

## The Business Situation

Recent data indicate that economic activity has continued to expand briskly. Retail sales rose markedly in May but then dropped in June, according to preliminary information. Sales were probably held down in June by the storm which affected much of the East. Industrial production posted a moderate, though broadly based increase in May. Over the first five months of the year, output has risen at a rapid 9 percent annual rate. In May, personal income climbed at roughly the pace of the first four months of the year and the volume of residential housing starts increased after easing off in the two previous months. Moreover, there are tentative signs of some strengthening in inventory spending. The unemployment rate fell to a seasonally adjusted 5.5 percent in June, as employment increased and the civilian labor force declined by nearly 100,000 workers.

The latest price information suggests that inflationary pressures persist. Seasonally adjusted consumer prices, boosted by a rapid rise in prices of some nonfood commodities, increased at an annual rate of 4 percent in May. Retail food prices declined for the second consecutive month, but this improvement is not expected to be maintained. Wholesale prices of farm products and processed foods and feeds rose rapidly again in June, and industrial wholesale prices advanced at a disappointing 5 percent annual rate. June data reveal only a modest increase in wages for the second consecutive month, although over the Phase Two period as a whole wages have climbed considerably.

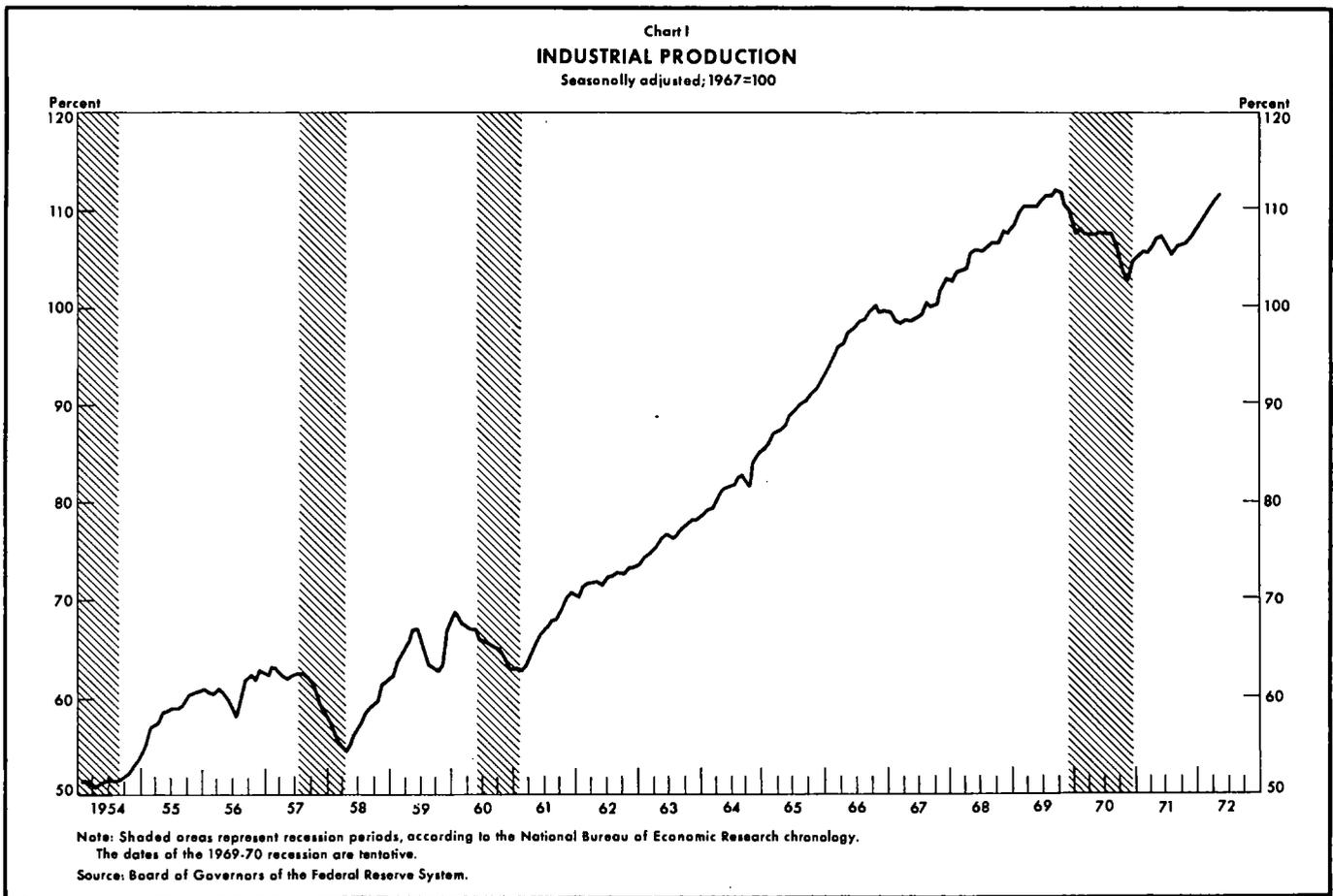
### PRODUCTION, ORDERS, AND INVENTORIES

The Federal Reserve Board's index of industrial production rose in May by 0.5 percent on a seasonally adjusted basis, and the readings for the preceding three months were revised upward slightly. Thus, in recent months output has resumed rapid growth after the decline and subsequent stagnation associated with the recession of 1969-70 (see Chart I). Since the beginning of the year, industrial production has climbed at a fast 9 percent seasonally adjusted annual rate, roughly the pace of ex-

pansion registered between early 1961 and mid-1969, to reach a level only 0.3 percent below its peak of September 1969. The May increase in output was widespread, including gains in the production of consumer goods, business equipment, and intermediate products. On the other hand, output of defense and space equipment and of materials edged down a bit following sharp advances in April.

