The Business Situation

The pace of economic activity continued to moderate as the new year began. In January, industrial production declined for the sixth month in a row, and the volume of new orders for durable goods fell for the fourth consecutive month. Activity in the construction sector—where output fell steadily throughout 1969—continued depressed, as housing starts and permits fell further. Conditions in the labor markets eased, with the unemployment rate rising to 4.2 percent in February. Reflecting the recent lack of growth in nonagricultural employment, personal incomes rose in January by the smallest amount in almost two years. Although signs of a slackening from the earlier hectic pace of business activity are widespread, the rate of price increases remains clearly excessive. At the consumer level, prices rose sharply in both December and January on a seasonally adjusted basis. At the wholesale level, the uptrend through January in prices of industrial commodities has been steep. The February rise in industrial wholesale prices was relatively small, but one month's reading of this series does not provide a basis for drawing significant conclusions.

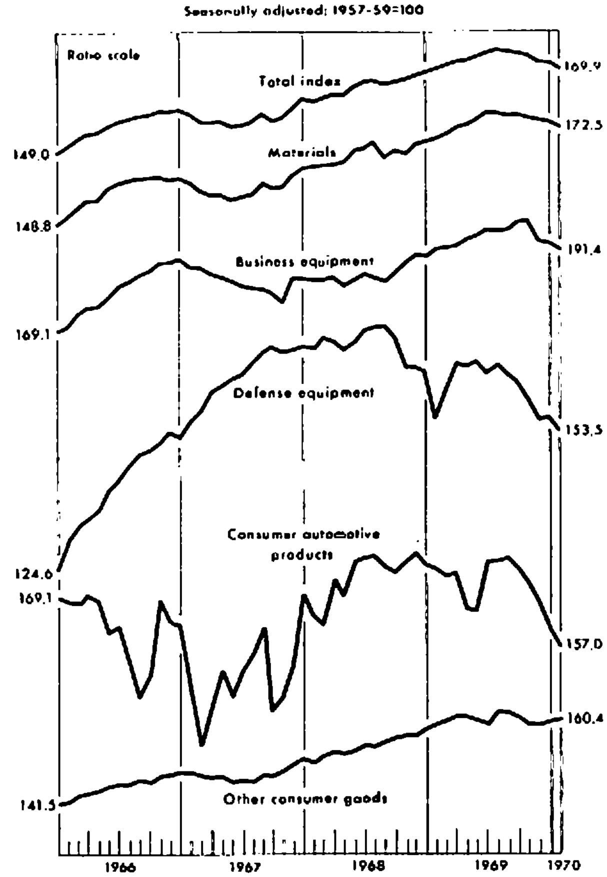
The continued decline of several monthly indicators in January, following the small drop in real gross national product (GNP) in the fourth quarter of 1969, has raised some discussion of the possibility that we may be in a period of "recession". The decline currently indicated for the fourth quarter of last year, however, was very small and would probably not have occurred in the absence of strikes. Moreover, given the small size of the reported decrease, its reality will remain a question until the Commerce Department's annual revision of the GNP data later on this year.

The danger is that the current period of slowdown, whatever language is ultimately used to describe it, may prove too brief to make a serious dent in the inflation problem. It would be most unfortunate if a renewal of excessive demand were to add further to inflationary pressures.

PRODUCTION

The volume of industrial output declined again in January, with the continuing slump in automobile production an important factor in the drop. The Federal Reserve Board's index of industrial production fell 1.2 percentage points to 169.9 percent of the 1957-59 average (see Chart I). This latest drop brought the index to a level 2.7 percent below the peak reached last July. The strike at General Electric, which began late in October and con-

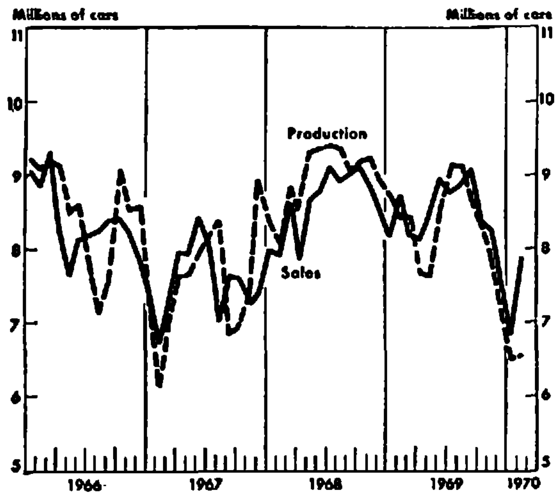
Chart I
INDUSTRIAL PRODUCTION
Seasonally adjusted: 1957-59=100



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. Data for latest four months are subject to revision.

