The Business Situation

Most sectors of the economy continue extremely strong. Industrial production and personal income rose rapidly in April. While new orders for durable manufactured goods declined in that month, the backlog of unfilled orders has climbed sharply thus far this year, suggesting further sizable increases in output accompanied by shortages and delays. Exceptionally low inventory-sales ratios, moreover, suggest the likelihood of strong inventory accumulation in coming months. Only residential construction is showing clear signs of weakening, as private housing starts in April fell to their lowest level in eighteen months. The unemployment rate remained unchanged at 5 percent in May, as both the civilian labor force and employment rose slightly.

Amidst the robust economic expansion, pressures on capacity and resultant demand pressures on prices are becoming increasingly severe. The revised fixed-weight price index for gross national product (GNP) increased at an 8.2 percent annual rate in the first quarter, up from the preliminary figure of 7.5 percent.[1] Consumer prices, seasonally adjusted, rose at a 7.8 percent annual rate in April as the advance of both food and nonfood commodity prices remained distressingly rapid. Over the past three months, consumer prices have risen at an annual rate in excess of 9 percent. In light of pervasive reports of shortages and delivery delays, demand pressures on prices seem likely to persist for some time to come.

[1] The Department of Commerce has revised the increase in current-dollar GNP in the first quarter from a seasonally adjusted annual rate of 14.3 percent to 15.2 percent. Most of this change reflected an increase in prices, as the growth in real GNP was raised only slightly. Inventory investment was revised downward, while the estimate of final sales was raised. Corporate profits before taxes climbed $3.4 billion to a $99 billion seasonally adjusted annual rate.

INDUSTRIAL PRODUCTION, ORDERS, CAPITAL APPROPRIATIONS, AND INVENTORIES

The Federal Reserve Board's index of industrial production climbed in April for the eighteenth consecutive month. The preliminary data indicate that the index rose at a robust 11.8 percent seasonally adjusted annual rate in April. During the first four months of this year the index has climbed at a 10 percent annual rate, the same increase as that experienced over 1972 as a whole.

Vigorous growth in most of the major market groupings combined to make the April rise in industrial production much larger than in March. Output of materials and business equipment grew twice as rapidly in April as in the previous month, and production of intermediate products and defense equipment rebounded sharply from declines in March. Similarly, production of consumer nondurables recovered strongly after having been sluggish in February and March. However, the expansion of consumer durable goods output slowed somewhat from the brisk pace of the preceding two months. Assemblies of domestically produced passenger cars eased slightly from the seasonally adjusted annual rate of 10 million units in March to 9.9 million units in April. These assemblies edged up to 10 million units in May, bringing new car production in the first five months of the year to a prodigious annual rate of 9.9 million units.

After increasing markedly over the first quarter, new orders for durable manufactured goods dropped in April by almost $0.9 billion (see Chart I), or about 2 percent, according to preliminary estimates. The decline was widely distributed among bookings for primary metals, machinery, household durables, and capital goods. At the same time, the backlog of unfilled orders continued to rise, as the level of new orders once again exceeded shipments. Since the beginning of the year, the seasonally adjusted stock of unfilled orders has increased at an exceptionally rapid

33 percent annual rate. While this suggests further sizable expansion in durable goods production in coming months, it may also be indicative of emerging shortages and lengthening delivery times in some industries.

According to the Conference Board, the nation's 1,000 largest manufacturers increased new appropriations for plant and equipment to a record $9.5 billion in the first quarter (see Chart II), a 15.5 percent gain over the level of the fourth quarter. The first-quarter advance was paced by large increases in the capital appropriations of durable good manufacturers, with particularly sizable gains in the automobile industry. This overall strength in appropriations corroborates earlier indications that capital spending by manufacturing firms will be robust throughout the year.

