# The Business Situation

The vigorous expansion of economic activity appears to have gained further momentum. Industrial production has shown unusual strength over the past few months, spurred on by increased new orders for both durable and nondurable goods. Inventory spending has also been accelerating. Retail sales have remained very robust, with automobile sales proceeding at a particularly rapid clip, and residential construction has continued to show undiminished strength.

Labor market developments also testify to the vigor of the economy. In December the civilian labor force and employment both advanced strongly, and the unemployment rate stood at 5.2 percent, the same as in November but down from 6 percent a year earlier. Recent price and wage movements are mixed, however. Overall consumer prices rose moderately in November, but food prices increased considerably. Average hourly earnings posted only a small rise that month but then jumped sharply in December. Indeed, over the final quarter of the year, wages rose more rapidly than in the two preceding quarters.

## INDUSTRIAL PRODUCTION, ORDERS, AND INVENTORIES

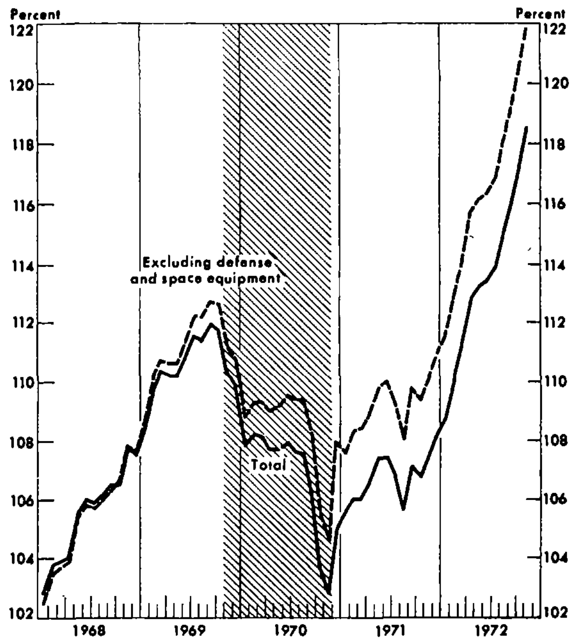
During November, the physical output of the nation's factories, mines, and utilities—as measured by the Federal Reserve Board's index of industrial production—climbed at an extremely rapid 13.3 percent seasonally adjusted annual rate. This constituted the fourth consecutive month of output growth at an annual rate in excess of 10 percent. Such sustained expansion has not been matched since the four-month period from December 1965 through March 1966. Over the first eleven months of the year, industrial production rose at an annual rate of 10.5 percent to a level more than 15 percent above the cyclical trough reached two years earlier (see Chart I).

The unusually rapid pace of expansion in November was widespread among production of final goods and materials other than the defense and space equipment category. Consumer goods production increased at a 14.4 percent annual rate, as the output of automobiles and parts, many types of appliances and furniture, and nondurable consumer goods increased rapidly. In November domestic car production rose to 9.7 million units at an annual rate, and in December to over 10 million units. Output in January is expected to run close to the November level. Since December 1971, production of consumer goods advanced at an 8.2 percent annual rate. Even this sizable gain is overshadowed by the exceptionally large increase in the production of business equipment, particularly since midyear. Business equipment output has advanced at an

Chart I

INDUSTRIAL PRODUCTION

Seasonally adjusted; 1967=100




Note: The National Bureau of Economic Research has tentatively placed the peak and trough points of the recession at November 1969 and November 1970, respectively. Data for latest four months are subject to revision.

Source: Board of Governors of the Federal Reserve System.

annual rate of 12.7 percent over the past eleven months and is now within 1 percent of the peak reached in September 1969.

New orders for durable manufactured goods rose sharply by more than $1 billion, or 3.1 percent, in November. The gain was widely distributed among bookings for primary metals, machinery, household durables, and capital goods. Orders for defense goods, which often fluctuate widely on a month-to-month basis, climbed by about $250 million in November, accounting for less than one fourth of the overall rise in bookings. The backlog of unfilled orders continued to rise during the month, increasing by slightly over $1 billion seasonally adjusted. This marked the fourteenth successive month in which the level of unfilled orders has advanced.

The accumulation of business inventories has gained momentum in recent months. In October, total business inventories rose nearly $1.2 billion. This increase came on the heels of the even more substantial August and September advances which averaged about $1.4 billion. By comparison, over the first seven months of 1972, inventory accumulation proceeded on average at less than $0.6 billion per month. Recent surveys indicate that this inventory buildup is expected to continue.

