## The Business Situation

The nation's output of goods and services declined substantially during the fourth quarter of 1970, when the automotive strike was superimposed upon an already slack economy. Inasmuch as the strike affected almost every individual component of the gross national product (GNP) accounts, it is difficult to measure the full impact of the work stoppage on GNP. Continuing a pattern which has been uninterrupted since last July, the unemployment rate rose throughout the fourth quarter, reaching the 6.2 percent mark in the final month of 1970. Although industrial production increased in December for the first time since July, virtually all the rise was related to the start-up of production at General Motors. Only spending on residential housing showed any significant advance. Whether the buoyancy in this sector will extend to others and generate an overall economic recovery depends primarily on whether there is a resurgence of consumer spending.

Despite the slowdown in business activity in the fourth quarter, the implicit price deflator for GNP rose sharply. While much of the acceleration in this indicator stemmed from technical factors associated with the automotive strike, the underlying price situation showed no apparent improvement over the rapid rate of inflation that had characterized the earlier part of 1970. Indeed, the rate of increase in consumer prices accelerated in the fourth quarter, with all components of the consumer price index (CPI) participating in this step-up. The acceleration in the price advance of nonfood commodities, which exceeded that of the other components of the CPI, was bitterly disappointing since these prices are usually the ones most sensitive to general demand conditions. At the same time, there was some slowdown in the rise of compensation per man-hour; nevertheless, the even greater fall in the growth of output per man-hour, largely the result of the GM strike, resulted in a strong advance in unit labor costs.

### GROSS NATIONAL PRODUCT

The market value of the nation's total output of goods and services edged up $5.4 billion during the fourth quarter of 1970 (see Chart I) to a seasonally adjusted annual rate of $990.9 billion, according to the Department of Commerce's preliminary estimate. This increase was less than half the average rise in GNP in the preceding three quarters and was the smallest quarterly increment since the first quarter of 1967. The depressing influence of the automotive strike on the economy was sizable though difficult to quantify precisely. After allowing for the effects of inflation, the output of real goods and services fell at an annual rate of 3.3 percent in the fourth quarter. This decline, coupled with that in the first quarter, more than offset the small gains in real GNP in the interim quarters. Thus, for the year as a whole, real output fell below the production level recorded in 1969: not since 1957 had there been a year-to-year drop in real GNP.

The rate of increase of final expenditures—GNP less inventory investment—abated in the final quarter of 1970. The increase in final spending was barely half that of the previous quarter. Underlying this slowdown were outright cutbacks in consumption spending on durable goods, in business fixed investment, and in defense spending by the Federal Government. These reductions, however, were more than offset by increases in consumer spending on nondurable goods and services, in residential housing expenditures, and in state and local government spending.

Businesses' inventory investment acted as a drag on the expansion of GNP in the fourth quarter. According to preliminary estimates based mainly on data for the first two months of the quarter, the annual rate of accumulation of inventories fell by $1.4 billion to $4.1 billion, following slight accelerations in the preceding two quarters. This slowdown primarily reflects the activities of retail automobile dealers who continued to sell automotive products after the strike had begun. Elsewhere in the economy, particularly at the wholesale trade outlets and durables manufacturing firms, the pace of inventory accumulation quickened in October and November. At the same time, manufacturers' sales declined, with most of the decrease centered among durables producers, so that it appeared that inventory stocks were somewhat in excess of requirements. The increases in the inventory-sales ratios for the durables and nondurables manufacturing sectors were reversed in December, owing to a slight decumulation of inventories and an increase in sales in both sectors.

