The Business Situation

The economy continues to exhibit substantial strength. Industrial production moved ahead at a rapid rate in February, exceeding increases in the two preceding months. According to the latest Commerce Department survey, businesses have revised upward their plant and equipment spending plans for 1973. Further indication of the strength in the capital goods area is provided by the record jump in capital appropriations by large manufacturers in the fourth quarter. Total business inventories rose in January at the fastest rate in over six years, and further gains in inventory spending appear likely in the months to come. In February, the pace of residential construction activity remained robust, with housing starts only slightly below the high January mark. Retail sales in the January-February period were well above the December level, and sales of domestic passenger cars reached a record seasonally adjusted annual rate of 10.6 million units in March. The strength of the expansion has also been evident in the labor market. Employment rose sharply in both February and March, and this was accompanied in February by large increases in both the average workweek and overtime hours in manufacturing.

On the other hand, the outlook for prices is very disturbing. Wholesale prices in March skyrocketed at a seasonally adjusted annual rate of nearly 30 percent, the largest monthly increase since January 1951. While prices of farm products and food posted the most dramatic advances, prices of a wide variety of industrial commodities experienced distressingly large increases as well, some of which doubtless reflected a bunching of price rises that had previously been restrained by the Phase Two controls. These wholesale price increases are likely to be reflected in retail prices in months to come. Even in February the consumer price index advanced at the fastest rate in twenty-two years. Average hourly earnings rose only modestly in March and over the first quarter as a whole, but recent price developments may have jeopardized the chances of continued moderation of wage increases.

INDUSTRIAL PRODUCTION, CAPITAL APPROPRIATIONS, ORDERS, AND INVENTORIES

Industrial production is estimated to have expanded in February at a seasonally adjusted annual rate of 9 percent. This advance, which was larger than the increases in the two previous months, was widely distributed among final products. Business equipment output climbed strongly following a large rise in the previous month. Production of consumer goods moved up further in February, paced by an exceptional increase in durable goods output. To a considerable extent, this gain probably reflected the acceleration in production of domestic automobiles. Passenger car output rose to a seasonally adjusted annual rate of 10.1 million units in February and dipped only slightly in March to 10 million units. By comparison, a total of 8.8 million cars was produced domestically in 1972. Furthermore, output of defense and space equipment rebounded sharply in February from its January decline.

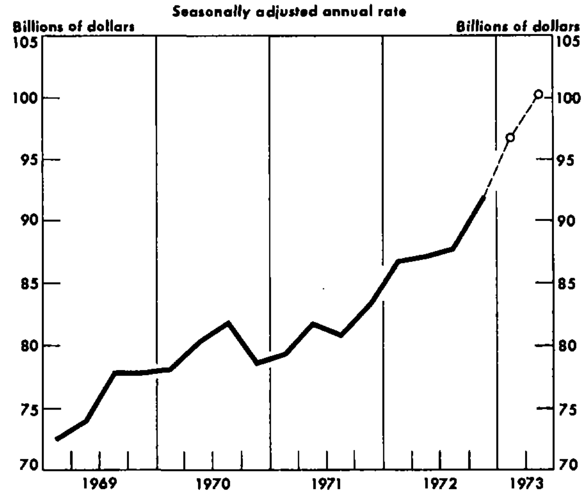
According to the Commerce Department's most recent estimates, businesses increased their expenditures on plant and equipment substantially in the fourth quarter, expanding them by $4.3 billion to a seasonally adjusted annual rate of $91.9 billion (see Chart I). Over 1972 as a whole, such spending was 8.9 percent above that of 1971. This latest Commerce survey indicates a rise in outlays for plant and equipment in 1973 of 13.8 percent, about 1 percentage point higher than the increase indicated in the December survey. Manufacturers' outlays for plant and equipment are expected to post a gain of 18 percent, while spending by nonmanufacturing firms is anticipated to rise 11.4 percent. In a separate survey conducted by the Conference Board, the 1,000 largest manufacturing firms reported that their capital appropriations rose by a record 12 percent in the fourth quarter. In addition, cancellations declined and, consequently, appropriations net of cancellations grew at an even more rapid 15½ percent pace. This sizable expansion in appropriations was accompanied by

Chart I

PLANT AND EQUIPMENT EXPENDITURES

ACTUAL AND ANTICIPATED

Seasonally adjusted annual rate



Note: Figures shown for the first and second quarters of 1973 are estimates of intended spending from the January-February survey.

Source: United States Department of Commerce, Bureau of Economic Analysis.

a further increase in the backlog of unspent funds, providing additional credibility for projections of sizable expansion in capital spending in 1973.

Preliminary data indicate that new orders placed with manufacturers of durable goods edged up $0.4 billion in February, after rising by a huge $1.9 billion in January. Increases in bookings for primary metals and household durables more than offset declines in orders for nondefense capital goods. Defense bookings rose $0.1 billion in the month.

