The Business Situation

Signs of weakness in the United States economy have multiplied in recent weeks. Industrial production fell sharply again in November, with the decrease extending far beyond the constricting effects of the coal strike, and home building weakened further. Moreover, both business and consumer demand have continued to slacken. New orders for durable goods and retail store sales dropped for the third consecutive month, and single-family home sales declined as well. With both production and demand declining, labor market conditions have deteriorated rather sharply. The unemployment rate rose in December to 7.1 percent of the civilian labor force, the highest rate in over thirteen years.

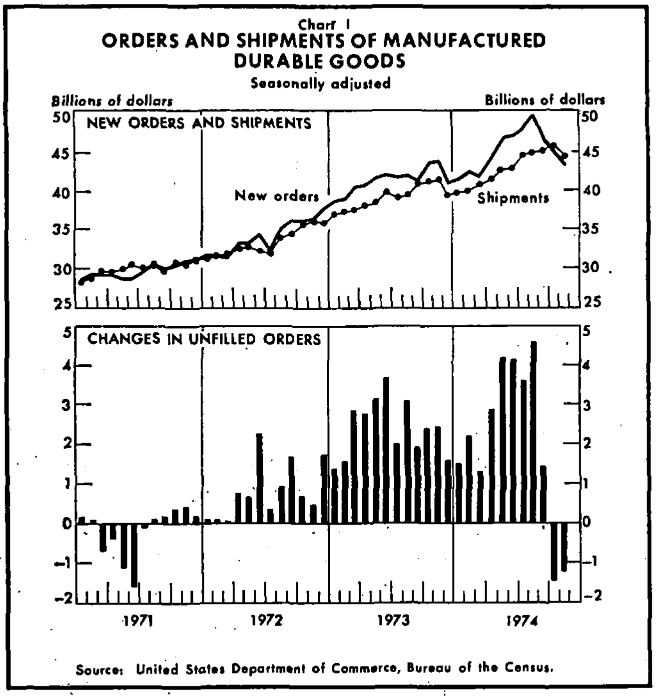
Prices have continued to increase at annual rates in the double-digit range, although at the wholesale level the recent rates have been significantly lower than earlier in 1974. Wholesale industrial prices rose at an annual rate of 10.3 percent in November, confirming the deceleration that began in the fall of 1974; earlier in the year, the index of wholesale industrial prices had climbed at a 32.9 percent annual rate. The consumer price index rose at a 10.8 percent annual rate in November, down slightly from the average over the previous ten months. In December, there were several hopeful signs in the price picture. The percentage of purchasing managers reporting higher prices continued to move lower, and at the retail level there were widespread reports of unusual pre-Christmas sales.

INDUSTRIAL PRODUCTION, INVENTORIES, AND DURABLES ORDERS

The industrial production index of the Board of Governors of the Federal Reserve System registered a 2.3 percent drop in November. Following a sizable decline in October, the November fall pushed the index to a level 4.3 percent below its peak in November 1973. Nevertheless, the total reduction in the output of the industrial sector since November 1973 has amounted to only about half of the decline registered in the last two recessions.

The November drop in industrial production reflected, in part, the effects of the coal strike and the cutbacks in automobile assemblies. The strike by members of the United Mine Workers union accounted for most of the 5.2 percent drop in output at the nation's mines. In addition, the strike hampered those industries dependent on coal. Domestic coal is used to produce coke, a material required for pig iron production and, therefore, steel production. Thus, a good part of the 4.1 percent decline in the iron and steel production index is probably attributable to the strike. Another major user of domestic coal is the electric utility industry which accounts for almost two thirds of total coal usage. Therefore, some part of the 1 percent fall in the output of utilities, which includes electricity production, probably also reflects the coal strike.

During the past several weeks the automobile manufacturers have tried to bring production into line with sagging sales. Layoffs, beginning in late November, cut domestic auto assemblies for that month as a whole to an annual rate of 7 million units, down from an 8.3 million unit rate in October. (During 1973, a record year, the production rate averaged 9.6 million cars.) Nevertheless, production continued to outpace sales of domestic-type autos, which fell further during November to an annual rate of 5.7 million. This was the lowest sales rate since December 1970 when dealers' stocks were depleted in the wake of the two-month General Motors strike. Consequently, inventories of unsold new cars rose further in November to 1.97 million units. In relation to sales, inventories in November amounted to 106 days' supply, the highest inventory-sales ratio in more than ten years. Auto manufacturers have cut production further by temporary plant closings, reduced assembly-line speeds, and large-scale layoffs. As a result, production of passenger cars in December dropped to an annual rate of only 5.3 million units.



