

The Business Situation

The economy's gradual but solid advance has continued in the past few weeks. Employment, production, and retail sales posted good gains in May, while backlogs of unfilled orders rose to the highest levels since around the end of the steel strike in early 1960. Auto output apparently rose slightly on a seasonally adjusted basis in June, while steel ingot production moved down. Although the unemployment rate rose in June after a sizable decline in May, there has been a distinct improvement in the labor market situation as a whole during the second quarter as compared with the first quarter and with a year ago. Incomplete data on retail sales in June suggest a slight weakening from the May level, underscoring the fact that, although such sales have shown a good gain since the tax cut went into effect, there have been no signs of a rapid surge in consumer spending. Furthermore, the broad price indexes have changed little.

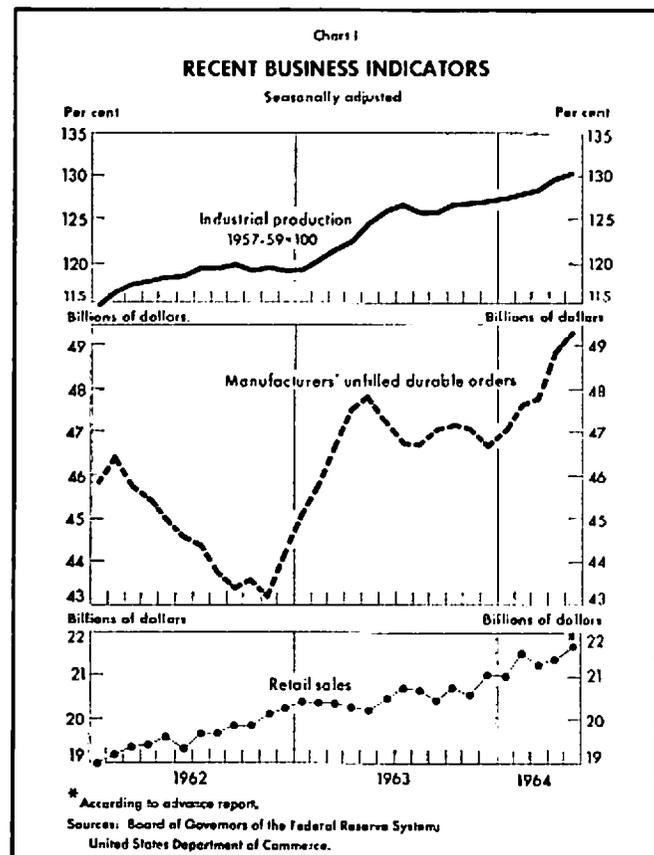
The steady pace of the expansion so far and the most recent showing of several important leading indicators continue to point toward an orderly rise in business activity over the near term. Recent surveys of business plans for capital spending still indicate a substantial gain in 1964, but do not suggest the type of sudden spurt in capital outlays that characterized the 1955-56 investment boom. Businessmen also plan to step up their rate of inventory accumulation over the next few months, but only at a pace well in line with expected gains in sales. At the same time, recent developments in the residential construction industry suggest that demand may have leveled off in that sector of the economy.

PRODUCTION, ORDERS, AND EMPLOYMENT

The Federal Reserve's index of industrial production posted its eighth consecutive monthly advance in May, rising by 0.7 percentage point to reach 130.3 per cent of the 1957-59 average (see Chart 1). The advance brought the over-all gain since December to nearly 3 per cent. This is not so large as the 4.5 per cent rise recorded in the first five months of 1963, but it will be recalled that part of

last year's increase was attributable to the strengthening effects on steel output of fears of a possible midyear strike. The May rise this year was centered largely in materials and equipment-producing industries, although consumer goods output also posted a modest pickup.

