The Business Situation

Economic activity continues to move higher but possibly at a somewhat slower pace than earlier in the year. Growth in production and income was more moderate during April, and total employment eased off slightly, resulting in some relaxation of the extreme tightness that prevailed in the labor markets during the winter months. And, for the third consecutive month, new housing starts were below the exceptionally high rate recorded earlier in the year. On the other hand, new orders received by durables manufacturers surged to a record in April and auto sales in May recovered a bit from the slow pace set during the winter months. Thus, while the recent business statistics appear to have been balanced on the softer side, it is too early to conclude that the rate of economic growth is slowing sufficiently to ease the upward thrust of prices. The April rise in consumer prices was again huge, and preliminary data for May indicate a further large overall gain in wholesale commodity prices even though the industrial component rose only moderately.

OUTPUT, INVENTORIES, AND CONSTRUCTION ACTIVITY

Industrial activity expanded further in April though by a considerably smaller margin than in the previous two months. The Federal Reserve Board's index of industrial production reached 171.5 percent of the 1957-59 average, up 0.3 percent from the March level. Output grew at about twice that rate in the two preceding months. However, the April slowing of overall output was chiefly due to sharply curtailed activity in the automobile industry which was hit by strikes during the month. Auto assemblies fell by more than 9 percent to a seasonally adjusted annual rate of 7.7 million units, substantially below the 8.4 million production level originally scheduled for the month. Output of business and defense equipment and of materials rose strongly in April, and there were sizable advances in the steel, coal, and petroleum industries. Production of household furniture and consumer nondurables also increased, but the sharp drop in auto assemblies resulted in a modest decline—the first since last November—in the aggregate output of goods for consumer markets.

Despite the continuation of strikes in the auto industry, auto assemblies in May were at an annual rate of 7.6 million units, down only slightly from the April figure, and the tentative June schedule points to a pace of 8.8 million units. Dealer inventories of new cars have recently declined from their record March levels, partly as a result of the strikes and partly because the pace of new car sales has become a bit livelier. In May, dealer sales of domestic-model cars were at a seasonally adjusted annual rate of 8.5 million units, up 4.3 percent from April.

Another development pointing to near-term strength in industrial production was a very sharp $1.3 billion April increase in the volume of new orders placed with durable goods manufacturers. This increase, which may have reflected some anticipation of the repeal of the 7 percent investment tax credit requested by President Nixon on April 21, brought the month's new orders to a record $31.0 billion. A large part of the gain was in orders placed for transportation equipment, but an expanded orders volume was also reported by the other major sectors of durables manufacturing. Shipments rose very little in April, and as a result the backlog of unfilled durables orders also rose sharply to $86.4 billion, a $1.3 billion gain for the month.

Durables manufacturers and wholesalers accumulated inventories in March at a fairly substantial pace, while stocks of nondurables manufacturers and retailers were virtually unchanged. With the availability of full data for March, the estimate of the inventory accumulation component of first-quarter gross national product (GNP) was revised to an annual rate of $6.9 billion, up by $0.5 billion from the preliminary estimate but still well below the fourth-quarter pace of $10.6 billion.[1]

Despite the continued fairly strong rise in the book

[1] The Department of Commerce has revised its preliminary estimate of GNP during the first quarter of 1969 from $903.4 billion, discussed in the May issue of this *Review*, to $903.3 billion. Inventory investment and spending by state and local governments were adjusted upward, while consumption outlays were revised downward.

