The Business Situation

After having moved essentially sideways in late spring, the domestic economy seems to have begun the second half of 1970 on a somewhat stronger note. Housing starts recorded a substantial gain in July, while industrial production edged upward. In addition, personal income grew modestly after having shown little change in recent months apart from the effects of the recent Federal pay increase and the rise in social security benefit payments. Revised gross national product (GNP) data for the second quarter show that both prices and real output increased by fractionally greater amounts in the April-June period than was previously indicated.[1] In August, however, employment weakened and the unemployment rate edged up to 5.1 percent. On balance, the decline in business activity appears to have bottomed out, and prospects for a near-term economic expansion are brighter than a month ago. However, the strength of such an upturn is hard to assess. The possibility of an automobile strike remains an important element of uncertainty in the economic outlook.

Meanwhile, recent price movements have given rise to the hope that the pace of inflation may at last be slowing. The seasonally adjusted consumer price index rose less rapidly during June and July than earlier in the year. At the same time, the rise in industrial wholesale prices has slowed in recent months, also suggesting an improvement in the price picture. As yet, however, there is no evidence indicating a significant moderation of wage pressures.

[1] The second-quarter revisions have GNP in current dollars at a seasonally adjusted annual rate of $971.1 billion, up $1 billion from the preliminary estimates. GNP adjusted for price changes increased by 0.6 percent, up slightly from the earlier figure of 0.3 percent despite a small upward revision in the GNP deflator. A major portion of the higher GNP levels revealed in the final data comes from the $0.5 billion upward adjustment in business inventories.

PRODUCTION, ORDERS, SHIPMENTS, AND INVENTORIES

Industrial production, as measured by the Federal Reserve Board's index, registered a slight increase of 0.2 percent in July, but remained 3 percent below its high of 174.6 reached twelve months earlier. The small gain recorded this July reflected increases in output of consumer goods and materials, which more than offset further declines in the production of defense and business equipment. Defense equipment production fell 1.5 percent in July, bringing the decline over the past year to 21 percent. This drop has resulted in some severe unemployment rises in localities where defense industries are major employers. Output of business equipment has also been on a fairly long slide, peaking last October and falling in every subsequent month except the two months immediately following settlement of the General Electric strike last winter. At current levels, output of business equipment is 7 percent below the October high. The weakness in business equipment production has accompanied a progressive trimming of capital spending plans, as reported in each of this year's Department of Commerce-Securities and Exchange Commission surveys. Against the backdrop of an 11.5 percent increase in plant and equipment expenditures in 1969, the Commerce-SEC survey early this year pointed to a rise of almost 10 percent. This figure was cut back to slightly less than 8 percent with the spring survey, and the latest forecast, based on July-August data, now places the 1970 growth of plant and equipment spending at 6.6 percent. This survey indicates that spending will continue to grow at a modest rate in the second half of 1970, with virtually all the increase concentrated in the public utilities sector. After taking price changes into account, the physical volume of plant and equipment investment in 1970 will probably remain close to last year's level.

In the consumer sector the production of automobiles and home goods rose somewhat in July. Allowing for normal seasonal factors, which at this time of year include the model changeover period, unit auto assemblies were at an annual rate of approximately 8½ million in July and August. Production schedules for September indicate that output will continue at about this pace. The volume of automobile production in subsequent months will, of course, be greatly affected by the scope and duration of a strike, if one takes place.

New orders for durable goods, which had posted gains in both May and June, rose 3.3 percent in July to a seasonally adjusted level of $30.7 billion. However, all the gain can be traced to a substantial growth in new orders for defense goods. Excluding the defense sector, new orders fell nearly 1 percent in contrast to the moderate upward trend over the previous two months. While defense orders certainly have implications for employment, prices, and output, they are not necessarily indicative of future trends in overall business activity. Moreover, on a month-to-month basis, the defense orders series has been particularly volatile, and the July increase may reflect an orders bulge at the start of the fiscal year which is not accounted for by the seasonal adjustment process. In the important producers' capital goods sector, new orders rose for the fourth straight month. Despite the rise in new orders for manufacturers' durables in July, shipments again exceeded new orders, and the backlog of unfilled orders declined for the seventh successive month.

Preliminary data indicate that total inventories in manufacturing rose by a substantial $0.8 billion in July, to a seasonally adjusted annual rate of $98.5 billion. All this increase occurred in the durable goods sector, where declines had taken place in the two preceding months. However, the rise in inventories was matched by the increase in manufacturers' sales of durables, so that the inventory-sales ratio was virtually unchanged from the fairly high June figure.