Source: Board of Governors of the Federal Reserve System.

Chart II
DOMESTIC AUTO PRODUCTION AND SALES
Seasonally adjusted annual rates



Source: Ward's Automotive Reports, seasonally adjusted at the Federal Reserve Bank of New York.

nued through early February, contributed to the slump. Excluding the effects of this strike, the overall decline has been about 2 percent. Last month's settlement of the GE strike will tend to shore up the February production index, particularly equipment output. The equipment index dropped rather sharply after the strike began, and December and January saw further small declines.

A good part of the recent slowdown in the industrial sector has resulted from developments in automobile sales and production. The final quarter of 1969 was marked by a substantial weakening in sales of domestically produced automobiles (see Chart II), although sales for the calendar year as a whole totaled 8.5 million units. The beginning of the new year saw a somewhat mixed pattern: in January, sales fell by over 10 percent to a seasonally adjusted annual rate of 6¾ million units; in February sales jumped to an 8 million unit rate, although a considerable part of this rise may reflect an unusually large number of sales contests as well as General Motors' introduction of new models. The drop in sales has led to a substantial increase in dealers' stocks. As in the past, auto producers reacted quickly to the change in demand and reduced production schedules. After averaging yearly production rates of 8¾ million units (seasonally adjusted) in the August-October period, production fell to an average of 7½ million units in the final two months of last year and then dropped to a 6¾ million unit rate in January and February, according to revised data. Indeed, the decline of the motor vehicles and parts component by itself has accounted for about a quarter of the total July-January decrease in the industrial production index, and has also created layoffs in that and other related industries.

While the index for automotive products was cut back substantially in January, output of most other consumer goods was about unchanged. There has been some weakening in production of consumer goods exclusive of automotive products since the July peak, but the decrease has not been large. Partly reflecting reduced demands from auto makers, iron and steel production fell 4.6 percent in January. Steel ingot production, which accounts for about half of the overall iron and steel component of the industrial production index, edged down further in February.

ORDERS, SHIPMENTS, AND INVENTORIES

The recent behavior of new orders for durable goods increases the prospects for a continuation of the current weakness in industrial production. The volume of durables orders fell by 5.2 percent in January, the fourth consecutive month of decline. This latest drop pushed the volume down to $28.7 billion, 11 percent below the record reached last September. The January fall was broadly based, as orders for automobiles, aircraft, fabricated metals, construction materials, and machinery all dropped.

The January data on manufacturers' inventories and shipments suggest further involuntary inventory accumulation among durables manufacturers. For durables industries, the inventory-sales ratio has increased steadily since last October, while the nondurables ratio has fallen to record lows. By December, it had become apparent that some imbalance between inventories and sales was developing in the trade sector as well as in manufacturing (see Chart III). In that month, total business sales dropped by $1 billion and total business stocks increased by that amount.[1] Thus the inventory-sales ratio for all business rose sharply, reaching the highest level since early

[1] The Department of Commerce has revised downward its gross national product estimate of business inventory accumulation to an annual rate of $7.7 billion from the preliminary figure of $7.8 billion discussed in the February issue of this *Review*. Consumption spending was revised upward, while the estimates for business fixed investment and government spending were reduced. The estimate of total fourth-quarter GNP was revised downward by $0.9 billion to a seasonally adjusted annual rate of $952.2 billion, and real GNP was revised down by $0.7 billion to $729.8 billion, $0.8 billion below the third-quarter rate.

