The Business Situation

The economy was revitalized in December by a swelling flow of urgently needed steel. Automobile producers and many other users of ferrous products who had been short of steel were able to recall furloughed employees and start filling back orders. Christmas buying apparently set a new peak, boosting employment in retail trade and certain other fields. And some uncertainties in the economic picture were removed by the settlement of wage negotiations covering many employees of the struck copper industry, the East Coast docks (which had been operating under a Taft-Hartley injunction), the aluminum industry, and the nation's two largest can companies. The settlement of the steel strike in early January, of course, removed another major question mark overhanging the business scene. However, there were still important factors contributing to an uneasy hesitation as to the weeks just ahead. The effects of the various wage settlements upon prices could not as yet be appraised. Numerous firms in need of steel were not yet receiving adequate supplies, and output and employment in many metal-working and machinery industries consequently remained much below pre-strike levels.

THE RENEWED UPTURN

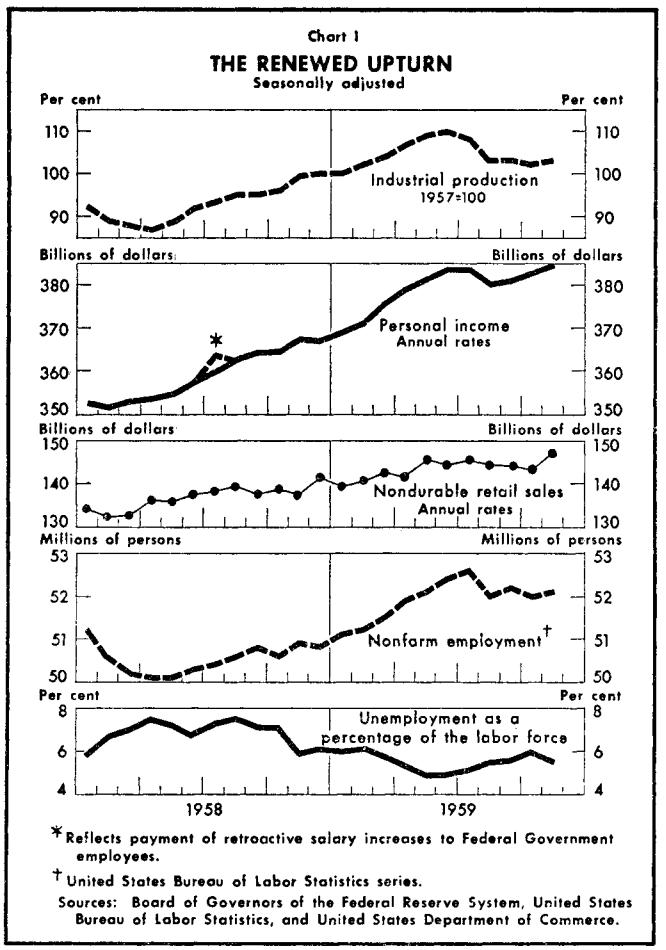
The struck steel mills, which achieved a surprisingly rapid recovery of output following the November 7 reopening, were operating at more than 96 per cent of capacity (rated as of the beginning of 1959) by the second week of December. In actual volume, weekly output reached a record 2.73 million tons of ingots. Output slipped slightly during the final half of the month, but this was a result of the usual holiday closings. Shipments lagged behind the high level of ingot production, because the processing of steel into the various products demanded by the mills' customers requires, in some cases, several additional weeks. Trade sources estimated, moreover, that about one fourth of the December shipments would be absorbed by "in transit" operations and by the rebuilding of the better balanced stocks needed for starting up operations in steel-using enterprises. A survey taken in late November by some 415 purchasing executives in steel-using industries showed that one fourth of those polled thought steel supplies for their companies would be insufficient for normal production until March or later. Unusually heavy demands by automobile and railroad equipment producers in the first quarter of 1960 are expected to aggravate the steel difficulties of other firms.

Total industrial production rose slightly in November and advanced more sharply in December. The October level had been the lowest point in the strike period, 7 per cent below the June record of 110 per cent of the 1957 base now used in the index. (The Federal Reserve's index has recently been extensively revised to use more up-to-date weights and to include output of electricity and gas; the new index is now available with a new base year, 1957, and also with the old base of 1947-49.) The one-point increase to 103 in November reflected primarily the sharp rise in steel production and an expansion in output of the bituminous coal and iron ore required by the reopened steel mills. Despite the increase in steel, the gain in total production was small because of offsetting declines in automobile production and electrical machinery. In December, however, the index is expected to reflect the steep climb that occurred that month in auto output, as well as the further expansion in steel production.

Employment also moved up again, as the wheels of industry started to turn faster. Nonagricultural employment rose by 124,000 between mid-October and mid-November, to a total of 52.1 million, seasonally adjusted (see Chart I). Although unemployment rose over the same period, the increase was less than seasonal and the seasonally adjusted ratio of unemployed to the total civilian labor force receded to 5.6 per cent from the October strike-time high of 6.0 per cent. Later in November, there were additional layoffs of automobile workers, but these had all been recalled by mid-December.

Personal income increased in November to a new all-time high of $384.8 billion (seasonally adjusted annual rate). The previous peak, $1 billion lower, had been reached in June. The $2.5 billion increase in November was the largest of the monthly rises that have occurred since September. Wage and salary payments rose by $1 billion, as sharply higher payrolls in the steel industry and in the dependent mining and transportation industries more than offset declines in steel-using industries. Transfer payments also increased substantially.

The rise in personal income helped push retail sales of nondurables to new heights in November, 2 per cent above the October level on a seasonally adjusted basis (see Chart I). Total retail sales, it is true, declined in November by 1 per cent after seasonal adjustment; but this was primarily attributable to a drop in sales of automobiles, resulting from the depletion of dealers' inventories



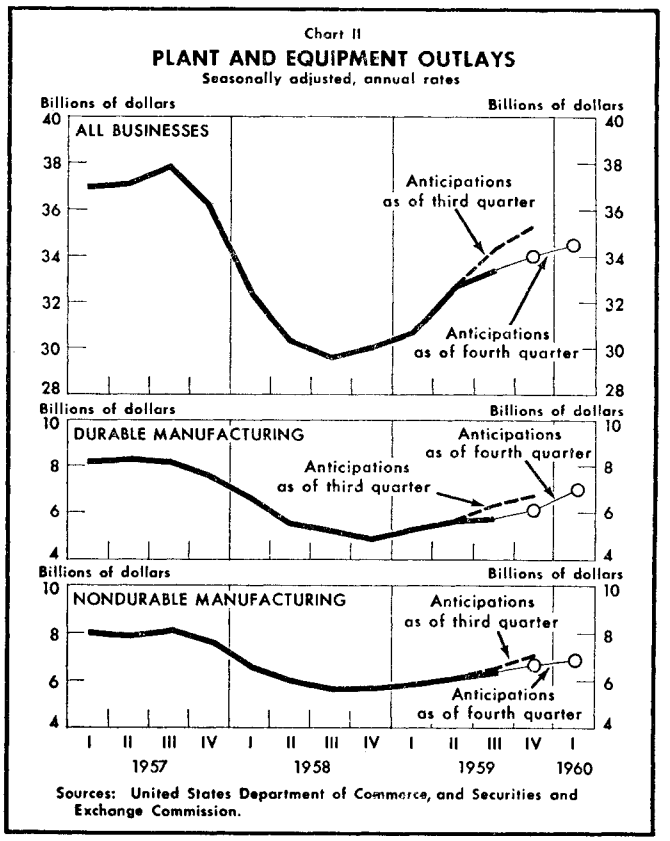
due to steel shortages. Preliminary data on department store sales suggest that consumer demand remained strong in December, although the increase in sales may have been less marked than in the previous month. Automobile sales were still depressed in the early part of December, but may have risen in the latter part as 1960 models began to reach dealers in greater numbers.

In contrast to the foregoing gains, construction outlays in November decreased—the sixth consecutive monthly decline. The biggest drop, $700 million out of the total of $1 billion, was in spending for private residential construction, which was 11 per cent below the May peak. The limited supply of mortgage funds, especially for FHA- and VA-underwritten instruments, was apparently the principal reason for this decline. The rest of the November decrease was attributable to the government sector, and particularly to State and local government outlays for road construction. On the other hand, outlays for private nonresidential construction, which had fallen in September and October partly because of steel shortages, rose slightly.

INVESTMENT ACTIVITY

Business plans for expenditures on plant and equipment indicate continuing strength in that area, although the anticipated growth is slower than the rates of increase achieved during the first three quarters of 1959. A survey conducted by the Securities and Exchange Commission and the Department of Commerce in late October and early November showed that business firms expected to make capital outlays during the fourth quarter of 1959 at a seasonally adjusted annual rate of $34.0 billion, up $600 million from the third quarter's actual outlays; in the first quarter of 1960, they intend to spend at an annual rate $450 million higher than in the last quarter of 1959 (see Chart II).

Shortages and uncertainties resulting from the steel strike did, of course, depress actual expenditures in the third quarter and presumably contributed to the downward revision in estimates for the fourth quarter. These factors may have held down the spending rate anticipated for the quarter just begun. The principal increases from the third to the fourth quarter of 1959 were expected to occur in manufacturing industries, with an almost equal



division between durables (mainly the iron and steel industry) and nondurables. The further advance foreseen for the first quarter of 1960 was limited entirely to manufacturing, and largely to expenditures planned by iron and steel companies and by manufacturers of motor vehicles and other transportation equipment.

Further confirmation of increasing investment activity is found in the 6 per cent increase in capital appropriations (seasonally adjusted) of large manufacturing firms between the second and third quarters of 1959, as reported by the National Industrial Conference Board. Appropriations—that is, formal approvals of capital spending plans—usually precede expenditures by several months. Excluding the strike-hit steel industry, the recent increase was the largest registered in any third quarter since this survey began in 1956.

Money Market in the Fourth Quarter

During the final quarter of 1959, while other areas of the economy slackened under the influence of the steel strike, demand and expectations remained buoyant in the money and capital markets. Interest rates, both long- and short-term, reached record highs for the past quarter century or more. Bank reserve positions, although no tighter than during the two preceding quarters, reflected the cumulative stress of seasonal credit demands and shrinking liquidity. While the expansion in commercial bank loans appeared to be less rapid than in previous months, this seems to have been due principally to the effects of the steel strike. With the resumption of steel output, and as the effects of the strike work themselves out, market observers generally were anticipating that the demand for credit would be relatively strong after the turn of the year.

The money market continued tight throughout the quarter despite some statistical indications of slightly reduced pressure on member bank reserve positions, as average net borrowed reserves of all member banks declined somewhat from their third-quarter level. The reduction in net borrowed reserves, however, in part reflected the release of reserves through changes in regulations permitting the use of certain amounts of vault cash to meet reserve requirements, and through other technical changes. These measures, which became effective in early December, primarily benefited country banks and, therefore, had little immediate or pronounced effect on the tone of the central money market.

Yields on Government securities declined in October but moved irregularly upward thereafter to close the quarter at a substantially higher level than at its start. Rate movements were particularly pronounced in the Treasury bill market, but also spread to notes and bonds. Market psychology during this period was strongly conditioned by expectations of bank and corporate liquidation of bills to meet the increased demand for funds, related not only to the resumption of steel production but also to the mid-December tax and dividend payments. The Government securities market was also affected by Treasury financing operations during the quarter, and by anticipations of additional financing which the Treasury will undertake early in the new year.

After the close of business on December 30, the Treasury announced that it would seek to raise $2 billion in cash through an additional issue of June 22 tax anticipation bills, to be sold at auction on January 5. In addition, it will replace $1.5 billion of the $2 billion bill issue maturing January 15 with a new issue of one-year bills, to be sold at auction on January 12, and will redeem the balance of the maturing bills for cash. Net Treasury cash borrowing in January would thus amount to $1.5 billion, or less than had been generally anticipated.

COMMERCIAL BANK CREDIT

Commercial bank credit developments in the fourth quarter of 1959 followed much the same over-all pattern that was in evidence all year long: there was little change in total loans and investments as a further, if somewhat less rapid, increase in loans was roughly offset by a continued liquidation of the banks' securities holdings.

In the first eleven months of 1959, responding to strong demands for bank credit from an expanding economy, loans of all commercial banks increased by $9.2 billion (data are not yet available for December). This rise was only slightly smaller than the $9.8 billion increase during the comparable period of 1955, when the economy was also in a strong expansion, and it was considerably greater than in any of the intervening years. Data for weekly reporting banks through December 23 point to a further

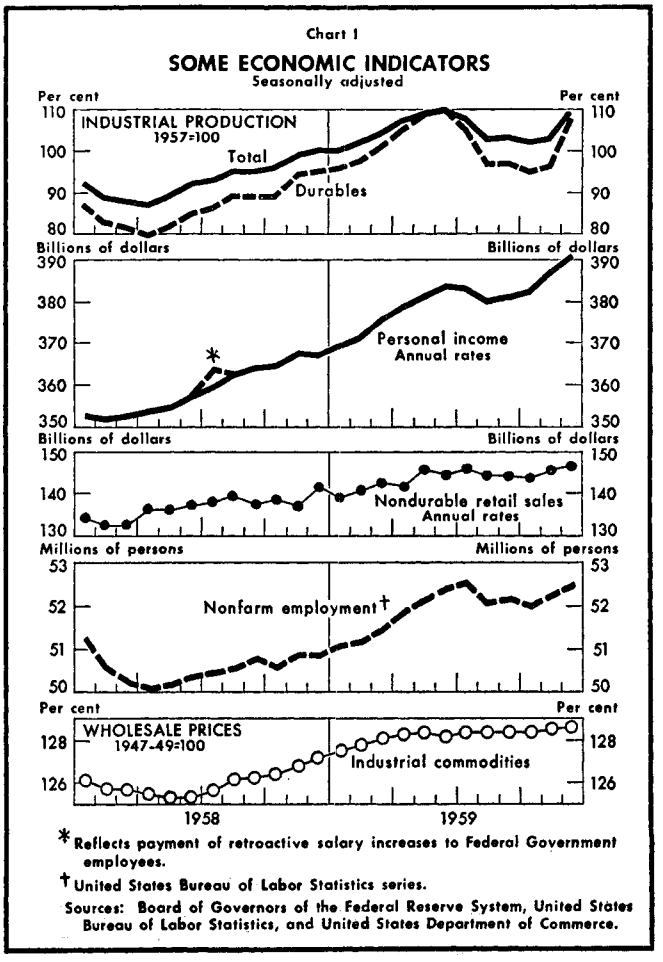
The Business Situation

Economic activity continued strongly upward in the first month of the new year, as industry sought to satisfy the pent-up demand for steel and to increase the output of business equipment and durable consumer goods. New production records were posted in several fields, including steel, while automobile assemblies approached the previous high of November 1955. Investment expenditures, dampened during the steel strike, were on the rise; and outlays for consumer goods, supported by an advancing level of personal income and a further growth in consumer credit, were apparently pushing ahead to fresh heights. Yet, despite the strengthening in all sectors, there was a noticeable quieting of the tempo of increasing demand, compared with the preceding two months, and earlier fears of an imminent outbreak of fresh inflationary developments were not realized.

THE CONTINUED ADVANCE

The need to rebuild business inventories depleted during the strike was a basic force in the upward momentum. By the end of November, the book value of total inventories had dropped $1.5 billion below the July level, seasonally adjusted, and the ratio of inventories to sales was just slightly above the unusually low levels that had prevailed during the spring of 1959. In many lines, stocks were apparently run down further by excellent sales records during the year-end holiday season. The rebuilding of steel and automobile inventories, begun late in the year, went on apace during January. Although steel mills were operating at over 95 per cent of the 1960-rated capacity (established at 148.6 million tons as against 1959's 147.6 million), industry sources estimated that current consumption of steel was equal to only about 80 per cent of capacity tonnage, with the balance being added to stockpiles held by steel users and warehouses. Some part of this heavy inventory demand may have stemmed from anticipations of steel price increases following recent wage settlements. But inventory shortages were obviously widespread. Steel warehouses, for instance, which are the main supply source for smaller users, and normally carry about 20 per cent of the country's steel inventories, reported that they thought it would be April before they would be reasonably well stocked, and August before they would have adequate inventories in all products. Automobile dealers' inventories were also still low at the end of December. With only 575,000 cars on hand, their stocks were slightly less than a year ago and more than 100,000 units below the 1955 and 1957 December levels. During January, however, stocks of cars moved up substantially, to an estimated 800,000.

A general increase in inventories could of course occur only after current demands for final goods by consumers, business, and government had been satisfied. The rise in stocks thus depended upon a rise in production beyond recent levels. Such a rise was evidenced by the new index of industrial production (described in more detail below), which bounced back from 103 in November (1957=100) to 109 in December, a level just 1 point short of the June peak (see Chart I). The principal element in this advance was the output of durables, which jumped 11 per



cent, reflecting particularly a sharp expansion of iron and steel and automobiles but also substantial increases in fabricated metal products and electrical machinery. The three other major components of the index—nondurables, mining, and utilities — rose too, but by much smaller amounts. The continuing high level of operations in many important fields suggests that the level of production for January will move beyond the record set last June.

The rise in December in industrial activity led to a further advance in nonfarm employment. The number at work rose to 52.5 million (seasonally adjusted), only 73,000 below the July record level. As in November, the ratio of unemployment to the total civilian labor force again moved down, dropping to 5.2 per cent after seasonal adjustment, compared with the 6.0 per cent reached in October as a result of the steel strike.

The gain in employment contributed to an increase in personal income that was almost as large as in November. On a seasonally adjusted basis, total income in December was at a record level, 2 per cent above the pre-strike high (see Chart I). Although most of the advance was in wages and salaries, farm income also improved markedly; by December, farm income had recovered two thirds of the 25 per cent dip in level that had occurred during the first nine months of the year. Indeed, the widespread gains throughout the economy following the resumption of steel-making operations early in November pushed up gross national product for the fourth quarter of 1959 to an estimated annual rate of $482 billion (seasonally adjusted), $3.4 billion above the third-quarter level. In real terms, GNP was still 1½ per cent below the high second-quarter rate but 3½ per cent above the 1958 fourth-quarter rate.

A drop in retail sales during the last two months of 1959, to a December level 4 per cent below October (seasonally adjusted), was accounted for by a decline in durables, attributable primarily to a shortage of automobiles. Demand for nondurables continued to move up in December, as Chart I shows. While preliminary figures for January department store sales do not suggest the same degree of strength in the demand for nondurables as in December, larger and more diversified stocks of automobiles are expected to stimulate auto buying and help increase total durables sales.

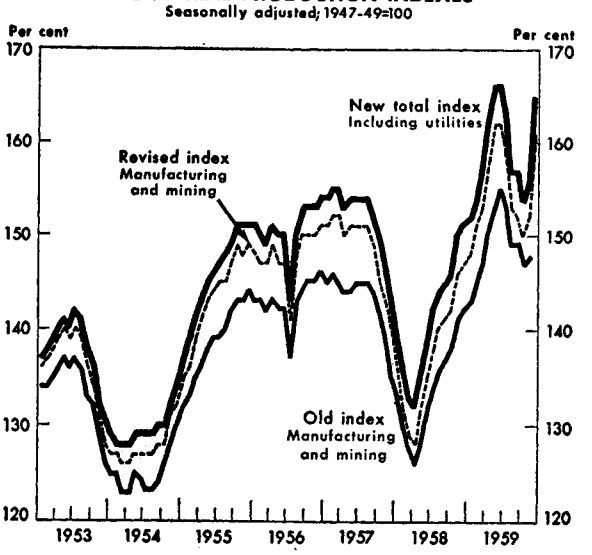
Continued strength in the economy was also indicated by the level of construction activity. On a seasonally adjusted basis, total construction outlays were up almost 6 per cent in January. However, the Census Bureau, which makes these estimates, believes that the December estimate of government spending on highways was too low, and that therefore the December-to-January increase in total expenditures was actually somewhat less than indicated. Gains occurred in all three components of construction—the residential, the nonresidential, and the public sectors.

Prices, meanwhile, have remained relatively stable. The wholesale price index was unchanged in December, at 118.9 (1947-49), just fractionally under the year-ago figure and 1 per cent below the year's April high. However, the wholesale prices of industrial commodities (that is, all commodities other than farm products and processed foods) continued to edge up in December (see Chart I); still, they ended the year only 1 per cent above December 1958. The consumer price index slipped 1/10 of a point in December, the first drop since August. Over the year as a whole, the consumer price index moved up 1.5 per cent, mostly because of increases in the prices of services.

THE NEW INDUSTRIAL PRODUCTION INDEX

A much refined tool for the analysis of United States business conditions was unveiled at the end of December with the publication by the Board of Governors of the Federal Reserve System of a thoroughly revised industrial production index. This is the third substantial revision of the index since it first appeared in 1927, and covers the period from January 1947 on. The changes are, in summary, as follows: (1) Electric and gas utility output has been added to the index, supplementing the output of manufacturing and mining industries. (2) The individual

Chart II
COMPARISON OF OLD AND NEW INDUSTRIAL PRODUCTION INDEXES
Seasonally adjusted; 1947-49=100



Note: Last date for old index is November 1959.
Source: Board of Governors of the Federal Reserve System.

production series, formerly grouped only by "industry" (for example, primary metals and transportation equipment), are now grouped also according to "market"—the three most comprehensive categories being consumer goods, equipment (business and defense), and materials. (3) The series have been adjusted to take into account new data that show the production of individual items more accurately; these "bench-mark" figures have been obtained primarily from the detailed 1954 Census of Manufactures. (4) The estimating procedures have been refined for those series that, for lack of current physical output data, are based on man-hour data. (5) Some new monthly series have been added. (6) All seasonal adjustments have been revised. (7) The industry groupings have been reclassified to accord with the Bureau of the Budget's 1957 Standard Industrial Classification. (8) The weights for the combining of individual series into groups continue to be derived from 1947 "value added" relationships for the years 1947-52, but, for the years beginning with 1953, 1957 relationships are used. (9) The "comparison base" for all series is now 1957 rather than 1947-49, and the regularly published figures will have this base (i.e., 1957=100) pending general adoption of a new one by other Federal agencies. (However, the total index as well as major groupings will continue to be published for an indefinite period on a 1947-49 base also.)[1]

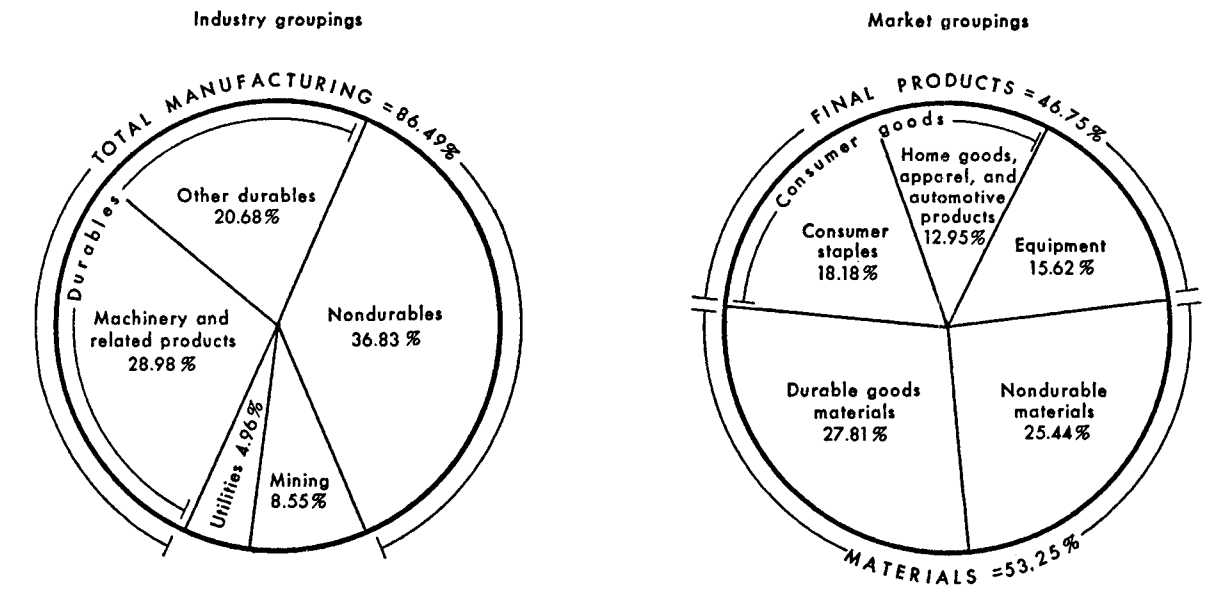
The effects of the revisions on the total industrial production index are shown in Chart II for the years 1953 through 1959. (Prior to 1953, when the new value-added relationships were incorporated, the differences between the old and the new indexes were not so substantial as later on.) To facilitate comparisons, all three series in the chart are given on a 1947-49 base. The series are: (a) the old index, which covered only manufacturing and mining; (b) the revised index of manufacturing and mining only, which will no longer be compiled by the Board as a separate index, and (c) the new index, which covers manufacturing, mining, and utilities. It will be noted that in 1959 the new index reached a pre-strike peak of 166 in May and June, while the old index at its June peak was only 155. About two thirds of this gap between the two is attributable, as the chart shows, to changes in the old manufacturing and mining series, and about one third to the inclusion of electric and gas utilities.

From the new index it now appears that production in the United States since 1947 has risen at an average annual rate of 4.1 per cent, significantly faster than the previously assumed rate of 3.8 per cent. These rates of course lump

[1] The December 1959 *Federal Reserve Bulletin* presents the new series of total and summary groupings back to January 1947 on both a 1957 and a 1947-49 base. More detailed historical series will be presented by the Board of Governors in a separate publication. While current figures for the total index and for the major industry and market groupings will be available in current issues of the *Bulletin*, the only published source of all the individual series will henceforth be the Board's midmonthly *Business Indexes* release.

Chart III

RELATIVE IMPORTANCE OF MAJOR GROUPINGS IN THE REVISED INDUSTRIAL PRODUCTION INDEX



Source: Board of Governors of the Federal Reserve System.

together years of rapid growth and years of slower growth and conceal the important swings that reflect cyclical variations in economic activity.

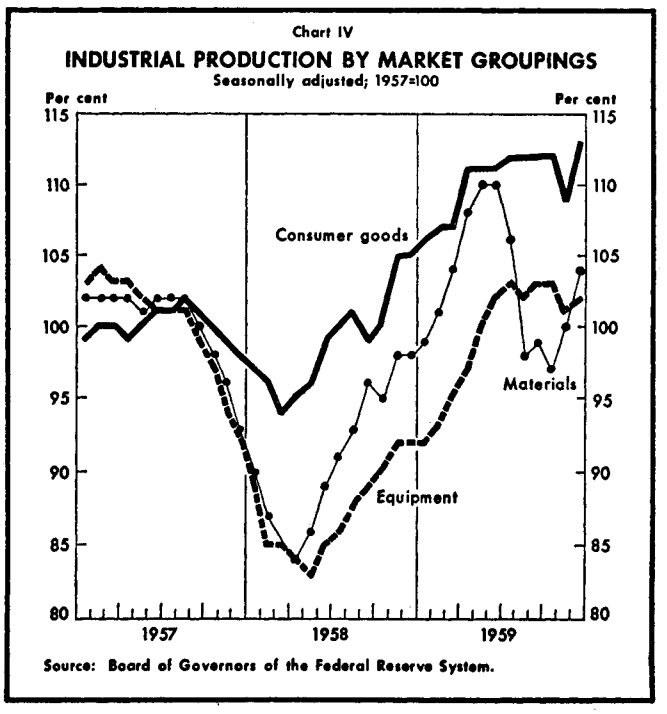
The revised figures show slightly greater fluctuations in recent years than was indicated by the old index. The upswing from 1954 to 1957 is 1 per cent more in the revised manufacturing-mining index than in the old index; the 1957-58 dip is 2 per cent more; and the rise from the spring of 1958 to the months just before the recent steel strike is almost 4 per cent more. When utilities are added, the fluctuations are similarly greater than before. The principal reason for these wider fluctuations is the shift from 1947 to 1957 value-added relationships, which gives greater weight to items whose prices rose relative to others between 1947 and 1957. And prominent among these were automobiles, steel, and machinery, all of which are especially sensitive to cyclical fluctuations.

The inclusion of utilities output in the total index, in order to have a better representation of fuel and power production, has naturally reduced somewhat the weight of manufacturing and mining. Previously, manufacturing accounted for 90 per cent, and mining for the remainder; now, manufacturing accounts for 86½ per cent, and mining for 8½ per cent, while utilities are assigned 5 per cent (see Chart III). Even more important have been the changes within the manufacturing sector itself. In the old index, nondurables and durables were given almost exactly the same weights. Now, however, durables account for 50 per cent of the total as against 37 per cent for nondurables. The gain of durables over nondurables reflects largely the growing importance of aircraft manufacturing, and the growth in metals and industrial and commercial machinery—items whose prices, as indicated earlier, rose substantially more than average. The change in weight for these products has pushed up the "machinery and related products group" from 51 per cent of the total durables group to 58 per cent, i.e., to 29 per cent of the total new index.

Before the index was reconstructed, the only "market" index published by the Federal Reserve Board was a limited, special "consumer durables goods" index. Now, however, all the series included in the industrial production index are classified according to market. The major categories may be seen in Chart III. The "final products" sector consists of (a) consumer goods and (b) business and defense equipment, and accounts for somewhat less than one half of the total new index (47 per cent), with consumer goods about twice as important as equipment. The other 53 per cent of the total new index is made up of "materials" and is divided almost equally between nondurables and durables. The individual series of the consumer goods sector are also being compiled in two alternative groups, different from those shown on the chart. One group includes the cyclically sensitive automotive products and home goods—appliances, furniture, and other durables—(7.75 per cent), and the other the less sensitive apparel and staple goods (23.38 per cent). Aside from these last two groups, the market breakdowns distinguish among a total of forty-seven major groups and subgroups.

With this amount of detail, important and sometimes critical economic developments can probably be spotted somewhat earlier than was heretofore feasible, and analyzed in greater depth. For instance, inventory movements of the sort mentioned earlier, in the discussion of current developments, can be a significant cyclical factor. The market groupings may facilitate an evaluation of movements in materials inventories by permitting fluctuations in materials output to be measured against fluctuations in the output of consumer goods and equipment; and a sharper rise in the former than in the latter could suggest that materials inventories are being accumulated. However, some estimate would have to be made of leakages into, for instance, exports and construction. The accumulation (or liquidation) of specific categories of materials inventories could perhaps be similarly examined by utilizing subgroups. The market groupings also permit growth patterns in different types of goods to be explored.

Comparison of the fluctuations in the consumer goods,



equipment, and materials indexes during the past three years shows that, over the period, the consumer goods index rose the most and that during the 1957-58 recession it fell the least (see Chart IV, in which 1957=100). The 1957-59 rise reflects primarily the secular increase in population, as well as the growth, over the period as a whole, in disposable income. The dip during the recession was less than in the other sectors, largely because the consumer goods index is heavily weighted by food, other consumer staples, and apparel, all of which are less sensitive to short-run changes in income than are consumer durables and the equipment and materials sectors. As regards the other two indexes, the equipment index shows only a slightly sharper dip than materials in 1957-58, but a substantially less sharp rise than materials in 1958-59. The latter relationship is in part attributable to the usual lag in demand for business equipment when a cyclical recovery begins. It also reflects, however, the rapid accumulation of primary metals inventories during the first half of 1959, undertaken in anticipation of the midyear steel and copper strikes. The sharp impact of the strikes on materials output is revealed in the steep drop of the materials index during the third quarter of 1959; and the subsequent curtailment in output of consumer goods and equipment that resulted from the ensuing materials shortages is also evident. The closing months of the year, on the other hand, show the pickup in materials production that followed the reopening of the steel mills in early November, and the positive influence this had on the output of final products in December.

Money Market in January

The money market continued tight during January, although seasonal repayment of bank loans and large flows of nonbank funds into the market relieved the severe pressure on short-term interest rates that had characterized the closing weeks of 1959. Reserve positions of member banks remained under pressure, as large seasonal reserve gains were offset by System open market operations. The effective rate on Federal funds held firmly at 4 per cent on most days of the period, and rates on new and renewal loans to Government securities dealers at the New York City banks rose from a flat 5 per cent at the end of December to 5¼-5½ per cent at midmonth, before declining to a uniform 5 per cent in the closing days of the period.

As often happens at this season of the year, yields declined during January in the Government and other securities markets. Treasury bill rates moved markedly lower over the month, as strong demand from nonbank investors encountered an increasing scarcity in the market supply of most issues of bills despite sizable sales and redemptions of these obligations by the System. The decline in rates, which was also evident in the market for Treasury notes and bonds, may also have reflected a number of loosely related background factors—reaction to the sharp rise in yields of the previous two months, the forecast of a sizable budget surplus for fiscal 1961, and the emergence of a feeling in the market that, contrary to earlier expectations, interest rates might not move further upward in the period ahead. There also were reports that the market for notes and bonds was strengthened by some movement of funds out of equities, which in turn may have been related to the sharp decline in stock prices during the month.

The Treasury announced on January 28 that it would offer 4⅞ per cent one-year certificates to mature February 15, 1961 and 4⅞ per cent four-year nine-month notes to mature November 15, 1964, in exchange for $11,363 million of 3¾ per cent certificates maturing February 15, 1960 and $198 million of 1½ per cent notes maturing April 1, 1960. The certificate will be offered at par, while the new 4⅞ per cent note is to be offered at 99.75 per cent of face value, making the effective yield about 4.93 per cent. The subscription books for the exchange will be open from February 1 to February 3.

MEMBER BANK RESERVES

Net borrowed reserves of all member banks averaged $416 million for the four statement weeks in January, little changed from the $444 million average for the five statement weeks ended in December. Average excess reserves were virtually unchanged at $487 million, and average borrowings at the Federal Reserve declined by $26 million to $903 million. The relative stability of the average level of net borrowed reserves, however, concealed large movements in the individual factors affecting reserves. The major source of reserves was the usual January return of currency to the banking system following the large increase in circulation during the Christ-

The Business Situation

Economic activity in February appears to have continued at a high level, sustaining the gains made in January after the first impulse from the reopening of the steel mills had spent its strength. Indeed, expansion over the four-month period of renewed steel output has been broadly based and, on the whole, rapid—although the pace recently has not been fully satisfactory to those who had expected the "soaring sixties" to produce immediate miracles. While steel production in February was slightly below the January record, preliminary data suggest that output in many other industries was steady or rising. Auto assemblies, however, were cut back from the very high rate reached in the preceding month, as inventories piled up. Sales of consumer goods maintained high levels and the rate of investment in fixed capital also appeared to be firm. Weekly figures on bank credit corroborated the impression of generally sustained strength, as business loan demand picked up in February following a somewhat weak performance earlier in the year.

THE POST-STRIKE REBOUND

The most pressing needs of the economy in the months immediately after the steel strike were to restore a steady flow of steel products to durable goods manufacturers and to rebuild automobile inventories so as to remove the restraint upon car sales imposed by limited dealer stocks. By the end of February, it appeared that the rapid rate of production since early November had fully met these immediate needs. Output had already risen sufficiently by the end of 1959, according to new United States Department of Commerce figures, to carry fourth-quarter gross national product to a seasonally adjusted annual rate of $483.5 billion ($1.5 billion higher than the preliminary estimates of the Council of Economic Advisers). This level was almost $5 billion above the preceding quarter, although still $1 billion below the second-quarter 1959 peak. The largest movement within the total was the change in nonfarm inventories, which had been liquidated at a seasonally adjusted annual rate of $1.8 billion in the third quarter and were replenished in the fourth quarter at a rate of $2.3 billion.

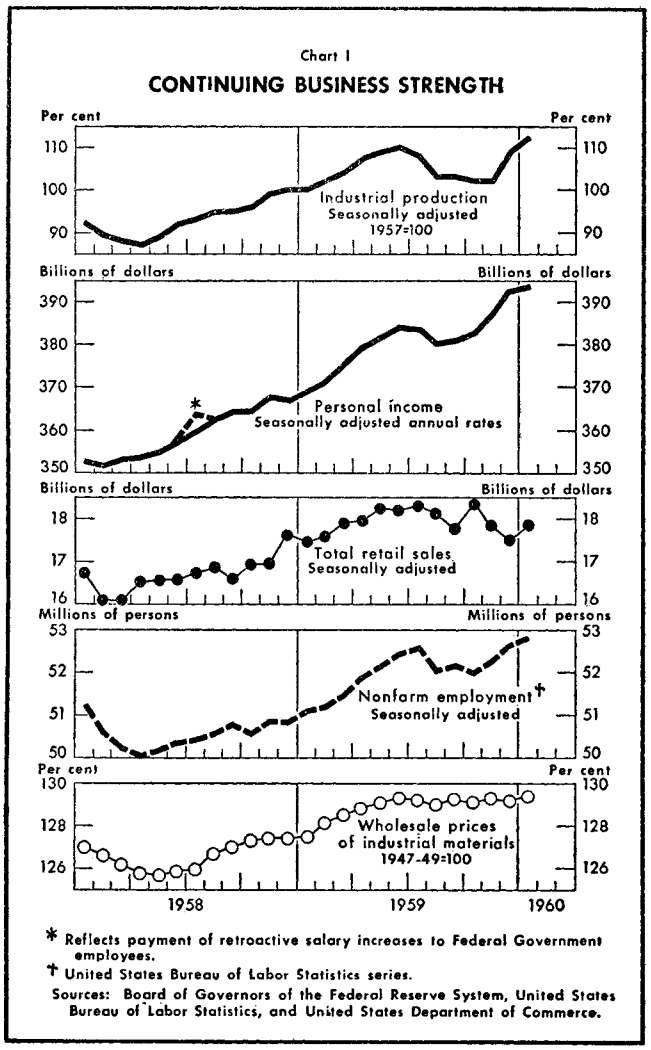
The brisk pace of industrial production continued into the new year, permitting further inventory building, and by early February a number of industries that had anticipated tight steel supplies for some months to come were accumulating stocks at a pace that they considered satisfactory. Steel ingot production edged below 95 per cent of capacity in February for the first time since the beginning of December (with the exception of Christmas week), but industry sources expect it to remain above 90 per cent of capacity through March.

Automobile inventories began to rise rapidly after the turn of the year, and dealers were expected to have almost 400,000 more domestically produced cars on hand by the end of February than at the end of December. This would bring inventories close to an all-time record. With stocks accumulating so rapidly, some producers sought to adjust output more closely to current levels of sales and consequently curtailed production during much of February. Although auto production in January had set a new record for that month, it is highly unlikely that the industry's earlier prediction of a quarterly output of 2.2 million cars will be fulfilled. The first-quarter total will still be quite high, however, and the sales figures for February (discussed below) are more encouraging than the January results which led to production cutbacks.

MODERATE BUT WIDESPREAD GAINS

Chiefly because of the sharp rise in output of automobiles and steel, but also reflecting production gains in machinery and other metal-working industries and in certain nondurable goods industries and utilities as well, total industrial production rose 3 points in January to 112 per cent of the 1957 average. This was 2 points above the previous peak, set last June, just before the steel strike (see Chart I). Substantial movements in the index are not likely in February, in view of the declines in steel and automobile output that offset the moderate gains which appear to have continued in some other lines.

Along with the new production record set in January, nonfarm employment also reached a new high, rising by nearly 150,000 persons to 52.8 million (seasonally adjusted Bureau of Labor Statistics series). The increase was concentrated in the auto industry and in retail and wholesale trade. There was a largely seasonal decline in total employment, according to the Census Bureau, reflecting such factors as the termination of holiday jobs. These estimates, based on a population sample survey rather than on reports from employers (and which include farm workers, self-employed persons, and domestic workers),

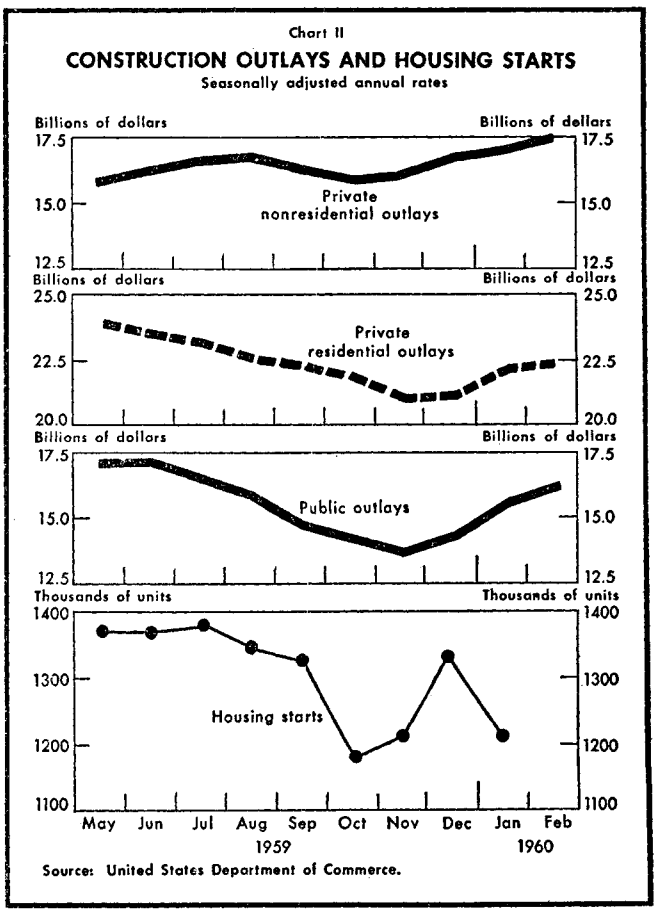


indicate that total employment fell about 3 per cent in January to 63.8 million persons. The seasonally adjusted unemployment rate remained at the December level of 5.2 per cent of the civilian labor force, close to the 4.9 per cent level prevailing before the steel strike.

Average hourly and weekly earnings in manufacturing rose to new highs in January, and average hours worked receded less than is usual for that month, with the result that personal income derived from wages and salaries moved up again. Smaller increases also occurred in some other nonagricultural components of personal income, but no further gains were registered in farm income which had been recovering in the preceding three months. Total personal income rose to a record $393.3 billion (seasonally adjusted annual rate), 2.5 per cent above the pre-strike peak of last June. The gain of $1.2 billion over December occurred despite a $1.1 billion increase in personal contributions for social insurance, arising primarily from the recent increase in contribution rates (such personal contributions are deducted in computing personal income).

The upward course of personal income, but more particularly the spurt in auto production that alleviated shortages of new cars in dealers' showrooms, pushed total retail sales in January 2 per cent above the reduced December level, after seasonal adjustment (see Chart I). At $17.8 billion, the January sales total was somewhat below the previous 1959 peak, possibly because income lost in strike-affected areas was still retarding sales in certain lines.

The daily average rate of automobile sales in January was 31 per cent higher than the previous month and almost 11 per cent above a year earlier. Year-to-year gains increased further during the first twenty days of February. If the February pace were to continue through the year, allowing for seasonal variations, total 1960 sales of domestic autos would be above 6 million units—although less than the 6.5 million figure appearing in many forecasts



late last year. Consumer purchases of other goods, both durable and nondurable, were sustained in January at the levels of the preceding month.

Wholesale prices remained relatively stable during the period of sharply expanding production in December and January. The wholesale price index was unchanged in December and then edged up in January by 4/10 of a percentage point. Half of the January increase was in farm products and processed foods, however, which usually move up at this time of year. The index of industrial materials prices—which includes all the unfinished goods in the wholesale price index, except for farm products, and is particularly responsive to movements in the prices of metals and minerals—might have been expected to show some upward movement as the production of durable goods rose rapidly. But this index rose only 2/10 of a point in January, following a drop of 1/10 in December. Although the January level was a new high, the net rise since mid-1959 has been slight (see Chart I), and there were no signs of any further advance in early February.

CONSTRUCTION TRENDS

Both public and private construction outlays (seasonally adjusted) increased in February for the third consecutive month, carrying total outlays almost 10 per cent above November. In the private sector, expenditures for new nonresidential construction expanded through most of 1959 (see Chart II) but fell in September and October as a result of steel shortages. While some part of the renewed expansion in the subsequent months was undoubtedly a reaction to this interruption and therefore temporary in character, the accelerated expansion in February seems to indicate basic strength in this area.

Outlays for private residential construction had been falling for six months before turning up in December, with strong competition for funds from other borrowers one major cause of the decline. Probably no great significance should be attached to the marked January increase in outlays, as the sharp jump in seasonally adjusted housing starts in December was followed by an equally sharp decline in the following month (see Chart II). The Federal Housing Administrator has characterized the December increase in housing starts as a "freak figure". The continued, though smaller, increase in outlays in February does suggest, however, that the 1959 decline may be leveling out. This tends to confirm other indications that the availability of mortgage funds is at least not tightening further.

Money Market in February

The money market remained moderately tight during February. Member bank reserve positions in the aggregate continued under pressure, despite a decline in required reserves resulting from a further seasonal reduction in bank credit. Irregular fluctuations among a number of factors influencing bank reserves caused intermittent relaxation of reserve pressures on the large New York City banks. There was occasional easing in the money market as a result, and some trading in Federal funds occurred at such times at rates below the 4 per cent discount rate. However, there were only three days during the month when the bulk of the trading in Federal funds took place at rates below 4 per cent. Rates on new and renewal loans to Government securities dealers at the New York City banks, which were 5 per cent at the start, ranged from 4½ per cent to 5¼ per cent during the course of the month, closing at 4½-5 per cent. Treasury bill rates extended their sharp decline of January into the early part of February, but moved higher during the balance of the month.