In January the book value of manufacturing and trade inventories advanced $1.9 billion, significantly above the $1.3 billion average gain posted over the last five months of 1972 when the pickup in inventory spending began. Indeed, the January rise was the largest percentage increase in inventories since December 1967. Despite the recent advances in inventories, the overall inventory-sales ratio has declined for eight consecutive quarters. Moreover, in January, total manufacturing and trade sales rose $3.7 billion and the inventory-sales ratio fell further to 1.43, the lowest level in nearly seven years. Indeed, with the exception of two months in 1966, this was the lowest ratio of inventories to sales since early 1951, when inventories were undoubtedly depressed by events related to the Korean war (see Chart II).

Preliminary data suggest that inventory accumulation in the manufacturing sector has stepped up further. In February, the book value of these inventories swelled by $0.9 billion on a seasonally adjusted basis. The February increase went well beyond the pace experienced during the preceding six months when monthly gains in manufacturing inventories averaged $0.6 billion. The inventory advance in February was broadly based in both durables and nondurables. Shipments moved ahead $0.6 billion in the month, after increasing by a considerably larger amount in January. Unfilled orders climbed a large $1.6 million in February, and the inventory-sales ratio edged down further to the lowest level since March 1951.

PERSONAL INCOME, RETAIL SALES, CONSUMER CREDIT, AND RESIDENTIAL CONSTRUCTION

Personal income climbed substantially by $8.3 billion in February, compared with increases in January and December of $2.7 billion and $6.7 billion, respectively. The bulk of the February increase was attributable to wage and salary disbursements, which rose $5.7 billion. In turn, this gain stemmed primarily from substantial advances in both employment and hours of work. It should be noted, however, that recent movements in this series have been affected by a variety of special factors. For example, an increase in social security benefits boosted personal income by $1.1 billion in February. In contrast, income in January was depressed by a rise in the social security tax rate and base.

Consumer spending has remained very healthy in recent months. Seasonally adjusted retail sales rose $0.6 billion in February on the heels of a huge $1.3 billion gain in the preceding month. Sales of both durable goods and nondurable goods increased in both months. Sales of new domestic-type automobiles were at a substantial 9.9 million unit annual rate in February, and in March such sales moved up to a record 10.6 million units.

Another indication of the buoyancy of consumer activity has been the rapid growth of consumer credit. Total consumer credit outstanding expanded 13.9 percent in 1972, its fastest growth rate since 1959. This increase was paced by the rise in instalment credit, although noninstalment debt also posted a strong advance. Some $5.5 billion of the $16 billion increase in consumer instalment credit was in automobile loans. In January and February, seasonally adjusted consumer credit rose by $2.1 billion and $2.0 billion, respectively. Almost all of the increases occurred in instalment credit, which posted successive record gains in the two months (see Chart III). The expansion in instalment credit was reflected in rapid increases in both auto and nonauto instalment debt.

LABOR MARKET DEVELOPMENTS

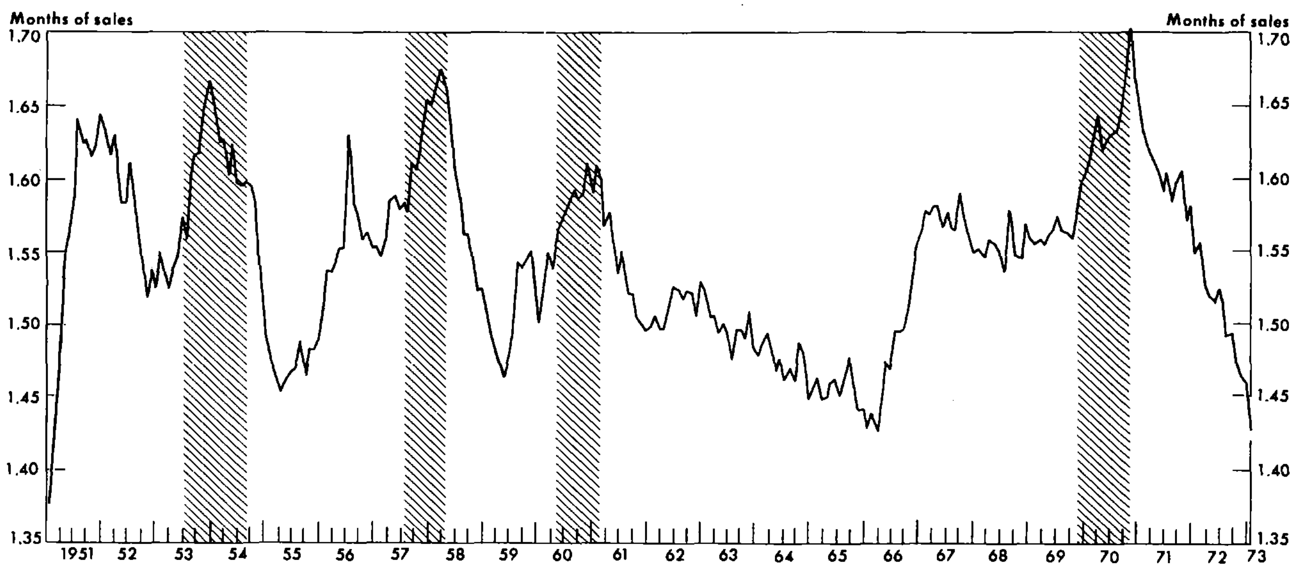
Recent developments in the labor market attest to the continuing strength of economic activity. According to the survey of households conducted by the Department of Labor, civilian employment rose by a huge 762,000 on a seasonally adjusted basis in March on the heels of a 572,000 increase in February. The civilian labor force also advanced by unusually large amounts of 648,000 and 699,000 in February and March, respectively. As a result, although the seasonally adjusted unemployment rate inched up to 5.1 percent in February, it declined to 5 percent in March. Taking a slightly longer viewpoint, the average unemployment rate for the first quarter of 1973 was 5 percent by comparison with 5.3 percent in the fourth quarter of 1972. Unemployment rates for adult males, adult females, and teen-agers were all below their fourth-quarter levels.

