

The Business Situation

Economic activity remained on a high plateau toward the close of 1962. Business sentiment continued to display an improved tone, but the major economic indicators showed little change after adjustment for the usual seasonal variations. Industrial production and employment remained steady in November. For December, currently available data suggest some increase in automobile and steel output, but new car sales and department store volume fell back somewhat from the high levels of the previous month. Among the more forward-looking indicators, the latest surveys of business spending plans for the first quarter of 1963 pointed to some reduction in expenditures for new plant and equipment and to some slowing-down in inventory building by manufacturers. On the other hand, new orders for durable goods and private housing starts were maintained at advanced rates in November. Of course, discussion about the prospects for a tax cut continues to loom large in the business outlook.

RECENT DEVELOPMENTS

The index of industrial production remained at 119.5 per cent of the 1957-59 average in November, and thus continued to mark time at about the high level first reached last July. In contrast to earlier months, the overall stability did not mask crosscurrents but was shared by most major industries. The notable exception was the steel industry, in which ingot production moved up sharply in response to renewed strength in orders placed by automobile manufacturers. In the preceding months, the auto industry had drawn a significant portion of its steel needs from inventories that had been accumulated early in the year. In December, auto assemblies (seasonally adjusted) rose very slightly beyond the average of the past several months, and seasonally adjusted steel ingot production appears to have advanced further.

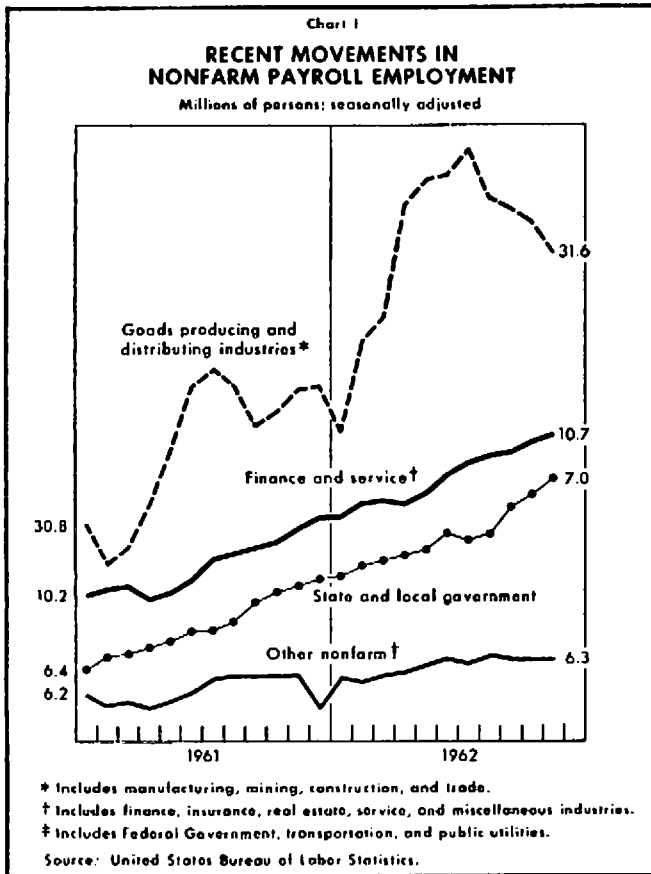
The employment situation has remained virtually unchanged. Indeed, total payroll employment, seasonally adjusted, showed no net change between June and November, the latest month for which payroll data are available. Gains in the service and financial sectors over this period and a particularly sharp rise in state and local government

employment—mainly reflecting the increased hiring of teachers—have been offset by a decline of almost 250,000 in the number of persons employed in the goods producing and distributing industries (see Chart 1). Unemployment climbed to 5.8 per cent of the civilian labor force in November, largely because many teen-age students were apparently unable to find part-time jobs before Christmas. Weekly data on unemployment insurance claims filed through mid-December suggest little change after seasonal adjustment in unemployment during that month.

Recent developments in the key demand sectors have been mixed and show little in the way of a clear trend. Consumer spending, which had picked up with the introduction of the new auto models in October, continued to boost the economy in November, as retail sales rose by over 2 per cent to an all-time high. The November increase, moreover, was achieved despite some lessening in the pace of auto sales following the bunching of deliveries in October. Sales gains among retailers other than automobile dealers were widespread, with seasonally adjusted department store sales reaching a record level. In December, however, department store volume fell slightly short of registering its usual Christmas surge; nevertheless, sales bettered the year-ago level despite the newspaper strikes in New York and Cleveland. The number of new cars sold in December (seasonally adjusted) was somewhat below the extraordinary pace that had been set in recent months by the 1963 models, but held fairly close to the average sales rate for the whole of 1962.

Business spending has not shown much buoyancy. To be sure, the recent Commerce Department-Securities and Exchange Commission survey, taken in late October and early November, suggested a higher level of capital expenditures in the second half of 1962 than had been projected earlier. However, plans for the first quarter of 1963 point to a 2 per cent decline in plant and equipment outlays from the projected fourth-quarter rate, largely because of anticipated cutbacks by durable goods manufacturers. If this decline materializes, it will be the first since the second quarter of 1961 when the economy was just pulling out of the recession.