The market for Treasury notes and bonds, particularly longer term issues, continued during the greater part of the month to react to expectations that the expansion in business and credit would be more moderate than had been anticipated earlier and that there was less danger of an inflationary boom. In the final week of the month, however, rates increased sharply on long-term issues and declined on intermediate issues, in response to legislative developments described below.

MEMBER BANK RESERVES

Average excess reserves of all member banks, at $423 million, were $95 million below the average for the four statement weeks in January, while average borrowings at the Federal Reserve were $90 million lower at $813 million. A sharp drop in net borrowed reserves during

The Business Situation

Economic activity appears to have moved sideward in March, following a February in which some business indicators registered an improvement while others remained unchanged or declined slightly. Hesitations of this type are not, of course, at all unusual during the course of a sustained business expansion. But they always create uncertainty as to whether there has been a pause for breath which will be followed by renewed progress or whether, on the other hand, an advance warning of business recession has been posted. The impact of this kind of uncertainty on the climate of opinion in the last few months has probably been unusually strong because the pace of economic activity has clearly fallen short of the exuberant expectations held by many observers at the start of the year. Sales and output have indeed lagged somewhat, but this may turn out to be largely the result of a relatively severe winter, culminating in the heavy snow storms in many parts of the country during March. Moreover, a recent survey suggests that consumers' optimism is strong and that their buying plans are considerably larger than a year ago. In addition, plant and equipment expenditures rose substantially in the first quarter, and business plans indicate that outlays during the year may rise at a rate which, if realized, would push fixed-investment expenditures (in current dollars) above the previous record reached in 1957.

PRODUCTION LEVELS OFF

The hesitation of production in February and March appears, from the evidence available, to have reflected efforts to bring output into closer alignment with current sales and new orders. With the passing of the period of steel shortages, the long-term trend toward closer management of inventories has once again become important, and in many lines business policy is said to be aimed at holding inventories at lower levels relative to sales than in earlier periods of expansion. Additions to business inventories were, of course, unusually large in January, as stocks were rebuilt following depletion resulting from the scarcity of steel. But with inventories approaching desired levels toward the end of the first quarter, manufacturers in many lines have shown an increasing tendency to curtail both production and orders for materials.

In the automobile industry, dealer stocks expanded again in February but the rate of increase was somewhat reduced, both because of improved sales and also because of a cutback in production to prevent inventories from piling up. For March, the industry scheduled production at about the same rate as in February, thus permitting continued, but slower, additions to stocks. While inventories of domestic cars reached a record high of slightly over 1 million units by the end of the month, this level is reported to be consistent with dealer needs in view of the greater variety of models, which require dealers to carry larger stocks than in the past.

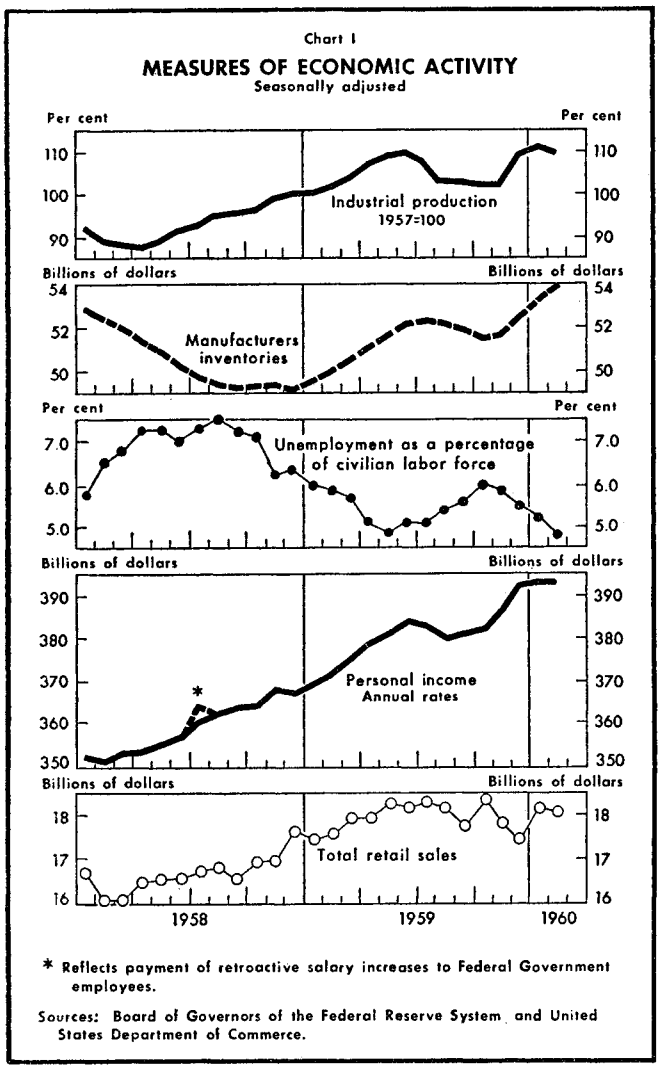
In the steel industry, the tendency of customers to gear output and inventory accumulation closely to sales has slowed the pace of incoming orders, and the rate of production of ingot steel has responded by moving lower again in March. As a major user of steel, the automobile industry has had an important impact. Curtailed auto production reduced the industry's steel consumption below the level originally anticipated. In addition, compact cars have captured more than 20 per cent of the domestic market and require about 25 per cent less steel than standard models. While new orders for steel from other industries have also fallen off after the unexpectedly rapid replenishment of stocks, some further additions seemed to be necessary to restore the balance among various types of processed steel. The total effect of these developments has been to reduce ingot production from almost 96 per cent of capacity in January to slightly above 94 per cent in February and about 91 per cent in March. Shipments of processed steel are still high, but industry sources expect some decline in the second quarter.

Reduced output in the steel and automobile industries accounted for much of the small decline in the industrial production index from 111 per cent of the 1957 base in January (revised from the original estimate of 112) to 110 in February (see Chart I). About one third of the decline was in materials output, largely attributable to ferrous metals. The rest was in production of consumer goods, where the automobile cutback was an important, though not the sole, element. Output of textiles and apparel and appliances also slipped, in response to a less rapid expansion of sales than had been anticipated. A further slight decline may appear in the over-all index for March, but no sharp movement seems likely.

Despite the small slippage of industrial production, both employment and nonagricultural income in February maintained the high levels reached in January. Manufacturing employment was down slightly, paralleling the movement

of output. This slight dip was more than offset, however, by gains in mining, services, trade, and government, which brought total nonagricultural employment (seasonally adjusted) to 52.9 million workers, very slightly above the record peak of the preceding month. Total employment (which also includes farm workers, self-employed persons, and domestic workers), on the other hand, rose by almost 1 per cent, as unemployment declined contraseasonally to 3.9 million, according to the Census Bureau. The seasonally adjusted unemployment rate fell to 4.8 per cent of the civilian labor force, 0.4 point below January and the lowest level since October 1957.

Personal income edged up to $393.0 billion from $392.8 billion (revised downward from the original estimate) in January. The rise in wages and salaries was less pronounced than in January, due to a reduction in the average number of hours worked and in overtime earnings as steel and automobile production eased. Agricultural income fell by $0.6 billion, and there were minor declines in business and professional income and in transfer payments.



The over-all stability of the cost of living since November has meant that the recent gains in income have been gains in purchasing power as well. The consumer price index edged off slightly in December and January but in February returned to the previous peak of 125.6 per cent of the 1947-49 average. Higher prices for most of the commodities and services associated with housing and for medical services were the major factors in the February rise, and were only partly offset by declines in prices of food and new cars.

Although personal income in February was 2.4 per cent above the June peak, retail sales, according to preliminary reports, were still 1.3 per cent below the high level reached before the steel strike. Sales in February were largely unchanged at $18.1 billion (seasonally adjusted), after having risen 3.8 per cent in the preceding month. Automobile purchases had provided much of the upward force in January and continued to expand in February, as the daily average rate rose 6.2 per cent above the preceding month and was 14.5 per cent above a year ago. During the first twenty days of March, sales were at a daily rate slightly above the comparable February period. Peering into the future, the Survey of Consumer Finances made by the University of Michigan in January and February found that the number of consumers intending to buy new cars during 1960 was about 20 per cent above a year earlier.

In contrast to the rise in auto sales, purchase of nonautomotive goods eased off in February. Expenditures for nondurable goods declined from the new peak reached in January, partly reflecting a slump in apparel sales, where production has also been weak. The largest reduction, however, occurred in sales of durable goods other than cars. Appliance sales, for example, seem to have been sufficiently slack to induce cutbacks in output. On the other hand, preliminary data suggest that department store sales in March, after allowing for the late date of Easter and other seasonal factors, were about unchanged from February in spite of unusually severe weather in many parts of the country. The Michigan survey referred to above found that consumer plans for buying household equipment were considerably larger than a year earlier.

In contrast to the slack in some other lines, exports have recently shown a marked gain. Nonmilitary exports moved up sharply in January and registered a further small gain in February. Exports for the two months were over 20 per cent higher than for the corresponding period

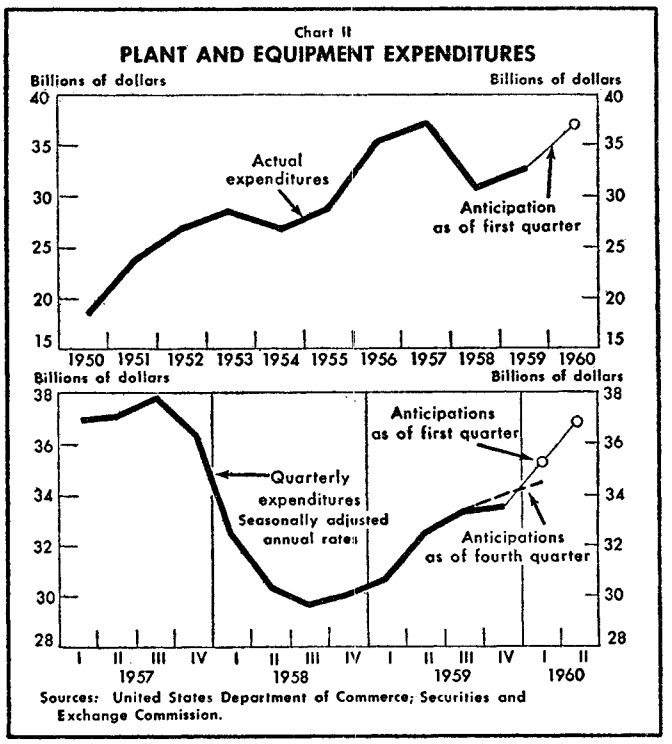
of 1959, while imports were up by only about 7 per cent. The trade surplus in the first quarter is now expected to be significantly larger than in the fourth quarter.

FIXED INVESTMENT PROSPECTS

In view of the limited expansion of consumer spending and the hesitation of production in recent months, the results of the latest survey by the United States Commerce Department and the Securities and Exchange Commission of businessmen's capital spending plans are of special interest. On the whole, the results of the survey taken in late January and February are favorable, although it is of course too early to tell whether actual outlays in 1960 will be up to, or exceed, plans. Businessmen are planning to spend about $37 billion for new plant and equipment in 1960 (see Chart II), 14 per cent more than in 1959 and about the same as the previous current dollar record reached in 1957 (but not quite as large if price changes are allowed for). The planned year-to-year increase compares with a 22 per cent increase in current dollar terms, and a 15 per cent increase in real terms during the capital goods boom of 1955-56, and is double the rate of advance between 1958 and 1959 when the steel strike slowed outlays in the fourth quarter.

Actual expenditures in the first quarter of this year are estimated to have risen to a seasonally adjusted annual rate of $35.3 billion, 5 per cent above the preceding quarter and almost $1 billion higher than the level anticipated one quarter earlier. A further increase of 4½ per cent is expected in the second quarter, and a somewhat slower expansion is implicitly predicted for the second half.

While the survey revealed, in general, a greater emphasis on improvement of production facilities than on expansion of capacity, a significant part of the first-quarter rise in spending was in construction, as demonstrated by the gains in nonresidential construction outlays in the first two months of the quarter. Private nonresidential building declined somewhat in March (on a seasonally adjusted basis), but spending in the entire first quarter was still 4.4 per cent above the preceding quarter.



Total construction expenditures also declined in March, by almost 3 per cent. This was primarily because of reduced investment in private residential construction, however, which has not maintained the strength that seemed to be present earlier in the year. Private housing starts fell in both January and February, on a seasonally adjusted basis, and the flow of spending for construction actually put in place rose at a reduced rate in February and declined in March. On the other hand, applications for mortgages insured by the Federal Housing Administration and Veterans Administration guarantees do not seem to indicate further weakening in housing starts. In addition, the Michigan Survey of Consumer Finances suggests that home-buying plans are stronger than they were a few months ago.

Money Market in the First Quarter

The first quarter of 1960 witnessed a significant turnaround in the money and financial markets. Treasury bill rates and other short-term money rates dropped sharply, as did yields on Government notes and bonds; and stock prices, despite a rally in the latter part of March, were about 8 per cent lower at the close of the quarter than at its start. Member bank borrowings from the Federal Reserve gradually declined, while Federal funds were

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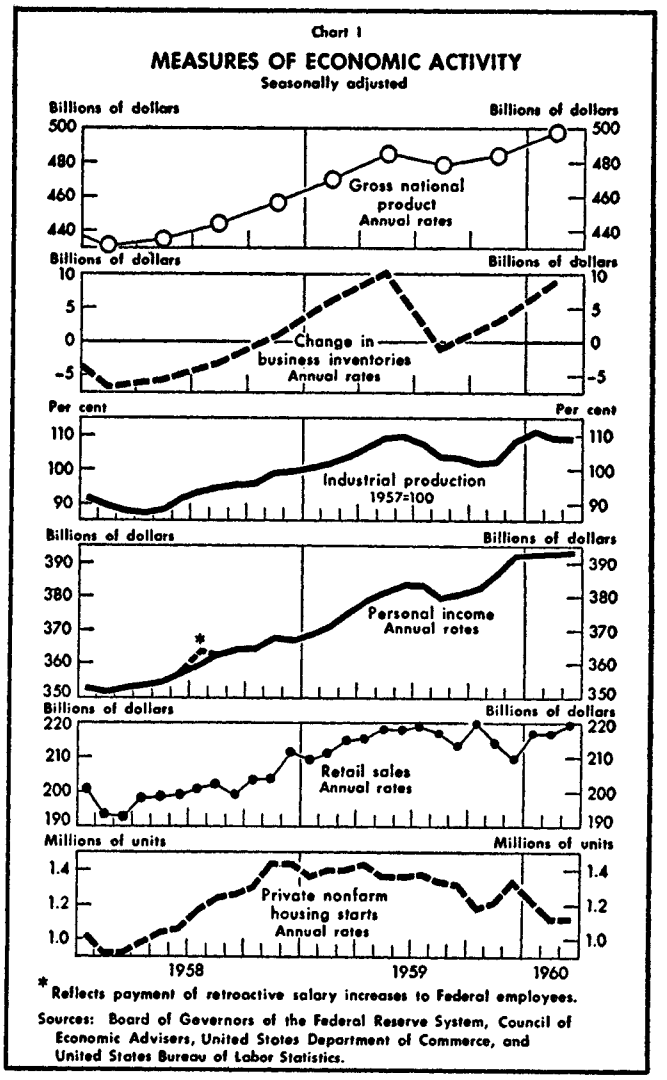
Preliminary information for April suggests that the economy has begun to pull out of its weather-influenced late-winter doldrums, although the evidence continues mixed. Consumer purchasing, in particular, brought a breath of springtime to businessmen. Automobile sales advanced smartly, and department stores reported a record Easter season. Industrial production may have steadied after two months of slight decline, a further downward pull of steel output from the very high post-strike level possibly being counterbalanced by firmness in some other lines. Hiring of workers for outdoor activities, postponed in blustery March, probably was made up in part in April, as winter turned abruptly into spring. Finally, a new survey of business investment spending plans, taken at the "high point of uncertainty" in March and early April, showed even larger planned outlays for 1960 than an earlier survey made only a few months ago.

THE PATTERN OF DEVELOPMENTS

During the first quarter of the year, despite the slight weakness in industrial production in February and March following the January record high, and in the face of a decline in stock market prices, gross national product rose 3 per cent to a seasonally adjusted annual rate of $498.0 billion (preliminary estimate; see Chart I). Measured in constant dollars, this was about 1½ per cent above the previous peak, reached in the second quarter of 1959, just before the steel strike. Slightly more than half of the $14.5 billion advance in the first quarter this year was in investment. Accumulation of business inventories accounted for most of this investment, the bulk comprising steel, automobiles, and other durables. The January-March quarter witnessed gains in the government, international, and consumer sectors of the economy, too. Of these, consumer spending showed the largest increase—$3.8 billion—with the major part being for services.

The industrial production index slipped again in March by one point, as it had in February, dropping to 109 (1957 = 100) compared with the January peak of 111 (see Chart I). The output of equipment remained unchanged at last summer's record level of 103, and the materials index was steady at 109. But the production of consumer goods edged downward again, the one-point decline bringing the series 2½ per cent below the record 116 attained in January. Reductions were recorded in the output of automobiles and of appliances and other house furnishings; only the production of consumer staples remained unchanged. During April, steel output was much below March levels, and there were scattered reports of contractions in other manufacturing fields. However, these movements may have been largely countered by increases elsewhere.

The decline in industrial production during March played some part in depressing employment, contraseason-



ally, by slightly more than a quarter of a million persons to 64.3 million, and in raising the rate of unemployment (percentage of the civilian labor force) from February's 4.8 per cent to 5.4 per cent, seasonally adjusted. Much more important, however, was the disruptive effect of the inclement March weather on agriculture and construction. Construction employment alone dropped by 224,000 persons, seasonally adjusted, more than the net decline in total nonfarm employment (Bureau of Labor Statistics series) of 214,000 persons. Employment in manufacturing and other sectors fell more moderately than in construction. And the contraction in private employment was partly offset by a rise in government employment, mainly because of temporary hirings for the 1960 Census. The more seasonable weather of April probably brought a larger-than-usual increase in employment, as work got under way on delayed outdoor activities, but it did not seem likely that unemployment would recede to the level reached in February, when the seasonally adjusted rate had for the first time in nine months dipped to (and even slightly below) the 1959 low.

The March drop in employment was accompanied by a slight shortening of the workweek (partly because of storms and partly because of reduction of overtime—mostly in automobile and other consumer goods plants). These factors, together with a further decline in farm income, served to hold personal income to a relatively small increase. The seasonally adjusted gain of $0.5 billion (annual rate) was larger than the previous month's advance of $0.2 billion (see Chart I), but smaller than any other monthly increase since 1958. (In mid-1959 there were of course two months when income declined because of the steel strike.) Wage and salary disbursements in the manufacturing and other commodity-producing industries actually fell, for the second successive month and by twice the loss in February. The decreases in personal income were slightly more than offset by advances in unemployment insurance and other transfer payments, in interest income, and in government wages and salaries (which included payments to temporary Census workers).

Accompanying the increase in total personal income, and despite the effects of bad weather, total retail sales moved a little higher in March to virtually regain the record level of last October (see Chart I). The gain in March was attributable entirely to an increase in nondurables. A very slight decline in durables seems to have been largely associated with the fall in home building that began last spring. Purchases at lumber, building, hardware, and furniture and appliance stores continued to fall off in March, while concurrently there were gains at food and general merchandise stores. Sales of automobiles in March rose markedly over February in number of units, although the gain in dollar value was probably less strong. An increasing share of sales consisted of the lower priced compacts; moreover, effective prices of practically all lines of cars seem to have been reduced as more generous discounts were offered in an effort to boost sales.

In April, the available evidence suggests, total retail sales took an even more favorable turn. Department store sales advanced during the first three weeks of the month—even after allowing for the special boost given to sales by the Easter holiday. Auto sales moved up more than seasonally during the first ten days of the month, compared with the parallel period of March, and again during the second ten days. Further surveys of consumer spending expectations confirmed a favorable outlook.

Spending still is unusually low relative to income, however. This lends support to expectations of an improvement in demand, although the flattening-out of income in the past few months, and particularly the weakness of wage and salary incomes, could have a dampening effect. The apparent slowing of the downward movement of residential construction that has been under way, with only a brief interruption, since last summer may also be interpreted as a sign of potential strengthening of demand for home furnishings and appliances. Although March and April residential construction outlays declined again, the seasonally adjusted level of housing starts in March remained steady despite the harsh weather (see Chart I). Continuing easing of mortgage funds and the lowering of downpayment requirements for mortgages insured by the Federal Housing Administration contributed to the expectation of an actual improvement in this sector. At the same time, there have been indications that the number of apartment vacancies has increased somewhat.

While it is unlikely that inventory accumulation will provide as great a stimulus to economic activity in the current quarter as in the first three months of the year, businesses will probably continue adding to stocks. In particular, stepped-up consumer demand may prompt businesses to increase their holdings, for in recent months inventory-sales ratios have been near last spring's low levels, which were the lowest since 1950. Several factors, however, militate against a very large increase in inventories unless demand surges strongly upward. There is, first, an apparently rapidly spreading trend, aided by electronic computing devices, toward better control of inventory levels. Secondly, relatively high interest rates may reinforce management's determination to keep inventories down to minimum levels. Thirdly, increased capacity in various producer goods fields en-

courages firms in the more advanced processing stages to expect rapid filling of their orders. Such inventory policies probably force the manufacturers of materials and other producer goods to keep somewhat larger inventories than they otherwise would, especially if they must compete for customers. Nevertheless, this more or less hand-to-mouth inventorying must be expected, if practiced on a wide enough scale, to lead to a more immediate, closer relationship between unforeseen changes in demand for final products and changes in demand for materials than would otherwise be the case.

Business plans for plant and equipment expenditures provide another encouraging note. The latest McGraw-Hill survey indicates that their respondents are now planning outlays for 1960 at a rate 16 per cent above the 1959 level. This compares with a much smaller 10 per cent rise in planned expenditures reported by McGraw-Hill in its preliminary survey last fall, and a 14 per cent increase projected in the recent Securities and Exchange Commission-Commerce Department survey. The latest McGraw-Hill survey was taken in late March and early April. This was a time when widespread disappointment about the pace of economic activity could have been expected to dampen spending intentions. The survey was also favorable in that it indicated a continued concentration of planned expenditures on modernization equipment as against expansion of capacity. This augurs well for the future, since modernization expenditures are likely to be maintained even if ample or excess capacity should develop at some time in certain sectors. Additional support for capital expenditures may come from the fact that profits in the first quarter of 1960 were, according to reports published thus far, close to the record level reached in the second quarter of 1959.

The industrial commodities component of the wholesale price index has remained relatively stable. The index for such commodities inched downward in February and March from the January record high of 128.8 (1947-49 = 100) to 128.6 at the end of the quarter, and during the first half of April prices changed little. The index of all wholesale prices, however, rose $\frac{7}{10}$ of a point in March to regain the April 1959 record high of 120.0—a result largely of higher farm and food prices. These price increases were in part seasonal, but March's unusually wintry weather helped push up livestock, meat, and egg prices. The consumer price index rose $\frac{1}{10}$ of a point in March to a new high of 125.7. As with wholesale prices, there was a more-than-seasonal increase in food prices, and most other components of the index also advanced. Automobile prices, however, declined substantially.

THE LONG-RUN UNEMPLOYMENT PICTURE

Total employment was at an all-time high in February, seasonally adjusted, before the raw March weather contributed to a sharp decline (see Chart II).[1] But unemployment remained relatively high in both months. In February, the number of jobless workers seeking employment was still 30 per cent larger than at the low point of the prior expansion (see Chart II), and more than twice as high as at the low point of the Korean war. The unemployment rate, which measures unemployment as a proportion of the civilian labor force, has continued for almost two and a half years at levels in excess of 4.7 per cent.

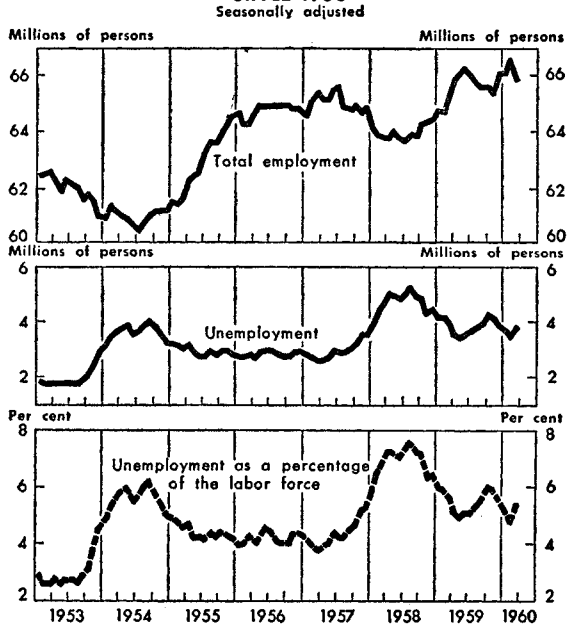
Some observers have suggested, in fact, that unemployment rates have drifted higher over the past decade as part of a long-term trend. If there is such a trend, it would appear to be somewhat more pronounced for periods of recovery and expansion than for the months of recession.

[1] See the March 1959 issue of this Bank's *Monthly Review* for a description of the technical features of the various statistical series of employment and unemployment.

Chart II

EMPLOYMENT AND UNEMPLOYMENT CHANGES SINCE 1953

Seasonally adjusted

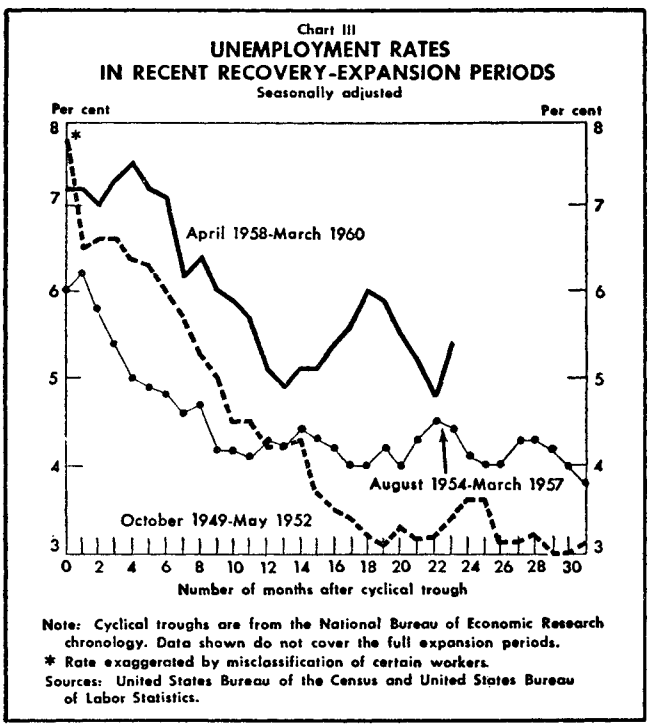


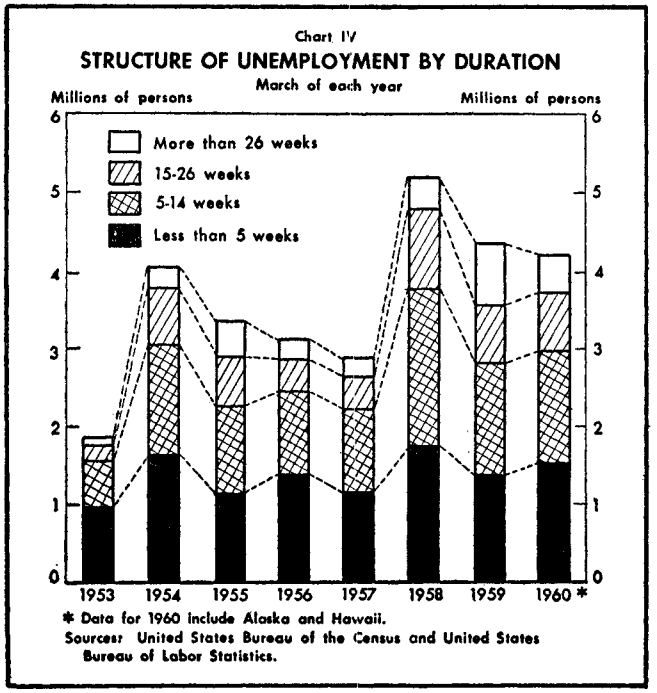
Note: Data include Alaska and Hawaii beginning January 1960. The inclusion of these two States added 266,000 persons to total employment in that month, mostly in nonagricultural industries. Unemployment level and rate were virtually unaffected.

Sources: United States Bureau of the Census and United States Bureau of Labor Statistics.

An upward movement is apparent in Chart III, which shows the unemployment rates in each of the last three postwar recovery-expansion periods. The principal aberration from the indicated upward cycle-to-cycle trend, which occurred during the second half of 1954 and early 1955, can perhaps be explained by the large number of men in the armed forces who, if they had been mustered out earlier, would have swelled the total of unemployed; but this must at best remain conjecture. Indeed, we probably do not have sufficient evidence to establish either the presence or absence of a clear-cut trend. The period involved is relatively short, and in any case interpretation of the years in it is clouded by the beginning and ending of a major military conflict.

Whether or not there is an upward trend in the rate of total unemployment, a rather striking change within the total may be seen in the rising number of long-term unemployed, i.e., those idle for fifteen weeks or more at a time (see Chart IV). In 1953, this group was 15 per cent of the total unemployed. In the seven years since then the rate of long-term unemployed has never fallen below 22 per cent of the total, and in four of those years has actually accounted for between 28 and 35 per cent. In addition, those who were out of work for more than twenty-six weeks rose from 5 per cent of the total unemployed in 1953 to as high as 18 per cent in 1959.





Who are these long-term unemployed? Many of them are workers forty-five years and older, or members of nonwhite minorities. In terms of their economic position, many are workers who have experienced "structural" unemployment. The causes of such dislocations exist in years of prosperity as well as in years of recession; they include long-term declines of industries and of occupations, the displacement of old products by new ones, changing consumer tastes and changing Government defense programs, and automation and other technological developments. The effects of structural dislocations are particularly strong in areas where a formerly dominant industry has declined. Such areas may even become chronically depressed, with ramifying influences on local service, construction, and transportation industries. The more mobile, younger workers can migrate from the area on relatively short notice, and many do. Older workers, probably most of them heads of families and many of them possessing skills for which there is no longer much demand, are less quick to move and tend to try to wait out what may sometimes appear initially to be a temporary shutdown. In the high employment period of June 1956-June 1957, unemployment in chronically depressed areas accounted for at least one fifth of total unemployment; and more than one fourth of the unemployed in these areas were out of work for six months or more, compared with only about half that percentage elsewhere. In May 1959,

before the steel strike, almost 15 per cent of the nationwide unemployed were located in such areas. Most of these areas were concentrated in eight states, with Pennsylvania and Massachusetts topping the list.[2]

Areas with relatively high levels of unemployment are not, of course, limited to the chronically depressed areas. In March 1960 there were 33 major labor market areas, out of a national total of 149, that were designated "surplus labor market" areas by the Bureau of Labor Statistics. These surplus areas had high unemployment (i.e., more than 6 per cent of the civilian labor force) primarily for reasons other than seasonal or temporary influences, and either had experienced these levels for more than four months or were expected to do so. A year earlier there had been 72 such areas, so that by March of this year the number of communities still in this condition had been reduced by more than half. It is well to recognize, however, that these remaining pockets of "surplus" labor represent close to one fourth of the country's major labor market areas.

The relatively short-term unemployed, i.e., those who were unemployed for less than fifteen weeks in any one spell, accounted in the prosperous years 1955-57 for about 75 per cent of the unemployed. About a fifth of the short-term unemployed were workers who were voluntarily shifting from one job to another. Many of these, however, were "repeats", indicating that a much smaller number of individuals were involved in such voluntary shifts than the proportion might suggest. About another 40 per cent of the short-term unemployed represented new workers just entering (or re-entering) the labor market. And 40 per cent or more were workers affected by seasonal fluctuations in employment. As Chart IV shows, short-term unemployment has grown in absolute level during the 1950's, comparing recession year with recession year and prosperity year with prosperity year—even though declining as a percentage of the unemployed.

The future may well bring other problems. During the 1960's, according to Department of Labor projections, 26 million young people will enter the labor force, 37 per cent more than entered during the 1950's, and 3 million women will return to the labor force. Withdrawals from the labor force are expected to offset only about half of this total increase. The new entrants to the labor force will of course be consumers too, and perhaps aggressively so if the current practice of early marriage and household formation continues. Nevertheless, it is quite clear that employment opportunities will have to be expanded considerably more rapidly than heretofore, if the number of unemployed is to be kept from swelling. The country will also be confronted with the special unemployment problems arising from the need for higher labor skills to cope with the more complex machinery that is being widely introduced, the need to retrain older workers who are a major part of the long-term unemployed, and the need to ameliorate conditions in chronically depressed areas. None of these problems, however, should be viewed as a cause for grave alarm. They are, in fact, the problems of a society that not only is expanding in size but also is growing in technology, extending its life span, and developing increasing recognition of social responsibilities.

[2] The criterion used by the Department of Labor in determining whether an area is chronically depressed is, in general, the persistence of unemployment rates 50 per cent or more above the national average for four of the preceding five years.

Money Market in April

The money market tone was somewhat easier in April than in other recent months, while member bank reserve positions, in the aggregate, were under moderate restraint. Partly because of the easier availability of funds at the money market banks, Federal funds traded at rates below the 4 per cent discount rate during part of each statement week. Rates on loans to Government securities dealers at the New York City banks ranged from 4 per cent to 5 per cent during the month.

Market rates of interest on most obligations moved significantly higher in the first half of April, after declining almost steadily during the first three months of the year. Later in the month, rates moved irregularly lower again, although most issues showed a net rise in yield over the month as a whole. The rate advance probably was attributable to a number of influences. Treasury financing was an important factor, as the Treasury marketed $2.6 billion of notes and bonds to raise new money and sold $2 billion of one-year bills to replace a maturing issue. Offerings of new tax-exempt securities also expanded. And

commercial demand for spot sterling, it was more than offset by persistent sterling offerings from the Continent. After the cancellation of the summit conference in Paris at the midmonth, these offerings increased substantially, causing a marked decline in the spot quotation. Following a brief partial recovery in the rate, Continental offerings were renewed and, with some commercial selling of sterling and commercial demand for dollars in London, depressed the quotation by May 31 to $2.8019, a decline of about 75 points for the month.

In the forward market the discounts on three and six months' sterling generally narrowed to 39 and 76 points, respectively, by mid-May. Subsequently, they tended to widen and at the month end were 46 and 86 points. Although there was some commercial activity, the discounts continued to reflect primarily adjustments to the short-term interest rate differential between London and New York.

The Canadian dollar, quoted at $1.03 9/16 at the beginning of May, steadily weakened, reaching its lowest level since January 1958. Market reaction to the withdrawal from registration of a Canadian municipal bond issue scheduled for the New York market (subsequently marketed in New York toward the month end) brought about an initial easing in the Canadian dollar quotation. Thereafter, short-term interest yields declined in Canada, and Canadian dollars were offered as short-term funds began to move to the Continent. This, together with substantial offerings of Canadian dollars by United States commercial interests and demand for United States dollars by Canadian commercial interests, forced the rate for the Canadian dollar down to a low of $1.01 1/64 by May 25. After recovering to $1.01 23/64 on covering of short positions, the Canadian dollar again moved lower to $1.01 9/32 at the month end.

The quotation for the Swiss franc, which had been depressed for some months, began to appreciate at the beginning of May, as investment capital was repatriated, and by May 24 stood at $0.2318¾, the highest quotation this year.

The Russian ruble, it was announced early in May, would be revalued next year on the basis of one new ruble for ten old. Currently, tourists are receiving ten rubles for one United States dollar.

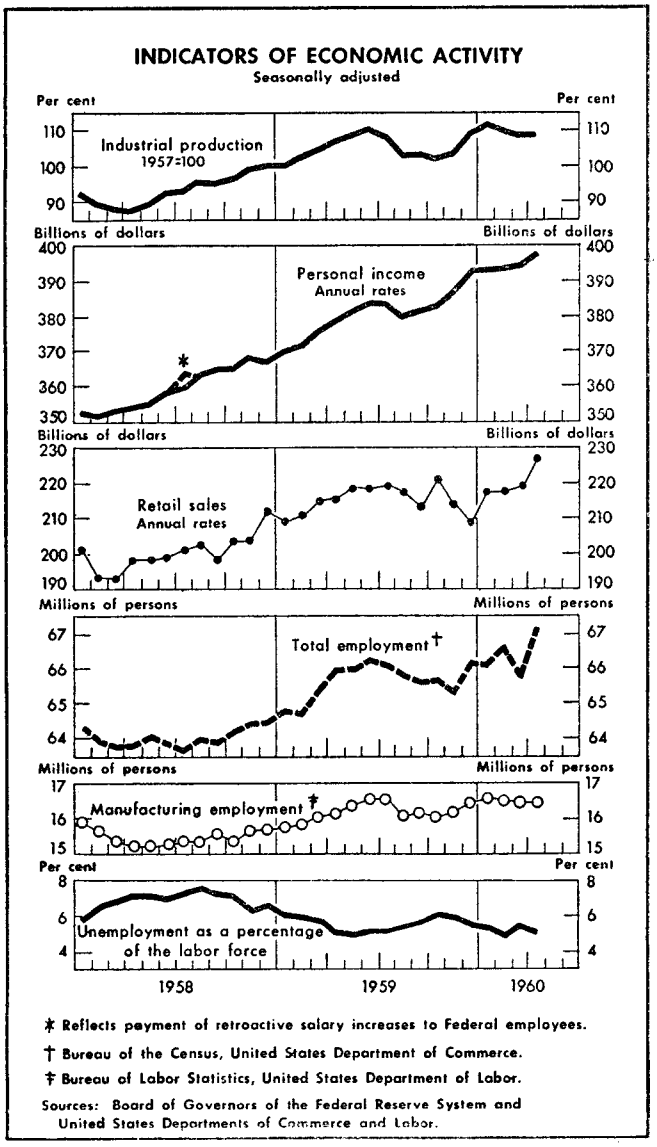
The Business Situation

Economic activity in May appears to have steadied at the high levels achieved in April. Automobile sales, which had risen in April, contributing much to that month's better tone, maintained the same pace during the first twenty days of May as during the comparable period of April. Early information on department store sales suggests, however, that in a number of other lines there may have been some declines from the very high April sales figures. Total factory output in May does not seem to have been pushed up by the substantial April expansion in consumer demand. Still, not all consumer purchases were met by further drawing-down of inventories, and production in some industries—including automobiles—registered further gains. The prospect, moreover, of later increases in production elsewhere was indicated by a recent survey of consumer buying plans, which showed buying intentions for many items to be stronger than a year earlier.

The information that has now come in for April confirms that most over-all measures of economic activity improved substantially during that month, but in some cases the advance seemed to be in large measure only an offset to the disappointing performance of the preceding month or two.

In mid-April, total employment (as computed by the Bureau of the Census, and including farm workers, the self-employed, and domestic workers) moved up sharply to a new all-time high, seasonally adjusted (see chart). The increase resulted primarily from a more-than-seasonal rise in agricultural and construction employment—probably making up for the slow hiring of workers for these outdoor industries during the unusually wintry March. The figure was also pushed up by the hiring of more than 150,000 temporary workers to take the decennial Census. Manufacturing employment (as estimated by the Bureau of Labor Statistics) was unchanged from mid-March, on a seasonally adjusted basis (see chart). This stability concealed important divergent movements, however; employment in durable goods industries declined by 66,000 persons, while in nondurables it increased by an equal amount.

Many of the people hired in April were seasonal or temporary workers who had not been listed as unemployed at the time of the previous Census Bureau survey in the middle of March. Therefore, the decline in unemployment was not so large as the rise in employment, and the number of unemployed remained fractionally higher than a year



earlier. As a proportion of the civilian labor force, however, unemployment fell from 5.4 per cent to 5.0 per cent, seasonally adjusted. This brought it close to the 2½-year low of 4.8 per cent reached in February this year.

With total employment up sharply in April, personal income showed a larger gain, seasonally adjusted, than in any other month in 1960 (see chart). Indeed, the $3.4 billion rise was almost double the increase over the entire first quarter. All major components either rose or at least remained unchanged. The largest improvement was in wages and salaries, although manufacturing wages and salaries fell for the third consecutive month. The April decline in manufacturing income apparently reflected mainly a reduction in hours worked and in overtime, premium pay, but it may have been partially a result, too, of the contraction in factory employment in durable industries, where wages are relatively high.

Retail sales in April increased, seasonally adjusted, by 3½ per cent (based on the advance report). This rise was far better than the increases during February and March (see chart), and a similarly sharp advance had occurred in just three other months since the business upturn in 1958. Even more significant, the increase was more than twice as large as the April advance in personal income. This resulted in a substantially higher spending-income ratio, and thus helped make up for the retarding effect on economic activity of a currently slowed rate of inventory accumulation.

In May, total retail sales may have remained at about the high April level. Automobile sales during the first twenty days of the month were about equal to the first twenty days of April, maintaining the relatively high level reached in the latter period. Department store sales during the first three weeks of May were slightly below the levels achieved a year ago, suggesting that for the month as a whole seasonally adjusted department store sales may have fallen below the very high April figure.

The climb in retail sales during April pushed up orders for nondurables received by manufacturers, but orders for durables declined by an equal amount, possibly largely as a result of the continued drop in steel orders. The March-April level of total new orders was 1 per cent (seasonally adjusted) below the February total.

Industrial production also leveled off in April, at 109 (1957 = 100), seasonally adjusted, following a small two-month decline (see chart). Substantial increases were registered in mining, in petroleum products, and in such consumer durables as autos and furniture. As a result, the index moved sidewise despite a further decline in the output of iron and steel, fabricated metal products, electrical machinery, and transportation equipment.

Automobile production, which had fallen off about 15 per cent between the January peak and April, rose in May, in response to strong sales during the preceding weeks. Although automobile inventories were still at the high level of about one million units at the end of April—partly reflecting larger inventory requirements associated with the greater variety of models—the faster sales pace apparently convinced producers that inventories were not too large for this time of year. In contrast, steel production continued its sharp decline into the fourth successive month, with mills utilizing less than 70 per cent of rated capacity, compared with the above 95 per cent levels prevailing at the turn of the year when steel inventories were being rebuilt following the steel strike. Officials of the top

steel companies, however, are of the opinion that steel consumers are using up more steel than is being currently produced. They consequently foresee an upturn in production after the usual summer lull, during which steel users' inventories are expected to fall to minimum levels compatible with efficient production.

Prices at the wholesale level seem to have moved slightly downward in May after remaining unchanged, on the whole, in April. The monthly index of all prices stood in April at 120.0 (1947-49 = 100), exactly the same as a year ago. The industrial commodity prices component had nudged up 1/10 of a point from March, to a level 3/10 of 1 per cent above April 1959. Of the two other major components, farm products moved up and processed foods down; both, however, were below year-earlier levels. The weekly figures thus far available for May show movements in the indexes of farm products and of processed foods that approximately offset each other, while the industrial commodities component remained steady at a level a bit below the April monthly figure.

Although the wholesale price index was steady in April, the consumer price index set another record high, advancing to 126.2 per cent of the 1947-49 average, 4/10 of 1 per cent above March and almost 2 per cent more than the previous April. The major reason for the March-to-April increase was a sharp rise in food prices, apparently attributable in part to seasonal advances and unusually bad spring weather. Partially counteracting the hike in food prices was a decline in the transportation component, the fifth in as many months; the April drop resulted entirely from a further decline in used-car prices. All other major components of the consumer price index advanced slightly.

The prospect that economic activity may be spurred by a further pickup in consumer demand is suggested by the continuing survey of consumer buying plans conducted by the National Industrial Conference Board with the financial sponsorship of *Newsweek* magazine. A recently published analysis of February and March interviews indicated that more consumers plan to buy new automobiles, new and old houses, and certain major appliances this spring and summer than had been the case a year ago. For a few items, namely used cars, television sets, and clothes dryers, buying plans were below a year ago.

These plans are of considerable interest in the light of the developments in retail sales and home building during the last several months. Sales by "furniture and appliance" stores have constituted one of the weakest components in retail sales; in March (when bad weather may have contributed to the low level), they were 8 per cent, seasonally adjusted, below their August 1959 high. The softness of the furniture and appliance markets would seem to have been associated in part with the decline since last spring in home completions, and an improvement may therefore depend upon an upturn in residential construction. It is probable, moreover, that retail sales of "lumber, building, and hardware" outlets—the one other component that in recent months has been considerably below last year's peak—would also benefit from the rise in the purchase of homes that is indicated by the survey.

A further positive influence on economic activity is also to be expected from business spending for new plant and equipment. The actual volume of outlays does not yet seem to have reached the levels indicated by surveys of business capital plans taken a few months ago, and new orders for machinery have shown little tendency to rise. There is no evidence, however, that business spending plans have been scaled down in the aggregate. Contract awards for private nonresidential construction appear to have risen in April for the second consecutive month by more than is usual at this time of year. In addition, preliminary May figures show construction outlays in this sector unchanged from April, following a two-month decline.

