The Business Situation

The nation's real output of goods and services was virtually unchanged in the fourth quarter of 1969, although price increases raised the market value of that output by more than $10 billion. The latest monthly figures point to continued slackening of economic activity. Industrial output declined in December, maintaining its steady downtrend from the July peak, new orders for durable goods registered a third consecutive monthly decrease, and housing starts fell still lower. Total retail sales in December were essentially unchanged, while successive declines have brought new domestic auto sales to the lowest level in two years, inducing the major producers to make sharp cuts in production. The lack of growth in real gross national product (GNP) in the past quarter has been reflected in slightly higher unemployment but not in any slowing in the rate of price inflation, and wage increases continue to far outstrip productivity rises. Furthermore, consumer purchasing power has been boosted by reduction of the surtax to 5 percent, social security benefit checks will shortly be increased, and the surtax is scheduled to be eliminated in July. In addition, surveys indicate record business capital spending plans for 1970 despite falling corporate profits and tight conditions in the financial markets. A major uncertainty is the extent of fiscal restraint to be achieved this year; it will take a determined effort by the Administration and the Congress to limit the rise of Federal spending.

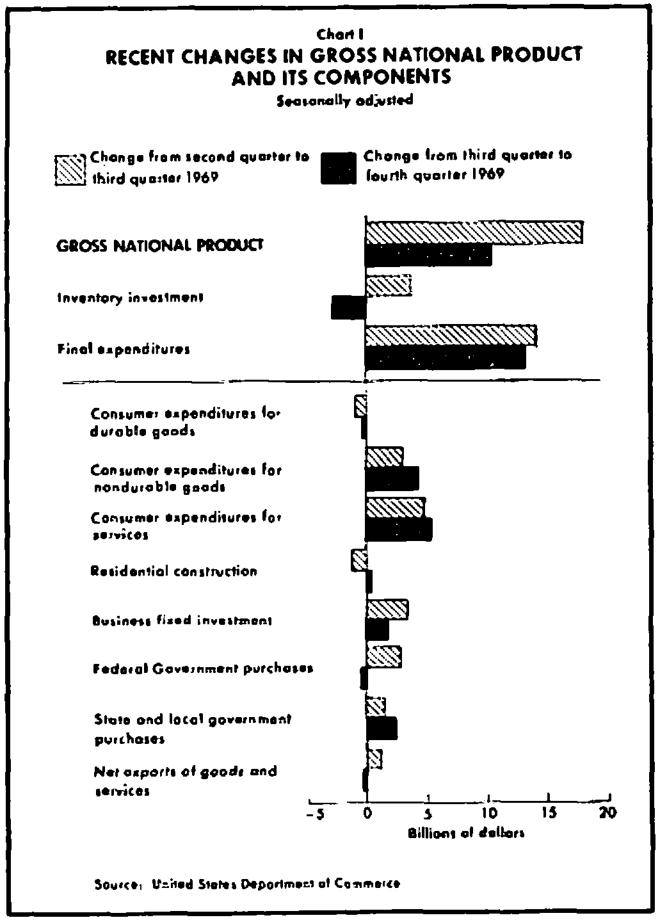
GROSS NATIONAL PRODUCT

The nation's total output of goods and services as measured in constant dollars failed to rise in the fourth quarter for the first time since the mini-recession of 1967, according to preliminary estimates. The market value of GNP rose $10.3 billion (see Chart I) to a seasonally adjusted annual rate of $953.1 billion as the result of price increases. This was the smallest quarterly advance of the year and was partly due to the General Electric strike. In the GNP accounts, most of the slowdown was in the amount of inventory accumulation.

The fourth-quarter decline of $2.9 billion (preliminary) inventory accumulation was not an unusually large drop and was certainly nothing like the abrupt $10.9 billion swing that marked the first quarter of 1967. (The fourth-quarter preliminary GNP inventory figure is based upon October and November inventories, since December data were not yet available.) On balance, the inventory situation toward the end of 1969 did not show broad-based excesses of the sort which preceded the 1967 mini-recession, although there is evidence of surpluses in some sectors. Durables manufacturers' inventories have been building up recently as sales growth has slackened. In November, inventories of durables manufacturers rose $445 million, while sales fell almost $1 billion; as a result the inventory-sales ratio jumped 3.8 percent, with both auto and nonauto durables manufacturers experiencing increases. Nondurables manufacturers experienced a modest rise in inventories and a small decline in sales, but total inventories did not appear to be excessive. At the retail level, markedly lower inventory accumulation at durables outlets resulted mainly from a reduction in inventory growth at auto dealers. Outlets for other durables and nondurables, however, experienced moderate-sized gains in November in the face of sluggish sales, and their already high inventory-sales ratios increased substantially. December data on the manufacturing sector indicate another sharp drop of $1 billion in durables sales. Meanwhile, durable goods inventories continued to rise, although at a reduced rate, and the inventory-sales ratio increased to the highest level since 1967.

The growth of GNP less inventory change (final expenditures) in the fourth quarter amounted to $13.2 billion, only two thirds the first quarter of 1969. The quarterly advances of final expenditures were successively less throughout 1969 and, by the end of the year, most components' growth rates were distinctly weaker.

