The Business Situation

The strike at General Motors Corporation, which began in mid-September, will greatly complicate for some time to come the task of assessing the underlying business situation. This situation was, in any event, already rather mixed before the strike began—as perhaps should be expected of an economy that is apparently no longer declining but which has yet to resume a clear-cut upward trend. The rise in the unemployment rate to 5.5 percent in September and the drops in average weekly hours worked and in overtime were disturbing, although these figures have been adversely affected by technical problems of seasonal adjustment. Elsewhere in the economy, there are some indications of increased strength. While housing starts backed down in August from their July high, they remained well above the average over the first half of 1970. Private housing construction permits were up in August and substantially ahead of the pace during the first six months of 1970. The considerably easier credit conditions that have characterized the third quarter[1] should channel additional funds into housing and should also help state and local governments finance greater expenditures. Personal income posted a fairly good gain in August, and retail sales were higher in the first two months of the third quarter than earlier this year.

Price increases for consumer goods and services, as well as those for wholesale industrial commodities, have begun to show encouraging signs of moderation and to provide tangible evidence of gains in the struggle against inflation. The prices of wholesale agricultural products, however, rose sharply in September, wiping out much of the improvement in this sector that had appeared during preceding months. Furthermore, there is a distinct danger of an inflationary contract settlement in the automobile industry, which could put increased pressure on wage settlements in other sectors and ultimately on price levels.

[1] See "The Money and Bond Markets in September", this Review, pages 227-33.

RESIDENTIAL CONSTRUCTION

Although private housing starts in August fell to a 1.43 million unit seasonally adjusted annual rate from the 1970 peak of 1.59 million units reached the previous month, the housing outlook is appreciably stronger than earlier in the year. If September housing starts remain close to the July and August average, the third quarter of 1970 will be the best since the second quarter of last year. Residential building permits, an important indicator of the future trend in housing starts, made an encouraging upward move during August, reversing the downward thrust of the previous two months. Over the July-August interval, newly issued permits were running about 10 percent ahead of the average during the first half of this year and only slightly behind the 1969 level. The backlog of unused permits rose considerably during the first half of 1970 and remained high even after falling in July and August. Continuing improvement in the availability of mortgage funds would help translate this backlog into actual housing starts, providing a source of strength for residential construction in coming months.

SALES, INVENTORIES, AND NEW ORDERS

Another possible source of strength is retail sales. Even though advance estimates for August, which are subject to large revisions, suggest some slippage from the comparatively vigorous July pace, retail sales have been moderately strong. Over July and August, seasonally adjusted retail sales averaged approximately $30.7 billion, compared with the $30.5 billion and $29.7 billion averages for the second and first quarters of 1970. Automobile sales were sluggish in September, with one of the probable causes being the auto strike. Nevertheless, third-quarter auto sales suggest a seasonally adjusted annual pace in excess of 8 million units, ahead of the 7.6 million unit rate of sales during the first six months of the year.

Brisk sales in July kept the inventory-sales ratio for total business essentially unchanged from the 1.57 June rate, despite a $1 billion climb in total business inventories on a seasonally adjusted basis. Most of the increases in total inventories and shipments were for manufacturers of durable goods. For retail outlets, inventories changed little relative to sales, although the inventory-sales ratio for retail automotive outlets rose. (A most likely impact of a sustained strike in the automobile industry would be to lower this ratio.) August data are available only for the manufacturing sector. Manufacturers of durables increased their inventories considerably less in August than in July. Their August shipments grew less than proportionately, so that the inventory-shipments ratio rose. For nondurable goods manufacturers, both July and August have been marked by inventory decumulation and smaller shipments; their inventory-shipments ratio, which had remained stable in July, rose during August.

After three monthly gains in a row, new orders for durable goods dropped $0.8 billion in August to a seasonally adjusted $30.6 billion. Even so, the August level was ahead of all previous months in 1970 with the exception of July. The August decline was primarily in new defense orders and followed the large increase in July, which marked the start of the 1971 fiscal year. Excluding defense, new orders for durable goods rose during August and were running $1.0 billion ahead of the average for the first seven months of the year. In the closely watched producers' capital goods sector, new orders fell $0.3 billion, almost back to the April level. For durable goods industries as a whole, new orders declined faster than shipments in August. As a result, the backlog of unfilled orders dropped $0.8 billion to $80.5 billion, with the producer capital goods sector accounting for $0.5 billion of the decline. The backlog of unfilled orders has fallen in each month of 1970, with the exception of July which was heavily influenced by the surge in new defense goods orders.

