The Business Situation

Economic activity was continuing to expand as the first quarter drew to a close, and business sentiment remained confident of substantial further gains in the months ahead. Industrial production inched ahead in February, payroll employment rose considerably, and average hours worked recovered to the advanced December level. Although still high, the unemployment rate edged down in February to its lowest point in over a year and was maintained at that rate in March. Retail sales appear to have fallen off somewhat from their record February level, while preliminary production data for March are somewhat mixed.

One key factor in the current strong business outlook is the prospect for capital spending. Expanded capital spending programs have recently been announced by several large firms, and—according to the latest Government survey—businessmen as a group plan to increase their outlays for plant and equipment by 10 per cent in 1964. This figure confirms (indeed, slightly exceeds) the year-to-year increase in planned spending reported by McGraw-Hill following a special survey taken in January.

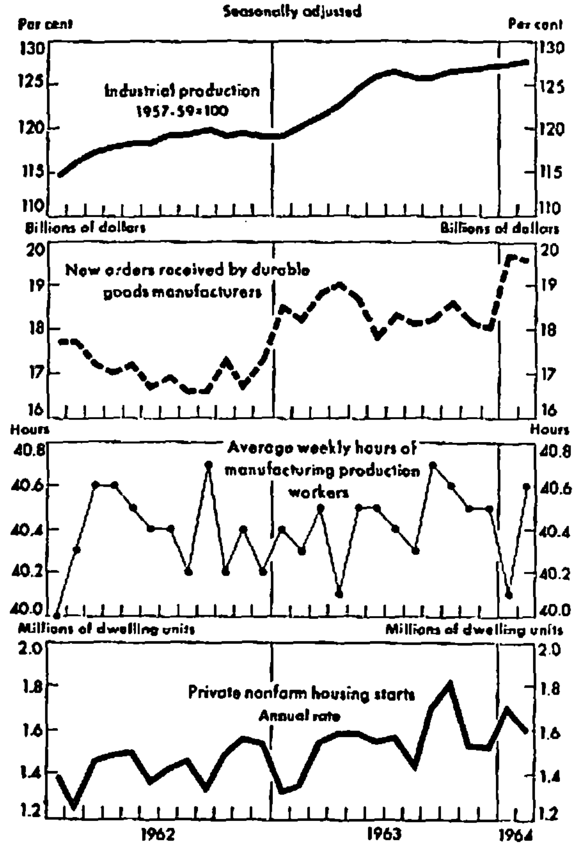
Manufacturers' inventory plans for the second quarter call for a rate of accumulation higher than in the first qua ter and about the same as achieved in the final quarter of 1963. Although new orders received by durables manufacturers in February only about matched their January record, they were still above sales, so that the backlog of unfilled orders rose for the second month in a row.

Price-wage developments thus far in 1964 have continued to be highlighted by a number of announcements of price increases for certain industrial commodities, as well as by preliminary discussion of bargaining positions to be taken in key labor negotiations later in the year. Developments in these areas will clearly bear close watching in a generally expansionary economic environment. As in 1963, however, movements in the over-all price indexes have been moderate; indeed, the over-all consumer price index actually edged downward in February. Wholesale food prices fell off in February and apparently were about unchanged in March, while the index for industrial wholesale prices has remained stable since December.

Chart I

RECENT BUSINESS INDICATORS

Seasonally adjusted



Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

PRODUCTION, EMPLOYMENT, AND RETAIL SALES

The Federal Reserve Board's seasonally adjusted index of industrial production edged upward in February to a record level of nearly 128 per cent of the 1957-59 average (see Chart I). A strike in the farm machinery industry during most of February caused a decline in equipment production, and mining output also fell slightly. These decreases, however, were more than offset by relatively sizable gains in automobile assemblies and iron and steel production, combined with somewhat smaller increases in output of nondurables manufacturers and utilities. With dealer inventories of new cars at a record level, preliminary data for March, after making allowance for seasonal factors, suggest that automobile producers are cutting back assemblies somewhat from their exceptionally high February level. Steel ingot production, on the other hand, remained as strong in March as in February. The outlook for additional increases in over-all industrial production was strengthened by the continued advance in February in the backlog of unfilled orders held by manufacturers of durables. Although the volume of incoming new orders actually slipped a bit in February, it was still at the second highest level on record, with the January-February average for new orders well above the level reached in the final quarter of 1963 (see Chart I).

Nonfarm payroll employment rose by 280,000 persons in February (seasonally adjusted). This gain, the largest in nearly two years, in large part reflected a substantial rebound in construction employment following a January decline. At the same time, however, employment in all other major sectors save mining showed some increase in February. In the manufacturing sector, for example, payrolls rose by 55,000 persons, while the average workweek clocked by production workers moved up to 40.6 hours (seasonally adjusted). This increase raised the average workweek once more to the high level that, except for January, has prevailed in the last six months (see Chart I). Hours of overtime are reportedly above the year-ago level in many manufacturing industries, and it is possible that further output gains may to an important extent be translated into increased hirings. Such a development, of course, would tend to reduce unemployment, which according to the Census Bureau's household survey edged down to 5.4 per cent of the civilian labor force in February and remained at that level in March. This rate is at the lower end of the range of unemployment that has prevailed during the past two years. The decline from January reflected small but rather widespread improvements among the various groups in the labor force; in particular, unemployment among married men edged down, and teen-age unemployment reached its lowest level in over a year.

