The Business Situation

Economic activity continues to expand at an inflationary pace. Preliminary estimates indicate a $16 billion rise in gross national product (GNP) in the first quarter of 1969, little changed from the expansion in late 1968. Consumers and businesses both stepped up their spending during the first three months of 1969, even though faced with higher tax payments and rising interest rates. The pickup in consumer spending was accompanied by a sharp reduction in personal saving; the saving-income ratio dropped a full percentage point to 5.8 percent. While consumer spending has been erratic over the past year, with periods of large increases alternating with small gains, the size of the latest quarter's rise was surprising in view of the dampening influence of higher social security deductions from paychecks beginning January 1 and large final payments due on 1968 income taxes. The broad-based strength of demand throughout the economy indicates that the existing anti-inflationary package of fiscal and monetary restraints has not yet achieved the goal of slowing the inflationary process. Though some indicators of business activity have recently moderated a bit, most remain at record or near-record levels, and price inflation shows no signs of abatement.

GROSS NATIONAL PRODUCT IN THE FIRST QUARTER

According to preliminary Department of Commerce estimates, the nation's total output of goods and services increased by $16.0 billion in the first quarter of 1969 (see Chart I), reaching a seasonally adjusted annual rate of $903.4 billion. The unexpectedly large first-quarter gain amounted to 7.2 percent at an annual rate, only slightly less than in the fourth quarter when GNP grew by $16.4 billion. A higher proportion of the latest quarter's advance, however, was due to price inflation, a factor which since early 1968 has been accounting for an ever-increasing share of the growth in GNP. As measured by the GNP price deflator, the overall price level rose 4.2 percent at an annual rate in the first quarter, the sharpest rate of gain so far in the current expansion. The proportion of the rise in gross national product attributable to real growth in output—that is, exclusive of price effects—was only 40 percent, smaller than in the fourth quarter and, indeed, smaller than at any time since the beginning of 1967. Real output rose by less than 3 percent at an annual rate, compared with an average increase of about 6¼ percent in the first half of 1968 and about 4¼ percent during the latter half of the year after the tax surcharge went into effect.

The major sources of strength in GNP during the first quarter of 1969 were consumer spending and business fixed investment. As a result, the growth in final demand—that is, total expenditures exclusive of inventory investment—amounted to $20.2 billion, substantially greater than in late 1968. By contrast with late 1968, when inventory investment accounted for a significant part of the overall expansion in GNP, accumulation of inventories in early 1969 was held back by the steep climb in final sales.

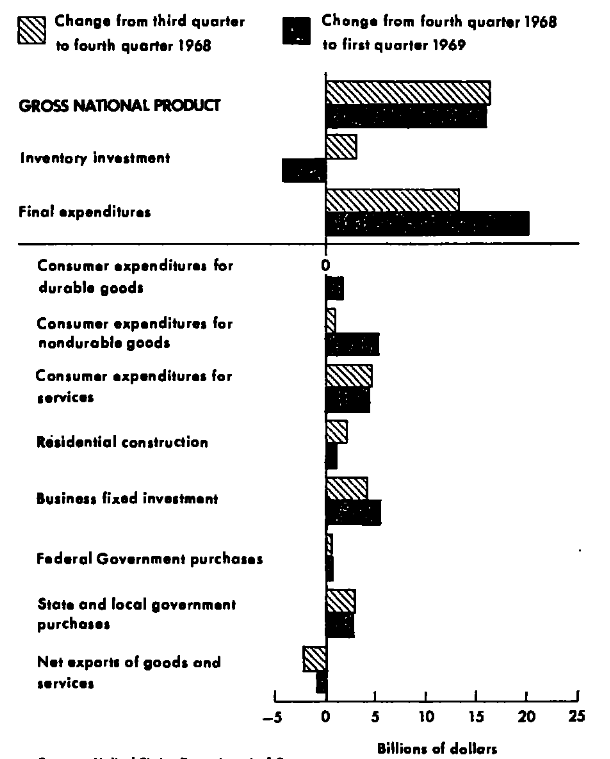
The first-quarter surge in consumer outlays was centered primarily in purchases of nondurable goods, which rose by $5.4 billion, the second largest increase in more than three years. Expenditures for services moved ahead by $4.4 billion, in line with their recent growth trend. Contributing least to the advance was consumer spending on durables—particularly for automobiles. Outlays for consumer durables increased by $1.8 billion, a large share of which was for furniture and appliances.

