The Business Situation

The economy moved up at a fast clip in the second quarter, and prices again rose very sharply. The increase in gross national product (GNP) was fully as large as in the first quarter, although real growth and the increase in final demand were both smaller. Most leading indicators point to the likelihood of further growth in the months ahead, but there are indications of easing in some areas of the economy. Housing starts, under pressure from tight mortgage market conditions, dropped in June for the fifth consecutive month. Also, retail sales at the end of the second quarter were apparently down to a level nearly 2 percent below that of April, though these statistics may tend to understate retail buying somewhat. The recent slump in the stock market possibly reflects a growing expectation in the business community that the pace of business activity will indeed moderate in the months ahead. However, other areas of the economy are continuing to show substantial strength. The upward thrust of state and local government spending shows little sign of slowing. Business capital outlays may continue to increase, in part because delivery and construction delays apparently held back planned spending in the first half of the year. Further, business inventory positions have apparently remained in good balance with sales. In sum, while there are suggestions of slowing in some sectors of the economy, there is little evidence that financial restraint has as yet sufficiently dampened the excessive pace of economic activity.

GROSS NATIONAL PRODUCT IN THE SECOND QUARTER

The market value of the nation's total output of goods and services continued to rise rapidly in the second quarter. However, an increasingly large share of the advance simply reflected higher prices, and real growth slowed further. According to the Department of Commerce's preliminary estimate, GNP rose $16.4 billion (see Chart I) to a seasonally adjusted annual rate of $925.1 billion. The rate of gain, which amounted to 7.2 percent on an annual basis, was about the same as in the first quarter.[1] Real growth in the April-June period eased to an annual rate of 2.3 percent, compared with 2.6 percent in the first quarter and 3.2 percent in the final quarter of last year. Prices in the GNP accounts rose at the first-quarter annual rate of 4.8 percent, compared with 4.2 percent in the last three months of 1968.

Although the total increase in GNP was about the same as that in the first quarter, the $13.5 billion growth of final spending—total GNP less inventory investment—was much more modest than in the earlier quarter when such spending surged by an unusually steep $20.1 billion. The slower growth of final purchases largely centered in consumer outlays, which rose by a fairly modest $8.7 billion to a seasonally adjusted annual rate of $570.7 billion. The moderation in consumer buying was almost entirely in nondurables, where spending climbed at less than half the first-quarter rate; expenditures on durable goods and services, however, also grew slightly less than in the January-March period. On a monthly basis, retail sales figures showed little buoyancy in the quarter. Following a large gain in April, retail sales fell in May and—according to the advance report—declined again in June. Although the advance estimate is frequently subject to major revision, it indicates that June sales ran at a seasonally adjusted level of $28.9 billion, virtually the same as in March. For the April-June period as a whole, retail sales were up from the first quarter, but only because of the strong volume in April.

Personal income advanced by a large $16.3 billion in the quarter, reaching a seasonally adjusted annual rate of $740.7 billion. The strength in personal income reflected

[1] The Commerce Department's annual midyear revisions of the national income and product accounts increased the first-quarter estimate of GNP by $5.3 billion to a level of $908.7 billion. The revisions also raised GNP by $2.3 billion in 1966, $3.8 billion in 1967, and $5.1 billion in 1968.