Preliminary manufacturing data for November suggest that inventory accumulation in this sector has continued at a healthy pace. Manufacturing inventories rose by $0.5 billion, seasonally adjusted, in November, which was about equal to the gain of the preceding month. The $0.6 billion monthly rise in manufacturing inventories averaged over the past six months is in line with increases posted in other expansionary periods. The advance of manufacturers' shipments surpassed inventory accumulation again in November, so that the ratio of inventories to sales continued to decline, reaching its lowest level since the beginning of 1966.

## RESIDENTIAL CONSTRUCTION AND RETAIL SALES

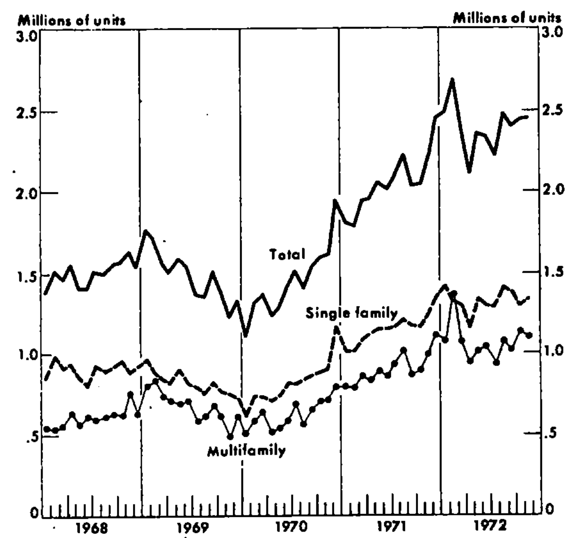
Residential construction is continuing at an extremely rapid pace. In November, private housing starts held steady at a substantial 2.4 million unit seasonally adjusted annual rate. Strength was evident in starts of both single- and multifamily dwellings (see Chart II). Although the multifamily total slipped somewhat from the October pace, it still was at one of the highest levels of the year. Single-family housing starts, on the other hand, rose from the previous month to a level slightly above the average of the first ten months of 1972. Sales of new one-family homes in October, the most recent month for which data are available, were at a seasonally adjusted annual rate of 853,000 units, easily surpassing the old record set in August. At the same time, builders' inventories of unsold new homes increased slightly to a record 394,000 at the end of October. These relatively high inventories and the 2½ percent November decline in newly issued building permits perhaps suggest a future reduction in starts to a rate more in line with estimates of long-run housing requirements.

Consumer spending has been extremely strong in recent months. According to preliminary data, retail sales in November held most of the exceptionally ample October gain. During these two months, retail sales averaged 3.6 percent above the monthly average of the third quarter. November sales of durable goods edged past the high October level, with automotive sales increasing and sales of other durable goods holding constant. The recent strength of the auto market is reflected in sales of domestically produced cars for November and December at seasonally adjusted annual rates approaching 10 million units. Moreover, unit sales of imported automobiles increased sharply in December for the second month in a row. Another indication of the exuberance of consumer demand is the rapid growth of consumer credit. The average monthly increase in consumer debt outstanding in 1972 through November, at $1.5 billion, was considerably greater than that of 1971 and nearly triple the low 1970 average.

Chart II

PRIVATE HOUSING STARTS

Seasonally adjusted annual rates




Source: United States Department of Commerce, Bureau of the Census.

### PERSONAL INCOME

Personal income expanded by a large $8.7 billion in November to a seasonally adjusted annual rate of $972.5 billion. This increase was considerably smaller than the $17 billion surge reported for the previous month, but the October gain included a 20 percent rise in social security benefits. Excluding this nonrecurring factor, the October and November increases were approximately equal. It should be noted that month-to-month fluctuations in personal income have been particularly large this year because of an exceptional number of unusual influences—the Federal civilian and military pay raise, the retroactive wage increases following the wage-price freeze, the increase in the social security tax base, the capital losses inflicted by tropical storm Agnes, and as noted above the social security benefits increase. In any event, over the first eleven months of 1972, personal income rose at an annual rate of 10.1 percent, with the wage and salary component advancing at a slightly slower pace.