INDUSTRIAL PRODUCTION AND STRIKE ACTIVITY

The Federal Reserve Board index of industrial production edged down in August, erasing about half the July gain. Output in August was off 3.2 percent from the peak reached in July 1969. Of the major industry groupings, only mining output, which often moves erratically on a month-to-month basis, rose as a result of increases in gas and oil production. The rather small decline in manufacturing was centered in durable goods, particularly iron and steel. Production of consumer goods was slightly below the July level and that of equipment, including defense, slipped for the fifth consecutive month to a level nearly 10 percent below the high reached in September of last year.

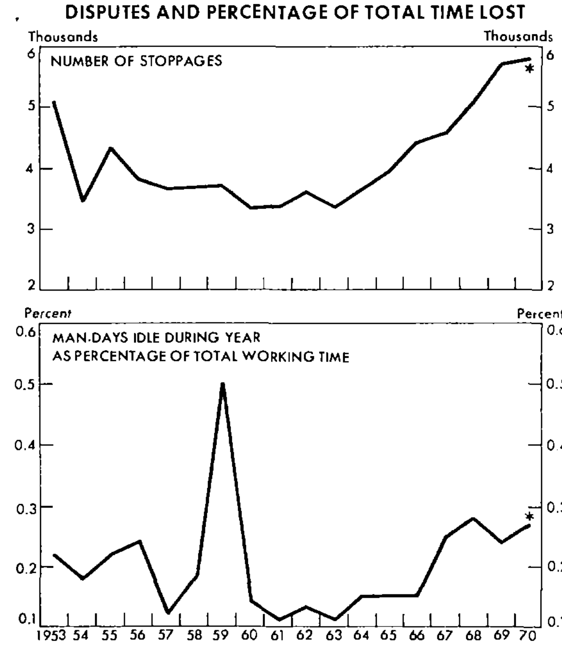
One important question currently facing the economy is how industrial production and business activity in general will fare in the wake of the auto strike that started in mid-September, for a prolonged dispute might adversely affect the timing and size of the expansion. Further labor uncertainty stems from the possibility of nationwide rail tie-ups that could have large secondary effects.

Each of the major automobile strikes during 1961, 1964, and 1967 seems to have been preceded by a quickening in the pace of automobile production and to have been closely followed by a surge in output. Extra production before and after the strikes apparently compensated for the losses during the disputes. The impact of the current dispute cannot, however, be predicted with any certainty from these earlier experiences, which occurred when the economy had already developed considerable upward momentum. In contrast, total industrial production and some other major economic indicators have not as yet established a clear-cut upward trend.

Overall strike activity has increased during the past sev-

Chart I

WORK STOPPAGES RESULTING FROM LABOR-MANAGEMENT DISPUTES AND PERCENTAGE OF TOTAL TIME LOST



* First half of 1970 at an annual rate.

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

eral years. Chart I depicts the number of disputes and the percentage of total working time lost by the employees directly involved in these stoppages beginning in each year since 1953. Available data cover only the first six months of 1970, and developments emerging over the final half of the year may be worse in view of the potentially large impact of the automobile dispute. (The huge 1959 increase in time lost is directly attributable to the 116-day steel strike, involving over half a million workers, which ended after the eighty-day "cooling off" period of the Taft-Hartley Act was invoked.) It should be noted that 1969 was characterized by a relatively "light" collective bargaining schedule, since approximately 2½ million of the roughly 10 million workers covered by "major" agreements[2] were engaged in negotiations. This year, in contrast, the number of workers whose contracts are up for renewal is closer to 5 million. Labor demands in these negotiations have been influenced by expectations of continuing inflation. Recent movements in the cost of living, however, offer some hope that the pace of price increases is at last slowing. Yet, an inflationary settlement of the auto strike could place additional pressure on wage demands in forthcoming labor negotiations.

PRICES

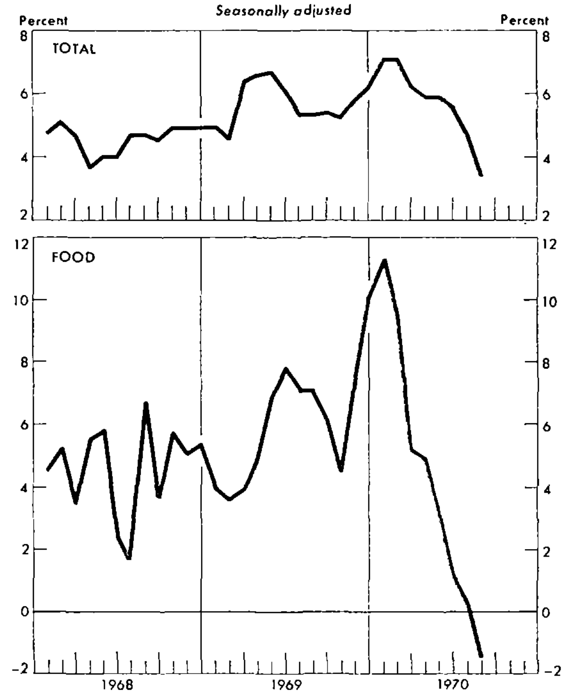
The seasonally adjusted consumer price index for August rose at a moderate 2.7 percent annual rate, the third consecutive monthly slowdown in the rate of increase. An important contribution to the August improvement on a seasonally adjusted basis was made by food prices. The rate of change in food prices, as measured by percentage changes from three months earlier (shown in Chart II) to smooth out some of the erratic monthly movements, has been dropping markedly since early this year under the influence of greater supplies of agricultural products. Similarly, there has been a substantial decline in the annual rate of price increases for the overall index since early this year. Increases in the cost of consumer services, although slower in July and August than in the first half of 1970, remained excessively high. Excluding food and services, prices of consumer commodities rose in annual terms at a seasonally adjusted 2.0 percent in August, the same rate as in July but the lowest for any month of 1970 except February.