The May rise in production of consumer goods was 10 percent at an annual rate. Output of most appliances, furniture, and consumer nondurable goods increased, while automobile assemblies declined somewhat from their April pace despite the strength of automobile sales. Since December 1971, consumer goods output, seasonally adjusted, has advanced at an annual rate of 6.7 percent, with the increase concentrated largely in durable goods. Output of business equipment climbed at an annual rate of 8.3 percent in May, after an upward revised increase of nearly 17 percent in April. Over the first five months of 1972, production of business equipment has risen rapidly at an annual rate of 12 percent and, in May, stood at 7.5 percent above its level of a year earlier.

Orders placed with manufacturers of durable goods edged up by about \$0.1 billion in May. Excluding the volatile transportation equipment sector, bookings rose by a healthy \$0.7 billion, or 2.8 percent, to a seasonally adjusted \$26.6 billion (see Chart II). This series, along with manufacturers' shipments, unfilled orders, and inventories, has recently been revised to reflect new benchmarks derived from the annual *Survey of Manufacturers* and new seasonal adjustment factors. As a result, there have been substantial downward revisions in the orders and shipments series, while inventory levels, and therefore inventory-sales ratios, were revised upward. In any event, in May new orders for electrical machinery and primary metals rose, while bookings for transportation equipment fell more than \$0.6 billion after posting a gain of similar magnitude in the previous month. Bookings for nondefense capital goods, a new category which replaces producers' capital equipment, were off slightly in May but



were still about 21 percent above the level of May 1971. Shipments of durable goods climbed modestly to a new record, while the backlog of unfilled orders increased for the eighth consecutive month.

There are tentative indications of some pickup in inventory spending after a prolonged period of sluggishness. During April, the book value of total business inventories increased at an \$8.3 billion annual rate following an upward revised March gain of \$6.2 billion. Trade stocks rose substantially, particularly at the wholesale level, but manufacturers' holdings declined slightly. However, preliminary May manufacturing data suggest a strengthening in inventory spending in this sector, as seasonally adjusted holdings climbed \$4.9 billion at an annual rate. This gain occurred entirely in the durable goods sector. In 1972 thus far, manufacturers' inventories have risen at a \$2.8 billion annual rate after remaining virtually flat

throughout 1971. For all manufacturers, the ratio of inventories to sales was 1.69 in May, the same as April's upward revised level.