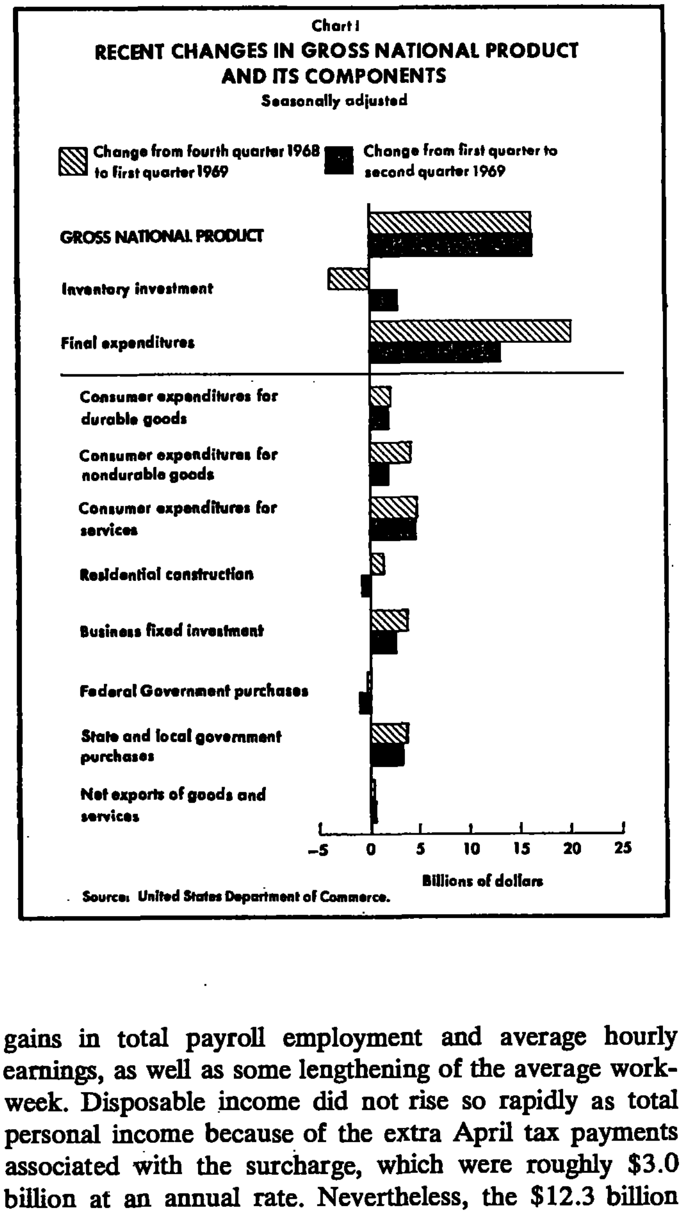


Chart I
RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS
Seasonally adjusted

Source: United States Department of Commerce.

gains in total payroll employment and average hourly earnings, as well as some lengthening of the average work-week. Disposable income did not rise so rapidly as total personal income because of the extra April tax payments associated with the surcharge, which were roughly $3.0 billion at an annual rate. Nevertheless, the $12.3 billion increase was sizable, particularly compared with the first quarter when final tax payments on 1968 incomes were also substantial and when higher social security taxes went into effect. In that period, disposable income expanded by only $6.4 billion. Reflecting both moderation in the growth of consumer demand and the large increase in disposable income, the savings rate in the second quarter rose 0.4 percentage point from the relatively low first-quarter level, reaching a more normal 5.8 percent.

In the first quarter, a large rise in total final demand was associated with a marked slowdown in the rate of inventory spending. In the second quarter the reverse was true. A moderation in final expenditures was coupled with a $2.9 billion increase in inventory accumulation, bringing inventory growth to an annual rate of $9.5 billion. Because this estimate of inventories is based on only two months of data, Commerce Department spokesmen emphasized the preliminary nature of these estimates for the full quarter. The rise in business inventories through May was chiefly in the manufacturing industries—particularly in durables manufacturing. But according to the June data, which were not available when the GNP estimates were made, manufacturers' inventories were about unchanged in that month. The second-quarter's increase in manufacturers' shipments was about in line with the inventory rise, and the inventory-sales ratio in manufacturing was essentially unchanged. At the trade level, sales rose considerably faster in April and May than did inventories, and the inventory-sales ratio dipped to the lowest level in seven months.