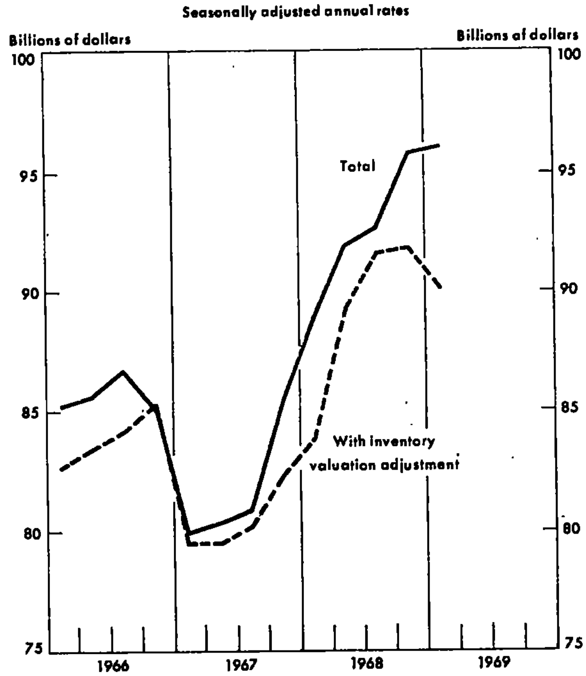
value of business inventories in recent months, there is little evidence to suggest any significant imbalance currently between inventories and the levels of business sales. The inventory-sales ratio for manufacturers moved higher in March and rose slightly further in April, but remained at about the 1968 average and well below the level of last December. At the same time, the ratio for wholesalers declined in March to the lowest level since last September, as strong increases in stocks were outweighed by even sharper sales advances. The inventory-sales ratio for retail trade firms moved up substantially in March when retail sales declined, but the strong sales recovery in April probably reversed that movement.

The rate of construction starts on new housing units moved lower in April for the third consecutive month. However, the decline—which may have been due in some degree to scattered strike activity—was substantially milder than in February or March. New private housing units were begun in April at a seasonally adjusted annual rate of 1.54 million units, down about 2 percent from the March pace and 18 percent from January's unusually high rate. On the other hand, there was a small gain in April in the number of residential building permits issued. The costliness and short supply of mortgage credit appear to have had a significant impact on the single-family sector of the housing market. The effective interest rate on conventional mortgages to purchase new single-family homes again rose sharply in April, reaching a nationwide average of 7.6 percent, nearly a percentage point higher than in the same month of 1968. Probably as a reflection of this, the starts rate for single-unit homes has fallen from an annual rate of 1.1 million units in January to 0.8 million units in April, a decline of 26 percent. Multi-unit building has fared better, probably in good measure because rates on such loans are generally unrestricted by state usury laws and because of the ability of institutional lenders to acquire an equity interest in apartment buildings on which they extend mortgages. Multi-unit housing in April was started at the rate of 0.8 million units, little changed from January's high level. A recent survey by the National Association of Home Builders found that builders expect multi-unit starts to register a modest rise in 1969 over 1968, but also expect that increase to be more than offset by a decline in single-unit starts.

Chart I

CORPORATE PROFITS BEFORE TAX

Seasonally adjusted annual rates



Source: United States Department of Commerce.

PROFITS AND PRODUCTION COSTS

Growth in corporate profits slowed markedly during early 1969 (see Chart 1). Pretax profits in the first quarter rose by only $0.3 billion to a seasonally adjusted annual rate of $96.0 billion, according to the preliminary figures of the Department of Commerce. The increase was the smallest in two years, with most of the gain attributable to nonmanufacturing corporations such as financial institutions and utilities. In the manufacturing sector, profits declined, largely because of lower earnings in the automobile industry. Moreover, when aggregate first-quarter book profits are adjusted for the effects of sharply rising prices on the valuation of inventories, the resulting pretax profits figure showed a drop of $1.7 billion, the first decline since early 1967.

Pressure on profit margins during the first three months of 1969 stemmed from steeply rising prices of materials and labor and from a slowdown in productivity. Unit labor costs in the private nonfarm economy rose in the first quarter by almost 2 percent to 122.4 percent of the 1957-59 average. Compensation per man-hour continued to increase, while output per man-hour declined. The drop in productivity, the first since 1967, reflected the fact that man-hours increased strongly in the first quarter but growth in real output was relatively modest. In the manufacturing sector, the gain in unit labor costs was not so steep as in the private economy as a whole. Productivity in manufacturing continued to grow, but the advance was less than half as large as the gain in compensation.

