

The Business Situation

The economy closed out its fourth full year of sustained growth with activity still moving ahead vigorously. Official tabulations have confirmed that, due to the October-November strikes in the automobile industry, over-all activity registered only a moderate advance in the fourth quarter as a whole, but various monthly and weekly indicators pointed to renewed widespread gains in December and January. Thus, industrial production, payroll employment, and durables new orders were all up strongly in December. Preliminary January data suggest that automobile assemblies were maintained a shade below December's record rate and that steel ingot production continued at the very high December level. Retail sales in January apparently moved past the high mark set in December. The drop in the unemployment rate to 4.8 per cent in January was a most encouraging development.

All major labor disputes in the railroad industry are reportedly settled. However, in a strike that has already had considerable adverse effects, East and Gulf Coast dock workers continue to be absent from their jobs despite contract agreements at most of the ports. The crucial labor-management negotiations in the steel industry are about to be resumed. Meanwhile, despite the late 1964 flurry of announcements of selective price increases, the broad price indicators have continued to show relative stability. Consumer prices rose less in 1964 than in 1963, while industrial wholesale prices last year inched up by just over ½ of a per cent. With the economy operating at a high level, restraint in wage-price decisions will be necessary to avoid a resurgence of the inflationary atmosphere characteristic of the mid-1950's.

One key factor affecting the course of over-all activity during the months ahead will be the actions taken by Congress on the Administration's fiscal 1966 budget and other economic proposals. The proposed Administration budget will stimulate the economy significantly, particularly in the second half of calendar 1965, and would thus serve as a counterbalance to any weakening that might develop in some sectors of demand. Most of the suggested expenditure increase in such areas as education, health, and social wel-

fare would have their initial impact at that time. In addition, an excise tax cut has been proposed, which would amount to \$1.75 billion per year when fully effective.

