The Business Situation

The most recent business news has continued to indicate some further current slowing in the economy. Industrial production drifted down in February for the seventh consecutive month, despite settlement of a major strike. While new orders received by durables manufacturers moved higher, the orders inflow was still substantially below the September peak. Although housing starts advanced, the near-term outlook for home building remains unfavorable. The unemployment rate rose to 4.2 percent, weekly working hours were shortened, and personal income registered only a modest gain. Despite the easing in demand pressures, prices continued to advance at a rapid pace. While March wholesale price data suggest the possibility that the rate of price advance may be starting to moderate, the evidence for any such turn of events is still very scanty. Recent sizable wage settlements and the prospect of further large contract agreements this year indicate that labor cost pressures will remain intense.

The slowdown in economic activity has been concentrated in certain particular sectors, most notably home building and automobiles. There is a possibility that the decline in automobile sales and production may be bottoming out. At the same time, recent surveys of capital spending intentions give no indication that plans for sizable 1970 increases have been cut back. The boost in social security payments in April, retroactive to the beginning of the year, and the phasing-out of the surtax are adding to spendable income. In addition, it would now appear that Federal Government employee pay increases cannot be postponed until 1971 and that the increases granted may be larger than foreseen when the budget was prepared.

PRODUCTION, INVENTORIES, AND SALES

The industrial production index drifted downward for the seventh consecutive month in February. The total drop has been 3.0 percent, a little greater than the 2.4 percent decline during the months of the 1967 mini-recession. On the other hand, the recent 3.0 percent drop is sharply below the 7.3 percent contraction recorded for the mildest post-World War II recession, which occurred at the outset of the 1960's. The February drop in the index of 0.5 percent exceeded only by a small margin the average monthly decline between last July and this January. If, however, allowance were made for the resumption of work at General Electric early in February, the total production index would have dropped close to 1.0 percent for the month.

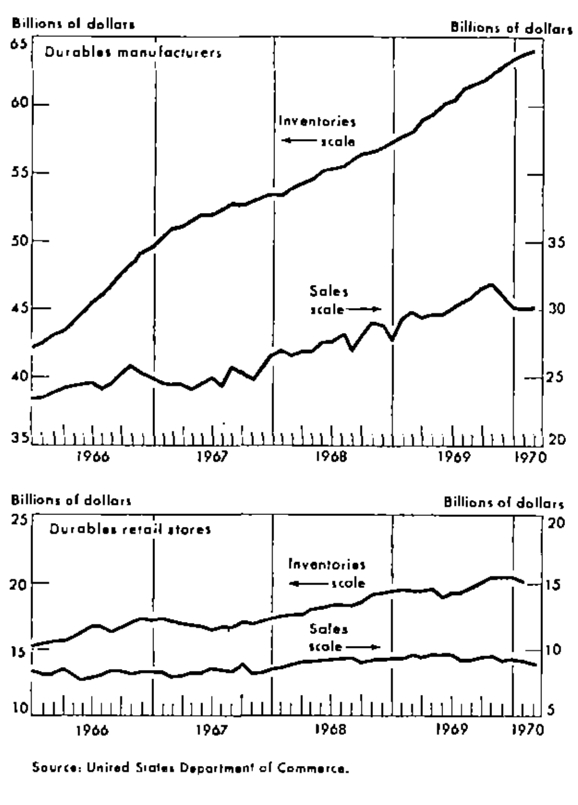
The February production decrease reflected a sizable reduction in the output of nondurables manufacturers, a sector that had held up well in the last half of 1969. February declines in this sector were widely shared by the textiles and apparel, paper, chemicals, petroleum, and rubber industries. The output of durables manufacturing, the sector accounting for the bulk of the seven-month drop in the overall production index, decreased again in February, with substantial further slippages in iron and steel output and the production of motor vehicles and parts. Ingot production figures for March, however, suggest a slight recovery in iron and steel production. The motor vehicles and parts component has accounted for approximately one quarter of the July-February drop in the overall index. Auto assemblies have fallen dramatically from a seasonally adjusted annual rate of 9.1 million units last summer to a 6.5 million unit rate in February. Higher output in March, running at a 7.0 million unit pace, and production schedules for the April-June period suggest that a bottoming out has occurred, although schedules may be cut back further if sales fall short of expectations. In contrast to manufacturing, considerable strength is still apparent in the mining and utilities components of the production index.