PERSONAL INCOME AND CONSUMER DEMAND

Personal income rose $2.8 billion in April to a seasonally adjusted annual rate of $730.5 billion. The gain was considerably smaller than those in recent months and reflected the distinctly smaller increase in wage and salary disbursements that accompanied the April slowdown in employment. Sluggish growth in payrolls was widespread among most of the major industry divisions, but was most marked in the manufacturing sector where wages and salaries rose by only $0.1 billion compared with an average gain of $1.2 billion during the first three months of the year. In the distributive and service industries, payroll growth was curtailed almost as sharply.

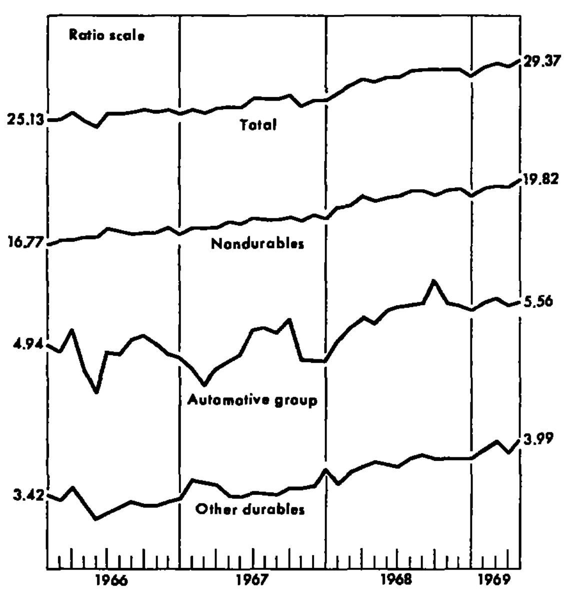
According to preliminary statistics, total retail sales in April rose by 1½ percent to a new all-time high of $29.4 billion—in a month when taxpayers were faced with large final payments on their 1968 income taxes. Nondurables led the advance, but steadier automobile sales and increases in other durable goods also contributed. Dealer sales of domestic-model cars ran at a seasonally adjusted annual rate of 8.1 million units in April, only fractionally lower than the March pace which was down 6 percent from that in February. The retail sales increase estimated for April followed a 1 percent decline during March and brought volume to an all-time high, but only $0.5 billion above the pace in September 1968. Following a temporary surge immediately after imposition of the surtax in mid-1968, retail sales have shown little change on balance in the past seven months (see Chart II). Indeed, the 1¾ percent gain in retail sales since September is smaller than the rise in retail prices over the same period.

The preliminary first-quarter estimate of total consumer expenditures on the GNP basis has been reduced by $1.0 billion because of a large downward revision in the initial estimate of March retail volume. The revision was centered in nondurables outlays. At the same time, the preliminary estimate for disposable income in the first three months of 1969 was revised upward, with the result that the personal saving ratio is now estimated at 6.1 percent in the first quarter, down 0.7 percentage point instead of the previously reported reduction of a full percentage point.

Chart II

RETAIL SALES

Billions of dollars; seasonally adjusted



Note: Latest data plotted are based on preliminary reports.
Source: United States Department of Commerce, Bureau of the Census.

PRICE DEVELOPMENTS

In April, consumer prices continued their rapid climb, increasing at a 7.6 percent annual rate. The consumer price index reached 126.4 percent of the 1957-59 average. The April rise was primarily due to higher prices for food and for services. However, mortgage interest and other household costs were sharply higher, and medical care also continued to rise steeply. In addition, the prices for apparel and recreation gained strongly.

Wholesale prices rose fairly modestly in April, but apparently again increased sharply in May. The wholesale price index rose at a 2.1 percent per annum rate in April when there was some easing of lumber and plywood prices and of farm products prices. In May, however, preliminary statistics indicate that total wholesale prices rose at a 7.5 percent annual rate, reaching 112.6 percent of the 1957-59 average. Farm products prices climbed in May at a phenomenal 49 percent per annum rate, and processed foods and feeds by 17 percent per annum. In contrast, industrial commodities in May rose by a modest 1.1 percent per annum, as increases in metals and machinery were partly offset by further decreases in lumber prices. Total wholesale prices thus far in 1969 have risen on balance at a far faster rate than in 1968, and the latest month's increase in farm and food prices is the most severe in eleven years.