CONSTRUCTION

The housing industry is showing some signs of coming out of its recent slump. After a rather weak April, housing starts strengthened in May and June and averaged a 1,280,000 unit annual rate in the second quarter, up slightly from 1,252,000 in the first quarter. In July, seasonally adjusted starts jumped a sharp 15 percent from the June level to a 1,585,000 unit annual rate. The starts series, to be sure, is highly volatile (see Chart I), and this latest jump may exaggerate the extent of the underlying improvement. Nevertheless, there have been some basic gains in the financing situation for home construction. The flow of funds to savings and loan associations and mutual savings banks, which specialize in home financing, has strengthened notably in recent months, and net mortgage acquisitions by these institutions have begun to rise. All of July's rise in private housing starts was concentrated in multifamily dwellings, with single family starts practically unchanged at an 827,000 unit annual rate. Since the number of single family starts was particularly depressed earlier in the year, the average for the first half of 1970 was held down to approximately the 700,000 mark. In contrast, total single family private starts numbered slightly less than 820,000 during 1969.

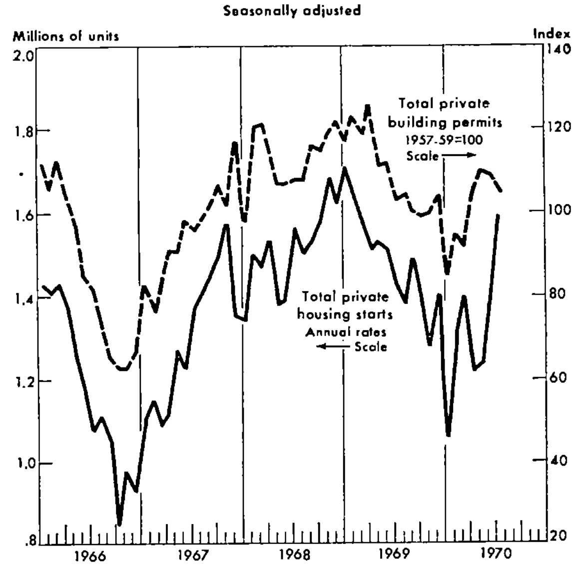
The recent strengthening of housing starts was foreshadowed, as is often the case, by an earlier gain in residential building permits (see Chart I). Permits jumped very sharply in April and edged up slightly in May to a 1,321,000 unit seasonally adjusted annual rate. Subsequently, there has been some backing-off from the May pace, but the 1,265,000 unit rate for July is still markedly above the levels registered in the first three months of the year.

In contrast to the housing starts improvement, preliminary estimates of the current-dollar value of total new construction activity fell 1 percent in July on a seasonally adjusted basis, continuing the rather steady decline of recent months. Public construction and private commercial

Chart I

TOTAL PRIVATE HOUSING STARTS AND PERMITS

Seasonally adjusted



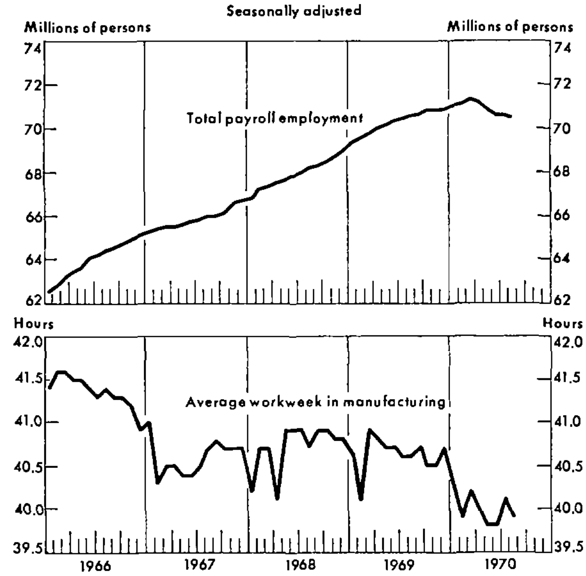
Source: United States Department of Commerce, Bureau of the Census.

buildings contributed to the decrease, while private residential and industrial buildings were both above the previous month's figures. After excluding the effects of rapidly rising prices, the volume of total construction activity is off almost 9 percent from a year earlier.

EMPLOYMENT, PERSONAL INCOME, AND RETAIL SALES

Despite recent indications of a somewhat stronger general business performance, labor markets have continued to show slack. The seasonally adjusted unemployment rate edged up to 5.1 percent in August from July's 5.0 percent. While the labor force shrank in August, a somewhat greater fall in employment pushed the jobless rate up. The small increase in the unemployment rate was concentrated among teen-agers, with the rate for adult males remaining unchanged and that for adult women declining. Long-term unemployment, i.e., the percentage of the work force out of a job for fifteen weeks or more, remained virtually unchanged in August at 0.9 percent. Although this rate has increased during 1970, it is generally considered to be a "lagging indicator". Joblessness among workers covered by state unemployment compensation programs, which usually extend insurance coverage only to experienced members of the labor force, moved back up to the June rate of 3.7 percent after dipping in July.

Chart II
EMPLOYMENT AND LENGTH OF WORKWEEK
Seasonally adjusted



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

The August monthly payroll survey indicated that the number of employees on nonagricultural payrolls slipped after the small July increase shown by the revised data (see Chart II). In recent months, employment has fallen off in the construction, manufacturing, trade, and finance sectors, with the decline being longest and most severe in manufacturing.

