The Business Situation

Although strikes in a number of key industries have slowed the business expansion in recent months—and international financial developments have added a new element of uncertainty to the economic outlook—the underlying cost and price pressures in the economy show no signs of diminishing.

During October, work stoppages played a major role in depressing industrial production, new orders for durable goods, and retail sales and in limiting gains in employment and personal income. However, housing starts posted a sizable gain in October, and industrial production is expected to have rebounded in November. Data on new capital appropriations, as well as the most recent survey of business plans for spending on plant and equipment, point to an increase in business fixed investment outlays. Meanwhile, prices continue to mount. The consumer price index rose sharply again in October despite a decline in food prices. Industrial wholesale prices also posted a large gain, and preliminary figures for November indicate a further rise. The need for fiscal restraint is compelling, not only to contain price pressures domestically, but also to protect the dollar in the international exchanges.

PRODUCTION, ORDERS, AND INVENTORIES

The volume of industrial output eased in October, as work stoppages and a further decline in crude oil production continued to dampen industrial activity. The Federal Reserve Board's production index (seasonally adjusted) declined 0.5 percentage point from the upward-revised September level to 156.2 per cent of the 1957-59 average. The materials index eased slightly further, as crude oil output was cut back once again. Following the June war in the Middle East, which sharply curtailed oil imports, state regulatory agencies had raised domestic production quotas but, with the resumption of shipments from the Middle East, quotas have been adjusted downward toward more normal levels. Overall output of consumer goods held at the strike-reduced September volume. The seasonally adjusted annual rate of automobile assemblies, at a little under 7 million units in October, was virtually unchanged from the September pace. In November, wildcat strikes at the Chrysler Corporation and General Motors Corporation as well as the slow return to full production at the Ford Motor Company held the assembly rate to just over 7 million units, well below the prestrike level of 8⅓ million units in August. Barring further strikes in the industry, assemblies are expected to rise very substantially in December as Ford attempts to make up some of its lost production.

Output of consumer goods other than automobiles was also about unchanged during October, although production of television sets and radios eased slightly, following a sharp rise in August and a further small gain in September. While output of defense equipment continued to advance, the index of business equipment declined, largely as the result of a strike at a major equipment producer which was settled late in the month.

The third-quarter rise in new capital appropriations made by manufacturers and the improvement in corporate profits strengthen the prospects for a step-up in capital spending in the coming months. Underscoring this improved outlook, the survey of capital spending plans taken by the Commerce Department and Securities and Exchange Commission in November suggests that business spending on plant and equipment will rise appreciably in the first half of 1968.

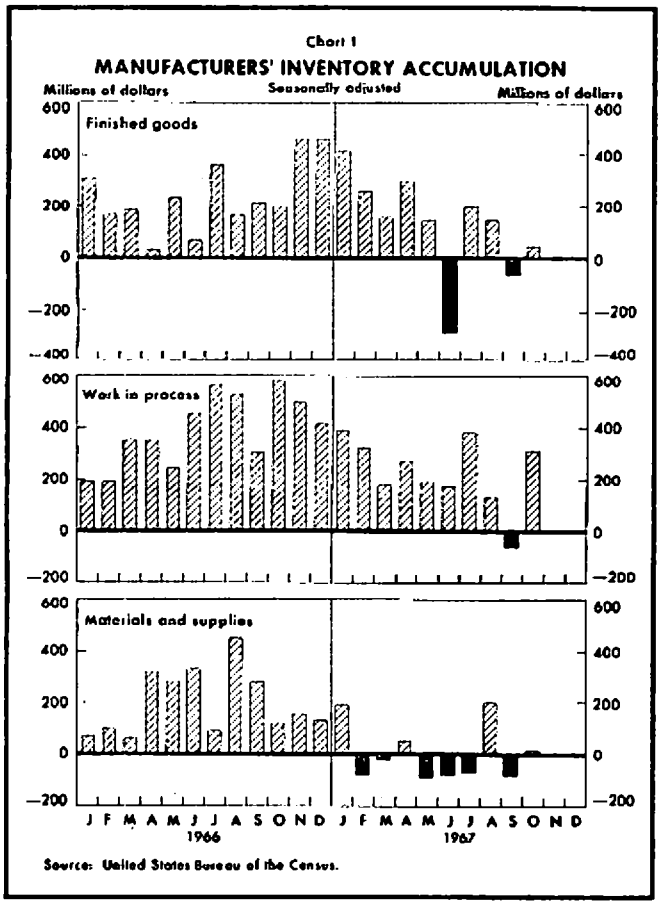
The effects of the strikes at Ford and other firms were reflected in a continued decline in October in new orders received by durable goods manufacturers. The drop was concentrated in the automobile and primary metals industries. Among other durables, the aggregate flow of orders was little changed, as advances in some sectors about offset declines elsewhere. The defense component recorded a large gain over the September level.

