## The Business Situation

The domestic economy was apparently continuing on a strong uptrend as the first quarter came to a close, with activity for the quarter as a whole probably about in line with the buoyant expectations for the period expressed by most analysts at the year's start. Industrial production, unfilled orders for durable goods, nonfarm payroll employment, and retail sales each moved up again in February. Indicators of residential construction activity, however, continue to be mixed. Preliminary data for March suggest that retail sales were off a bit, while unit assemblies of new automobiles advanced to a new record rate and steel ingot production showed a more-than-seasonal increase as mills continued to strain finishing capacity in the attempt to work down their huge order backlogs. The unemployment rate in March, moreover, dropped to 4.7 per cent, the lowest reading since late 1957. The updrift in industrial wholesale prices that began last fall seems to have continued. As in February, such prices apparently failed in March to register their expected seasonal decline. The mild but steady advance in the over-all level of consumer prices was interrupted in February when the price index showed no change, although Labor Department analysts noted that the advance was probably resumed in March.

The high level of over-all economic activity in recent months is, of course, partly attributable to the direct and indirect effects of the bulges in automobile and steel output. To some extent, these reflect temporary factors—although high output in both industries is also being supported by the strong general advance of the economy. The demand for further additions to steel stockpiles will presumably continue only so long as the threat of a strike remains, although the filling of previously placed noncancelable orders could lead to some further rise in actual inventories even if the strike threat were removed. In this connection, it is gratifying that the union, despite the continued uncertainty over the outcome of its election, was able to reach a settlement with the can producers, and that intensive steel labor talks are under way. The hope has been expressed that these talks will result either in a contract settlement by the May 1 deadline or at least in a postponement of the deadline to permit the making up of bargaining time lost during the union election.

Despite the possibility of some future cutback from the present extremely high rates of auto and steel output, prospects for further over-all economic advance in the months ahead remain good and have, in fact, become more firmly based. Thus, the results of the Government's latest capital spending survey, taken in February, confirmed the widespread belief that businessmen's spending plans for 1965 have been substantially upgraded since first reported last fall—which is not unusual—and that such outlays may well continue to grow at a good rate during the year. Another recent survey points to strength during the first half of the year in manufacturers' demand for additional inventories. Along with this indicated strength in the private business sector, of course, there is the prospective stimulus to be provided by the Government's fiscal activities during the second half of the year.

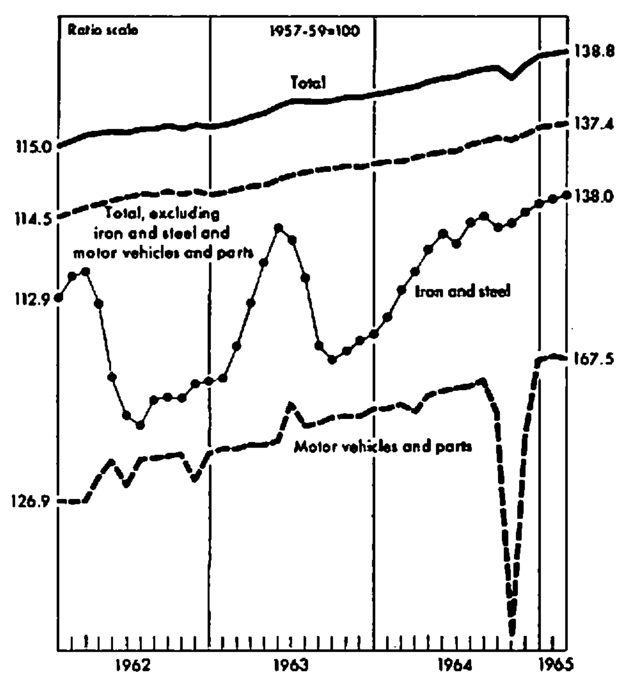
### INDICATORS OF RECENT ACTIVITY

Industrial production continued upward in February. The Federal Reserve Board's seasonally adjusted index was up for the fourth month in a row, rising by 0.7 percentage point to 138.8 per cent of the 1957-59 average (see Chart I). Over-all output was thus 8.3 per cent above its year-earlier level. The recent advance was sparked by higher output of furniture, television sets, and commercial and industrial machinery, while materials production also moved ahead. Iron and steel producers succeeded in pushing output a little further above the very high level of the month before, but motor vehicle assemblies edged off a bit from the surging January pace, owing to a severe snow storm that forced many plants in the Midwest to close temporarily. In March, early indications are that automobile assemblies hit a new record and that output of finished steel

Chart I

**RECENT DEVELOPMENTS IN INDUSTRIAL PRODUCTION**

Seasonally adjusted monthly data




Source: Board of Governors of the Federal Reserve System.

edged up in response to heavier demand for products for which there was some unused finishing capacity. Steel ingot production also was up in March (seasonally adjusted), with unadjusted weekly output averaging more than 86 per cent of estimated capacity.