According to the separate survey of establishments, nonagricultural payroll employment in March moved up by 188,000 workers on a seasonally adjusted basis, following a huge 468,000 increase in the preceding month. Over the January-March period, gains in employment were broadly based with large increases in manufacturing and construction. The average workweek in manufacturing climbed sharply in February by 0.6 hour to 40.9 hours; overtime in manufacturing rose 0.2 hour to 3.9 hours, the highest since October 1966. Both the average workweek and overtime in manufacturing remained at these levels in March.

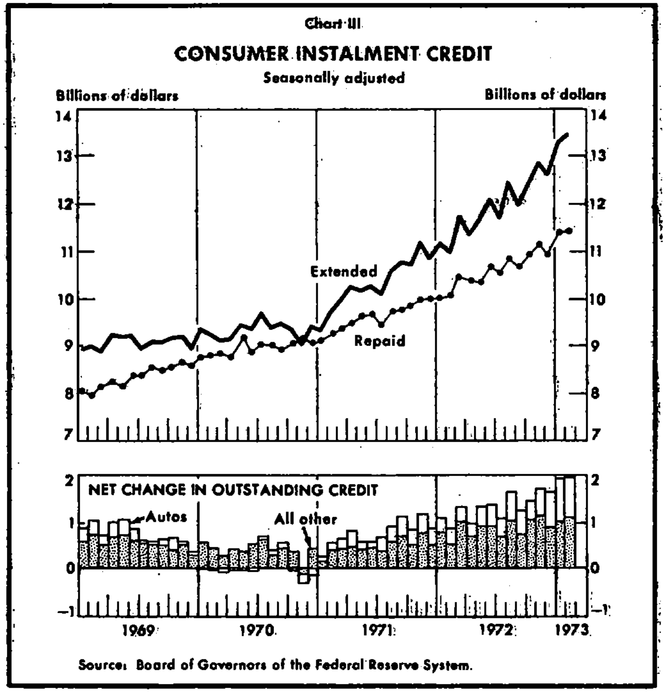
PRICES AND WAGES

Although an initial Phase Three bulge doubtless accounts for some of the recent price increases, the latest information on prices points to serious inflationary problems. The rate of increase of consumer prices accelerated in February following already large advances in January. In February the consumer price index moved ahead at a seasonally adjusted annual rate of 9.8 percent, the largest monthly rise in twenty-two years. Food prices soared at an annual rate of 29.5 percent on the heels of a January advance in excess of 25 percent. In a move to prevent meat prices from rising above the already high levels that they had reached, President Nixon on March 29 announced the imposition of price ceilings on beef, pork, and lamb at the wholesale and retail levels but not on farmers' live animal sales. Prices of nonfood commodities

Chart II
BUSINESS INVENTORY-SALES RATIO
Seasonally adjusted



Source: United States Department of Commerce, Bureau of Economic Analysis.



moved up at a 6.1 percent seasonally adjusted annual rate in February. These prices had been steady in the previous month. Prices of services, which are not adjusted for seasonal variation, climbed at a 4.5 percent annual rate, also faster than the January increase.

Wholesale prices exploded in March at a seasonally adjusted annual rate of nearly 30 percent, the most rapid increase since January 1951. Prices of farm products and processed foods and feeds shot upward at a 74 percent seasonally adjusted annual rate, well above the already extremely rapid pace of the two preceding months. Prices of industrial commodities in March rose sharply at a seasonally adjusted annual rate of 15 percent, also the largest increase since January 1951. The March rise in industrial prices marked the second consecutive month of inordinately large advances. While the increases were widespread among industrial product groupings, particularly large advances were registered in prices of lumber and wood products, metals and metal products, textiles and apparels, and chemical and allied products.

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, rose at a modest 4.3 percent annual rate in March. The increase over the first three months of the year was only 2.8 percent. In the past six months the rate of increase in wages has been a moderate 5.4 percent. This is an encouraging development, to be sure, but continued moderation in wage increases may be very difficult to achieve in view of the steep increases in prices—especially food prices—that have occurred recently.