# The Business Situation

The latest business statistics indicate little change in the recent lackluster pace of economic activity. In September, domestic automobile sales declined, as the August spurt attributed to consumers' attempts to avoid the announced higher prices on 1975 models apparently ended. Also in September, the labor market weakened as the unemployment rate rose from 5.4 percent to 5.8 percent. In August, the dollar value of new orders at durable goods manufacturers rose sharply, and manufacturers' shipments and inventories continued to advance. Industrial production declined that month, however, and nonauto retail sales were unchanged. Construction continued depressed as housing starts and permits fell further.

The most recent price statistics confirm a continuation of steep inflation. Moreover, a widespread feeling that a rollback in oil prices has become increasingly unlikely has been a source of additional concern. Wholesale prices exploded in August, and consumer prices posted their largest increase in a year. The pervasiveness of inflation was evident in price advances in all sectors of economic activity. The prices of services, foods, and nonfood commodities skyrocketed. Furthermore, concern over frost damage to the already weather-beaten Midwest corn and soybean crops has reversed the recent declines in spot prices of agricultural commodities.

## INDUSTRIAL PRODUCTION AND WORK STOPPAGES

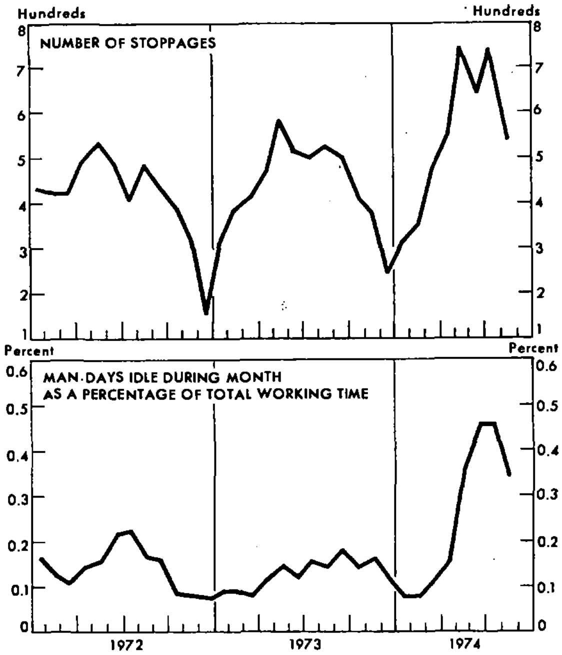
The Federal Reserve Board's index of industrial production fell at a seasonally adjusted annual rate of 4.8 percent in August. This was the sharpest decline in industrial output since last winter's energy-related contraction, leaving output 1 percent below the level of a year earlier. Although the size of the August decline was magnified by labor disputes in numerous industries, the pervasive sluggishness of economic activity suggested that production would have edged downward even in the absence of these disputes. Production of defense and space equipment, construction materials, and durable consumer goods all fell, in addition to the strike-related cutbacks in the production of business equipment, coal, and iron mining. The housing slump no doubt accounts for the decline in the output of construction materials. Also, since the reduction in consumer durable goods production was centered in household appliances and furniture, it too may reflect the depressed state of housing activity. As fewer new housing units are completed, correspondingly fewer new appliances are needed. In contrast to most major market groups, production of nondurable consumer goods and materials rose in August.

Despite the relative calm in most major collective bargaining negotiations, the number of work stoppages and working time lost from labor disputes have jumped since the end of wage controls in April. Thus, it appears that the attempts by unions to recoup lost purchasing power through wage increases and cost-of-living protection may be meeting stiff management resistance at smaller concerns. In the four months since wages were decontrolled in April, the number of stoppages have spurted sharply, averaging more than 660, compared with the 425 stoppages averaged in the first four months of 1974. In August, however, labor disputes moderated, declining to 540 from over 700 in July (see Chart I). The percentage of total working time lost by employees directly involved in these stoppages fell to 0.34 percent in August from the three-year high of 0.46 percent reached in June and July. This measure, which allows for the growth of the labor force, neglects the indirect or secondary effects on other establishments or industries where employees are idle as a result of material or service shortages. Despite this recent decline in strike activity, it is likely these strikes may have had greater direct impact on industrial production, as it appears that these disputes have shifted from construction to the manufacturing sector.