New orders received by durable goods producers in February were a shade under the record volume of the month before. Orders for electrical machinery and equipment showed a noticeable decline, reportedly attributable in part to the aftermath of a January bunching of defense orders for electronic equipment. Nevertheless, the average volume of durables orders received during the first two months of the year was above the average for any quarter of 1964. Moreover, the total backlog of unfilled orders, which has grown without interruption for more than a year, increased further in February and reached a level nearly 16 per cent above that of a year earlier.

The strength in industrial production in February contributed to the addition of 232,000 persons to the payrolls of nonfarm establishments. Gains were recorded in all major sectors, but manufacturing employment showed an especially strong increase and reached the highest level since the Korean war. The growth in factory employment was concentrated in the durable goods industries, reflecting in part the high operating rates of steel users. There was also a substantial amount of overtime in the durables sector, and as a result the average workweek clocked by all manufacturing production workers was maintained at the postwar record of 41.4 hours for the second month in a row. The return of longshoremen to their jobs buoyed the employment figures in the transportation industry. In March, with total employment (seasonally adjusted) expanding further while the civilian labor force contracted a bit, the over-all unemployment rate dropped to a seven-and-a-half-year low of 4.7 per cent, from 5.0 per cent in February. The decline in over-all unemployment, moreover, extended to all major labor force groups.

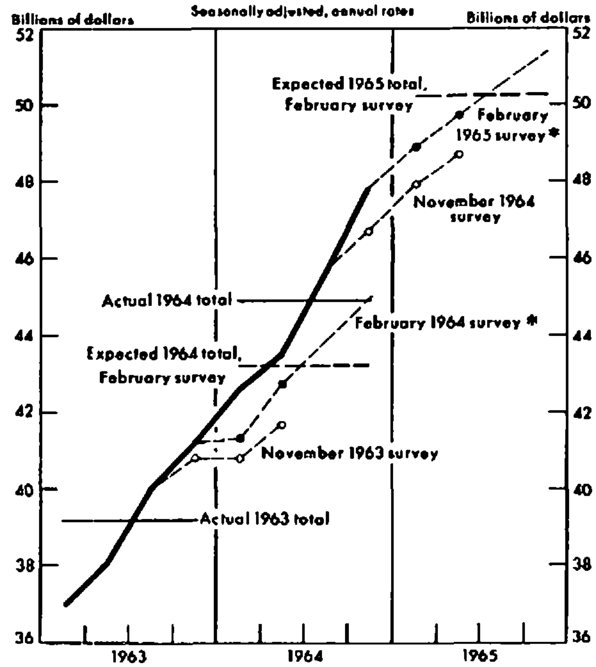
The rise in employment pushed personal incomes up further in February, and consumers continued to be in a spending mood. Thus, sales volume at retail outlets rose for the fourth month in a row. Sales at stores featuring nondurables were especially strong in February, in contrast to their sluggishness in preceding months, while durables sales were also up. Partial data for March suggest that total retail volume slipped a bit from the record February level. The decrease apparently in part reflected a decline—after seasonal adjustment—in unit sales of new cars from the extraordinary January-February pace, though sales of domestically built cars in March still amounted to a seasonally adjusted annual rate of around 8.7 million units. The sustained high rate of new car sales appears to reflect stronger demand than can be attributed solely to the recovery of sales lost during the strikes last fall. Industry forecasts of sales of domestically built cars this year have ranged up to 8½ million units.

Developments in the residential construction sector continue to present a mixed picture. Both nonfarm housing starts and building permits issued—indicators that tend to foreshadow future activity—moved down in February. On the other hand, the F. W. Dodge Corporation reported that the value of residential building contracts awarded in February showed a slightly more-than-seasonal gain. Moreover, outlays for nonfarm residential construction in March were up for the fourth month in a row. For the first quarter as a whole, outlays were $26.9 billion (at an annual rate), or 4.5 per cent higher than in the final quarter of 1964. The mixed showing in residential construction thus far in 1965 seems to be about in line with the outlook for the year as a whole that many analysts deemed most likely. In general, no further decline in starts from late-1964 levels was foreseen, but a strong upward push was not expected either. This appraisal was held to be compatible with a moderate growth in outlays, attributable to the construction of a greater proportion of relatively costly units.