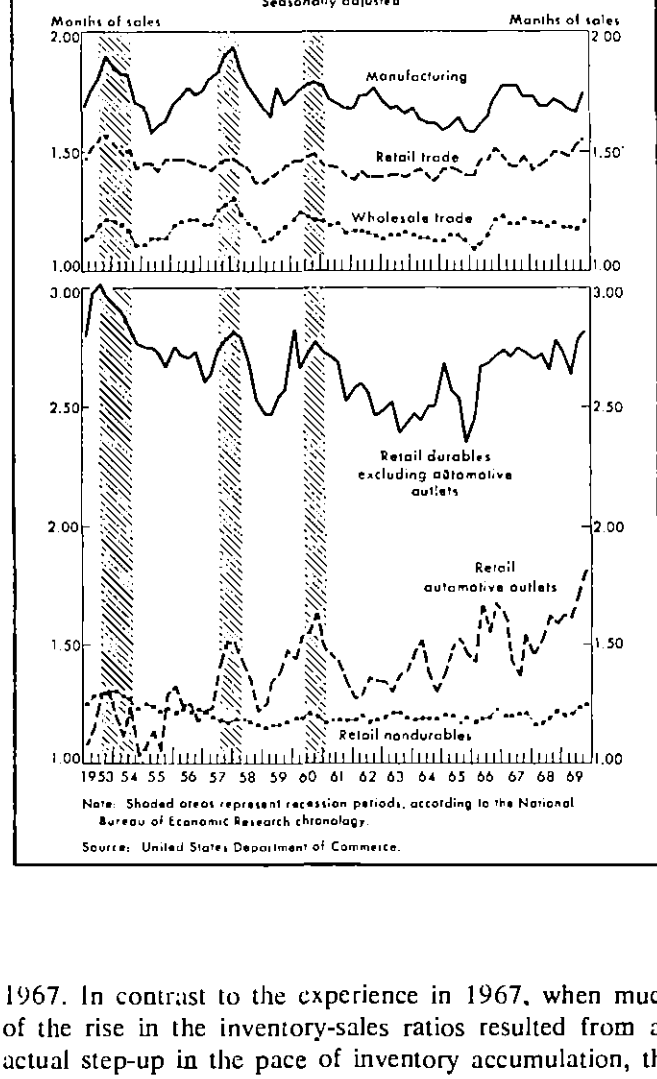


Chart III
INVENTORY-SALES RATIOS
Seasonally adjusted

Note: Shaded areas represent recession periods, according to the National Bureau of Economic Research chronology.
Source: United States Department of Commerce.

1967. In contrast to the experience in 1967, when much of the rise in the inventory-sales ratios resulted from an actual step-up in the pace of inventory accumulation, the recent rise in the ratios stems chiefly from a decline in sales. The major inventory-sales problem appeared to be in the retail sector, where the ratio was the highest since 1954. While an increase in retail auto inventories was a factor in this rise, a steep run-up in the inventory-sales ratio also occurred among other durables stores and at nondurables outlets. These increases occurred at a time when high interest rates presumably would have encouraged low inventory levels.

RESIDENTIAL CONSTRUCTION

The downtrend in residential construction activity has been much steeper than the decline in the industrial sector, and the near-term outlook remains weak. Throughout 1969 the number of new private housing starts declined, although for the year as a whole starts totaled 1,463,000 units—slightly above the levels averaged in the last eight years. In January the downward movement continued, as the volume of starts fell by almost 100,000 to a seasonally adjusted annual rate of 1,166,000 units, the lowest since early 1967. Recent behavior of the series on building permits also points to continued weakness in residential construction. The volume of permits issued by local authorities headed down for most of last year, and in January of this year permits dropped by a precipitous 25 percent to a level 20 percent below the 1957-59 average and about 40 percent below the 1969 rate.

Data on housing starts and permits relate to housing units built on site—that is, these data measure output in the residential construction sector and do not include mobile home production. If mobile home output is added to the public and private starts figure, the volume of new housing units produced in 1969 actually surpassed 1968 output. While mobile homes are not necessarily close substitutes for conventional housing, an increasing number of persons apparently regard them as an attractive alternative, particularly in light of current housing market conditions. Last year, mobile home sales reached 400,000 units, almost half of all new single-family housing units purchased. Moreover, these sales accounted for 90 percent of those new units which sold for under $15,000.

