The Business Situation

As had been generally expected, the advance in economic activity has slowed somewhat following the exceptional buoyancy in the first three months of the year. Two major factors in the more moderate pace of the current advance are the easing-off in automobile sales and production following all-time records in the first quarter and the postponement of the threat of a steel strike until the fall, which has led to a downward adjustment of steel production from the record levels reached in the January-April period. Underlying forces of expansion remain strong, however, and the over-all business outlook continues to be bright. In April, new orders booked by durable goods manufacturers surged to a new record, despite a decline in steel orders, and the number of housing units started was up for the second month in a row. While steel ingot production fell off in May, automobile assemblies and scattered other production indicators moved up, and retail sales apparently also advanced.

The bill currently before Congress proposing a sizable multistage cut in Federal excise taxes should, if enacted, help to sustain economic expansion during the second half of this year; it should also provide a further boost to activity at the start of 1966, just in time to offset part of the scheduled rise in social security taxes. Many businesses have already announced their intention of passing whatever tax savings are eventually enacted on to customers in the form of lower prices. Moreover, the Federal Government may possibly provide some additional direct boost to demand, at least over the near term, since expanded military commitments abroad may tend to halt the recent downtrend in defense spending. Consumer responses to the Census Bureau's mid-April survey, taken before the tax-cut proposals were announced, confirmed earlier indications that buying intentions remain high. Businessmen's own confidence in the economy is evident in the results of the Government's latest capital spending survey, which points to an increase in outlays of 12.3 per cent for 1965 as a whole with advances in each quarter. Such gains should help to offset the adverse effects on over-all activity that may occur as a result of further readjustment of steel production and should also aid in maintaining a strong demand for steel itself.

The price situation continues to bear watching. While the rate of increase in industrial wholesale prices remains mild, such prices were up once again in April and perhaps also in May, and there is evidence of some acceleration in recent months. The gain in the three-month period from January through April was at a seasonally adjusted annual rate of about 2 per cent, compared with an annual rate of about 1½ per cent over the entire period since last September. Over the first nine months of 1964, the rise in the index was at an annual rate of only 0.3 per cent. Consumer prices in April registered the largest seasonally adjusted rise since December 1963. The gain was attributable in good part to the effects of tighter supply conditions for many food items. The advances in nonfood prices, on the other hand, were more nearly in line with the moderate increases of recent months.

RECENT MONTHLY INDICATORS

Increases in production were moderate but widespread in April, and the Federal Reserve Board's seasonally adjusted index moved up by 0.3 percentage point to 140.8 per cent of the 1957-59 average. The gain was smaller than in the preceding few months, partly as a result of floods and other adverse weather conditions that curtailed workweeks in several regions. At the same time, there was some downward adjustment in the automobile assembly rate—an adjustment that came after an enormous surge in production following the strikes of last fall. Output of consumer goods other than automobiles advanced further in April, and production of television sets continued to show particular strength. Production of materials was up once again, as was the output of business equipment, paced by a record rate of truck assemblies.

The outlook for continued strength in over-all production was enhanced by a 2 per cent rise in the volume of new orders received by durable goods manufacturers in April. Orders for steel were down appreciably from the very heavy pace set earlier this year when strike-hedging efforts were in full swing, but the decline was more than offset by strength in orders for machinery and equipment, reflecting a rise in defense ordering as well as the buoyancy in businessmen's capital spending plans.

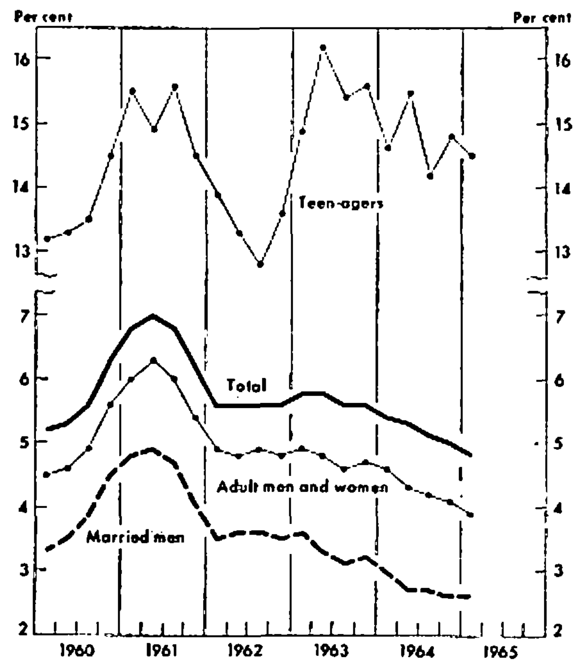
Actual production data available for May are scanty and mixed. Automobile output (seasonally adjusted) advanced a bit after dropping off in April, and preliminary schedules suggest that the May production rate will be sustained in June. In the wake of the interim settlement of the steel labor contract, however, ingot production in May fell off by about 6 per cent from the record annual rate of 146½ million tons in April (seasonally adjusted), and the industry expects some further decline in June. Nevertheless, the steel mills report that there were unexpectedly few order cancellations following the four-month extension of the labor negotiations. It has been observed that the current high rate of steel consumption will act as a brake on the downward adjustment of steel production, and trade sources have in fact expressed the opinion that there will be some further inventory accumulation over the summer months. However, it should be noted that in recent months, just as in other periods of threatened shortages, foreign steel has made substantial inroads into the United States market.