### BUSINESS SPENDING PLANS

There is now a somewhat firmer indication than had been the case earlier that business capital spending is likely to continue to expand throughout 1965. A survey taken in February by the Commerce Department and the Securities and Exchange Commission indicates that businessmen plan to spend about $50.2 billion for plant and equipment in 1965 (see Chart II). If the February plans are realized, outlays this year will be almost 12 per cent larger than the amount actually spent in 1964—a sign of continuing business optimism and strong demand for capital goods as the economy moves into its fifth year of expansion. Larger expenditures are planned this year in all major industry groups. Spending plans by nondurables manufacturers show particular strength, especially in the textile and chemical industries, and the nondurables group as a whole projects a percentage rise in outlays for 1965 which is actually larger than that recorded in 1964. Durables manufacturers also expect to show another sizable spending increase. Outside manufacturing, it is noteworthy that the railroads have plans for a 15 per cent rise in capital investment this year, which, if achieved, would put their expenditures at a total almost twice as large as three years ago. Spending by commercial and communications firms is also expected to show strength.

Chart II
ACTUAL AND ANTICIPATED PLANT AND EQUIPMENT SPENDING
Seasonally adjusted, annual rates




* February surveys report an average for the second half but no separate figures for the third and fourth quarters. Straight lines are drawn from the second-quarter figure through a point representing the second-half average.

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

The February survey shows that since late fall there has been a considerable upgrading of aggregate business capital spending plans for the first half of 1965 and for the year as a whole. Some upgrading between fall and spring is generally to be expected in years of over-all business expansion. Given the substantial 14½ per cent increase in 1964, however, many analysts had not been counting on the degree of optimism that in fact has apparently emerged. The only previous survey of plans for 1965 as a whole was that taken last fall by McGraw-Hill, which indicated that business at that time planned a year-to-year increase of only 5 per cent, compared with the February plans for a rise of nearly 12 per cent. For the first half of 1965, the Commerce-SEC survey taken last November indicated that expenditures in the six-month period, expressed at an annual rate, would be about 8 per cent above the 1964 total, but the upgrading shown in the latest survey was sufficient to push the rise to more than 9½ per cent. Furthermore, actual outlays in the fourth quarter of 1964 exceeded the amount indicated in the November survey by about $1 billion (at a seasonally adjusted annual rate).

While it thus appears that the general pattern of repeated upward revisions which prevailed throughout 1964 may be continuing into 1965, there remains of course a margin of uncertainty. It is notable also that the February plans, if realized, imply a slower quarter-to-quarter growth in plant and equipment spending during 1965 than that which occurred during 1964. A further upgrading of spending plans would be necessary if the 1964 rate of growth were to be duplicated. The need for caution is underscored by the results of a National Industrial Conference Board survey, which show that new capital appropriations by leading manufacturers (net of cancellations) fell sharply in the fourth quarter of 1964. It should be noted, however, that the large size of the fourth-quarter decline was mainly attributable to a big drop in appropriations in one industry grouping, petroleum and coal products. Moreover, the backlog of manufacturers' unspent appropriations, which had been rising without interruption since the second quarter of 1963, was still expanding in the fourth quarter. Furthermore, the Treasury has meanwhile removed one possible drag on capital spending with its announcement, in February, that a planned review of corporate depreciation practices will be postponed. This review might have cost the affected corporations an estimated $700 million in additional taxes this year as a result of possible Treasury challenges of corporate practices since the 1962 liberalization of depreciation guidelines.

Prospects for inventory spending also show near-term strength, although further accumulation is planned at a more moderate pace than was recorded in the fourth quarter of 1964. According to a survey taken by the Commerce Department in February, manufacturers planned to add $900 million to inventories in the second quarter of the year following an expected addition of only $700 million in the first quarter. The actual accumulation in the fourth quarter of last year was $1.9 billion, but that figure was of course influenced by the initial widespread push to stockpile steel as a hedge against a possible strike. The plans for the first half of 1965 are more nearly in line with the moderate pace of accumulation that has prevailed throughout most of the current expansion. Moreover, manufacturers' inventory plans seem modest even if judged against a projected sales decline in the second quarter of this year, when auto and steel producers expect their shipments to move back to more normal levels from the exceptionally high first-quarter volume. Thus, the plans imply a further decline in the inventory-sales ratio, which has been generally trending downward since 1962 and is near its postwar low.