

The Business Situation and Recent Price Trends

Buoyed by the economy's appreciable gains in December and in the fourth quarter as a whole, business sentiment in the early weeks of 1964 was almost uniformly optimistic. Most observers felt that these gains and the absence of speculative inventory accumulation in the current upswing, together with the stimulus of a prospective tax cut, would provide a firm basis for a fourth consecutive year of expansion. The achievement of so sustained an advance would be truly impressive, having no post-World War II parallel.

The stronger note on which 1963 closed carried gross national product to \$600 billion in the fourth quarter, with the rise from the previous quarter being the largest in two years. The gains recorded in December contributed importantly to this outcome, as retail sales surged to all-time highs and industrial production and employment advanced further. Moreover, economic activity seemed to be continuing at a high level in January.

Favorable appraisals of business prospects were thus based on both the recent strength of the economy and the increasing certainty that a tax cut would shortly be enacted. Indeed, the Council of Economic Advisers suggests that 1964 GNP could amount to about \$621 billion (plus or minus \$5 billion), about 6 per cent higher than in 1963, on the assumption that a tax cut is effective March 1. Such a sizable rise, in the Council's view, might reduce the unemployment rate to about 5 per cent by the end of the year. Despite the possibility that a substantial amount of human resources may continue to be unused, the recent rise in industrial prices, though modest in size, makes it apparent that a close watch of price developments will be necessary in 1964.

INDICATORS OF RECENT ACTIVITY

Industrial production, as measured by the Federal Reserve's seasonally adjusted index, advanced by 0.5 percentage points in December, with small gains spread through most industries. This brought the December-to-December advance in production during 1963 to 7 per cent, compared with a rise of only 3 per cent during 1962.

In both years, most of the gain occurred during the January-July period, partly reflecting in each case the temporary surge in steel output in anticipation of a possible strike. There is no threat of a steel strike in 1964 but, with steel consumption high and still rising, ingot production continued to move up in January. On the other hand, assemblies of new automobiles in the opening month of the year fell off from the very high rate in December, as the industry attempted to bring production more closely into line with expected sales.

In contrast to the rise in production during December, new orders received by manufacturers of durable goods declined for the second consecutive month. The total fall since October amounted to 5 per cent. Most of this slippage was concentrated in the transportation equipment sector, and reflected a sharp decline for the second month in a row in the somewhat erratic series on aircraft orders and a decrease in orders for motor vehicles and parts. (The statistics for the motor vehicles series largely represent manufacturers' shipments of new cars to dealers rather than orders for future production.) Total new orders for durables excluding those for transportation equipment remained about unchanged in December.

Total employment rose substantially in December and the number of persons on nonagricultural payrolls increased by 182,000, reflecting gains in the government, service, and construction sectors as well as in manufacturing. Over the past year as a whole, total employment grew by 1.1 million persons but, with the labor force rising by about the same amount, there was no net reduction in unemployment. Thus, the over-all unemployment rate—although down from 5.9 per cent in November to 5.5 per cent in December—was unchanged from a year earlier. There was a small net decline over the year in unemployment of adult men, but this was offset by an over-the-year rise in joblessness among teen-agers.

Perhaps the brightest note in December was the strong support coming from the consumer sector. Following a relatively sluggish performance from August through November, retail sales jumped substantially in December.

A part of this rise, to be sure, reflected a recouping of sales lost in November, owing to the assassination of President Kennedy and also the later than usual date of Thanksgiving. But the very fact that Christmas shoppers indicated a desire to catch up seems to have removed many of the doubts about the underlying strength of consumer buying intentions. Weekly figures in January suggest that total retail sales remained at about the high December level, on a seasonally adjusted basis, despite a slackening in the pace of automobile sales from the very high December rate. Even with this decline, dealers were still selling the new models at weekly rates high enough to suggest that seasonally adjusted annual rates of sales exceeded 7 million units.