Despite the decline in industrial production, there had been a continuing modest accumulation of inventories until January, when the first outright decrease since Ju

1967 occurred. Falling sales, however, have largely accounted for the increase to a very high level in the ratio of stocks to business sales. Even for January, when businesses in certain sectors had some success in correcting inventory imbalances, the overall ratio remained high. The imbalances have been centered in the positions of durables retailers and durables manufacturers, for which decreasing sales have been marked (see Chart I).

Durables retailers' inventories declined in January, but by proportionately less than sales, so that the ratio of stocks to sales continued to rise. While the ratio has been high for many sectors, autos dominate the statistics. Inventories of automotive retailers were reduced each month from October to January, even though sales dropped sharply. Although the ratio of stocks to sales thus rose through January, recent unit sales and production figures point to success in industry efforts to improve the alignment of the stock of unsold cars and the pace of sales.

Chart I
INVENTORIES AND SALES OF DURABLE GOODS



Source: United States Department of Commerce.

Unit sales of domestic-model cars registered a pronounced advance in February to a seasonally adjusted annual rate of nearly 8 million units; this advance was partly attributable to new-model introductions and sales contests. As a result, the stock of unsold cars, on a seasonally adjusted basis, dropped to the lowest level since last July. In March, the sales pace slipped back to close to 7½ million units but remained considerably above the January rate of less than 7 million units.

The inventory buildup of durables manufacturers was modest in both January and February. Although shipments rose in February for the first time since last October, the improvement in the balance between inventory holdings and sales was slight. Except for January, the inventory-sales ratio in February was the highest since October 1967. The sharp advance in the ratio to the high level at the outset of 1970 reflects a softening in sales rather than unusually large inventory gains. Half the drop in durables shipments since the October peak resulted from weakening sales of auto manufacturers; the remainder reflected lower shipments of electrical machinery and equipment, instruments, and aircraft. This pattern suggests that the work stoppage at General Electric and the declining demands for autos and defense-related products were largely responsible for the drop in sales.

The inflow of new orders to durables producers rose in February, and the January figure was revised upward; nonetheless, new bookings remained considerably below the peak recorded last September. The principal source of strength was new orders for aircraft. Orders received by machinery and equipment industries continue to reflect the strength in capital spending.

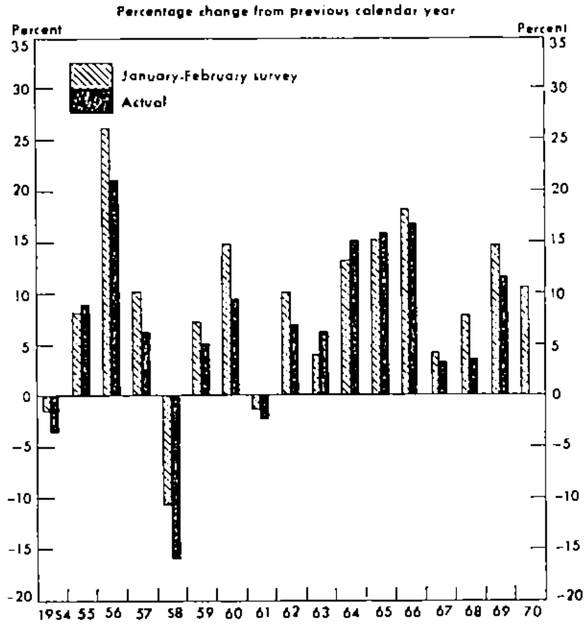
CAPITAL SPENDING AND RESIDENTIAL CONSTRUCTION

Businessmen plan to continue to increase their spending for expansion and modernization of production facilities at a rapid pace, according to a recent survey conducted by the Commerce Department and the Securities and Exchange Commission. The findings of the survey, taken in late January and in February, indicate that expenditures on plant and equipment will advance 10.6 percent in 1970 from the 1969 level, which was 11.5 percent above that for 1968 (see Chart II). Last year's increase in capital spending fell short of the 14.7 percent gain that the survey conducted in early 1969 had indicated. This suggests that some postponements, delays, or cancellations affected 1969 spending. Since late last summer, businessmen have raised their capital spending intentions for 1970 from around 5 percent above last year's

