

The Business Situation

Business activity continued to expand as the summer began. The pace of advance has recently been slower than in the unusual first quarter of the year, which has led to a more cautious reassessment of future prospects by a number of observers. Some of this reassessment has shown up in a change in the previously highly buoyant atmosphere of the stock market. The underlying sources of strength in the economy remain intact, however, and are being recognized both by business analysts and in current official appraisals. These positive factors include business plans for further increases in plant and equipment spending, the stimulus to consumer spending expected from the excise tax cut effective June 22, and a further expansion in the combined spending of Federal and state and local governments on goods and services in the months ahead.

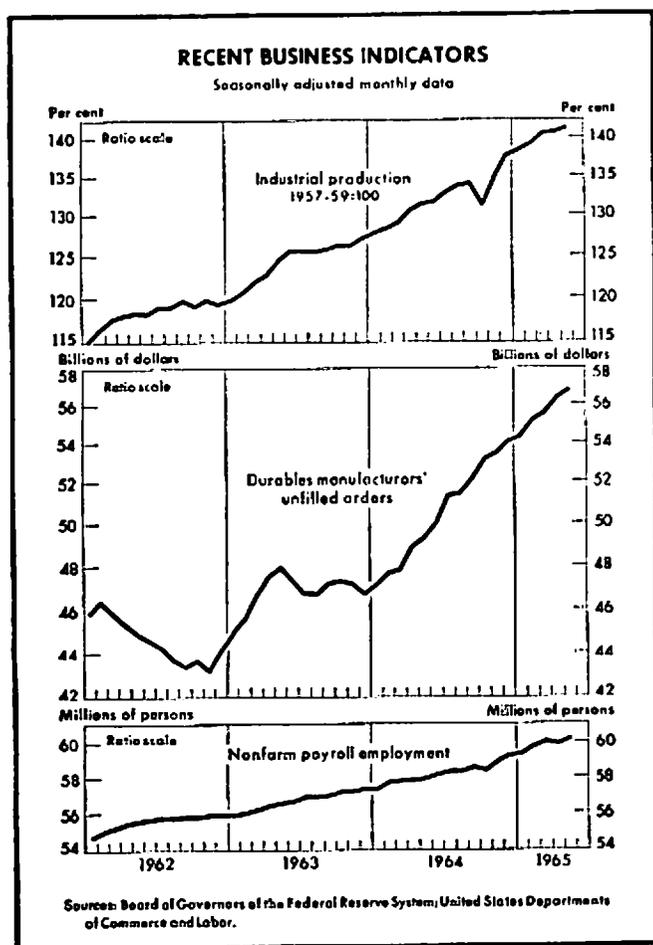
That the economy has in fact remained strong over the past several weeks is reflected in the gains in such key indicators of activity in May as industrial production, durables manufacturers' unfilled orders, employment, and retail sales. Fragmentary data for June suggest that both automobile assemblies and steel ingot production were well maintained, while retail sales apparently continued near the record rate of the month before. The unemployment rate, to be sure, did edge up in June after a marked decline in the month before. Nevertheless, there has been a distinct improvement in the labor market situation during the second quarter as a whole, compared with both the first quarter of 1965 and the second quarter of 1964.

The economy continues to show signs of increased vulnerability to upward price pressures. The over-all consumer price index was up by 0.6 percentage point in the April-May period, largely reflecting higher prices for meats. The excise tax cut has already resulted in price reductions in a significant number of consumer items, and these decreases should show up in the index

for July, but it must be remembered that this is essentially a one-time effect (until the next round of reductions that becomes effective January 1). The wholesale price index was also up again in May, and apparently in June as well. It is true that some of the wholesale price increase in the past several weeks also reflected special factors relating to possibly temporary shortfalls in food supplies, which may ease again soon. Nevertheless, there continues to be a noticeable upcreep in prices for industrial commodities, and while the rate of advance in this component of the wholesale price index is still modest in comparison with the inflationary surge of the mid-1950's, it nevertheless contrasts with the stability the country achieved during the earlier portion of the current expansion. Against the background of these developments, the need for restraint in price-wage decisions has become even more pronounced. The steel industry, in which labor negotiations were recently resumed, will clearly be a bellwether of the future.

