

The Business Situation

The economy is continuing to expand strongly. Boosted by an increase in the minimum wage, personal income advanced sharply in February, and another large rise probably occurred in March, partly reflecting stepped-up social security benefit payments. Retail sales have been showing new buoyancy so far this year, suggesting a strong advance in total outlays by consumers during the current quarter. The housing sector moved ahead in February, with starts in January and February averaging somewhat above their fourth-quarter rate. At the same time, the latest Government survey of businessmen's plant and equipment spending plans points to increases in such outlays in the current quarter and in 1968 as a whole. Industrial production held at a high level in February, and new orders posted a modest advance. Although the unemployment rate edged up from January's fourteen-year low, the labor market remains extremely tight. Consumer and wholesale prices continue to climb sharply, and the rise in labor costs in manufacturing has accelerated, intensifying the inflationary pressures in the economy. The hectic scramble for gold in the first half of March reflected in part the adverse impact of continued domestic inflation on confidence in the dollar and dramatically pointed up the need for fiscal restraint.

PRODUCTION, ORDERS, AND CONSTRUCTION

Industrial production held at about the January level in February despite the dampening effect of labor disputes. The Federal Reserve Board's seasonally adjusted production index edged up 0.1 percentage point to 161.3 per cent of the 1957-59 average but remained below the 162.0 per cent December peak. Local work stoppages in the auto industry continued to hold back auto assemblies in February, and the glassblowers' strike also cut into durables output. The production of industrial materials weakened, despite the high rate of activity in the steel industry. Investment outlays and military requirements pushed business and defense equipment output higher in both January and February. The utilities index rose sharply, in part reflecting increased use of electricity during February's unusually cold weather.

In March, strike-hedge buying continued to keep steel production at a record level. On a seasonally adjusted basis, March output was more than 13 per cent above the October level before strike-hedge buying began. Automobile production expanded in March to a seasonally adjusted annual rate of 9.0 million units, nearly 11 per cent higher than February's rate. New car sales surged 10½ per cent to an annual rate of 8.7 million units in March.

New orders to manufacturers of durable goods increased slightly in February to a seasonally adjusted level of \$24.8 billion. This indicator of future production has behaved erratically in the past few months. In December, orders surged to an unsustainable level, and then declined sharply in January. Steel and defense products industries spurred the February advance. Durable goods shipments eased somewhat in February and, since the volume of new orders exceeded shipments, the backlog of unfilled orders rose.

The latest Government survey of business plans for capital spending, taken in late January and early February by the Department of Commerce and the Securities and Exchange Commission, indicates that businessmen anticipated a \$2.1 billion upturn in such outlays in the first quarter of 1968 to a seasonally adjusted annual rate of \$64.8 billion. Most of the first-quarter gain is due to an upsurge in investment spending by manufacturers. After a small decline of \$0.5 billion in the second quarter, the survey points to advances averaging \$1.2 billion per quarter in the last half of the year. Thus, for the year as a whole, the survey reports that businessmen plan a moderate 5.8 per cent increase in the pace of plant and equipment investment.

The sharp upswing in corporate profits late in 1967 may have contributed to the planned rise in investment spending. After edging downward in the first half of 1967, corporate profits before taxes stabilized in the second and third quarters and then leaped \$5.4 billion in the fourth quarter to a record \$85.4 billion at a seasonally adjusted annual rate.

Manufacturers' inventories increased by a seasonally adjusted \$0.3 billion in February, with the gain occurring entirely in durables stocks. At the same time, shipments

fell by a seasonally adjusted \$0.7 billion, and the inventory-sales ratios for both durable and nondurable goods turned up but remained close to the lowest levels reached in 1967.

The latest survey of manufacturers' inventory and sales expectations, taken by the Department of Commerce in February, shows that manufacturers expect their inventories to rise by about \$2 billion in each of the first two quarters of this year, a bit more than the \$1.6 billion fourth-quarter increase. At the same time, they expect inventory-sales ratios to edge down from fourth-quarter levels for durables and to remain about unchanged for nondurables.