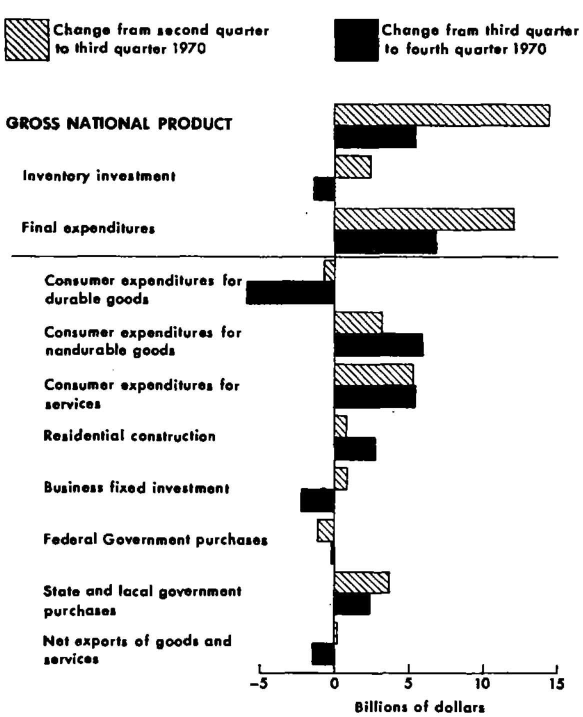
The growth in personal consumption expenditures dropped rather sharply in the fourth quarter. This slowing reflected the reduction in spending on durables, while outlays on nondurable consumer goods and services accelerated slightly. The 6.4 percent decline in spending on durable goods in the fourth quarter was the largest such decrease since 1951. All of the decline centered in the automotive component of durables spending, as the strike-related effects reinforced an apparently underlying weakness in automotive demand. Outlays on consumer nondurables and services in the fourth quarter increased by $11.3 billion. Looking at the year as a whole, consumer spending exclusive of durables expenditures increased slightly more than in the previous year, while durables spending posted a substantial decline, only part of which was attributable to the GM strike.

Although consumer spending slowed, it outpaced the very small $3.9 billion rise in disposable income in the fourth quarter of 1970. As a result, the personal savings rate dipped 0.3 percentage point to a still high level of 7.3 percent. During the last three quarters of 1970, the savings rate averaged 7.5 percent. This prolonged period of very high levels of personal saving is most unusual by historical standards. Whether or not the savings rate will move downward this year is one of the key factors which will determine the pace of overall economic activity over the course of the year.

Chart I

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted




Source: United States Department of Commerce.

Spending on residential structures expanded by a substantial $2.8 billion in the fourth quarter, the largest increase since the third quarter of 1967. This increase followed declines in the first two quarters and a small rise in the third quarter of 1970. The upward trend in spending on residential construction gives promise of extending for several months to come, according to advance indicators. For example, in the closing month of 1970, the rate at which new housing units were begun surged 18 percent and building permits issued by local authorities jumped 17 percent.

Because work progresses on a new housing structure for some time after the unit is begun, the expenditures series lags the housing starts series. Housing starts fell in the first quarter of 1970 to the lowest level since the second quarter of 1967 and have risen in each subsequent quarter, so that fourth-quarter seasonally adjusted starts were on the average 40 percent above those in the beginning quarter. Both single-family and multifamily structures have participated in this recovery, though single-family units expanded at a somewhat faster rate. Following the movement in the starts series, residential expenditures bottomed out in the second quarter and have gained momentum since then; in the fourth quarter, expenditures were 13 percent higher than those in the second. The sharply increased activity in this sector stems from the increased availability of mortgage financing as well as from the swelling of Federal housing subsidy programs. Large inflows of funds into savings institutions—the result, in part, of the high personal savings rate and declines in market interest rates which have improved the competitive position of thrift institutions—have led to some easing in the terms under which new mortgages are extended. Indicative of this trend were the December and January reductions in Federal Housing Administration-insured and Veterans Administration-guaranteed rates and the January lowering of conventional mortgage interest rates by some large New York City commercial banks.

