The Business Situation

Economic activity rebounded sharply in November and December from the strike-depressed levels of the two preceding months. Auto production picked up substantially, following the October 25 settlement at the Ford Motor Company, and late-October strike settlements in other industries also contributed to the improved economic picture. November gains were widespread, however, and included many sectors not directly affected by the recent labor disputes. The strength of the November advance is evident in the sharp, broad-based rise in industrial production, the surge in new orders for durable goods, the substantial decline in unemployment, and the strong gains in personal income, retail sales, and housing starts. Reflecting mounting cost and demand pressures, consumer and wholesale prices rose sharply in November.

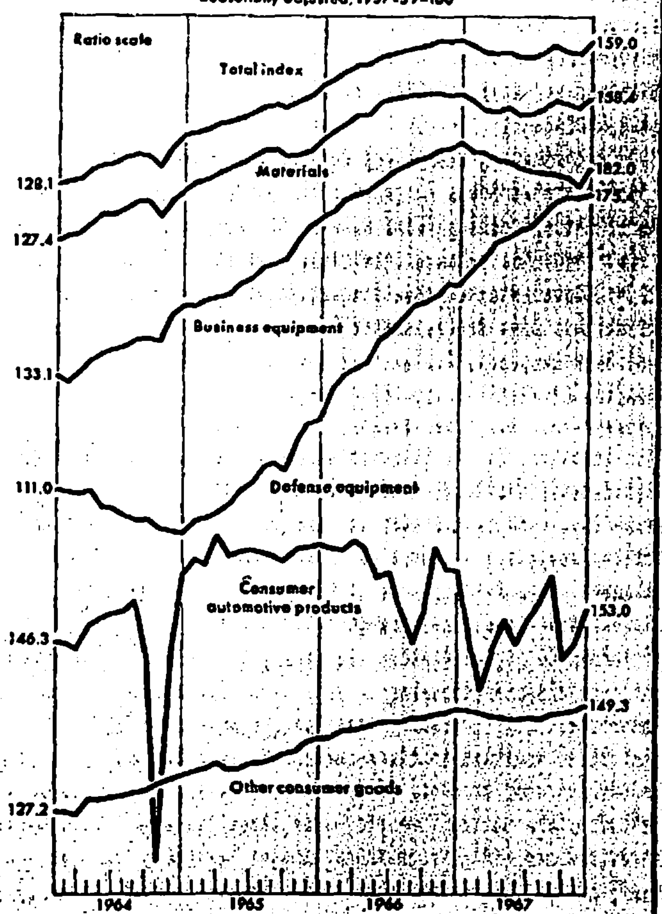
Recent developments point to further strong gains for economic activity in early 1968. Surveys suggest that capital spending will rise. Outlays on inventories should also increase, as the auto industry rebuilds its strike-depleted stocks and as steel users intensify inventory building in anticipation of a possible strike later in the year. Consumer spending should be stimulated by Federal pay increases, a rise in the minimum wage, a boost in social security benefits, and higher wages won in recent contract settlements. Against this background, price pressures at both the consumer and wholesale levels can be expected to heighten.

PRODUCTION, ORDERS, INVESTMENT, AND CONSTRUCTION

Industrial output posted a broad gain in November. The Federal Reserve Board's production index jumped by 2.6 percentage points to 159.0 per cent (seasonally adjusted) of the 1957-59 average (see Chart I). At that level, the index was at its 1967 high and had returned very close to the all-time peak reached in December 1966. The sharp November rise in the index was of course partly due to the recovery of production following the settlement of strikes, particularly in the auto industry. The improvement, however, also reflected increases in output across a broad range of industries, and encompassed gains in production of materials, consumer goods, and equipment.