Construction was strong in February, in contrast to the mixed picture of the two previous months. Private nonfarm housing starts rose in February by 7.1 per cent to a seasonally adjusted annual rate of 1,528,000 units, following a sharp gain in January and a precipitous decline in December. In February, starts increased in most sections of the country, with the southern and north central areas leading the advance. Half of the December decline had been in the South, and starts there were practically unchanged in January. The index of permits for new private housing shot up 24.6 per cent in February to 121.2 per cent of the 1957-59 base, the highest level since the early months of 1964. The permits index, which is usually less volatile than the series on housing starts, had risen by 14.3 per cent in December only to fall by 16.7 per cent in January.

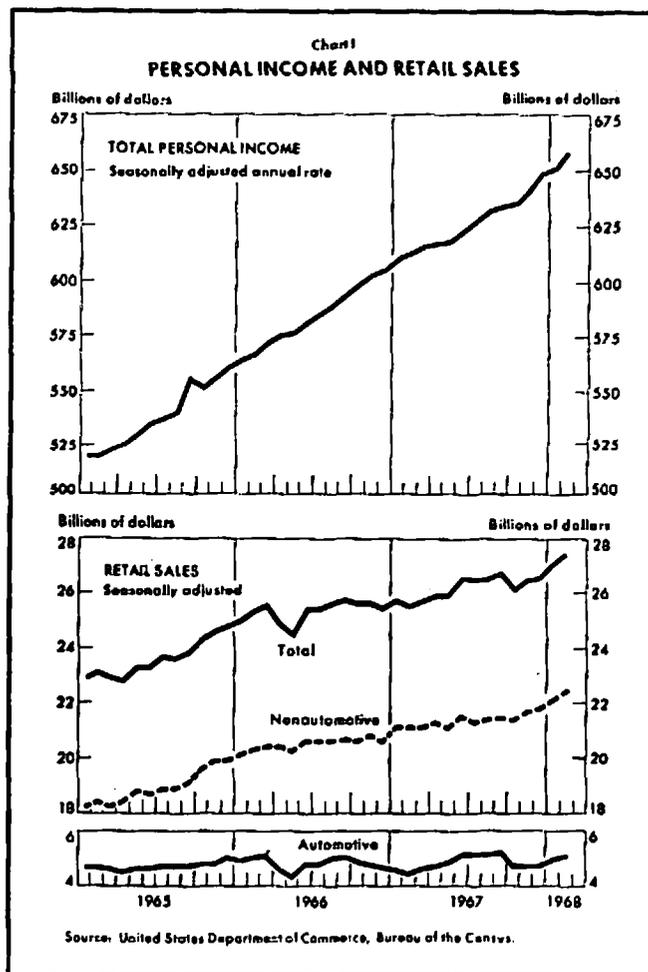
EMPLOYMENT, PERSONAL INCOME, AND CONSUMER DEMAND

The continued strength of the labor market was evidenced by the strong February expansion in employment. Nonfarm payroll employment rose by an impressive 550,000 persons in February, following a small advance in January. While most sectors of the economy contributed to the gain, nearly half of the increase was concentrated in the construction industry as workers returned to construction sites they had been forced to leave because of unusually bad weather in January. Construction employment has picked up substantially since October, after showing little growth during most of 1967. Manufacturing payroll employment, which has been recovering from the reduced levels of 1967, advanced by 66,000 persons to a new high in February.

While employment grew vigorously in February, the civilian labor force expanded even more rapidly, and the unemployment rate edged up 0.2 percentage point to 3.7 per cent of the labor force. February's rise followed a 0.2 point decline in January, which had dropped the job-

less rate to the lowest level in more than fourteen years. A large increase in the teen-age labor force, which had been declining throughout most of 1967, accounted for most of the February rise in unemployment. Three quarters of the teen-agers entering the job market were searching for part-time work. The unemployment rate for adult women also rose in February. The rate for adult men held steady at 2.3 per cent, and underlying labor market tightness was evident in the continued low rate of unemployment for married men, which edged up only 0.1 percentage point to 1.7 per cent.