While fourth-quarter consumption expenditures rose $9.4 billion, compared with a $7.0 billion advance in the third quarter, the increase was considerably less strong than in the first two quarters, mainly because of a reduction in the purchase of durables. The retail sales figures also indicate lackluster consumer demand. Retail sales, sluggish since the spring of 1969, were essentially unchanged in December. Over the twelve months of 1969,



dollar sales grew only 3.4 percent, while consumer goods prices rose 5.5 percent, suggesting about a 2 percent fall in real sales volume. Approximately half the decline occurred during the fourth quarter of the year, when dollar sales were growing more slowly and prices rising more rapidly than on average during 1969. In particular, unit sales of domestic cars have shown substantial softening. On a seasonally adjusted annual basis, unit sales fell from 8.3 million in November to 7.7 million in December, and in January declined to 6.8 million.

Business fixed investment registered only a relatively small advance in the fourth quarter, increasing $1.9 billion as compared with $3.3 billion in the previous quarter. This slowdown had been previously estimated by Department of Commerce and Securities and Exchange Commission surveys of business spending plans. Capital spending surveys also indicate that in the first half of 1970 the annual growth rate of plant and equipment expenditures could be 13½ percent, about the same as during 1969 on the whole and considerably above the fourth-quarter rate.

The near-term outlook for residential construction, however, is for further moderation. Although residential construction in dollar terms actually rose slightly in the fourth quarter after dropping in the second and third quarters, this reflected home repairs and modernization rather than new building. Recent monthly statistics on housing starts have shown steady declines, as individuals have found growing difficulty in obtaining mortgage financing. Private nonfarm housing starts fell 3 percent in December to a seasonally adjusted annual rate of 1.24 million—the lowest level since December 1967. On the average, starts in the fourth quarter of 1969 were at a seasonally adjusted annual rate of 1.30 million units, 23 percent below the average during the first quarter of 1969. Moreover, in November and December, declines in housing activity occurred in the western part of the country, where usury ceilings are generally higher and home building had been relatively strong. The number of newly issued building permits authorizing new private housing units has been declining, and during the last quarter averaged a full 17 percent less than in the first quarter of 1969. The fall in starts and permits took place despite substantial advances to savings and loan associations by the Federal Home Loan Bank Board (FHLBB) and purchases of insured mortgages in secondary markets by the Federal National Mortgage Association. The recent action of the FHLBB permitting savings and loan associations to raise interest rates paid on all types of accounts may reduce the rate of deposit outflow.

Although Government spending has continued to rise, the increases have tended to lessen. In total, Federal, state, and local government spending edged up $1.9 billion in the fourth quarter, down substantially from the relatively moderate $4.1 billion rise during the July-September period. National defense spending in the fourth quarter actually fell to a level below that of a year ago. While the growth rate of state and local expenditures was up a bit from the third quarter, the fourth-quarter rate is still considerably below rates registered in the first half. Statutory limitations on interest rates that state and local governments may pay on bonds have impeded financing of expansion in this time of tight credit.

INDUSTRIAL PRODUCTION AND ORDERS

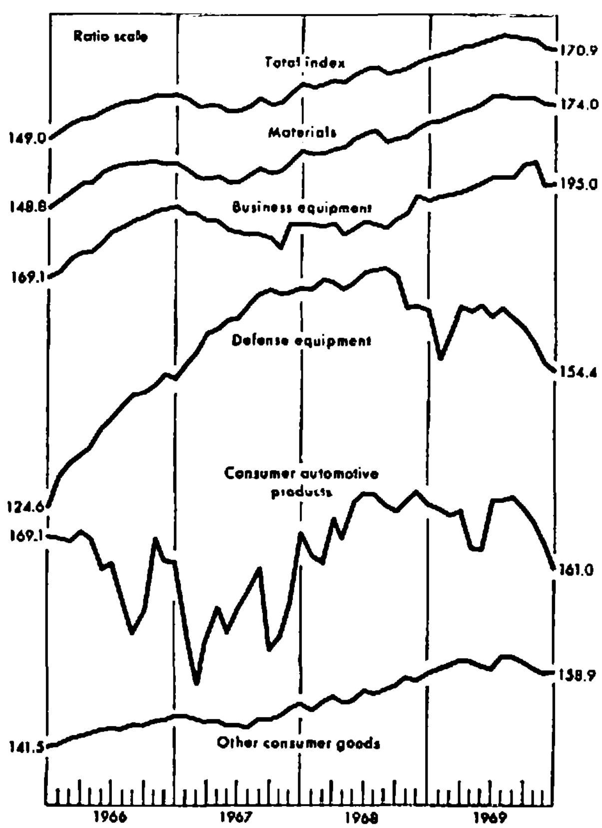
Recent industrial production and new orders data indicate gradual slackening over the months of the fourth quarter. The Federal Reserve Board's index of industrial production fell 0.3 percent in December to 170.9 percent of its 1957-59 level (see Chart II). While the current five-month decline has been the longest continuous monthly downswing in the index since the 1960 recession, the total magnitude of the decline from the July peak has been only 2.1 percent, somewhat less than from December 1966 to May 1967. Furthermore, about one third of the total fall is directly attributable to the General Electric strike, which began in late October.

