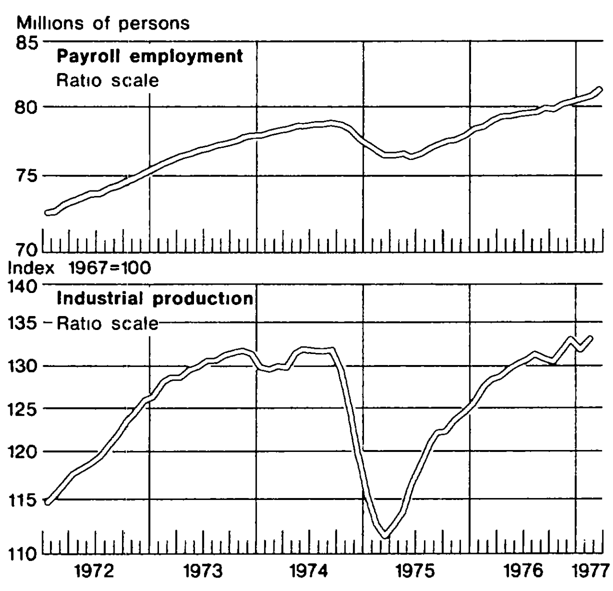
The business situation
Current developments

Chart 1
Employment and Production
Seasonally adjusted



Sources Bureau of Labor Statistics and Board of Governors of the Federal Reserve System

The economy recovered quickly from the disruptions caused by the bitter weather that plagued much of the eastern half of the country early in the year. That weather made it difficult to interpret what was happening in the economy· first came the retarding effects of the cold spell, and then came the stimulating effects of business' efforts to recoup earlier losses in output and sales As spring arrived, however, the economy's renewed vitality began to take on a solid look.

Consumer spending has contributed a great deal to that vitality After retail sales were crippled by the weather in January, they rebounded to a record high level in February and rose sharply again in March. Sales of autos during March reached a seasonally adjusted annual rate of 12 million units, including imports, the best rate since the spring of 1973

Consumer confidence, according to private surveys taken in February, was virtually unchanged from the comparatively high level it had reached prior to the onset of the freezing weather. Consumers' willingness to spend is also suggested by large increases in consumer credit.

Vigorous buying at retail reflects the consumers' improving income position Personal income, which was depressed by the weather and other factors in January, rose at a high rate in February Further sizable increases in incomes probably occurred in March as payrolls continued to swell. Consumer buying power will, of course, be enhanced to the extent that any kind of tax cut may be granted to individuals this year.

Housing continues to be an important sector sustaining economic activity Residential construction picked up handsomely during the lull in the general economy last summer and fall, and it quickly recovered from the effects of extreme cold this year. Building of single-family homes has been particularly active, February starts reached the highest level since the record peak of January 1973.

Apartment house construction, in contrast, remains relatively subdued Notwithstanding the almost steady recovery from the extreme recession low, multifamily housing starts are below previous highs by about half. Yet, there appear to be some encouraging signs. The rental markets have been tightening; vacancy rates, for example, are down significantly and now stand at five-year lows In the condominium market, too, sales have improved somewhat, suggesting that a slow turn for the better may have begun. Increased activity under the various Federal housing assistance programs helped to push multifamily housing starts up in the latter part of last year, and there is widespread expectation that such assistance will be expanded further. For both single and multifamily housing, the immediate outlook is further buttressed by the continuing inflow of deposits at thrift institutions that is keeping mortgage money in ample supply. All in all, the consensus that the rate of total home building will at least stay at current levels for the whole of 1977 looks reasonable

The business capital investment situation still shows no great improvement. As discussed in the following article, outlays have remained relatively sluggish in this recovery and significantly lag the pace during previous upswings. All the latest government and private surveys of plant and equipment spending confirm earlier expectations that business intends to increase such outlays only moderately in 1977.