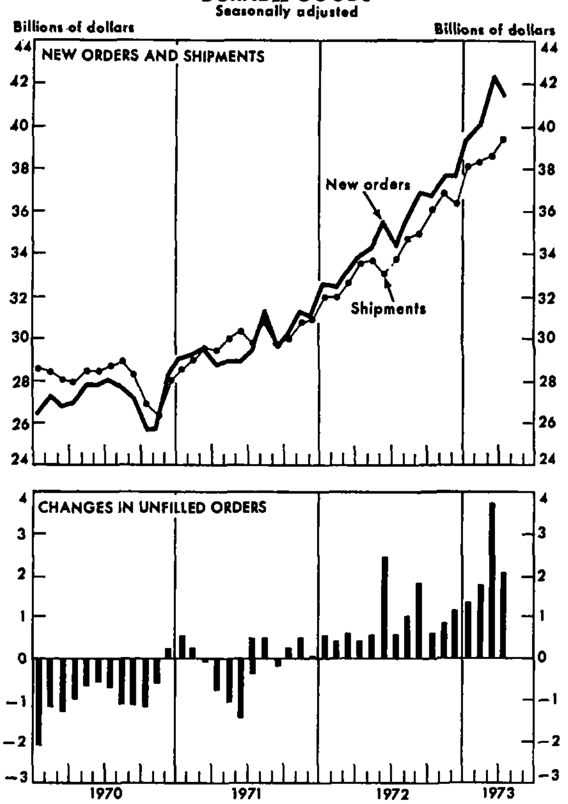
In March, seasonally adjusted manufacturing and trade inventories climbed $1.4 billion. The gain was smaller than the unusually large $2 billion increase averaged over the previous two months, but was about the same as the monthly rise from August to December of last year when the current inventory buildup began. The $5.4 billion runup in the book value of inventories in the first quarter was the largest in twenty-two years. However, to a considerable extent the recent rise in book value inventories reflected sharply higher prices rather than an acceleration in the accumulation of physical stocks. In any event, nearly all of the March rise in inventory spending occurred in the manufacturing sector. Manufacturers added $1.2 billion to inventories and, in particular, the stocks of durable goods producers rose $800 million. Aggregate retail trade stocks moved up slightly but, reflecting declines in autos, furniture, and household appliances, inventories of durable goods declined. Wholesalers' inventories inched up only $50 million. Meanwhile, sales of manufacturing and trade firms continued their strong upward trend and, as a result, the inventory-sales ratio fell further in March to the lowest level since January 1951.

According to preliminary data, the book value of manu-

Chart I

ORDERS AND SHIPMENTS OF MANUFACTURED DURABLE GOODS

Seasonally adjusted



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

Chart II

NEW CAPITAL APPROPRIATIONS IN MANUFACTURING

Seasonally adjusted

Source: The Conference Board, Inc.

facturing inventories was unchanged in April, following the very large March increase. Small gains in the durable goods sector offset correspondingly small declines in nondurables. Since manufacturing shipments moved ahead strongly, the inventory-sales ratio declined further from its already very low March level.

PERSONAL INCOME, RETAIL SALES, AND RESIDENTIAL CONSTRUCTION

The growth of personal income quickened in April from the pace of the first quarter. The $7.6 billion advance raised personal income to $1,009 billion at a seasonally adjusted annual rate. Most of this increase was accounted for by a $6 billion gain in wage and salary receipts. Manufacturing payrolls alone rose $3 billion, with the bulk of the increase coming in durable goods industries.

According to the advance report, retail sales slipped 1.5 percent in April on a seasonally adjusted basis following a strong and unusually steady climb. Inasmuch as this series typically moves somewhat erratically, one-month movements—especially in the advance data—are not likely to be very significant. Estimates of retail sales for both February and March were revised down slightly, but the data still show an extraordinary advance in the first quarter. The April drop in total sales reflected a widespread easing in spending. Outlays for furniture and appliances as well as for apparel and other soft goods declined. Sales of new domestically produced autos dipped to a still strong 9.8 million units at a seasonally adjusted annual rate, compared with the record 10.6 million units in March, and imported car sales were down slightly to 1.9 million units annually. In May, however, domestic auto sales moved up to 10.1 million units. While it is still too early to tell if some of the exuberance is consumer spending is beginning to fade, the April Census Bureau survey of consumer buying intentions revealed a pronounced decrease in consumer optimism. Plans to purchase most durable goods, including new cars and furniture and appliances, were noticeably lower than they were in the January survey.