The second quarter's $2.7 billion gain in business fixed investment was smaller than in the first quarter, because spending on structures declined by $0.7 billion. Expenditures for producers' durables climbed $3.3 billion—twice the first-quarter rate. Recent surveys of business plans for capital investment had indicated there would be a large increase in plant and equipment spending in the first half of the year, followed by little growth thereafter. However, according to the Commerce Department, the anticipated rise in the first half of the year was not fully realized, probably as a result of delivery bottlenecks and construction delays. Thus, spending in the second half of the year may run higher than the earlier surveys had indicated as the shortfall in the first half is made up.

Not unexpectedly, spending on residential construction dropped to an annual rate of $32.4 billion in the past quarter, down $0.9 billion from the January-March pace. According to seasonally adjusted monthly data, private nonfarm housing starts have fallen steadily since January when they reached the unusually high annual rate of 1.85 million units. Starts in June were down to an annual rate of 1.42 million units, 70,000 below the May pace. Building permits issued by local authorities in recent months have also shown a weakening housing picture. In June, the permits level was about unchanged, following a large decline in May.

Total spending by governments at all levels increased by a small $2.5 billion, contributing to the slower growth of final demand in the second quarter. Federal Government purchases actually declined $1.0 billion to $10[illegible] billion, as spending for both defense and nondefense purposes moved down. Because of the $2.8 billion July pay raise for Federal Government employees, Federal spending is expected to increase in the current quarter

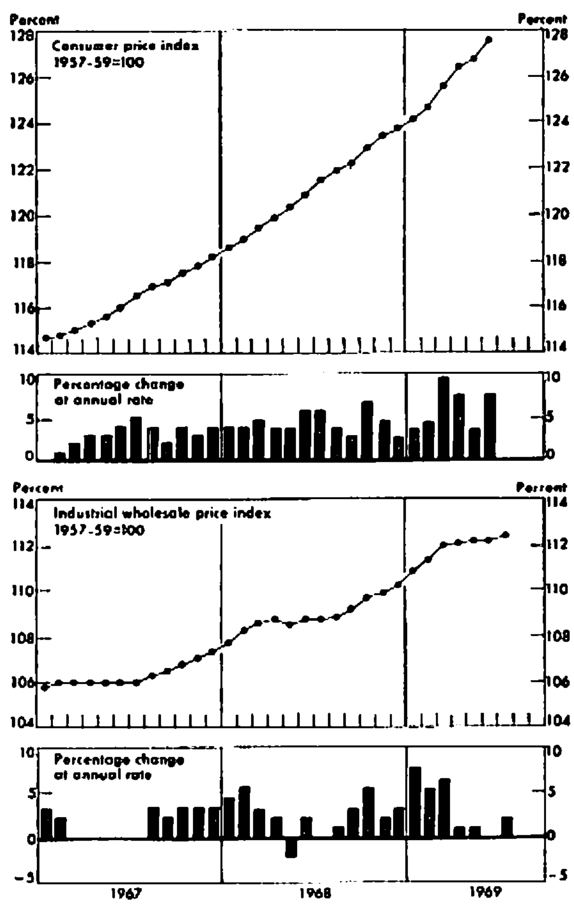
State and local expenditures in the April-June period continued to rise about in line with the sharp gains of recent quarters, and no significant change from this uptrend is in sight. In the past quarter, such spending amounted to an annual rate of $111.9 billion, fully $3.4 billion higher than in the previous period.

Settlement of the first-quarter dock strikes brought a surge in both imports and exports. Net exports rose by $0.5 billion to a slim $2.0 billion annual rate, as the gain in exports only slightly exceeded the rise in imports.