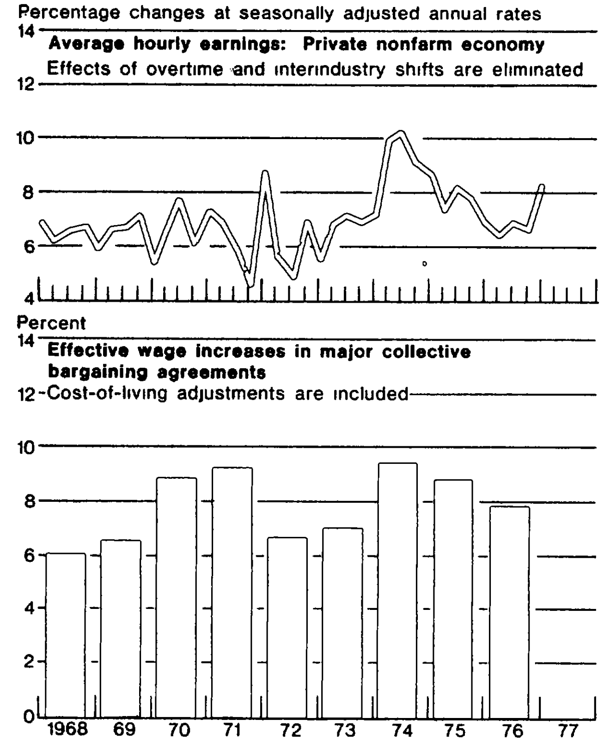
Business' additions to its stock of goods and materials may lend further impetus to the upturn. The sharp slowdown in inventory accumulation in the closing months of last year, together with an increase in final sales, has brought inventory-sales ratios to low levels. By March, inventory buying appeared to be advancing with vigor, according to the survey of the National Association of Purchasing Management.

The pickup in the tempo of consumer and business demands is mirrored in the trend of industrial production as well as in the behavior of payroll employment, which has risen at a monthly average of 300,000 starting last November (Chart 1) The production index more than regained its January loss in February and made another significant gain in March. By March the index exceeded last December's level by 1 5 percent. Auto makers were responding to healthy sales rates by raising their production schedules for March and April to the highest rates for those months in recent years.

A look at the business picture as a whole shows a different pattern from that generally prevailing after

Chart 2

Trends in Wages



Source Bureau of Labor Statistics

eight quarters of expansion. While the overall recovery has been as vigorous as the average of previous recoveries, it has been chiefly propelled by the consumer. Capital spending hasn't caught fire, capacity utilization has risen only modestly, inventories remain relatively low, and unemployment is still a major problem.

The unemployment rate averaged 7.9 percent in the fourth quarter of last year and declined to 7.4 percent in the first quarter of this year. This is a welcome improvement from the recession peak of near 9 percent, but the rate is nevertheless unacceptably high Insuring that many more of the unemployed get jobs is likely to command high priority for some time.

The unemployment problem continues to run in tandem with the inflation problem. Wholesale prices, which had already begun to rise more rapidly during the autumn of last year, jumped 1 percent (seasonally adjusted) in both February and March. Not only did food and farm prices increase faster, but more significantly, industrial wholesale prices accelerated.

Similarly, the rise in consumer prices, which had been contained to a monthly average of 0.4 percent in 1976, climbed 0.8 percent in January and 1 percent in February.

The resurgence of prices can in part be explained as the special effect of cold weather. Nevertheless, it is disturbing and is contributing to a revival of inflationary psychology, with all the attendant adverse impact on confidence. Still there are reasons to think that the recent speedup in price increases is only temporary. The economy's resources seem ample. There are no serious shortages, except perhaps for natural gas. There are no real signs of excessive pressure on industrial capacity. And there is of course no shortage of labor.

While unemployment and prices claim a great deal of attention, another crucial element in the health of the economy is coming under scrutiny. That element is the growth of productivity. Gains in output per manhour in the private nonfarm business sector fell away after hitting an unusual high in the first quarter of last year. Since compensation per hour continued to grow at a fairly rapid pace, the increase in unit labor costs accelerated. If the present rate of growth in output continues, productivity should speed up once again. To what extent the gain will be translated into an improvement in labor costs, however, will depend a great deal on how moderate wage settlements turn out to be.

This year's bargaining calendar is relatively heavy. Major collective bargaining agreements covering some 5 million workers expire or can be reopened during the year, including contracts in the steel, communications, railroad, textile, and construction industries. Most contracts that will be negotiated or can be reopened in 1977 already incorporate provisions for cost-of-living adjustments, so that there need be few major wage "catch ups" written into contracts in order to restore the real income positions of workers. Effective wage increases in collective bargaining agreements have come down gradually in the past two years (Chart 2), but it is far from certain that another step down will be taken this year.

To sum up, most economic news suggests that the recovery is in rather strong stride. Whether that stride proceeds at a pace strong enough to lower unemployment significantly but not so strong as to feed inflation is the economic question of the day.