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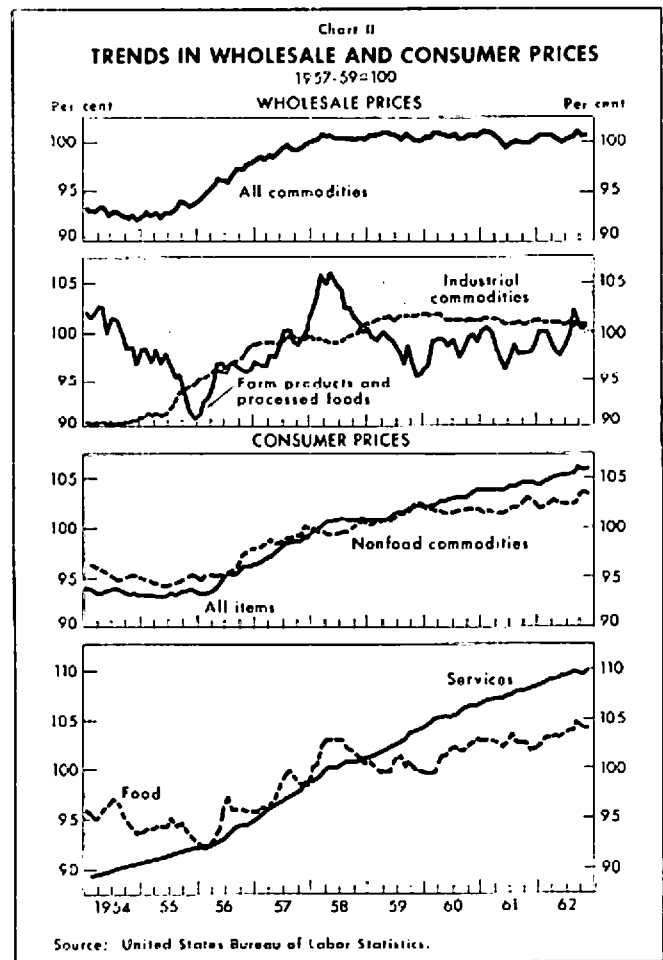
STABILITY IN PRICES

Price changes during the past year were rather moderate. Despite some increase in farm prices during the year, aggregate wholesale prices at the end of 1962 were virtually unchanged from a year earlier; indeed, such prices have hovered within a very narrow range since the beginning of 1958 (see Chart II). In the consumer sector, prices through November 1962 had increased slightly more than in 1961. The larger rise, however, was primarily attributable to food prices, rather than to those components of the over-all consumer price index which are more sensitive to general business trends.

The stability of wholesale prices during a period of economic advance of course reflects in part the more intense competition resulting from the failure of demand in this country to approach productive capacity. Other factors have also contributed to a more competitive climate, with competition from foreign producers, in particular, remaining strong, even though in the past two years prices

direction of change in capital expenditures in only three quarters since 1953. However, the recent survey may have been taken too soon to reflect fully the improvement in business sentiment that developed toward the end of October. Furthermore, recently developed investment plans—including some of those stimulated by the new investment credit legislation and the revised depreciation schedules—may not be reflected in actual disbursements until later in 1963. Thus, even if a dip in capital outlays does develop in the current quarter, it would not necessarily preclude achievement of an increase in capital spending in 1963 as a whole, as projected by the McGraw-Hill survey taken a month earlier.

Manufacturers' sales expectations and plans for inventory investment show a pattern rather similar to that for plant and equipment. Although the overhang of steel inventories has been pretty much worked off, manufacturers, according to the November Commerce Department survey, expected their inventory investment to increase only slightly in the fourth quarter and then to slip back somewhat in the current quarter. These plans appear to be closely geared to the expected trends in manufacturers' sales.



in other major industrial nations have risen more than in the United States. Increased competition has also played a role in the recent slowdown in the rate of increase in wages, which in turn has helped to hold down upward pressures on prices. Collective bargaining agreements negotiated last year in manufacturing industries tended to provide smaller increases than were obtained in earlier contracts. Since productivity also rose during the period, direct wage costs per unit of output remained virtually unchanged in 1962, and indeed at the end of the year were no higher (and possibly slightly lower) than the level reached more than five years earlier at the peak in business activity in 1957.

Among the important components of the price structure that are not greatly affected by cyclical changes in business activity are the prices of consumer services. These prices, which account for more than one third of the total consumer price index, have been rising continuously, in part because of the steady shift in demand to the service sector. In addition, productivity gains in many service sectors appear to be relatively hard to achieve or at least to measure. It is noteworthy, however, that even in this area price rises in most of the recent months have been more moderate than they had been for some time.

To some extent, furthermore, the magnitude of the rise in service prices over the postwar period is probably overstated because of the special difficulties of taking improvements in the quality of services into full account. For example, while the "medical care" component of the consumer price index has shown a much more rapid rate of advance than most other "service" components of the index, the price equivalent of higher quality medical care is exceedingly difficult to define, much less to measure.

Farm prices in recent years also have been largely insensitive to the over-all level of business activity. The chief cause of these fluctuations in the aggregate level of farm prices seems to be the livestock cycle. During the two upswings in general business activity preceding the present one, from mid-1954 to 1956 and from early 1958 to 1960, the timing of the livestock cycle brought to market a large increase in the supply of cattle and hogs and thus drove down food prices at both the wholesale and retail levels, offsetting rising prices for manufactured goods. In the current upswing, however, livestock production has stabilized at a fairly high level. As a result, wholesale prices of farm products and processed foods on balance have dipped only slightly since the business upswing began in early 1961, and retail food prices have risen. Food prices in general were stronger in 1962 than in 1961, reflecting increases in meat prices and continuing uptrends in cereal and bakery product prices.

Prices of goods other than food have not shown the sizable increases in the current business expansion that occurred in previous postwar upswings. Retail prices of nonfood consumer goods, to be sure, have risen somewhat since the upturn began (in February 1961), but the increase has been less than in the comparable period of the preceding economic expansion. At the wholesale level, moreover, industrial commodity prices (i.e., wholesale prices other than farm products and processed foods) have changed little since the last recession trough, in contrast to a mild rise in the previous cyclical expansion and a considerable advance in the 1954-57 upswing. In all major categories, industrial wholesale prices are currently below their peak levels of the late 1950's.