The performance of consumer durables sales through the early months of 1969 has been related in large measure to weak automobile sales. From a seasonally adjusted annual rate of just over 9 million units in October, dealer sales of new domestic-model cars slipped 10 percent to a rate of about 8¼ million units in March, and data for April indicate sales of new cars continued at that pace.

Chart I

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted



Source: United States Department of Commerce.

According to preliminary statistics, retail sales rose at an annual rate of 6.6 percent from the final quarter of 1968 to the first quarter of 1969. Most of this gain occurred during the month of January when retail buying was recovering from the sharp December slump. Sales did continue to edge up during February to an all-time high, but then eased about 1 percent in March according to the latest estimates.

Businessmen stepped up their capital spending during the first three months of the year. Business fixed investment rose to an annual rate of $99.8 billion, $5.5 billion more than in the final three months of 1968. Reflecting the capital investment boom in evidence since mid-1968, as well as rising prices, the growth in capital outlays—particularly for new plant—has accelerated in each recent quarter. The latest increase was the largest on record and conforms with recent surveys of business plans pointing to a 13 or 14 percent increase in capital spending during 1969. Repeal of the 7 percent investment tax credit, as recently proposed by President Nixon, would undoubtedly modify these plans, since this credit now provides an estimated $3 billion of annual tax savings for businesses. However, over the near term, the extent of this modification is likely to be fairly moderate. An important mitigating influence is the substantial backlog of unused investment credit carried over from prior years. Moreover, the credit applies only to equipment and, hence, its repeal would have only an indirect effect on spending for additional plant. In any event, dampening of investment plans due to repeal of the credit on equipment ordered after April 21 is not likely to show up quickly in the statistics for business fixed investment. These figures reflect outlays for plant and equipment put in place, and such spending totals can lag behind investment decisions and the placement of new orders by many months.

Spending for residential construction moved ahead in the first quarter by $1.1 billion to an annual rate of $32.7 billion, reflecting the rising trend of new housing starts beginning in the second half of 1968. Despite higher interest rates and personal taxes, the demand for new housing was strong enough to bring the annual rate of housing starts to a peak level of 1.8 million units in January (after adjustment for seasonal influences). Thereafter, the starts rate retreated to 1.5 million units in March. Most of the recent drop was in single-unit structures; there has been little slowing in the rate at which new apartment buildings are begun. The decline after January may reflect simply a movement away from an unsustainably high rate which represented an aberration in a highly volatile series. On the other hand, some of the recent moderation may have been a reaction to tighter credit conditions, higher personal tax payments this spring, and sharply rising construction costs, especially for lumber.

Inventory investment in the first quarter of 1969 is estimated to have been at an annual rate of $6.4 billion, substantially below the previous quarter's $10.6 billion. The cutback accompanied a pronounced pickup in sales by manufacturers and retailers in the first three months of 1969. Sales increases were especially strong for manufacturers of durable goods whose sales volume, on an annual basis, was $13 billion higher than in the final quarter of 1968. Similarly, the annual rate of sales at retail outlets in the beginning months of 1969 rose by almost $6 billion from the fourth-quarter rate. As a consequence, the inventory-sales ratios for durables manufacturers and retailers backed off a bit from their year-end highs.

Increased spending by governments at all levels contributed $3.2 billion to the overall gain in GNP during the January-March period, almost the same as in the previous three months. In both quarters, the contribution of the

Federal Government to the overall rise was small, reflecting the distinct slowing in the growth of Federal spending —particularly for defense purposes—that has been in evidence since mid-1968. Total Federal purchases of goods and services rose by only $0.6 billion in the first quarter, while state and local spending was up by $2.7 billion.