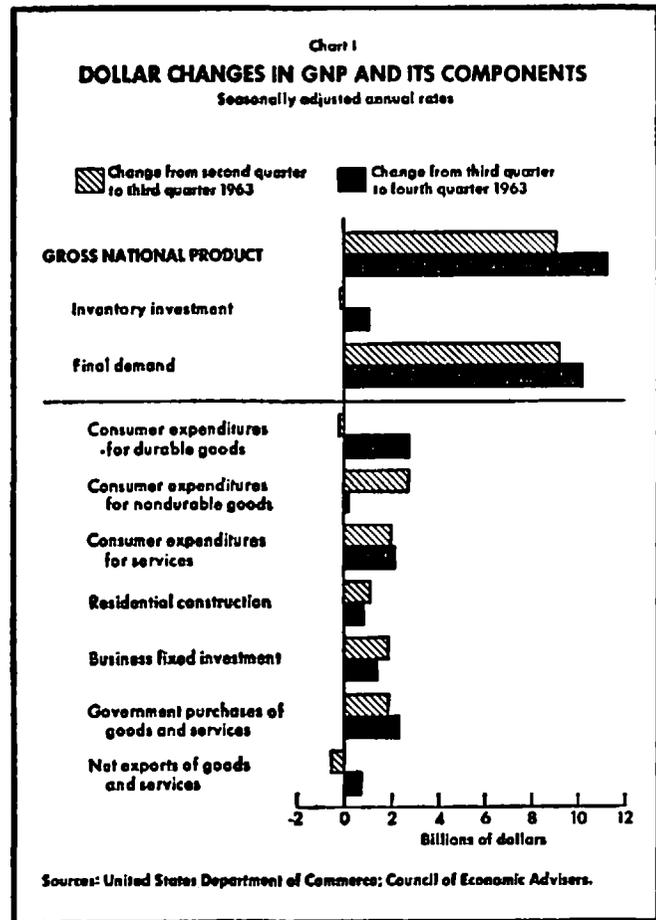
Residential construction in the closing months of 1963 was at record levels, with December only fractionally below the high November rate. Indicators of future activity point to continued strength in the months ahead, as housing starts edged upward in December while new permits jumped to record levels.

Partly as a result of the year-end surge in consumer buying, GNP in the fourth quarter rose by \$11.3 billion (seasonally adjusted annual rate, Council of Economic Advisers estimate)—a somewhat larger advance than in the previous quarter (see Chart I). Although there was some step-up in the rate of inventory accumulation, most of the fourth-quarter gain came in final purchases, with outlays for consumer durables providing the largest push. Government purchases of goods and services also rose appreciably, as the military pay rise boosted Federal spending and as state and local government expenditures continued upward. Outlays for residential construction and business fixed investment also rose, although less than in the third quarter; and increased United States exports, together with a slight decline in imports, contributed to an advance in the "net exports" component of GNP.

With the gain in the fourth quarter, GNP for the year as a whole reached \$585 billion, 5.4 per cent above the 1962 level. From the fourth quarter of 1962 to the fourth quarter of 1963, the rise was even larger, amounting to 6.2 per cent. Price rises accounted for some of the advance on either basis, but more than two thirds of the increase reflected a gain in real output.

RECENT PRICE TRENDS

The absence of strong upward price movements through a three-year expansion is certainly encouraging, particularly when contrasted with the experience of the early and mid-1950's. Nevertheless, prices have continued to rise modestly in an irregular pattern, and continuation of



a reasonable degree of stability cannot be taken for granted. Moreover, further gains in business activity, which would tend to reduce excess manufacturing capacity, could leave the economy more vulnerable to inflation. Awareness of the danger has led President Johnson to reaffirm his predecessor's wage-price "guideposts" and to institute an "early warning system" for detecting prospective price and wage increases.