In June, steel ingot production declined slightly, but producers in the automobile industry raised the already high rate of automobile assemblies a bit further in an attempt to end the 1964 model run with sufficient inventories for the model change-over period. Seasonal inventory needs have been enlarged this year as a result of



plans by most major producers to make extensive styling changes, which will entail a somewhat longer shutdown period than is usually required. Another factor that may be influencing inventory demand is the imminence of labor negotiations. The present contracts expire at the end of August, and bargaining on new contracts is scheduled to start in July.

The prospects for future strength in production were reinforced in May by the fifth consecutive monthly advance in unfilled orders held by manufacturers of durable goods (see Chart I). The volume of incoming new orders for durables, to be sure, slipped somewhat, but it was still at the second highest level on record. The small month-to-month decline that did take place in May, moreover, largely reflected a slackening in steel orders, which was probably induced by the earlier-than-usual summer shutdown in the automobile industry.

After substantial increases in April and May, total employment fell in June. Large month-to-month movements in this series are not unusual, however, and it is encouraging that for the second quarter as a whole total employment averaged more than 800,000 above the average for the quarter before. The second-quarter increase in the civilian labor force was also quite sizable, perhaps reflecting in part the entrance into the job market of persons who had previously felt that jobs would not be available for them. A more-than-seasonal rise in unemployment among college students and recent college graduates contributed to a 0.2 percentage point rise in the unemployment rate, to 5.3 per cent, in June. The second quarter nevertheless ended with a rate somewhat below the 5.4-5.6 per cent range which prevailed early this year and for much of 1963.

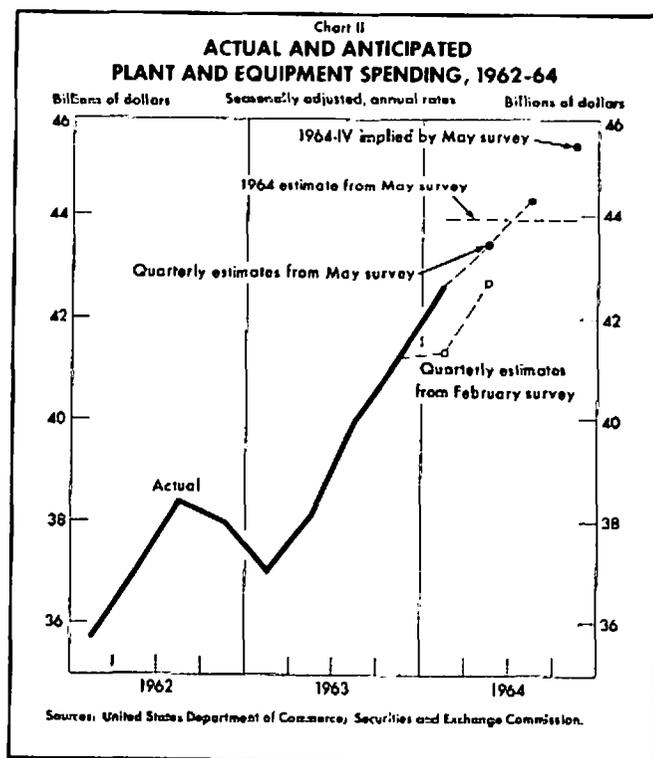
CONSUMER SPENDING AND RESIDENTIAL CONSTRUCTION

Consumer spending at retail outlets registered a good gain in May, moving up by 1.4 per cent to reach a record \$21.7 billion, seasonally adjusted (see Chart I). The May advance, following a small April increase, was largely attributable to a substantial rise in sales of nondurable goods, which had been somewhat sluggish in the previous four months. Sales of durable goods were essentially unchanged in May, despite a slight advance in new automobile sales. Fragmentary data for June suggest that total retail sales may recently have edged off a bit, although automobile sales apparently continued strong.

On the basis of present evidence, the rate of gain in retail sales in the April-June quarter appears to be somewhat less than the January-March advance, despite the fact that the tax reduction was in effect for the entire sec-

ond quarter. The absence of an accelerated gain in sales, however, does not mean that the tax cut has been without an impact on consumer spending. It is quite possible that the considerable strength of retail sales early in the year may have reflected consumer anticipations of the tax cut. Furthermore, it is by no means certain that the tax cut has as yet had its full effect on consumer spending.