The remaining component of GNP, net exports of goods and services, dropped $1 billion to a level of zero in the first quarter of 1969. The further deterioration in the level of net exports was, of course, principally due to the extended dock strike which affected ports along the Eastern Seaboard and the Gulf Coast. About 50,000 longshoremen were involved, most of whom were out until February 22, though workers at Boston and the Gulf Coast ports remained out until March 31. With resumption of port operations, a sharp recovery of net exports is expected in the second quarter.

EMPLOYMENT, INCOME, AND OUTPUT

Labor market conditions were very tight during the first quarter of 1969, with employment at all-time highs and unemployment rates at exceptionally low levels. For the quarter as a whole, the civilian labor force and civilian employment were each up by about 1.2 million persons from the preceding three-month period, compared with average quarterly increases in each aggregate of about 300,000 persons during 1968. Most of the quarter's gain occurred in the first two months of 1969. The March employment increases were considerably smaller because of weakness in the agricultural sector. During that month, the unemployment rate moved fractionally higher to 3.4 percent from the 3.3 percent rate of the previous three months, because of an increase in the volatile rate for teen-agers. Rates of unemployment for the various major adult groups remained at near-record lows throughout the quarter. In April, however, the unemployment rate increased further to 3.5 percent, as unemployment among adult men and women rose fractionally. Total civilian employment fell in April by 160,000 persons, seasonally adjusted, while the civilian labor force dropped a smaller 45,000.

For workers on the payrolls of nonagricultural establishments, a breakdown of the first quarter's increase in employment reveals the same trends. The March advance of 197,000 persons was two-thirds as large as the gains of 300,000 to 350,000 registered in the two preceding months. In general, all industry groups shared in the first-quarter job expansion, but the largest gains occurred in trade, services, the government sector, and manufacturing. In April, however, the decline in total civilian employment was accompanied by a very small 34,000 increase in the number of employees at nonagricultural establishments.

Accompanying the broad-based gains in employment during the first quarter was another decline in the average workweek of manufacturing production workers, which reached its low for the quarter in February because of heavy snow storms. The workweek lengthened again during March to 40.8 hours, and preliminary data for April indicate the workweek remained about unchanged at 40.7 hours. There was little change in the utilization rate of industrial capacity in the first quarter. The factory operating rate stood at 84.1 percent, compared with 84.2 percent the previous quarter. This stability was the result of a decline in the operating rate for advanced processing industries offset by a rise in that for primary processing industries, such as steel.

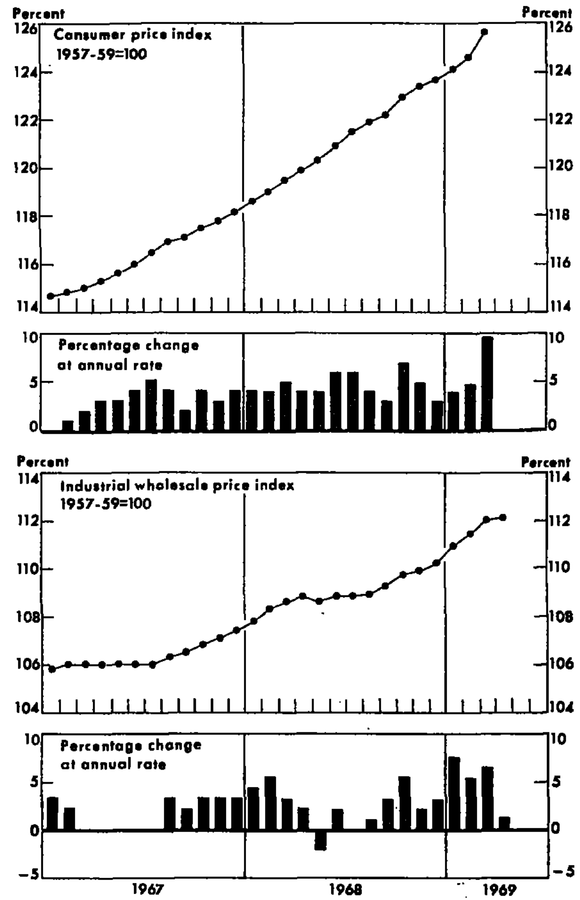
Wage and salary disbursements rose $11.5 billion between the fourth quarter of 1968 and the first quarter of 1969, in line with the large gain in employment. Higher payrolls were evident in all major industry divisions. This latest expansion brought total personal income (seasonally adjusted at an annual rate) to an average level of $721.4 billion for the quarter and to $726.7 billion for March.