#### **RETAIL SALES, PERSONAL INCOME, AND RESIDENTIAL CONSTRUCTION**

Recent data provide impressive evidence of continued strengthening in consumer spending. In May, seasonally adjusted retail sales climbed \$0.6 billion above the upward revised April level to a record \$36.9 billion. Sales of both durables and nondurables increased, with automotive sales accounting for much of the strength in durables. Among nondurables, sales of general merchandise and food rose sizably. Preliminary June data indicate a drop in retail sales from the May peak, but spending was still a healthy \$36.4 billion. Moreover, June sales were

undoubtedly held down somewhat by the tropical storm which affected much of the East Coast. Nevertheless, over the second quarter retail sales were a substantial 2.8 percent above the first-quarter average. In June, sales of new domestic-type automobiles moderated somewhat from their very rapid May pace to a 9 million unit seasonally adjusted annual rate, still a strong showing. Over the April-June period, sales of new domestic-type autos averaged 9.2 million units at an annual rate by comparison with an 8.7 million unit pace in the first quarter. Meantime, sales of imported cars were at an annual rate of 1.6 million units in June by comparison with 1.5 million units in both April and May.

Personal income posted a \$4.8 billion increase in May, reaching a seasonally adjusted annual rate of \$915.9 billion. It should be noted that month-to-month fluctuations in this series have been affected recently by retroactive payments of wage increases approved by the Pay Board, as well as by other special factors. After adjustment for these influences, the May gain in personal income was \$5.3 billion, roughly in line with the adjusted increases of the past several months. Further, over the January-May period, personal income averaged \$905.4 billion, 8 percent above the average of the first five months of 1971. Wage and salary disbursements were up moderately in May, with a rise in manufacturing payrolls providing about half of the overall gain. The durable goods sector, particularly primary and fabricated metals and machinery, accounted for most of the rise in manufacturing payrolls.

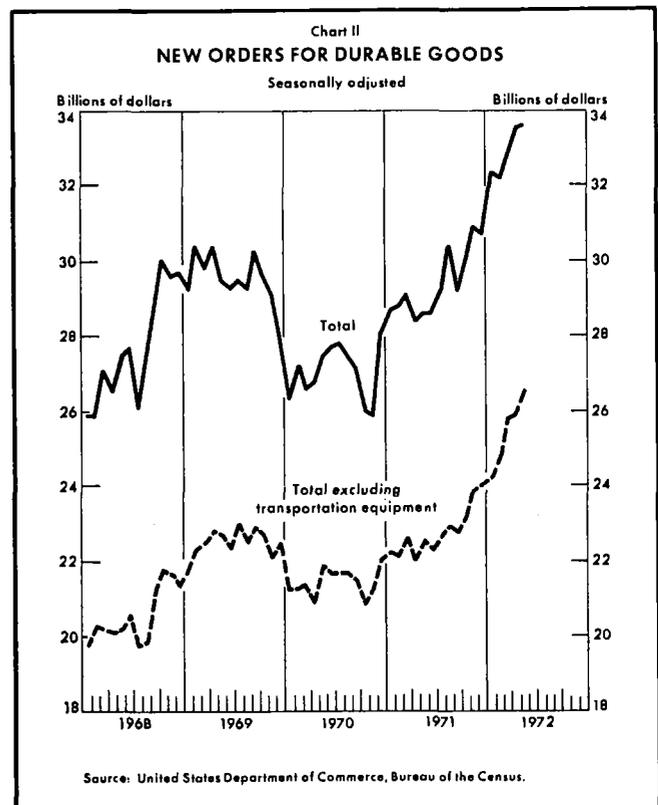
After declining for two consecutive months, the pace of private housing starts increased by 221,000 units in May to a volume of 2.3 million units at a seasonally adjusted annual rate. While this was below the extraordinarily strong performance of the first quarter, it nevertheless represented a healthy total by most other standards. The May advance was concentrated in starts of single-family units, which climbed to their highest level in four months. Newly issued building permits increased slightly in May as well. Recent information suggests a modest tightening in mortgage market conditions. The average interest cost on conventional new home mortgages inched higher in May as did the effective rate on loans for existing homes. Moreover, the secondary-market yields of Federal Housing Administration-insured loans edged up for the second consecutive month.