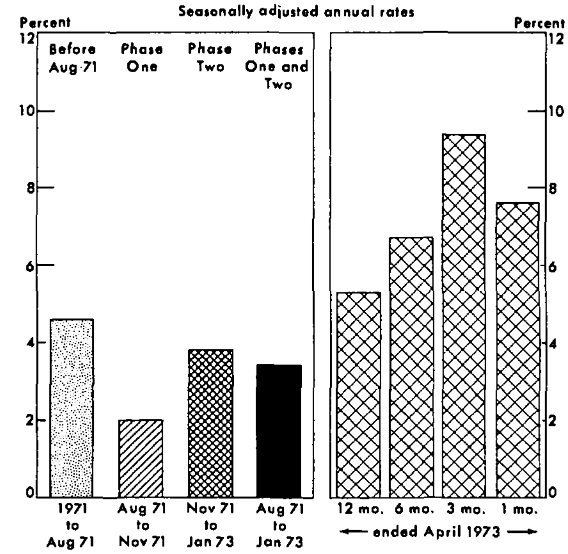
There are more definite signs of slackening in residential construction activity. Although housing starts remain high by historical standards, they have declined for three months in a row. In April, a drop-off in both single-family and multifamily units led to a fall in total starts to 2.1 million units annually, their lowest level since October 1971. Moreover, building permits have fallen steeply over the first four months of this year to 1.8 million units. Newly issued permits were about a third less in April than the level of their December 1972 peak. While mobile home sales rose substantially in March (the latest data available), sales of new single-family homes declined markedly. Furthermore, the ratio of unsold new homes to sales of new one-family homes climbed rather sharply over the first quarter.

CONSUMER PRICES

The economy continues to exhibit serious price strains. Consumer prices rose at a seasonally adjusted annual rate of 7.8 percent in April, following even more rapid increases in the two preceding months. Over the entire three-month interval, consumer prices rose at a 9.2 percent annual rate. To be sure, a concentration of price increases early in Phase Three has contributed to some extent to the recent pace of inflation, but there are signs that significant demand pressures are at work as well. Food prices at the consumer level climbed at an annual rate of 18.3 percent in April, bringing the rate of rise in such prices thus far this year to an extraordinary 26 percent per annum. Prices of nonfood commodities advanced at a rapid 5 percent rate in April, somewhat below the pace of the previous month, and prices of services were up 3.6 percent on an annual rate basis.

Taking a somewhat longer perspective, total consumer prices increased 5.1 percent over the twelve months ended

Chart III
CHANGES IN CONSUMER PRICES
EXCLUDING MORTGAGE INTEREST COSTS
Seasonally adjusted annual rates



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

April 1973. If mortgage interest costs are excluded, the growth was 5.3 percent. While changes in mortgage rates had little impact on the rate of increase in the overall consumer price index during the past year, they have had a sizable impact in some earlier periods. In early 1971, for example, mortgage rates fell sharply, thereby moderating somewhat the rise in the overall consumer price index. Consequently, in comparing recent price experience with that of the period before the Economic Stabilization Program, a better picture is obtained if mortgage interest costs are excluded. Chart III depicts annual growth rates in consumer prices excluding mortgage costs over several periods. As the chart illustrates, the 5.3 percent increase in consumer prices, excluding mortgage costs, during the past twelve months was faster than the rate of increase in these prices during the first eight months of 1971 prior to the price and wage freeze.

Food prices were up 11.5 percent during the twelve months ended April 1973, compared with an increase of only 4 percent in the preceding year. Prices of meats, poultry, and fish led the advance, climbing by more than 20 percent, and prices of fruits and vegetables moved up sharply as well. Nonfood commodity prices rose a moderate 3.2 percent over this same period, compared with 2.3 percent in the preceding year. Prices of nondurables—particularly home and auto fuel—increased relatively rapidly, but these gains were offset to a degree by generally modest rises in prices of durable goods. Prices of consumer services rose 3.5 percent over the twelve months ended April 1973, compared with 4.4 percent during the preceding twelve-month period.

LABOR MARKET DEVELOPMENTS

The survey of households conducted by the Department of Labor indicated that the civilian labor force rose by only 55,000 workers in May, the second small monthly advance after the huge increase in the first quarter. At the same time, civilian employment was also little changed in May, so that the unemployment rate remained at 5 percent for the third consecutive month. In addition, the unemployment rates of the major age-sex groups were virtually unchanged from the previous month.

According to the separate survey of the nation's establishments, payroll employment advanced by 148,000 workers in May following an increase of similar magnitude in the previous month. These recent increases are significantly smaller than the average monthly gains in employment experienced over the fourth quarter of 1972 and the first quarter of this year. Over these two quarters, the average monthly increase in payroll employment was approximately 275,000 workers. Both the average workweek and overtime in manufacturing fell slightly in May from their very high April levels.