Money Market in May

Aggregate reserve positions of all member banks eased perceptibly in May, although the extent of the easing was not wholly reflected in the money market. Banks in the money market centers in particular were under diminished immediate reserve pressures, and Federal funds trading frequently took place below 4 per cent. Rates on loans to Government securities dealers at the New York City banks were generally in a 4¼-4½ per cent range until the tenth of the month and then in a 4½-4¾ per cent range until the final week, when they were a uniform 4½ per cent.

In the Government securities market, yields continued the zigzag pattern of the previous month—moving down steadily in the early part of May, turning up again to offset these losses, and then declining once more toward the close of the period. The early decline in rates reflected in part the Treasury's completion of its $6.4 billion re-

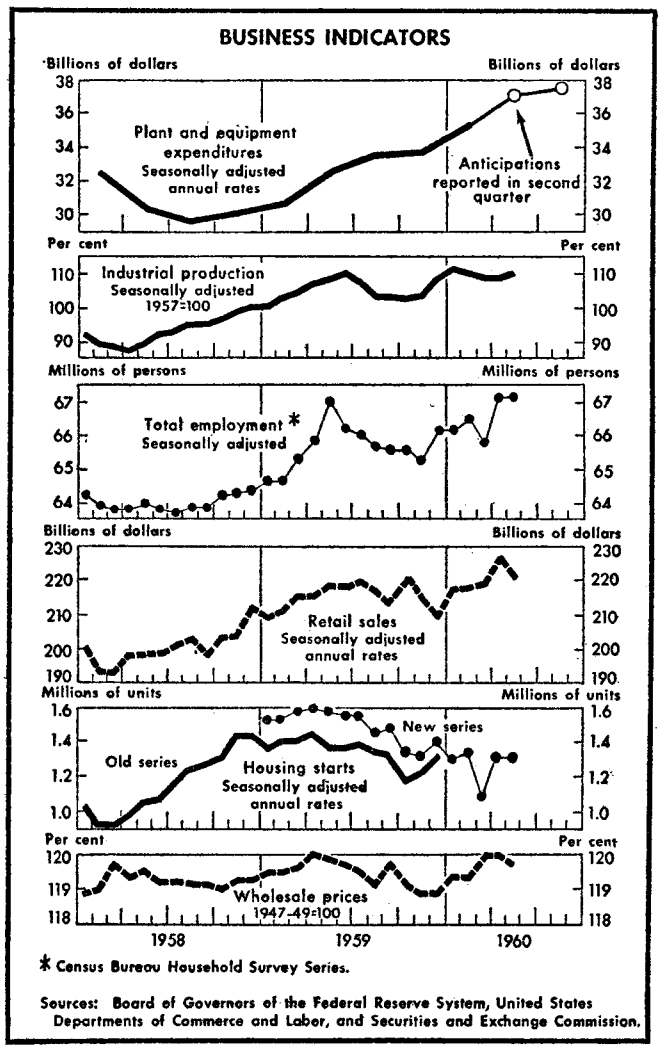
The Business Situation

As the second quarter of 1960 ended, the economy appeared to be moving along a high plateau. While the current crop of indicators has yielded signs of both strength and weakness, the outlook remains favorable for some further expansion of economic activity. One of the most encouraging pieces of news on the immediate situation appears in the latest survey of plant and equipment expenditures. Business plans for expanded capital outlays were almost exactly realized in the first quarter of 1960, and plans for even higher outlays in the second quarter were unchanged from what business had expected three months earlier. Although consumer purchases in May were not fully sustained at the record April level, they nevertheless surpassed all other preceding months. It now seems likely that this sales rate was at least maintained in June. Thus two important components of final demand appear to be at near-record levels, and probably served to keep June employment at the May high. On the other hand, the absence of a strong expansionary thrust in any important sector of the economy has raised the question in many analysts' minds whether over-all production will expand sufficiently during the months ahead to cut down on the still large number of unemployed and, at the same time, to absorb the net additions to the labor force that are expected.

The increase in business spending for fixed capital so far this year has been substantial. The survey conducted by the United States Department of Commerce and the Securities and Exchange Commission during late April and May put actual outlays in the first three months of the year at a seasonally adjusted annual rate of $35.2 billion, $1.6 billion above the fourth quarter of 1959 (see chart). Plans for a further $1.8 billion rise to $37.0 billion in the second quarter, reported in the January-February survey, were found to be about unchanged in the recent sampling.

Plans for the rest of the year, however, point to a much slower rate of advance in plant and equipment outlays. The increase expected in the third quarter is considerably smaller than in the second, and the projected rate of spending for the entire year implies only a minor further increase in the fourth quarter. If this latest estimate of spending for the year as a whole ($36.9 billion) is realized, it will exceed 1959 expenditures by about 13 per cent, rather than the 14 per cent margin originally anticipated.

There are some other signs that capital outlays may lose momentum later in the year. Machinery orders have slipped to a somewhat lower level in recent months, after a rapid expansion during most of 1959 that foreshadowed the growth in actual spending during the first half of this year. Also, the recent study of capital appropriations in manufacturing industries—i.e., spending plans formally approved by business management for some time in the



future—conducted by the National Industrial Conference Board, revealed a 5 per cent decline in new appropriations in the first quarter of the year, after seasonal adjustment. As appropriations usually precede actual outlays by six to twelve months, sustained strength in business sales could, of course, lead to an upward revision in these plans by the time actual spending gets under way.

Total business sales did rise in April by almost 2 per cent (seasonally adjusted), reversing the March decline and carrying the level to a new record. More than half of this increase resulted from the 3.5 per cent rise in retail sales, as consumers "caught up" after unusually bad weather had curtailed their purchases earlier in the year. The largest relative increases were in durable goods associated with home furnishing and repair—the sectors that had been the weakest earlier this year. In May total business sales receded slightly, as manufacturers' sales maintained the April rate but retail sales declined by 2.0 per cent. Retail sales, however, remained above the volume of either March or the previous peak in October 1959. A substantial part of the May decline was statistical, reflecting the absence of the usual upsurge in automobile sales. The daily average rate of car sales of 22,666 units (excluding the Memorial Day holiday) about equaled the April rate. A smaller volume of department store sales accounted for another large part of the decline. The late date of Easter, which is taken into account in adjusting sales for seasonal influences during the preceding but not subsequent weeks, may have accounted for some of the decrease. Preliminary indications suggest that the rate of consumer outlays may have been sustained at a high level in June. The daily average rate of automobile sales early in the month did not show quite so much strength as in May but was expected by industry spokesmen to show a spurt in the last ten days as sales contests closed (data are not yet available). Department store sales appear to have risen from the May rate after seasonal adjustment.

Spending for residential construction, seasonally adjusted, edged up very slightly in June after a four-month decline, and recent movements in the number of starts of private nonfarm dwelling units also offer the prospect of a leveling-out in this sector. As measured in a revised series, housing starts advanced from a low level of 1.1 million units (seasonally adjusted annual rate) in March to 1.3 million units in April, and maintained the same rate in May. (These statistics have recently been revised on the basis of a more inclusive definition—which now covers vacation houses and other "low cost" units—and more information from current surveys; as a consequence, the new series shows a higher level of starts than did the old series—about 11 per cent higher for the year 1959; month-to-month fluctuations may also be larger since current information on the actual start of construction is used instead of estimates based on a fixed lag between the issuance of housing permits and start of construction.) Spending on private nonresidential and public construction is estimated to have declined slightly in June.

Foreign spending for United States goods has been an element of strength in the domestic business picture. In May, merchandise exports declined from an unusually high April level but remained above the earlier months of this year. The trade surplus, which had increased quite sharply in April, also edged down in May but appears to have remained about equal to the first-quarter average after seasonal adjustment.

The recent higher levels of domestic and foreign sales and the firm demand in the investment sector were undoubtedly factors in the small but widespread gains in industrial production in May. The total production index (seasonally adjusted) rose by one point to 110 per cent of the 1957 base, just one point short of the all-time record set in January. The largest increase was in the business equipment component which rose two points to 105 per cent, matching the January peak. Production of consumer goods, which moved up for the second month, also returned to its January peak as the output of consumer durables recovered markedly. The automobile industry contributed substantially to this expansion, with the number of units produced rising almost 5 per cent from April to May in contrast to the usual seasonal decline. A further step-up was scheduled in June, before producers begin the expected sharp summer cutback in order to reduce inventories of 1960 models. The June expansion in auto output, if realized, should have done much to offset the decline that apparently occurred in the appliance industry.

Output of materials, however, moved down again in May for the fourth successive month, reaching a level 2.7 per cent below January. A major influence in this component was, of course, the continued decline in steel production which dropped by one third from 93.1 per cent of rated capacity at the beginning of March to 60.6 per cent at the end of May. Subsequently the operating rate leveled off in the low 60's for three weeks before falling to about 55 per cent at the end of June. Some increase is generally expected later in the summer, for it now appears that users' inventories of steel are being depleted at a rate that cannot continue for long without stocks reaching inconveniently low levels. In this industry, as elsewhere

in manufacturing, however, any major future expansion of output will depend heavily on growth in the sales of finished goods, since order backlogs have declined steadily throughout the year and businessmen apparently continue to aim at minimum efficient levels of inventories.

The increase in production and the renewed strength in some components of construction resulted in a slight rise in employment in May, despite layoffs in some manufacturing industries and the termination of temporary government jobs for census takers. Total employment, according to the household survey of employment conducted by the Census Bureau, rose to the record level of 67.1 million persons (seasonally adjusted). While this was a gain of less than 1/10 of 1 per cent, nonagricultural employment rose by a full percentage point. The payroll survey conducted by the Bureau of Labor Statistics (which does not include self-employed persons and domestics) showed a very slight decline in nonagricultural employment, partly due to small losses in manufacturing but primarily attributable to reductions in government employment. Unemployment (seasonally adjusted) fell by 2 per cent in May to 3.5 million, and the seasonally adjusted unemployment rate fell to 4.9 per cent of the civilian labor force, only 1/10 of a point above the 2½-year low reached in February.

Personal income, reflecting the small gains in employment, edged up 4/10 of 1 per cent in May to a seasonally adjusted annual rate of $399.4 billion. Slightly more than one third of the $1.6 billion increase was in labor income. Construction payrolls continued to rise sharply from the unusually depressed levels of late winter, and average hours worked rose. Farm income rose for the second month, after having declined sharply from December through March, and small increases also occurred in the other major components of income, with the exception of rental income which was steady and of transfer payments which declined slightly.

Consumers supplemented the high level of income in April with large additions to consumer credit to finance their record purchases. Total consumer credit outstanding rose to $52.2 billion in April, carrying the ratio of credit to annual personal income slightly above 13 per cent for the first time since January. On a seasonally adjusted basis, the increase of $692 million in credit outstanding was not only the largest this year but was surpassed in only one month last year. In May, although the ratio of credit to personal income rose somewhat further, the addition to credit outstanding was relatively small on a seasonally adjusted basis.

The rise in economic activity in recent months has been coupled with relatively stable prices. Although wholesale prices in general rose about 8/10 of 1 per cent from December through April, the index of all commodities other than farm products and foods rose less than 1/10 of 1 per cent. In May the total index declined by 3/10 of a point to 119.7 per cent of the 1947-49 base—2/10 of a point below a year ago—as prices of farm products edged down and the index of industrial prices dropped by ½ of a point, the largest month-to-month decline in over five years. Some further decline seems to have occurred in June.

The total consumer price index continued to creep upward in May despite a decline in the index for all commodities other than foods. The rise of 1/10 of a point, the fourth consecutive month-to-month increase, resulted from increases in the prices of foods, which appear to be largely seasonal, and of services, which have risen steadily since October 1958. At 126.3 per cent of the 1947-49 base, the total index in May was 8/10 of 1 per cent above the level at the end of 1959 and almost 2 per cent above a year ago. Average prices of goods other than foods, however, have declined 9/10 of 1 per cent during the current year and were less than 1 per cent above a year ago.

International Developments

THE LONDON GOLD MARKET

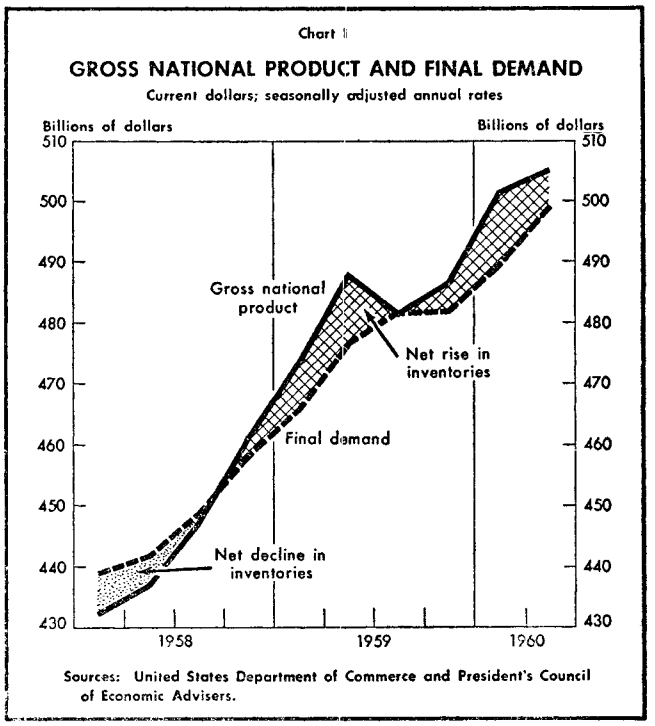
The closing of the London gold market in 1939 deprived the international economy for fifteen years of one of its major institutions. Since the market's reopening on March 22, 1954, however, it has been gradually resuming its prewar functions, and now is again providing a center through which the bulk of the non-Communist world's gold output is flowing.

The first steps toward reopening the market were taken by the British authorities in 1952. In that year specified London firms were given permission to act as agents for the sale against United States dollars of newly mined British Commonwealth gold to buyers outside the sterling

The Business Situation

There has been little change recently in the business situation. The economy continues to move along a high plateau, and prices remain relatively stable. Divergent movements in the major components of demand, which limited the advance of gross national product (GNP) in the April-June quarter, appear to have persisted in July. Preliminary estimates show continued strength in the "final demand" of consumers, business, government, and foreign countries, which rose by a slightly larger amount in the second quarter than in the preceding three months. The leveling-off of economic activity resulted from the decline during the second quarter in the rate of accumulation of business inventories. Although this decline was sharp, the second-quarter build-up of stocks was nevertheless substantial and has, along with the dwindling of manufacturers' order backlogs, contributed to some apparent deterioration of business sentiment. While the economy continues to produce a record level of real output, some business analysts note an absence of factors which would lead to a further pronounced surge of final demand, and see the possibility that some continued reduction in the rate of inventory accumulation may be a drag on activity over the next few months.

Major monthly indicators of business activity show movements similar to those occurring in GNP. Industrial production during the second quarter hovered a point or two below the January peak, and unemployment as a percentage of the civilian labor force fluctuated around the 5 per cent mark, after seasonal adjustment, although gains in nonindustrial sectors of the economy carried total employment to new highs. Unemployment appears to have receded little in July as slackness continued in some durable goods industries, particularly steel. At the same time, however, total consumer demand appears to have been sustained at a high level, as both department store and automobile sales showed continued gains over a year ago. Current indicators suggest that business capital outlays may hold close to present levels but without any strong upward push.

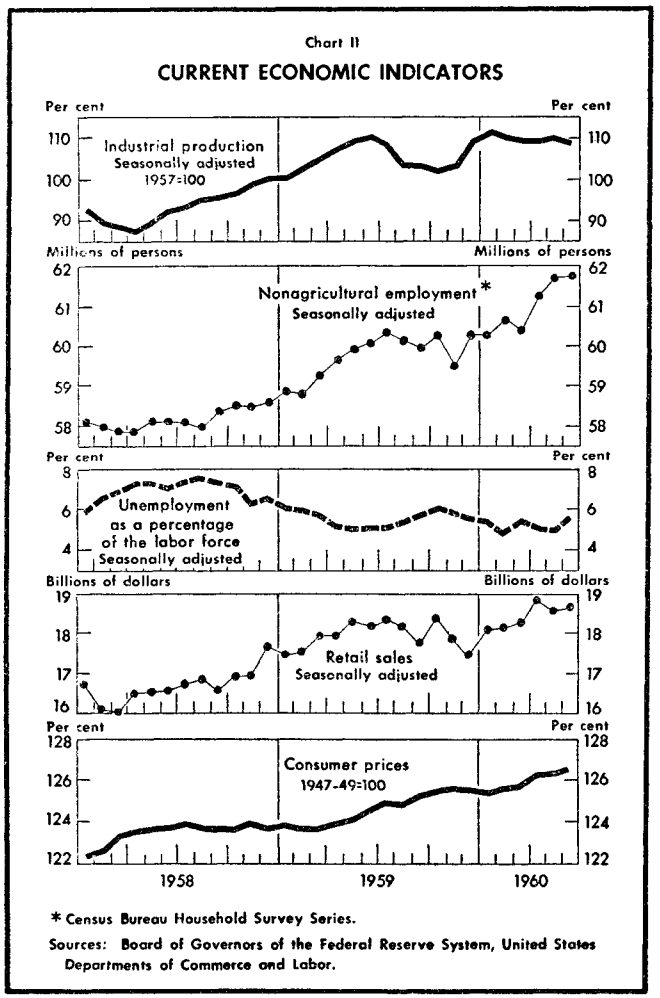


MODEST GAINS IN TOTAL OUTPUT

In the second quarter, GNP rose by $3.7 billion to a record, seasonally adjusted annual rate of $505 billion, according to preliminary estimates by the Council of Economic Advisers (see Chart I). The gain of only 0.7 per cent was significantly smaller than the 3.1 per cent spurt during the first quarter, when total output rebounded from the steel strike to surpass the previous peak reached in the second quarter of 1959. Final purchases for use by consumers and government, fixed investment by business, and net foreign purchases of United States products—that is, GNP exclusive of the change in business inventories—expanded by $9.1 billion in the second quarter, compared with an increase of $8.2 billion in the preceding quarter. Offsetting much of this increase, however, was a decline estimated at $5.4 billion in the annual rate at which businesses were adding to their inventories.

Nonagricultural employment expanded during the second quarter, but in June it showed a negligible gain of less than 0.1 per cent, seasonally adjusted, according to the Census Bureau's survey (see Chart II). Total employment (seasonally adjusted) rose more substantially in June, reaching a new record of 67.4 million persons; the major factor was a large advance in the volatile agricultural sector. The labor force, however, expanded more

sharply than employment. As a result, the seasonally adjusted unemployment rate rose to 5.5 per cent from 4.9 per cent in May. The June rate was, in fact, the highest since the steel strike period of last December. In part, the increased unemployment rate came from the upward trend of recent years in the number of teenagers and recent college graduates entering the labor force at this season, thus highlighting the challenge which the economy will have to face in the years ahead. However, the survey week —which is always the calendar week containing the twelfth day of the month—was as late as is possible this June, and as a result an unusually high proportion of students just out of school was covered in the survey. Bureau of Labor Statistics data, based on payroll information, suggest that declines in manufacturing and government employment also may have contributed to the rise in unemployment. Part of the decline in manufacturing employment, however, is traceable to a strike among aircraft workers rather than to a lack of employment opportunities.



The decline of manufacturing employment in June reflected, in part, the slight decrease in industrial production. The total index (seasonally adjusted) declined by 1 point to 109 per cent of the 1957 base. Output of finished equipment declined by 2 points, to a large extent reflecting the already mentioned aircraft production strike. Total output of consumer goods was unchanged in June, as expansion of automobile production and consumer staples offset declines in output of some consumer durables. Materials output slipped by 1 point, primarily as a result of the continued slump in the steel industry, which depressed coal and metal mining as well as primary metal production. In July, operations in the steel industry dropped to slightly above 50 per cent of capacity and the output of automobiles was cut back in preparation for somewhat earlier-than-usual model change-overs.

Declines in production, both in the steel industry and in some lines of consumer durables, reflect in large part an attempt to bring inventories into a better relationship with sales. Additions to total business inventories dropped sharply in the second quarter (as noted above) to an estimated annual rate of $6.0 billion. The near-record $11.4 billion rate of accumulation in the first quarter represented, in good part, a post-strike restocking of steel and various steel products such as automobiles. Thus it was virtually certain that additions to inventories in the following months would be smaller if there was not to be an appreciable, and in most cases unwanted, increase in the ratio of inventories to sales. Yet the second-quarter pace of accumulation was substantial. While inventory-sales ratios remain low relative to past periods of prosperity, further efforts to cut back the rate of accumulation may exert continued downward pressure on the economy in coming months.

Over half of the $9.1 billion advance in final demand in the second quarter was accounted for by a $5.2 billion gain in personal consumption outlays. In relative terms, the rise in business fixed investment was even steeper, surpassing the first-quarter increase despite a leveling-off in nonresidential construction. Outlays for home building, however, showed a small decline. Government expenditures on goods and services rose by $1 billion—or about the same amount as in the first quarter—as the continued growth in State and local expenditures more than offset a slight decline in Federal defense outlays. Estimates indicate that net exports of goods and services also increased further to a seasonally adjusted annual rate of $2.5 billion, more than double the first quarter and the highest rate in over two years.

Personal consumption expenditures in the second quarter scored the largest quarterly gain since early 1959. Slightly more than half of the increase in spending was on nondurable goods and the rest for services, while purchases of durable goods remained at the first-quarter level. This strong advance in consumer spending had, of course, already shown up in the monthly movements of retail store sales. The all-time peak in retail sales was reached in April, partly on the strength of some purchases that had been postponed during an unusually blustery March. Sales, adjusted for seasonal influences, slipped almost 2 per cent in May, but an increase of almost 1 per cent in June recovered part of this loss. The strength in automobile sales, which in June reached the highest daily average rate since September 1955 (22,848 units), served to offset weakening sales of other consumer durable goods. Both automobile and department store sales continued strong through July.

The steady advance in personal consumption at least in part reflected the 2 per cent expansion in personal income in the second quarter. Recently revised monthly statistics show that personal income at seasonally adjusted annual rates, after a fairly sharp increase of $2.8 billion between April and May, rose by only $1.1 billion in June to $405.8 billion. The June decline in factory wages and salaries, largely attributable to the low level of activity in the steel industry and the aircraft strike, was more than offset by increases in other forms of income.

Business outlays on fixed investment in the April-June quarter reached a new record of $48.4 billion (seasonally adjusted annual rate). This resulted from a $2.1 billion rise in expenditures for producers' durable equipment to a peak $29.2 billion, surpassing the previous records posted in 1957. Meanwhile, outlays for nonresidential construction remained at about the first-quarter rate.

INDICATORS OF CAPITAL SPENDING

The important role of plant and equipment spending in the growth of economic activity during the first half of the year directs particular attention to current trends in this area of spending and, in turn, to advance indicators which may throw light on trends over the period immediately ahead. Such indicators have predictive value because fairly concrete plans and commitments normally precede major capital outlays. Well before actual spending occurs, detailed decisions must be made about specific financial outlays, and orders must be placed or contracts awarded. At almost any stage, of course, there can be subsequent modifications. Projects can be curtailed or expanded, and the schedule of actual work and expenditures can be stretched out or accelerated. It is therefore useful to study information on plans and on each subsequent stage of the investment process in assessing past trends and current prospects, even though not all plans or changes in plans are accurately reflected in published data.

Corresponding in rough fashion to the planning-ordering-spending process of business firms, there are a number of statistical series to which the analyst of capital expenditures may turn. Best known—and most comprehensive—are the surveys of planned outlays for new plant and equipment by the United States Department of Commerce and the Securities and Exchange Commission (Commerce-SEC) and by the McGraw-Hill Publishing Company. The Commerce-SEC annual survey is taken in January-February and measures the volume of outlays for fixed investment which are planned for the entire coming year and for the first and second quarters. It is followed by quarterly surveys taken throughout the balance of the year and released early in the last month of each quarter. The principal McGraw-Hill survey which is taken each spring and released in April also measures annual spending plans; it is preceded by a preliminary survey taken in the previous fall and usually released in November. Both Commerce-SEC and McGraw-Hill draw on fairly large samples, although the McGraw-Hill survey is more heavily weighted with large industrial firms (and until 1960 included certain outlays by the petroleum industry which are charged to current account).

By using the January-February results of the Commerce-SEC survey, it is possible to estimate the portion of planned annual spending expected to take place in the first half of the year and the part implicitly expected to occur in the second half. To some extent, these expectations and implications can be substantiated, or perhaps put in doubt, by the degree to which they are paralleled by the flow of new capital spending "appropriations" (official top-management approvals of expenditures on specific parts of plans) and by the flow of "commitments" (primarily new orders for equipment or contract awards for construction work).

Appropriations by an important segment of business are covered in a quarterly survey by the National Industrial Conference Board (NICB) which is released in the last month of the following quarter. This survey covers a sample of the largest manufacturing firms that have formalized budget procedures. These firms report on new spending appropriations, the volume of appropriations "used up" by firm commitments or actual expenditures, and the backlog of unused appropriations. Thus, while the Commerce-SEC and McGraw-Hill surveys measure the spending that firms expect to make within a specified time

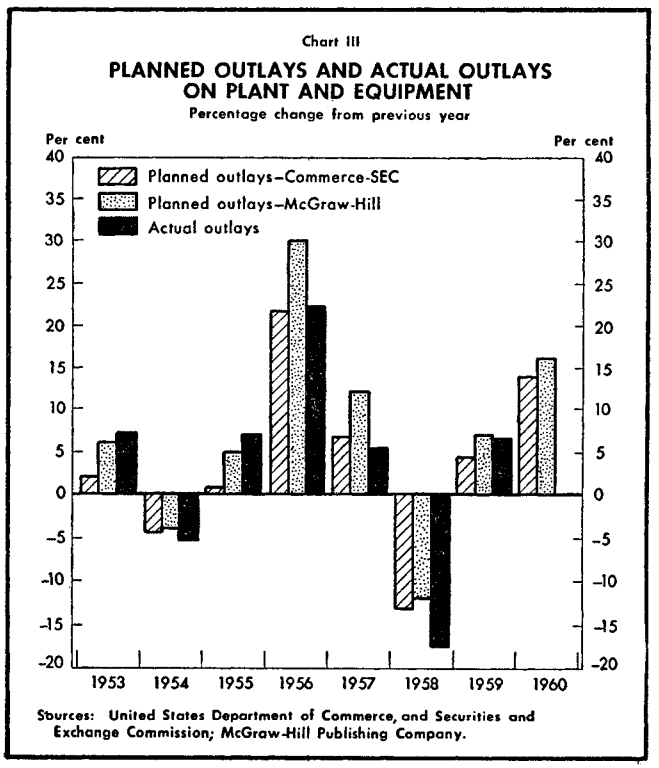
period, the appropriations survey measures the "flow" of new spending decisions (and the backlog of approvals) without specifying when the spending will occur.

There is no theoretical reason for any hard and fast timing relationship between these two types of series. Many of the appropriations made, for example, in the last half of a year will be for spending that is planned for the first half of the following year and, therefore, covered by the annual surveys of spending plans in the first half of the calendar year. Some appropriations, however, will be for immediate spending and others may be for spending to occur a year or more later. It is possible, therefore, for movements in the volume of planned expenditures and the volume of appropriations to diverge without necessarily implying major changes in plans. However, since major turning points in the appropriations series have tended to "lead" turns in expenditures, divergent movements of the series do raise the question whether plans are being modified.

Actual commitments for spending — new equipment orders or construction contract awards—might be expected to give a more concrete indication of the extent to which plans are carried out. These commitments are also significant because they have a direct impact on production, employment, and inventory policies of the firms receiving the orders. Some of the major statistical series on commitments are the Department of Commerce measure of new orders for nonelectrical machinery, the index of new orders for nonelectrical machinery compiled by the McGraw-Hill Publishing Company, the Machine Tool Builders Association series on domestic orders for machine tools, and nonresidential building contract awards tabulated by the F. W. Dodge Corporation.[1] There are limitations, however, to the usefulness of these series as advance indicators of actual outlays, the major ones being the erratic short-run fluctuations in the series and the variation in the time lag between commitments and expenditures. In good part, the erratic nature of month-to-month fluctuations is an inevitable outgrowth of the "lumpiness" of individual large orders—for example, for complicated turbines or the construction of large plants. Changes in the time lags result in part from changes in the composition of orders; a few large orders for turbines with particular specifications and a long production time cannot be filled so quickly as many small orders for simple standardized motors which can perhaps be filled from stock or assembled from standard parts. The delay between ordering and receiving shipment may also be longer if manufacturers have large backlogs of orders.

A brief historical review of the relationship among movements in the series relating to capital spending may shed some light on their analytical value. Chart III shows that both the Commerce-SEC and the McGraw-Hill surveys predicted the direction of change in actual spending correctly in each year while neither was consistently superior in estimating the magnitude of change. The Commerce-SEC survey underestimated the magnitude of changes in spending in every year except 1957. The McGraw-Hill survey, on the other hand, appears to have had a slight upward bias, overestimating an increase or underestimating a decrease in five cases out of seven. This may have resulted from the greater proportion of large firms in its sample; it has been found that large firms are more likely to overestimate their outlays than the reverse.

There also seems to be a significant relationship between the point in the business cycle at which a survey is taken and the accuracy of the forecast. In the first quarter of 1955, for example, a turning point in capital outlays was reached just as the Commerce-SEC survey was taken; the survey predicted a less than 1 per cent gain while output actually rose about 7 per cent. The McGraw-Hill survey, taken slightly later, was closer to the mark. In



[1] All these series are published monthly and released about a month after the data are gathered. The first two are based on broad samples, are seasonally adjusted, and include foreign orders. There are many additional surveys of more limited (usually industry-wide) scope.

1956, however, when a decided upturn had already been under way for nearly a year, the Commerce-SEC survey estimate of a 22 per cent gain was almost exactly realized.

Examination of anticipated and actual expenditures on a half-yearly basis indicates that spending plans shown in the Commerce-SEC survey have overestimated the volume of actual expenditures in the first half of each year since 1955. In the implicit forecasts for the second half, outlays were underestimated in the periods of sharp expansion—1955, 1956, and 1959. In contrast, in 1957 when a recession began around midyear, the actual level of outlays in the second half of the year fell short of the implicit estimate. In 1958, also, the level of spending in the second half was overestimated, although it was correctly anticipated early in the year that spending would decline further in the second half.

Since the appropriations series has the same broad contour as capital outlays, but with an average lead of about two quarters, appropriations, cautiously interpreted, can be used as a supplement to the Commerce-SEC quarterly data in giving a "warning signal" of turning points that may be in the offing. However, it appears that the appropriations data cannot be used to estimate the actual volume of outlays, or to improve upon estimates derived from the Commerce-SEC survey, since the appropriations series is subject to occasional abrupt deviations from a smooth cyclical pattern and since the amplitudes of the two series show no close correspondence.

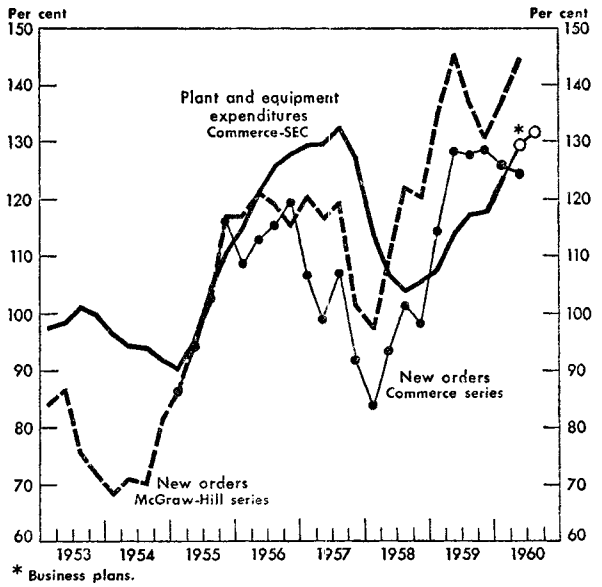
The new orders series for nonelectrical machinery also tends to foreshadow movements in capital spending (see Chart IV). Both the Commerce and the McGraw-Hill new orders series, however, exhibit frequent and large short-term fluctuations, so that there is no fixed interval between turning points in these series and in actual expenditures. The McGraw-Hill orders series, which is available over a longer period, led the 1953 downturn in spending by one quarter and the 1955 and 1958 upturns by two quarters. It moved concurrently with spending in 1957, however, after considerable random fluctuation. The Commerce series showed the same pattern as the McGraw-Hill series in 1958 but preceded the 1957 downturn by three quarters. The pattern of machine tool orders is less helpful since its coverage is limited to only one industry and it, therefore, has a slightly different contour than total outlays. The series on construction contract awards can be a misleading indicator because of strong seasonal patterns and erratic fluctuations resulting from the influence of a few large projects.

Applying these results to the present scene, in the early months of 1960 businessmen were planning to increase their plant and equipment spending this year by 14 per cent (Commerce-SEC) or 16 per cent (McGraw-Hill) over 1959. Six quarters of rising appropriations—through the fourth quarter of 1959—seemed to substantiate a firm upward trend in capital outlays. Results of the quarterly Commerce-SEC survey taken in April-May, and discussed in the last issue of the *Monthly Review,* suggested that anticipations of substantially higher spending were being fulfilled in the first half of the year but that spending in the second half would expand at a much slower rate. Earlier in the year, it seemed entirely possible that plans for spending in the second half might be revised upward, as has happened in previous periods of expansion. Furthermore, substantial backlogs of appropriations by large corporations combined with their high level of liquidity indicated the *potential* for a continued strong advance in the level of outlays. The recent behavior of new appropriations and orders does not, however, support this expectation. In the first quarter, new appropriations declined on a seasonally adjusted basis. The Commerce new orders series slipped in both the first and second quarters; although the McGraw-Hill new orders series rose during the same period, it remained slightly below the peak reached a year earlier. Shrinking profit margins, declining stock market prices, and a quite pervasive mood of hesitation are factors which may work against upward revision of capital spending

Chart IV

MOVEMENTS OF NONELECTRICAL MACHINERY ORDERS AND PLANT AND EQUIPMENT OUTLAYS

Quarterly, seasonally adjusted; 1955=100



* Business plans.

Sources: United States Department of Commerce, and Securities and Exchange Commission; McGraw-Hill Publishing Company.

plans. On the other hand, there has been little to indicate that earlier plans have been revised downward, either. The strongest likelihood at present seems to be that the economy will continue to draw some support from gently rising capital expenditures over the balance of the year.

Electronic Check Handling

The Federal Reserve Bank of New York will receive delivery in the next few weeks of the various components of its pilot installation of high-speed electronic check-processing equipment. Similar equipment will be installed at four other Federal Reserve Banks in the next several months, thereby providing a thorough System-wide testing of performance capability and operational feasibility of equipment of various manufacturers under the requirements of check handling in different Federal Reserve offices.[1] In efforts to move toward practical electronic processing of checks, the Federal Reserve System has been working closely with the American Bankers Association (ABA), the organization which has been the prime mover behind the progress toward check automation.

This introduction of "machines that can read if written to in their own language", the common machine language in E-13B magnetic ink characters recommended by the ABA, represents another significant step toward solution of the most pressing operational problem facing banks today —namely, how to process efficiently an enormous and ever-mounting volume of checks. The number of checks used each year was about 3.5 billion before World War II but grew to about 8 billion in 1952, and to more than 12 billion last year, of which some 4 billion passed through the Federal Reserve System. By 1970 the annual volume of checks passing through the banking system is expected to exceed 20 billion.

Staggering as these totals may be, they reveal only part of the work involved, since each check is handled ten to twenty times and by two or more different banks. Hand in hand with the expansion of check-handling operations has come an increasingly acute shortage of qualified personnel and a corresponding increase in the costs of sorting, posting, and other check-handling operations. And just as the old-fashioned hand processing became hopelessly inadequate twenty years ago, the conventional check sorting and listing machine now in general use is also rapidly becoming inadequate to cope with today's flow of checks. It was the acuteness of this problem that led the Bank Management Commission of the ABA to explore the possibility of automation.

CHECK AUTOMATION—PROGRESS SO FAR

The large-scale testing of electronic check-handling equipment about to start at five Federal Reserve Banks follows a period of intensive study, designing, and pretesting by the various institutions and manufacturers concerned. In December 1958, the common machine language in magnetic ink characters—developed under ABA auspices and with the cooperation of the check-printing industry and equipment manufacturers—was unanimously approved by all major manufacturers involved. Since about 80 per cent of all the checks deposited in or cashed at one bank must be sent to other banks for payment, the development of such a common language for all machines to "read" was an all-important step in the program. This language, which has now gained widespread acceptance, is known as MICR (Magnetic Ink Character Recognition).

The test about to be made at various Federal Reserve Banks will be meaningful only if the transit number and amount fields are encoded, as described below, on a sizable number of checks passing through the Federal Reserve Banks. The progress achieved so far has been highly encouraging. For a number of months, the Federal Reserve Bank of New York has been preprinting the routing symbol-transit number in magnetic ink on all its own checks, and has been supplying preprinted check forms to member and nonmember clearing banks for drawing on their accounts at the "Fed". The commercial banks have also begun to make significant progress in implementing the program. A survey in June by the Federal Reserve Bank of New York revealed that 125 out of the approximately 1,000 banking offices to which this Bank sends

[1] The five Federal Reserve Banks selected for these testing operations, and the major basic equipment to be used, are the following: Boston—National Cash Register Co.; New York—Ferranti-Packard Electric, Ltd. and Pitney-Bowes, Inc.; Philadelphia—IBM Corporation; Chicago—Burroughs Corporation; San Francisco—National Data Processing Corporation.

too rapid an expansion of domestic credit, and in Finland, where credit also has been expanding rapidly, the central bank in August increased its penalty rate to 3 per cent above the discount rate on rediscounts for commercial banks.

In the United Kingdom, the authorities have not had to contend with similar difficulties—partly because the institutional framework is more suitable for dealing with the liquidity effects of foreign exchange flows, and partly because the inflow of short-term funds seems to have assumed sizable proportions only recently. Thus, they have been able to concentrate on curbing the domestic factors in the expansion. On June 23, in the third of a series of restraint measures begun early this year, the Bank of England raised its discount rate to 6 per cent from 5 and also doubled its original April call for "special deposits" from the London clearing banks and Scottish banks (to 2 and 1 per cent of gross deposits, respectively). At the same time, the Chancellor of the Exchequer announced the government's intention to hold public capital expenditures in fiscal year 1961-62 to the current year's level. The severity of the new measures had not been anticipated by the market in view of the strength of the pound and of the sharp drop in the expansion of clearing bank advances in May and the first part of June. Bank advances again rose sharply in the following five-week period, but dropped —for the first time since August 1958—in the statement period ended August 17.

The classic problem of falling foreign exchange reserves accompanying inflationary pressures has been faced in Sweden, where the government acted to tighten bank liquidity by raising the statutory liquidity reserve requirements against sight liabilities and by authorizing the central bank to negotiate with the commercial banks for an increase in the voluntary variable liquidity reserves applicable to total deposits. An increase in the latter requirements would be especially important since time deposits in Sweden account for the bulk of bank deposits. Another country under pressure was Belgium, where the effect of the Congo situation in weakening the franc was a major factor behind the increase in the central bank's discount rate to 5 per cent from 4 on August 4.

In contrast to these credit tightening measures, the Bank of Japan on August 24 lowered its discount rate to 6.935 per cent from 7.3 (reversing its December increase), as domestic business conditions showed weakening tendencies following two years of very rapid economic expansion. In Canada, meanwhile, where business conditions continued hesitant, the government relaxed its terms for low-income housing loans and increased its grants for public works. In spite of the general uncertainty, however, the chartered banks' business loans have continued to expand somewhat more than seasonally. Although there was some tightness in the money market in early July, interest rates have since declined further.

EXCHANGE RATES

In the New York foreign exchange market, spot sterling gradually advanced during the first part of August as short-term funds continued to flow to London. Following the August 11 announcement of the reduction to 3 per cent in the discount rate of certain Federal Reserve Banks, the quotation moved abruptly to $2.8123, the highest in over a year. It then turned lower, reflecting substantial offerings from the Continent and a reduced movement of capital to London as the result of the rising interest yields on United States Treasury bills. At the month end it closed at $2.8114. In the forward market the discounts on three and six months' sterling moved somewhat erratically, in a relatively narrow range.

The Canadian dollar, principally as the result of movements of long-term capital to Canada, appreciated approximately one cent, to reach $1.03 17/32 by August 15. By the end of the month, however, it had eased to $1.02 61/64.

The Business Situation

The economy apparently has continued to edge sidewise in recent weeks. Comprehensive measures of economic activity such as employment and industrial production remained in July at or near the high June levels, and personal income advanced a bit. Private nonresidential construction outlays showed a small gain in August, after virtual stability in July, but outlays for residential construction declined further. Some weakness appeared in consumer demand during July, principally in sales of new automobiles, and incomplete auto and department store data suggest that consumer demand did not improve in August. The hesitant business atmosphere has been reflected in a

further decrease in manufacturers' new orders and also in price declines for certain industrial commodities. On the other hand, efforts to hold back inventory accumulation, and to effect actual reductions in durable goods lines, are meeting with a measure of success. Such efforts have been a prime factor hindering expansion in output, and their easing could add strength to employment and to economic activity generally. Over all, the summer months, traditionally a sluggish period, have thus far done little to clarify the business situation.

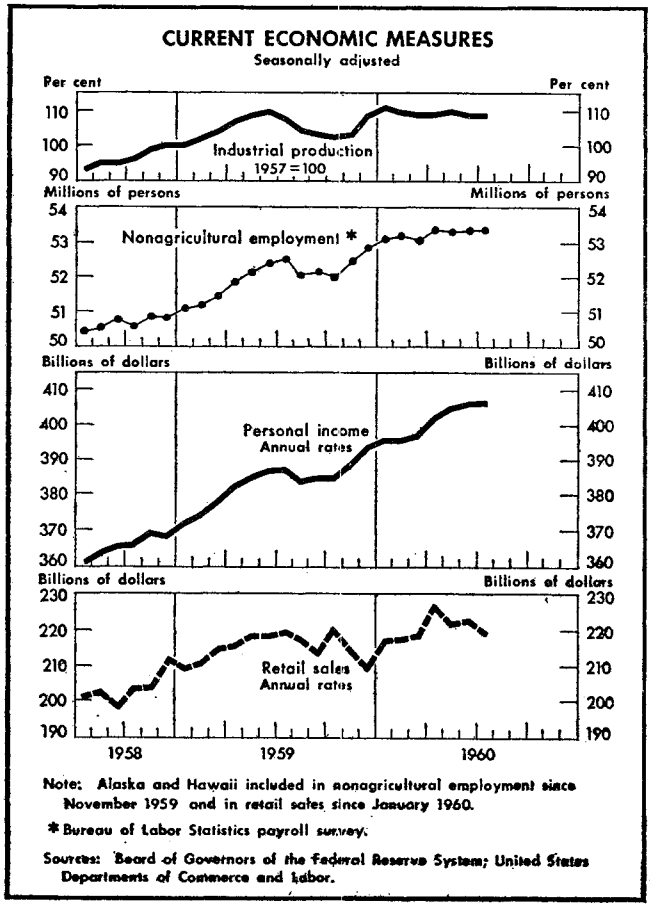
THE DIVERGENT INDICATORS

In July, the Federal Reserve index of industrial production remained, after allowing for the usual seasonal dip, at the June level of 109 (1957=100). The manufacturing component of the index was also unchanged in July, as sharp cutbacks in automobile assemblies and a slightly more-than-seasonal decline in iron and steel output were offset by small increases throughout a wide range of products, both durable and nondurable. In terms of "market" classification, some strength was shown in (nondefense) business equipment output, which rose to a record level. Consumer goods output, however, slipped a little—a result of the deep cut in automobile assemblies and of a small reduction, for the second consecutive month, in the "home goods and apparel" group. Production of materials was stable, as a rise in the output of nondurable materials compensated for a continued, although more gradual, decline in durables.

Steel production, which had dropped to 50 per cent of capacity in July, was close to 55 per cent of capacity throughout August, despite two railroad strikes in the Pittsburgh area that caused the closing of several mills for some time. Industry sources continued to express disappointment with the level of incoming orders, and it was reported that the industry did not anticipate a significant improvement before October. Most steel orders during August were for "quick" delivery, suggesting that steel users had worked down their inventories and were now operating hand to mouth. But there were also reports that other steel users had not yet reduced inventories as much as intended. The principal source of disappointment for steel producers has been the automobile industry. Although auto assembly plants were closed for model change-over earlier than usual this year, the expected large-scale orders for steel for the new models have not yet materialized.

Total employment (as measured by the Census Bureau household survey) inched up in July to 68.7 million persons. The increase was entirely a result of the employment of young people newly out of school; the number of adults employed actually declined. The total was sustained, moreover, by farm employment, which usually falls in July but this year remained at about the June level because of a late planting season. Still, after seasonal adjustment, total employment was down 300,000 from the June peak. The Bureau of Labor Statistics payroll survey of nonfarm employment (which differs in some significant respects from the household survey) showed a seasonal decline of almost 400,000, so that after adjustment this series was about equal to the previous month's 53.4 million total (see chart). More-than-seasonal contractions in employment in automobile and steel manufacturing and—because of the reduced pace of steel output—in the coal mining and transportation industries were offset by gains in construction, trade, finance, and services. Unemployment as a proportion of the civilian labor force was down in July by a scant $\frac{1}{10}$ of a point to 5.4 per cent, seasonally adjusted.