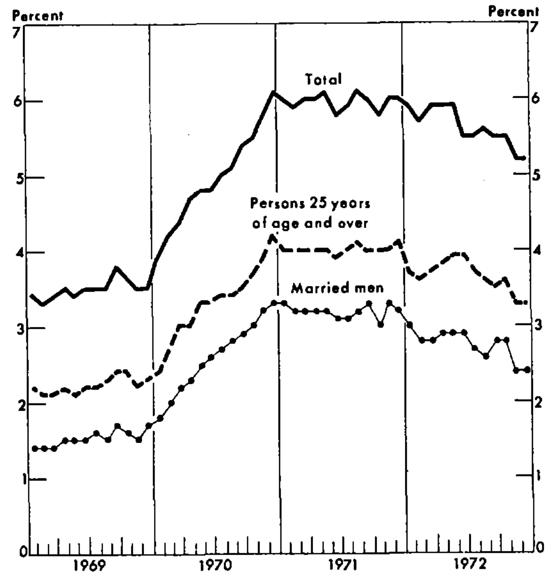
### EMPLOYMENT AND UNEMPLOYMENT

The labor market continued to show signs of strength in December. According to the survey of households conducted by the Department of Labor, civilian employment rose by 280,000 workers on a seasonally adjusted basis in December. Since the civilian labor force grew by a comparable magnitude, the overall rate of unemployment remained unchanged at November's level of 5.2 percent (see Chart III). Before November the unemployment rate had been stuck around 5.5 percent for five months. With the December figure, the total unemployment rate averaged 5.6 percent in 1972, down from the sticky 6 percent rate prevailing in 1971. Similarly, the unemployment rate for persons twenty-five years of age and older declined gradually in 1972, particularly over the last six months, so that the year's average of 3.6 percent was below the 4 percent rate posted in 1971. Fluctuations in unemployment rates for adults seem to be more meaningful indicators of labor market conditions than do changes in rates of younger workers, since the latter tend to be more volatile as a result of high turnover rates and resultant periodic employment. Married men constitute another significant labor subgroup because of their exceptionally strong attachment to the labor force. The unemployment rate of married men declined considerably over the year, averaging 2.8 percent in 1972 compared with the 3.2 percent level of the preceding year. By the fourth quarter of 1972, the rate of unemployment for married men was down to an average of 2.5 percent. In the past, such low levels of unemployment among these primary workers have tended to be accompanied by upward pressures on prices.

Chart III

SELECTED UNEMPLOYMENT RATES

Seasonally adjusted




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

Although nonagricultural payroll employment increased only marginally in December, payroll data over the final quarter of 1972 show a healthy 716,000 worker increase —more than one fourth the substantial gain registered in 1972. The overall improvement in the labor market last year is clearly evident as the increase in payroll employment of over 2.6 million workers was more than two and a half times the expansion in 1971. Manufacturing payrolls, which actually declined in 1971, climbed by 4½ percent in 1972, and this was accompanied by a marked rise in both the average factory workweek and hours of overtime. In fact, in December, weekly hours in manufacturing reached their highest level since mid-1968 and overtime was at its highest since late 1966.

### WAGES AND PRICES

There have been some indications in recent months that the pace of the advance in wages is again beginning to quicken, although the month-to-month variation in wage growth has been quite wide. Average hourly earnings of production and nonsupervisory workers in the private nonfarm economy, adjusted for overtime hours in manufacturing and for shifts in the composition of employment among industries, increased in December at a rapid 10.7 percent seasonally adjusted annual rate after advancing at only a 1.7 percent pace in the previous month. On average over the fourth quarter, the growth in hourly earnings accelerated to a 7.4 percent annual rate from the preceding three-month period, up from the more moderate second- and third-quarter gains of 5.4 percent and 5.1 percent, respectively. Although on balance the 5.9 percent annual rate of advance in wages since January 1972 is still slower than the 7.2 percent increase experienced in 1971 before the freeze, increases in the final months of last year suggest that movements in wages will bear watching closely in 1973, with its heavy schedule of collective bargaining agreements to be negotiated.

Consumer prices rose at a 3.3 percent seasonally adjusted annual rate in November, the slowest advance in three months. Food prices surged ahead at a 14 percent annual rate, but prices of consumer nonfood commodities and services rose only moderately. Over the three months ended in November, prices of consumer nonfood commodities increased at less than a 2 percent annual rate and in the year since November 1971—the period covered by Phase Two of the Economic Stabilization Program—such prices rose about 2½ percent. Of course, the recent slowdown was strongly influenced by delay in Price Commission approval of some price increases for new 1973 model cars. Nevertheless, over the past year, nonfood commodity price increases represent considerable improvement relative to the rapid advances experienced in 1969 and 1970. Similarly, prices of services have risen 3½ percent over the past year, well under the pace of 1969, 1970, and the first eight months of 1971.