The latest statistics for industrial production show that the volume of industrial output gained sharply in March after two months of comparatively moderate increases, due in part to output disruptions caused by strikes. The Federal Reserve Board's index of industrial production rose in March by 0.6 percent to reach a seasonally adjusted 170.5 percent of the 1957-59 average. Virtually all major industries shared in the expansion but, as in February, the nonconsumer sector was in the forefront. Gains were particularly large in mining and in the production of defense equipment and steel. The sharp 4.7 percent gain in defense equipment output was the second such monthly increase. It reflected recovery from a strike of 18,000 aircraft workers in January, and was probably also related to a very large increase in new orders placed with the aircraft industry during February. Total mining output was also up strongly, rising 2.3 percent in the wake of a settlement of the petroleum workers' strike. In addition, steel production continued its very strong recovery from the reduced levels of output last summer, and new orders for steel remain high.

The production of consumer goods also expanded during March but by considerably more modest proportions. Nonetheless, the March gain was somewhat more buoyant than in February, as production levels of household durables and apparel rose. The month's higher output level was also influenced by the fact that automobile production, which has been drifting downward since November, registered a more modest decline in March than in preceding months. However, in April, domestic auto production fell further as scattered strikes held assemblies well below scheduled levels.

Revised statistics indicate that new orders received by manufacturers of durable goods in March were 2½ percent smaller than February's record level. Most of the decline was in orders for aircraft and parts which fell 19 percent from their high February level, a particularly sharp cutback even for this volatile series. Orders for motor vehicles and parts were also down but, in general, orders for most other types of durable goods held firm. Moreover, the backlog of unfilled orders totaled $85.2 billion, up slightly from the previous month.

Chart II
CONSUMER AND INDUSTRIAL WHOLESALE PRICES



Note: Consumer prices are plotted through March; wholesale prices are plotted through April (preliminary).

Source: United States Department of Labor, Bureau of Labor Statistics.

PRICE DEVELOPMENTS

Consumer prices rose over the first three months of the year at an annual rate of 6.1 percent and wholesale prices at 6.9 percent, in both cases considerably faster than in the closing quarter of 1968. The data for March, moreover, show that the consumer price advance accelerated to an extraordinary annual rate of 9.6 percent (see Chart II), the steepest monthly gain since 1951 when the Korean war inflation was at its worst.

The March surge in consumer prices was twice as rapid as that in February and also double the rate of gain in 1968 as a whole. Moreover, prices advanced on a broad front, although increases were most pronounced in homeownership costs such as mortgage interest rates, in used car and gasoline prices, and in the costs of medical care.

The wholesale price index stood in March at 111.7 percent of the 1957-59 average, up 6.5 percent, at an annual rate from the preceding month. The index for industrial commodities rose at a 6.5 percent rate, with price increases in lumber, pulp and paper, fuels, metals, and machinery providing the most push. Overall farm prices rose even more steeply, at an annual rate of 7.6 percent. For April, preliminary data point to a more moderate advance in the wholesale index. The April estimate puts the overall wholesale price index at 111.9 percent of the 1957-59 average, up at an annual rate of 2.1 percent from March. Agricultural commodities are estimated to have risen very steeply, while industrial commodities advanced at a quite modest pace to 112.1 percent of the 1957-59 average, reflecting a reversal of the earlier sharp run-up in lumber and plywood prices.