The maintenance of high levels of employment helped push up personal income in July to a record annual rate



Note: Alaska and Hawaii included in nonagricultural employment since November 1959 and in retail sales since January 1960.

* Bureau of Labor Statistics payroll survey.

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

of $407.1 billion, seasonally adjusted. This was, however, just $1 billion more than in June, and with a single exception was the smallest monthly advance since last year's steel strike. About half of the gain was in wages and salaries; increased payments in the construction industry plus the effects of the recently enacted pay rise for Federal Government employees more than offset a reduction in the manufacturing sector. Interest income also rose. However, about one quarter of the month's total income gain resulted from an increase in unemployment insurance benefits. Meanwhile, farmers' income dropped for the first time in four months as a result of a decline in meat prices.

At the same time that personal income has been posting new records, retail sales have been sluggish. In July, sales slipped for the second time in three months— falling, according to the advance report, 1½ per cent below the June total and 3 per cent under the April peak, seasonally adjusted. Most of the July decline reflected slower automobile sales, but purchases of nondurables also decreased somewhat. The data so far available for August on automobile and department store sales do not suggest an upturn in consumer expenditures. These developments may possibly reflect some lessening of consumer optimism regarding the business and employment outlook.

Probably as the combined result of the lack of spark in consumer demand and the absence of increased strength in investment demand, new orders received by manufacturers, which had risen slightly in April and May, seasonally adjusted, declined in June and again in July, falling back close to the November 1959 level. The June decrease was entirely in durables and covered several important industries. In July, durables declined somewhat further but nondurables accounted for almost three fourths of the total drop. New domestic orders for machine tools, which had risen in June after two months of decline, fell sharply in July to mid-1958 levels, although industry sources continued hopeful that orders would pick up after the Machine Tool Exposition in Chicago this month.

Order backlogs, which had declined in June to the lowest level since December 1958, increased a bit in July, principally as a result of a small growth in unfilled orders in the durable goods industries. Data for unfilled orders are not seasonally adjusted, however, and an increase in backlogs is normal for July—but this time it was unusually small. Backlogs in nondurable goods industries fell, meanwhile, to early 1959 levels. Manufacturers' inventories, seasonally adjusted, fell slightly in July after rising for eight successive months, although recently at a declining pace. Stocks held by producers of durable goods declined from the record level reached the previous month, while stocks in the hands of nondurable goods producers remained unchanged from the high June total. The inventory-sales ratio of all manufacturers was at its highest point since November 1958—although not so high as it had been during most of the 1956-58 period.

Data on construction activity have been mixed. Outlays for private nonresidential construction, which had fallen for four consecutive months through June, seasonally adjusted, remained almost unchanged in July and advanced in August. Moreover, nonresidential contract awards rose in July. Private residential construction outlays, however, declined in both July and August, and July residential contract awards were also down.

Money Market in August

The Board of Governors of the Federal Reserve System on August 8 announced several actions liberalizing member bank reserve requirements. From August 25 country banks may include in their reserves vault cash in excess of 2½ per cent (instead of 4 per cent) of their net demand deposits, and effective September 1 reserve city and central reserve city banks may count as reserves vault cash in excess of 1 per cent (rather than 2 per cent) of their net demand deposits. Also effective September 1, the reserve requirement against net demand deposits of central reserve city banks was reduced from 18 to 17½ per cent. After the close of business on August 11, this Bank and three other Reserve Banks announced a reduction in the discount rate from 3½ to 3 per cent effective the following day. During the remainder of the month six other Reserve Banks followed suit.

Bank reserve positions eased somewhat further in August. While New York City and Chicago banks continued to be net purchasers of Federal funds on most days, the effective rate prior to the August 12 discount rate reduction was often below the 3½ per cent "ceiling". After August 12 the effective rate for Federal funds traded by New York City banks on most days stood at or close to the new 3 per cent "ceiling", although some trading

mit financial statements and provide information necessary to ensure that bank laws and regulations are complied with. The Malayan central bank is also empowered to direct the policies, and if necessary take over the operation, of banks threatened with insolvency, thus increasing the safety of depositors' funds and encouraging the holding and use of bank deposits.

In brief, it appears that all the new central banks are generally equipped to facilitate the financial and economic development of their countries. Experience in developed as well as in other underdeveloped countries suggests, however, that the effectiveness of credit controls depends, in large part, on how judiciously and flexibly the available instruments are used and to what extent fiscal policy coincides with central bank objectives.

EXCHANGE RATES

In the New York foreign exchange market, the quotation for spot sterling was subject to substantial movement during September. Good commercial demand during the first half of the month enabled dealers to reduce their balances of sterling to minimum levels in the face of an anticipated reduction in the British bank rate. This resulted in day-to-day shortages and gradually advanced the rate to $2.8167 by midmonth, the highest since May 1959. Thereafter, a further strengthening of market expectations of a cut in the bank rate prompted substantial offerings of sterling, primarily from Continental sources, which weakened the rate to $2.8077 on September 27. At the month end, however, with the bank rate remaining unchanged and the announcement of a British Treasury bond issue, on attractive terms for nonresident investors, the rate climbed to $2.8117.

In the forward market the discounts on three and six months' sterling generally widened during most of the month, reaching 168 and 240 points, respectively, on September 20. A subsequent narrowing brought the spreads to 137 and 209 points at the month end.

The Canadian dollar quotation fluctuated erratically within a range of about one cent on a relatively small volume and registered a net decline for the month to close at $1.02 23/64.

The Business Situation

The over-all level of economic activity remained generally unchanged between July and August, and so far there are no indications that the results for September will show any significant shift in the business situation. Many of the seasonal forces that ordinarily contribute to a strengthening of activity as the autumn begins were again evident, but not in sufficient strength to offset the dampening influence of other adjustments that have been under way in the economy for several months. The automobile industry, which has been widely viewed as a possible bellwether of the direction and momentum of economic change in the current period, clearly reflected the mixture of offsetting influences now at work in many sectors of the economy. Attempting to reduce stocks of existing models, dealers made generous price concessions, and, as the public responded to these price inducements, auto sales actually rose in August in seasonally adjusted terms. Retail sales of other goods apparently fell slightly behind seasonal expectations in August and September, but questions were being asked as to whether the current declines in dollar sales might not reflect only the initial impact of price reductions that had not yet been followed by larger physical volume. Capital expenditures continued upward, though apparently not so strongly as originally anticipated, and surveys of future plans suggested that such expenditures might level or edge downward. At the same time, there were some signs of a moderate edging upward of residential construction, and spending by all levels of government has also continued expanding slowly.

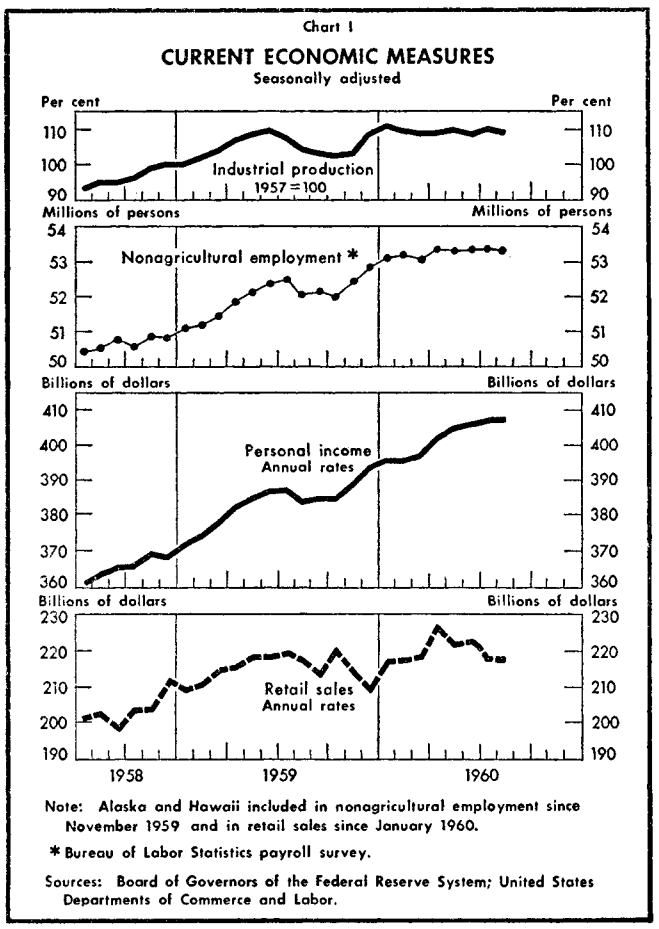
OUTPUT AND EMPLOYMENT

The Federal Reserve's industrial production index reached a seasonally adjusted peak of 111 in January (1957=100), and has since been fluctuating from 109 to 110. In August, the index dipped again to the lower figure (see Chart I).

Output did begin to pick up in mining and in nondurable manufacturing, but, since the August seasonal pattern calls for considerably larger increases, the adjusted figures actually showed a decline in nondurables. Most increases in durable goods manufacturing were so small that the customary statistical adjustment for the expected seasonal rise converted them into declines also. The one area of definite advance on a seasonally adjusted basis was motor vehicles, where there occurred a 3 per cent increase after allowing for the decline that usually results in August from time lost during model change-overs. The better-than-usual performance reflected efforts of manufac-

turers to get large stocks of 1961 cars into dealers' hands before the cars were officially introduced to the public. On the other hand, the seasonal push fell short of the customary intensity in the iron and steel industry, with the result that adjusted iron and steel output declined by about 1 per cent in August. While auto production for September pointed to another better-than-seasonal advance, September steel production, which usually rises, was about the same as in August.

Nonfarm employment (as measured by the Bureau of Labor Statistics payroll survey) rose in August, on an unadjusted basis, to a record 53.4 million persons, mostly because of a strong seasonal increase in the canning industry. The seasonally adjusted figure was 53.3 million, down about 100,000 from July (see Chart I). This decline is overstated, however, since it reflects to a large extent the temporary curtailment of activity in the auto industry for model change-overs; no allowance is ever made in the employment statistics for model change-over idleness, which this year was heavily concentrated in August rather than being spread over two or three months. There were, in addition, substantial cutbacks, on a seasonally adjusted basis, in the metal and metal products industries, in the apparel field, and in service industries. Less-than-seasonal reductions in government and retail trade employment established the principal offsets to these declines. Total employment (as measured by the Census Bureau's household survey) slipped about ½ of 1 per cent, seasonally adjusted, although agricultural employment declined less than seasonally. With this over-all contraction in the number of jobholders, the unemployment rate rose to 5.9 per cent from 5.4 per cent in July. Without the temporary idleness resulting from automobile model change-overs, the increase in the unemployment rate would have been smaller.



Note: Alaska and Hawaii included in nonagricultural employment since November 1959 and in retail sales since January 1960.

* Bureau of Labor Statistics payroll survey.

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

INCOME AND SALES

Personal income rose to a new high in August, although the increase was less than 1/10 of 1 per cent, seasonally adjusted. Income derived from the private sector of the economy actually declined. Wage and salary income in the manufacturing industries fell almost 1½ per cent, reflecting the decrease in automobile and other manufacturing employment as well as a shorter workweek (seasonally adjusted) and a slight drop in hourly earnings. (The latter was attributable to reduced overtime and to some shift in employment from high- to low-paying industries.) An expansion of wages and salaries in the service and distributive industries, and increases in dividends and personal interest income almost offset the decline in manufacturing wages and salaries. Concomitantly, farm income again moved lower. An increase in government wages and salaries, resulting partly from a Federal Government wage rise that became effective during July, and an increase in transfer payments, mostly through a rise in unemployment insurance benefits, accounted for a sum considerably larger than the size of the total August gain in personal income.

Retail sales in August, according to the advance report, were practically unchanged from July (see Chart I). The apparent stability in retail sales resulted primarily from increased sales of automobiles above the low July figure, stimulated by sizable price reductions made by dealers in order to cut their large stocks of 1960 models. Dealers were assisted in this effort by automobile manufacturers, who in August began to grant special, large premiums and bonuses. Consumer purchases other than automobiles were lower than in July. During the early weeks of September, the number of automobiles sold fell below August levels, but this may have been no more than the usual seasonal drop. Department store data suggest, however,

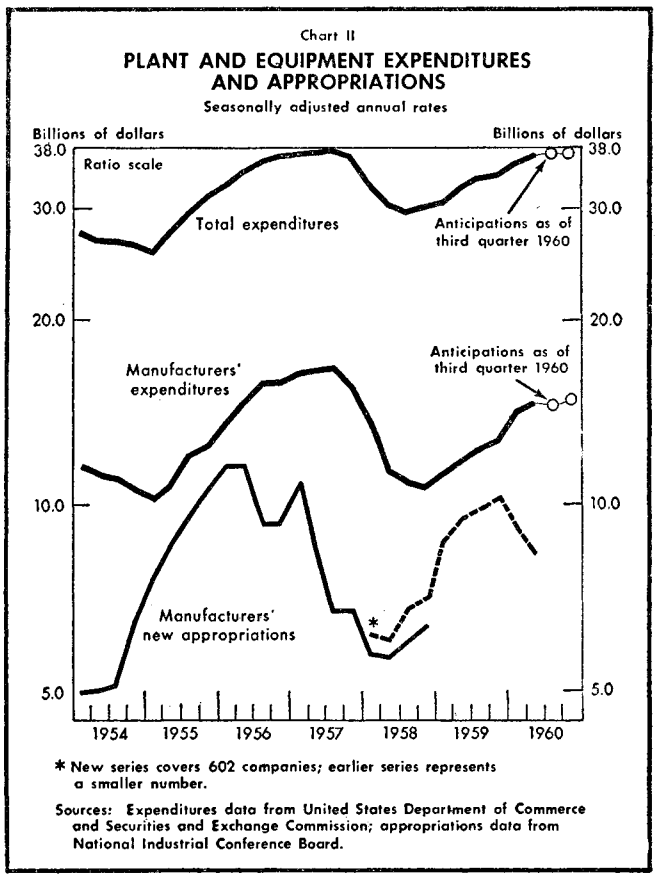
that purchases of other types of consumer goods declined again in September.

CONSTRUCTION AND CAPITAL EXPENDITURES

On the other hand, spending may be picking up in another important sector, residential construction. Interest in the building of new homes, which had appeared particularly weak in July, seemed to strengthen somewhat in August. Housing starts rose, following sharp declines in June and July. In addition, applications for FHA-insured mortgages and requests for VA appraisals increased. This could presage a long-awaited upturn in housing outlays, although the FHA and VA series are so erratic that it is hazardous to draw conclusions on the basis of changes over one month. Housing outlays, which include expenditures on additions and repairs as well as on new buildings, continued downward meanwhile, slipping in August and slightly further in September.

Business spending on plant and equipment has been leveling off, presumably as a result of reduced profit margins, idle capacity, and uncertainty about future demand. The latest joint survey by the Department of Commerce and the Securities and Exchange Commission, taken in late July and August, indicated that businesses planned to invest in fixed capital 2 per cent more (seasonally adjusted) in the third quarter than they actually spent in the second quarter. And they expected to hold spending in the fourth quarter to the third-quarter level (see Chart II). In the manufacturing sector alone, plans were for a slight decrease in the third quarter, followed by an increase of somewhat larger magnitude in the last quarter.

These projections fall short of earlier plans, just as the actual expenditures in the second quarter were somewhat below previously stated intentions. In the past history of the survey, when plans have been revised downward, actual expenditures have usually fallen even lower. This may happen again. Such an eventuality is also suggested by the National Industrial Conference Board's recent survey of plant and equipment appropriations, which usually precede expenditures by some months. Appropriations by the companies covered in the survey reached a peak in the fourth quarter of 1959 (see Chart II) and then fell rather sharply in the first two quarters of 1960.



On the whole, however, August and September have continued to demonstrate the influence of mixed forces, providing no firm basis for expectations of a major move, either upward or downward, in the immediate future.

Federal Reserve Publications

The following Federal Reserve System publications are available from the Publications Section of the Federal Reserve Bank of New York, New York 45, N. Y. Where a charge is indicated, remittance should include New York City sales tax, if applicable.

The Federal Reserve System, Purposes and Functions. A 208-page booklet, explaining the structure, objectives, and methods of operation of the Federal Reserve System.

Money: Master or Servant? A 48-page booklet explaining in nontechnical language the role of money and banking in our economy.

Federal Reserve Operations in the Money and Government Securities Markets. A 105-page booklet discussing the manner in which operations are conducted through the Federal Reserve Bank of New York's Trading Desk in carrying out the directions of the Federal Open Market Committee.

The Money Side of "The Street". A 103-page account of the workings of the New York money market, including a discussion of the functions and usefulness of the short-term wholesale money market and of its role in the operations of the Federal Reserve. 70 cents per copy; 35 cents a copy on orders from educational institutions.

The Quest for Stability. A 54-page booklet of five essays describing efforts to achieve an efficient monetary system in the United States.

Forty-five Years of the Federal Reserve Act. An 18-page booklet describing in layman's language the history of the Federal Reserve Act from 1913 to 1958.

Readings on Money. A 47-page booklet, discussing the nature of money and the processes of its creation and circulation. Articles include the rising money supply, currency and coin, kinds of currency and coin, demand deposits, bank reserves, and money lenders.

Deposit Velocity and Its Significance. An 88-page booklet on the behavior of deposit velocity, over the business cycle and over long periods. 60 cents per copy; 30 cents per copy on orders from educational institutions.

Weekly Financial Barometers. A 37-page booklet telling how to interpret the weekly reports of member banks and the Federal Reserve Banks. Among the subjects treated are the loans and investments of weekly reporting member banks in leading cities and the sources and uses of bank reserve funds. A glossary of terms used in the weekly Reserve Bank statement is included.

Exercises in the Debits and Credits of Bank Reserves. A 16-page booklet of exercises, in simple "T account" form, indicating the essential nature of transactions affecting bank reserves. Explanations include the effect on reserves of changes in Federal Reserve credit, gold and currency flows, and Treasury transactions.

The New York Foreign Exchange Market. A 56-page booklet describing the New York foreign exchange market as it exists today. 50 cents per copy; 25 cents a copy on orders from educational institutions.

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Monetary Policy Under the International Gold Standard, 1880-1914. A 62-page analysis of the performance and policies of central banks under the pre-1914 gold standard, in the light of current monetary and banking theory. 50 cents per copy; 25 cents per copy on orders from educational institutions.

Each of the Reserve Banks publishes a monthly review of credit and business developments available upon request from the following addresses. The Board of Governors of the Federal Reserve System (Washington 25, D. C.) publishes the *Federal Reserve Bulletin* monthly; an annual subscription in the United States costs $6.00.

Federal Reserve Bank of Atlanta
Atlanta 3, Georgia

Federal Reserve Bank of Boston
Boston 6, Massachusetts

Federal Reserve Bank of Chicago
Chicago 90, Illinois

Federal Reserve Bank of Cleveland
Cleveland 1, Ohio

Federal Reserve Bank of Dallas
Dallas 13, Texas

Federal Reserve Bank of Kansas City
Kansas City 6, Missouri

Federal Reserve Bank of Minneapolis
Minneapolis 2, Minnesota

Federal Reserve Bank of New York
New York 45, New York

Federal Reserve Bank of Philadelphia
Philadelphia 1, Pennsylvania

Federal Reserve Bank of Richmond
Richmond 13, Virginia

Federal Reserve Bank of St. Louis
St. Louis 2, Missouri

Federal Reserve Bank of San Francisco
San Francisco 20, California

The Business Situation

Through most of the year, the economy has been dominated by a process of business and consumer adjustment to the abatement of inflationary pressures and the dissipation of inflationary psychology. These developments have been associated with all-round ample capacity, ready availabilities of all kinds of finished goods and materials, and generally stable prices. Understandably, the repercussions of the many varied changes occurring in business practices and in the aggressiveness of consumer buying had their most conspicuous influence upon inventory accumulation. Because these changes affected in some degree all layers of production and distribution, and spread through all kinds of business and consumer planning and spending, the over-all effect has been to produce a gentle sag throughout much of the economy. By the second quarter, business profits in almost all fields had begun to feel some squeeze.

This rather unspectacular period of adaptation has continued through September and into October and may yet have some distance to go. In the area of industrial output, automobile assemblies rose more than seasonally in September, but this increase was more than offset in other industries by declines or by smaller gains than normally occur during the fall season. Similarly, spending by the various sectors exhibited divergent movements. In the consumer sector, automobile sales advanced briskly in late September and into October, but most types of retail outlets reported sales declines in September. Business spending for fixed capital, as indicated by industrial construction activity and orders for industrial machinery, has apparently changed little, but total business inventories continued to decline. Government spending, on the other hand, is increasing at the Federal as well as at the State and local levels. Largely reflecting these crosscurrents, personal income in September was almost the same as in August, and total employment also showed little change.

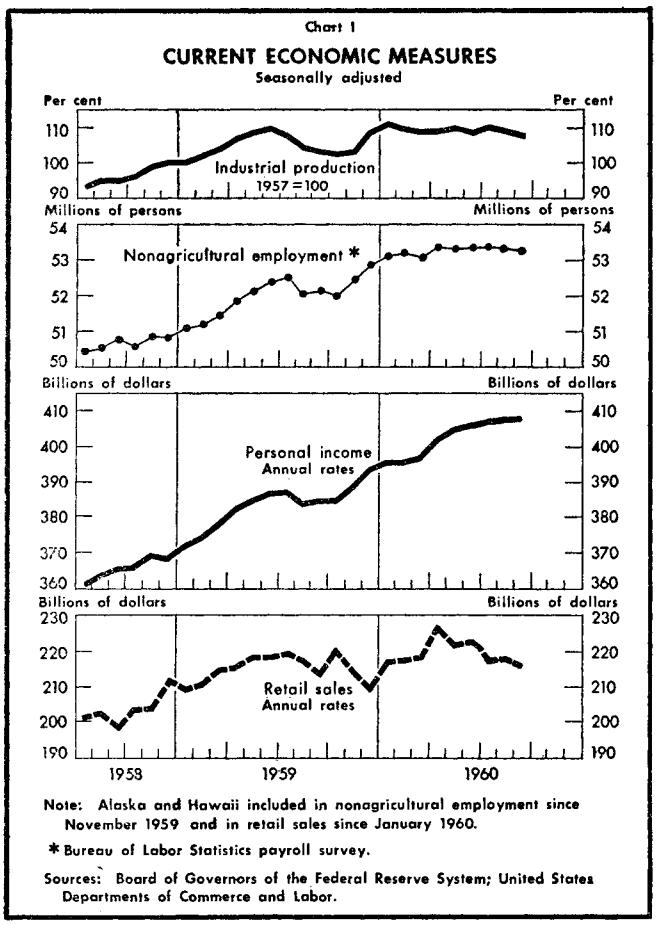
Indeed, the entire July-September quarter was dominated by this pattern of crosscurrents. The estimate of third-quarter gross national product recently released by the Council of Economic Advisers shows that the slight decline to $503 billion (seasonally adjusted annual rate) from $505 billion in the preceding quarter was more than accounted for by a decrease of $5.3 billion in spending for inventories. Final demand (GNP less the net change in business inventories) moved up by $3.3 billion, although this gain was smaller than the $9.8 billion rate of increase in the preceding quarter. There were sharp rises of $1.9 billion in government spending, and $1.5 billion in net exports of goods and services, but the increase of $0.6 billion in business outlays for plant and equipment was relatively slight. Personal consumption expenditures and outlays on residential construction declined by the comparatively small amounts of $0.5 billion and $0.3 billion, respectively.

RECENT DEVELOPMENTS

Industrial output rose less than seasonally in September for the second consecutive month, with the result that the seasonally adjusted Federal Reserve index dropped one point (see Chart I) to 107 (1957=100). The major part of this decline was attributable to the materials industries, where the low level of steel production continued to be a drag. Slight reductions also occurred in the other market groupings. All components of the business equipment group declined except for freight and passenger equipment, and a strong advance in automobile production provided only a partial offset to reductions in other consumer goods industries. In October, steel production moved up to about 55 per cent of capacity from the September rate of about 53 per cent but was somewhat lower again in the last week of the month. Strength continued in the automotive industry, however, as output reached a new October record despite some cutbacks from original schedules.

Activity in September in the construction sector, which is not included in the Federal Reserve production index, remained mixed. The number of houses on which construction was started in September dropped sharply, seasonally adjusted, following a rise in August. Not too much significance should be read into month-to-month changes in this normally volatile series, however. Nonresidential construction, in contrast, has continued to expand. Nonresidential building contract awards in September surpassed their year-ago volume by a substantial margin, and both private nonresidential and public construction expenditures are estimated to have risen in October.

Despite some contraction in hiring by the industrial and construction sectors between August and September, total payroll employment dropped by only about 1 per cent,



seasonally adjusted (see Chart I), as employment by the finance and service industries and governments rose. Nonagricultural employment seasonally adjusted, as measured by the household survey (which includes domestics and self-employed), was maintained at the August level, while total employment rose because of an unusually large September increase in agricultural employment that was associated with an early harvest. The seasonally adjusted unemployment rate declined in September from 5.9 to 5.7 per cent, primarily because large numbers of young people left the labor force to return to school and because automobile workers, who had been laid off in August during the model change-over period, were recalled to their jobs.

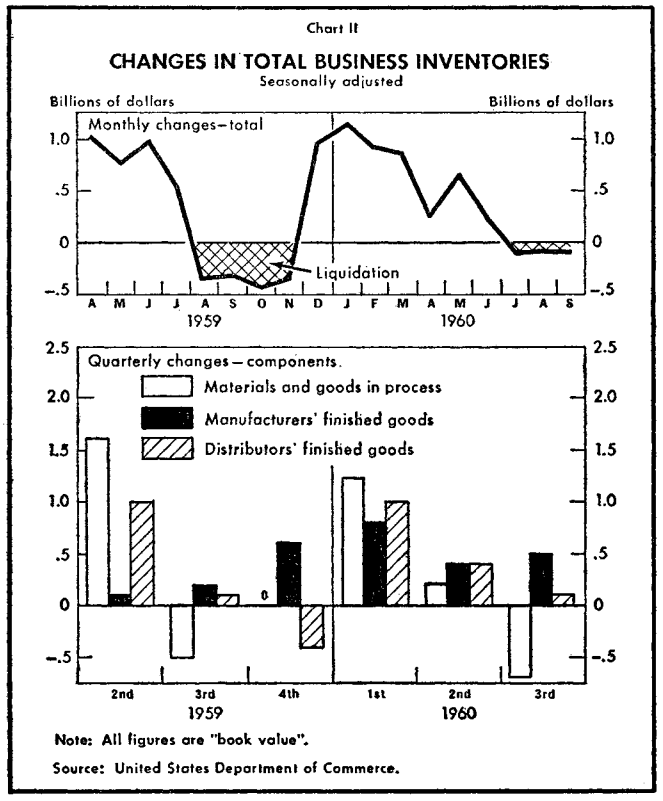
Total personal income rose in September to a seasonally adjusted annual rate of $408.4 billion. This was a record figure, but the increase from August was the smallest monthly increase this year (see Chart I). Paralleling the developments in employment, reductions in factory and construction industry payrolls were partially offset by gains in wage and salary payments by service industries and governments. Continuing increases in personal interest income and government transfer payments also contributed to the advance.

Retail sales in September edged down 1 per cent from the August level (seasonally adjusted), according to the advance report, slipping slightly below the July figure (see Chart I). Declines occurred in both the durable and the nondurable goods sectors, the latter accounting for the larger part of the total decrease. Although automobile sales may have slipped in September in dollar terms, on a unit basis they showed strength, particularly at the end of the month. In October, unit sales of automobiles continued upward, the daily average during the first twenty days amounting to 6 per cent more than in the corresponding 1959 period. While some of these sales consisted of 1960 models, which are being pushed out at reduced prices, the reception of the 1961 models appears to be good. Preliminary information on department store sales also suggests increases during October in consumer purchases of other goods.

INVENTORY SPENDING IN 1960

GNP estimates for the third quarter, as noted above, clearly show the effects of substantial inventory adjustments. Indeed, wide inventory swings have been the dominant factor in changes in the level of business activity over the past two years. In the second quarter of 1959, business engaged in heavy inventory accumulation, mostly in anticipation of strikes in steel and other metals industries later that year. During the summer and fall of 1959, inventories melted away (see top of Chart II), in large part as a direct result of the prolonged steel strike. Subsequently, on conclusion of that strike in November last year, the rate of accumulation (measured by "book value") jumped to a near record but, since the beginning of this year, it has fallen by an almost equal amount. Some of the factors underlying the inventory adjustments of 1960 have already been briefly mentioned. Several are explored further here.

The decline in inventory accumulation since the opening months of this year cannot be adequately explained simply as the end of "post-strike restocking". When steel production was resumed in November, it was generally expected that several months would be required for pipelines to be refilled with steel and for production of steel-consuming goods to catch up with the backlog of demand. However, steel production reached the peak post-strike rate of 96.5 per cent of capacity within five weeks, and the output of all finished products (as measured by the industrial production index) rose in December to a level only fractionally below the preceding June peak. Inven-



tory restocking was therefore able to commence in December, considerably earlier than had been foreseen.

As 1960 began, shortages were much less severe than had been feared. The build-up of supplies prior to the strike, and the rapid rebound in production, had enabled manufacturers to maintain and even increase their inventories of finished goods throughout the strike and immediate post-strike period (see lower part of Chart II). Declines occurred in stocks at the distributive level but were limited to a few durable goods, largely transportation equipment. It is likely, therefore, that even during the restocking phase—which had probably run its course by March—some of the extraordinarily large additions to inventories may have been prompted mainly by the rather exhuberant sales forecasts current in early 1960. In any event, once stocks had been rebuilt, more and more questions began to be raised within various kinds of businesses as to why stocks of such size were really necessary in the emerging conditions of 1960. If replacement orders could be filled promptly, if there were no serious reasons to expect prices of purchased supplies to rise appreciably in the near future—why expand inventories further? If practicable, why not gradually prune stocks down to a lower proportion of sales?

Paralleling the emergence of this kind of reappraisal, over-all industrial production began a slight decline in February. Price shading in certain lines and various comments from a variety of trade sources suggested widespread disappointment with markets soon after the beginning of the year. Thus, although the period of rapid inventory accumulation was not particularly long by historical standards, some of the early 1960 additions to stocks may have already been found superfluous by the end of the January-March quarter.

If this was in fact the case, the sharp decline in the rate of inventory accumulation during the second quarter of 1960 and the over-all liquidation which occurred in the third quarter appear less surprising. Despite these declines, the composition of inventory changes suggests that some unintended additions to stocks may have taken place after March. Indeed, it seemed that, in some degree, the consumer was beginning to make some of the same kinds of calculations with respect to his own purchases that the businessman was making with respect to his inventories. Perhaps that is one of the reasons why the rise in stocks of finished goods was so striking. Finished goods at the distributive and manufacturing levels combined accounted for a very large proportion of the inventory increase during the second quarter, and continued to rise in the third quarter, while stocks of unfinished goods declined. To some extent the heavy build-up in stocks of finished goods at the retail level was concentrated in a few products, such as automobiles. At the manufacturing level, however, large additions to stocks of finished goods were fairly widespread among durable goods industries, including an unusual accumulation of finished steel in the hands of steel producers. This pattern could have been an intentional response to a "buyers' market"—that is, weak demand relative to productive capacity—in which purchasing is done on a short-run basis and speed of delivery is an important tool of competition. Occurring in the face of declines in sales and some cuts in production, this pattern could also indicate further unintended inventory accumulation.

Some of the factors underlying the weak demand for inventories thus far this year may prove to be long run in nature. Various structural forces, previously concealed by cyclical movements and strike effects, may be causing a secular downtrend in the inventory level required to support a given volume of sales. Although the evidence for such a trend is not conclusive, inventory-sales ratios during cyclical expansions have been progressively lower in each of the successive postwar business cycles. At the distributive level, where the differences among recent cycles are quite clear, inventory needs have probably been

reduced relative to sales, not only by some recent shifts in the urgency of consumer buying, but also by the increasing importance of large-scale self-service stores and of chain stores with centralized order procedures and the opportunity to shift stocks quickly among branches. At both the distributive and manufacturing levels, the more flexible transportation opportunities offered by combinations of truck, rail, and air facilities have cut down the relative volume of goods "in transit". Some shifts in the composition of output may also have reduced stock needs; for instance, the rapidly growing chemical industry reportedly requires a small volume of goods in process relative to final output. Greater reliance on "production to order", increased use of high-speed computers for inventory control, and development of techniques for determining the most efficient location of plants and warehouses may all also play some part in a tendency to conserve inventories.

The recent behavior of inventories has also been influenced by aspects of the current economic situation that are not structural in character. To some extent, the changes in inventories themselves lead to further effects upon employment and income that in turn affect the level of sales, wholly apart from any changes that may have occurred in the purchasing done by consumers for stocking their own households. Total business sales, which bounded up sharply during the first year of recovery from the April 1958 cyclical trough, expanded subsequently at a very moderate pace, rising only slightly more than 3 per cent during the next year through April 1960. In the more recent months—May through August—sales edged down. A look at specific manufacturing industries reveals that increases in inventories during 1960 have been larger than average in industries either where sales were comparatively high (automobiles and, in the early part of the year, textiles) or where, to judge from trade reports, involuntary accumulation occurred (for example, primary metals and household appliances). Thus, whatever may be the complex of underlying reasons, it does appear reasonably clear that part of the recent weakness in inventories is a reflection of the limited expansion in sales.

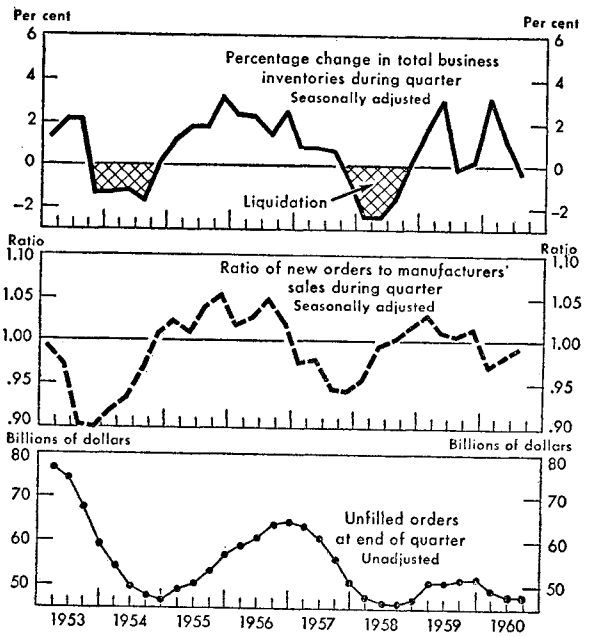
There is also rather convincing support for the view that the dampening, or even reversal, of inflationary psychology has had a marked influence. The industrial commodities component of the wholesale price index has declined almost steadily, though gently to be sure, throughout the year. There is widespread evidence, too, of markedly stepped-up price competition at the retail level—though some of it may be undetected by the reporting methods used in compiling the consumer price index. Certainly earlier fears of price markups in steel and copper, resulting from contractually scheduled wage increases, have waned.

Changes in manufacturers' future sales indicated by fluctuations in their new orders may not only reflect some scaling-back in the inventory plans of the potential purchasers, but are also of great relevance for the size of inventories that the producers themselves wish to carry. Fluctuations in total inventories (roughly one half of which are normally in manufacturers' hands) therefore tend to parallel, with a lag, movements in the ratio of new orders to manufacturers' sales. This relationship is illustrated in the top and middle sections of Chart III. The chart also shows the lower level of the new orders-sales ratio since the beginning of this year. New orders have fluctuated in a generally downward direction since December—compared to a somewhat more steady decline in sales since the first quarter—but they moved up slightly in August and September, primarily on the strength of rising defense orders. There can be little question that the flow of new orders in 1960 has reflected inventory caution at one level of business activity and has also been a dampening force on the inventories carried at another level, that of producers.

Another repercussion from declining new orders is, of

Chart III

INVENTORIES AND ORDERS



Note: Inventory figures are "book value".

Source: United States Department of Commerce.

course, some chilling of manufacturers' expectations of future output. At the same time, such declines relative to sales also reduce the backlog of manufacturers' unfilled orders. Such backlogs have declined to a September level almost 8 per cent below their most recent peak in November 1959 (see bottom section of Chart III). Falling backlogs suggest a rising margin of idle capacity. This in turn raises the expectation that customers can get quicker deliveries, and thus encourages customers to reduce their own inventory levels relative to their sales. In recent months this expectation has been reinforced by the low operating rates in some primary materials industries, most notably steel.

It appears, therefore, that the recent decline in inventory spending has much of the quality of "chicken and egg" that characterizes so many of the interacting influences at work in a complex modern economy. The principal visible phenomenon, however, is a closer adjustment of business inventories to the pace of business sales and orders. In turn, there is some basis for thinking that the consumer, too, has been readjusting some of his buying habits. Whatever their slackening influence upon over-all economic activity in the transitional period of gradual readjustment, these developments do reduce the possibility of an eventual, later sharp reaction to overextended inventory positions. Moreover, an upturn in sales, should it develop, is now more likely to be followed by a parallel movement in inventory levels.

Money Market in October

On balance, member bank reserve positions eased somewhat further in October. However, shifts in reserve availability during the month were somewhat wider than usual, while a relatively large part of the supply of excess reserves continued to be concentrated among banks outside the money market centers. During the greater part of the month the money market remained moderately firm, and the New York City and Chicago banks were net purchasers of Federal funds on most days. The effective rate on Federal funds generally ranged from 2¾ per cent to the 3 per cent ceiling, and rates posted by New York City banks on loans to dealers in Government securities varied between 3½ and 4½ per cent. In the third statement week, however, there was an exceptionally large inflow of funds to New York associated with the reserve settlement date for country banks, which caused a marked easing in the market for several days as evidenced by net sales of Federal funds by the New York City banks and by temporary reductions in rates on Federal funds, loans to dealers, and some other short-term instruments.

The market for intermediate- and long-term Government securities during October was subjected to a number of diverse influences and crosscurrents that resulted in an attitude of hesitancy and caution on the part of investors. Such influences included the Treasury's financing operations, congestion in the capital markets until late in the month, and uncertainties concerning the general outlook which were underscored by diverse interpretations of economic conditions in the press and by public officials, by the speculative flurry in the London gold market, and as usual by the approach of the Presidential election. Yields on intermediate- and long-term issues rose unevenly to midmonth on light trading and then gradually declined, showing little change on balance over the period. Treasury bill rates, after rising early in the month, declined over most of the balance of the period to reach the lowest levels of the year, but they rose slightly toward the end.

On October 26 the Board of Governors of the Federal Reserve System announced several changes in its Regulation D affecting member bank reserve requirements. Effective November 24, member banks will be able to count all of their vault cash toward satisfying reserve requirements, whereas previously only amounts in excess of certain prescribed percentages of net demand deposits were so eligible. Also effective November 24 the reserve requirement against net demand deposits for country banks, which obtain the greatest advantage from the change in vault cash procedures, will be increased from 11 per cent to 12 per cent, and on December 1 the reserve requirement of central reserve city banks will be reduced from 17½ per cent to 16½ per cent. These changes, on balance, will release about $1.3 billion of member bank reserves at a time when seasonal reserve pressures are high.

MEMBER BANK RESERVES

Reserve losses in October from operating factors and a rise in required reserves were about offset by System open market operations. On a weekly average basis, the release of reserves by open market operations occurred mainly in the first two weeks, offsetting the reserve losses resulting from increases in currency in circulation (occasioned partly by the Columbus Day holiday), declines

The Business Situation

The economy has continued in a state of "high-level stagnation" through November. While general demand has been slack, there has been no pervasive cumulative decline in either production or distribution. What stands out instead is the failure of the economy as a whole to expand, while the labor force and productive capacity have continued to grow throughout the year.

One of the most disturbing consequences of the economy's performance has been the rise in unemployment. The usual sample survey indicated that 6.4 per cent of the civilian labor force was unemployed in October, and no improvement was implied by the volume of new unemployment compensation claims filed in November. A more reassuring development was the sharp rise of total retail sales in October, mainly in durable goods, and the continuation of seasonally adjusted industrial production in October at almost the September level. However, fragmentary data suggested the possibility that both sales and production might have declined slightly during November. The mixture of contrasting early indicators of November performance included a growth of bank loans to business that was about in line with the average for the month over recent years, and a somewhat stronger rise in bank loans to consumers. The gentleness of the present adjustment to date is also suggested by the recently published McGraw-Hill survey of businessmen's capital spending plans for 1961, which points to only a small decline from the 1960 level.

THE THIRD-QUARTER DIP

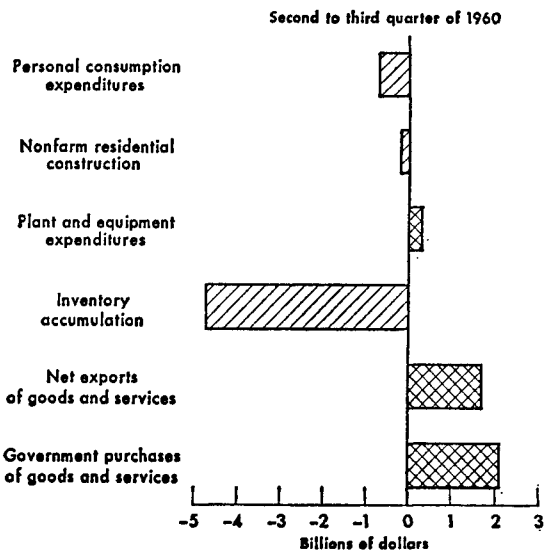
While, statistically, reduced accumulation of inventory was the major factor in the $1.5 billion (current dollar) decline of GNP in the third quarter of this year, perhaps the most disappointing feature was the failure of the consumer to exert his usual upward pull (see Chart I). The decline in total personal consumption spending was just $0.7 billion, seasonally adjusted annual rate, but in only three other quarters since the end of the Korean war has consumption failed to rise, and these were all recession periods. Outlays for both durable and nondurable goods were down, and the rise in spending for services was smaller than usual. Some of the decline in consumer outlays no doubt reflected lower incomes for the unemployed. In addition, however, the ratio of consumption to disposable income dropped to the lowest level since the end of the last recession, suggesting that consumers have also been slowing their expenditures for other reasons.

Gross private domestic investment was again pulled down by a reduction in the rate of inventory accumulation and by a slight further sag in residential construction. The fall in the rate of inventory accumulation, which has been a major drag since early this year, was smaller, however, than it had been in the second quarter of 1960. Indeed, final demand (GNP minus inventory accumulation) was up again although by much less than in the second quarter. Producers' outlays for plant and equipment edged up at the relatively slow rate of $0.3 billion, following strong advances earlier in the year. The government sector, however, boosted its demand over the second-quarter level by a substantial $2.1 billion, about twice the increase in each of the two previous quarters. The rise reflected primarily higher Federal pay scales, increased employment by State and local governments, and heavier outlays for highway construction. Strong

Chart I

CHANGES IN GROSS NATIONAL PRODUCT COMPONENTS

Seasonally adjusted annual rates



Source: United States Department of Commerce.

support for the domestic economy also came from a $0.9 billion increase in exports. A fall in imports of about the same magnitude pushed net exports of goods and services up by $1.7 billion to the highest level in three years and thereby provided some encouragement on the balance-of-payments situation.

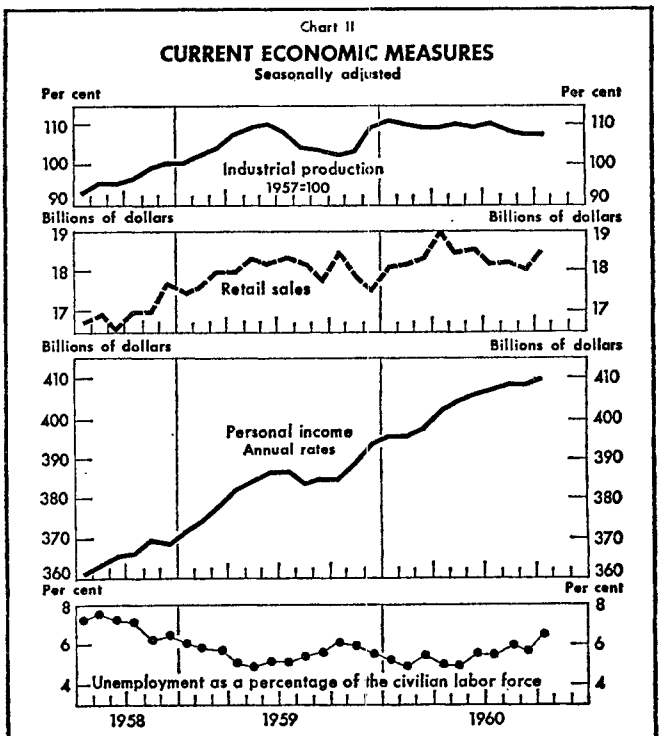
MORE RECENT PATTERNS

The limited data thus far available on developments since the third quarter place demand in a slightly more favorable light. As noted before there was a sizable boost in retail sales in October, to the highest level since June (see Chart II). Automobile sales were particularly strong, setting a record for the month. There were also widespread—albeit small—gains in other retail fields, including a 4 per cent rise in seasonally adjusted department store sales. In November, department store sales apparently declined substantially (on an adjusted basis). However, if automobile sales in the latter part of the month continued the relatively good performance of the first twenty days, they will have contributed much to maintaining total retail sales.