Nevertheless, the bulk of this year's heavy calendar of major collective bargaining agreements (defined by the Bureau of Labor Statistics as agreements covering 1,000 workers or more) that expire or contain wage reopening provisions have been peacefully settled. Major accords have been reached in the steel, telephone, aluminum, and can industries, with few or no labor-management disputes.

Chart I

WORK STOPPAGES AND TIME LOST RESULTING FROM LABOR-MANAGEMENT DISPUTES




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

Even the volatile construction industry has had only relatively minor labor stoppages. However, one major industry settlement that could bear heavily on economic activity—coal—has not yet come up for renegotiation. Coal is an important energy source for the steel and electric utility industries. Indeed, it accounts for almost half of all the electricity produced in the United States. Coupled with the prospective shortages of natural gas this winter, a sustained nationwide strike by the United Mine Workers in November could have a seriously deleterious impact on the economy. Utilities' inventories of coal, which were already low in July, have been reduced further by August's "memorial" work stoppages. At least one major utility, the Tennessee Valley Authority, has already requested its users to reduce voluntarily electricity consumption in an attempt to maintain its dwindling stock of coal.

## RETAIL SALES, NEW ORDERS, AND INVENTORIES

According to the advance report, retail sales in August rose at a 6.8 percent annual rate. However, the bulk of this increase was the result of the continued improvement in sales of new domestic automobiles, which in large part probably reflected the attempt by consumers to avoid the announced higher prices on the forthcoming 1975 models. Sales of nondurable goods rose in August but, excluding the automotive sector, durable goods sales slipped slightly. In September, sales of new cars weakened, although they remained ahead of the pace of early summer. New car inventories are down sharply from the peaks recorded in the gasoline-short winter months.

Allowing for the impact of surging prices, both durable and nondurable retail sales have shown little improvement in recent months, after recovering from last winter's lows. Slackening retail sales to some extent reflect the continued deterioration in real personal income that has characterized the twelve-month period ended in August. The most recent survey of consumer sentiment and spending plans suggests that little improvement is in the offing for real retail sales. The Conference Board's index of consumer confidence in August was close to a four-year low.

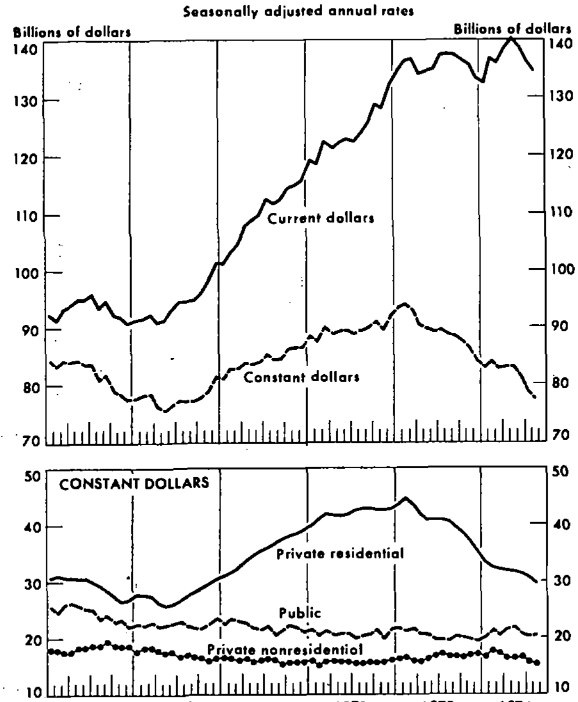
New orders received by durable goods manufacturers rose $1.73 billion, or 3.6 percent, in August. A sharp spurt in defense equipment orders, especially for aircraft, and a pickup in primary metals orders accounted for all of the advance. Excluding the defense sector, new orders registered a slight decline in August. Although new orders have risen almost continuously in 1974, these data are expressed in nominal terms and thus reflect the rapid rate of inflation. Allowing for the effect of higher wholesale prices of manufacturers' durable goods, it appears that the physical volume of new orders has advanced only slightly in the past few months.

As measured by their book value, manufacturers' inventories rose by $31 billion at an annual rate in August, the fourth consecutive month that the rate of inventory accumulation equaled or exceeded $30 billion. The August growth in manufacturers' shipments equaled that of inventories, leaving the inventory-sales ratio unchanged at 1.63 months of shipments. This apparent stability in the inventory-sales ratio, however, tends to disguise real accumulation since the value of sales reflects the rapid rate of inflation more fully than the book value of inventories. Despite this limitation, these inventory-sales ratios can indicate relative accumulation in particular sectors. Examination of these ratios by market groups indicates marked accumulation in the household durable and capital goods industries, where inventories have jumped over the past few months even though shipments have declined. Unlike recent months, in which finished goods accounted for a rising portion of the buildup in manufacturers' inventories, more than 80 percent of the August increase was in inventories of materials and supplies and work in process. At the trade level, inventories at both wholesale and retail rose sharply in July, with nondurables inventories accounting for the bulk of the increase.