Reflecting the impact of adverse weather conditions in many parts of the country during April, payroll employment in the construction industry registered a substantial decline that slightly more than offset strength in other sectors. Employment in manufacturing—which is at the highest level in over twenty-one years—expanded somewhat further in April, with gains centered in the metal-using industries. On the other hand, most manufacturing industries reported a decline in overtime—a decline that was perhaps slightly overstated, since the survey week included important religious holidays—and the average workweek put in by manufacturing production workers was shortened to 40.8 hours in April from 41.4 hours in March. In May, the civilian labor force expanded a bit further but the volume of employment registered a larger gain. As a result the over-all unemployment rate was reduced to 4.6 per cent, the lowest reading since the fall of 1957. The over-all rate has moved down fairly steadily since early 1964, partly in response to the more rapid growth in aggregate activity that has occurred during the past year and a half (see Chart I). The improvement, which followed two years of stubbornly high rates of generally about 5½ per cent, has brought the average unemployment rate in the first five months of 1965 to 4.8 per cent, the lowest for any such extended period since 1957.

Chart I

UNEMPLOYMENT RATES

Quarterly averages of seasonally adjusted monthly data

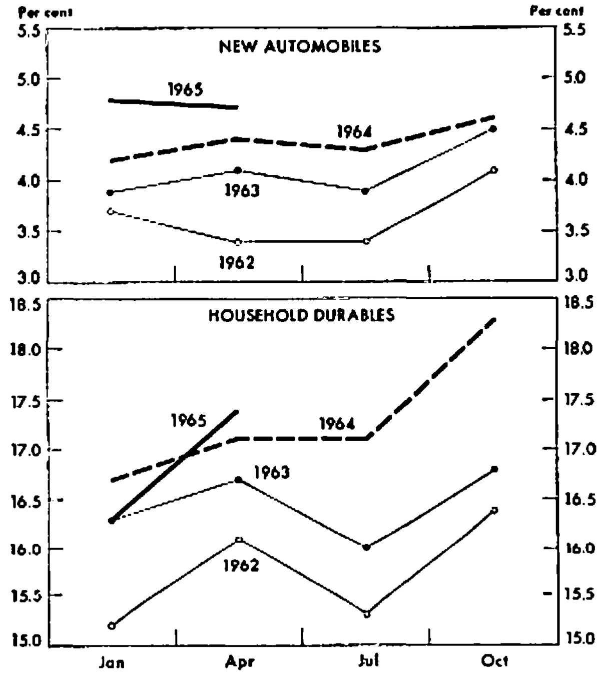


Source: United States Bureau of Labor Statistics.

It is significant that this recent improvement in the labor market situation has affected the unemployment rates in all age groups, including even the teen-agers. While the absolute level of the unemployment rate among teen-agers remains about three times as high as the overall unemployment rate, the general downtrend since mid-1963 contrasts with the increase in teen-age joblessness that occurred during late 1962-early 1963. However, the possibility of future problems in this important sector of the job market should be clearly borne in mind. An exceptionally large rise in the teen-age labor force is expected this summer as the children born in the immediate postwar years graduate from high school. Adult women have likewise come into the labor market in great numbers over the course of the current business expansion, but the unemployment rate in this category has also moved downward during the past year. For adult men, particularly those who are married and have a family to support, unemployment rates have fallen to very low levels. Indeed, the rate for married men was at 2.5 per cent in May for the third consecutive month, only 0.4 percentage point above the lowest rate since collection of such data began in 1954. At the time of that lowest recorded reading—in the latter part of 1955—there were clear signs of strain in the supply of skilled labor, and some such shortages have likewise been reported in recent months. A basic improvement in the employment situation is also reflected in the fact that in April the number of major labor market areas classified by the Government as having substantial unemployment was reduced from 29 to 25, the lowest number since the fall of 1957.