An indirect reflection of consumer demand—outlays for home building—rose slightly in November, seasonally adjusted, after a five-month decline. This series lags behind the new housing starts series, which increased substantially in October, seasonally adjusted, from the disappointing September pace. This latter series, however, has been highly erratic since it was redesigned last May and should be interpreted with caution.

Backing up the consumers' more favorable showing in October, personal income registered a further gain of $0.8 billion in that month to a seasonally adjusted annual rate of $409.6 billion (see Chart II). Wage and salary payments rose somewhat, more than offsetting September's small decline. This advance took place despite a rise in unemployment because of increases in the government wage bill. The dip in total wage payments in manufacturing was cushioned by a rise in average hours worked and by a small gain in hourly earnings. Government transfer payments rose again, by $0.3 billion, largely reflecting the increased flow of unemployment benefits.

Turning to the production side, although the Federal Reserve's index of industrial production did in fact fall slightly in October, the decline was too small to show up in the rounded figures, which remained unchanged at 107 per cent of the 1957 base period, seasonally adjusted (see Chart II). Output of consumer goods was up a little, due mainly to the high automobile production but also reflecting small rises in staples. These increases more than



Note: Alaska and Hawaii included in the unemployment rate and in retail sales since January 1960.

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

offset moderate declines in appliances and in rugs and furniture. There was also a rather sharp drop in television and radio output, in part the result of labor disputes. Business equipment production was up insignificantly. While output of most materials was down, iron and steel production was unchanged after allowing for seasonal factors. A decline in manufacturers' new orders in October was attributable mainly to reductions in defense orders (which had accounted for most of the rise in the two preceding months), but it nevertheless pointed to the possibility of a further decline in industrial production in November. Available November data for iron and steel production, as well as for automobile production, indicate more-than-seasonal declines.

The normally sensitive business spending for plant and equipment seems to have been only moderately dampened by the recent sluggish course of business. Domestic machine tool orders appear to have risen in October after a sharp drop-off in September, and construction contract awards in October for manufacturing plants recouped part of the September loss. Some encouragement on capital spending by business is also offered by the October McGraw-Hill survey. While it is estimated that outlays for 1960 will be 5 per cent below the level planned last

April, the level now planned for 1961 is only 3 per cent below the present estimates for 1960 outlays. A similar survey in October 1957 showed planned spending for 1958 down considerably more (7 per cent) from the estimated 1957 level.

Perhaps the most unsatisfactory element in the recent business news was the information that unemployment in October had climbed to a seasonally adjusted level of 4.5 million persons or 6.4 per cent of the civilian labor force, the highest percentage since December 1958 (see Chart II). Early November reports on unemployment insurance claims suggest some further deterioration. A major part of the employment decline in October (seasonally adjusted) was in farm jobs, largely reflecting an early harvest.

The wholesale price index rose 0.4 per cent in October, contrary to both normal seasonal expectations and the generally downward trend of recent months. Abnormally short supplies of various farm products caused most of the advance. The consumer price index also moved up in October by 0.4 per cent. The increase, the largest since April, was primarily seasonal. Service prices continued to climb, but the biggest advances occurred in automobile and food prices.

Money Market in November

Aggregate member bank reserves rose more than seasonally during November, as seasonal and other drains of funds were more than offset by sizable Federal Reserve open market operations in the first part of the month and by the release of reserves through full liberalization of vault cash regulations toward the month's close. During the first half of November, the three-month bill rate rose ½ per cent from the 2 per cent level to which it had declined in late October. During the second half, however, bill rates moved moderately downward.

Excess reserves remained concentrated at country banks over most of the month. The New York City banks reported a sharp rise in loans early in the month, and the ensuing deposit drains kept the reserve positions of the money market banks under some pressure. During the first half of the month, their large net purchases of Federal funds kept the effective rate for funds at the 3 per cent ceiling on almost every day. In the latter part of the month, with the reflux of funds from country banks and the increased eligibility of vault cash for meeting reserve requirements, the position of the money market banks improved and Federal funds generally traded at rates of 2 per cent or lower. Correspondingly, rates posted by New York City banks on loans to Government securities dealers were in a 3¾-4¼ per cent range over the early part of the month and then moved progressively lower to 2¾-4 per cent at the month's close.

The rise in Treasury bill rates in the first half of the month reflected several factors. Among them was the view in some quarters that the easing of vault cash and reserve requirements (announced October 26) might bring a smaller net demand for bills than would have occurred if seasonal reserve needs had been met through System open market purchases. Subsequently, with the greater attractiveness of yields, there was some pickup in demand and rates moved lower again. In the markets for longer term Treasury and corporate obligations, investor psychology remained particularly hesitant as political, economic, and balance-of-payments uncertainties found no clear resolution. The Treasury bond market was affected also by congestion in the corporate market and the resultant markup in corporate bond yields, which prompted some switching out of Governments as the spread between corporate and Government yields widened. Consequently, prices for Treasury bonds drifted downward with few interruptions over the month.

BANK RESERVES AND BANK CREDIT

During the first two statement weeks ended in November, reserve drains resulting from declines in float, heavy gold outflows, and the preholiday expansion of currency in circulation were offset by System open market operations, which supplied $1,255 million in reserves through both outright purchases and increases in the repurchase account. Some $276.5 million of the System's outright purchases in these weeks consisted of certificates and short-term notes and bonds. Operating factors first absorbed and then released reserves during the following two weeks, with both movements moderated by System open market operations.

In the final statement week of the month, reserves absorbed by various market factors, a rise in required reserves, and a runoff of System holdings under repurchase agreements were more than offset by the liberalization of

The Business Situation

The sluggish pace of economic activity in recent months has continued to be evident in most of the current indicators reported during December. It has also had its effect on spending plans indicated in the recently published results of two surveys taken early in the fourth quarter. These point to mild reductions in businessmen's plans for fixed investment during the second half of 1960 and the first quarter of 1961 as well as to reductions in consumers' near-term intentions to purchase durable goods. This hesitant attitude on the part of two important groups of spenders is one of the factors causing the current weakness in durable goods sales at both the manufacturing and the retail levels. It is echoed in the prevalent cautious views of many business analysts who foresee only small gains in sales and a continued squeeze on profits in 1961. In combination, these factors seem to have caused a further scaling-down of desired inventory levels, leading to some additional declines in industrial production and nonagricultural employment.

SPENDING PLANS AND SALES

The latest quarterly survey of businessmen's capital spending plans and actual outlays, taken by the Commerce Department and the Securities and Exchange Commission in October and early November, shows that plant and equipment spending in the third quarter declined to a seasonally adjusted annual rate of $35.9 billion. This was $0.4 billion below the peak rate reached in the second quarter of 1960 and $1.6 billion less than planned outlays indicated in a similar survey made in the second quarter (see Chart I). Fourth-quarter outlays were estimated to have been trimmed by another $0.3 billion. If actual outlays match these estimates, the decline in capital spending during the second half of the year will have been relatively moderate—somewhat less than a third of the drop occurring in the two quarters following the 1957 peak. Total 1960 outlays of $35.7 billion would be almost 10 per cent above the 1959 level but would fall short of the 13 per cent gain anticipated at the beginning of the year.

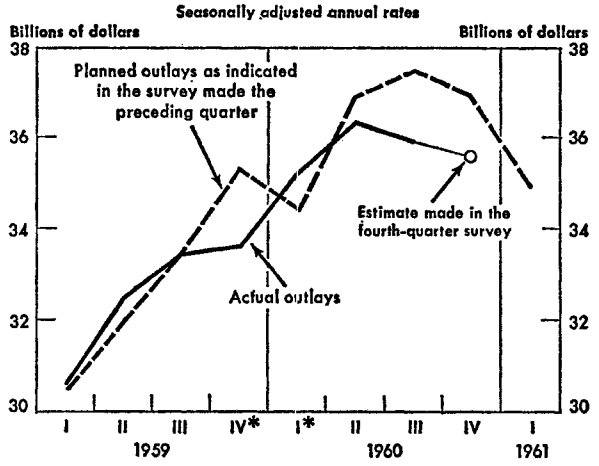
The dip in capital spending is expected to continue, at a somewhat accelerated rate, in the first quarter of 1961, when outlays are scheduled to decline to a $34.9 billion rate. This expectation is generally consistent with the results of a survey of capital appropriations by large manufacturing firms, taken in the third quarter by the National Industrial Conference Board. The declines shown by this survey, both in new appropriations (spending plans approved by top-level management) and in backlogs of appropriations, were interpreted as implying a 5 to 10 per cent reduction in outlays in subsequent months.

The sag in capital spending plans appears to be paralleled by some curtailment in consumer intentions to purchase certain durable goods. In the October survey made by the Census Bureau for the Federal Reserve System, the proportion of consumers planning to buy automobiles (new or used) and various appliances within the next six months was substantially (10-20 per cent) below October 1959. While plans to buy cars and television sets rose from July to October, the rise may well have been less than seasonal. These results must be interpreted with some caution, since quarter-to-quarter fluctuations are not always closely associated with current movements in retail sales and the year-to-year decline may be exaggerated by the sharp peak in plans in October 1959. It may be significant, however, that the percentage of consumers planning durable goods purchases stood above the year-ago level in January and April of 1960, was about equal in July, and fell below in October.

Chart I

PLANT AND EQUIPMENT OUTLAYS

Seasonally adjusted annual rates

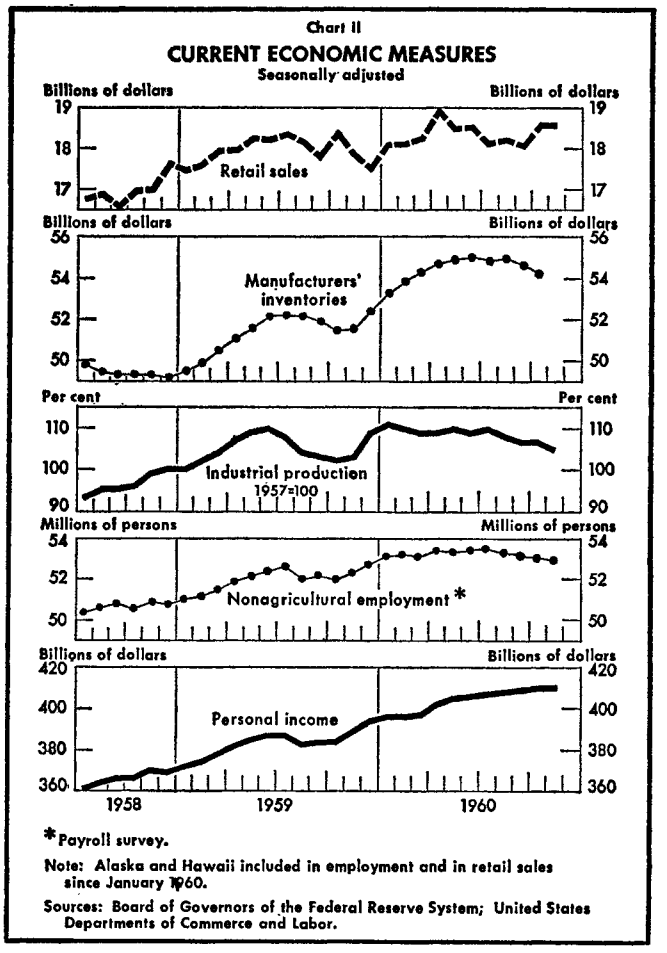


*Periods particularly affected by the steel strike.

Sources: United States Department of Commerce and Securities and Exchange Commission.

This scaling-down of businesses' and consumers' planned purchases for final use may already have been a factor in sales reductions in some sectors, but has not resulted in any sharp declines. At the retail level, sales in November (seasonally adjusted) remained virtually unchanged at the improved October rate (see Chart II). A small decline in sales at durable goods outlets was offset by a similar rise at nondurable goods stores, according to the advance report. The pace of new car sales improved slightly (after adjustment for the number of trading days) on the good October performance and set a new record for November. Although the proportion of sales attributable to 1960 models—at bargain prices—was reduced from the preceding month, an increase in the proportion of sales of compact cars and continued price reductions for used cars may have held down the dollar volume of total car sales. Incomplete data available for December suggest that auto sales were dropping somewhat; department store sales, however, were apparently registering approximately their customary seasonal upsurge.

Manufacturers' sales, on the other hand, have declined gradually but steadily to a November level almost 6 per cent below their April peak, with 70 per cent of this decline recorded in the durable goods sector. New orders have also moved down somewhat for the second consecutive month, reaching a new low for the year. These declines presumably reflect, however, the continued downward movement in business purchasing for inventories as well as declines in final demand. Total business inventories were liquidated at an increased pace in October, with the major reductions occurring in durable goods manufacturers' stocks of purchased materials and goods in process. Declines continued at the manufacturing level in November.



EFFECTS ON PRODUCTION AND EMPLOYMENT

Reflecting the pressures associated with some weakness in final sales and with inventory liquidation, industrial production slackened once again in November after remaining about unchanged between September and October (see Chart II). The seasonally adjusted total index slipped from 107 to 105 per cent of the 1957 base, as output of metals, textiles, and construction materials continued to decline, automobile assemblies were cut back sharply after a rise in October, and production of some other consumer goods—including apparel, appliances, and television sets—was reduced. Output of business equipment rose slightly from the strike-curtailed October level. More recent indicators show the rate of steel production remaining about level from mid-November to mid-December at slightly below 50 per cent of capacity but subsequently dipping, in part because of the holidays. Automobile production schedules appeared to be down somewhat more than seasonally in December.

Paralleling the movement in production was a further curtailment in nonagricultural employment which declined in November by about 100,000 persons (seasonally adjusted) to 52.9 million (see Chart II), according to the payroll survey taken in the middle of the month by the Bureau of Labor Statistics. About 60 per cent of this reduction was in manufacturing, where cutbacks were widespread, but employment in all other major sectors except services and government also declined. Between July and November of 1960 nonfarm employment fell by about 450,000, or 60 per cent of the drop during the same months of 1957 which marked the early part of the 1957-58 recession (peaks in employment occurred in July of both 1957 and 1960). The major difference lay in the greater expansion of hiring by State and local governments during the recent period. On the other hand, the Census household survey taken in early November

showed a rise in both farm and nonfarm employment, the latter primarily because of the temporary hiring of election workers. Total employment rose almost 1 per cent, and unemployment was reduced slightly on a seasonally adjusted basis. The minor decline in the seasonally adjusted unemployment rate to 6.3 per cent from 6.4 per cent in October does not appear to constitute a significant turning point in employment developments, particularly in view of the further rise in unemployment insurance claims in early December.

Although manufacturing employment and the average number of hours worked declined, personal income in November maintained the October level of $409.5 billion (seasonally adjusted annual rate). Reductions of $0.4 billion in wages and salaries and $0.1 billion in business and professional income were offset by a further increase in transfer payments. While November was the first month since February 1960 in which personal income failed to rise, corporate profits began to fall in the second quarter, and in the third declined further to a seasonally adjusted annual rate of $41.5 billion, $7.3 billion below the first-quarter peak. This decline resulted in part from reduced profit margins, as sharpened competition led to scattered price declines and some costs continued to creep up. It also reflected a smaller volume of sales in some industries.

In contrast to the slackness of domestic demand in the industrial sector, the number of private housing starts in November maintained the improved October rate. United States exports, after rising about 6 per cent in October and carrying the trade surplus to the highest level in over three years, remained approximately steady in November at a seasonally adjusted annual rate of $20.4 billion.

The Money Market in the Fourth Quarter

Bank reserve positions eased further during the fourth quarter, as the Federal Reserve System more than met seasonal and other reserve needs through sizable purchases of Government securities and the liberalization of reserve requirements. Bank credit expanded substantially over the quarter and, with this expansion concentrated until late in the quarter in the acquisition of Government securities, bank liquidity positions were improved. Some reserve pressures were in evidence at times in the central money market, particularly during October and early November, but over the balance of the period Federal funds were generally in comfortable supply, trading at rates well below the 3 per cent discount rate through the end of December.

By December, too, a much more confident mood had emerged in the securities markets, following a period of cautious hesitation in October and November, when investors failed to find in the welter of economic data and comment a single clear configuration upon which action could be based. While business news continued to show some slack in the economy, there was press speculation that the cyclical low in interest rates, and perhaps even in the economy as a whole, had been passed. Meanwhile, the stock market seesawed to reach a two-year low and then a four-month peak. In the background throughout the October-November period was the concern over the balance-of-payments situation — heightened by the flurry of gold prices in the London market—which brought new doubts to the market over the lengths to which monetary ease might proceed. Very much in the forefront was the Presidential election, bringing political uncertainties to a peak in early November.

In this setting, prices of fixed-income securities moved inconclusively within narrow bounds. Institutional investors generally held to the sidelines in the corporate market, where a heavy volume of new offerings was floated. Market congestion frequently developed, leading to higher yield levels on new issues and to syndicate terminations and higher yields on slow-moving recent issues. This congestion also weakened the market for Treasury bonds, where rates had fallen further from earlier peaks, as the resulting yield advantage prompted some switching into corporates. In the market for Treasury bills, rates fluctuated within a relatively narrow range, with the rate on three-month bills descending briefly to 2.07 per cent in late October but rebounding sharply before declining again to close the year at 2.20 per cent.

The strengthening of confidence in December extended to the markets for both long- and short-term fixed-income securities. Business indicators reinforced a growing consensus that a business upturn was at least some months away, while the reduced gold outflow and declining interest rates in Europe led some market participants to take a more confident view of the balance-of-payments situation. A 5 per cent rate on a utility issue finally broke the ice of investor resistance in the corporate bond market, and de-

The Business Situation

Business activity has continued to decline in recent months and unemployment in January stood near the peak level of the postwar period. Consumer buying, after an encouraging upturn early in the autumn, did not show the usual seasonal rise in the closing months of 1960, and there seems to have been a more-than-seasonal weakening in January. Business fixed investment outlays also have been falling somewhat. At the same time, it is noteworthy that the over-all pace of decline has remained moderate and that apparently much of the downward pressure on activity has come from business efforts to trim inventories rather than from any severe weakening in the final demand for goods and services. Significant progress has in fact been made in reducing manufacturers' stocks toward more sustainable levels, while underlying business and consumer confidence appear to have remained high. Taking a longer look backward, it is also noteworthy—from the standpoint of building a sound recovery and protecting the United States balance of payments—that the over-all price level has been relatively steady during the past year, with some key areas of industrial prices displaying significant downward flexibility.

MILD DECLINE IN ACTIVITY

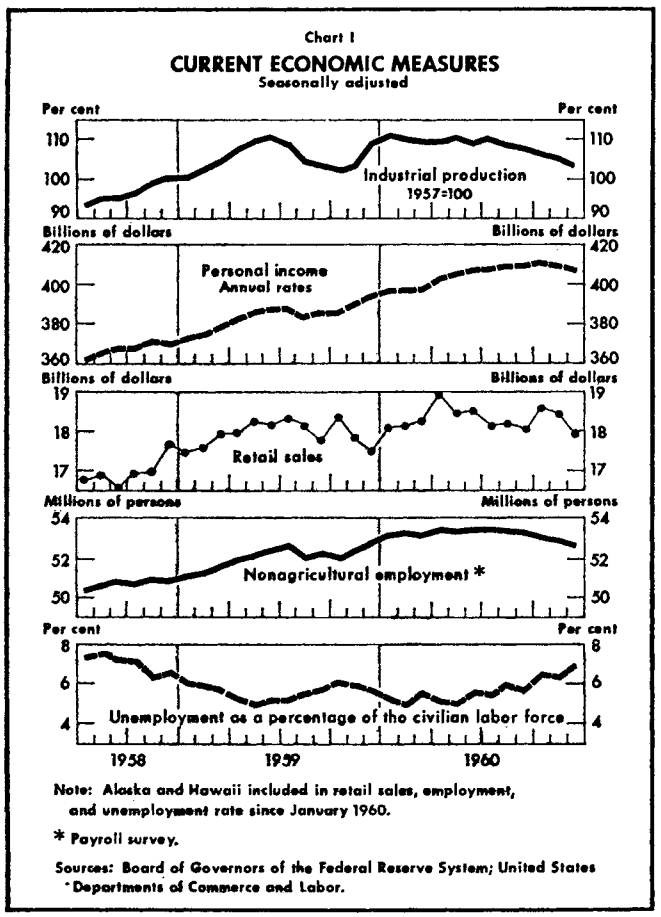
According to preliminary estimates by the Council of Economic Advisers (CEA), gross national product in the fourth quarter was unchanged from the third quarter's seasonally adjusted annual rate of $503.5 billion. There were important changes within the total, however. Personal consumption spending increased by $3.7 billion, more than offsetting the third-quarter decline. On the other hand, there was a sharp swing from a $0.6 billion rate of inventory accumulation in the third quarter to a $4.0 billion rate of inventory liquidation in the final quarter. Government outlays for goods and services, and net exports, increased moderately. Residential construction again declined somewhat, while outlays for plant and equipment reversed their direction and edged off a bit.

The fairly substantial increase in consumer spending indicated by the CEA estimate conceals a downward trend in month-to-month movements. Estimates of spending on services, which are included in the GNP accounts, are made only quarterly, and these figures have been climbing upward without any break throughout the postwar period. Information on consumer spending for commodities, however, is gathered monthly from retail sales figures. Retail purchases rose sharply in October (seasonally adjusted) but declined in each of the two following months. As a result, retail sales by December had slipped below the level of the third quarter (see Chart I). The December drop centered in new car sales, and the incomplete January data now available suggest a further substantial decrease in car sales for that month, after seasonal adjustment. Department store sales in January also slipped more than seasonally.

At the manufacturing level, sales dropped slightly more than 1 per cent (seasonally adjusted) in December. This marked the eighth month of uninterrupted decline. Manufacturers' new orders also fell again in December, and unfilled orders (unadjusted) were at their lowest level since December 1950.

The declines in sales at the manufacturing and retail levels were great enough to cause a further increase in the ratio of total business inventories to sales despite the progress made by businessmen in reducing inventories. At the end of 1960 the book value of inventories was 1.56 times the value of monthly sales; a year earlier inventories had been 1.47 times the sales total. As long as the ratio continues to rise, further attempts to cut back stocks are likely, even though the ratio is below the levels that prevailed during the corresponding months of the previous business decline. One important element pointing strongly to further efforts to reduce stocks is the large volume of auto inventories, which during January stood at around one million units. It was partly for the purpose of reducing these inventories that auto output was cut back in January.

The continued weakness in sales, new orders, and inventory positions was again reflected in the industrial production index, which fell two points in December to 103 per cent, seasonally adjusted, of the 1957 base (see Chart I). The latest drop brought the index, which has fallen in every month since July, to 6 per cent below the July level. This decline was somewhat less, however, than that which occurred during the second half of 1957. In January, auto production dropped substantially, but steel output may have advanced somewhat more than seasonally from the depressed December levels. New orders from many steel users outside the automobile industry were showing some improvement in January, although this may have been largely counterbalanced by cutbacks in orders from auto firms.



Perhaps the most disturbing feature of recent business news was the further substantial rise in unemployment (see Chart I). In December the seasonally adjusted rate was 6.8 per cent of the civilian labor force, and in January, according to President Kennedy's economic message to Congress, it declined only slightly, to 6.6 per cent. The December 4.9 million unemployment total (seasonally adjusted) was the largest in any month since September 1958. Unemployment was already at relatively high levels when the economy began to slow down this past summer, and in the remainder of 1960 it tended to be substantially higher—both in absolute terms and as a fraction of the labor force—than it was in the corresponding months of the 1957-58 contraction or in earlier postwar recessions. The unemployment ratio in December was higher than at the deepest part of the 1953-54 recession and not far below the ratio at the trough of the 1957-58 recession.

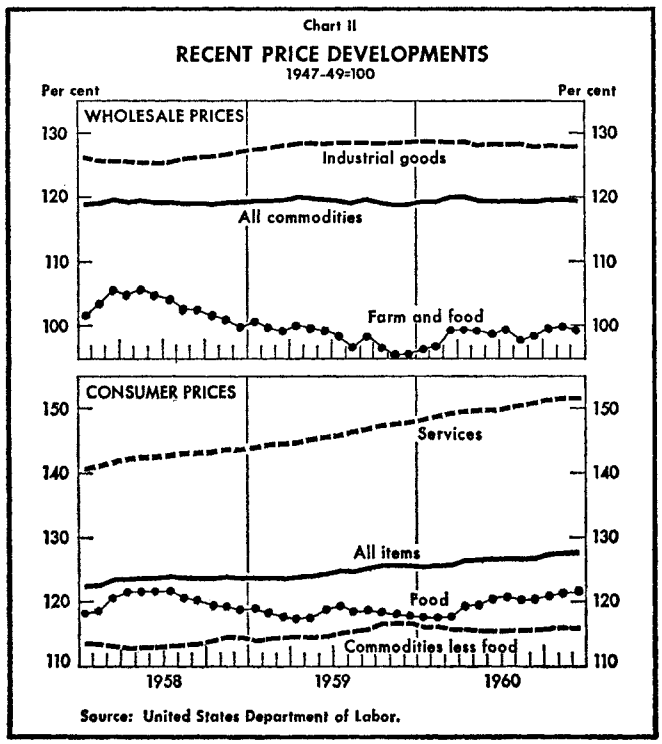
Total employment (according to the household survey) was off by 0.4 million persons in December to 66.4 million, seasonally adjusted. Nonagricultural employment in December, as indicated by the payroll survey, declined by 0.3 million persons to 52.4 million (see Chart I), bringing the cumulative decrease since last July's peak to nearly one million persons. (This was about the same rate of decline as in the corresponding months of 1957.) The reduction in nonfarm employment between November and December was in part attributable to the termination of temporary jobs for election workers and to the December snowstorm in the Northeast which reduced construction activity.

The impact of the December decline in employment was felt in total personal income, which fell by $2.3 billion from the revised November figure to the lowest level since June (see Chart I). Almost all the December drop was in wages and salaries, which have slipped in each of the last four months. Declines in other components of personal income were small, while the only income source to rise was government transfer payments; this increase was attributable mainly to expanded social security payments, resulting from extended coverage and a liberalized benefit formula.

The most recent data on construction present a mixed picture. Outlays in January fell more than seasonally, primarily because of declines in spending on residential and highway construction. Bad weather may have been partially responsible for these downward movements, however. In the residential sector, a note of optimism was sounded by a December increase in requests for Veterans Administration- and Federal Housing Administration-supported mortgages on new homes. At the same time, private nonresidential contract awards rose significantly. In January, construction outlays in that sector strengthened a bit.

PRICE TRENDS IN 1960

The sag in business activity during 1960 was accompanied by some softening of prices. Indeed, the two developments were, as was to be expected, mutually reinforcing, for, while the abatement of upward price pressures and expectations early last year apparently was one of the chief causes of the trimming of inventory investment, the resultant slack in total demand early last year produced a further softening of the price picture. The industrial components (including all commodities other than farm and food) in both the wholesale and the consumer price indexes declined through much of 1960 (see Chart II). While the total index in each case rose over the year, the increases were relatively small and attributable largely to higher farm prices and, in the case of the consumer index, also to the steadily rising trend in the prices of services.

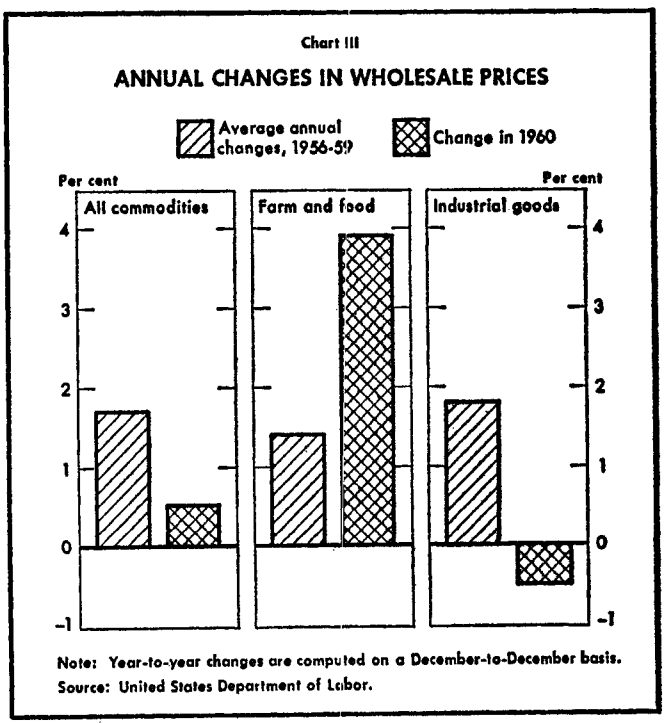


Generally speaking, the total wholesale price index has been fairly stable for nearly three years, but its industrial component did not begin to level out until the middle of 1959. When this component fell in 1960, it was the first such December-to-December drop since 1952. Within the industrial category, the largest price decreases were recorded for those commodities which normally are especially sensitive to changes in supply and demand conditions —primarily goods at or near the raw materials stage. Some scrap metal prices, for example, fell between 10 and 25 per cent, while the list prices of most finished and semifinished metals showed only small declines or remained unchanged. The downward pressure on many primary commodity prices during 1960, it may be noted, stemmed partly from changing world market conditions and partly from the influence of the domestic economic situation.

Altogether, the drop in industrial goods prices at the wholesale level between December 1959 and December 1960 amounted to 0.5 per cent (see Chart III)—a welcome break in the series of annual increases that had carried the index up by 14 per cent from the end of 1952 to mid-1959. The actual decline during 1960 is, moreover, probably somewhat understated, since the index relies heavily on list-price quotations. It therefore does not fully reflect the increased use of price-shading in the form of discounts, absorption of freight charges, and free installation and other services—arrangements that typically emerge in periods of slackened demand.

Among the various product groupings, the biggest price drop took place in lumber; this reflected several factors, including the 1960 decline in residential construction and the growth of productive capacity in plywood. Hides, skins, and leather prices also fell sharply, owing largely to increased supplies of cattle for slaughter. Idle capacity brought fairly substantial price reductions in the metals group, and unwanted inventory accumulations (principally in cotton goods) resulted in a moderate decline for the textiles and apparel component. Reductions of smaller amounts took place in furniture, machinery, and chemical prices. The only industrial group to show any sizable increase was fuel, power, and lighting materials.

Farm and food prices at the wholesale level moved upward in 1960 by a sizable 3.9 per cent. This followed a nearly uninterrupted slide in such prices since early in 1958. The increase last year primarily reflected lessened supplies of certain agricultural goods rather than any general burgeoning of demand, although increased export demand was a factor in some cases. The rise was led by a sharp spurt in egg prices, due to a reduction in the flocks of laying hens, which in turn was a consequence of the low 1959 prices. Substantial increases in pork and poultry prices had similar causes, while a rise in fresh fruit prices was partly the result of hurricane damage.

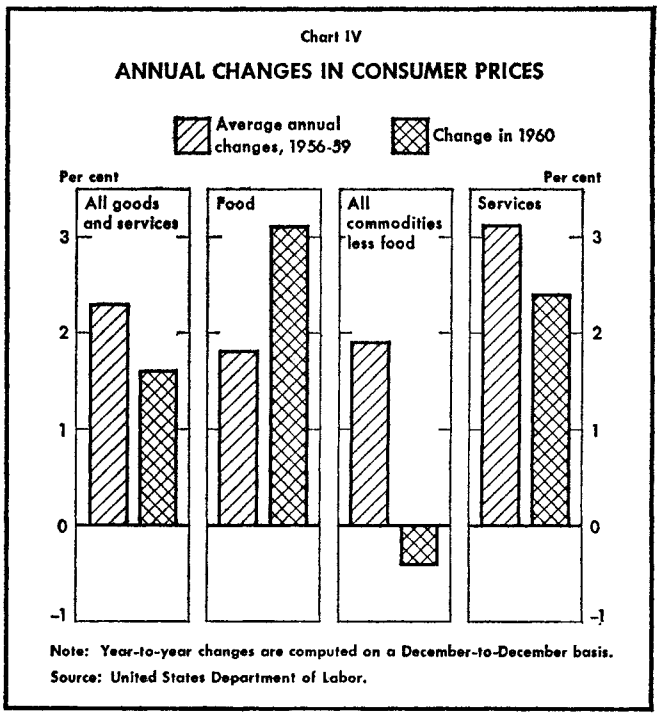


The general trends in 1960 in the two major components of the wholesale price index (i.e., the industrial component and the farm and food component) were to a substantial extent reflected in the behavior of retail prices. Nevertheless, there were also significant differences. This was not surprising since movements in the wholesale and consumer index totals frequently diverge for a time, and, although over longer periods the direction of both indexes is usually the same, the steepness of rise or fall may differ. Thus, while the average of all wholesale prices increased by only a little over 0.5 per cent in 1960, the consumer index rose about three times as fast (see Chart IV).

There are several reasons for a divergence, perhaps the most important being the fact that the wholesale index excludes service prices. A second major reason is that price changes that take place at earlier stages of production are sometimes transmitted to the consumer level only with a considerable lag. In many highly competitive primary markets, prices react almost immediately to downward pressures, but at later stages of fabrication the resulting cost reductions may be translated into lower prices only after they have become fairly substantial and after they have been in effect for some time. Thus the prices of nonfood commodities in the consumer index rose rather steadily until the end of 1959 although wholesale industrial prices, as noted above, had begun to stabilize several months earlier.

In 1960, the prices of consumer goods other than foods declined by 0.4 per cent, the first such December-to-December fall since 1954. All of the 1960 drop took place in the first half of the year. Average prices in this category actually drifted up a little between June and December, but this was largely seasonal and the increases were substantially smaller than in the second halves of other recent years. The over-all decline for the year was concentrated in the durables field, one of the largest drops being recorded for used-car prices which were under pressure from the competition of low-priced compact cars. New car prices were also down a little, even though volume was somewhat better than in 1959, as dealers vigorously sought to boost their sales. In the appliance field, where competition is traditionally very keen, some price declines in 1960 appear to have been attributable to declines in demand. In contrast, the prices of nonfood soft goods rose throughout the year, though at a much more moderate rate than in 1959; apparel prices, for example, edged up slightly.

The sharp rise in the farm and food component of the wholesale index during 1960 resulted in an upturn in retail food prices. Over the year the total increase in retail food prices, 3.1 per cent, was somewhat less than the 3.9 per cent increase in wholesale prices. Retail prices for all major types of foods increased, causing rises in the prices of restaurant meals as well as of groceries for home consumption, and some foods failed to show normal seasonal declines in the fall. Several of the sharpest advances in retail food prices, such as the prices of eggs and pork, reflected the higher quotations at the wholesale level which have already been noted.



The prices of services, the third major category in the consumer price index, also rose last year, as they have in every postwar year. The increase in 1960 was 2.4 per cent, which was slightly less than the average for recent years, although a rise of this magnitude in a period of weakening over-all demand may call for explanation. First, the prices for a large number of services (including water, telephone, electricity, and gas rates) apparently follow cost increases only with a lag, and the increases in 1960 may thus partly reflect advances in production costs that occurred in earlier years. In a second group of services, such as haircuts, medical care, laundry, and various types of repair services, wages and salaries are a very large portion of total costs, and opportunities for offsetting any increases in such costs through technological advances are generally believed to be relatively limited. A third element in the service index—rent—was affected last year by higher property taxes and by increases in maintenance

and repair costs. In fact, every major category of the service component in the consumer index rose in 1960, with the largest increases occurring in the field of medical care. In good part, the latter rise reflected charges for medical insurance.

The behavior of prices in 1960 was, on the whole, encouraging, but this cannot permit a relaxation of national concern with the long-term problem of controlling inflation. The need for general stability in the price level to encourage sound growth and to help avert hazardous boom-bust patterns is always present. Even beyond this, however, inflation would have particularly unfortunate consequences at the present time when a large balance-of-payments deficit requires the strengthening of our competitive position in world markets. It is therefore highly important that a resumption of growth in employment and output is not accompanied by a renewed upward surge in prices.

Canada's New Economic Measures

In an attempt to deal with distinct weaknesses in the economy and, even more, to encourage greater domestic initiative in Canada's long-term development, the Canadian Government in December 1960 introduced a series of new economic measures as part of a revised budget for the current fiscal year ending March 31. The budget measures reflect government acceptance, in part at least, of a widely held view that Canada's economic development has heretofore depended too heavily on foreign capital and henceforth must be more largely financed from savings originating in Canada itself. The measures have consequently led to expectations that the inflow of capital into Canada will slacken, and this in turn resulted in a temporary decline in the exchange rate of the Canadian dollar. While the budget measures are already in effect, they as yet must obtain Parliamentary approval. This article reviews the background and the major facets of the revised budget.

RECENT BUSINESS DEVELOPMENTS AND BUDGET MEASURES

The forward spurt that had characterized the Canadian economy in 1958-59 came to a halt in 1960. The year as a whole set new records for gross national product, personal consumption, and exports, but, as it progressed, significant weaknesses developed in important sectors. Expenditures during the first nine months for plant and equipment, residential construction, and inventory accumulation were below those of 1959, and retail sales rose more slowly than in earlier years. As a result, the seasonally adjusted industrial production index by July had declined 5.3 per cent from the all-time January 1960 high, largely because of weakness in durable goods production; and the seasonally adjusted gross national product was 1.5 per cent lower in the second quarter than in the first, mainly reflecting lower corporate profits. On the other hand, some strength was imparted after midyear by improved export sales outside the United States market and higher over-all exports, by a partial recovery in industrial production after July, by increased government outlays, and by a rise in construction. Nevertheless, the seasonally adjusted unemployment index rose during most of the year and reached 7.9 per cent of the labor force in December—a substantial increase from an already high 6.3 per cent recorded a year earlier.

The revised government budget reflects these developments, as well as concern about the outlook for exports to Western Europe and the United States. The budget forecast is now for a $286 million deficit, compared with an initially envisaged $12 million surplus.[1] This shift is the result mainly of a 3.6 per cent decline in estimated revenues, in turn a consequence of lower economic activity. Expenditure estimates have been raised only moderately (1.5 per cent), owing to increased costs associated with the farm program, the national railroad deficit, and a modest enlargement of the regular winter public works programs. The government rejected suggestions for massive emergency expenditures and instead provided incentives to private domestic investment in Canada over the longer term. Thus, it extended the lower of the two corporate tax rates (21 per cent as against 50 per cent) to incomes of up to $35,000 instead of $25,000; imposed taxes on pension funds and increased those on mutual funds, where they derive more than a prescribed share of their income from sources outside Canada; authorized accelerated depreciation allowances (to be used at any time within the first three years) on the first-year investment of industries introducing new products, undertak-

[1] All amounts are in Canadian dollars unless otherwise noted.

mand spread to other high-rated issues as well. By the month end, yields on seasoned Aaa-rated corporates, as measured by Moody's, had receded to 4.22 per cent, from 4.30 per cent at the end of January.

In the market for tax-exempt bonds, in contrast, the more substantial volume of new offerings—$620 million for the month, following $650 million in January—and the heavy calendar ahead brought mixed receptions on several new issues and a further build-up in the advertised inventory of dealer offerings. Strength in the corporate and Government bond markets was imparted to this market as well, however, and Moody's average of yields on Aaa-rated tax exempts showed a 4 basis point decline for the month, to close at 3.12 per cent.

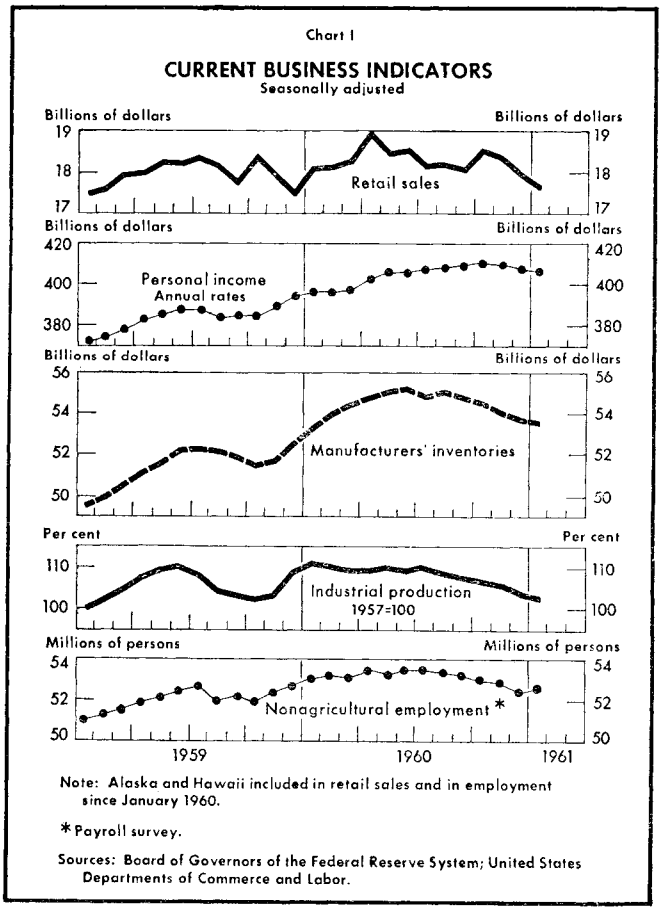
The Business Situation

Business activity has continued to decline since the turn of the year. The downtrend in some of the major indicators seems to be moderating, and recent business news has had a slightly more mixed tone than in previous months. But it is too early to say that the recession—so far the mildest of those in the postwar period—is bottoming out. The pace of inventory liquidation has slowed at the manufacturing level, but total inventories may decline further, as both manufacturers' and distributors' stocks of finished goods are drawn down. At the same time, the mildness of the current decline in business fixed capital outlays was underscored by the official report in early March that 1961 expenditures are expected to decline only slightly. In some lines, declines in consumer spending have recently shown signs of leveling out or turning into advances, and government spending has been exerting a moderate upward thrust which is likely to continue under the stimulus of anti-recessionary programs. Weather conditions have been an important factor in recent months, making the distinction between shifts in timing of sales and genuine improvements in final takings particularly difficult.

Despite the moderate pace of the general business decline, unemployment has reached near-record levels for the postwar period; in part, this is the result of considerable unemployment even at the start of the current business downturn. In January, unemployment rose a little less than seasonally, but it is disquieting that there was a substantial rise in longer term unemployment and in unemployment of heads of families. This is significant not only from a welfare standpoint, but also because it implies further cuts in family spending which would constitute a restraining force on the general course of business.

CURRENT DEVELOPMENTS

In assessing the current business situation, a good deal of attention has been focused on trends in consumer spending—not only because this is the largest sector of final demand in dollar terms but also because such spending has been widely looked to as a cushion for the overall decline. As shown in Chart I, retail buying weakened substantially following a brief upturn in October, but the decline in January was not quite so sharp as in the preceding month. Like the October rise, the recent decline



in sales resulted mainly from marked fluctuations in the pace of new car deliveries, although sales of other durable goods and of nondurables also moved somewhat lower. New car sales slipped further in early February—in contrast to the usual seasonal advance and despite the special efforts of dealers competing in sales contests—but turned up sharply later in the month. Department store sales, after weakening in January, also strengthened in February.

The decline in consumers' incomes was undoubtedly a major reason for the slackening in consumer spending. Personal income in January declined for the third consecutive month (see Chart I), although by only $0.6 billion (seasonally adjusted annual rate) compared with the $2.1 billion drop in December. On the other hand, results of the latest surveys conducted by the National Industrial Conference Board for *Newsweek* and by the Census Bureau for the Federal Reserve System do not suggest any marked deterioration in consumers' confidence.

Residential construction, a sector ultimately dependent on final consumer demand, has also continued to be sluggish despite some increase in the availability of credit. Private nonfarm housing starts (seasonally adjusted) rose slightly in January, but outlays for residential construction continued to decline through February. Various steps have been taken recently to increase further the availability of mortgage credit and reduce its cost, including a cut in the maximum allowable interest rate on FHA mortgages and an expansion of the potential supply of funds to savings and loan associations by the Federal Home Loan Bank System. The extension of Federal Reserve open market operations to longer term issues may also tend to affect the flow of long-term capital in general which, of course, includes the flow of mortgage funds. It remains to be seen whether the underlying demand is strong enough to permit a quickening of the tempo of residential construction as the availability of credit is stepped up.

According to the recent Commerce Department estimates, the principal downward pressure on business activity in the final quarter of 1960 was exerted by the shift from a low rate of accumulation of business inventories (as measured in the gross national product accounts) to a $3 billion annual rate of liquidation. The rate of liquidation has probably not changed significantly in early 1961; if so, it is providing little or no additional contractionary pressure on the current pace of activity. Indeed, in the case of manufacturers' inventories, liquidation of stocks of materials halted in January, thus reducing the decline in inventory holdings in that month (see Chart I). In contrast, efforts to reduce stocks of finished goods in the hands of manufacturers and distributors appear to have had only limited success due to declines in sales which have paralleled cutbacks in production.