Residential construction activity continued to move up strongly in October, approaching the level that prevailed before the housing slump began in early 1966. Housing starts recorded a large advance, achieving a rate fully 80 per cent above the depressed level reached just a year earlier. At the same time, there was a substantial gain in the number of building permits issued by local authorities.

The inventory situation in both the trade and manufacturing sectors has been a major concern since the fourth

quarter of 1966, when a sharp buildup in stocks occurred as consumer demand moderated. In an effort to bring inventories into better alignment with sales, businessmen reduced the pace of inventory accumulation from a seasonally adjusted annual rate of $18.5 billion in the fourth quarter of 1966 to a scant $0.5 billion in the second quarter of 1967. In the third quarter, however, businessmen stepped up inventory spending once more. Indeed, revised GNP figures indicate that inventories grew in that three-month period at a rate of $3.8 billion, rather than the $1.5 billion of the preliminary estimate.

In the trade sector, firms reacted quickly to the late-1966 rise in inventories. Following the moderation of consumer demand in the middle of that year, the trade sector initially reduced the pace of accumulation, and then made a series of actual cutbacks in inventory holdings that continued uninterrupted over the first seven months of 1967. This decline in inventories, coupled with rising sales, resulted in a steady drop in inventory-sales ratios during the first three quarters of this year. In September, the pace of accumulation at the retail level increased although wholesale inventories showed little change, following a sizable accumulation in August.



The problem of excessive stocks dating from the latter part of 1966 has been considerably more serious in manufacturing than in the trade sector. Manufacturers cut the pace of inventory accumulation from an average monthly rate of $1 billion (seasonally adjusted) in the fourth quarter of 1966 to only $227 million in the second quarter of this year. The slowdown in spending affected additions to inventories at all three stages of fabrication: finished goods, work in process, and materials (see Chart I). Accumulation of finished goods dropped from a monthly average of $373 million in the fourth quarter of 1966 to $58 million in the second quarter of 1967. At the same time, additions to stocks of work in process declined from a monthly rate of $493 million to $210 million. The fact that work-in-process accumulation remained relatively high was in large part due to the continued growth of output in aircraft and other defense-oriented industries, where production time is generally longer than for other goods. Inventories of purchased materials which grew at a monthly average of $138 million in the last three months of 1966 showed an actual decline, averaging $41 million in the second quarter of this year. In July and August, manufacturers' total stocks increased at a fairly rapid pace, but strikes cut sharply into accumulation in September—and inventories actually declined. Stocks rose strongly in October, however, and the improved outlook for shipments as well as the Ford settlement suggests that the accumulation rate may increase in the near future.

EMPLOYMENT, INCOME, CONSUMER DEMAND, AND PRICE DEVELOPMENTS

The employment picture remains clouded by the effects of labor disputes. The number of persons on nonagricultural payrolls increased in October, but a large part of the advance was due to the return of workers who had been on strike in September, notably in the government sector which had been affected by a number of teachers' strikes. Employment in manufacturing—where strikes continued to be a strong dampening factor—showed a small rise in October as an increase in nondurables industries offset a further decline in the durables category. The average workweek of manufacturing production workers eased during the month. Though the Ford strike had cut sharply into manufacturing employment in September, the Bureau of Labor Statistics reported that the strike apparently had few secondary effects in that month. However,