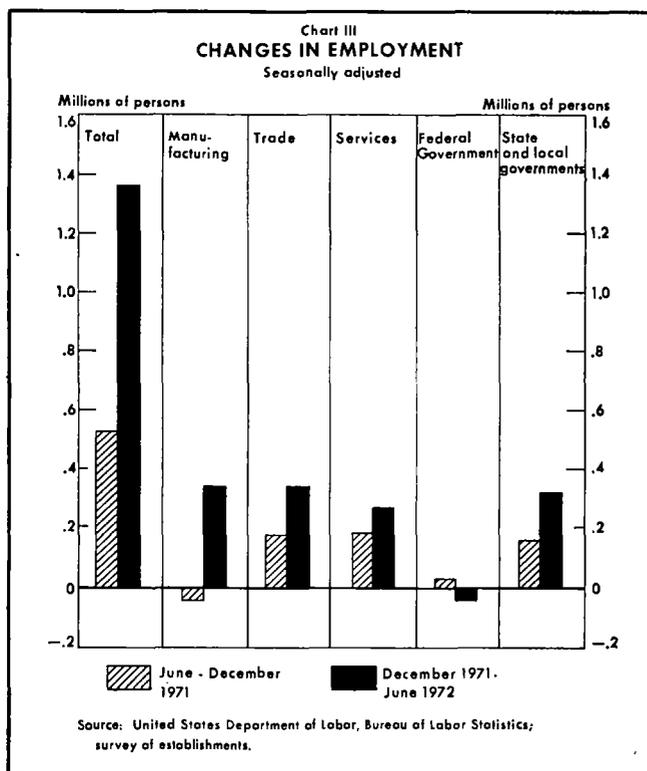
#### LABOR MARKET DEVELOPMENTS

According to the monthly survey of households, civilian employment, seasonally adjusted, rose by 273,000 workers in June, while the labor force decreased by 91,000. As a

consequence, the unemployment rate fell to 5.5 percent after holding steady at 5.9 percent over the previous three months. In June, the rates of unemployment for most major labor force groups declined, with a particularly pronounced drop in joblessness among teen-agers. This decline stemmed, in part, from a smaller than seasonal influx of young people into the labor force. At the same time, the unemployment rate for adult men dipped to 4 percent, compared with 4.3 percent in both April and May, and the rate of unemployment for adult women fell to 5.5 percent in June from 5.9 percent in May. On balance, these data suggest that the rather substantial increases in employment in recent months have begun to have an impact on joblessness. Over the April-June period, civilian employment averaged a sizable 589,000 above the level of the first quarter, an annual rate of increase of 2.9 percent. Expansion of the labor force was also rapid in the second quarter, amounting to 2.5 percent at an annual rate.

After several months of sizable gains, the most recent survey of establishments indicates only a small increase in nonfarm payroll employment in June. With this advance,





nonfarm employment reached a level 2.7 percent above that of a year earlier. Growth has been more rapid since the end of 1971, proceeding at a 3.9 percent seasonally adjusted annual rate over the first half of this year. Manufacturing employment declined in June, but over the January-June period manufacturing payrolls have risen by a healthy 342,000 workers, or 3.7 percent at an annual rate. In contrast, during the last half of 1971, factory employment dropped by more than 40,000 workers (see Chart III). About 75 percent of the gain in manufacturing jobs over the last six months has occurred in durable goods industries. The rise has been widespread within the durables sector, as there have been sizable employment increases in primary and fabricated metals, machinery, electrical equipment, and transportation equipment. The average factory workweek and hours of overtime both were essentially unchanged in June.