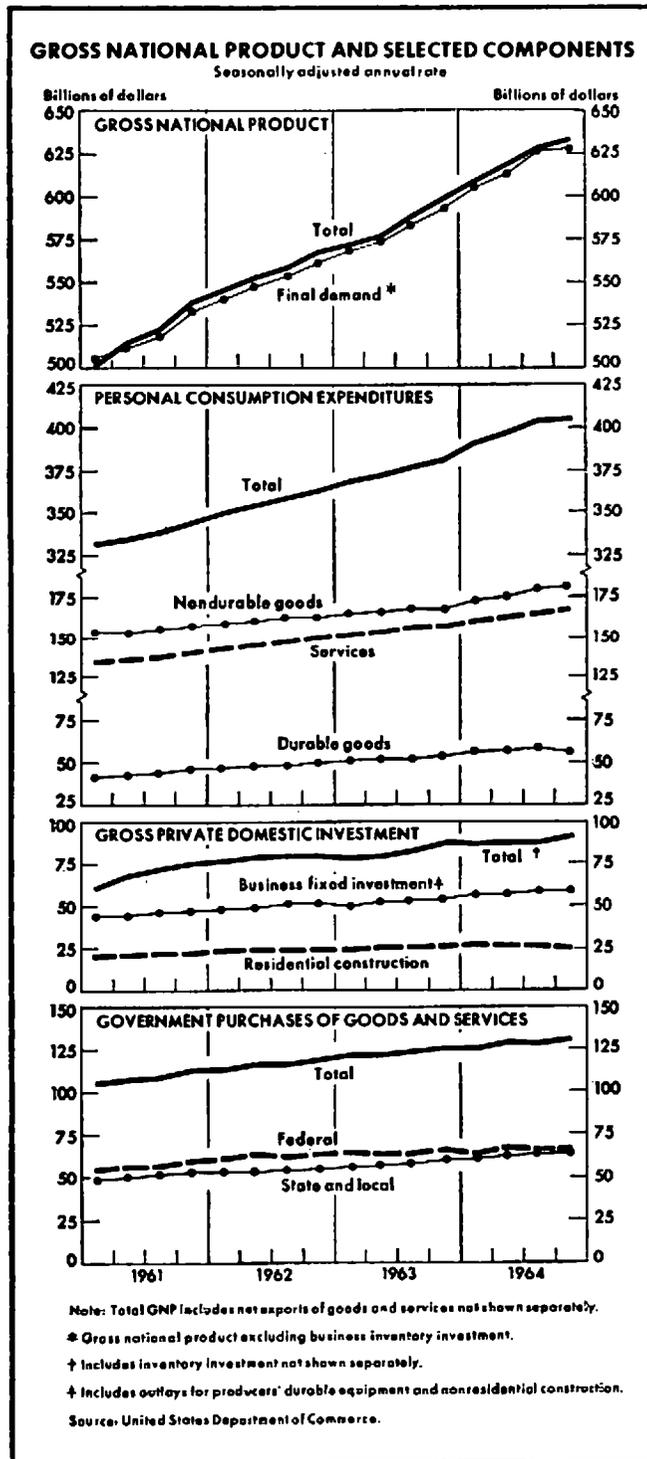
RECENT PATTERNS OF DEMAND

According to the preliminary estimates of the Commerce Department, gross national product in the final quarter of 1964 (measured at a seasonally adjusted annual rate) rose by \$5.1 billion to \$633.5 billion (see chart), bringing the total for the year to \$622.3 billion. This represented a 6.6 per cent increase over the 1963 figure and brought the nation's total output to a level 24 per cent above that prevailing at the start of the current business expansion. As had been expected, the figures for the fourth quarter were depressed, owing to the strikes that took place in the automobile industry in October and November. As a result, the rise in total GNP in the quarter was the smallest since early 1961.

In a reflection of the shortage of the new models in the last several months of the year, consumer spending for automobiles and parts dropped by \$2.9 billion. Consumer outlays for other durables and for nondurables and services, on the other hand, rose by \$4.5 billion in the quarter. With new cars once again in ready supply in dealers' showrooms, automobile sales surged to a record in the final month of the quarter and moved even higher in January. Trade reports indicate a high degree of optimism about near-term auto sales prospects. Moreover, retail sales in general appear to have continued to advance in January, as they did in December (even after allowance for seasonal factors).

The fourth quarter also witnessed the third consecutive quarterly decline in outlays for residential construction. There is, however, some evidence that the downtrend in residential construction activity may have leveled out. In December, nonfarm housing starts rose by 7 per cent, and the dollar value of residential construction contract awards moved up markedly in the final two months of 1964.

Business fixed investment showed an increase in the fourth quarter of 1964, although the gain was estimated to



reflected the enforced partial deferment of truck and automobile buying plans—in many cases involving whole fleets of vehicles—because of strike-induced shortages. With normal supply conditions restored, and with commercial and industrial contract awards up strongly in the final quarter of 1964, the prospects appear bright that capital spending will move to new records in the months ahead.

Government expenditures for goods and services expanded following a very slight third-quarter decline. State and local government spending, up for the tenth consecutive quarter, provided most of the strength, while Federal purchases rose only slightly. Indeed, the average quarterly increase in Federal purchases in calendar 1964 was \$0.2 billion as against a \$0.6 billion average in the 1962-63 period. (Under the proposed budget, the quarterly average advance in purchases of goods and services during fiscal 1966 would be about the same as in calendar 1964. Most of the stimulative impact of the budget arises from projected larger expenditures on social programs that do not involve direct purchases of goods and services.)

PRODUCTION, ORDERS, AND EMPLOYMENT

The Federal Reserve Board's seasonally adjusted index of industrial production chalked up a 2.2 percentage point increase in December, following an even larger gain the month before. This rise brought industrial output to a level 8 per cent higher than at the end of 1963 and 32 per cent above the level that prevailed at the beginning of the current upswing. As in November, a large part of the December increase in total output was attributable to the automobile industry where most workers clocked a considerable amount of overtime in an effort to alleviate shortages of new cars in dealer showrooms. At the same time, however, good gains were recorded by producers of most other consumer goods—there was an especially sharp rise in the output of television sets—while production of business equipment also showed strength. Among the widespread gains in materials output was a further rise in iron and steel production, which brought operations in that industry to near the record rates reached just before and after the long strike in 1959.

The total flow of new orders received by manufacturers of durable goods rose by 6.3 per cent in December, as new orders for motor vehicles and parts and primary and fabricated metals surged forward. Moreover, the backlog of unfilled orders on the books of durable goods manufacturers moved up for the twelfth consecutive month and reached the highest level since 1957. Weekly data at hand for January point to continuing strength in production in that month. Automobile assemblies were again responding

be smaller than those recorded in most of the quarters of the current business upswing. In large part, the slower advance

to the favorable reports of dealer sales, while demands for steel—apparently mainly for current consumption but partly also for inventory building as a hedge against a possible strike—continued to stimulate high production of steel ingots, putting pressure on steel-finishing capacity.

The strong upward movement in industrial production helped materially in raising seasonally adjusted nonfarm payroll employment by 226,000 persons in December. All major industry groups shared in the increase, but particularly strong gains were registered in manufacturing and construction as well as in the number of persons at work for state and local governments. The employment rise in manufacturing brought total employment in that sector up

to 17.6 million, the highest level in more than ten years and nearly 500,000 persons more than at the end of 1963. Average hours worked in manufacturing also rose further in December and, at 41.1 hours per week, were the highest since 1953.

In January, the seasonally adjusted unemployment rate dropped to 4.8 per cent from the revised December level of 5.0 per cent. This represents the lowest monthly reading since October 1957 and continues the gradual but marked improvement in unemployment that took place last year. In 1964, the unemployment rate averaged 5.2 per cent, which represented considerable progress over the 5.7 per cent average for 1963.