Chart II

CONSUMER INTENTIONS TO BUY NEW AUTOMOBILES AND HOUSEHOLD DURABLES WITHIN SIX MONTHS



Note: Buying plans are expressed as the ratio of the number of families who indicate they intend to buy to the total number of families in the survey.

Source: United States Department of Commerce, Bureau of the Census.

INDICATORS OF FUTURE CONSUMER DEMAND AND CAPITAL SPENDING

The Census Bureau's latest survey of consumer buying plans, taken in mid-April, has confirmed the earlier signs of continued underlying strength in consumer demand—which of course may be stimulated further by passage of the proposed excise tax cut. The proportion of families planning to purchase, within six months, at least one of the seven household durable goods included in the survey jumped sharply from a January figure that had been below that of 1964 to one well above the readings for 1964 and earlier years. At the same time, the proportion of families planning to buy a new car remained essentially unchanged at the high January level and was substantially above the year-ago reading (see Chart II). The lack of a significant decline since January is especially noteworthy when it is recalled that the car-buying plans reported in that month's survey may well have been inflated a bit by the responses of persons who were unable to buy during the strike-affected fourth quarter. Actual sales in January were at the extraordinary seasonally adjusted annual rate of around 9.7 million units. While some decline in auto sales has occurred in subsequent months, it is reported that the industry is increasingly optimistic over the prospects for total 1965 sales of 8.5 million domestically built units, which would of course easily surpass the previous record of 7.6 million units set last year. Data for May point to a seasonally adjusted annual sales rate in excess of 8 million units for the month; total sales for the first five months of 1965 amounted to an annual rate of about 8.9 million units. Over-all retail sales volume appears to have gone up a bit in May, reaching a level close to the record set in February.

In proposing a substantial cut in Federal excise taxes, the Administration strongly urged that the benefits of whatever reductions are enacted be passed on directly to buyers in the form of lower prices. The current bill provides that the first stage of the tax cut would amount to $1.75 billion annually, effective July 1. The reductions in taxes on automobiles and air conditioners would be retroactive to May 15, to avert possible delays by buyers waiting for lower prices after July 1. A second major round of reductions, amounting to an additional $1.75 billion, would occur on January 1, 1966. Including allowance for the eventual complete elimination of the tax on autos, written into the bill by the House Ways and Means Committee, still further cuts totaling $1.4 billion would take place at one-year intervals to January 1969. The effect of these cuts on consumer spending will depend importantly on how much of the total tax reduction is passed on to buyers in the form of lower prices.

Business spending for new plant and equipment should also provide a boost to over-all activity during the months ahead. According to the latest survey by the Commerce Department and the Securities and Exchange Commission, conducted in mid-May, capital spending plans for 1965 total $50.4 billion, or 12.3 per cent higher than the volume of outlays during 1964. The year-to-year rise is slightly larger than the 11.7 per cent increase indicated in the February Commerce-SEC survey—a change that reflects a modest step-up in planned expenditures for the second half of the year. A survey taken by McGraw-Hill in the early spring had pointed to a 15 per cent rise in capital outlays this year, but the McGraw-Hill results are more heavily weighted by responses from large firms and are thus not entirely comparable to the Commerce-SEC results.

Actual capital outlays in the first quarter of this year reached a seasonally adjusted annual rate of $49.0 billion, about the level that had been anticipated in the February Commerce-SEC survey and up $1.25 billion from the fourth quarter of last year. A further gain of $0.6 billion is expected for the current quarter, and the May plans called for progressively larger rises in the final two quarters of the year. If these plans are realized, capital spending in the fourth quarter of this year will reach a seasonally adjusted annual rate of $52.1 billion, 9.1 per cent higher than a year earlier. This would cap off four and one-half years of rising outlays and bring to more than 50 per cent the total increase since the end of the last recession in early 1961.

Manufacturers, especially in the durable goods industries, are responsible for the bulk of this year's planned increase in capital spending. The continued growth of output has brought a number of industries fairly close to their preferred rates of capacity utilization, and the expectation of still further sales gains has increased the need for additional capacity. There are indications that firms are actually proceeding with their capital spending plans. A recent National Industrial Conference Board survey found that manufacturers' net new capital appropriations rose by 11 per cent in the first quarter.