The post-strike rise in automobile production lifted the seasonally adjusted annual rate of new car assemblies to 7.4 million units in November, up from 6.9 million units in October. Reflecting this recovery, the overall pro-

Chart I
INDUSTRIAL PRODUCTION
Seasonally adjusted; 1957-59=100

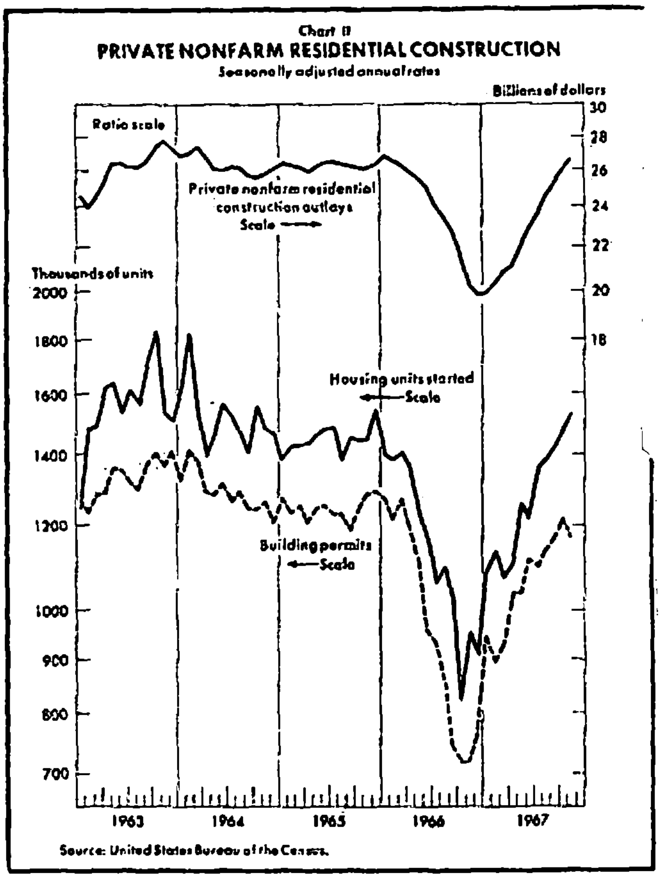


Note: Indexes for defense equipment and nonautomotive consumer goods were calculated at the Federal Reserve Bank of New York from data published by the Board of Governors of the Federal Reserve System.

Source: Board of Governors of the Federal Reserve System.

duction index for motor vehicles and parts jumped by almost 12 per cent but was still well below the midsummer level. Another factor contributing to the November rise in industrial production was the strong further advance in iron and steel output, which reached a 1967 high. This advance reflected an improved demand from the auto manufacturers as well as from a wide range of other steel users. There is some evidence, according to industry analysts, that steel users are already beginning to build inventories as a hedge against a possible steel strike next summer.

In December, the pace of auto production surged 21 per cent to a seasonally adjusted annual rate of 8.9 million units and steel output rose a strong 8 per cent. A further buoyant note was provided by the substantial November rise in the flow of new orders to manufacturers of durable goods. The volume of new orders grew by almost $500 million—the largest increase since May—with the advance occurring despite a sharp drop in the highly volatile series on orders for defense-related goods (largely aircraft). Though durables shipments reached a 1967 high in November, they were slightly exceeded by the volume of new orders and thus the unfilled orders backlog increased a bit further.



The recent quickening of the pace of business activity apparently reflects in part a strengthening of business investment spending. The latest Government survey of business plans for capital spending, taken in late October and early November by the Department of Commerce and the Securities and Exchange Commission, indicates that businessmen anticipated an upturn in such outlays in the final quarter of 1967, following modest declines in the first three quarters of the year. The survey points to a substantial further increase in the pace of business investment in plant and equipment during the first half of this year. These results must be interpreted with caution, however, since the survey historically has tended to overestimate expenditures when outlays were falling—as in 1967—and to underestimate expenditures when outlays were rising.

Inventory investment in manufacturing appears to be accelerating. Following a rise of $350 million in October, inventories of durables manufacturers rose by a substantial $600 million in November. At the same time, the gain in shipments was so large that their inventory-sales ratio fell sharply to the lowest level since August. Nondurables manufacturers' inventories edged upward in November and, with sales rising, the inventory-sales ratio for that sector dropped to a new low.