Reduced auto production has been responsible for about one fourth of the decline in the total production index and is a major reason for the 3.2 percent fall in the output of consumer goods since July. Strikes at General Motors and American Motors plants held auto output down in September-October. In both November and December, Chrysler and General Motors shut down various plants several days in an effort to cut excessive inventories. In the month of December, assemblies declined a full 8 percent from an annual rate of 7.9 million units to 7.2 million units. The latest information indicates still further cuts in auto production. In January, auto assemblies fell to 6.5 million units (annual rate) as the Ford Motor Company joined the other two major auto producers in reducing output; moreover, the big three auto producers have announced additional layoffs for February. The production of other consumer goods, which began to decline before the onset of the GE strike, was 2.4 percent below the July level at the year-end.

Chart II

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. Data for latest four months are subject to revision.

Source: Board of Governors of the Federal Reserve System.

Other categories of output have also fallen. Business equipment production had been quite strong until November, the first full month of the GE strike, when it plunged 3.3 percent. In December, there was only a slight recovery. Decreases in defense equipment output, however, have totaled 9.2 percent since July, and account for about 10 percent of the July-December decline in the total industrial production index. After a large drop in November, materials production edged down in December, with both the iron and steel component and the other materials component reaching levels about 1.4 percent below July. Moreover, ingot production, which is about half of the iron and steel component, declined 6 percent in January.

Another indication of slowing is that new orders received by manufacturers of durable goods have dropped. The orders series fell 4 percent in December to a level that is 8 percent below the September peak. This was the third consecutive month of decline. The December fall was entirely in the transportation equipment category, reflecting slower spending on autos and national defense.

EMPLOYMENT AND PERSONAL INCOME

The aggregate unemployment rate and other labor market indicators have suggested an easing of labor market conditions. The January unemployment rate of 3.9 percent was somewhat above the revised fourth-quarter average rate of 3.6 percent and showed an increase of joblessness in most age-sex categories. Other labor market indicators have shown reduced tightness over the fourth quarter, and January data suggest further moderation. The insured unemployment rate (the percentage of covered individuals receiving unemployment insurance benefits) was up significantly in November and December. Nonagricultural payroll employment has failed to grow from November through January. Furthermore, the average factory workweek in the last quarter of 1969 was down a bit, and in January there was a particularly sizable drop: the average workweek for factory workers in January fell from 40.6 hours to 40.2 hours, while average overtime declined from 3.5 hours to 3.2 hours, the lowest level since mid-1967.

These factors, together with the GE strike, account for much of the reduction in the growth of personal income. Personal income increased by a modest $2.3 billion in December, bringing the average annual rate of growth during the fourth quarter of 1969 to 4.7 percent, down substantially from the annual rates of 7.8 percent in the third quarter and 8.4 percent in the first half. The more modest increases in personal income reflected a reduction in the growth rate of wage and salary disbursements, from 9.0 percent (annual rate) in the third quarter to 5.6 percent in the last three months of the year.

PRICE AND WAGE DEVELOPMENTS

Despite the current slowing of economic activity, there has been no apparent effect as yet on the rate of inflation. Wholesale industrial prices advanced at an annual rate of 4.2 percent in January, as prices of metals and metal products rose sharply. The January increase, about the same as that in December, was in line with the average price rise during the last half of 1969.

Recent increases in consumer prices belie earlier indications of slowing in the rate of inflation. It now appears that the third-quarter rate of 5.3 percent was not indicative of a downward trend in price increases: in December, consumer prices rose at a 7.4 percent annual rate, bringing the fourth-quarter annual rate of advance to 6.2 percent which is just about the same as the average rate during the first half of 1969. Overall, consumer prices rose 6.1 percent in 1969, compared with 4.7 percent in 1968. In fact, the rise from December 1968 to 1969 was the greatest twelve-month increase since the November 1950-November 1951 Korean war period. The huge December jump reflected a sharp rise in food prices, particularly those of fresh vegetables and eggs, and a large increase in the prices of consumer services.

Wage increases have also been large and well in excess of productivity gains. The rapid rise of labor compensation accompanied by lagging productivity resulted in substantial increases in unit labor costs in the private sector during 1969. The rise was almost 7 percent, compared with 5 percent in 1968, mainly because of much smaller productivity increases. Man-hour productivity recovered somewhat over the year, however, and the annual rate of increase of unit labor cost declined from 7.3 percent in the first quarter to 6.0 percent in the fourth quarter.

Furthermore, provisions of 1969 labor contracts covering 1,000 or more workers suggest that wages will rise rapidly over the near term as well. The median per annum wage and fringe benefit increase negotiated in 1969 major labor contracts was 7.4 percent, a substantial acceleration from the 6.0 percent per year median negotiated in 1968 contracts. Moreover, most of the contracts were front loaded—as has been typical in recent years—and provide in the first year of the contract for an 8.2 percent increase in wages alone; in 1968 the median advance in wages during the first year of the contract was 7.2 percent.