While the coal strike and the automobile industry slump contributed to the November decline, production in other sectors dropped as well. Large declines occurred in the output of nonautomotive consumer durables, and business equipment production, which had remained strong through October, fell 1.1 percent. Output of construction products dropped 2.8 percent in November, the sixth straight monthly decline, and production of most other durable and nondurable industrial materials also moved lower. As of November, business equipment output was one of the few components of industrial production that was still above the level of a year earlier.

The continued deterioration in the economy was also evident from the third consecutive monthly decline in new orders for durable goods received by manufacturers (see Chart I). The 3.8 percent drop in November brought new orders to $43.4 billion at an annual rate, 12.3 percent below the peak August pace. The latest decline in bookings was mainly in primary metals, machinery, and transportation equipment. For nondefense capital goods as a whole, bookings were down 4.8 percent over the month to $10.8 billion, the lowest level since September 1973. Unfilled orders declined for the second consecutive month, after rising steadily for three and a half years.

It is expected that the figures, when available, will show that production remained weak in December partly because of the lingering effects of the coal strike. In addition, the decline in new orders and the large overhang in inventories are likely to dampen the level of output. Total business inventories rose by $5.6 billion in October, the largest increase so far this year; about one third of the advance was attributable to an increase in automobile dealer inventories. With overall business sales rising by less than $1 billion in October, the ratio of inventories to sales increased substantially. At 1.54 months of sales, the ratio was the highest in almost two and a half years and represents a significant increase from rates of 1.51 months in September and 1.48 in August. Moreover, the strong advance in the ratio occurred despite recent changes in accounting practices that effectively lowered book-value estimates of inventories at some firms.

PERSONAL INCOME, RETAIL SALES, AND RESIDENTIAL CONSTRUCTION

Personal income fell $2.2 billion, or 0.2 percent in November, as mounting layoffs and the coal strike reduced factory payrolls over the month. Wage and salary disbursements in manufacturing declined by $5.2 billion, the largest drop since the General Motors strike in October 1970. Over the year ended in November, personal income rose by 7.5 percent, substantially less than the price level.

Consumer demand has weakened materially in recent months, reflecting the decline in real income and growing employment uncertainties. Retail sales dropped by $0.6 billion in November, an amount equal to the average decline in the previous two months. Slow sales at automobile dealers accounted for much of the November decrease, but business was down as well in furniture and appliance stores, apparel shops, gasoline stations, and equipment supply shops, on a not seasonally adjusted basis. Compared with a year ago, total retail sales were up only 5.3 percent, indicating a substantial decline in real terms (see Chart II which shows retail sales deflated by the consumer price index).

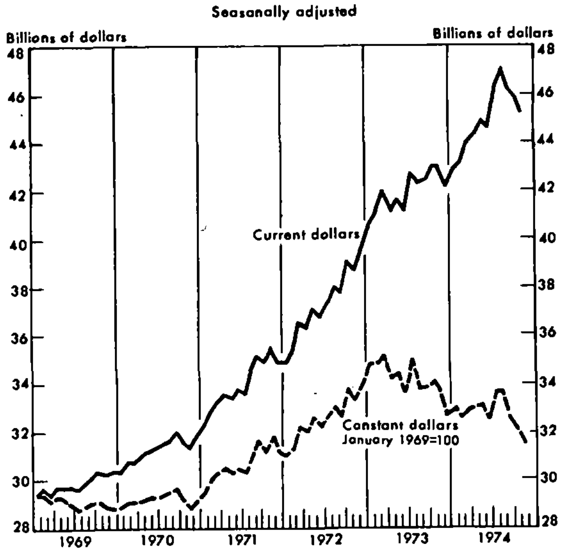
The home-building slump worsened in November. Housing starts dipped to 990,000 units at an annual rate, an eight-year low, and new building permits were issued at the lowest rate since the Department of Commerce began collecting the data in 1959. The seasonally adjusted pace of housing starts in November was 10.5 percent below the previous month and down 40.9 percent from a year earlier. A sharp drop in the construction of rental apartments and condominiums accounted for most of the latest decline. In sum, new construction of buildings with two or more units has fallen to 28 percent of its November 1973 level and is at the lowest rate since March 1960.

Conditions in the market for new one-family homes remained depressed also. Single-unit housing starts in November were 16.4 percent below the rate of a year ago. The slowing in the pace of new home buying has contributed to the recent declines. In October, the number of new one-family homes sold fell to 410,000 units at an annual rate, 18.8 percent below October 1973. While the inventory of new homes for sale declined in October to the lowest level since December 1972, the ratio of homes for sale to homes sold remained at historically high levels.

PRICES

Severe inflation persists at the retail level, as the prices of commodities and services continue to advance on a broad front. In November, total consumer prices, adjusted for seasonal variations, rose 10.8 percent at an annual rate. Food prices jumped at a 16.5 percent annual rate over the month, largely as a result of soaring sugar costs. In the past year, the retail price of sugar has increased by about 185 percent, reflecting growing world demand and poor harvests. Since the November price survey, however, retail sugar prices have reportedly stabilized and even declined slightly.