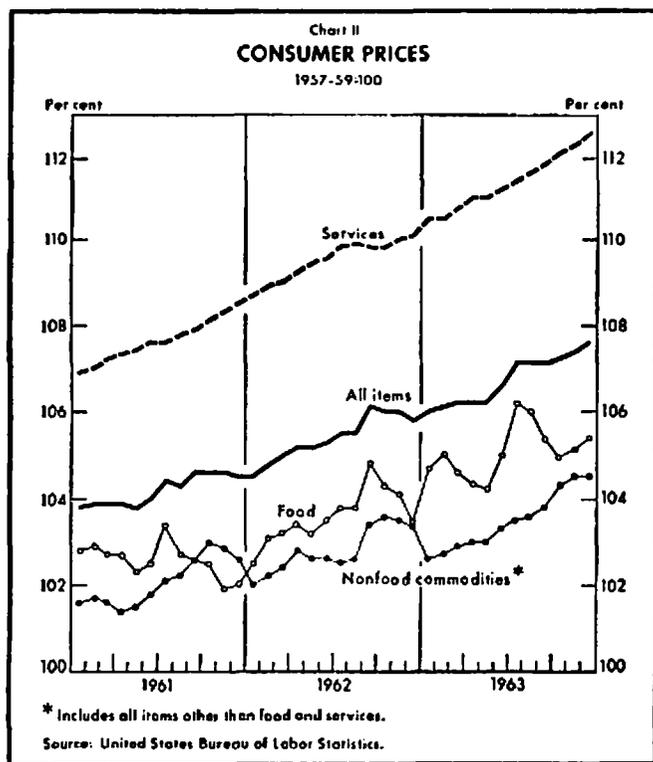
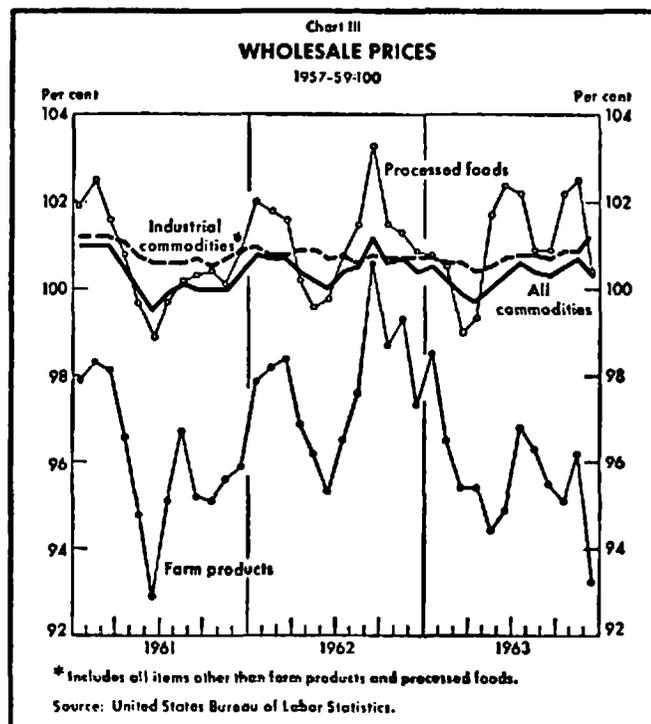
Last year's price movements included another rise in the Consumer Price Index, as now computed, with the December figure 1.7 per cent above its year-earlier level.¹ The increase was somewhat greater than in 1961 and 1962, though about equal to the advances registered in

¹ The Consumer Price Index, like other important economic statistics, is updated and refined from time to time. A revised series is due shortly; among its major changes will be weights based on urban spending patterns in 1960-61 rather than 1950, and reflecting budgets of single persons as well as of families.

each of the three preceding years. Prices of services, food, and nonfood commodities all rose a bit more last year than in 1962, with the largest advance—as usual—coming in the service category (see Chart II). At the wholesale level, the over-all price index showed virtually no net change on a December-to-December basis, as a drop in farm product prices offset a modest 0.5 per cent increase in the average price of industrial goods (see Chart III). Within the year, however, wholesale prices declined slightly through mid-April, and then turned moderately upward—reflecting price boosts in the spring and fall.

