

The Business Situation

As the economy moves into the seasonally active spring months, the prospects remain good that further business gains will extend the duration of what is already the longest expansion since the Korean War. Industrial production and nonagricultural employment both advanced further in March in an economic atmosphere that remained essentially free from inflation. Indeed, broad price measures have remained virtually steady in spite of a recent upturn of some sensitive materials prices. For the first quarter as a whole, total output of goods and services reached a seasonally adjusted annual rate of \$608.5 billion, higher than had generally been expected. Retail sales apparently edged off again in April, but both steel ingot production and automobile assemblies recorded considerable gains. Business sentiment, as reflected in plans for capital spending, continues to be optimistic: the regular spring McGraw-Hill survey reports a 12 per cent rise in planned capital outlays this year, slightly more than the increases reported by surveys taken earlier this year.

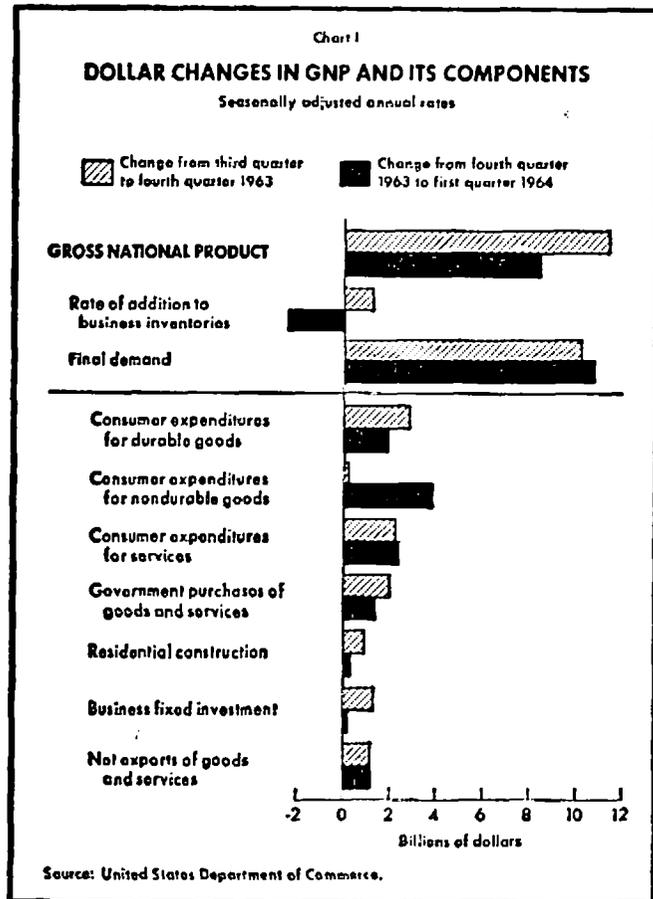
The recent settlement of the long railroad industry dispute has removed one of the major uncertainties in the economic outlook. Other important labor negotiations, however, still lie ahead—most notably in the automobile industry in August—and their results will have an important influence on the outlook for price stability and on the pace of economic advance. With a generally expansionary economic environment, there will be a continued need for businessmen and labor unions to exercise restraint in wage and pricing decisions.

RECENT DEVELOPMENTS IN KEY DEMAND SECTORS

Gross national product rose by \$8.4 billion in the first quarter of 1964, according to preliminary estimates of the Department of Commerce (see Chart I). This gain was only a little less than the sizable increases in the last two quarters of 1963. In fact, final demand—the rate at which business, government, and consumers purchased newly produced goods and services for purposes other

than inventory accumulation—registered its sharpest advance since late 1961 when the economy was still in the initial phase of the cyclical upswing. The slight slowdown that did occur in GNP growth thus reflected a decline in the rate of inventory accumulation, implying a continued tight alignment between stocks and sales.

Consumer spending accounted for most of the strength in final demand and registered its largest quarterly upsurge since the first quarter of 1951 (during the Korean



War). Automobile sales, after allowing for seasonal variation, climbed only slightly from the very high rate that had prevailed in the fourth quarter of 1963, but consumers spent quite heavily on appliances and furniture and also increased substantially their outlays on nondurable commodities such as apparel. Most of this rise in spending reflected the continued advance in consumers' disposable incomes, but the proportion of income spent on consumption also rose. The push in consumption came largely before the tax cut started to go into effect in the first week in March: retail sales during that month actually fell off a bit from their record February pace. Retail sales volume may also have edged downward in April—though the problems of adjusting the figures for the earlier than usual date of Easter make it difficult to assess the underlying trend of sales during the last two months. In any case, too much significance should not be attached to minor variations in the retail sales series, which tends to fluctuate erratically from month to month.

The government spending component of GNP also moved up somewhat in the first quarter, although the increase was a little smaller than in the preceding two quarters. The Federal Government's purchases of goods and services for national defense purposes rose at an annual rate of only \$200 million. Defense outlays are scheduled to show a somewhat larger increase in the current quarter, but there are indications that such outlays for the fiscal year as a whole may fall short of the total projected last January.