Since employers tend to adjust the hours worked by their employees before varying the total number of workers on their payrolls, the length of the manufacturing workweek is often viewed as a leading indicator of business conditions. The index has, however, behaved erratically in recent months (see Chart II). During August, the seasonally adjusted workweek in manufacturing fell 0.2 hours, partially reversing the 0.3 hour rise in July. Nevertheless, the 39.9 hour workweek for August was still above the levels for May and June of this year.

Personal income rose by $3.6 billion in July. Excluding the Federal pay raise and the improvement in social security payments, personal income had grown by an average of only $1.3 billion per month in the second quarter. Thus, the July increase, while still smaller than the roughly $5 billion per month average growth experienced in the first half of 1969 prior to the economic slowdown, nevertheless represents an improvement over the weak performance registered in the second quarter of 1970. However, Federal actions did supply massive injections of income during the April-June interval. As a consequence, the actual climb in personal income, including the Federal payments, averaged $3.5 billion per month in the period. Consumer spending responded with a large 2.5 percent quarterly increase in retail sales, and during July—perhaps bolstered by the final elimination of the surtax—retail sales rose a further $0.2 billion from June, or 0.7 percent over the second-quarter average. Better new car sales have been an important element in the pickup of consumer buying, with the seasonally adjusted annual rate of sales of domestically produced automobiles rising from about 7.4 million in the first quarter to 7.9 million in the second quarter. Over July and August, auto sales averaged approximately 8½ million units.

PRODUCTIVITY, COSTS, AND PRICES

During the second quarter of 1970, the combined impact of higher average output per man-hour and a slower average rate of increase in hourly compensation led to a slowdown in the average rate of increase in labor costs per unit of output. As measured by the change in output per man-hour, productivity in the private nonfarm economy rose at a 3.3 percent seasonally adjusted annual rate during the second quarter, after having fallen at a 2.9 percent rate in the first three months of 1970 and a 0.2 percent rate over the four quarters of 1969. The second-quarter rise in productivity reflected the combination of an essentially unchanged aggregate output and a substantial 3.3 percent drop (annual rate) in man-hours. Clearly, employers were less inclined to hoard labor in the second quarter than they had been earlier in the economic contraction and thus began to release workers made redundant by the lower output rates.

Average compensation per man-hour in the private nonfarm economy, including both wage and benefit payments, slowed to a 5.6 percent annual rate of increase in the second quarter, down from 6.6 percent in the preceding three months and from 6.6 percent in the four quarters of 1969. The slower rate of gain in the April-June period this year reflected a cutback in expensive overtime hours and the economic contraction that has tended to be concentrated in industries with relatively high rates of compensation. Thus, a reduction in these industries' share of total output has helped to pull down the overall average rate of compensation. However, wages and salary benefits negotiated in recent major labor contract settlements have suggested, if anything, an acceleration rather than a slowdown in the rate of increase.

The second-quarter combination of productivity gains and smaller average rates of increase in compensation brought about a slowdown in the average rate of increase of labor costs per unit of output. During the second quarter, unit labor costs in the private nonfarm economy rose at a 2.2 percent seasonally adjusted annual rate, down sharply from the 9.8 percent gain during the first three months of the year and the 6.8 percent rise averaged over the four quarters of 1969.

A slower rate of growth in consumer prices during June and July has raised hopes that the pace of inflation may at last have begun to ease. The consumer price index rose at a 4.2 percent seasonally adjusted annual rate in June and at a 3.4 percent rate in July. Both months represented an improvement over the 6.3 percent rate of growth registered in the first five months of 1970 and the 6.1 percent rate recorded in 1969. Retail prices of food, other goods, and services have all risen less rapidly lately, but the most clear-cut movement in the desired direction has been in food prices. On a seasonally adjusted basis, the food component of the index actually declined in June and was little changed in July. These favorable developments had been foreshadowed somewhat earlier by a generally downward trend in wholesale farm prices, which began around April and has been extended through August. Farm prices, however, are heavily influenced by agricultural supply factors and are not necessarily good indicators of price conditions elsewhere in the economy. Moreover, the recently reported appearance of a corn blight has apparently dampened prospects for further declines in wholesale food prices over the coming months.

The most recent slowdown in the overall consumer price index is certainly encouraging. Unfortunately, however, it is necessary to keep in mind that other similar intervals of improvement were quickly reversed. For example, a decline in the rate of price increases during July and August 1969 was followed by an acceleration in the rate of increase. The cooling effects of the economic slowdown are a major reason for hoping that the current easing will prove more lasting. The balance between supply and demand is now markedly less favorable to rapid price increases. Weaker demand has apparently been a factor in the recent easing in prices for some nonferrous metals, thus contributing to the somewhat slower growth of industrial wholesale prices in the June-August period.