INDUSTRIAL COMMODITIES. The wholesale index for commodities other than farm products and processed food has fluctuated within a remarkably narrow range since the late 1950's. In December 1963 this measure was a shade below its level of four years earlier, but slightly higher than at the end of 1962, because of a moderate updrift after early spring.

This strengthening of wholesale industrial prices over the last two thirds of 1963 was clearly associated, at least in part, with the continuing business expansion. As slack capacity was gradually being taken up and demand strengthened, producers of certain important items were



able to make price increases "stick", while others could reduce or drop discounts from list prices. Thus, prices were boosted in either the spring or early fall for such heavily used steel mill products as sheet, strip, bars, and plates, with the over-all steel industry index advancing by about 2 per cent. At the same time, higher steel production apparently helped reverse the previous downdrift in steel scrap prices, which had partly reflected reduced use of scrap per ton of steel manufactured. In the aluminum industry, ingot prices—after tending downward for several years as a result of severe competition and slackened demand—recovered some ground last October. Prices of other nonferrous metals also strengthened noticeably in 1963, with lead and zinc hikes reflecting growing demand and a removal of the drag exerted by previous high levels of inventories.

Prices of metals and other industrial commodities are of course very closely related to world market conditions. The continuing growth of industrial production in Western Europe and other major manufacturing centers over the last few years, combined with the sustained United States expansion, appears at long last to have brought demand for primary goods into closer balance with supplies, after years of actual or potential surplus. Tin production, for example, has failed to expand sufficiently during the last

half decade to match a rapidly rising world-wide industrial demand. In spite of new techniques that economize on tin, the previously accumulated stockpiles of the metal, including those of the International Tin Council, have been drawn down gradually so that tin prices have now come under increasing upward pressure. In 1963, the tin price reached a high not matched since early in the Korean conflict.

Last year's moderate rise in industrial prices was not limited to metals. Increases were registered also for certain types of machinery and construction materials as well as for other goods. Moreover, several announced rises for industrial products have just taken effect or are scheduled to take effect shortly, and hence have not yet been reflected in the available statistics. On the other hand, some price hikes could not be maintained—among them two recent attempts to boost further the price of aluminum ingot—and declines such as those registered by fuels, leather, and chemicals were by no means uncommon in 1963. The maintenance of prices for new car models at essentially the levels prevailing in the previous year and the apparently widespread practice among fabricators of absorbing increases in their material costs also contributed to the relative over-all stability of industrial prices. At the retail level, increases occurred for apparel, newspapers, and cigarettes—although higher sales and excise taxes were a factor in some instances, along with higher manufacturing costs.

There is always a question whether cyclical changes are faithfully reflected in the wholesale index. Company reporting on price discount practices may at times be less than complete, particularly when salesmen and buyers are given some discretion in negotiating these arrangements. The Bureau of Labor Statistics uses a variety of survey techniques to ascertain at what prices transactions are actually consummated, but it is doubtful that even the most refined methods provide a full solution. Thus, the index may not reflect the direction of unrecorded short-run adjustments in actual transaction prices, which would of course be upward when demand increases relative to supply and downward when the opposite condition holds. With a gradual fading-away of the "buyer's market" in a number of lines, unreported changes may in recent months have led to an understatement of actual price rises.

FARM PRODUCTS AND FOOD. The wholesale farm products index—which moved downward after early 1958 but turned moderately upward in 1962—resumed its decline in the past year. The downdrift in 1963 was mainly due to a substantial easing of livestock prices. Indeed, movements in meat-animal prices have been a prime influence

on the course of the wholesale farm products (and processed foods) index over much of the postwar period. These changes have in turn been associated with livestock production cycles, which are fairly independent of general business conditions. In early 1958, when the low points in the cycles of cattle and hog production coincided and fewer animals were marketed, farm product prices reached a peak. Since then, livestock prices have generally trended downward, with most of the decline occurring in 1958-59. This movement was interrupted, however, in the third quarter of 1962, when many farmers temporarily withheld animals from slaughter. Partly in reaction to this development, marketings subsequently rose and prices again declined.