Chart II
RETAIL SALES
Seasonally adjusted



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

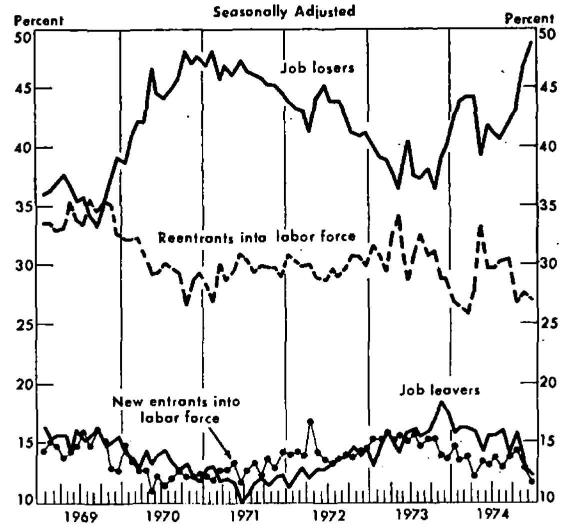
Price increases were widespread among other consumer goods in November. The index of all commodities less food rose at a 9.3 percent rate. Although faster than the 6.8 percent annual-rate advance in October, the November pace was significantly below the 15 percent rise in the first nine months of the year. Higher clothing prices accounted for about one fourth of the November increase, with prices for appliances, coal and fuel oil, and other nondurables continuing to move ahead rapidly. Gasoline prices fell for the fourth consecutive month but were still 26 percent above a year ago. There were widespread reports of unusual pre-Christmas sales at retail stores during December, which should have a favorable impact on the December price figures. However, it remains to be seen whether this signals a trend toward more moderate price behavior at the retail level.

Wholesale prices advanced at a 14.6 percent annual rate in November, about half the October pace, as the rate of increase in prices of farm and food products slowed from the very rapid 61.5 percent annual rate recorded in October. Despite the slowdown, the index of farm products and processed foods and feeds continued to soar, advancing at almost a 30 percent annual rate. The November increase was attributable largely to sugar and confectionery price rises.

The November wholesale price statistics for nonfood commodities showed further tentative evidence of a deceleration in inflation. Wholesale industrial prices rose at a 10.3 percent annual rate in November, less than the September and October rates and one third the rate of advance in the preceding eight months of the year. Moreover, price increases have become less widespread, especially for goods at the beginning stages of fabrication. After rising 47.1 percent at an annual rate in the first seven months of the year, the index of crude materials has declined by 0.7 percent at an annual rate in the last four months. More recently, the rate of advance in prices of intermediate materials has slowed. In the three months ended in November, the index of intermediate materials less materials for food manufacturing and manufactured animal feeds moved up 10.6 percent, compared with a 37.4 percent pace in the preceding eight months. However, finished goods prices continued to advance rapidly, increasing at an average annual rate of over 20 percent in the last three months.

During a period of general inflation, many prices rise in any month, but as inflation subsides the percentage of prices rising generally declines. In this regard, it is interesting to note that in recent months increasingly fewer purchasing managers have been reporting higher prices on purchased materials. Each month, the National Association of Purchasing Management, Inc., surveys its members on purchased materials prices, among other things. In November, only 49 percent reported higher prices, whereas 95 percent had reported higher prices in March 1974. According to the latest report, the proportion dropped further in December to 43 percent.

Chart III
REASON FOR UNEMPLOYMENT
AS PERCENTAGE OF UNEMPLOYMENT
Seasonally Adjusted



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

EMPLOYMENT

The unemployment rate jumped 0.6 percentage point to 7.1 percent in December, the highest rate in over thirteen years. The latest spurt in the unemployment rate was widespread, with the jobless rate for adult men and adult women increasing by 0.5 percent and 0.6 percent, respectively. White collar workers had an unemployment rate of 4.1 percent in December, up from 3.7 percent in November and the highest rate since 1958 when the statistics were first collected. The jobless rate for blue collar workers increased to 9.4 percent in December from 8.2 percent a month earlier.

In December, the civilian labor force remained virtually unchanged; civilian employment dropped by 550,000 persons to the lowest level since September 1973. Over the last two months, the number of unemployed has risen by a substantial 1,022,000 persons, with job losers—those leaving their jobs involuntarily and persons on layoff—accounting for over 75 percent of the increase. As a result, the number of job losers as a percentage of the total number unemployed has risen from 43.2 percent in October to 48.8 percent in December, similar to rates resulting from the 1969-70 recession (see Chart III).