The Business Situation

Most recent business indicators have suggested some further easing of economic activity, but the depressing effects of several major strikes have made the numbers difficult to interpret. Strikes were a major factor in April declines in payroll employment, private wage and salary incomes, and industrial production. Housing starts also declined in April, but the decrease in this often volatile series followed unexpected rises in the two previous months. Moreover, residential building permits rose in April, raising the possibility that the longer term downtrend in housing may be approaching an end.

Despite the indications of further business declines in April and the sharp drop in stock prices—partly reversed after the May 26 low—there is no evidence that the slowdown in economic activity is intensifying. Industrial production, for example, has been about flat on balance in the first four months of 1970 in contrast to a distinct downtrend in the last half of 1969. As to the future, prospects for some resumption of real growth during the last half of the year still seem good. While the declines in stock prices may have some adverse effect on the outlook for consumer spending, personal incomes have received a powerful boost from higher social security payments and the Federal pay increase. The scheduled elimination of the remaining 5 percent tax surcharge will further add to disposable incomes beginning in July. Corporate profits declined sharply in the first quarter, and manufacturers have marked down their plant and equipment spending plans. Nonetheless, capital spending plans of manufacturing and nonmanufacturing firms as a whole are still scheduled to rise over the rest of the year. Spending by state and local governments will almost certainly be another plus item. The two major areas of weakness so far this year have been residential construction and inventory spending. Even a flattening-out in these sectors would represent an important contribution to revived real growth in the overall economy. In the meanwhile, inflation remains a major concern, since recent price and wage trends have as yet shown little response to the slowdown in economic activity.

PRODUCTION, SHIPMENTS, AND INVENTORIES

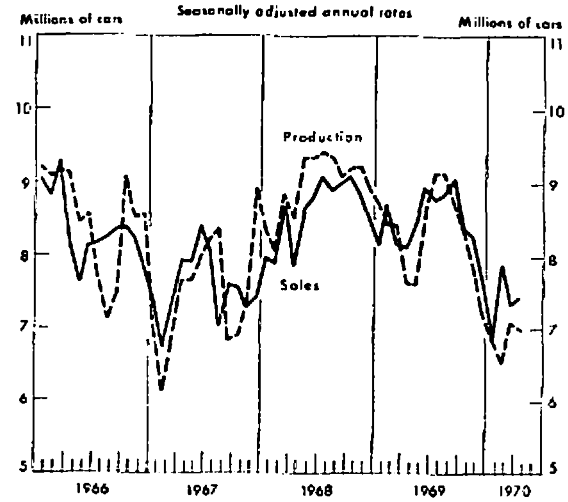
Activity in the industrial sector was sluggish in April, although the situation was accentuated by the strikes and lockouts in the trucking industry that reduced supplies of component parts used in production lines. Following two months of increase, the Federal Reserve Board's index of industrial production slipped 0.4 percent on a seasonally adjusted basis and fell back to the January low of 170.4 percent of the 1957-59 average. Thus, in contrast to the 2.0 percent slide in the production index between the July peak and last December, the index has basically moved sideways so far this year. The April decline was centered in the equipment category, where output of both business and defense industries fell. Defense output has been moving down since mid-1968 and is currently running at a rate that is more than 20 percent below its high. The materials index was a bit lower in April, despite an increase in iron and steel output. Steel ingot production—which accounts for about half the iron and steel index—was up 4 percent in that month, but preliminary data indicate steel production in May fell off by about the same amount. Consumer goods output was about unchanged in April, but the number of passenger cars produced eased to a seasonally adjusted annual rate of 7 million units. The dip in passenger car output was temporary, and auto assemblies in May rose 15 percent to a seasonally adjusted annual rate of 8 million units. Production schedules point to a further small rise in June. Although it appears that the recent slump in automobile sales bottomed in January (see Chart I), car buying has remained depressed relative to the levels of recent years. In March, April, and May, sales averaged a seasonally adjusted annual rate of about 7½ million units, compared with last September's peak of 9 million units and a low of 6¾ million units reached in January.

The flow of new orders received by manufacturers of durable goods rose slightly in April after falling sharply the month before. For the first four months of the year, durables orders averaged $29.0 billion, $2.1 billion below the fourth-quarter average. The continuing weakness in durables orders has resulted in a decline in the backlog of unfilled orders, which in April reached the lowest level in seventeen months.