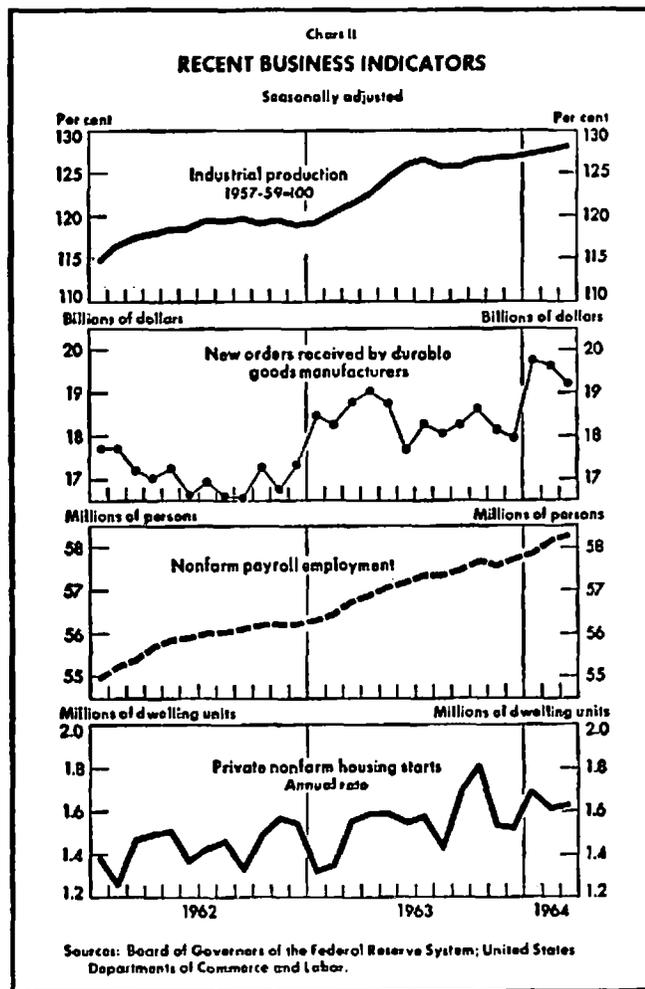
Outlays for residential construction, after a sharp rise in the last three quarters of 1963, showed only a very slight gain in the first quarter. Even this small increase, however, was contrary to the expectations of those observers who have been predicting an end to what is the longest building boom since World War II. Moreover, the high level of housing starts throughout the first quarter suggests that residential construction outlays may be well sustained in the months immediately ahead.

As had appeared likely on the basis of earlier surveys of capital spending plans, business outlays for fixed investment showed little push in the first quarter. Orders and contract awards in the first quarter as a whole were well above the average levels of the previous quarter, however, suggesting that the advance in capital spending anticipated for the last three quarters of the year may now be in progress. The latest survey of spending plans, conducted by McGraw-Hill in March and April, suggests that manufacturers, particularly auto firms, have raised the total of their planned outlays for 1964 even above the intentions expressed at the beginning of the year. The McGraw-Hill survey points to a 12 per cent rise in

over-all plant and equipment expenditures this year, compared with the 10 per cent gain indicated by the Commerce Department-Securities and Exchange Commission survey conducted in February and the 9 per cent rise reported in a special January McGraw-Hill survey. It should be noted that in years of over-all economic expansion the McGraw-Hill spring survey has tended to be on the high side, and the Commerce-SEC spring survey on the low side, of the actual final capital spending figures.

PRODUCTION, EMPLOYMENT, AND PRICES

The Federal Reserve Board's seasonally adjusted index of industrial production edged ahead in March for the sixth month in a row, reaching 128.2 per cent of the 1957-59 average (see Chart II). So far in 1964, total industrial



production has shown only modest gains, in contrast to the substantial increases in the first halves of 1962 and 1963. In both of the past two years, however, anticipations of a midyear steel strike had helped spur the rise in overall output. For most industry groupings, changes in output during March were small. Equipment production, however, moved ahead after two months of decline, a fact that may reflect the start of the anticipated rise in capital spending. Preliminary data for April point to a sharp increase in steel ingot production (on a seasonally adjusted basis), the gain being the largest since April 1963. Automobile assemblies, which slipped somewhat in March after allowing for seasonal influences, also appear to have advanced considerably in April, with producers apparently continuing to be encouraged by reports on dealer sales.

New orders for durable goods edged off for the second month in a row in March. Nevertheless, such orders remained close to the record January high and were still somewhat above durables shipments. The slight backing-away from the January peak in total new bookings probably reflects reduced defense ordering rather than a decline in private orders, which continue to be substantial.

Total nonfarm payroll employment moved further ahead in March and was 1.5 million persons higher than a year earlier, despite a reduction in the number of workers

in the construction and trade sectors. In manufacturing, employment moved up to a total only 200,000 persons shy of the post-Korean War high recorded in 1957, and average weekly hours also increased. The recent improvement in the employment situation has apparently been geographically widespread: only 40 of the nation's 150 major labor market areas were classified as having "substantial labor surplus" (an unemployment rate of 6 per cent or more) in March, compared with 48 such areas a year earlier.

Broad indicators of price developments continue to show no inflationary uptrend. The consumer price index, although edging ahead in March after a February decline, has registered little net increase so far this year. Wholesale food prices have remained about unchanged in March and April after a February decline. Average industrial wholesale prices, moreover, have drifted down very slightly this year, in spite of quite a few price increases in sensitive raw industrial materials. Special supply factors in world markets appear to be a major, although not the sole, factor in explaining the movements in sensitive commodity prices. Nevertheless, any such concentration of price increases underscores the need for paying particularly careful attention to price developments in a period when most observers foresee rapid gains in economic activity.