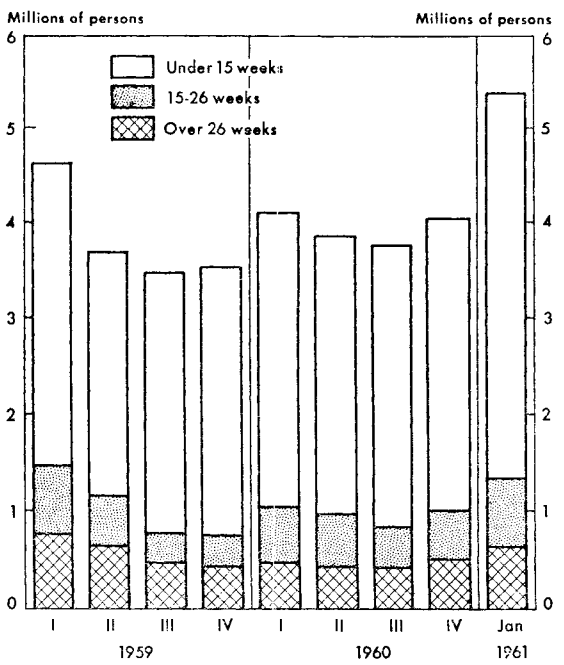
Reflecting the decline in spending in various sectors of the economy, the rate of industrial output has continued to slacken. In January, the Federal Reserve's index edged down by another point (seasonally adjusted) to 102 per cent of the 1957 base, following a two-point decline in the preceding month (see Chart I). A rise in steel output was an important factor underlying the smaller rate of decline, and there appears to have been a further gain in steel production in February despite the reduced volume of orders from automobile producers. On the other hand, the cut in automobile production which contributed heavily to the January decline in total output was carried further in February.

EMPLOYMENT AND UNEMPLOYMENT TRENDS

The lower rate of industrial production led to a continued contraction of manufacturing employment in January, after allowing for seasonal influences. At the same time, increased employment (seasonally adjusted) in other sectors—particularly construction, trade, and government—resulted in a slight rise in total nonagricultural

Chart II

UNEMPLOYMENT BY DURATION



Source: United States Department of Labor.

employment for the first time in six months (see Chart I). The seasonally adjusted unemployment rate edged down from 6.8 per cent to 6.6 per cent of the civilian labor force. Some deterioration, however, appears to have occurred in February.

The volume and composition of unemployment have also been a cause of serious concern. The January level of 5.4 million persons (unadjusted) was the highest since June 1958—the peak for the postwar period—and resulted in a substantial labor surplus in half of the 150 major labor market areas surveyed by the Bureau of Employment Security. The unemployment total included over 1 million persons who have been out of work for more than fifteen weeks (see Chart II) and about 2 million married men with families. Furthermore, the number of persons exhausting their rights to unemployment insurance benefits during the single month of January climbed close to 200,000.

ANNUAL REPORT – 1960

This Bank has just published its forty-sixth *Annual Report,* which reviews economic and financial developments of 1960 in this country and abroad. The *Report* also gives attention to the particularly difficult problems for monetary policy in 1960, when the changes in policy clearly indicated by domestic developments had to be taken with a view to avoiding excessive downward pressure on short-term rates. In addition, the *Report* discusses the longer run developments in the world economy that have created strains in the international payments mechanism and brought the problems of world finance so sharply to the fore. Copies of the *Annual Report* are available, upon request, from the Publications Section, Public Information Division, Federal Reserve Bank of New York, New York 45, N. Y.

Foreign Economic and Financial Developments

During the final quarter of 1960 the economic boom in foreign industrial countries lost some of its earlier vigor, although business activity expanded further in Germany and Japan and remained at a high level in most other countries. In Canada, the mild decline persisted without marked change. Continuing price stability enabled the monetary authorities in several countries to lower interest rates in response to balance-of-payments considerations. On March 4 the German Government announced the revaluation of the Deutsche mark by 5 per cent, and on March 5 the Dutch Government followed with the announcement of a similar revaluation of the Dutch guilder. The German move should help to correct the basic imbalance in international payments and, by dispelling uncertainties as to the future level of the D-mark rate, slow the flow of short-term funds to Germany.

BUSINESS CONDITIONS ABROAD

Despite moderate reductions in output in some countries during the closing months of 1960, foreign industrial nations generally reported rates of growth for 1960 comparing favorably with those of the boom year 1959. In most of these countries, economic activity continued to receive major support from the vigorous investment boom. Although wage levels drifted upward during the second half of the year, owing mainly to continued and widespread labor shortages, prices remained relatively stable in most countries.

A certain tempering of the pace of economic activity abroad was reflected in industrial production trends in a number of foreign countries (see Chart I). In France, fourth-quarter industrial production increased by less than 1 per cent over the third quarter, following a substantial rise since the spring. Moreover, in the United Kingdom, industrial production declined by about 1 per cent from the preceding quarter, as a reduction in the demand for consumer durables and apparently also for inventories proved more of an influence on total production than the continuing boom in the capital goods industries. In Canada, industrial production continued to fluctuate at 3 to 4 per cent below the all-time peak of January 1960. However, in Germany, industrial production continued to expand at a rapid rate, despite indications that the earlier rapid inventory accumulation and strong export demand were abating somewhat. Japan, finally, remained the fastest growing of all major foreign industrial countries, with industrial production in November 1960 no less than 24 per cent above a year previous.

Although the rapid rise in over-all industrial output has tapered off in a number of countries in recent months, large increases have continued to be registered in certain basic sectors. Nearly everywhere in Western Europe, there has been a further expansion in the capital goods

month's volume after August was smaller than a year before, and the January 1961 rise was nearly 40 per cent below that of January 1960.

It was quite late in 1960 before net mortgage acquisitions by savings and loan associations caught up with their pace of a year earlier. By January 1961, their acquisitions were up by 15 per cent over the year-before level. Commercial bank mortgage holdings, however, were unchanged in January and February, while FNMA on balance absorbed funds in February by selling more mortgages than it purchased.

To stimulate construction activity and a downturn in mortgage rates in line with the President's early February statement, several official actions were taken. The maximum rate on Federal Housing Administration-insured home mortgages was reduced by ¼ per cent. FNMA increased its purchase prices on mortgages by a full point and its sale prices by 2½ to 3 points, in order to make more funds available to the mortgage market. The Federal Home Loan Bank Board increased the amounts that member savings and loan associations may borrow from their Home Loan Banks and widened their lending powers. In addition, conferences were held between Government and savings and loan officials over the possibility of reducing the associations' dividend rates to facilitate a lowering in their rates on mortgage loans. With these several actions, and the cumulative impact of monetary ease, there were some signs by the quarter's close of a more substantial improvement in the mortgage market. One nation-wide survey in late March indicated that home mortgage rates had declined by ¼ per cent in most areas over the past three months, with those in some high-rate areas—Florida and southern California—down by as much as ½ per cent. Residential construction outlays turned up in March, following two successive monthly increases in housing starts.

The Business Situation

The over-all pace of economic activity has changed little within the past two months, and there have been some further indications that the recession may be bottoming out. Declines in the more important indicators have become fewer in number and smaller in size, and some key series have either leveled out or turned upward. While these developments have led to a widespread expectation that the turn-around may come some time within the current quarter, few business analysts have forecast a strong upturn, and businessmen themselves apparently anticipate only a mild increase in sales during the year. Thus, even if an upturn is soon to begin, a serious question remains as to whether the ensuing expansion will be vigorous enough to bring a substantial reduction in unemployment from the current high level.

In some lines, orders and sales have already shown signs of improvement, to some extent reflecting a step-up in government spending as well as expanded private demand which was bolstered, in part, by rebounds following unusually bad weather and pre-Easter buying. Even these latter factors may provide a timely stimulant to economic activity if they cause an expansion in output rather than simply a further liquidation of inventories. In many industries, however, large stocks of finished goods have continued to act as a buffer, tending to moderate, or even to preclude, the gains in output and employment which might be expected from upturns in sales. This has been the case, for instance, with automobiles, even though the inventory picture there was improving late last month. Steel, on the other hand, is one industry where expectations of a seasonal upturn in demand of final users—notably the construction industry—appears to have triggered a more general improvement in orders and production. Thus, steel output has moved up moderately from the January low point, even after allowing for normal seasonal advances.

FIXED INVESTMENT DURING THE RECESSION

There are some tentative indications that residential construction activity may be on the verge of a revival. Housing starts (seasonally adjusted) rose in both January and February despite the severe weather, leading to a modest increase in residential construction spending in March. Until recently, the performance of this sector has been weak relative to that of earlier recessions (Chart I). Private residential construction outlays moved erratically downward from July 1959 through the early part of this year, whereas during the 1957-58 recession construction expenditures were roughly level, and in 1953-54 there was a relatively early upturn.

It has been suggested that, because the backlog of postwar housing demand has been satisfied, home building may have become significantly less responsive to credit

inducements. In support of this argument, it is pointed out that in 1960 some slight easing of credit availability to the housing sector occurred even prior to the general business peak during the second quarter, whereas in earlier recessions an easing of mortgage credit had not occurred until after the start of the business downturn. On the other hand, mortgage interest rates in early 1960 had reached a much higher level than they had prior to the previous business downturns, while the easing in such rates, though starting sooner, progressed more slowly during the current recession. Now there are indications that a more substantial shift in the tone of the mortgage market may finally have occurred—a result of the cumulative impact of the general easing in credit conditions since early last year, along with the recent counter-recession actions of the Federal Government (discussed elsewhere in this *Review*)—so that a more decisive test of the strength of the underlying demand for housing may be close at hand. The next several months probably will show whether the recent rise in housing starts points toward a revival in residential construction, or whether it is just another erratic swing in this volatile series.

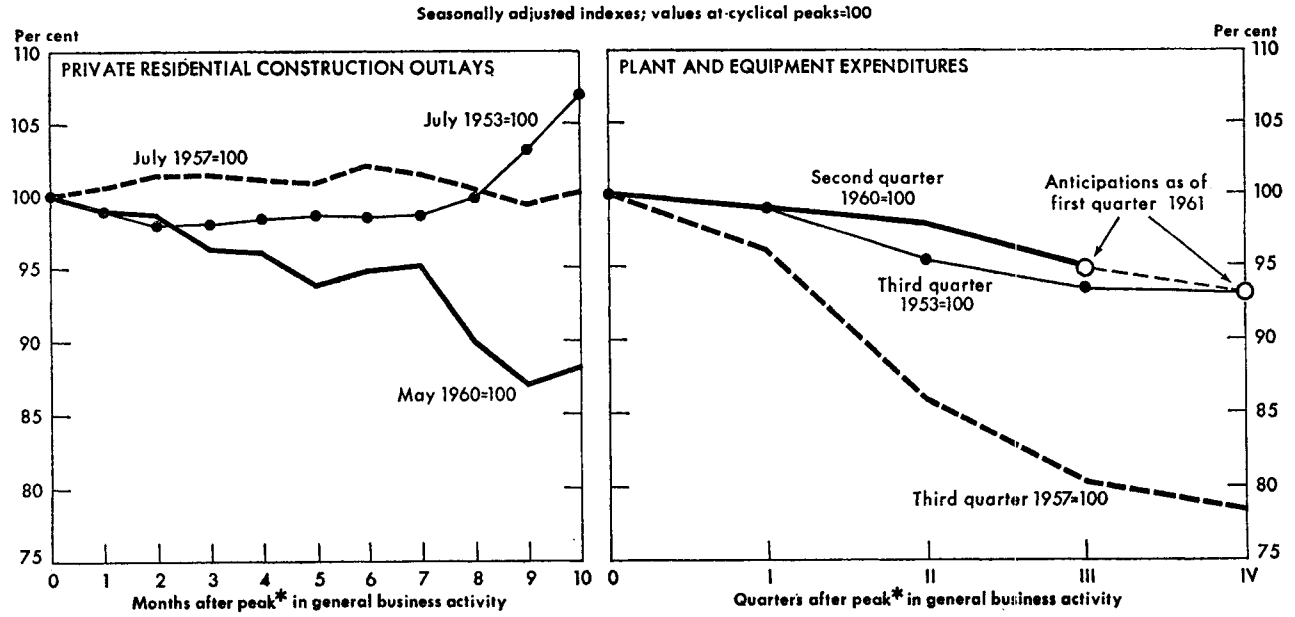
Recently, the Federal Government has also acted to stimulate public construction by accelerating the supply of funds available during the current half year for highways and post office buildings. Total public construction outlays had already moved markedly upward during 1960, but declined somewhat during the first quarter of 1961 as a result of reductions in spending for highways and nonresidential buildings.

In contrast to indications that both private residential and public construction may show growing strength in coming months, businessmen's plans for plant and equipment spending suggest a continuing decline through the first half of the current year. The total contraction in such outlays during this recession remains, however, quite mild in comparison with the previous recession (see Chart I). According to the latest survey of business plans for fixed investment, taken by the United States Commerce Department and the Securities and Exchange Commission in February, spending was expected to slip by 3 per cent in the first quarter of this year and by another 2 per cent in the quarter just begun. Planned outlays for the whole of 1961, however, are only 3 per cent below the actual 1960 level (although 7 per cent below the level anticipated early in 1960), which implies an upturn some time during the second half of this year. The anticipated mild decline from outlays of $35.7 billion in 1960 to $34.6 billion in 1961 contrasts with a 17 per cent actual drop (from $37.0 billion to $30.5 billion) between 1957 and 1958.

Chart I

CYCLICAL CHANGES IN COMPONENTS OF FIXED INVESTMENT

Seasonally adjusted indexes; values at cyclical peaks=100



*National Bureau of Economic Research reference cycle peaks, except for quarterly peak in 1953 when the third quarter is used.

Sources: United States Department of Commerce; Securities and Exchange Commission.

OTHER DEVELOPMENTS

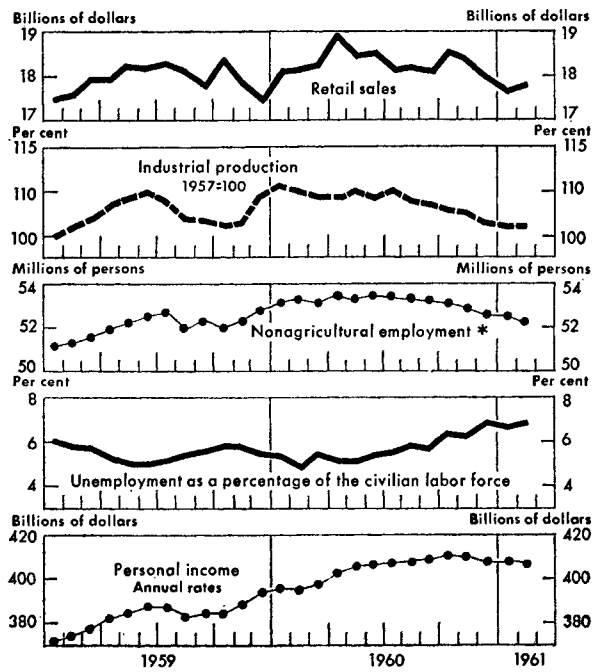
Sales of new cars are another significant type of spending which has recently turned up. A sharp rise in automobile sales during the final days of February left the total monthly rise of almost 2 per cent in average daily sales somewhat short of the usual seasonal gain, but after two months of sharp declines it was an encouraging sign. It served, moreover, to cut slightly into distributors' excess stocks. In the first part of March, automobile deliveries appeared to be holding at the improved level but did not seem to be achieving new gains.

Department store sales in February improved even more than auto sales, rising contraseasonally and contributing to a 1 per cent gain in total retail sales. It is probable, however, that this gain—the first since last October (see Chart II)—was largely a reflection of such special factors as better weather and a pickup in spending preceding an early Easter. Department store sales in March appear to have maintained the improved February pace but not to have shown further advances.

Small gains in both retailers' and manufacturers' sales in February had little effect on total inventories of finished goods, but manufacturers' stocks of materials once again declined. Manufacturers' new orders also rose in February, for the first time since September. The rise resulted primarily from an expansion of defense contracts, while other orders were about unchanged—but the absence of change was itself an improvement, compared with declines in previous months. It may reflect more favorable expectations for sales and production and consequent strengthening in orders for materials where current stocks have already been drawn down to minimal levels. Such developments appear to have resulted, in particular, in a slightly increased flow of orders for steel and other primary metals.

Thus far, small increases in sales and orders have cushioned the decline in total manufacturing activity, after seasonal adjustment, but have not reversed it. The total industrial production index edged down in February by only ½ of 1 per cent (and on a rounded basis the index was unchanged). The latest decrease was substantially smaller than in other recent months, as increased output of primary metals and electrical machinery partially offset fairly widespread reductions elsewhere. The most significant reduction was in passenger car output, which was accompanied by sharp cuts in ordering of materials by the automobile industry. As a result, steel output slipped back slightly in early March before rising again in the middle of the month. Automobile production in March showed about the usual seasonal expansion.

Chart II
RECENT BUSINESS DEVELOPMENTS
Seasonally adjusted



Note: Alaska and Hawaii included in retail sales and in employment since January 1960.

* Payroll survey.

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

Manufacturing employment, seasonally adjusted, fell further in February, paralleling the decline in output. Employment in several other sectors also declined, leaving a total of 276,000 (½ of 1 per cent) fewer people on payrolls than in the preceding month. In contrast, total nonagricultural employment, including household and self-employed workers, edged up very slightly. This may reflect, in part, increased employment among women who may be supplementing family income where the usual breadwinner was unemployed or working only part time. The small rise in total employment was insufficient, however, to absorb an increase in the labor force that was somewhat more than seasonal. As a result, the seasonally adjusted unemployment rate returned in mid-February to the high December level of 6.8 per cent. It rose further in March to 6.9 per cent.

Total personal income in February reflected the decline in payroll employment and in business income, falling by $0.7 billion to a seasonally adjusted annual rate of $405.9 billion. This was more than the decline of $0.3 billion (revised figure) that occurred in January but smaller than December's relatively marked drop.

The Business Situation

There are growing indications that the low point of the recession may now have been passed. In March, industrial production registered a slight gain, the first in eight months, and manufacturers of durable goods reported rising orders for the second month in a row. Moderate gains were also reported for personal income, retail sales, residential construction, and employment. In addition, new survey results suggest an improved outlook for fixed business capital formation, and current data seem to point to a better outlook for housing construction. All in all, the recent behavior of economic time series, including those regarded as "leading" indicators, strengthens the impression that economic activity has begun to move in an upward direction. Preliminary data for April suggest that the March gains have generally been maintained or broadened. If the recession should, in fact, prove to have run its course, it would pass into history as the mildest of the four cyclical contractions in the postwar period.

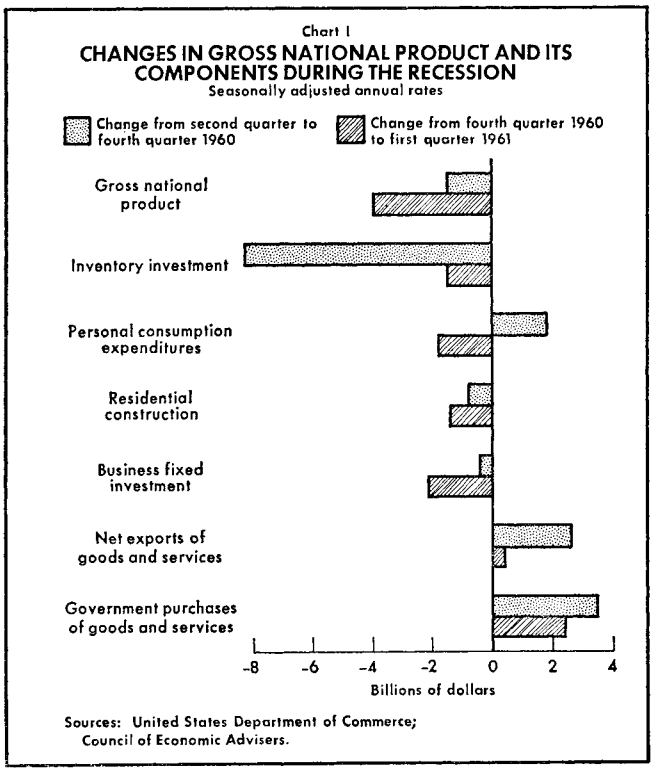
While the evidence pointing to an end of the contraction is substantial, it will take some time before a more conclusive appraisal of the prospects of recovery becomes possible. There are as yet no signs that the recovery will be vigorous, but the expansion could nonetheless start out with an initially strong upward thrust since a shift away from rapid inventory liquidation might give the economy a marked boost. This in itself, however, is not likely to provide more than a temporary push to aggregate activity and might indeed convey a misleading impression of the rate of advance that the economy will achieve over a somewhat longer period. Even an expansion in total output matching the improvement registered in the strongest postwar recovery period would in all likelihood leave unemployment higher than in the previous recoveries because of the large number of persons expected to enter the labor force. Should there be a noticeable step-up in productivity as a result of technological advances, better utilization of existing capacity with rising output, and other factors, the more immediate task of generating a satisfactory volume of new job opportunities would loom still larger, even though the longer term prospects for the economy's advance would be strengthened.

RECENT DEVELOPMENTS

During the first quarter of 1961, the nation's aggregate output of goods and services slipped by $4.0 billion (seasonally adjusted annual rate) from the level of the preceding quarter to $499.5 billion, according to preliminary estimates by the Council of Economic Advisers. The total decline in gross national product since the spring 1960 peak of $505 billion has amounted to an estimated $5.5 billion, or only 1 per cent. In contrast, the full GNP decline in the 1957-58 recession amounted to 3½ per cent, in 1953-54 to 2½ per cent, and in 1948-49 to 3½ per cent. Thus, if the first quarter proves to have been the low point of the current recession—and if the Council's estimates are confirmed by later data—the GNP decline this time will have been smaller than that recorded in any of the three previous postwar recessions.

Final demand in the current recession apparently has held up considerably better than in other recent periods of cyclical decline; by contrast, the reduction in inventory investment has been more pronounced. During the first two quarters of the recession, expanding final demand nearly offset the contractionary impact on GNP of the switch from rapid accumulation to heavy liquidation of business inventories (see Chart I). In the January-March quarter of 1961, however, final demand declined, thus adding to the downward pull on economic activity stemming from an accelerated rate of inventory liquidation. Not only did residential construction and business fixed investment continue to drop—and at a faster pace than in the earlier period—but personal consumption, which had risen in late 1960, also slipped. Net exports advanced less than in prior months. Government spending for goods and on wages and salaries, on the other hand, expanded even more than in each of the two preceding quarters as the Administration sought to bolster business activity by speeding up already authorized programs, especially those for defense and for highway construction.

Although net inventory liquidation in the first quarter of 1961 was larger than in the preceding quarter, the pattern of inventory change shifted in an encouraging direction. Cutbacks in stocks, previously entirely at the manufacturing level, were largely at the retail level. Moreover, the reductions in manufacturers' stocks were very small and were spread rather evenly over all levels of fabrication. This suggested that manufacturers in general did not feel that their stocks were excessive, and that in some cases rising demand could be satisfied only from inventories. A major part of the retail liquidation prob-



ably centered in automobile dealers' inventories, which were unusually burdensome at the turn of the year; by the end of March, lower output and higher sales had reduced auto inventories to a more acceptable level. Stocks were cut and sales expanded in late winter in other fields, too, with inventory-sales ratios falling accordingly. The way was thus paved for some increase in orders in various industries where new orders had been moving downward. This was already evident in the orders received by manufacturers in February (when the gains were, however, heavily boosted by a rise in the flow of defense contracts), and there was an even greater improvement in March.

Reflecting the rising flow of orders, the Federal Reserve Board's index of industrial production, which had been falling almost without a break since last May, rose in March by ½ point, seasonally adjusted. (On a rounded basis, the index remained level at 102 for the third consecutive month.) Most of the gain was in nondurable goods, but output also rose in some durable goods industries (mainly steel, furniture, and household appliances). During April steel output again rose, contraseasonally, and the rate of auto assemblies also increased, even though there usually is a decline in that month.

Construction activity, too, has shown a gain, rising in March for the first time in three months on a seasonally adjusted basis and falling back only slightly in April. Spending for private business buildings and for public construction was down over the two months as a whole, and most of the improvement in total expenditures derived from an increase in each month in private residential outlays. In March, private nonfarm housing starts also moved up, by a sizable 10 per cent (seasonally adjusted), suggesting some further advance in residential outlays in the months ahead. Part of the advance reflected the much improved weather, but it is nonetheless encouraging that starts have now risen three months in a row. The number of requests for Government-backed financing, however, remained relatively low, and rental vacancies during the first quarter rose to a new post-World War II high. Thus, it is still uncertain whether the recent easing of mortgage terms and increased availability of credit for the housing sector are in fact beginning to elicit a significant response in home-building activity. Allowance must, of course, be made for the usual lag in response.

Primarily because of the lift from some sectors of construction, total employment as measured by the household survey rose more than seasonally in March, the third increase in as many months. In April, employment slipped to slightly below the January figure, but this resulted entirely from a contraseasonal decline in agricultural employment. The March payroll survey of nonfarm workers also turned up slightly, following a drop in February to the lowest figure in two years. Along with the increased hiring of construction workers, there were small gains in the number of workers on State and local government payrolls and on those of financial enterprises. Employment slipped in all other sectors covered by the survey. The decrease in the manufacturing sector was, however, the smallest of any during the past six months. In addition, factory employees worked more hours per week for the third consecutive month, a development that usually foreshadows an increase in hirings.

Personal income (seasonally adjusted), which had been falling for four months, jumped sharply in March to slightly above last October's peak. About half of the February-to-March gain was traceable to earlier-than-usual payments of 1961 dividends on veterans' life insurance. Normally, payments are spread fairly evenly over the year; the advance payments this year were a contracyclical measure to get purchasing power more rapidly into the hands of the public. The remainder of the March income rise came principally from wages and salaries, which increased for the first time since last July, with construction payrolls the chief source of the improvement.

March also witnessed an increase in retail sales of 1 per cent, seasonally adjusted, following a smaller rise during the

previous month. Sales advanced in many fields, but the largest increases were recorded in apparel and in new and used autos. Sales of new autos, which have much significance for near-term employment and income, and which were maintained throughout March at the sharply higher levels (allowing for seasonal increases) achieved during the second half of February, held the gain in early April. Sales of consumer goods at department stores during the early part of April made an even better showing, rising more than seasonally from March.

Despite such economic gains, unemployment continues to be high. The proportion of the labor force out of work remained, after allowance for seasonal factors, virtually unchanged during December-April at about 6.8 per cent. This reflects in part the fact that the labor force has been growing at a relatively rapid rate. The labor market has been receiving the first waves of young people born during the wartime baby boom; in addition, many women whose husbands became unemployed during the past year apparently entered the market. The problem of providing work for the currently unemployed and the new jobseekers is likely to be compounded by an increase in productivity. In 1960, the gain in output per worker in the private sector amounted to only 1¼ per cent, comparing poorly even with the recession years 1953 and 1957. If the cyclical patterns of the fifties are repeated, however, productivity can be expected to rise sharply within the first twelve months after recovery has started.

BUSINESS DATA AT THE TURN

In the past, there have been very rapid revivals following a recession as well as slow revivals. In 1958, for example, a sharp contraction in economic activity ended in an unusually quick turnaround, producing the so-called V-shaped recession and recovery. But more common is the U-shaped pattern that characterized 1954 and 1949 when the economy followed a sideway course for a while before an upward climb began.

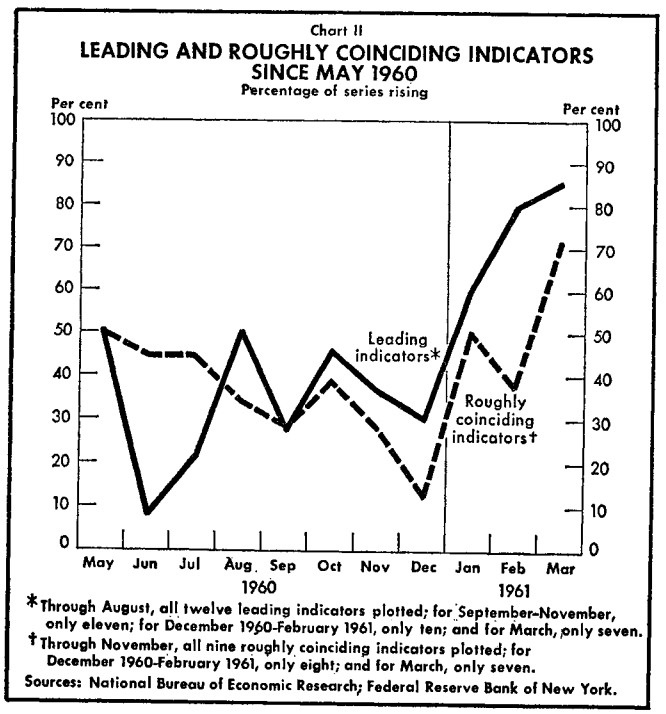
How can a lower turning point be clearly recognized when it does arrive? Analysts have long been intrigued with the possibility that a turning point can be identified —and perhaps even anticipated—by a close study of certain key indicators of economic activity. The National Bureau of Economic Research, after many years of careful exploration, has recently focused attention on twelve economic series that commonly have led a turn in general business activity. Another nine series have been found to coincide with the turn, at least roughly. But, as the National Bureau is quick to point out, there is of course no single series or set of series that can signal in advance precisely when a recession will end and a recovery will begin. Sometimes a series may turn up as much as a year, or more, ahead of the general cyclical turn. At other times, the same "leading" series may actually lag behind the cyclical turning point. For example, of the National Bureau's twelve "leading" series, four have failed to lead in about a third of the turns examined by the Bureau, and eight have actually lagged at one time or another. Similarly, less than half of the series labeled as "roughly coinciding" have in fact coincided, even roughly, with the cyclical trough as much as 75 per cent of the time. The pitfalls of a purely mechanical use of statistical series for predicting a cyclical upturn are illustrated by the behavior of the twelve leading indicators during the last three recessions. The number of leading indicators moving upward just prior to the end of each recession was different in each case, and in the trough month of each of the recessions there was actually a temporary, misleading dip in the number of series expanding.

The recent development of other new sets of business indicators by the National Bureau and other organizations will provide better tools for a systematic appraisal of the state of the economy. These new tools include so-called "diffusion indexes" which present a cross-sectional view of more aggregative series to reveal how many of the components are moving up or down at a given time, as well as summary series showing how many of the significant indicators have reached new highs or lows during the month. But, while these new guides can help in business analysis, they cannot yield precise pinpointing of cyclical turning points. It is unlikely that quantitative measures will ever fully replace qualitative analysis.

Efforts to foresee a cyclical turnaround are made all the more difficult by delays in the reporting of current information. Most of the monthly series are available only three or more weeks after the end of the month. Very few data are available weekly, and these are limited in coverage and often quite erratic. Even some of the monthly series are so volatile that figures for two or more months have to be averaged to be of any use, thus in effect further delaying their availability. Other data that are frequently leaders at cyclical turns are available only quarterly and usually with a considerable delay. Hence many of the series that historically are good indicators of an upturn are never available until after the turn. As of the end of April, for instance, the published statistics covering the month of March included only seven of the twelve indicators comprising the National Bureau's leading group.

The most recent business data, including the National Bureau's "leading" and "roughly coinciding" indicators, do point to an end of the recession. Chart II summarizes the behavior of these latter two sets of data since May 1960, the month tentatively chosen by the Bureau as marking the last cyclical peak. Using the Bureau's method, each of the twelve leading series that has moved upward during a particular month is counted as one twelfth of the total of 100 per cent, or 8⅓ per cent, while each sidewise-moving series is accorded one half of this weight. Similarly, each of the nine roughly coinciding series is counted as one ninth of the total, or 11⅑ per cent, and each sidewise-moving series as one half of this amount. When fewer data are available for a particular month, the total is apportioned accordingly. Whenever a line passes above 50 per cent, it indicates that a majority of the series are moving up. This has been the situation with the leading series since January and was true for the coinciding series in March.

Many observers expect substantial support for the economy from an early renewal of inventory accumulation, stimulated by higher sales and increased production. This support may well be of limited duration, however. In many fields inventory-sales ratios remain comparatively high, and the National Association of Purchasing Agents reports that its March survey showed continuing widespread resistance to inventory increases. Nor does there seem to be any general expectation of rising materials prices that could cause a prolonged surge of inventory investment; this partly reflects an anticipation of continued foreign competition as well as of increasing domestic competition arising out of recent technological developments.



Business outlays for plant and equipment are probably continuing downward in the current quarter. However, the trend may well prove to be more favorable for the year than originally anticipated. A National Industrial Conference Board survey has indicated that capital appropriations by business rose between the third and fourth quarters of 1960. It is thus possible that there will be a turnaround in expenditures before the middle of 1961. According to a recent McGraw-Hill survey of spending plans, moreover, businessmen have raised their spending plans since the winter and now intend to lay out only 1 per cent less during the current year than they did in 1960. This would appear to imply a significant increase in fixed capital outlays during the latter half of the year.

Foreign trade has been a strong force throughout the recession, but it is not clear whether it will continue to be such in the coming months. In a recovery period, imports are likely to increase. Exports will then have to expand more than commensurately to provide a further push to the economy; the prospects, of course, depend in large part on business developments in Europe and elsewhere.

It would appear that, if the economy does gain strong momentum during the year from forces other than an initial inventory spurt, the principal contributory factors are likely to be government and consumer spending. Federal Government outlays may well advance at a higher rate than in the first quarter. This is indicated by the recent increases in appropriations and contract awards, as well as by the enactment of various new programs proposed by the Administration. State and local expenditures can also be expected to continue to rise, as they have almost without interruption for several years. It is as yet by no means clear, however, that total government spending will exert more than a moderate push on the economy.

Consumer outlays could well be the most significant force in the upturn. The decline in such outlays in the past quarter was limited to purchases of durables, and the small increase in the demand for durables in March may be furthered by the recent rise in employment and personal income and by a consequent greater optimism about future prospects. Since personal savings during these last three quarters have been relatively high, it would seem that total personal expenditures could be easily increased if there were a will to spend more. The recent decline in instalment debt suggests, moreover, that some

individuals are now in a somewhat better position to bolster their buying by additional recourse to consumer credit. The relative stability in consumer prices during the last year may also prove to be a factor encouraging demand. Indeed, avoidance of price increases may be crucial for the achievement of sustained expansion in consumer buying.

Financing Economic Development in Puerto Rico

A greatly enhanced role for Puerto Rico in United States-Latin American relations was envisaged at President Kennedy's meeting with Governor Muñoz Marin last January, when the two leaders agreed on increased use of the Commonwealth as a "meeting place and workshop" for this country and its neighbors south of the border. Puerto Rico's qualifications for such a role derive in large part from its extraordinary economic progress over the past decade. Last year, at a time when economic growth remained slow in many Latin American countries, Puerto Rico's gross product expanded by a record 9.4 per cent and per capita personal income rose to $571, nearly double the 1950 level and higher than in any Latin American country except Venezuela.[1] Of course, Puerto Rico is a very special case among underdeveloped countries because of its unique position within the United States political and economic system, a position that has been especially significant for the extent to which it has enabled the Commonwealth to tap the mainland capital market.[2] The share of mainland capital in financing Puerto Rico's economic development has increased significantly, rising from about 35 per cent in 1950 to 50-60 per cent in recent years, far more than the share of United States capital in the development of any of the twenty Latin American republics.

Nevertheless, the financing of Puerto Rico's economic development also owes much to the vigorous efforts of the island's government and financial institutions both in exploiting their access to mainland capital and in mobilizing local savings. An article last year in this Bank's *Monthly Review* showed how Puerto Rico has worked through "Operation Bootstrap" to make optimum use of its tax and other attractions for industry.[3] Similarly, although the fact that Puerto Rican public bonds are tax exempt in the United States has been a big help, the sound management of the Commonwealth's public finances and its efforts to develop a market for its public securities on the mainland have also contributed much to making the sale of such bonds an important source of United States capital in recent years. And while Federal Housing Administration insurance has been the key to the sale of Puerto Rican mortgages on the mainland, the Puerto Rican banking system has played an important role in developing this market, and also in bringing in funds from mainland head offices and correspondents. Moreover, the preponderant role of mainland capital should not be allowed to detract from the importance of the steadily increasing volume of savings by government and business in Puerto Rico. The growth of personal savings is attested to by the rapid increases in insurance-company and pension-fund reserves, in savings and loan accounts, and especially in time and savings deposits in the commercial banks. Nevertheless, personal debt has also risen rapidly and, while estimates differ, net personal savings appear at best to have been relatively small.

GROWTH AND STRUCTURE OF THE BANKING SYSTEM

The Puerto Rican banking system has unquestionably made an outstanding record in increasing its resources and putting them to work, and in so doing it has contributed importantly to the island's economic progress. Indeed, a recent study of banking in Puerto Rico, prepared under official auspices by Dr. John S. deBeers, shows that the banking system has grown more rapidly than the rest of the economy and that it is already relatively highly developed.[4] Nevertheless, as the deBeers study also points out, credit is very tight in Puerto Rico, and business needs for bank financing appear generally to be less well filled than on the mainland. Rapid expansion and intensive use

[1] Puerto Rican economic and financial statistics are reported for the fiscal year ending June 30. Except where otherwise noted, all annual data given in this article are for the fiscal year.

[2] "Mainland" as here used refers to the continental United States.

[3] "Private Investment and the Industrialization of Puerto Rico", *Monthly Review*, April 1960, p. 68.

[4] J. S. deBeers, *A Study of Puerto Rico's Banking System*, prepared for the Finance Council of Puerto Rico, February 1960.

were "cooperating closely in the exchange markets". Commenting on this cooperation at the end of April, the president of the German central bank, which has been a major participant in these cooperative arrangements, affirmed that "speculation could not succeed against closely cooperating central banks".

In addition, the Netherlands recently made prepayments of $40 million on its postwar debt to the United States, and Germany (as previously noted) has made substantial advance repayment of obligations falling due in future years. At the end of April, some $189 million equivalent was repaid to Britain out of sterling balances of the German central bank and, on April 28, $587 million was transferred to the United States. Part of the latter payment was in Deutsche marks, thereby providing the United States authorities with resources with which to counter any possible future speculation.

Such cooperative measures to help strengthen individual countries' reserves can of course be buttressed by the machinery of international financial cooperation already existing in the IMF. As the currencies of continental Western Europe have increased in strength, the need for making these currencies available to help assure a smoothly operating international payments system has risen correspondingly. The IMF has therefore been exploring the possibility of using its authority under Article VII of its charter to increase its resources by borrowing. In particular, the IMF, according to its managing director, Per Jacobsson, is considering the advisability of establishing:

> a network of stand-by arrangements with the main industrial countries, under which the Fund will be able to use increased amounts of their currencies whenever the need for such use would arise as part of a Fund operation. Our aim is to look beyond immediate needs and to seek to equip the Fund to be able to handle flexibly the many and varied situations that may arise under a system of freely convertible currencies.[2]

[2] From Mr. Jacobsson's report to the thirty-first session of the Economic and Social Council of the United Nations, April 20, 1961.

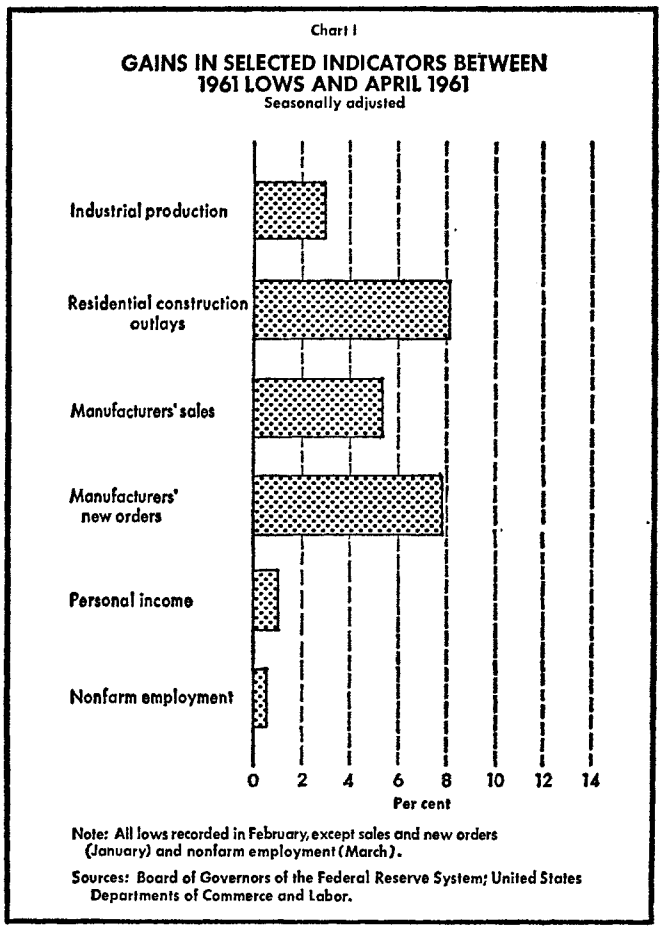
THE CHALLENGE OF GOLD AND THE DOLLAR

This Bank has recently published an illustrated booklet — intended for the interested layman — entitled *The Challenge of Gold and the Dollar*. Written by Paul Meek, Manager of the Public Information Department, the booklet presents the basic features of the present international financial position of the United States and discusses the factors behind the large United States balance-of-payments deficits in 1958-60. Copies are available in limited quantities, without charge, from the Publications Section, Federal Reserve Bank of New York, New York 45, N. Y.

The Business Situation

Signs that the economy is now moving upward continue to multiply, while at the same time the over-all price stability of recent months has continued. Substantial gains have been recorded by many important business indicators, including industrial production, residential construction outlays, sales by manufacturers, and new orders received by them (see Chart I). Personal income has also risen, as has nonfarm employment. Retail sales, on the other hand, have been somewhat disappointing, and neither the Federal Reserve Board's April survey of consumer buying intentions nor the National Industrial Conference Board's March-April survey gives any particular indication of a strong surge in consumer demand. Government spending has continued upward, however, and, in line with the President's proposals in his special message to Congress, may soon be stepped up even more than previously expected. Business spending on plant and equipment is also scheduled to rise, with prospects for higher levels of Government spending apparently an important factor in business expectations. These developments in the Government and business sectors should lead to more substantial gains in personal income than have occurred until now, and thus help to stimulate consumer buying.

Despite encouraging developments in several areas, it is still too early to tell whether the expansion will prove more vigorous than that following the 1957-58 recession. The importance of this question is obvious, particularly in view of the fact that the unemployment rate has not declined even though employment has expanded.



OUTPUT, ORDERS, AND INVENTORIES

One of the most important indications of improvement in business conditions in April was the seasonally adjusted rise of three points in the industrial production index. This brought the index to 105 per cent of the 1957 average, the highest level since last October, and erased approximately one third of the recession decline. While April increases in production were quite general, the largest rise was in the durables sector, with particularly large advances being posted by the steel and auto industries. In May, steel production continued to rise more than seasonally and output was higher than at any time since May 1960. An easing in steel operations is usually expected during the summer months, but some industry spokesmen believe the decline this year may prove smaller than usual. Auto production in May also showed greater-than-seasonal strength. In view of the gains in autos and steel, it appears likely that the production index as a whole moved up again in May.

The April increase in the production index was paralleled by a gain of 3 per cent (seasonally adjusted) in new orders received by manufacturers and brought a slight increase in manufacturers' inventories. Orders, which began to rise in February, have now reached their highest level since December 1959. The April advance was centered in durables, particularly in the auto and steel industries (with orders in the auto industry actually representing deliveries made to dealers in that month). Increases in defense orders for durables were also substantial. Machine tool orders, on the other hand, fell sharply in April, but the significance of this decline is hard to assess because of the erratic nature of this series. While manufacturers' inventories fell again in the durables sector, the decline was small, and in the nondurables sector inventories were accumulated at a somewhat faster pace than in preceding months. Total business inventories, including trade as well as manufacturing stocks, rose slightly in April after nine months of declines.

TRENDS IN FINAL DEMAND

In contrast to the marked improvement at the manufacturing level, consumer outlays in April showed moderate weakness. Retail sales of both durable and nondurable goods (seasonally adjusted) declined, wiping out two thirds of the total March increase. In May, auto sales appear to have shown a significant gain over April, but department stores sold less in May than in the preceding month, even after allowing for seasonal influences.

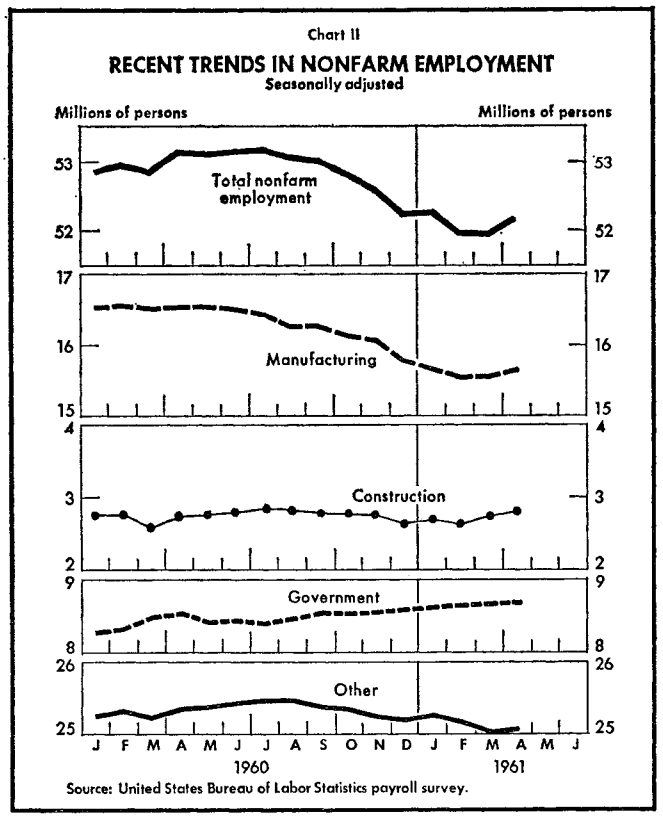
Personal income, which is one of the major determinants of consumer spending, rose again in April. The increase was larger than the March gain, if allowance is made for the concentration of payments in March of veterans' 1961 insurance dividends, and was mainly in wages and salaries. If the current upward movement in personal income continues, it is sooner or later bound to result in higher retail sales. But a really strong increase in consumer demand must await a rise in the share of their income that people are willing to spend; this share has been relatively low since the middle of last year.