### CONSTRUCTION

Residential construction activity deteriorated further in August, as mortgage market conditions became even more stringent. Housing starts dropped to an annual rate of 1.13 million units in August, down 44 percent from a year earlier and the lowest level in more than four years. While single-family starts were 26 percent below the level of a year ago, multifamily starts, which have been especially hard hit, stood at a seven-year low of 302,000 units in August. Building permits fell 10 percent in August to an annual rate of 912,000, the first time since early 1967 that newly issued permits have fallen below the million mark. Sales of single-family homes fell 15 percent at an annual rate in July to a level of 518,000 units. The inventory of unsold homes remained virtually unchanged and, at the current sales rate, represents a large ten months' supply.

Chart II
VALUE OF NEW CONSTRUCTION PUT IN PLACE
Seasonally adjusted annual rates




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

The mortgage market tightened further in August. Despite a slight pickup in the growth of thrift deposits, which was concentrated at savings and loan associations, deposit growth remained near July's four-year low. In August, mutual savings banks, which have been hard hit by deposit outflows, suffered their fourth deposit loss in the past five months. As a result of these deposit flows, thrift institutions continued to curtail both their mortgage lending and their commitments to lend in the future. Interest rates on both new mortgage commitments and mortgage closings recently have climbed, with mortgage rates reportedly exceeding 10 percent in many areas of the nation in September.

After climbing to a peak in May, the value of new construction has begun to decline in recent months. Thus, it appears that the protracted decline in construction activity not only has spread beyond the residential building sector, but also has more than offset the effect of higher prices. Real construction outlays have been falling over the past eighteen months and dropped to a four-year low in August (see Chart II). In constant-dollar terms, private residential construction outlays have declined almost $17 billion from their peak in February 1973. Furthermore, spending on public construction, even though it has risen in current dollars over the past year and a half, has shown little real growth. Finally, private nonresidential construction activity, which edged upward in 1973 and early 1974, has recently been declining under the weight of high interest rates and construction costs.

### PRICE DEVELOPMENTS

Inflationary pressures remain intense. According to the latest price statistics, almost all sectors of the economy continue to be gripped by accelerating inflation. In August, wholesale prices surged at a seasonally adjusted annual rate of more than 45 percent for the second consecutive month. As these wholesale price increases are likely to work their way through the economy, there can be little hope for near-term improvement in inflation at the retail level. The August advance in consumer food prices was the sharpest in six months, and the full impact of the drought-related runup in farm product prices has yet to be felt by the consumer. Moreover, the edging-down of agricultural spot prices following their earlier sharp advance has recently been reversed by concern over frost damage.

Consumer prices advanced at a 16 percent seasonally adjusted annual rate in August, the largest increase in one year. Also discouraging was the pervasiveness of the price rise. The prices of both food and nonfood commodities rose at slightly more than a 17 percent annual rate, and prices of services increased at an annual rate of more than 13 percent. Gasoline prices were one of the few consumer prices that declined. Higher prices of meats, apparel, and medical care services led the consumer price advance.

Propelled by continuing increases in industrial prices and a large advance in the price of farm and food products, wholesale prices rose at a seasonally adjusted annual rate of 46.4 percent in August. Wholesale industrial prices rose 30.3 percent at an annual rate in the month and have advanced at a sizzling 32.9 percent annual rate thus far this year. Even after allowance for the expected price bulge due to the termination of controls, the magnitude and duration of the upsurge in wholesale industrial prices has sharply dimmed prospects of a near-term slowdown in the rate of inflation. Among the many products for which prices were higher in August, the increases in the prices of chemicals and paper and pulp products were especially large. In addition to the industrial price advance, prices of farm products and processed foods and feeds, led by increases in the prices of livestock and feed grains, skyrocketed for the second consecutive month, jumping at an 88.9 percent seasonally adjusted annual rate in August. However, agricultural prices have moved erratically, and earlier in the year wholesale farm and food prices declined for four consecutive months.