The backlog has fallen because the pace of durables sales has outstripped the flow of orders, even though the sales rate has been declining. In April, sales by durables manufacturers were the slowest in a year. Shipments of nondurables producers also eased in that month, so that total manufacturers' sales fell substantially. At the same time both durables and nondurables inventories jumped, and the combination of a sales decline and inventory increase again boosted the inventory-sales ratio for manufacturers. Although the ratio stood at the highest level in three years, the problem of excess stocks was concentrated in durables manufacturing, where imbalances were widespread and where the inventory-sales ratio was the highest since early 1961.

In March, durables shipments had slumped by $700 million, accounting for all the drop in manufacturers' shipments. Trade sales had also moved lower, and the fall in total business sales amounted to about $1 billion. Total business inventories, however, rose by $300 million in March.[1]

Chart I
DOMESTIC AUTO PRODUCTION AND SALES



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

RESIDENTIAL CONSTRUCTION AND CAPITAL SPENDING

Recent data on residential construction suggest some firming in home-building activity in contrast to last year's marked downtrend. Residential housing starts were surprisingly strong in February and March, but dipped back in April. The volume of building permits issued by local authorities rose sharply in April and, although movements in this series are sometimes erratic, this strength suggests the possibility that housing starts may be leveling out.

Business spending on plant and equipment has been considerably stronger than investment in residential construction. Recent developments, however, suggest that businesses have trimmed plans for a big increase in capital spending this year. Surveys of business plans for plant and equipment spending, taken last fall and winter by the Department of Commerce and the Securities and Exchange Commission, had pointed to a rise of about 10 percent in 1970. The latest Commerce-SEC survey, however, taken in April and May, pointed to an overall gain of less than 8 percent. Manufacturing industries accounted for almost all the cutback from earlier plans. Total manufacturers' outlays on plant and equipment are now scheduled to rise by 4 percent this year, compared with a 10 percent advance anticipated earlier. Durables producers scaled down their plans from a 10 percent increase to 3 percent. Some evidence that manufacturers were reducing investment plans had been seen in first-quarter data on capital appropriations by the nation's 1,000 largest manufacturers. Net new appropriations declined sharply, and closing backlogs fell for the first time in al-

[1] The Department of Commerce has reduced its first-quarter estimate of the inventory spending component of GNP by $2.1 billion, bringing total inventory investment for the quarter down to a rate of $0.8 billion. The Department also revised its estimate of Federal Government spending up by $2.1 billion to allow for the retroactive portion of the Federal pay raise, which was approved in April. Other small revisions were made which, when cumulated, subtracted $0.8 billion from the preliminary GNP estimate. (The preliminary GNP figures were discussed in the May issue of this *Review*.) GNP is now reported to have risen by $7.4 billion in the first three months of the year to a seasonally adjusted annual rate of $959.6 billion. Although the pay raise offset the downward revision in inventory accumulation in terms of current-dollar GNP, it added nothing to the real value of goods and services purchased. Thus, real GNP fell by $5.5 billion, $2.6 billion more than in the preliminary numbers. By the same reasoning, the Government spent more to obtain the same services, and consequently the deflator rose at a 6.3 percent compound annual rate, compared with 5.0 percent in the preliminary estimate. Although the Commerce Department allocated the retroactive portion of the pay raise to first-quarter GNP, the raise was not disbursed until April. Thus, in the national income accounts all the pay raise will be reflected in the second-quarter wage and salary figures.

most two years. Major factors underlying the cutbacks and postponements in manufacturing have included relatively low factory operating rates, the drop in stock market prices, and the continuation of tight credit conditions. Another important factor has been a substantial decline in corporate profits which in the first quarter fell by $2.9 billion, after taxes, to a $46.1 billion annual rate, the lowest since the first quarter of 1967. In contrast to the drop in manufacturers' investment plans, nonmanufacturing firms—which are generally less sensitive to cyclical changes—have not significantly revised their spending schedules. Nonmanufacturers now anticipate capital spending to run 11 percent above last year.