Chart II

CONSUMER PRICES

ANNUAL RATE OF INCREASE FROM THREE MONTHS EARLIER

Seasonally adjusted



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

In contrast to the slowing in consumer price increases, the pace of wholesale prices rose to a seasonally adjusted annual rate of 5.1 percent in September, following August's 1.0 percent decline. Agricultural prices largely accounted for these differences. While the consumer price index for food fell in August, wholesale agricultural prices surged ahead at more than a 15 percent annual rate in September, after having fallen at about a 5 percent rate in August. Much of this upward thrust came from higher prices for corn and other grains, linked to anticipations of short supplies because of the corn blight and adverse weather conditions. As a consequence of the September increase, prices for farm products returned to the level of this past April, wiping out all but a small portion of the improvement recorded this year. This raises the prospect that consumer prices for food could soon reflect these developments. However, industrial wholesale commodities prices rose in September by only 2 percent, the same relatively slow pace as in August. This is additional evidence of progress against inflation in an important part of the econ-

[2] The Bureau of Labor Statistics series on major collective bargaining agreements pertains to contracts covering 1,000 or more workers.

omy. Most of the slowing in industrial prices has been in manufactured goods, as fuel and power costs continue to be a source of upward pressure.

PERSONAL INCOME AND THE LABOR MARKET

July and August have been characterized by a marked improvement in the growth of personal income, compared with the second quarter of this year when there was little gain apart from the rise in Federal pay scales and social security benefits. Preliminary estimates for August indicate that personal income rose by $4.1 billion to a seasonally adjusted annual rate of $807.4 billion and, after a substantial upward revision, a $5.1 billion rise was recorded in July.

Larger wage and salary disbursements, mainly in the distributive, services, and government sectors, accounted for a major portion of the personal income gain during both July and August. Wages and salaries in manufacturing, which constitute roughly one fifth of overall personal income, were virtually unchanged in August, after relatively small gains in both June and July and decreases in four of the first five months of this year. These manufacturing data, unlike total personal income, do not reflect the direct impact of Federal pay and social security changes implemented earlier this year and, as such, are indicative of a basic lack of strength in an important sector of the economy.

Labor market weakness continued to be apparent in September, as unemployment rose and hours of work fell. Although seasonally adjusted nonagricultural employment was unchanged in September after five straight months of decline, downward revisions for both July and August reveal even more labor market slack than had been previously indicated. September employment gains in state and local government, trade, services, finance, and transportation and public utilities balanced cutbacks in construction and mining. Manufacturing employment, which had declined sharply since September of last year, was unchanged during September of this year. While hours of work in manufacturing fell to the lowest point since March 1961, a portion of this decline may stem from this year's inclusion of Labor Day in the survey week, thereby reducing the weekly payroll hours of those employees not paid for the holiday.

The September household survey indicated that the seasonally adjusted unemployment rate rose to 5.5 percent from August's 5.1 percent level. The jobless rate in September was the highest since January 1964 and stemmed from the combination of a large expansion in the labor force and unchanging employment. Patterns of unemployment for younger workers suggest that data for September and the preceding summer months may have been distorted by the difficulty of seasonal adjustment. Both the payroll and household surveys for September were conducted prior to the start of the strike at General Motors; should the dispute continue through mid-October, labor market data for that month may also be difficult to interpret. Each survey would be influenced in a different manner by the strike. For the household survey, strikers are counted as employed so that any increase in the unemployment rate associated with the dispute would have to come from its secondary effects, e.g., layoffs of employees working for nonstruck suppliers of parts and materials. Since neither strikers nor laid-off workers appear on company payrolls, nonagricultural employment as recorded in the payroll survey could be markedly depressed by the strike.