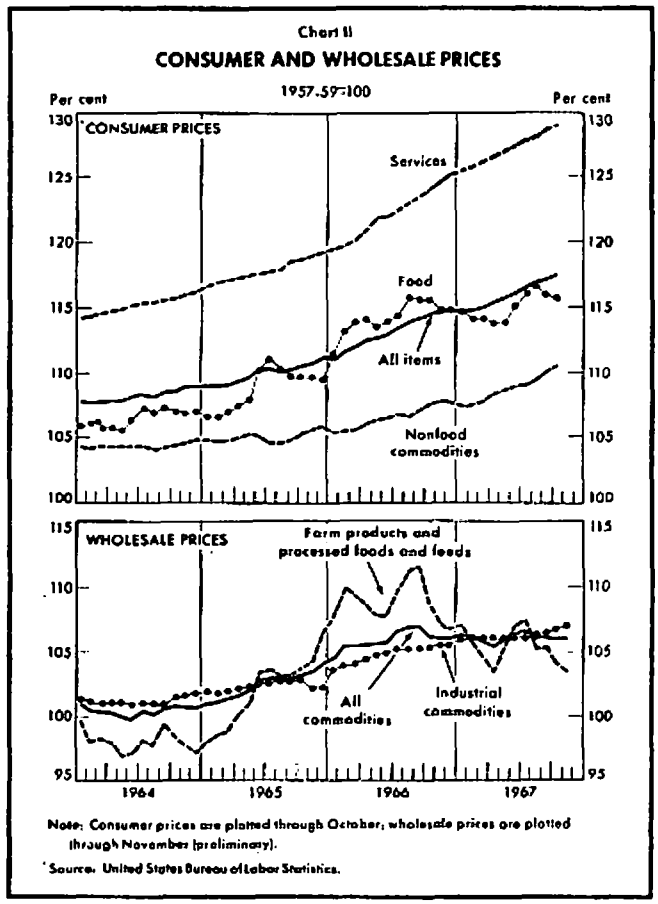
the October declines in the manufacturing workweek and in durables employment suggest that the indirect effects of the strike increased during its second month.

The civilian labor force grew sharply again in October. In contrast to the first six months of 1967 when the civilian labor force remained quite stable, September and October were marked by unusually large increases, especially in the number of women and teen-age entrants. In both months, total employment was essentially unchanged, so that the increase in the number of labor force participants boosted unemployment. In October, the unemployment rate rose 0.2 percentage point to 4.3 per cent, up 0.5 percentage point from August. The rate for married men increased slightly during the month, following a decline during September.

Reflecting the limited growth of employment, personal income in October recorded the smallest advance in six months. This modest showing was due primarily to an unusually small rise in wage and salary payments which grew by a seasonally adjusted rate of only $0.9 billion, compared with an average monthly rise of $2.5 billion in the third quarter. Payrolls in durables manufacturing actually declined during the month, chiefly in industries affected by strikes.

Against the background of sluggish growth in personal income, preliminary figures indicate that retail sales volume (seasonally adjusted) declined in October. The number of new cars sold fell by about 15 per cent. Since July, when auto sales reached a 1967 peak of 8½ million units (annual rate), the sales pace has been dampened by supply problems. Beginning in late July, shortages appeared in many popular model lines, and sales in August fell to 7⅓ million units. The introduction of the new models late in September improved supplies, and sales increased to a rate of about 8 million units. However, in October, sales dropped to 7 million units as the stock of new models made by Ford dried up. Shortages continued in November, and sales again were at an annual rate of about 7 million units.

Despite the strike-related slackness in the economy, the consumer price index rose sharply again in October (see Chart II). Although food prices declined, the overall index moved up 0.4 percentage point, reflecting substantially higher costs of apparel, new cars, and services. Although the rate of advance in the consumer price index moderated in the first months of the year, prices began to rise



sharply in the spring months, and in the six-month period ended in October the advance amounted to a high 3.8 per cent (annual rate). Wholesale prices eased in October as a decline in food products outweighed a rise of 0.3 percentage point in industrial commodities. Preliminary figures for November indicate that, while the overall index remained unchanged, food prices again declined and industrial prices increased further. This divergent trend between food and industrial prices has been apparent for several months. Between July and November, the index of industrial commodities rose 1.0 percentage point, after six months of stability. The farm products index, however, dropped fully 6.3 percentage points in these last four months, lowering the overall index by 0.4 percentage point since July.