Concern over recent frost damage to Midwest crops has reversed earlier declines in spot prices of several agricultural commodities. Most notably, the prices of corn, soybeans, and other grains, which had begun to retreat from their drought-related peak in mid-August, have spurted in recent trading. For example, the spot price of corn, after falling more than 30 cents per bushel in the weeks following mid-August, has recently jumped above its earlier peak. Soybeans, which because of their longer growing period have been particularly hard hit by the frost, have jumped about $1.20 per bushel in the last two weeks of September.

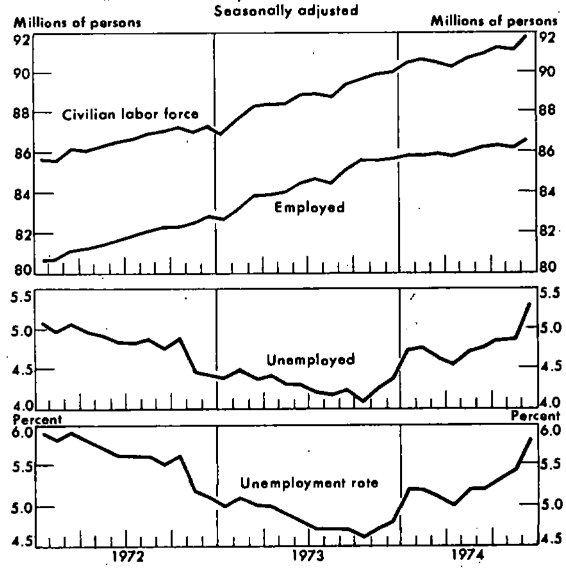
## LABOR MARKET DEVELOPMENTS

The sluggish pace of economic activity has resulted in weakness in the labor market (see Chart III). The seasonally adjusted unemployment rate rose 0.4 percentage point to 5.8 percent in September, the highest level in more than two years. Although the September jump in the jobless rate was widespread among most major age-sex groups, the burden fell more heavily on teen-agers, especially men, and women 25 years of age and over. The unemployment rate for male teen-agers jumped almost

Chart III

THE CIVILIAN LABOR FORCE, EMPLOYMENT, AND UNEMPLOYMENT

Seasonally adjusted




Source: United States Department of Labor.

2 percentage points to 17.1 percent in September, and the rate for women 25 years of age and over climbed a substantial 0.6 percentage point to 4.8 percent. The rate for married men rose to 2.8 percent, the highest for that group since October 1972. Most major industry groupings registered large increases in jobless rates; the 12.4 percent rate for construction workers was the highest in four years.

Despite the sluggishness of economic activity following the Arab oil embargo, the household survey indicates that civilian employment has risen by about 870,000 over the first nine months of this year. Employment increased by a substantial 351,000 workers in September. However, most of the September growth was the result of persons who, although seeking full-time employment, were forced to accept part-time employment. The number of these involuntary part-time workers jumped 310,000 in September, accounting for almost nine tenths of the growth of total employment. At the same time, the rise in the number of unemployed workers—948,000 over the first nine months of this year—has been primarily the result of growth in the labor force rather than increased layoffs. The civilian labor force rose sharply in September, continuing the growth that began in May. The bulk of the recent expansion in the labor force has stemmed from a pronounced rise in the number of women and teen-agers seeking employment. Over the May-September period the number of adult women in the labor force has risen at a 4 percent annual rate and that of teen-agers surged at a 14.2 percent annual rate.

The separate payroll survey, which differs from the household survey in definition, coverage, and other factors, indicates that employment has grown by 520,000 workers over the first nine months of 1974, with most of the gain in the service-producing sector of the economy. In contrast to the similar employment growth recorded by these surveys over extended periods, payroll employment in September was considerably weaker than indicated by the household survey. Payroll employment remained relatively flat in that month, rising only 33,000 workers. This gain was particularly small in light of the large number of employees returning from strikes who did not appear on company payrolls in August.

Although in real terms workers' wages are probably continuing to decline, it does appear that unions have been successful to some extent in arresting the erosion in purchasing power that has resulted from inflation. The adjusted index of average hourly earnings for production workers on private nonagricultural payrolls increased at an 11.2 percent seasonally adjusted annual rate in September. Manufacturing earnings alone rose at a 12.9 percent rate in that month. Manufacturing wage gains adjusted for interindustry shifts and overtime have proceeded at a double-digit pace over the past six months, considerably above the pace of the earlier part of the year.