Prospects for the capital goods sector continue to be favorable. As reported last month, the McGraw-Hill April survey of businessmen's spending intentions indicated planned outlays for 1961 at only 1 per cent below 1960 outlays. This suggests a higher level of outlays during the second half of 1961 than in the first half. Additional support for the view that a turnabout in plant and equipment outlays is in the making has come from an April McGraw-Hill survey of machinery manufacturers, which indicated that the respondents were anticipating a steady increase

in new orders (seasonally adjusted) during the last three quarters of 1961, with fourth-quarter orders running 9 per cent above orders in the first quarter.

While recent reports on business plans point to a prospective expansion in fixed capital spending, current outlays still tend to reflect plans made several months earlier —a fact that may explain the continued decline in May (2 per cent, seasonally adjusted) of outlays on commercial and industrial construction. This reduction was nearly offset, however, by increases in other types of private nonresidential construction, so that total private nonresidential outlays declined only very slightly. Government construction outlays rose in May after a rather sharp contraction in April, owing primarily to a rebound in highway construction. In mid-May the Federal Government released $818 million of highway funds originally scheduled for allocation to the States during the summer, and this may lead to further expansion in highway outlays.

Residential construction outlays (seasonally adjusted) were up in May for the third straight month. While the total rise since the low in February has amounted to over 10 per cent, the industry is still depressed relative to 1959 and 1960. Residential contract awards and private nonfarm housing starts, which tend to lead fluctuations in outlays, were both weak in April. The small rise in contract awards for that month appears to have been below seasonal expectations, and housing starts declined moderately after seasonal adjustment, following three successive rises. At least some part of the March-to-April decline in starts, however, was attributable to the smaller number of working days in the latter month.



EMPLOYMENT AND PRICES

In April, the payroll survey of nonfarm employment showed its first significant gain, seasonally adjusted, in a year (see Chart II). Most of the advance represented nearly equal increments to manufacturing and construction payrolls. The addition of 81,000 workers to manufacturing payrolls in April was especially encouraging, since the manufacturing sector has been the most important source of weakness in over-all employment during the recession. The government sector is the only major area of nonfarm employment that has shown steady increases in the past six months. All of this gain has been in the State and local field. According to Census Bureau data, nonfarm employment advanced further in May. On the other hand, the improved pace of business activity has as yet had little effect on unemployment. The seasonally adjusted level of unemployment in May, even though slightly below the March high, actually showed a small rise over the April total, and the May unemployment rate of 6.9 per cent was equal to the highest levels reached in the 1960-61 recession. The unemployment rate has been fluctuating within a narrow range, just under the 7 per cent mark, for the past six months.

Prices at both retail and wholesale levels have shown considerable stability in recent months. The consumer price index in April was unchanged from its December level of 127.5 per cent of the 1947-49 average. This reflected offsetting movements in the prices of services, which continued to creep upward, and in the prices of goods, which moved slightly downward. While a decline in food prices appears to have been largely seasonal, declines in other nondurable goods and in durable goods indicate softness in demand for some products. As for wholesale prices, the index of all commodities actually fell a little over the December-April period, owing primarily to decreases in the farm and processed foods components. Prices of producers' and consumers' finished industrial goods, however, also showed declines, and the only substantial increase for any major component of the wholesale price index was registered by the industrial raw materials group, a cyclically sensitive component.

tion on March 6, until late in the period, when there appeared to be a growing conviction that further revaluation was not in prospect and when certain technical conditions, arising out of official operations in the forward exchange market, led to some searching in the market for dollars.[5]

Sterling, which had remained relatively firm during 1960, dropped to $2.7929 in the wake of the March revaluations, but recovered with the central bankers' March 12 declaration of mutual support. Subsequently, however, the rate again gradually drifted lower, reaching $2.7868 in early June, as Britain's trade returns proved somewhat disappointing. That sterling will be vigorously defended at its current parity has been made abundantly clear by the British authorities, who have stated that there will be no delay in mobilizing, as required, all available resources, including Britain's large drawing rights at the IMF. As regards forward sterling, the market was generally quiet despite a rather wide range in the discounts for three and six months' deliveries during the period. Quoted early in February at discounts of about 0.8 per cent and 0.6 per cent for three and six months, respectively, the discounts gradually widened to about 3.5 per cent and 2.9 per cent at the end of June.

The quotation for the Canadian dollar remained quite steady through the first five months of 1961, ranging from U.S.$1.00 21/64 to U.S.$1.01 25/32. In mid-June, however, the rate dropped to under U.S.$1.00, for the first time since December 1955, as the government publicly called for the resignation of the governor of the Bank of Canada in a policy conflict. Subsequently, the rate broke sharply to about U.S.$0.97—the lowest quotation since November 1951—in an uneasy and sometimes erratic market following the June 20 Canadian budget message in which the Minister of Finance stated the intention of the government to bring the Canadian dollar to a discount vis-à-vis the United States dollar. This exchange rate policy, it was stated, is designed to improve Canada's trade balance and to reduce Canadian borrowing in the United States.

As regards other currencies, the Japanese yen came under some pressure and tended to weaken with Japan's continued heavy trade deficits and the accompanying reduced short-term capital inflows. South Africa, on February 14, replaced the pound with the rand (equal to U.S.$1.40, or one half the value of the former pound) as its basic currency unit. In the market, the exchange value of the South African currency has continued to weaken, mainly owing to persistent outflows of capital from that country. Many primary-producing countries, including Brazil, Venezuela, Ecuador, Indonesia, and South Korea, took important steps during the past six months toward more realistic exchange values for their currencies or toward simplification of their exchange rate structures, or both.

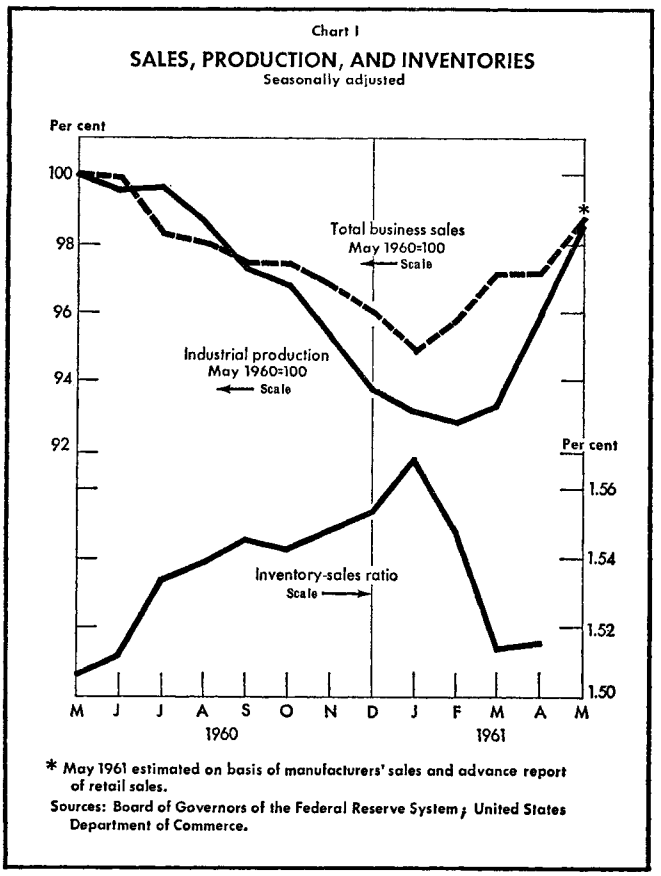
[5] See "The German and Dutch Revaluations" in the *Monthly Review* for April 1961, pp. 62-4.

The Business Situation

The recovery in economic activity continues to be evident in a wide range of current indicators. Industrial production, in particular, scored sharp gains in April and May, responding to the significant impetus from a cessation of inventory liquidation—and possibly some incipient inventory rebuilding—as well as to gains in final demand. At the same time, scattered reports of price shadings for several types of industrial materials reflect in the main competitive pressures in an economy with ample capacity and subject to price competition from foreign suppliers. Seasonal factors, moreover, are causing some slackening in steel output which is likely to continue and to be paralleled in other major industries during the summer months; output in the automobile industry, in particular, will be affected by an early model change-over. These seasonal influences may, but need not, affect business sentiment and expectations and should not interfere with further solid expansion in over-all activity so long as prospects for growth in final demand remain favorable. At the present time, it is virtually certain that Government spending will continue to exert an important upward thrust; there has been further confirmation of an imminent, but moderate, expansion in capital spending; and consumer outlays appear to be making some new gains, although no real buoyancy has yet appeared.

INVENTORIES AND PRODUCTION

Investment in inventories was about unchanged in April and May after having moved generally downward for more than a year. Although businessmen had been cutting stocks



continuously during the seven months ended in January, sales had fallen even more rapidly, causing a rise in the inventory-sales ratio. In February and March an upturn in sales and continued inventory liquidation combined to push the stock-sales ratio down; by the end of the first quarter, it had reached the lowest level since last June. The slight upturn in inventories and the further decline in the inventory-sales ratio in April and May suggest that stocks are approaching a better relationship to current and expected sales. Trade sources report that businessmen now intend to hold the inventory-sales ratio near its present level or to allow it to fall slightly further as sales move up.

As the downward push from inventory liquidation abated in the second quarter, industrial production expanded more strongly than total business sales (see Chart I) after having declined more rapidly during most of the recession. In May, the industrial production index (seasonally adjusted) scored a second consecutive monthly gain of almost 3 per cent, as output of consumer goods, business equipment, and materials all increased. Iron and steel led the advance, rising by more than 10 per cent in response to improved demand from metal-using industries. New orders received in May by manufacturers of durable goods rose by 3 per cent, suggesting that activity in metal-using industries may continue to expand on a seasonally adjusted basis. Steel ingot production, however, appears to have declined slightly more than normally in June, and may fall off about seasonally during the summer as the auto industry cuts back assemblies in preparation for the introduction of new models.

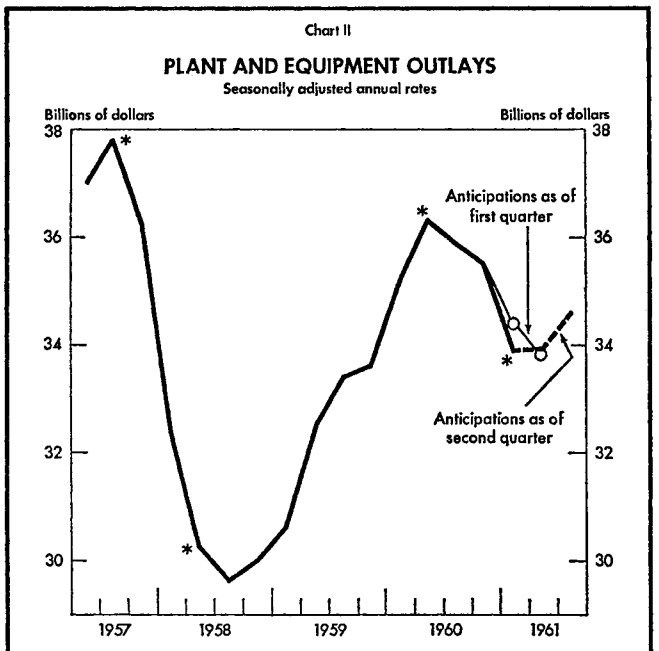
While industrial production rose approximately 6 per cent from the low point in February, manufacturing employment has registered an increase of only 2 per cent. Three quarters of this rise occurred in May, and helped to push up total payroll employment (seasonally adjusted) by 200,000 persons to 52.7 million, according to the mid-month survey of the Bureau of Labor Statistics. The smaller increase in manufacturing employment relative to output reflects the continued lengthening of the average workweek and the expansion in productivity which usually occur in the early phase of a cyclical recovery. A similar pattern held in construction, where employment actually moved downward despite a 1 per cent rise in outlays. Other types of nonagricultural employment, however, showed at least small gains in May. According to more recent information from the Census Bureau, total nonagricultural employment rose $7/10$ of 1 per cent in June after seasonal adjustment. The seasonally adjusted unemployment rate, on the other hand, changed imperceptibly from 6.9 to 6.8 per cent, staying in the narrow range within which it has moved since the beginning of the year.

FINAL DEMAND AND CAPITAL SPENDING

A key determinant of the pace of economic recovery in the months ahead will be the volume of spending for fixed investment. The second-quarter survey of plant and equipment outlays, taken by the Commerce Department and Securities and Exchange Commission, shows that business firms plan a gradual increase in such spending in the second half of this year (see Chart II). Actual outlays of $33.9 billion (seasonally adjusted annual rate) in the first quarter were $1.7 billion below the preceding quarter, constituting a sharper drop in spending than had previously been estimated. Plans for the second quarter, however, call for outlays to remain at about the first-quarter rate, and planned outlays of $34.6 billion for the third quarter mark the beginning of the upturn in spending. The estimated annual rate of spending indicates a continued advance in the final quarter of the year.

If the most recent plans are realized, the performance of the capital goods sector will compare very favorably with the experience in the 1957-58 recession and recovery. At that time, capital spending continued to fall for one

quarter following the trough in general business and the total decline was more than three times as large as in the recent recession. The expansion of outlays in the three quarters following the 1958 trough was less than one fourth of the expansion anticipated in the corresponding period of this recovery.



Total new construction activity, which has been rising at a modest pace since February, increased by another 1½ per cent (seasonally adjusted) in June. Private residential building continued to spark the expansion in construction, but the behavior of several leading indicators, particularly housing starts, suggests that the rate of advance in this sector may prove to be somewhat slower in the months ahead. Private business construction outlays continued to move slightly downward, while public construction outlays rose in June for the second consecutive month.

Recent improvements in consumer spending have remained rather moderate despite a continuous expansion in personal income since February. Retail sales, which had dipped disappointingly in April, moved up in May by 1.2 per cent, seasonally adjusted, but were still slightly short of the March rate. Most of the increase was in sales of durable goods, particularly automobiles, which had accounted for most of the April decline. The daily average rate of deliveries of new cars in May spurted by much more than the usual seasonal rise. New car sales appear to have leveled off or even declined slightly in June, but some contraseasonal strengthening in department store sales may indicate expanded buying of other consumer goods.

The Money Market in June

The money market was easy over most of June. Although the effective rate on Federal funds generally ranged between 1½ and 2¾ per cent, some trading was occasionally reported at rates as low as ¼ per cent. Similarly, while rates on loans to Government securities dealers generally fluctuated between 1¾ and 3 per cent, they were at times posted as low as 1 per cent.

Prices in the market for Treasury notes and bonds declined rather sharply early in the month, in part reflecting market uncertainty regarding future rate movements. A depressing influence was also exerted by the upward adjustment of yields in the corporate and tax-exempt bond markets which resulted from a large volume of new corporate and municipal issues at a time when a considerable backlog of unsold bonds had accumulated in dealer inventories. As the month progressed, the market for intermediate- and long-term Government securities stabilized somewhat, although prices continued to drift irregularly downward in very light trading. Treasury bill rates rose perceptibly early in the month, but subsequently declined and, except for a temporary dip in the latter part of the month, remained generally steady throughout the balance of the period.

MEMBER BANK RESERVES

Free reserves averaged $517 million for the four statement weeks ended June 28, an increase over the $453 million average for the five weeks in May. Average excess reserves rose to $581 million from $544 million, while average borrowings from the Federal Reserve Banks declined to $64 million from $91 million.

Operating factors as a whole released $223 million of reserves over the four weeks, as a larger-than-usual expansion in average float was well in excess of the net absorption of reserves through movements in other operating factors. The net gain from operating factors, however,

The Business Situation

Evidence is now accumulating that the recovery of the economy in the second quarter was even stronger than had been generally assumed and that gains continue to be widely diffused. At the same time, there was some slackening in the rate of advance in June and probably July, on top of the usual seasonal influences. Moreover, a substantial gap still remains between total demands and available resources. While the shift from inventory liquidation in the first quarter to net accumulation in the second quarter has been considerable, much of it appears to have reflected developments in the automotive sector. There are no indications of any abrupt changes in inventory policies generally.

The President's speech of July 25 and his request for a sharp step-up in military and civil defense spending have, of course, injected a major new element into the business outlook. The proposed $3.5 billion increase in the defense budget will undoubtedly be a strong expansionary influence. It is as yet difficult to determine, however, to what extent it will speed the return to full utilization of the economy's resources or at what point it might, together with the recovery forces already under way, begin to exert a definite upward pressure on prices. In contrast to previous defense build-ups that involved production of weapons with very long lead-times and in some cases requiring new facilities, the measures now contemplated will probably be rather quickly translated into actual expenditures, since they center heavily on expansion of military manpower and increases in the output of conventional types of armaments. By the same token, however, the secondary impact of the current program may prove less pronounced. With capacity still ample, deliveries prompt, and prices relatively stable, the demands arising from the added spending need not by themselves cause a marked revision in business inventory policies or a marked expansion of facilities. The full effect of the new appropriations will depend also on their over-all impact on business and consumer expectations. These expectations will, of course, be influenced by subsequent developments on the international scene which, as the past teaches, are not predictable.

THE PACE OF RECOVERY

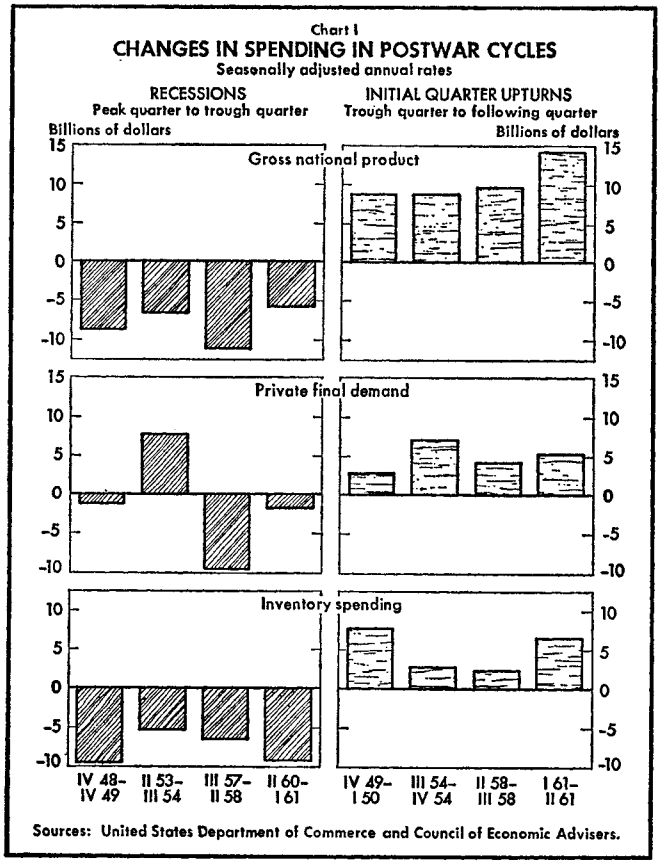
According to preliminary estimates by the Council of Economic Advisers, gross national product rose to $515 billion in the second quarter, at a seasonally adjusted annual rate. This was an increase of $14.2 billion over the recession low reached in the first quarter, and a larger absolute rise than during any initial quarter of general recovery in the postwar period (Chart I). Close to one half of the gain, or $6.5 billion, was attributable to the inventory sector: whereas in the first quarter of 1961 businessmen had on balance reduced their stocks at an adjusted annual rate of $4.0 billion, they expanded their inventories by $2.5 billion in the second quarter.

The vigor of the recovery revealed by these data has certainly been impressive. It is particularly significant that all of the main segments of domestic demand have participated in the expansion (Chart II). In the comparable periods of the two previous recoveries, at least one important component of domestic demand was still declining.

At the same time, in the comparison with previous postwar recoveries the recent gains should not be exaggerated. In percentage terms, the current GNP upswing of about 3 per cent was somewhat below the initial-quarter recovery in 1949 and only slightly better than in 1954 and 1958. Various monthly data similarly show that the current recovery rate has been pretty much in line with those experienced during the early stages of the other postwar cyclical upturns.

The relative vigor of the current upswing would also be overstated if one were to compare the recent GNP upturn with the initial quarter of upturn in GNP in the previous two cycles. The current upturn happened to coincide with a full quarter of recovery in the broadest sense, as manifested by trends in production, employment, and a wide range of other indicators. In the previous two cycles, by contrast, the initial GNP upturn came earlier, coinciding with the trough of the cycle, and was thus dampened by the tail end of the recession. The more relevant comparison is with the GNP upswing in the initial quarter of general recovery, as is done in Chart I.

In June, the rate of increase in industrial production fell somewhat short of the pace recorded in April and May. The Federal Reserve's seasonally adjusted index rose by two points during the month, reaching a level only one point below the previous high of 111 per cent of the 1957 average attained in January 1960. Manufacturers' sales also advanced by a smaller percentage than in the previous four months. The expansion in total nonagricul-



tural employment, on the other hand, was the largest monthly gain in the current recovery. According to the payroll survey, seasonally adjusted nonagricultural employment increased by 300,000 persons during June. However, it edged off slightly in early July, on the basis of the household survey conducted by the Census Bureau, while total unemployment and the unemployment rate (both seasonally adjusted) were virtually unchanged.

BUSINESS SPENDING

The shift from net inventory liquidation in the first quarter to net build-up in the second quarter does not necessarily indicate an abrupt change in business policy. Examination of the more detailed inventory statistics suggests that a good part of the shift in the GNP inventory component occurred in retail stocks of automobiles and automotive accessories. Whereas such stocks were being reduced quite markedly during the first quarter, in the second quarter they were increased sharply on a seasonally adjusted basis. In part, this reflected a more optimistic appraisal of sales prospects by the industry, but it may also have reflected the need for inventories during the unusually early model change-over. Meanwhile, manufacturers' stocks, seasonally adjusted, remained about steady (the June level was actually slightly below May), while wholesale inventories continued the gradual upward movement that had been in evidence since February.

The absence of a major shift in business inventory policies is suggested also by the recent behavior of orders and prices. Seasonally adjusted new orders received by manufacturers in June actually declined somewhat from May, and unfilled orders were virtually unchanged. The wholesale price index has gradually tapered downward since February. In July, weekly price indexes suggest only a slight upward movement.

As sales improve and confidence in the recovery firms, inventory policies may shift more markedly, quite apart from any influence of the new defense proposals. Unless the shift is unusually rapid, however, the inventory sector can hardly be expected to boost GNP by as much during the coming months as it did in the second quarter.

Business spending for fixed investment in the second quarter also advanced, with outlays on private nonresidential construction and producers' durable equipment both rising moderately. This would seem to suggest a somewhat steeper rise in plant and equipment spending than had been indicated in the last Commerce Department-Securities and Exchange Commission survey of business investment plans (taken in April and May) which had anticipated no change in the second quarter. Corporate profits have turned up sharply, with manufacturers' profits up 23 per cent in the second quarter over the depressed level of the first quarter, according to the First National City Bank. This rate of advance compares favorably with other recovery periods, and should give still further stimulus to the rise in plant and equipment spending.

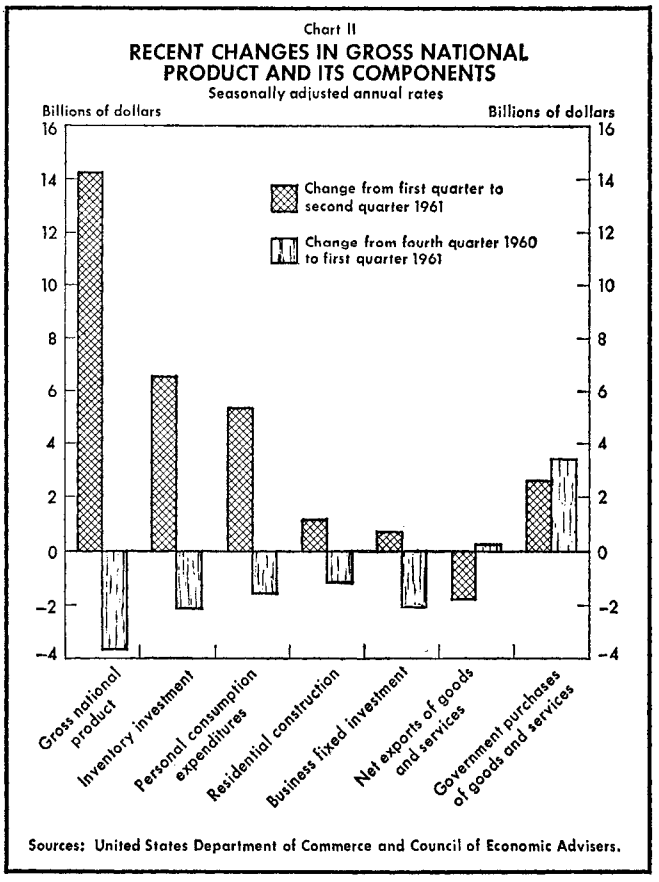
THE CONSUMER SECTOR

More than a third of the second-quarter rise in GNP was accounted for by the $5.3 billion (or 1.6 per cent) increase in consumer spending; in the first quarter, consumer spending had declined by $1.6 billion (see Chart II). The consumers' contribution to the recovery of the economy has thus been slightly larger than in the comparable quarter of the previous general business recovery, although not quite so great as in the expansion of 1954.

Roughly equal gains in spending for durable goods and services accounted for almost all of the rise in total consumption outlays. Services continued their steady secular growth. However, the percentage gain in outlays for durable goods was much larger. Moreover, the change from

a net decline in consumer spending in the first quarter to a net rise in the second quarter can be almost entirely explained by the behavior of the durables sector. Even so, this sharp swing in outlays for durables regained only about half of the drop in such outlays during the recession. Monthly figures (seasonally adjusted) on retail sales show that sales by automotive dealers were responsible for a large share of the fluctuations in total retail sales from January to May. In June, automobile sales actually declined slightly but total retail sales expanded by 1 per cent, about in line with the increase in May. Gains were recorded by a wide range of durable commodities other than automobiles. The growth in automobile sales apparently resumed in July. Thus, the market for consumer durables may now be developing greater breadth as well as strength.

In contrast to the wide swings in spending on consumer durables, outlays for nondurables declined in only one recession quarter—the third quarter of 1960. During the fourth quarter of 1960 and the first half of this year, however, they rose at a somewhat slower pace than in comparable phases of the last two cycles. An acceleration in June of the rise in retail sales of nondurables and a further improvement in department store sales in July suggest a return to a more normal rate of growth.



An important factor in this recovery of consumer spending has, of course, been the upswing in consumer income. By June, personal income (seasonally adjusted) had risen by 3.4 per cent from its February trough and almost 2 per cent above the previous October peak. Both transfer payments and payments of wages and salaries contributed significantly to the expansion. (Transfer payments had, of course, done much to moderate the decline in personal income during the recession.) In terms of per capita disposable income (personal income less taxes) the gain in the second quarter of this year was almost 2 per cent, about the same as the increase in the initial quarter of general recovery in 1958. As GNP heads upward, it is virtually certain that consumers' income will continue to rise and will exert a further upward push on personal spending. Improvements in consumers' financial asset and debt positions during the recession and the expected increase in the rate of household formation over the next few years also favor a healthy revival in consumption spending, particularly on durable goods.

While the prevailing mood among consumers is reported as still somewhat hesitant, consumer attitudes change rapidly. In addition, a substantial downward revision in the personal savings ratio, going back to the beginning of 1960, suggests that consumers have been somewhat less reluctant about spending their incomes than had formerly been thought. The nature of consumer reactions to the projected step-up in military outlays and in civil defense programs clearly remains a major question mark in the economic outlook.

The prospective rate of increase in defense spending is of course substantial, though picayune alongside the Korean build-up. Federal spending rose by $21 billion and $16 billion in 1951 and 1952—at a time when the economy was only two thirds as large as it is today. Nevertheless, defense expenditures during the next year or two seem almost certain to be more than $5 billion higher than at present. There is still a question of how much such spending will actually be and of how fast the new appropriations will be translated into higher production and higher incomes. The size and nature of the impact will presumably become clearer in the weeks ahead as appropriations and spending plans crystallize.

The Business Situation

The economy is now moving up to new high ground. The recovery in output to pre-recession peaks is completed, and a period lies ahead in which the economy's ability to advance rapidly to a reasonably full utilization of resources will be tested. In the second quarter, the nation's output of goods and services rebounded sharply and reached a level some 1 per cent, in real terms, above the pre-recession peak of a year before. Since midyear, the pace of the advance has been somewhat more moderate than during the recovery phase.

So far the economy appears to be taking in its stride the heightening of world tensions and the plans for further increases in defense spending. There is no evidence as yet that consumers or businessmen have drastically revised their attitudes. This generally restrained reaction undoubtedly stems from the fact that the economy is still not using available manpower and physical resources to the full. The steel, automobile, and residential construction industries, for instance, are all operating well below capacity. The number of unemployed has been at about five million (seasonally adjusted) for fully nine months, and approximately one million of these have been out of work for at least six months.

THE ADVANCE BROADENS

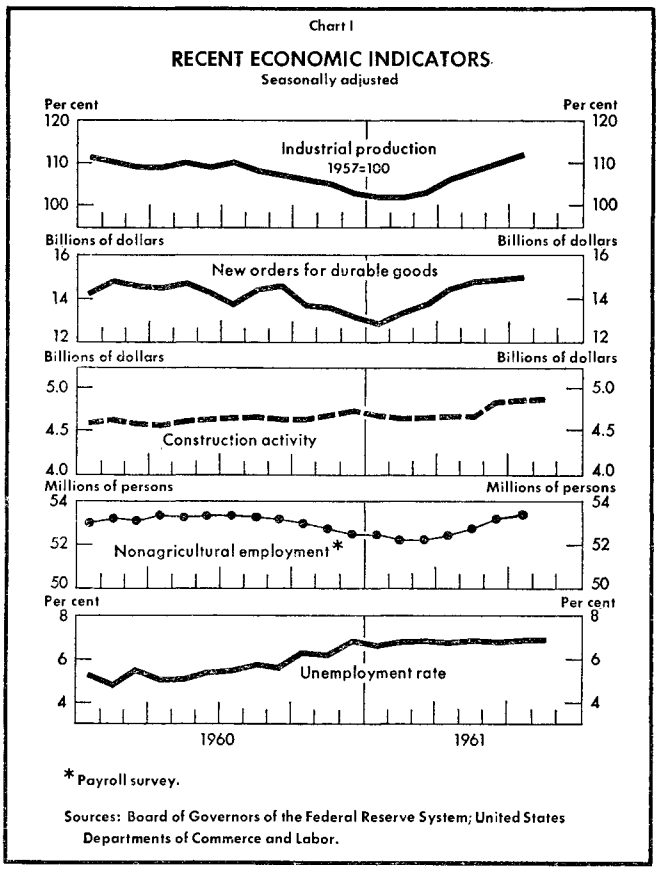
In July the Federal Reserve's seasonally adjusted index of industrial production rose two points to 112 per cent of the 1957 average, breaking past the pre-recession record of 111 per cent (see Chart I). Increases in the output of materials and of equipment were larger than in June, and consumer goods production continued to rise although less than in the previous month. Furthermore, new orders received by manufacturers of durable goods advanced another 1 per cent, seasonally adjusted, and covered a wide range of both defense and civilian goods, in contrast to a rather limited range the previous month. The advance in industrial activity has thus clearly broadened, suggesting the establishment of a firm base for a strong economic rise.

Inventory accumulation—which in the spring was heavily concentrated in the auto industry—is one factor stimulating production. Total inventories rose ½ of 1 per cent in July, the largest gain since mid-1960, with a major part of the increase occurring in durables manufacturers' stocks. This had been foreshadowed in a quarterly survey taken by the Commerce Department in May, when manufacturers of durables reported that they intended to accumulate inventories at a rather substantial pace during the July-September quarter. Evidence of further inventory accumulation is contained in the latest survey by the National Association of Purchasing Agents. The survey showed that by August the vast majority of the association's members had shifted from a policy of inventory liquidation to a policy of inventory stability or accumulation, and that about one fourth of the members were planning to add to inventories in September and October.

In construction as in manufacturing, activity appears to be not only advancing but also broadening. Although total construction outlays turned up in March, several sectors continued weak. One of these, the Government sector, has moved up during the last three months, however, and should continue strong. With regard to the private sector, private housing starts (which often indicate the strength of residential outlays some two months later) were down slightly in July. Nonetheless, the June-July total for this erratic series was almost 10 per cent higher, seasonally adjusted, than that for April-May. In addition, requests for Government-backed mortgages, which usually also are a guide to residential construction trends, remained firm.

EMPLOYMENT AND CONSUMER SPENDING

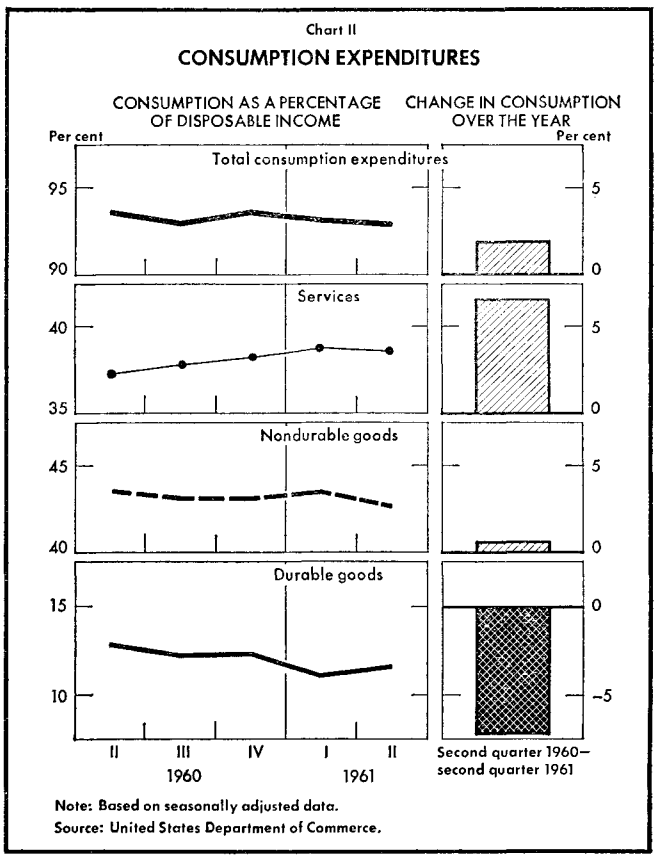
The employment picture is mixed. The improvement in construction and manufacturing activity and a continuing expansion in the service industries nudged up July's nonagricultural employment, as measured by the Bureau of Labor Statistics payroll survey, by ½ of 1 per cent, seasonally adjusted, to a new record (Chart I). At the same time, the household survey conducted by the Census Bureau showed nonagricultural employment dropping almost 1 per cent and remaining at that level in August. (This latter series, which has a wider coverage than the payroll survey and includes domestic workers, the self-employed, and nonpaid family workers, is generally considered a less useful guide for month-to-month fluctuations.) Total employment, seasonally adjusted, also



fell slightly in July, according to the household survey, but recouped about half of that loss in August. The lower levels of employment in these two months were only partly offset by a contraction of the labor force—even though many young people dropped out because they were unable to find summertime jobs—and the unemployment rate was 6.9 per cent in both July and August. The rate has now been hovering around that level for nine straight months.

Personal income was another series that pushed up to a new record in July. However, if the special life insurance dividends received by veterans are left aside, the month's rise amounted to only ½ of 1 per cent. As personal income has moved upward, disposable income (personal income after taxes) has also increased. In the April-June quarter, disposable income was about 3 per cent higher than a year earlier. The percentage of disposable income spent for goods and services, however, was lower (Chart II), mainly reflecting a 7 per cent decline in sales of durable goods. Expenditures on nondurables also failed to keep pace with disposable income and, in dollar terms, rose only slightly. Services, however, actually rose more, in percentage terms, than did disposable income—despite the slight decline, relative to income, in the second quarter of 1961. In July, retail demand for goods continued to be sluggish. Sales of durables declined by almost 2 per cent, seasonally adjusted, and nondurables by almost 1 per cent. The weakness in durables was actually limited, however, to the automotive sector, where sales fell sharply. Appliances and furniture and a number of other durables lines that had been weak earlier showed strength for the second month in a row.

More recent data suggest that in the first weeks of August automobile sales held up reasonably well considering the shortages of many models, and the Federal Reserve Board's latest Quarterly Survey of Consumer Buying Intentions, taken during the third week of July, points to a rather promising sales outlook for automobiles over the next half year. The survey reveals a declining interest, on the other hand, in household appliances. It is very possible, however, that the continuing improvement in the outlook for business and for job opportunities may prompt consumers to spend more than they foresaw a month and a half ago.



The Business Situation

The economic advance slowed during the last weeks of summer, but special influences such as strikes in the automobile industry and intemperate weather were at least partly responsible. Retail sales were apparently adversely affected by unseasonable heat and violent hurricanes; and an actual drop in sales of the few remaining 1961-model cars was to some extent attributable to less aggressive selling by dealers who thought strikes by auto workers might cause prolonged delays in the receipt of 1962 models. The strikes, moreover, held down production not only in the auto industry but also in the steel, tire, and other industries heavily dependent upon auto manufacturing. These dampening influences largely offset the stimulus the economy received from a step-up in Government defense orders and in materials and equipment orders from private business. Toward the end of September, however, there were signs of a renewed strengthening of the expansion. At the same time, industrial prices continued relatively stable. While quotations rose for a number of commodities, there were also announcements of price cuts in several areas, induced by both foreign and domestic competition.

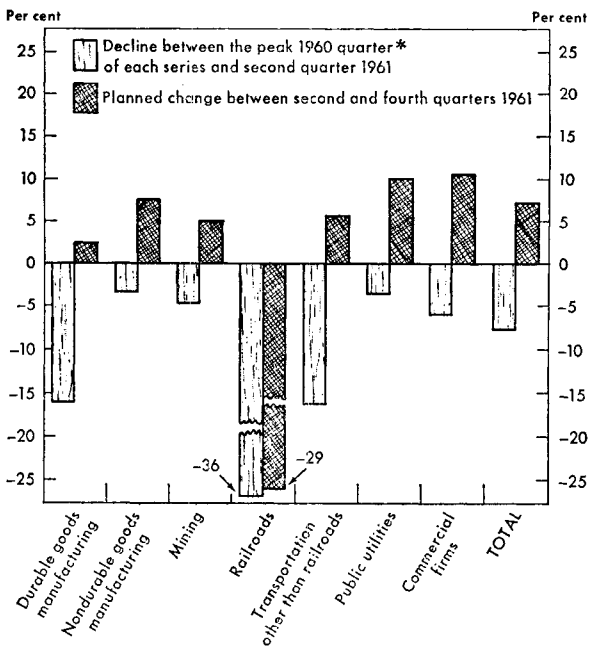
THE ADVANCE CONTINUES

Industrial production rose in August for the sixth consecutive month, but the seasonally adjusted increase of about ½ of 1 percentage point was the smallest since March. Primarily this reflected a leveling-off in consumer goods output, following sharp advances in previous months. Production of most types of consumer goods edged only slightly above July levels, while the output of television sets and home radios, which had been expanding at a rapid pace, slumped sharply. The failure of consumer goods output to continue to rise in August reflected slack in consumer demand. Total retail sales had declined almost 1 per cent in July, and in August had risen merely back to the June level, with only sales of nondurables showing strength. Partial sales data suggest that there was little improvement in September as a whole. It may be significant, however, that department store sales, which were very poor during the first half of the month, made impressive gains later on. Auto sales in the latter part of the month, moreover, pointed to relatively strong consumer interest in the 1962 models.

The production of materials and of equipment, in contrast to consumer goods output, continued upward in August. A rise of 2½ per cent in new orders received by manufacturers during the month, after two months of little change (and a further strong rise in September, according to a survey conducted by the National Association of Purchasing Agents) suggested there would be even larger increases in the output of materials and equipment in subsequent months. The August rise in materials output alone, it is true, was relatively small, as a slight decline in iron and steel output partly offset expansion in other categories; and the rebound in iron and steel production during September was quite modest. Nevertheless, the steel mills did receive larger orders from an increasing number of industries in September, and were expecting a substantial rise in orders from the auto industry following completion of the Detroit labor contract negotiations.

Chart I

CHANGES IN CAPITAL SPENDING



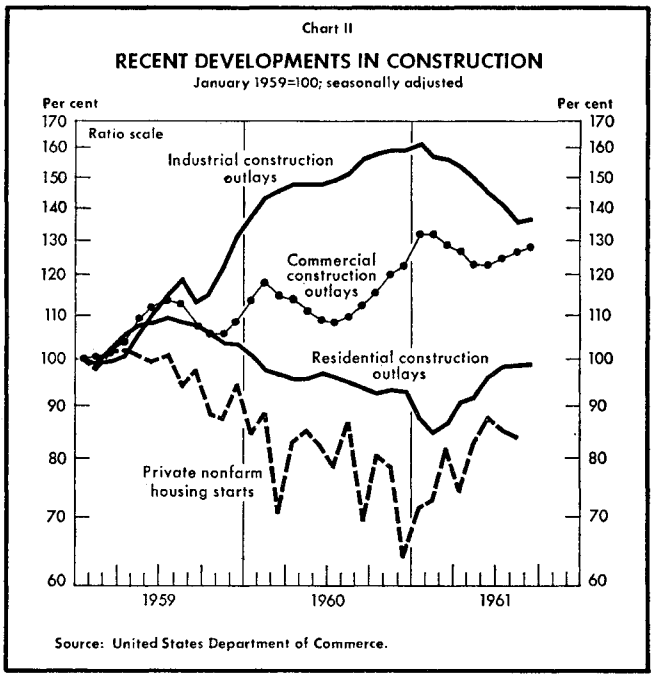
*The peak 1960 quarter was the second quarter of 1960 for the total and for all components except commercial firms (third quarter) and nondurable goods manufacturing (fourth quarter).

Sources: United States Department of Commerce; Securities and Exchange Commission.

The rise in the production of equipment, unlike that of materials, continued very brisk in August, under the stimulus of orders from both the Government and private business. Government orders will increase further in the coming months, as recently expanded space and defense programs assume more definite shape. Private businessmen, who cut back plant and equipment outlays by almost 8 per cent during the twelve months ended June (see Chart I), can also be expected to increase their orders for equipment. According to the quarterly Securities and Exchange Commission-Commerce Department survey taken in late July and August, businessmen were planning to step up their capital spending by 4 per cent during the third quarter, and by an additional 3 per cent during the fourth quarter. This would bring total capital expenditures during the year to within 3 per cent of the 1960 volume—the same level that had been indicated in the spring survey before it was known that second-quarter spending would be lower than planned. The largest percentage increases in outlays were scheduled in the public utilities and commercial sectors, and the smallest in durable goods manufacturing. Railroads were the only group to expect a further drop, with anticipated expenditures for the year as a whole cut back to almost half the 1960 figure.

The rapid turn-around in businessmen's capital investment plans has not only benefited machinery producers but also the construction industry. Outlays for commercial construction have been rising since the middle of the year, as can be seen in Chart II, and in September outlays for industrial construction inched up for the first time.

The outlook for residential construction does not appear to be as favorable, even though expenditures in this sector have been advancing since March. The August and September increases were quite small (see Chart II), while seasonally adjusted housing starts, a series that leads outlays, declined slightly during the summer.



UNEMPLOYMENT RATE STILL HIGH

Nonagricultural employment (as measured by the Bureau of Labor Statistics payroll survey) rose in August for the fifth straight month, on a seasonally adjusted basis. The gain was the smallest since the initial improvement, but this was primarily the result of temporary layoffs in the auto industry while assembly lines were being prepared for the production of 1962 models. (The BLS does not take account of such layoffs in its seasonal adjustment of employment data, owing to the uncertainties of the timing of model change-over periods.) More significant were the fairly sizable gains in seasonally adjusted employment in other durable goods industries (especially machinery and primary metals) and in the government sector.

Total employment (as determined by the Census Bureau's household survey), which had risen somewhat in August, dropped in September by 1 per cent, on a seasonally adjusted basis, as both farm and nonfarm employment declined. At the same time, however, the labor force also fell by 1 per cent, seasonally adjusted. Consequently, unemployment as a percentage of the civilian labor force dropped, but only very slightly; in fact, the decline from 6.9 per cent to 6.8 per cent left the rate just below 7 per cent for the tenth successive month. According to a Labor Department spokesman, the unemployment rate would probably have shown a more pronounced decline if it had not been for hurricane Carla. A breakdown of the unemployment statistics for September actually does show evidence of some improvement. There were rather substantial reductions in adult male unemployment, in long-term unemployment, and in the number of persons employed only part time.