The large rise in employment and the higher minimum wage raised personal income by a seasonally adjusted annual rate of \$7.5 billion in February. This was the largest increase since September 1965, when a rise in social security benefits increased incomes by \$14.9 billion. According to the Department of Commerce, \$2 billion to \$3



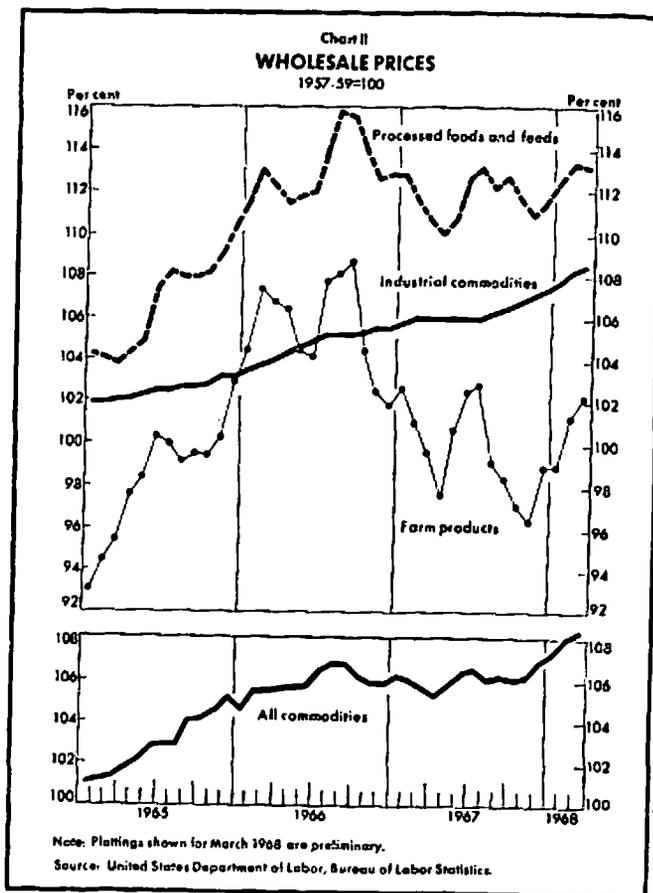
billion of the advance resulted from the February hike in the minimum wage. While other special factors also served to magnify the February rise, it was substantial even apart from these adjustments. Wage and salary payments increased by \$6.3 billion, and manufacturing payrolls rose by \$2.3 billion. Better weather conditions lengthened working hours in the construction industry, and payrolls consequently rose sharply there. Personal income will receive still another boost in March of approximately \$3.6 billion, at an annual rate, from the step-up in social security benefit payments.

Bolstered by the impressive gains in personal income, retail sales in February rose by 1.5 per cent to \$27.4 billion, following a larger advance in January (see Chart I). Durables sales, boosted by increased auto sales, were up by 2.1 per cent. Sales at nondurables outlets increased, with the apparel and general merchandise groups (notably department store sales) showing strong advances. Further evidence of the resurgence in consumer spending was given by the large February rise in consumer credit, the sharpest gain since March 1966. Instalment credit advanced strongly; gains in automotive credit and personal loans were particularly striking.

PRICES AND COSTS

Prices and costs rose sharply in February. The wholesale price index jumped 0.8 percentage point, the largest increase in two years, to 108.0 per cent of the 1957-59 base (see Chart II). Preliminary data for March indicate a further advance of 0.3 percentage point. The rise in industrial commodity prices, which began last August, has accelerated in the current quarter. Prices of farm products reached a trough in November, but since then have been rising at a rapid pace; in February they surged 2.3 percentage points to 101.3 per cent of the 1957-59 base and are expected to rise another 0.9 percentage point in March.

The consumer price index climbed 0.4 percentage point in February to 119.0 per cent of the 1957-59 base. The upturn in wholesale food prices was reflected in a 0.4 percentage point rise in retail food prices. All the major components of the consumer price index showed large



increases in line with their recent rate of advance. Prices of services rose 0.5 percentage point, as health, housing, and recreation costs moved higher.

Labor costs jumped sharply in February—1.8 per cent—the largest monthly increase since 1956. The combination of a higher minimum wage, longer overtime, and a decline in output per man-hour in manufacturing raised the index of unit labor costs in manufacturing to 110.3 per cent of the 1957-59 average. Unit labor costs have risen by a rapid 2.9 per cent in the first two months of the current quarter, considerably faster than the 0.4 per cent increase during the second half of 1967.