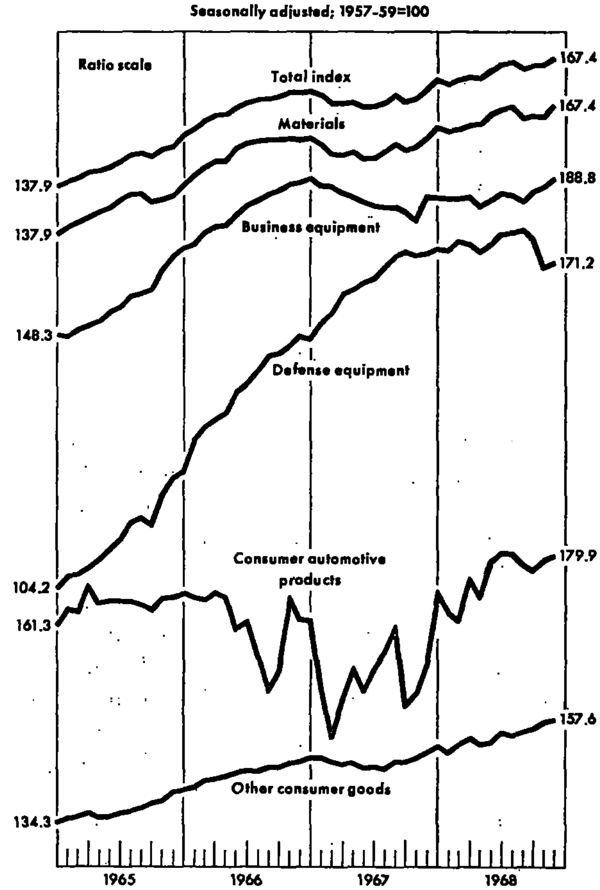
The Business Situation

As 1968 drew to a close, the economy continued to expand at an excessive rate. In November, almost every indicator of business activity was strong. Industrial production rose a full 1 percent to a new peak. The backlog of unfilled orders for durable goods increased again, as the volume of new orders remained at a high level. Employment registered a sharp advance, and the December increase was even more marked. The unemployment rate in these two months was down to 3.3 percent, the lowest since 1953. Retail sales advanced approximately ½ percent in November, following two months of slight easing. Price developments continued to be disturbing, with significant increases occurring at both wholesale and retail levels. When the Board of Governors of the Federal Reserve System announced its mid-December approval of an increase in the discount rate from 5¼ percent to 5½ percent, it cited "the resurgence in inflationary expectations that is impeding the restoration of economic stability" as one reason for its action.[1]

OUTPUT, INVENTORIES, AND CONSTRUCTION ACTIVITY

In November, industrial output registered its largest and most broadly based rise since last spring. The Federal Reserve Board's index of industrial production rose by 1.7 percentage points (seasonally adjusted) to 167.4 percent of the 1957-59 average (see Chart I). This advance brought the index to a new high, surpassing the peak set last July when the steel industry was working at a feverish pace to meet the demands of users who were building up inventory as a hedge against a possible steel strike. The sharp cutback in steel production that followed the August 1 contract settlement had caused the total production index to fall substantially that month. After a further moderate decline in September, steel production turned up in October. In November, the index of iron and steel output advanced again, account-

Chart I
INDUSTRIAL PRODUCTION
Seasonally adjusted; 1957-59=100



Note: Indexes for defense equipment and nonautomotive consumer goods were calculated at the Federal Reserve Bank of New York from data published by the Board of Governors of the Federal Reserve System. Indexes are not plotted in rank order.

Source: Board of Governors of the Federal Reserve System.

[1] For a fuller reference, see page 7.

ing for about a quarter of the month's total production gain. In December, output of steel ingots rose by 12 percent, pushing the level of activity closer to normal.