In contrast to the farm products index, wholesale prices of processed foods—although easing a bit in early 1963—were close to their year-earlier level in December. At retail, prices of food consumed at home, which tended moderately higher in 1961 and 1962, showed a further net rise last year. Declines for meats and several other items were more than offset by higher prices for fruits and vegetables, baked goods, and sugar. Restaurant meals—which contain a large service element—continued their long-term uptrend.

Price gyrations of one single commodity—sugar—have recently had a significant influence on the wholesale and retail food indexes. The price of raw sugar advanced very strongly in April and May, mainly reflecting tightened world supplies associated with poor beet crops in Western Europe and reduced availabilities from Cuba. The price increase in the raw material spread to the refined product and to such sugar-using items as canned and frozen fruits, beverages, and confectioneries. Sugar prices subsequently experienced wide fluctuations, with a downward influence from an unusually high domestic beet crop and further upward pressure from hurricane damage to Caribbean cane. As of mid-December, they were substantially higher than a year before but somewhat below their May peak.

CONSUMER SERVICES. The index of consumer service prices has continued the seemingly inexorable climb that has characterized its postwar history. Although the annual rate of advance dropped to less than 2 per cent in 1961 and 1962 from the 3 per cent average registered in the 1952-60 period, the pace last year was again somewhat steeper, with the over-the-year increase to December reaching 2.3 per cent.

Nevertheless, there is little in the past year's experience to suggest the likelihood of a renewed and prolonged acceleration of service price rises. A good part of the step-up was in transportation services, which resumed their 1960-

61 rate of increase after an unusually small advance in 1962. The main influence here was the cost of auto insurance, which declined in 1962 when many persons first became eligible for lower "merit" rates but rose again last year, perhaps partly as a result of some large accident awards made by the courts. Although greater price rises were recorded in 1963 for several other services, such as dry cleaning, increases in costs of medical care and rent again slackened, as they had for several years.

THE FUTURE. Prospects for further general price stability depend largely, of course, on such underlying elements as world market trends in primary products and movements in the rate of capacity utilization, productivity, and wages and salaries. The outlook for raw material prices is mixed. Prices of metals and selected foodstuffs may rise further; coffee prices have already moved upward following the frost and drought damage to the Brazilian crop. Nevertheless, a wide range of key materials—including many foodstuffs and fibers—have been and are likely to remain in ample supply. As regards the utilization of productive resources in this country, factory output is still significantly below capacity levels, but the available measures indicate that some decrease in the gap occurred during 1963. Recent surveys, moreover, suggest that operating rates were fairly close to preferred rates in several

individual manufacturing sectors, notably the textile, paper, and aluminum industries. A further expansion with concomitantly higher operating rates could strengthen tendencies toward higher prices.

It is, of course, desirable—indeed necessary—that further movements toward fuller use of the economy's resources will be achieved while keeping price rises in check. Some developments of recent years give cause for encouragement in this regard. Thus, strong import competition has placed restraints on upward price adjustments of domestic producers, and will most likely continue to do so. In addition, manufacturing output per man-hour has risen at an accelerated pace since the beginning of 1961, thereby helping to offset wage increases, which in turn have been relatively more moderate than in most of the earlier post-war years. The acid test will, of course, be the actual wage and price changes that may follow this year's important labor negotiations in such industries as automobile manufacturing, meat packing, and East Coast stevedoring.

Price stability is required not only to protect the domestic purchasing power of the dollar but also to strengthen the international competitiveness of the United States and thus improve the balance of payments. The progress achieved thus far toward price stability in a period of business expansion has been encouraging; the country should aim to do as well or better in 1964 and beyond.