EMPLOYMENT, INCOME, AND CONSUMER DEMAND

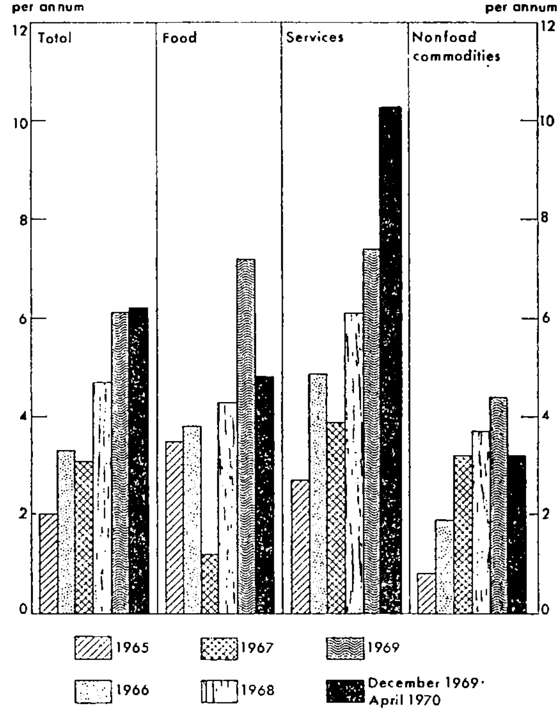
Conditions in the labor market continued to ease in April, as the unemployment rate shot up 0.4 percentage point to 4.8 percent, the highest in five years. Employment dropped substantially in the month, and the labor force rose modestly. The April increase in the labor force was centered among adult men, while the employment decline took place in the adult men and teen-age categories. There was little change in either the employment or labor force participation of adult women.

The number of persons reported on the payrolls of nonagricultural firms declined by 88,000 in April, compared with an average monthly rise of 150,000 last year. While there were small gains in the finance and service categories and a substantial rise in government employment, reflecting Federal Government hiring of 80,000 for the decennial census, all other components recorded declines. The Bureau of Labor Statistics attributes the April drop to greater strike activity. Major stoppages included several strikes in the construction industry, the Los Angeles teachers' strike, and the strikes and lockouts in the trucking industry. Manufacturing payrolls dropped by 144,000, with most of that decline occurring in durables manufacturing. Layoffs were substantial in the automobile, aircraft, electrical equipment, primary metals, and fabricated metals industries. In manufacturing, shortages of component parts stemming from the trucking strike apparently resulted in a reduced workweek in some industries, and the overall factory workweek of production workers declined in April, falling 0.2 hour to 40.0 hours. This was the lowest since July 1964 and was 0.7 hour below the December level.

Reflecting the reductions in employment and in the workweek, private wage and salary incomes in April fell by $1.6 billion, the first decrease in over five years. The decline was partly attributable to the effects of the strikes in the construction and trucking industries. Half the April drop was in manufacturing. In contrast, total personal income soared by a record $17.8 billion to a seasonally adjusted annual rate of $801.1 billion. The 15 percent increase in social security benefits and the 6 percent pay raise for Federal Government employees, both of which were retroactive to January, boosted personal incomes by $12.5 billion and $6.3 billion, respectively.

The large rise in total personal incomes in April was presumably an important factor in the preliminary estimate of a sizable increase in retail sales. Consumer spending will presumably receive another boost at the end of this month with the expiration of the income tax surcharge. Aside from the impact of these special, large increases in income, retail sales have been generally sluggish since last fall. While some of this weakness has reflected the slump in automobile purchases, retail sales excluding spending at automotive outlets have not shown much growth since the autumn. The outlook for a pickup in sales is clouded by

Chart II
CONSUMER PRICE CHANGES
Annual rates; not seasonally adjusted



Source: United States Department of Labor, Bureau of Labor Statistics.

the unknown impact of the current uncertainties over the Indochina situation and the decline in stock market prices.

THE PRICE SITUATION

Inflationary price increases at both the consumer and industrial wholesale levels have continued unabated, and there is as yet no significant evidence of cooling (see Chart II). The consumer price index rose at a 7.2 percent annual rate in April, or 6.3 percent on a seasonally adjusted basis. This brought the climb so far this year to a 6.2 percent annual rate on both an adjusted and unadjusted basis, not much different from last year's 6.1 percent gain. In April, prices of nonfood commodities as well as services rose sharply while food prices moved up at a relatively moderate rate. Higher costs of medical care, automobile insurance, and residential property taxes led the rise in service prices. For the first four months of the year, service prices have climbed at an annual rate even more sharp than last year's. In contrast, there apparently has been some slowing this year in hikes of nonfood commodity prices, although these took a big jump in April. At the wholesale level, prices of industrial commodities rose at a 4.1 percent annual rate in April. In the first four months of this year, industrial prices have advanced at a 4.2 percent rate, compared with a 4.0 percent increase in 1969. The April rise was led by higher prices for fuels, metals, lumber, and hides. Wholesale agricultural prices fell in April, offsetting the increase in the index of industrial commodities, and the total wholesale price index was unchanged. The preliminary estimate of wholesale prices in May indicates that industrial prices moved up at a 4.1 percent annual rate again last month. The estimate also indicated another decline in agricultural prices.