After increasing slightly in the preceding two quarters, business fixed investment fell in the fourth quarter, the result of reduced spending on both structures and producers' durable equipment. The slight fall in expenditures on new business structures marks the third successive quarterly decline. Since trucks and fleet automobiles are an important component of businesses' equipment expenditures, the decline in equipment spending was due mostly to the GM strike. Thus, the resumption of production at GM is likely to boost this component of capital spending somewhat in the current quarter. Apart from the strike, however, business fixed investment spending appears to have leveled off. Separate surveys by McGraw-Hill and by the Commerce Department and Securities and Exchange Commission indicate that firms are planning to increase their plant and equipment expenditures in 1971 by a modest 1 to 2 percent; moreover, all of this increase is scheduled by nonmanufacturing firms, while manufacturers reported that they were planning a cutback in capital spending. This projected weakness reflects, among other things, the depressed level of corporate profits, sluggish sales, and the increasingly large proportion of unused capacity. After these surveys were taken, the Treasury announced its intention to ease the rules by which businesses may depreciate their capital equipment. Nevertheless, it seems unlikely that this move will spur producers' durable equipment spending significantly unless there are concurrent improvements in underlying business conditions.

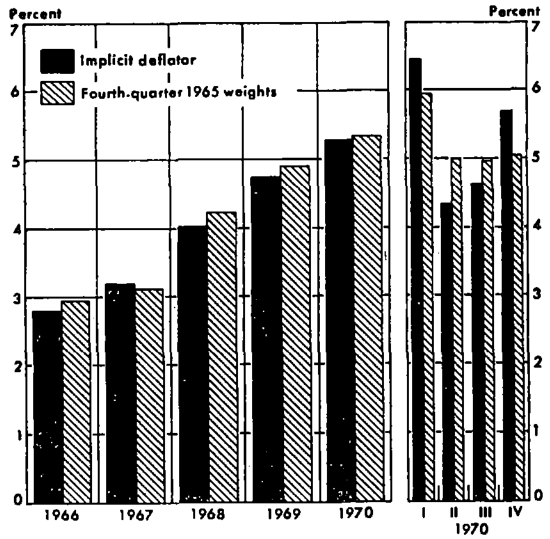
Increased spending by state and local governments contributed \$2.4 billion to the small gain in current-dollar GNP in the fourth quarter. This was somewhat below the rise in state and local government expenditures in the previous quarter. Taking the two quarters together, however, such spending rose at a faster rate than in any half year since the first half of 1968. This acceleration was to some extent related to the marked easing in credit market conditions which characterized the last six months of 1970. Federal Government expenditures, on the other hand, declined slightly in the final quarter of 1970, as a result of a further decrease in defense spending. This more than offset a resurgence in nondefense outlays which followed a net decrease in such spending over the three previous quarters.

### PRICE DEVELOPMENTS

All of the increase in current-dollar GNP in the final quarter of 1970 stemmed from rising prices. The rate of increase of the implicit price deflator for total GNP accelerated to 5.7 percent in the fourth quarter, up considerably from the 4.5 percent average rise in the previous two quarters. Much of this acceleration resulted from the compositional shift in output associated with the strike. The implicit deflator is a weighted average of price indexes for all goods and services; the weight attached to a particular good or service is equal to the proportion of total expenditures in real terms (1958 dollars) that is spent on it in the current quarter. Since 1958, automotive prices have risen less than prices of other goods, so that the price index for autos is low relative to the price indexes for other goods and services. With the output and consumption of automotive goods depressed in the fourth quarter, the composition of output was concentrated in goods with higher price indexes. Even if all prices had remained constant in the fourth quarter, this compositional shift would still have caused the deflator to rise.

The importance of such compositional shifts in the "output mix" as a source of changes in the implicit deflator is not limited to the latest quarter. As an alternative price index, one which abstracts from compositional shifts, the weights used in computing the GNP deflator could be set equal to their value in a particular period—say, the fourth quarter of 1965—and not allowed to change. Any variations in this alternative constant-weight price index (to which class belong the consumer and wholesale price indexes) solely reflect price changes. A comparison of movements of this constant-weight price index with the implicit price deflator (see Chart II) provides a rough guide as to the importance of compositional shifts in inducing changes in the implicit deflator. While the two indexes have moved on a yearly basis along broadly similar lines, their quarterly rates of acceleration or deceleration have differed. In the fourth quarter, this constant-weight price index for total GNP rose at an annual rate of 5.0 percent, only slightly higher than the 4.9 percent average increase for the previous two quarters. Thus, as technical factors were largely responsible for the acceleration in the GNP deflator, it appears that the underlying price situation was essentially unchanged in the fourth quarter. Inflation still gave no clear sign of having yielded to the economic slowdown.