November marked another month of strong recovery in residential building, as both housing starts and construction outlays posted large gains (see Chart II). With only two interruptions, private nonfarm starts moved up throughout 1967 from a very low seasonally adjusted annual rate of only 0.9 million in December 1966 to a rate of 1.5 million in November 1967. At that level, starts were at their highest point since late 1965. While the high and rising starts pace indicates an increasing level of construction outlays over the near term, the substantial November decline in building permits issued for new housing units could point toward a moderation of the strong upswing in residential building later in 1968.

EMPLOYMENT, INCOME, AND CONSUMER DEMAND

Reflecting the brisk pace of economic activity and the settlement of strikes, employment expanded vigorously in November and increased still further in December. The number of persons on the payrolls of nonagricultural establishments registered the largest increase of the year in November. The bulk of the gain was in durable goods manufacturing, with the return of striking auto workers responsible for a good share of the rise. Employment gains were also reported, however, by a broad range of other manufacturing industries as well as by the nonmanufacturing sectors of the economy in both November and December. A further indication of quickening in the pace of economic activity was the increase (seasonally adjusted) in the average length of the workweek of manufacturing production workers in December.

The acceleration in economic activity was accompanied by a sharp drop in the unemployment rate, to 3.9 per cent in November from 4.3 per cent in October. The decline was the largest monthly reduction in six years. The unemployment rates for adult women and teen-agers, who had accounted for much of the increase in the overall unemployment rate in the previous two months, dropped substantially in November, while the key unemployment rate for married men fell to a very low 1.7 per cent.

As a result of the rapid growth in employment, personal income in November recorded the largest advance in more than two years. This impressive showing was of course partly due to the termination of strikes, which had depressed wage and salary payments in September and October. However, the Commerce Department estimated that only about $2 billion of the nearly $6 billion November rise in the seasonally adjusted annual rate of personal income was due to the ending of strikes. The primary factor in the month's income growth was the more rapid tempo of industrial activity, which led to higher employment, longer hours, and greater earnings.

In addition to rising economic activity, a Federal pay increase covering five million employees is currently contributing to the expansion of personal income. Moreover, the sizable wage increase won in the auto industry and the scheduled February rise in the minimum wage from $1.40 an hour to $1.60 an hour are expected to boost wage and salary payments in the early months of the year. The rise in social security payments should also increase personal income in early 1968.

While the quickening in economic activity has increased the rate of growth in income and employment, consumer demand still appears to be somewhat restrained. Recent surveys of consumer buying intentions indicate a significant downgrading of consumer plans to purchase new cars, homes, and household durables in the coming months. Though retail sales volume rose appreciably in November, reversing a substantial part of the October decline, retail sales have not shown much vigor in recent months. Thus, November sales were about even with last June's total and only a shade over sales in July and August. Sales of nondurables registered their largest advance of the year in November, but the growth of durables volume was virtually unchanged. Sales of new autos in November were about unchanged from the previous month's strike-reduced annual rate of 7 million units. While December auto sales were up over 6 per cent to a rate of 7½ million units, they were considerably below industry expectations.

PRICES

The price picture remains highly disturbing. The overall consumer price index rose sharply again in November, despite the fact that its food component continued to decline. The overall index moved up 0.3 percentage point to 117.8 per cent of the 1957-59 average, largely because of substantially higher costs of apparel, gasoline, and services. The wholesale price level edged up in November, as a decline in farm products partially offset a large 0.3 percentage point rise in the index for industrial commodities. Metal prices advanced strongly, due primarily to shortages caused by the copper strike as well as price boosts in the steel industry. Preliminary figures for December indicate that the overall wholesale index jumped 0.5 percentage point, as agricultural prices shot up 2.3 percentage points. The Bureau of Labor Statistics cautioned that the increase in food prices should not be interpreted as the beginning of a sharp upward trend, because the unusual rise may be something of a statistical fluke. Industrial prices, a key measure of inflationary pressures, also advanced at a relatively high 2.2 per cent annual rate in December. Rising demand and large wage increases practically ensure that price pressures will remain a problem in the months ahead.