THE CURRENT PRICE SITUATION

Reflecting both demand and cost factors, pressures on the price level have intensified in recent months. Although wage cost increases are increasingly a concern, excess demand still exists. As an indication of the strength of this demand, raw materials prices have climbed a steep 10 percent in the first half of 1969 alone. The rise in total industrial wholesale prices has been much slower, in good part because of rapidly declining lumber and wood prices. According to the preliminary estimate, industrial wholesale prices rose in July by a relatively small 0.2 percentage point to 112.4 percent of the 1957-59 average, after remaining stable in June. On the cost side, the recent trend in wage settlements suggests that wage increases are becoming progressively larger. Under collective bargaining contracts settled in the first half of the year, the median package increase for wages and benefits amounted to 7.1 percent a year. In 1968 the median was about 6.0 percent. The combination of demand and cost pressures and a precipitous rise in food prices—particularly of beef—has led to a rapid rise in consumer prices in recent months (see Chart II). In June, the total consumer price index advanced at an annual rate of 7.6 percent. Excluding food, prices at retail rose at an annual rate of 4.7 percent in June. In both the first and second quarters, total consumer prices advanced at an annual rate of almost 6½ percent.

Chart II
CONSUMER AND INDUSTRIAL WHOLESALE PRICES



Note: Consumer prices are plotted through June; wholesale prices are plotted through July (preliminary).
Source: United States Department of Labor, Bureau of Labor Statistics.

RECENT DEVELOPMENTS IN PRODUCTION AND EMPLOYMENT

Industrial production registered a large advance in June, as output was spurred by the post-strike recovery in the auto industry and by continuing gains in production of both business equipment and industrial materials. The Federal Reserve Board's index of industrial production rose 0.7 percent in June to a seasonally adjusted 173.9 percent of the 1957-59 average. Almost half of the June advance reflected the rebound in production of motor vehicles and parts from the depressed April and May levels, when the industry was affected by scattered strikes. Passenger car production rose 13 percent in June from the April-May rate to a seasonally adjusted annual rate of 8.6 million units. For the first six months of this year, automobile output has averaged an 8¼ million unit rate. Although actual production declined in July because of preparations for the model changeover, the seasonally adjusted rate advanced further to 8.8 million units.

The continued strong uptrend in business equipment output also contributed to the overall June rise in industrial production. Since last summer when business capital spending began to move up, production of business equipment has increased at a seasonally adjusted annual rate of over 10 percent. However, the growth of the total equipment index has been much less marked during this time because defense production has declined by over 10 percent, in part reflecting strikes in the aircraft industries. Defense output accounts for about 20 percent of the total equipment index.

Iron and steel production continued to increase rapidly in June. Reflecting healthy domestic demand—particularly in the capital goods industries—and vigorous European demand, iron and steel output has shown surprising strength this year. The increases in iron and steel production in the first half of 1969 boosted output to about the peak rate set during last year's inventory buildup, just prior to the midyear strike threat in the industry. Moreover, steel ingot production, which comprises about half of the iron and steel index, increased again in July.

In June, declines in orders for construction materials and aerospace equipment outweighed increases elsewhere. Thus, total new orders received by manufacturers of durable goods fell $1.1 billion to a level of $28.9 billion. Durables orders had also fallen in the previous month, following a surge in April which was associated with President Nixon's recommendation for repeal of the investment tax credit. At the same time, manufacturers' durables shipments rose $0.5 billion to a seasonally adjusted rate of $30.0 billion. As the flow of shipments exceeded orders, the backlog of unfilled orders on the books of durables manufacturers declined for the first time since last July.

For the second quarter as a whole, nonfarm payroll employment, seasonally adjusted, gained an average of 187,000 persons per month. This was quite a strong performance for employment, although not so buoyant as in the first quarter when nonagricultural payrolls rose at an unsustainable rate of 278,000 per month. In July, moreover, payroll employment continued to rise rapidly; total payrolls were up 192,000 in that month. The July gain in manufacturing employment exceeded the sizable June increase which accompanied that month's large advance in industrial production.

Turning to the household survey of employment, total civilian employment rose strongly in July despite a sizable decline in agricultural employment. However, the labor force expansion was greater than that of employment, and the unemployment rate rose to 3.6 percent from 3.4 percent in June. A large increase of adult men in the labor force resulted in a rise to 2.2 percent from 2.0 percent in the jobless rate for this group. On the other hand, a large increase of adult women seeking jobs was fully absorbed, and their unemployment rate was unchanged at 3.7 percent.