Consumer prices in December rose 6.4 percent on a seasonally adjusted annual rate basis, considerably above the 3.7 percent November advance. As the rate of increase in prices of services declined somewhat, all the December acceleration in the overall index stemmed from rising commodities prices. After falling slightly in November, food prices posted a 2.7 percent rise in December, thus contributing partly to the speedup in consumer prices. The rate of increase in nonfood consumer prices also accelerated in December to 6.7 percent, well above the 4.6 percent average monthly increase for the year ended in November. During the fourth quarter, consumer prices



Source: United States Department of Commerce, Office of Business Economics.

increased at a faster rate. While prices of services and food both contributed to this development, most of the quarterly acceleration stemmed from nonfood commodities prices which increased 5.8 percent in the fourth quarter, compared with the 3.9 percent growth in the previous quarter. At the wholesale level, prices increased 4.6 percent on a seasonally adjusted annual rate basis in January, after remaining unchanged in December. A sharp jump in wholesale agricultural prices entirely accounted for the January acceleration, while the rate of increase in wholesale industrial prices dropped from 4.0 percent in December to 1.7 percent in January.

## PRODUCTION AND EMPLOYMENT

Following the resumption of production at GM, the Federal Reserve Board's index of industrial output climbed 1.4 percent on a seasonally adjusted basis to 163.9 percent of the 1957-59 average. Apart from the increased automotive production, it appears that the pace of the economy was little changed from the preceding month; industrial output less the automotive component nosed up only 0.1 percent and was 5.5 percent below the peak attained in July 1969. Output of motor vehicles and parts jumped 45 percent but failed to reach the pre-strike level. For the most part, this reflected the slow production start-up at GM, but production and sales of automobiles by GM's competitors were decidedly sluggish at the close of the year, leading to some employment layoffs.

The surge in automotive production was reflected in varying degrees in all the market grouping indexes. Within the consumer goods category, a decline in the production of appliances was offset by a rise in that of consumer staples, so that the index for nonautomotive consumer goods was unchanged. Thus, the 2.4 percent rise in the overall consumer goods index was attributable wholly to the automotive component. Reflecting the increase in truck production, the index for defense and business equipment edged up, while declines were registered in the production of industrial equipment, defense goods, and commercial aircraft. Finally, the materials index advanced, the result in part of increased iron and steel output stemming from the automotive start-up.

Concurrent with the fourth-quarter decline in real output, labor market conditions eased noticeably. While part of this deterioration was associated with the GM strike, the December data suggest that the easing went beyond the direct and indirect effects of the strike. In December, the unemployment rate rose 0.3 percentage point to 6.2 percent despite the resumption of production at GM. This latest rise in joblessness brought the average unemployment rate for the quarter to 5.9 percent, well above the third-quarter average of 5.2 percent and dramatically above the 3.7 percent level that prevailed in the fourth quarter of 1969. In January, the unemployment rate fell slightly to 6.0 percent.

The data for nonagricultural payroll employment also reflect some slippage during December. About 180,000 workers were added to the payrolls of nonagricultural firms. This gain was more than accounted for by the 276,000 increase in manufacturing jobs, which reflected the return to work of most of the 350,000 striking automotive workers. Nevertheless, at its December level of 18.8 million workers, manufacturing employment was still 460,000 below the August pre-strike level and was more than 1 million below the December 1969 level. Similarly, total nonagricultural employment in December 1970 failed to return to its pre-strike level and was about 600,000 below the December 1969 level. In January, total nonagricultural employment posted an increase of about 200,000, which was centered in the services and trade sectors while manufacturing employment was virtually unchanged.