The Business Situation

Recent indicators of business activity have continued to show a mixed pattern. Signs of a slowing in the rate of expansion have apparently multiplied of late—although the possibility that some of these reflect little more than random movements must be kept in mind, especially in summer months when seasonal adjustments are particularly difficult to make. In August, industrial production recorded its first decline in a year, new orders for durable goods fell, and housing starts and permits dropped a bit further. Higher inventory-sales ratios among durables manufacturers and retail merchants may have contributed to the recent moderation of production. Retail sales showed little buoyancy over the summer, and while personal income gains have been sizable, this strength resulted largely from special and nonrecurring factors. Some easing of exceptionally tight labor market conditions became apparent, as nonfarm employment continued to show relatively little growth. The unemployment rate rose sharply in September, though the rise was probably swollen by special factors. On the other hand, recent surveys of business spending plans indicate that the current boom in capital outlays may well be sustained into 1970, though at a less hectic pace than early this year. Also, a phasing-out of the 10 percent income tax surcharge next year, together with a proposed sizable increase in social security benefits, is likely to provide considerable stimulus to the private economy. Meanwhile, the price situation remains very unsatisfactory. Consumers continue to be faced with sizable price increases on a wide array of goods and services, and industrial wholesale prices have resumed their climb.

PRODUCTION, ORDERS, INVENTORIES, AND RESIDENTIAL CONSTRUCTION

The volume of industrial production declined in August, as iron and steel output fell and activity in most other industries remained about unchanged. The Federal Reserve Board's index of industrial production edged down 0.3 percentage point to 174.3 percent of the 1957-59 average, the first drop since August 1968. At the same time, the July increase in production was revised down substantially from the preliminary estimate. Physical output in the iron and steel industry fell about 3½ percent in August, after leveling off in July. Moreover, the output of raw steel—which accounts for about half the iron and steel index—was up only slightly in September from the August level. This apparent flattening of activity in the iron and steel industry followed a very sharp uptrend in the first half of 1969 when production expanded rapidly in response to vigorous European demand and to the surge in business capital spending.

Business equipment output remained unchanged in August after many months of uninterrupted large gains. Although the absence of a further rise in equipment production may simply have been a random variation, there is supporting evidence that capital spending may be entering a period of slower growth. Recent surveys of business plans for plant and equipment suggest that capital spending outlays will rise more slowly in the current half year than in the first six months of 1969, though the same surveys also indicate that the uptrend will continue into next year. In view of record borrowing costs, the squeeze on profit margins, probable repeal of the investment tax credit, and relatively low capacity utilization rates in manufacturing, the planned further rise of plant and equipment spending apparently rests on expectations of sharply higher labor costs and robust product demand.

Consumer goods production continued to grow at a modest pace in August, although output of automotive products was about unchanged. On a seasonally adjusted basis, auto assemblies remained at the very strong July rate of 9 million units per year. That pace was maintained in September, but industry production schedules point to a cut in automobile assemblies in October to an 8½ million unit rate.

