slow rate of inventory building in the third quarter, but anticipated a step-up in the pace of accumulation toward the year-end. The prospective acceleration of inventory investment is centered in durables manufacturing. Producers of both durable and nondurable goods formulated their inventory anticipations on the basis of an expectation that shipments would be increasing rapidly throughout the second half of 1967. Taken together, the reported inventory and shipments expectations point to a modest second-half decline in the stock-shipments ratio in durables manufacturing and a sharper drop in the nondurables ratio.

Following an upturn during the spring, the volume of new orders for durable goods dropped sharply in July and edged off in August. In both July and August, however, the decline resulted from substantial reductions in the volatile defense component. The total August volume of durables new orders exclusive of those received by defense-oriented industries was the highest this year, and fully 7½ per cent above the slower pace of last spring. The machinery and equipment industries reported another rise in their orders volume, bringing it close to the record high set a year ago. Shipments of durable goods, which have been growing steadily since April, advanced again in August and the backlog of unfilled orders edged off.

BUSINESS INVESTMENT PLANS AND CONSTRUCTION

The latest Government survey of business spending plans provides confirmation of the expectation that capital investment is rising in the second half of 1967, following a dip in the first two quarters. According to the August survey by the Commerce Department and the Securities and Exchange Commission, outlays on new plant and equipment in both the third and fourth quarters were planned at a seasonally adjusted annual rate of about $62½ billion, compared with a first-half spending rate of about $61½ billion (see Chart II). This increase would bring total 1967 outlays to $62.0 billion for a 2.3 per cent rise over 1966. Although most major industries plan to spend more this year than last, the increases in individual industries and in the total are modest when compared with

Chart II
ACTUAL AND ANTICIPATED
PLANT AND EQUIPMENT SPENDING



Note. Figures shown for the third and fourth quarters of 1967 are estimates from the August Commerce SEC survey.
Sources. United States Department of Commerce; Securities and Exchange Commission.

the rate of expansion in the past three years. However, according to two surveys taken recently by private firms, the rise in the second half is expected to continue, gaining strength in 1968.

It was clear that the exceptionally rapid growth of capital spending last year was contributing significantly to the buildup of serious inflationary pressures. It was for this reason that President Johnson asked the Congress to suspend the investment tax credit and certain accelerated depreciation methods; their suspension, between October and March, was one factor dampening investment spending in 1967. Possibly in response to the restoration of the investment incentives, some upward revisions have been made by nonmanufacturing industries since the Commerce-SEC's spring survey of spending plans for the second half of 1967. These upward revisions were notable in the plans of nonrail transportation industries and public utilities. At the same time, however, business capital investment programs generally have continued to be moderated by a number of factors, including the anticipation of a tax increase, the relatively high cost of credit, the easing of corporate profits from the very high levels reached last year, and the slackening of capacity utilization rates in manufacturing.

The 1967 slowdown in capital spending has been reflected in activity in the construction industry. Following a brief bulge at the beginning of the year, commercial and industrial building outlays have declined steadily from the high 1966 rate. Activity in the housing industry has continued to improve, however. In August, nonfarm housing starts rose again, following a large gain in July, and the number of housing units authorized by new building permits also increased. Thus far, the recovery in residential building has progressed almost as rapidly as the precipitous decline experienced in 1966. From a seasonally adjusted annual rate of 1.40 million units in March of last year, housing starts plunged for seven months to a rate of 0.82 million units in October. Seven months of recovery lifted the starts rate to 1.25 million in May 1967, and continuing advances brought the pace up to the 1.36 million units indicated by the preliminary August figures.

INCOME, CONSUMER DEMAND, AND PRICES

Reflecting the more rapid tempo of industrial activity, employment showed strong gains during the summer months. These advances were, in turn, the chief factor behind the recent acceleration in the expansion of personal income. Following two months of substantial increases, personal income in August registered the largest advance since last January. At an annual rate, the August gain amounted to \$4.5 billion, of which \$3.5 billion stemmed from increased wage and salary payments. In contrast, several earlier months this year saw wage and salary gains of only about \$0.5 billion.

Consumers appear to be increasingly willing to translate income gains into greater spending. Retail sales have shown a steady upward trend since the spring, and the advance seems to be strengthening. Further, recent surveys of consumer sentiment suggest that this uptrend will continue through the rest of the year and into 1968. According to preliminary figures, the volume of retail sales rose appreciably in August. In contrast to the several preceding months when sales of durable goods moved up rapidly, the August increase stemmed entirely from a large advance in sales at nondurables outlets. Total sales of durables edged off slightly in August, with the decline primarily reflecting a drop in new car sales that was not quite offset by gains in other durables lines. One factor behind the slippage in automobile sales was the exceptionally low level of stocks in popular model lines. In September, supply shortages continued to affect sales until the introduction of the new models late in the month. While the strike against Ford may create new shortages, apparently it did not have much direct effect on sales in September.

Price increases were widespread in August. The consumer price index rose by 0.3 per cent, making August the fifth straight month of substantial advance. Gains were recorded in virtually all major components—most notably in the services, housing, and food categories. Consumer food prices, which had declined last winter, rose strongly in the May-August period. However, a recent easing in the wholesale food index suggests that the rise in retail food prices may moderate. The overall wholesale price index declined in August, as lower food prices offset a rather sizable increase in the index of industrial commodities. Preliminary figures for September, on the other hand, indicate that further rises in industrial prices outweighed the reduced food prices, resulting in a small rise in the overall wholesale index. In addition, there has recently been a wave of price increases which are not yet incorporated in the indexes; these included higher prices for automobiles, color television sets, a variety of steel products, nickel alloys, sulfur, and other chemical products.