PRODUCTION, ORDERS, AND EMPLOYMENT

The Federal Reserve's seasonally adjusted index of industrial production rose by 0.5 percentage point in May to 141.3 per cent of the 1957-59 average (see chart). Output in industries producing business equipment showed particular strength in the month and reached a level 11 per cent higher than in the corresponding month a year earlier. Production of consumer goods was also up in May, buoyed by a slight rise in automobile assemblies as well as by some increase in output of consumer staples. Output of industrial materials, on the other hand, was essentially unchanged, following the sharp run-up that reflected the surge in steel production earlier in the year. In June, steel ingot production edged back close to the record rate reached in April, and producers in the auto-



mobile industry assembled new cars at a seasonally adjusted annual rate of 9.6 million units—a further slight gain in comparison with the advanced rate of the month before.

Prospects for future strength in production remain good. Although the volume of incoming new orders for durable goods declined somewhat in May, such orders were still well above the current rate of shipments. As a result, the backlog of unfilled orders held by durables manufacturers rose for the seventeenth consecutive month (see chart). This brought the stock of unfilled orders to a level equal to more than 2.7 times the current monthly rate of shipments, which is 7 per cent above the ratio for the corresponding month a year ago.

Nonfarm payroll employment also rose in May, more than recouping the mild decline that occurred in April (see chart). Employment was off slightly in the manufacturing sector in May, but this decline largely reflected a smaller number of persons at work in the primary metals industry following the interim labor settlement in

the steel industry. Outside the manufacturing sector, gains were widespread in May. For the April-May period combined, the total number of persons on establishment payrolls averaged more than 300,000 persons above the figure for the first quarter. Along with the continuing rise in business activity in June, both total employment and the number of persons seeking jobs expanded further. The over-all unemployment rate in the month was 4.7 per cent, a shade above the 4.6 per cent rate in May, reflecting a rise in unemployment among adult women. The unemployment rate for adult men, and married men, on the other hand, edged downward; and unemployment among teenagers was also down a bit. For the second quarter as a whole, the over-all unemployment rate averaged 4.7 per cent, compared with 4.8 per cent in the first quarter and 5.3 per cent in the corresponding year-ago period.

CONSUMER SPENDING AND RESIDENTIAL CONSTRUCTION

Retail sales rose by 2.2 per cent in May to a record seasonally adjusted annual rate of nearly \$281 billion. The dollar volume of both nondurables and durables sales advanced by slightly more than 2 per cent. In June, new-car sales surged to a seasonally adjusted annual rate of 8.8 million units. Over-all retail volume was well maintained in the month as a whole, and sales in the last few days of the month probably received some stimulus from the excise tax cut, which the President signed into law June 21 to take effect the following day. (In the case of both new automobiles and air conditioners, the reductions were retroactive to cover purchases made on or after May 15.)

There were, to be sure, some reports of disappointment with the initial consumer reaction to the excise tax cuts in terms of actual purchases. Past experience indicates, however, that there tends to be a lag between the enactment of tax cuts and the response in consumer spending. It would seem that such a lag is especially likely in the case of an excise tax cut which has its immediate effect only on specific goods. As consumers in the weeks ahead come to realize more fully that previously taxed items now take less of their income to purchase, they will find more income left over for spending on other things. There will therefore be a tendency for the effects of the excise tax cut to spread over the entire range of consumer goods and services.

Developments in residential construction continued, on balance, to suggest improvement, although the erratic fluctuations in many of the statistical series relating to this sector of activity make it difficult to draw conclusions from any one month's returns. One way of gaining per-

spective is to look at average levels of activity over several months. The number of nonfarm housing starts, for example, fell by 4 per cent in May. This decline, however, followed an advance the month before, and the average

level of starts in the April-May period shows an increase from the January-March average. With respect to actual outlays for residential construction, activity in the second quarter was on a par with the previous quarter.