Retail sales increased substantially in February, with most of the push coming in sales of durables. Preliminary data suggest a possible drop in over-all retail sales volume in March, though there have been reports of good pre-Easter sales of apparel and other spring merchandise. The tax cut affected consumer take-home pay during the month, since it went into effect with the first pay checks received on and after March 5, but it is too early to appraise the impact of this factor on retail sales. Furthermore, the variability of the date of the Easter holiday always makes assessment of sales figures at this time of the year somewhat difficult.

Despite what appears to have been a slight decline in March, sales of domestically produced cars for the first quarter as a whole were at a seasonally adjusted annual rate of about 7.8 million units—a level somewhat above the pace that most manufacturers had forecast. With auto sales already at such high levels, some observers have expressed skepticism as to the possibility of substantial further gains even with the tax cut. Nevertheless, a Census Bureau survey of consumer buying intentions taken in January showed that plans to purchase new cars within the next six months, and within the next twelve months, were both higher than at the start of 1963 (see March *Review*). The results of the latest University of Michigan survey of consumer buying attitudes—conducted about the same time as the Census Bureau survey but covering a different (and smaller) sample of households—suggest that consumers generally regarded the next six months as a good time to buy. The Michigan survey also indicated, however, that plans to purchase new cars within twelve months were noticeably lower than a year earlier—a result at variance with that of the Census survey.

RESIDENTIAL CONSTRUCTION AND INVENTORIES

Activity in the housing sector has continued at a high level, as residential construction outlays edged up for the third month in a row in March. For the first quarter as a whole, outlays were 1 per cent above the advanced level reached in the fourth quarter of 1963. Although housing starts fell off by 6 per cent in February (see Chart I), the average for the first two months of this year was actually above that in the final quarter of last year—a quarter that included a record level of starts in October. Some further gain in outlays may therefore be in prospect, a view supported by a sharp rise in the number of new building permits issued in February.

As regards business inventories, a Commerce Department survey taken in February suggests that manufacturers planned an inventory increase of only $300 million in the first quarter of 1964, a substantial drop from the $1 billion recorded in the last quarter of 1963. Plans for the second quarter, however, call for an accumulation once again of $1 billion. These planned additions to stocks are about in line with manufacturers' sales expectations, and point to a second-quarter inventory-sales ratio that is virtually the same as that prevailing at the end of 1963—a level that manufacturers holding 85 per cent of the inventories covered in the Commerce survey judged to be about right. Except for a good part of 1962, manufacturers' inventory-sales ratios have declined rather persistently throughout the current expansion. Earlier cyclical expansions, in contrast, showed some recovery in inventory-sales ratios following an initial period of decline.

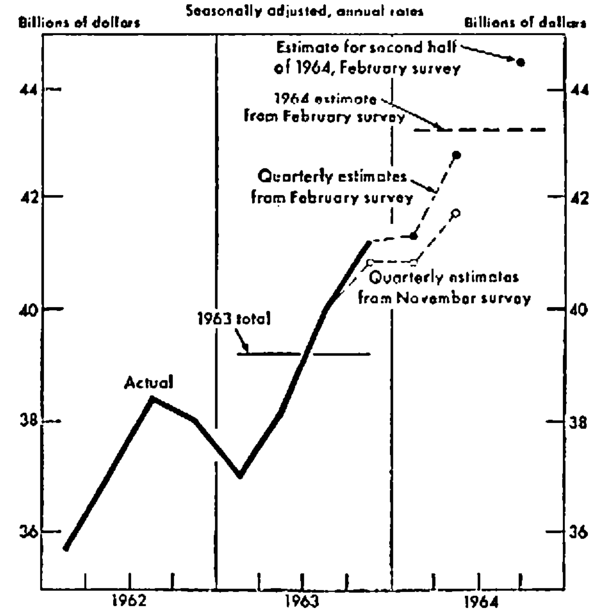
CAPITAL SPENDING

The economic outlook has received a major boost from evidence of developing strength in businessmen's capital spending plans. The February Commerce Department survey (undertaken jointly with the Securities and Exchange Commission) points toward a rise in plant and equipment

Chart II

ACTUAL AND ANTICIPATED PLANT AND EQUIPMENT SPENDING

Seasonally adjusted, annual rates



Sources: United States Department of Commerce; Securities and Exchange Commission.

outlays in 1964 that is larger in both absolute and percentage terms than any of the actual annual gains since the advance recorded in the investment boom year of 1956. A special McGraw-Hill survey taken in January already had confirmed that spending plans had been revised upward substantially since first reported last fall, and these findings are now reinforced by the 10 per cent rise shown in the Government survey.

Actual spending in the fourth quarter of 1963 turned out to be somewhat higher than had been indicated in the Government's survey taken last November (see Chart II). A similar upward revision is evident in the estimated level of spending for the first quarter of this year, but this revision still implies little change over the fourth-quarter level. Plans for the second quarter of 1964 call for an increase in outlays of nearly \$1.5 billion, or 3½ per cent over the first quarter; and, if the projected full-year total is to be reached, outlays in the second half of 1964 will have to climb about 6 per cent above the first-half average. The record of this survey in previous years suggests that plans reported at the beginning of the year are in large part carried out—indeed bettered in years of business expansion. The understatement in the February survey was, however, rather small for 1962 and 1963.