PLANT AND EQUIPMENT SPENDING

In sharp contrast to the slowing in most sectors of the economy, the demand for capital investment was firm through the end of 1969, and it is possible that this strength will continue this year. The results of private surveys, taken in February, of business spending plans for plant and equipment were in line with the trend seen in both Government and private surveys taken in the latter half of last year. As 1969 drew to a close, successive surveys tended to report increasingly higher advances in capital investment plans for 1970. The size of the planned rise reported in these surveys varied between 5 percent and 9½ percent, with the latter increase reported by the special survey taken by the Department of Commerce and the Securities and Exchange Commission in December. These late-1969 surveys were taken before the slackening in economic activity became very marked, and it has been widely thought that subsequent surveys would indicate a downward revision in business spending plans. The private February surveys did point to a cutback by automotive companies, but total outlays by manufacturers are scheduled to rise by more than had been anticipated last fall. The fourth-quarter

1969 decline in manufacturers' net new capital appropriations suggests that the increase in manufacturing outlays may be confined to the first half of 1970. The private surveys taken in February forecast a 10 to 14 percent rise in total plant and equipment expenditures in 1970. While the results of these surveys are consistent with the trend shown in those taken last year, their findings must be viewed with caution. Tight credit conditions, the profit squeeze, the low level of corporate liquidity, and the weaker sales outlook are all major factors dampening the prospects for capital spending this year.

CONSUMER DEMAND, EMPLOYMENT, AND PERSONAL INCOME

Much of the current slowing in economic activity has stemmed from the continued sluggishness of retail sales. For most of 1969 the sales pace was lackluster: total sales for the year were up only 3½ percent from 1968, compared with an 8¼ percent advance the year before. The increase in sales was substantially less than the 5½ percent rate averaged by the consumer price index. In the last several months, retail sales have declined steadily and the weakness has been broad based, though the slump in auto sales has been a major factor. In January, according to the preliminary estimate, sales fell a further 1 percent to $29.1 billion—a level $0.5 billion below the October peak.

Part of the recent weakness in retail sales can be attributed to the slowdown in personal income growth. In January, the increase in incomes was the smallest in almost two years. Wage and salary disbursements rose by only $1.2 billion to a seasonally adjusted annual rate of $529.0 billion. Since October the monthly gains in wage and salary disbursements have averaged $2.3 billion, compared with an average of $3.6 billion in the first ten months of last year.

The lower rate of advance in personal income has largely reflected the recent easing in labor market conditions. Payroll employment surveys indicate that between October and February nonfarm employment rose by only 100,000, compared with an advance of 1¾ million in the first ten months of last year. The employment survey conducted among households also points to an easing of labor market pressures. The unemployment rate, which had averaged 3.4 percent in the first eight months of last year, rose in the September-December period to an average of 3.7 percent. The rate jumped to 3.9 percent in January, as a large increase in the labor force outweighed a gain in employment. In February, nonagricultural employment fell back to the December level and the number of unemployed rose, pushing the unemployment rate to 4.2 percent.

RECENT PRICE DEVELOPMENTS

Despite the clearly evident slowing of the economy in the last few months, the excessive rate of price increases has thus far continued unabated. In January the seasonally adjusted consumer price index rose at a 7.2 percent annual rate for the third month in a row.[2] Leading the January advance was a jump in the transportation index, which reflected increases in automobile insurance and repairs as well as the 50 percent hike in the New York City transit fare. Higher food prices—particularly for meat and eggs—were a major factor in the latest rise. On a December-to-December basis, food prices last year climbed by 7.2 percent, while the total index rose by 6.1 percent.

At wholesale, prices of both industrial goods and farm and food products rose sharply in January, pushing the total wholesale price index up by 0.8 percent. Increases in the cost of both ferrous and nonferrous metals were major factors in the advance in industrial prices. The preliminary estimate for February indicates only a small rise in prices for both industrial and agricultural commodities, following January's surge.

[2] The Bureau of Labor Statistics is now incorporating a seasonal adjustment factor into its series on consumer prices. While some of the components of the index—such as food—have substantial seasonal variations, for most months these changes are about offsetting. Thus, the seasonal pattern for the total index is small.