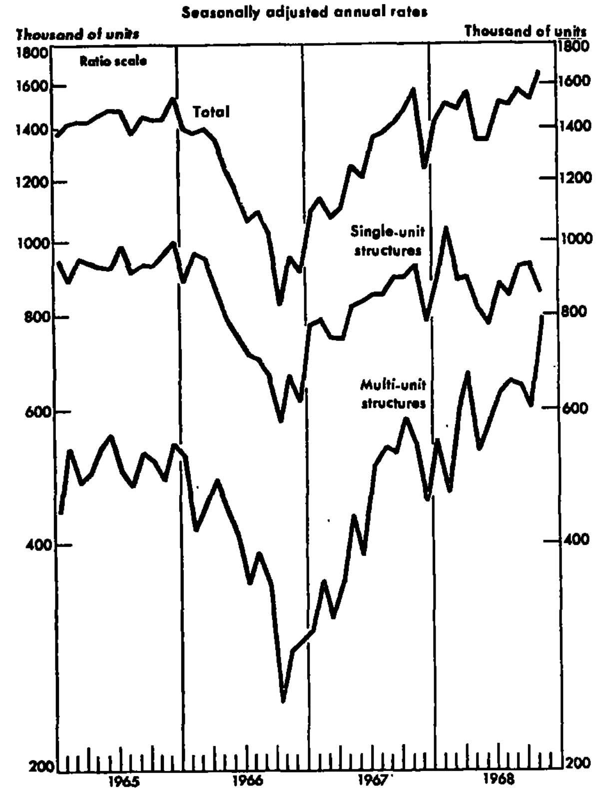
The materials component of the total index recorded a sharp rise in November, due partly to the increase in steel. However, advances in the output of other industrial materials, as well as the settlement of a strike in the coal industry, contributed to the gain. Output of both business and defense equipment advanced substantially. Beginning with September, the production of business equipment has moved up sharply, suggesting that the considerable increase in outlays indicated by recent surveys of business capital spending plans is indeed taking place. Production of consumer goods also rose in November. The gain in the automotive index, however, was limited by the stability of auto assemblies, which held at a seasonally adjusted annual rate of 9.2 million units. In December, automobile output slipped about 3 percent.

The recent behavior of new orders for durable goods underscores the strong outlook for industrial production. Although the volume of new orders edged off in November by $0.6 billion, this easing followed two very large monthly increases. The decline in new orders was concentrated in the machinery and defense-oriented industries; these were the groups in which the October increases had been particularly large. New orders for construction materials rose for the fourth consecutive month, and orders received by blast furnaces and steel mills advanced for the third month in a row. Since the volume of new orders continued to outstrip the volume of shipments, the backlog of unfilled orders expanded further to reach $82.6 billion.

The relationship between total business inventories and total sales remained relatively stable in October, with strong increases occurring in both sales and inventories. For the trade sector, however, the inventory-sales ratio moved up from a very low level as stocks rose and sales declined. A substantial part of the increase was at automotive outlets, reflecting continued high motor vehicle production in a month when sales moved down. The rise in the trade ratio was offset by a decline in the manufacturing ratio, which stemmed from a sizable advance in durables shipments. In November, the inventory-sales ratio for manufacturing recovered a bit.

Residential construction activity was vigorous again in November. The volume of building permits issued by local authorities increased 1 percent from October, seasonally adjusted, while private nonfarm housing starts climbed 7½ percent to a seasonally adjusted annual rate of 1.65 million units. The starts figure was the highest since early 1964. This November surge was centered entirely in multi-unit structures, where there was a jump of over 30 percent in the number of units begun. In the first year following the sharp 1966 slump in residential construction, both single-home and multi-unit starts had increased rapidly (see Chart II). The rise in multi-unit home building was particularly strong, and similar strength was exhibited again in 1968. Consequently, in the first eleven months of 1968, the rate of multi-unit starts averaged a full 20 percent above the number of such starts in 1965, prior to the slump. In contrast, the slower recovery of nonfarm single-unit starts in 1967, and the leveling-out that occurred in 1968, produced a 1968 average that was just under the 1965 rate. This change in the composition of new housing construction is not surprising in view of population trends. The shift may, however, also reflect the reluctance of some institutional investors to add to holdings of single-family mortgages and their growing preference for apartment mortgages, particularly when financing arrangements provide equity participation for the mortgage lender.

Chart II
PRIVATE NONFARM HOUSING STARTS
Seasonally adjusted annual rates



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

EMPLOYMENT, INCOME, AND CONSUMER DEMAND

The labor market tightened appreciably in November. There was a relatively large increase in the labor force, but an even sharper rise in employment. On a seasonally adjusted basis, the number of unemployed persons declined and the unemployment rate dropped 0.3 percentage point to 3.3 percent, the lowest since 1953. Moreover, in contrast to developments in other months when there was a large change, the unemployment rate decreased in virtually all categories. The rates for adult women and adult men both fell to post-Korean war lows.

The number of persons on nonfarm payrolls increased by 219,000, seasonally adjusted, bringing the total to a record 68.9 million. Manufacturing employment moved up, chiefly reflecting the settlement of labor disputes in the ordnance and machinery industries. Similarly, the settlement of the strike in the coal industry boosted mining employment by 44,000, but this rise was offset by the effect of the New York City teachers' strike. A major part of the large increase in total employment occurred in the relatively low-paying service industries. In addition, a decline in the average workweek of manufacturing production workers partially offset the effect on incomes of the gains in manufacturing employment and hourly pay. Reflecting these developments, the wage and salary component of personal income rose in November by a relatively modest $2.5 billion. In the first two months of the fourth quarter, wage and salary growth averaged $2.3 billion, compared with an average of $3.2 billion in the first three quarters of the year.