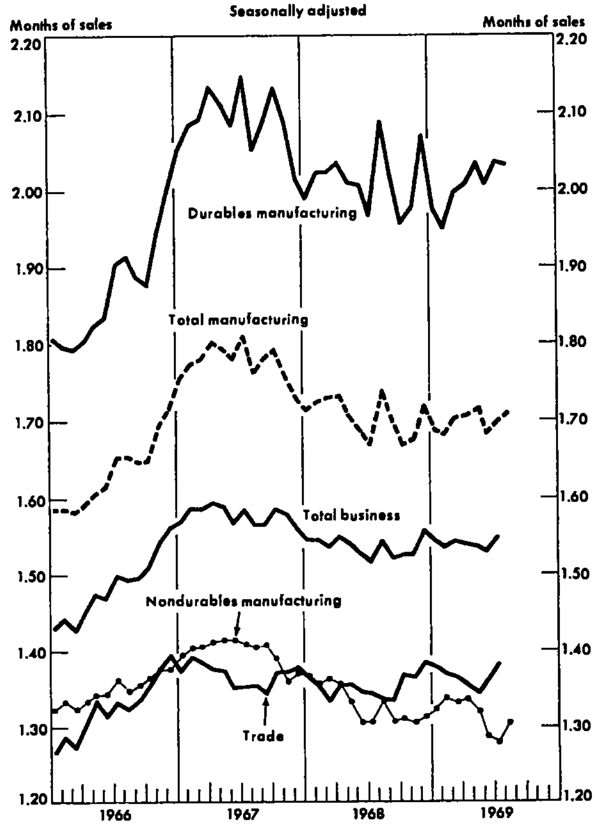
Recent movements in the volume of new orders received by manufacturers of durable goods have been dominated by wide swings in defense bookings, which are a particularly volatile component of the orders series. Perhaps reflecting timing factors related to the Federal Government's fiscal year, defense orders slackened toward the end of fiscal 1969 but were quite strong in July, the first month of the new fiscal year. Defense bookings fell back in August, giving rise to a $0.7 billion decline in total new durables orders, to a level of $29.9 billion. The backlog of unfilled orders for durable goods has also been affected by the erratic movements of defense orders. Following a steady uptrend that lasted about a year, the backlog of unfilled orders at durables manufacturing establishments declined in June as orders fell and shipments rose. There was a partial rebuilding of the backlog in July, but it dropped again in August as shipments volume, though lower than July, again exceeded orders. Nevertheless, excluding the defense component, the flow of durables orders remained above shipments, and the backlog of nondefense orders expanded through August.

The inventory situation continued to appear relatively well balanced during the summer, though there may have been some involuntary accumulation (see Chart I). Total business inventories rose by a sizable \$1.3 billion in July. While accumulation in the trade sector accounted for only \$0.4 billion of the increase, both wholesalers and retailers experienced a decline in sales and a noticeable rise in their inventory-sales ratio. The ratio in manufacturing also advanced in July, as durables inventories surged by \$1.0 billion and total shipments moved up by only \$0.1 billion. In August, the ratio in manufacturing rose again as inventories climbed by \$0.5 billion and shipments fell.

Chart I

INVENTORY-SALES RATIOS

Seasonally adjusted



Note: The ratios for total business and trade are plotted through July. The ratios for durables, nondurables, and total manufacturing are plotted through August.

Source: United States Department of Commerce.

Residential construction activity continues to be the one distinctly weak part of the business picture. Private nonfarm housing starts fell in August for the seventh month in a row, although the decline was small, and the number of building permits issued by local authorities also edged down further. The reduced availability of mortgage credit for new-home purchase has clearly exerted a restraining influence on home building this year. In August, the national average rate on conventional new-home mortgages was over 8 percent. At the same time, the prices of both new and existing homes have climbed steeply, increasing the amount of mortgage credit needed by the typical purchaser. The rise in mortgage rates has also resulted in problems with usury ceilings, which in twenty states are at or below 8 percent. A further complication in the housing industry has been the fact that builders may have encountered difficulty obtaining loans from commercial banks to finance construction operations.

EMPLOYMENT, PERSONAL INCOME, AND RETAIL SALES

In the past two months, the labor market indicators have shown signs of easing from the very tight conditions which have prevailed most of this year. However, the easing may have been overstated as a result of special factors. The timing of the automobile industry's model changeover brought an earlier return to full operating schedules than in past years, thus raising August employment and lowering September employment on a seasonally adjusted basis. Employment outside the transportation industry changed little in August and September. Difficulties with seasonal adjustment apparently also played a role in the household survey of employment. The September rise in the civilian labor force was mostly among persons aged 16 to 24, for whom seasonal adjustments are difficult to make as the school year begins. The sizable advance in the labor force, together with a small decline in total employment, resulted in a jump in the unemployment rate of 0.5 percentage point, the largest monthly change in nine years, to 4.0 percent. Although the most dramatic movement in the September data was in the younger age group, the unemployment rate for those 25 and over rose substantially, moving up 0.2 percentage point to 2.5 percent.