Chart II

PLANT AND EQUIPMENT EXPENDITURES

Percentage change from previous calendar year



Source: United States Department of Commerce and the Securities and Exchange Commission.

level to the latest Commerce-SEC estimate of 10.6 percent. In addition, the latest survey results show that capital spending will accelerate during the second half of this year following a period of modest growth. The fall in 1969 estimates and the rise in those for 1970 suggest a shift to 1970 of spending originally planned for late last year. There is a possibility that further stretch-outs may be in the offing; when economic activity slows, businessmen's early estimates often overshoot actual spending. Nonetheless, the January-February Commerce-SEC survey results have generally proven fairly accurate in estimating the year-to-year changes in plant and equipment expenditures.

The January-February survey shows substantial further increases in capital spending for 1970 by the electrical and nonelectrical machinery, railroad, electric utility, and communications industries, where demands for products and services have remained relatively firm. On the other hand, weak demands in several industries have apparently led to planned reductions in capital spending; cutbacks are expected by the steel, motor vehicle, aircraft, and rubber industries. Possibly in response to steeply rising prices, capital spending plans point to greater efforts by food processors and the nonferrous metals industries to expand or modernize their production facilities.

While capital spending has been a buoyant factor in the economy, spending on residential construction has been in a steep downtrend since April 1969, and housing starts have fallen through January 1970. Although starts recovered in February, jumping 10.4 percent, it is doubtful that this upsurge represents a real turnaround in the housing sector. Unusually severe weather conditions in January could have cut deeply into starts that month, with postponements reducing the January figure and lifting the February rate; the January-February average at a seasonally adjusted annual rate of 1.26 million units was lower than the rate for any other two-month period since the spring of 1967.

EMPLOYMENT AND PRICES

The unemployment rate moved to 4.2 percent in February from the previous month's 3.9 percent. Although still low by historical standards, the unemployment rate was nearly 1 percentage point above that recorded a year before. The jobless rates for most labor force groups are appreciably higher than in early 1969, but much of the increase in unemployment has occurred for adult males. Since men normally remain in the labor force when they become unemployed, rising unemployment has not appreciably diminished strong growth in the civilian labor force, and the overall unemployment rate has rather fully reflected the easing in the demand for labor. While this demand has weakened more in the areas where a dominant proportion of those employed are men, the sizable reduction in the number serving in the armed forces—202,000 persons from September 1969 to February 1970—has also contributed to the larger increase in unemployment among adult males. By occupational groups, the unemployment rate for blue-collar workers has increased more than those for white-collar workers and service workers; by industry classes, the rates for manufacturing and construction have advanced more than those for trade, finance and services, and government.

The easing in demand for labor may also be seen in shortened workweeks. Most of the reduction in hours has occurred in manufacturing, where the seasonally adjusted workweek dropped below forty hours in February for the first time since January 1962. The average workweek has declined a full hour since March 1969, and average overtime hours have fallen markedly. Even though premium-pay overtime hours have been reduced, labor costs per unit of output continue to soar. While cost pressures are expected to remain very strong, the passing of these costs on to buyers in the form of higher prices becomes more difficult as demand pressures ease. As yet, however, these forces have had a minimal impact on inflation.

At the wholesale level, industrial commodities prices continued rising at close to a 4 percent annual rate in February, about the same as the average monthly increase recorded last year. In March the upward pace slowed to about 3 percent mainly because of a much smaller rise in iron and steel prices. With the notable exception of the lumber and wood products component, which continued on a downtrend, most other major industrial commodities classes showed rising prices. Agricultural commodities prices edged up in March after increasing sharply for three months. Thus, price boosts are still widespread and, given the often erratic movements in these price indexes, it is too soon to draw a firm conclusion regarding the trend in wholesale prices.

The consumer price index continued its excessive climb in February, advancing at an annual rate of 6.4 percent, compared with last year's average rate of 6.1 percent. Both services prices and food costs are still rising at extremely high rates, nearly 9 percent and 7 percent, respectively. Nonfood commodities prices registered a fairly small increase, however, rising at a 3 percent rate as compared with 4½ percent through 1969 largely because of further declines in the prices of new and used cars. Sizable increases in the costs of medical care, apparel prices, and mortgage interest charges contributed heavily to the overall gain.