Most other areas of the economy have experienced gains in employment in recent months, which surpassed the increases in the last half of 1971. For example, over the first six months of this year, employment in trade and services rose by 336,000 and 270,000 workers, re-

spectively, whereas the corresponding advances between June and December 1971 were less than 200,000 workers in each case. Total government employment, including Federal, state, and local but excluding the armed forces, rose slightly in June to a level 3.7 percent above that of a year earlier. Thus far in 1972, government employment has increased at an annual rate of 4.3 percent. All of this increase has been at the state and local government levels, as such employment rose by 317,000 workers over the six months ended in June. In contrast, reductions were ordered in Federal employment as part of the package of new economic policies instituted in August 1971 and, over the past ten months, Federal civilian employment declined in addition to the sizable reduction in the armed forces.

This pattern of growth in government employment has prevailed for some time. Between June 1969 and June 1971, Federal civilian employment dropped by about 140,000 workers while employment at the state and local levels climbed by nearly 760,000. As a result, state and local governments have accounted for an increasing portion of overall government employment. In June 1972, state and local employment constituted more than 80 percent of civilian government employment, whereas in June 1969 it made up about 77 percent of the total. The recent declines in Federal civilian employment have centered on the Department of Defense, as jobs in most other areas have held relatively steady.

Seasonally adjusted average hourly earnings of production and nonsupervisory workers in the private nonfarm economy, adjusted for overtime hours in manufacturing and for shifts in the composition of employment among industries, increased at a 1.8 percent annual rate in June. This marked the second consecutive month of modest growth in earnings. Over the seven months since the end of the wage freeze last November, the index has climbed at a considerably more rapid 7 percent rate, about the pace of 1970 and the first eight months of 1971. However, excluding the sharp advances of December and January which may have resulted from a post-freeze bunching of increases, earnings have advanced at an annual rate of only about 4.5 percent over the five months ended in June.

#### RECENT PRICE DEVELOPMENTS

The latest price statistics suggest that serious inflationary pressures still persist. The consumer price index rose at a 4 percent seasonally adjusted annual rate in May, despite the second consecutive monthly decline in retail food prices. Moreover, food prices advanced sharply at the wholesale level in May and June, and it is likely that consumer food prices will soon reflect these increases.

Reportedly, retail prices of meats and some other products increased considerably in the last half of June. Because of the timing of the survey, these rises probably will not affect the consumer price index until July. To help slow the advance of food prices, the President recently removed quota restrictions on imported meats and, shortly thereafter, controls were extended to cover prices of some unprocessed foods at the wholesale and retail levels. In any event, over the past three months, consumer prices have advanced moderately at an annual rate of 2.1 percent, while over the Phase Two period as a whole they have moved up at a 3.5 percent rate, modestly below the pace of the first eight months of 1971. Food prices have climbed at a 4.4 percent pace over the six months ended in May, somewhat slower than the 5 percent annual rate of gain registered in 1971 before the price freeze.

The May rise in the consumer price index stemmed from a rapid advance in prices of some nonfood commodities; in contrast, service charges increased moderately. Nonfood commodity prices rose at a 6.2 percent seasonally adjusted annual rate in May, the fastest pace in a year. Prices for used cars and gasoline climbed par-

ticularly sharply. With the large May increase, the index for all commodities less food has now risen at an almost 3 percent annual rate since the termination of the price freeze, the same pace as during the first eight months of 1971. Nevertheless, this still represents considerable improvement relative to the increases experienced in non-food commodity prices in 1970 and 1969.

At the wholesale level the advance of prices has continued to be disappointingly rapid. In June, such prices, seasonally adjusted, climbed at a 5.7 percent annual rate. With this increase, wholesale prices have risen at a 5.2 percent rate following the termination of the price freeze, the same pace experienced over the first eight months of 1971. Wholesale prices of farm products and processed foods and feeds increased at nearly a 6 percent annual rate in June while, at the same time, industrial wholesale prices advanced at a 5 percent rate. Prices of hides, skins, leather, and related products and prices of lumber and wood products rose very sharply again in June. In Phase Two thus far, industrial wholesale prices have increased at a 4.3 percent annual rate by comparison with the 4.7 percent pace of the first eight months of 1971.