In the residential construction sector, activity has continued at a high level but without providing much additional stimulus in recent months. After moving up slightly in April, outlays on housing declined substantially in May and June. Moreover, the recent behavior of leading indicators in this sector does not suggest a renewed upward push in such expenditures for the near future. The seasonally adjusted value of residential contract awards, to be sure, was slightly above April in May, but April had declined markedly below March, so that awards in both April and May were significantly under the first-quarter average. Furthermore, the level of nonfarm housing starts in May was virtually unchanged from April, and the April figure was revised downward to a level distinctly below the first-quarter average. Similarly, the number of new building permits issued in May was about the same as in April, and both months were significantly below the first-quarter average.

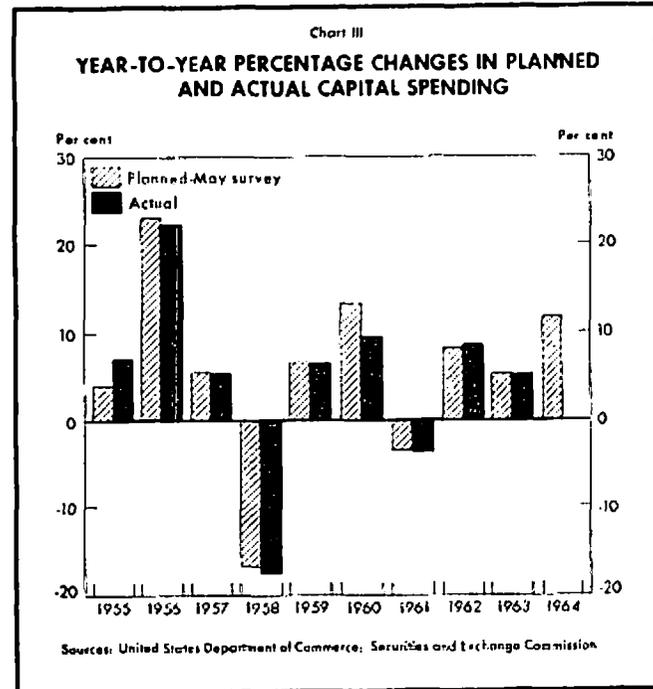


BUSINESS SPENDING PLANS

Recent surveys of businessmen's spending plans reinforce widely held expectations of strong support for the economy from this sector over the balance of the year. According to a May survey by the Department of Commerce, manufacturers plan to add \$700 million to their inventories during the third quarter of this year as against an expected increase of \$400 million in the second quarter. Much of the planned additions to inventories are in the durables sector, where producers are looking forward to a substantial sales gain. Despite anticipations of a stepped-up rate of inventory accumulation, therefore, the expected rise in sales, if realized, will be sufficient only to maintain the inventory-sales ratios of both durables and nondurables manufacturers at roughly the low levels that have recently prevailed, suggesting that over-all inventory policies remain cautious.

In another May survey, taken by the Department of Commerce and the Securities and Exchange Commission, business plans for capital spending in 1964 were reported at a level 12 per cent above 1963 outlays (see Chart II). This increase was somewhat above the 10 per cent advance reported in the February Commerce-SEC survey and was about in line with the rise reported in the spring McGraw-Hill survey taken in March-April. The latest survey, of course, is still not necessarily an accurate forecast; however, in previous years of business expansion—such as 1959, 1962, and 1963—the May survey has proved to be highly accurate (see Chart III).

The upgrading in spending plans for 1964 as a whole in the May, as compared with the February, Commerce-



SEC survey represents in part a substantial (\$1 billion) upward revision in the first-quarter estimate. Planned outlays reported for the second half of the year are about \$0.5 billion higher than had been indicated in the February report but, because of the first-quarter revision, the expected increase between the first and second halves of the year is slightly smaller than had been estimated in February.