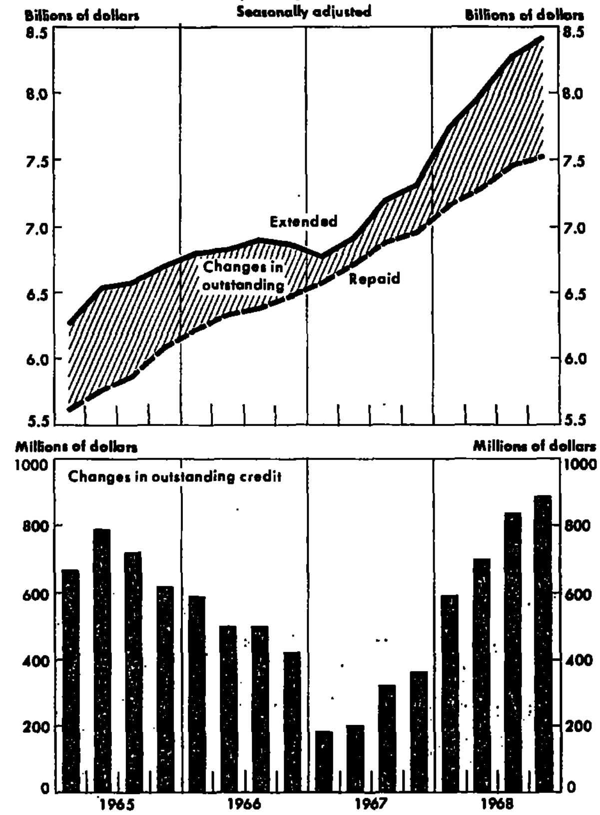
In December, payroll employment made a further sharp gain of 266,000, seasonally adjusted. Both service and manufacturing employment again showed particular strength. Settlement of the New York City teachers' strike, which had lasted five weeks, contributed to a large rise in the number of persons on government payrolls. Construction employment also advanced strongly, following virtual stability in November, when unusually bad weather held down employment gains. The civilian labor force, seasonally adjusted, advanced markedly again in December, with the rise about matching the increase in total employment. The unemployment rate thus remained at 3.3 percent. The rate for adult men, however, dropped further, reaching the lowest level since the series began in 1948.

Retail sales rose 0.6 percent in November to $28.9 billion, seasonally adjusted. However, this rise, which followed two months of moderate decline, was entirely in sales at nondurables outlets. Durables sales were off 1 percent,

Chart III

CONSUMER INSTALMENT CREDIT

Monthly average in each quarter
Seasonally adjusted



Note: Figures shown for the fourth quarter of 1968 are the averages of October and November data.

Source: Board of Governors of the Federal Reserve System.

mainly reflecting a decrease in the automotive group, which in addition to new cars includes used cars, auto parts, and repairs.

Sales of new domestic automobiles declined in November by almost 3 percent to a seasonally adjusted annual rate of just under 9 million units. In December, sales volume fell again to a pace of about 8¼ million units. For 1968 as a whole, sales of domestically produced automobiles will probably be about 8.6 million units. This compares very favorably with the 7.6 million units sold in 1967 and is only slightly below the 1965 high of 8.8 million units. However, sales of imported cars, which have claimed an increasingly large share of the American market, reached a record in 1968 of about 1 million units. Thus, total new car sales for the year may wind up at about 9.6 million units. This would be an all-time high.

Considering the increase in the income tax withholding rates that became effective in mid-July as a result of the tax surcharge, consumer demand over the July-November period has shown surprising strength. Consumers have financed this high level of spending in part by greater use of instalment credit (see Chart III). Indeed, the increase in outstanding credit reached a record $947 million (seasonally adjusted) in October. In November, the rise was somewhat smaller, largely reflecting a decline in extensions of automobile credit and personal loans. However, this recent sharp uptrend in consumer credit outstanding was in line with the rapid advance that started in mid-1967.

PRICE DEVELOPMENTS

Prices at the consumer level climbed steeply again in November, although the rise was not so great as the extraordinarily large gain in the previous month. At an annual rate, the November increase was 4.9 percent. This brought the advance for the first eleven months of 1968 to a yearly rate of 4.8 percent. The November rise would have been even larger but for some seasonal declines in retail food prices. All other components advanced, with particularly sharp increases occurring in housing and service costs. Wholesale prices also rose in November, with the wholesale price index showing an increase of 0.5 percentage point. Preliminary data for December indicate that the total wholesale price index advanced 0.2 percentage point to 109.8 percent of the 1957-59 average. Prices rose for farm products as well as for industrial commodities. The December increase in prices of industrial commodities brought that index to a level 2.6 percent above the year-ago figure. This advance was not only considerably larger than the 1967 rise of 1.8 percent, but was the steepest since 1956.