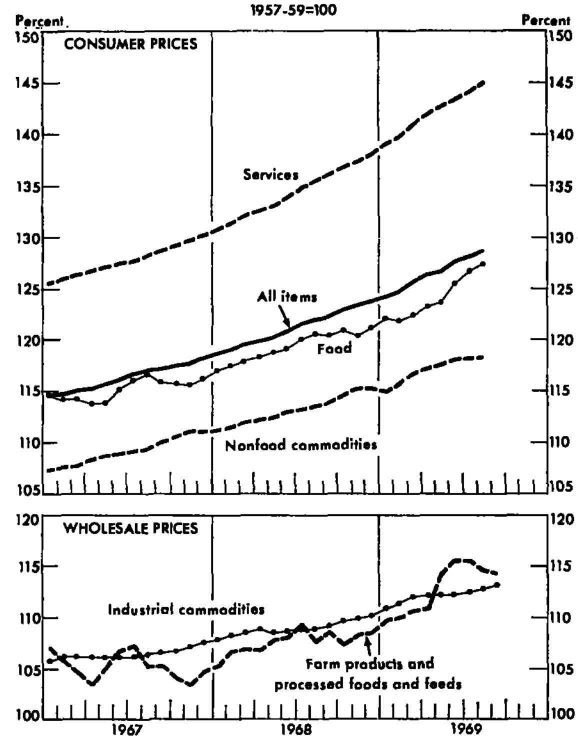
Personal income rose in August by \$5.2 billion to a seasonally adjusted annual rate of \$756.6 billion, following a similar advance of \$5.3 billion in July. The expansion in July and August was in line with the roughly 8½ percent annual rate of gain recorded over the first six months of this year. However, income growth in both those summer months was buoyed by the pay raise for Federal Government employees, which first appeared in July salaries and became fully effective in August. Furthermore, the personal income estimate for August received an extra boost from the timing of this year's automobile model changeover. Excluding these nonrecurring factors, income growth in July and August was at a rate considerably less than in the first half of 1969.

Consumer demand showed no signs of strength in the summer months, as monthly retail sales continued little changed from the $29.4 billion level reached in April. Also, a recent survey of consumer attitudes has found a marked drop in optimism, suggesting that the current sluggishness may continue. Retail sales in August recovered a $0.3 billion dip in July, moving back to a seasonally adjusted rate of $29.4 billion. Automobile sales have shared in the general weakness. For the first nine months of 1969, sales of domestic cars averaged 8.4 million units at a seasonally adjusted annual rate, down from the 1968 total of 8.6 million units but still well above the 7.6 million units sold in 1967. While sales advanced in September, the introduction of the 1970 models came too late in the period for the month's figure to be a reliable indication of market acceptance of the new cars. The real test for the 1970 models will be in the weeks following introductory sales promotions and deliveries to fleet-buyers and auto-leasing organizations. Sales of imported cars have continued to rise this year, although the advance has been distinctly smaller than the large gains of the last few years. For the first eight months of 1969, sales of imports were 6 percent above the comparable period in 1968. Earlier, imported car sales had been growing at about 25 percent per year. This slowing may reflect fresh competition from new low-priced models produced in this country, or it may simply have stemmed from the absence of growth in the demand for new cars generally.

Chart II

CONSUMER AND WHOLESALE PRICES

1957-59=100



Note: Consumer prices are plotted through August; wholesale prices are plotted through September (preliminary).

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

RECENT PRICE DEVELOPMENTS

The price situation remains a major concern. At both the retail and wholesale levels, rates of increase have continued to be very large, threatening not only our fragile balance-of-payments position but also the prospects for orderly economic growth. The average July-August gain in the consumer price index was at a 5 percent annual rate—only slightly less than the 6 percent rate averaged in the first six months of 1969 (see Chart II). To be sure, much of the recent increase in the consumer index can be attributed to a sharp run-up in food prices. Nevertheless, during the June-August period substantial increases were also recorded in the nonfood components—notably in housing and services—and the aggregate index for all items except food rose at a 4½ percent annual rate.

At wholesale, increases since June in the overall index have been small only because declining agricultural prices largely offset increases in prices of industrial commodities. The index of farm and food products is, nevertheless, still far above the levels of the first part of the year, despite the recent declines. Also, there has been a renewed upward trend in industrial prices since June. During the spring, the index of industrial wholesale prices had been relatively stable, as sharp declines in lumber and wood prices about offset other increases. The downtrend in lumber moderated in the summer, and price increases elsewhere—particularly in iron and steel—caused the industrial index to rise once again. The industrial commodities index rose a further 0.4 percent in September, reaching a level of 113.2 percent of the 1957-59 average.