While total personal income fell in August, this was attributable to the special insurance dividend payment that veterans received in the prior month. Other types of income rose, in the aggregate, but the advance was the smallest since the series started upward in the spring. Earnings of factory workers did not increase at all, chiefly because of a decline in the auto industry where employment was temporarily reduced. Additional declines in earnings occurred in the apparel and lumber industries. Sizable gains were scored, on the other hand, in the metals and machinery-producing industries, and there were fur-

ther small advances in most nonmanufacturing sectors, including agriculture.

PRICES REMAIN STABLE

The industrial goods component of the wholesale price index, which had leveled out in July following a three-month decline, remained unchanged in August, although individual series showed divergent movements. In September, price developments continued to be mixed, with virtually no change on the average. The BLS weekly index of wholesale prices of industrial goods edged downward, while the National Association of Purchasing Agents reported that an increased, although still small, percentage of their members had found prices higher in September than in August. Prices of steel scrap and of paperboard for packaging were among those that rose during the month, and the first price increase in several years was posted for polystyrene, one of the most widely used plastics. On the other hand, copper scrap prices fell after the termination of the Chilean copper mine strikes and an easing of foreign demand had brought a decline in prices abroad. Prices of aluminum ingots and some fabricated aluminum products were also lowered, following a reduction in the prices charged American customers by a Canadian concern. These cuts in aluminum prices, made despite the fact that wages for aluminum workers were raised in August, may be an important factor restraining increases in the price of steel, since aluminum has recently been making heavy inroads as a substitute for steel in the production of various products.

Automobile producers, now bringing out their 1962 models, also have reduced some prices, notwithstanding higher wage rates. One firm, on the other hand, raised prices on several models, and in a few cases the lowest priced lines have been dropped. Price comparisons, however, are made difficult by the fact that many of the standard models now include equipment that was previously optional and thus bear higher price tags.

Pricing a Corporate Bond Issue: A Look Behind the Scenes

Making markets for securities means setting prices. This is a demanding job, for it requires a continuous evaluation of the various factors acting and reacting in the markets. Securities dealers must make day-to-day, hour-to-hour, and sometimes minute-to-minute adjustments, and the dealer who falls asleep, even briefly, may find his snooze a costly one.

Underwriters engaged in competitive bidding for new corporate bonds have a special pricing problem in that each flotation involves the distribution of a relatively large supply of securities in the shortest time feasible. While the market for outstanding securities does provide some guidance to the pricing process, it is a rough guide at best. A new bond issue will be similar to, but rarely identical with, any securities being traded in the secondary market. Furthermore, the relatively large amount involved in many new offerings increases the difficulty of gauging the market. Finally, pricing decisions on new securities are not made at the actual time of sale to the ultimate investors but must be made a short time before the bonds are released for trading, while the distribution itself may stretch over a number of days during which market rates may be in motion. The pricing of a new issue even under the best conditions thus takes place at the edge of the unknown.

The specialized job of buying, selling, and pricing new corporate securities is primarily the province of investment bankers.[1] Not all issues are priced through a competitive bidding process, however, and the pricing of some flotations is negotiated directly beween borrower and underwriter. But in all successful flotations, investment bankers function as quick intermediaries for new securities between borrowers and ultimate investors. This involves two distinct, although closely related, objectives. In cases of competitive bidding—formal or informal—the first objective is to "win" the right to offer the security to the public by paying the borrower more for it than any other underwriter. The second is to "reoffer" the security to investors at a price higher than that paid the borrower. If a number of underwriting groups are competing against

[1] These firms have traditionally been called "investment bankers" although they are now bankers in name only. As is well-known, the Banking Act of 1933 specifically prohibits commercial banks that accept deposits and make loans from underwriting corporate securities. Under the act, commercial banks are permitted to continue some "investment banking"-type activities, such as underwriting direct obligations of the United States and general obligations of States and political subdivisions. At present, underwriters for corporate issues perform none of the basic functions of commercial banks, but the term "investment bankers" continues in use, and this usage will be followed in this article.

The Business Situation

Assessment of the strength of the current economic expansion continues to be complicated by the fact that many of the more important recent statistics bear the imprint of various special influences. Strikes, abnormal weather conditions, and irregular fluctuations in defense outlays played a large role in the slowing of gross national product expansion during the third quarter and the slight decline in industrial production during September, although the precise importance of these factors remains difficult to evaluate. Information that has become available in the past few weeks suggests that a somewhat more pronounced improvement in over-all activity may now be getting under way. Since mid-September, in particular, consumer spending at department stores has risen noticeably and purchases of automobiles have been stepped up. There are also indications that the rate of defense orders has increased substantially. These are fragmentary data, however, and no clear evidence is as yet at hand to indicate how much momentum the economy will gain during the fall seasonal upturn.

A noteworthy feature of the current business expansion has been the relative stability of prices, especially at the wholesale level. While the consumer price index rose by 0.2 per cent in September, the entire advance since the February trough in business has been only about 0.5 per cent, and wholesale prices have moved down on balance. Over the sixteen-month period since the beginning of the recent recession, prices at both the wholesale and retail levels have risen less than over the comparable months in 1957-58. Yet it is clear that the real testing period for prices still lies ahead.

THE FIRST HALF YEAR OF BUSINESS EXPANSION

In contrast to the near-record $15 billion rise in GNP during the second quarter of 1961—the initial full quarter of upswing in general business activity—the third-quarter advance amounted to a more modest $10 billion, according to estimates by the President's Council of Economic Advisers.

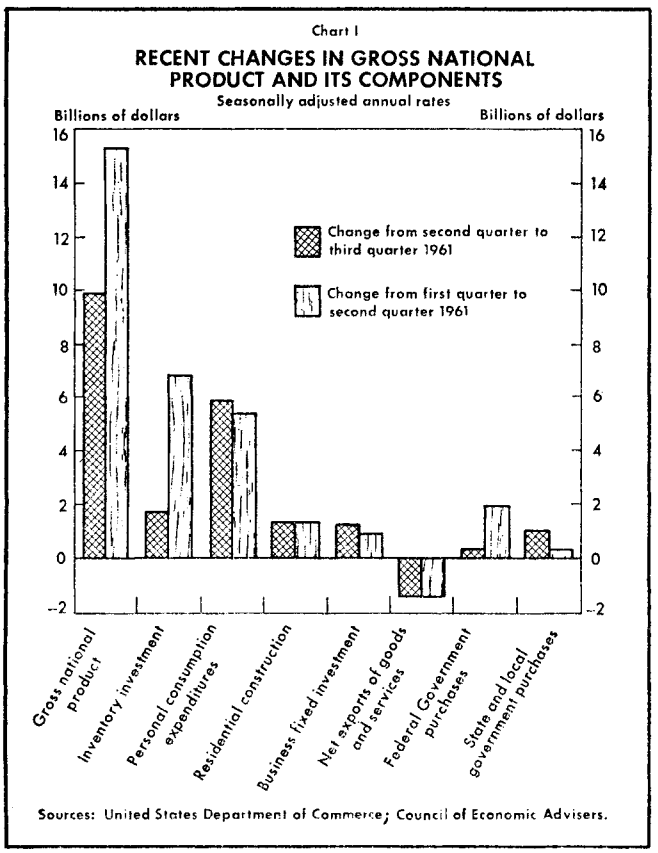
Just as there was a danger of overestimating the momentum of the business upswing on the basis of the GNP data for the second quarter of 1961,[1] it must be recognized that the smaller GNP advance during the summer months may have failed to reflect the full underlying strength of the expansion. Much of the GNP gain during the April-June quarter was attributable to the unusually prompt and sharp shift in inventory investment (see Chart I), resulting from a swing from rapid inventory liquidation to moderate inventory accumulation (a swing which in large part reflected restocking by automobile dealers). While inventory investment made a substantially smaller contribution to the GNP advance in the third quarter of 1961, the rise in final demand during that period was only slightly less than the second-quarter increase. Allowance must be made, moreover, for several unusual and temporary factors, already noted, that tended to dampen the growth of final demand during recent months.

The continuing rise during the July-September quarter in all of the broad sectors of final demand except one could in itself be regarded as evidence of strength in the underlying economic situation. The only decline was in the foreign trade sector, where a small gain in exports was more than offset by a large increase in imports. Yet some of the July-September increases in domestic final demand were considerably smaller than the second-quarter gains. This was notably true of consumer outlays on durable goods and Federal Government expenditures on defense. (The lag in defense expenditures was, however, almost certainly a temporary development, induced by the irregular timing of defense contracts and disbursements. The 1962 Budget Review, released at the end of October, clearly implies a substantial step-up in defense spending during the fiscal year ending next June.) While private fixed business investment rose between the second and third quarters, the nonresidential construction component actually declined slightly.

It is also instructive to compare the over-all expansion in GNP during the second and third quarters of 1961 with the gains in GNP during the initial half years of the two previous cyclical upswings. The 5 per cent rise in GNP during the first half year of the current expansion[2] was appreciably below the rise during the first full half year of business upswing in 1954-55 (6.2 per cent), but only

[1] See *Monthly Review*, August 1961, p. 134.

[2] I.e., the first half year of expansion in the broadest sense, as manifested by trends in production, employment, and a wide range of other indicators.



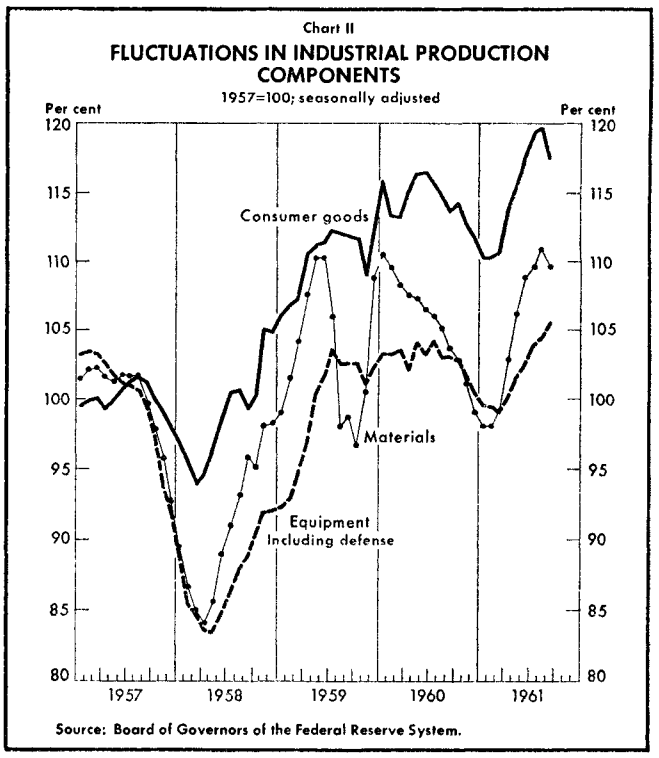
slightly less than the advance in the comparable period of upswing in 1958 (5.4 per cent). Compared with the earlier cycles, the strongest element in the current expansion—as evidenced by the percentages of rise in GNP contributed by various sectors—was business investment, both in inventories and, even more, in fixed capital. An expansion in Federal Government purchases also contributed importantly, but relatively less so than in 1958. This time, however, much more of the increase in Government outlays reflected a rise in defense spending (despite the temporary slowdown in the summer months), and undoubtedly defense orders, or expectations of such orders, caused some of the expansion in business investment also. Investment in residential construction—which during the 1960-61 recession was not the cushioning factor that it had been in earlier recessions—has also been a less important source of strength during the initial upswing.

Personal consumption expenditures accounted for a larger part of the rise in GNP than in the 1958 upswing, but for much less than in the 1954-55 recovery. Spending on durable goods alone, which is the most volatile component of consumer outlays, was in fact weaker than in either of the two preceding expansions. Undoubtedly, special factors such as the unusual weather conditions and the auto industry strikes affected consumer spending in some degree. It remains to be seen, however, whether such factors were fully responsible for sluggish durables sales or whether more pervasive influences have been at work.

RECENT CHANGES IN ECONOMIC INDICATORS

In September the industrial production index slipped back about 1 per cent after having risen almost 11 per cent in six months of uninterrupted climb. The decline, however, was apparently attributable almost entirely to the work stoppages at General Motors, which in many plants lasted three full weeks, and to hurricane Carla, which hit hard at some large industrial installations in the Southwest. The GM strikes slowed not only the output of automobiles but also activity in other industries that are heavily dependent upon auto industry orders. Output in most categories that were not directly affected by the strikes or the hurricane advanced or, at worst, remained steady.

These crosscurrents in production are visible in Chart II, which shows sharp drops during September in production of both consumer goods and materials. The equipment component of the industrial production index, on



the other hand, which comprises defense as well as business items and which was probably less affected by the strikes and weather, continued to rise in September. This component has moved upward more slowly than the other two components since the recovery began, and also more slowly than in the comparable period of the 1958 upswing. It had, however, declined much less during the recent recession than during 1957-58, and by August, which was only the fifth month after the series had reached its trough, it had already passed the mid-1960 high. After the 1957-58 recession, in contrast, more than a year had been required to reattain the early-1957 high.

The effects of the automobile strike also appear to have accounted for much of the weakness in a number of other indicators of manufacturing activity during September. Thus, sales by manufacturers of durables, which previously had advanced for seven consecutive months, declined slightly. New orders received by such manufacturers, which had been moving roughly parallel to sales and had gained some 3½ per cent in August, rose less than 1 per cent in September. Apparently, an increase in orders for defense items was responsible for offsetting part of the decline stemming from the auto industry strikes. The average length of the workweek in manufacturing dropped 2 per cent after allowing for seasonal adjustment.

In contrast to the weakness evidenced in these several series, nonfarm employment in September, according to the payroll survey taken by the Bureau of Labor Statistics, edged upward for the sixth consecutive monthly rise, on a seasonally adjusted basis. The increase was only about one fourth of the August gain, but manufacturing employment rose slightly, more than offsetting the decrease that had occurred in August as a result of layoffs for model change-overs in the auto industry. Government employment, moreover, rose by almost 1 per cent. Employment increased in other sectors too, except in trade and construction where there were small reductions.

Despite a decline in wage and salary disbursements in manufacturing, which could be traced largely to the auto industry strikes, total personal income rose in September at an annual rate of $800 million, seasonally adjusted. This increase was about the same as in August (after making allowance for the special life insurance dividend that veterans had received in July). Part of the September advance was attributable to newly effective amendments to the minimum wage and social security laws, which provided increased wages or social security benefits for a substantial number of people and expanded the coverage of both laws. The September gain in personal income pushed third-quarter disposable personal income to almost 4 per cent above the figure for the first quarter.

In October, strikes continued to have an adverse influence on production. Work stoppages at Ford plants began early in the month and lasted for about two weeks, affecting (as had the GM strikes) not only auto output but also production in steel and several other industries. Although some plants at Ford and GM were working overtime during the latter part of October, there did not seem to be a strong effort under way to make up the lost output. Nevertheless, there were also various indications of a strengthening in the underlying economic situation. Consumer spending on commodities has shown a decided improvement in recent weeks. While retail sales did not advance in September as a whole, compared with August, the latter part of the month did bring a gain in department store sales as well as in sales of automobiles. The higher level of department store sales was maintained throughout October. Although there was a mild decline in auto sales in the middle third of the month, this was attributable in some measure to shortages of Ford and GM models.

It is worth noting, too, that a recent Commerce Department survey points to a continued expansion of manufacturers' inventories. The survey indicates that manufacturers expect sales to rise substantially through the final months of this year, and that they intend to maintain approximately the existing relationship between inventories and sales during that time. This would appear to imply a continuation in the fourth quarter of the fairly vigorous, but not exuberant, pace of inventory accumulation that has prevailed at the manufacturing level in recent months. In addition, there are indications that defense orders for hard goods have started to flow in really substantial volume within the last several weeks.

PRICE DEVELOPMENTS SINCE THE CYCLICAL TROUGH

In September, wholesale prices of industrial commodities were almost ½ of 1 per cent lower than they had been seven months earlier, at the end of the recession. This contrasts with fairly sharp upward movements during the previous post-recession periods. All major components of the industrial price index have contributed to its recent stability. Prices of industrial materials, consumer finished goods, and producer finished goods in September were all somewhat below their levels at the business trough. They were also either below or approximately at the levels at which they had stood just before the recession had started. This demonstrates substantially greater price stability than in the two previous cycles.

In contrast to the decline in industrial wholesale prices between February and September, the consumer price

index moved up about ½ of 1 per cent. One quarter of this rise could be attributed to seasonal influences. The nonfood component of the index has advanced about 1 per cent, almost entirely because of a continuing climb in the price of services and a (partly seasonal) rise in apparel and used car prices. Even though the advance in the consumer price index was relatively small, it was nevertheless larger than that registered in the first seven months of the 1958-59 upswing and contrasted with an actual decline in the comparable period of the preceding business upturn. However, the comparison with 1958-59 is somewhat misleading, because consumer prices rose more sharply during the 1957-58 recession than in the most recent recession. Measured over the sixteen-month periods beginning with the respective peaks in business activity (July 1957 and May 1960, respectively), prices have risen 1½ per cent this time, compared with 2½ per cent during the earlier period.

Recent Developments in Bank Liquidity

Commercial banks have increased their liquidity markedly since the beginning of the most recent recession in early 1960. Under the stimulus of ample reserve availability, the banks have added heavily to their holdings of liquid assets, particularly short-term Government securities. This additional liquidity is available to meet credit needs in the economic expansion now under way.

An improvement in bank liquidity is characteristic of periods of recession and initial business upswings. The extent of the recent improvement is not easily assessed, however. It depends partly upon the particular liquidity concepts used to interpret recent developments, and also on the degree to which the banks' own view of their liquidity (which is partly a subjective concept) has changed as a result of changes in the economic environment. This article discusses some of the problems involved in measuring bank liquidity, and examines recent movements in several liquidity measures.

CONCEPTS AND MEASURES OF BANK LIQUIDITY

The relative ease with which a bank can meet its cash needs is usually termed its "liquidity position" (or "liquidity" for short). Since cash needs have a time dimension—ranging from the immediate demands of depositors making withdrawals to prospective demands of borrowers barely visible on the horizon—at least two types of bank liquidity should be distinguished. A bank's "immediate liquidity" is the relative ease with which it can meet deposit withdrawals (including those arising from new loan demands) on the near horizon. A bank's "longer run liquidity" is its potential for meeting loan demands and deposit losses over a prolonged period.

The immediate liquidity of banks is usually measured as a ratio of short-term liquid assets (cash plus assets that can readily be converted into cash without appreciable loss) to liabilities.[1] One commonly used measure of this type, shown in Chart I, is defined as the sum of vault cash,[2] balances with domestic banks, loans to banks, loans to brokers and dealers, and Government securities maturing within one year, less borrowings, as a percentage of total deposits less cash items in process of collection and reserves held at the Federal Reserve Banks.

In assessing the banks' longer run liquidity, one measure that could be used is the ratio of short-term liquid assets plus other securities to deposits; over the longer run most of the "other securities" included in the numerator of the ratio are also a source of liquidity, since they can over time be sold or allowed to mature in order to expand the loan portfolio. Actually, the ratio customarily used to measure the longer term liquidity position of banks is the loan-deposit ratio, in which the numerator represents total *illiquid* assets, i.e., assets other than short-term liquid assets and other securities. Total illiquid assets are roughly approximated by total loans or, as in Chart II, by total loans adjusted less loans to brokers and dealers.

[1] Claims against a bank that represent an imminent cash drain, such as borrowing from the Federal Reserve, may be deducted from cash assets (as in the liquid assets ratio defined below) rather than added to liabilities.

[2] The character of vault cash as a liquid asset changed during late 1959 and 1960 as it became eligible to be counted as part of reserves. In the computation of the liquid assets ratios shown in Chart I, vault cash has been retained in the numerator of the ratio, and has not been deducted from the denominator, in order to maintain the historical continuity of the series. If vault cash were taken out of both the numerator and denominator for the period from November 1960 (when it was first fully countable as reserves), the resulting ratios during 1961 would fall below those shown in Chart I by roughly ⅔ percentage point for New York City banks and by about 1¼ points for banks outside New York.

The Business Situation

Substantial economic gains during the past two months suggest that the underlying forces of business expansion continue to be strong and that the September slippage in output and sales was merely temporary. Despite strikes in the auto industry during the first half of October, industrial production rose markedly during the month, completely offsetting the previous month's decline. Early reports for November, moreover, point to further strength in steel and automobile output. Retail sales, propelled largely by a sharp advance in automobile sales, have recently shown their first strong upward movement since the spring turn-around in general business activity. The 2½ per cent rise in October retail sales and further increases in auto and department store sales in November suggest that the business expansion is now receiving new impetus from the consumer sector. The scheduled build-up in defense orders and outlays should also continue to provide stimulus to the economy in the months ahead.

Even before the first significant October figures had reached the public, business sentiment had turned more buoyant. This was reflected, among other things, in a Dun and Bradstreet survey taken during the month, which indicated that businessmen expected sales to reach an all-time peak in the first quarter of 1962 and thought that profits would rise well above present levels—adding up to a more optimistic short-range outlook than reported by this survey at any time since the second quarter of 1959.

PRODUCTION AND CONSTRUCTION

With the end of the strikes in the auto industry in mid-October and the disappearance of the other special circumstances that had brought a hesitation in the economic advance during September, the index of industrial production returned in October to the record high of 113 per cent of the 1957 average attained in August (see Chart I). All major groupings of the index increased, with the largest gain occurring in the automotive sector. Auto manufacturers that had suffered from strikes strove to provide dealers with adequate supplies of 1962 models, and other automotive firms stepped up production in response to a general strengthening of consumer demand. In November, automobile production continued to rise strongly and steel output declined less than seasonally.

The rebound in auto production was also the major factor underlying the sharp gain in sales by manufacturers of durables in October, after the mild dip in September. In addition, a number of other industries, including those engaged in defense work, showed sales increases. This helped to push up total sales by manufacturers of durables by more than 2 per cent, to a 1961 high that was 16 per cent above the low reached last January. New orders received by manufacturers of durables also rose in October, the ninth consecutive monthly advance, and the ninth month in a row in which new orders have exceeded sales. This gap, noticeably large since August (see Chart I), has led to an appreciable rise in unfilled orders.

Total construction activity moved up in November, following a slight dip in October. The gain was attributable almost entirely to a 3 per cent rise in private residential construction, the largest increase since the series turned up in March. The improvement in housing outlays more than offset the declines that occurred in most other sectors,

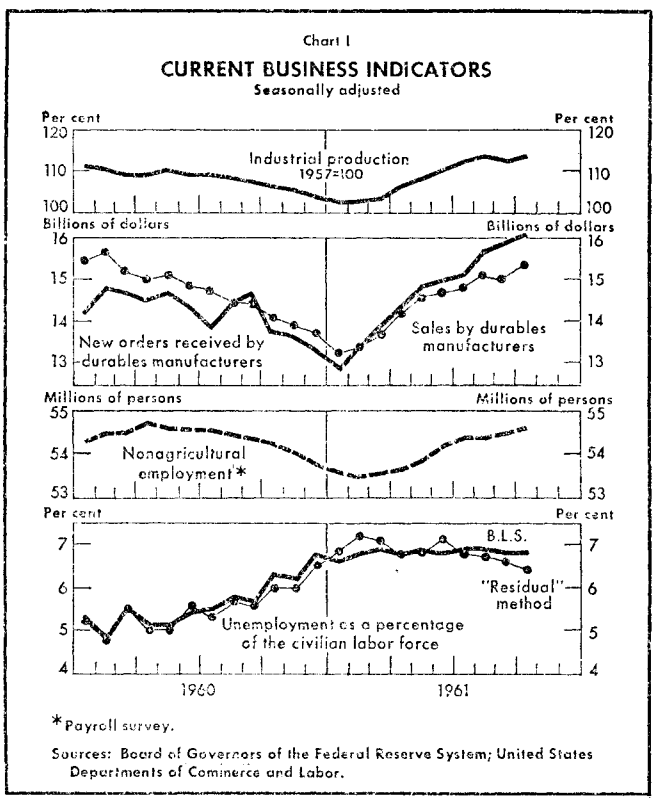
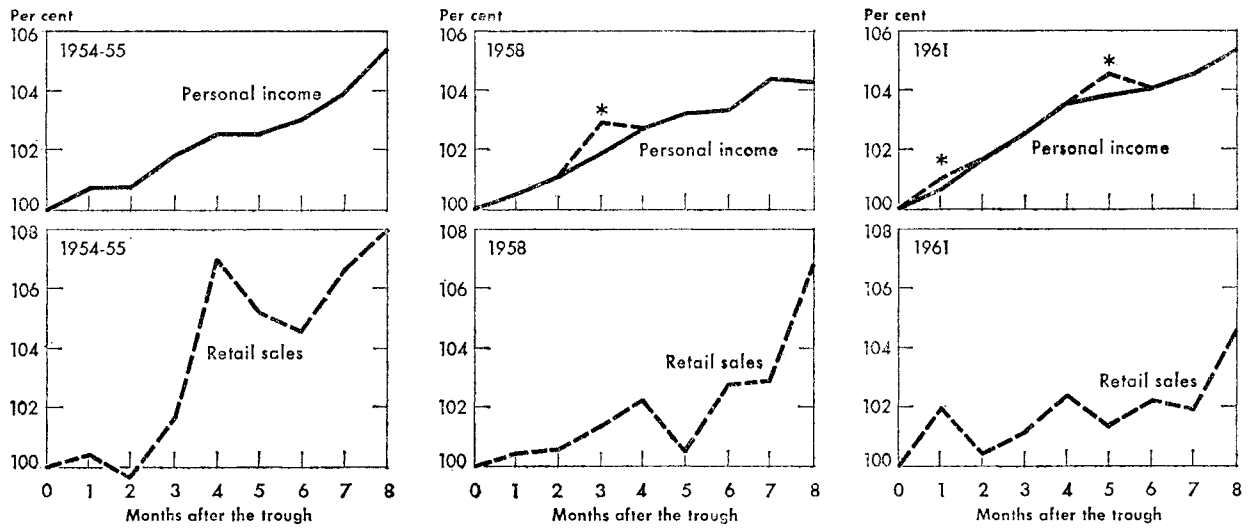


Chart II

PERSONAL INCOME AND RETAIL SALES IN THREE RECENT RECOVERIES

Seasonally adjusted



Note: Trough month=100 in each case. Trough months are those indicated by the National Bureau of Economic Research chronology: August 1954, April 1958, and February 1961.

*Reflects special one-time payments: July 1958, retroactive salary increases for Federal employees; March 1961, prepaid dividends on National Service Life Insurance policies; and July 1961, special dividend on such policies.

Source: United States Department of Commerce.

with military construction the major exception. It is noteworthy that rental vacancies edged off during the third quarter, after almost two years of uninterrupted rise, a sign favorable to the housing outlook.

Perhaps of more importance for the immediate prospects of the housing industry, however, are conditions in the mortgage market; these have been responsible for much of the cyclical fluctuation in housing construction during recent years. Despite a moderate tightening during the third quarter associated with the higher yields that developed on other securities, mortgage interest rates remain below the level which prevailed at the beginning of the current recovery. At the same stage in the 1958 cyclical upswing, mortgage rates had risen sharply from the recession lows. Of course, even if mortgage rates show no further tendency to rise in the months ahead, this would not necessarily imply a substantial advance in construction activity. It might mean, however, that residential construction will remain at fairly high levels for a while rather than dropping off sharply as had been the case at comparable stages of earlier periods of economic expansion.

RETAIL SALES REVIVE

Retail sales in October shook off their lethargy of several months' standing and advanced an impressive 2½ per cent. The total of $18.6 billion (seasonally adjusted) fell short only of the record $18.9 billion registered in April 1960. Most of the gain was attributable to an increase in new car sales, but there were also advances in sales of other durables as well as of many nondurables. During November, department store sales apparently moved slightly above their October level, and new car sales jumped about 15 per cent over the October average. The recent surge in auto sales has led some representatives of the auto industry to predict a 7-million-car year in 1962.

It is possible that the strength in retail sales during the last two months was only temporary, reflecting in some measure purchases that had been postponed in the immediately preceding weeks because of hurricanes, unseasonably warm weather, and shortages of the 1962-model automobiles. That this is the complete explanation of the rise, however, seems unlikely. The Federal Reserve Board's latest quarterly survey of consumer buying plans, taken in October, pointed to a small increase in plans to purchase automobiles (although little, if any, rise in plans to purchase houses and major household durables). Moreover, the steady advance in personal income to a new record level in October (see Chart II), together with other evidences of improvement in consumers' financial circumstances, makes it reasonable to expect that consumers should at this stage of the cycle be ready to step up the

pace of their purchases. As Chart II shows, retail sales had through September been slower to respond to the gain in income in the current upswing than in comparable periods of either of the two previous recoveries. Thus, the October increase may be regarded as having brought such sales more closely into line with personal income.

EMPLOYMENT AND UNEMPLOYMENT

One factor that may have contributed to the October increase in retail sales is the recent improvement in employment, which in the nonfarm sector (as measured by the Bureau of Labor Statistics payroll survey) rose by 160,000 persons in October to a level about one million persons higher, seasonally adjusted, than last February's low (see Chart I). The October gains were widespread, with only mining employment showing a slight decrease. Total employment (as determined by the Census Bureau's household survey) rose by 380,000, seasonally adjusted, largely owing to a substantial increase in the agricultural sector following the decline in September, when hurricane Carla delayed harvesting in the Southwest.

The increase in the civilian labor force in October was about as large as the advance in total employment. Seasonally adjusted unemployment remained virtually unchanged at 4.8 million and the rate of unemployment also was unchanged at 6.8 per cent of the labor force, only 1/10 of a point lower than the 1960-61 high of 6.9 per cent. However, an alternative seasonal adjustment technique that differs somewhat from the one employed by the BLS —the so-called "residual" method—did show a decline in the unemployment rate, from 6.6 per cent in September to 6.4 per cent in October.[1]

Although total unemployment, as determined by the BLS seasonal adjustment, has not changed significantly since the recovery began, unemployment in some important categories has recently dropped. Between July and October, the number of unemployed adult males fell about 20 per cent and the number of "hard-core" unemployed (those out of work a half year or more) decreased 30 per cent. In addition, the number of persons working part time in October but wanting full-time work was more than 20 per cent below the July figure. September-to-October changes contributed to all of these movements, and although seasonal factors were partly responsible, the improvement was to a significant extent attributable to the business expansion.

[1] Under the "residual" method, seasonally adjusted unemployment is calculated by subtracting seasonally adjusted employment from the seasonally adjusted labor force. The BLS method is to adjust each of the three series independently. Compared with the BLS method, the residual technique tends to show higher unemployment rates in the first three months of the year and lower rates during the late summer and early fall months. Thus, unemployment, adjusted according to the residual technique, reached 7.2 per cent at the business cycle trough in February, compared with 6.8 per cent in the BLS series. The October figures, on the other hand, show 6.4 per cent by the residual method and 6.8 per cent by the BLS method.

International Economic and Financial Developments

BUSINESS CONDITIONS ABROAD

In many European countries, the rate of increase in output has distinctly slowed in recent months. This slackening—which followed the rapid expansion of 1959 and 1960—has, however, varied in degree from country to country, and can be traced to a number of factors. In some cases, supply limitations—combined, at times, with official restraint measures—appear to be the principal cause of the slowing down, while in others less buoyant demand is of greater importance. Nowhere, however, can the current slackening be regarded as severe. Indeed, consumer expenditures and foreign demand remain relatively strong in the majority of the industrialized countries abroad. Actual declines in production have, moreover, occurred only in a few cases (see Chart I).

In Canada, where economic developments are, of course, closely linked to those in the United States, definite signs of a further acceleration of expansion could be discerned this autumn. Some of the lift has come from the upturn in the United States, and some from the wide range of expansionary measures adopted by the Canadian authorities over the past year.

In Japan the industrial production index in September was some 22 per cent above a year earlier, and was still rising rapidly in October. Some slackening in the rate of growth may, however, be in prospect, for the inflationary overtones of the domestic boom and the widening balance-of-payments deficit have been a growing source of concern.

Switzerland—not a Fund member—may become associated) evolved in response to the need to offset the potentially disruptive effects of large-scale capital flows in a world of convertible currencies. Together with the further active use of inter-central-bank cooperation, such as has been practiced during the past year, the plan should significantly improve the chances for the stability of the foreign exchange markets in the future. In the long run, of course, exchange stability will depend not only on such temporary cooperative actions but also on broader policy adjustments by individual countries to correct imbalances in their fundamental balance-of-payments positions.

The Business Situation

Increased spending by business, consumers, and government during the final months of 1961 brought new strength to the economic expansion. Business investment, both in plant and equipment and in inventories, appeared to be on the rise and was expected to move up further in the first quarter of 1962. Consumer buying, which had spurted markedly in October, rose even more sharply in November, and seemed to be holding near that new high level in December. Defense orders and spending continued to exert an expansionary influence. Partly due to this new strength in demand, industrial production in November advanced for the second month in a row; moreover, gains in steel and automobile output in December suggested a further increase in total industrial production was likely. At the same time, the seasonally adjusted rate of unemployment moved sharply downward, to just above 6 per cent in November, after eleven consecutive months near the 7 per cent level.

RISE IN DEMAND

The latest survey of businessmen's capital spending plans and actual outlays, conducted in October and early November by the Commerce Department and Securities and Exchange Commission, showed that plant and equipment expenditures were expected to rise to $35.9 billion (seasonally adjusted annual rate) in the final quarter of 1961, up 3½ per cent over actual outlays in the preceding quarter. The estimated gains were widespread, with only spending by railroads due to decline. While both manufacturers of nondurables and mining firms had apparently scheduled somewhat smaller outlays than had been anticipated in last August's survey, such shortfalls are not uncommon during the early stages of a business upturn.

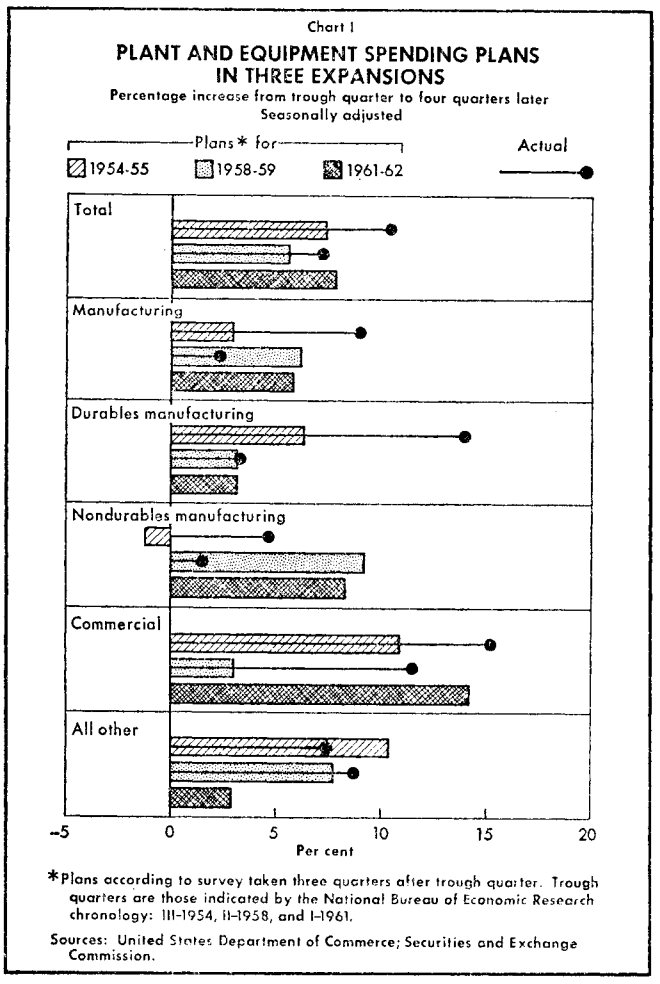
Total capital outlays were scheduled to increase further, by 1½ per cent to $36.5 billion, in the first quarter of 1962; only public utilities and transportation industries other than railroads planned to reduce their spending. The outlays expected for the first quarter of 1962 were almost 8 per cent above the level of capital spending four quarters earlier (i.e., in the first quarter of 1961), when the business cycle reached its trough. At similar stages of both of the two preceding business expansions, capital spending schedules for the fourth quarter after the trough showed a somewhat smaller gain from the level that had prevailed during the trough quarter (see Chart I). In those two previous cycles, moreover, the total outlays that were actually realized four quarters after the trough were higher than had been anticipated, even though a few individual industries spent less than originally planned.

That capital expenditures might again rise beyond the indicated levels is suggested by the recent gains in business sales—gains which may well have exceeded the expectations held when the survey was taken. At the time of the survey, sales were just recovering from the third-quarter slowdown which had culminated in the September sales decline. In October, however, total business sales moved up nearly 2 per cent to a record $63 billion (seasonally adjusted), mainly on the strength of advances in sales by manufacturers and retailers of durable goods. In November, seasonally adjusted sales by manufacturers of durables increased an additional 3¼ per cent, with almost all industries sharing in the gain.

In retail establishments, cash registers rang up a record $19.3 billion in November—3½ per cent more than in October and the first monthly sales volume to surpass the pre-recession peak. Continued strength in retail sales appeared to be evident in December, as Christmas shoppers pushed department store sales up by more than 1 per cent, seasonally adjusted. Sales of new automobiles, which normally decline in the pre-Christmas season, did so last month (although perhaps somewhat more than is cus-

tomary), but dealers expected a strong demand to reemerge in the new year. Further gains in retail sales in 1962 may be foreshadowed by the steady expansion in consumer incomes, which advanced another 1 per cent in November. The sharp October rise in newly extended consumer credit highlights the recent increase in the consumer's readiness to spend.

In addition to the possibility of further gains in final demand, the rate of inventory accumulation, particularly by manufacturers, may be increasing. According to a Commerce Department survey taken in November, manufacturers expected their (seasonally adjusted) inventories to reach $55.3 billion by the end of December—$0.9 billion above the end-of-September level—and were scheduling an additional $1 billion increase by March 1962. Manufacturers of durable goods account for the major portion of the planned first-quarter 1962 increase. This probably in part reflects hedging against a possible steel strike in mid-year. Such hedging may already have been in evidence in December, after the survey was taken, as steel users began to hop on the "order now" bandwagon, causing an appreciable rise in backlogs of unfilled orders in the steel industry.

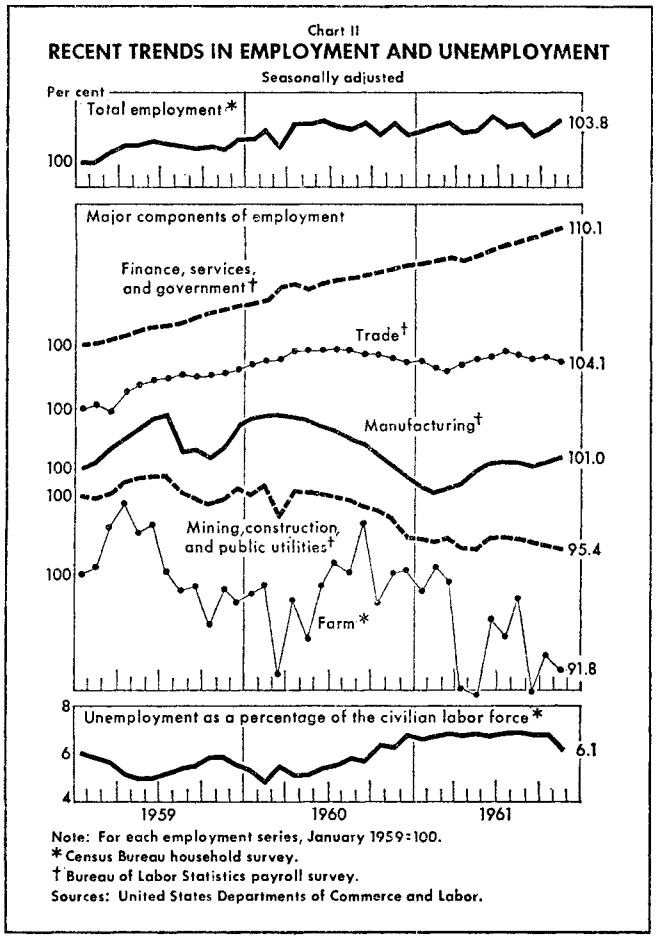


EFFECTS ON PRODUCTION AND EMPLOYMENT

Responding to higher levels of demand, the index of industrial production in November moved up 1 per cent to a record 114 per cent of the 1957 average. Output by manufacturers of nondurable goods and by mining and utilities firms each advanced about ½ of 1 per cent. The largest gain, a 2 per cent rise over October, was scored by durables manufacturers. This resulted primarily from an increase in automobile output, which was no longer hampered by strikes and was spurred on by the sharp rise in the demand for new cars. More automobiles were produced this past November than in any November since 1955. In December, when auto production normally slows down, output in the first three weeks continued at the high November level, as producers sought to augment dealer's relatively modest inventories. For the month as a whole, auto output rose more than 9 per cent (seasonally adjusted) above the November pace. Also pointing to a December increase in industrial production was a rise in steel output. Toward the end of the month, unofficial estimates showed steel producers operating at about 75 per cent of capacity—up from around 70 per cent estimated for the end of November.

In contrast to the expansionary trend in most major sectors as 1961 drew to a close, total construction activity in December declined about 2 per cent (seasonally adjusted). The decrease reflected sharp reductions in highway outlays and in construction for military purposes, which more than offset a fairly substantial gain in private residential construction. Outlays for private residential building have now advanced for ten consecutive months and in December were higher than at any time since September 1959. According to Department of Commerce forecasts, private housing starts are expected to show an increase in 1962 over the average for 1961. The predicted 1962 average, however, is not much different from the rate of starts reached this past October, thus implying a possible leveling-off in outlays for residential construction in the coming months.

The general expansion in business activity helped to push up seasonally adjusted total employment in November by about 1 per cent (see Chart II) to 67.2 million persons. This was only fractionally below the record level of employment reached last June. The unevenness of November's



improvement was highlighted by the fact that a gain of more than 500,000 persons in nonfarm employment (as measured by the Census Bureau's household survey) was partly offset by a decline in the number of persons at work in agriculture. Nonfarm employment according to the Bureau of Labor Statistics payroll survey rose only slightly in November and was similarly characterized by divergent movements in major components. The largest gain came in manufacturing employment, which advanced to 3 per cent above last February's figure. There were also increases in the number of persons at work in finance, services, and government, as employment in each of these sectors continued its long-term upward trend. In contrast, fewer persons were employed in trade, construction, and public utilities, while mining employment increased only slightly.

The civilian labor force showed only a small rise in November. As a result, the substantial gain in employment brought seasonally adjusted unemployment down to 4.3 million persons; since December 1960 unemployment had been near the 5 million mark. The drop in unemployment —which, if alternative seasonal adjustment techniques are used, appears to have begun earlier and proceeded more gradually—pushed the unemployment rate (unemployment as a percentage of the civilian labor force) down to 6.1 per cent in November, the lowest rate reported since September 1960 (see Chart II). The November decline in unemployment was fairly widespread geographically. The Labor Department reduced to 60 the number of the country's 150 major labor market areas classified as having substantial unemployment (an unemployment rate of 6.0 per cent or higher). In October the number had been 68. It is interesting to note, however, that in November 1958 (which came at roughly the same stage of the business expansion) the unemployment rate also dropped sharply, from 6.9 to 6.1 per cent, but that it was not until six months later, in May 1959, that the rate fell another percentage point to 5 per cent.

PERSPECTIVE ON 1961

Each year in February the Federal Reserve Bank of New York publishes *Perspective,* a 12-page illustrated review of economic and financial developments in the preceding year. Many businessmen find *Perspective* useful as a layman's summary of the economic highlights treated more fully in the Bank's *Annual Report.* If you would like to receive without charge *Perspective on 1961* when it appears in mid-February, write to the Publications Section, Federal Reserve Bank of New York, 33 Liberty Street, New York 45, N. Y. For those who are not familiar with this publication, copies of *Perspective on 1960* are available upon request as long as the supply lasts.

The Business Situation

As the new year got under way, the economy appeared to be expanding at a good though not exuberant pace. Preliminary estimates for the fourth quarter of 1961 indicate a strong advance in gross national product that entirely reflected gains in final demand. In December, to be sure, the rate of increase in industrial production and in various other monthly measures was somewhat less than in the two preceding months, while automobile sales declined from their November high. In January, moreover, department store sales slipped back from the record proportions reached in December, and new car sales apparently continued at the December pace. But such forward-looking indicators as orders received by manufacturers of durable goods, and commercial and industrial construction contracts, made a strong showing during November and December, giving support to the view that over-all activity would continue to move ahead. Another favorable sign was the decline of the unemployment rate in January to 5.8 per cent of the labor force. Late in that month, President Kennedy stated in his *Economic Report* that GNP is expected to amount to $570 billion in 1962, a rise of about 9 per cent over 1961.

Whether such an advance can be achieved, and whether it will be followed by still further expansion, will be importantly influenced by the behavior of prices. A renewal of the upsurge in prices of the sort experienced in the mid-1950's could well hamper the growth in consumer demand that is essential for a sustained economic expansion. It would also seriously reduce our ability to meet the rising challenge of foreign competition. Although prices have been unusually stable since the business upturn in early 1961, this stability will be put to its real test as the economy reaches higher levels of capacity utilization and as wage contracts in major industries are renewed.

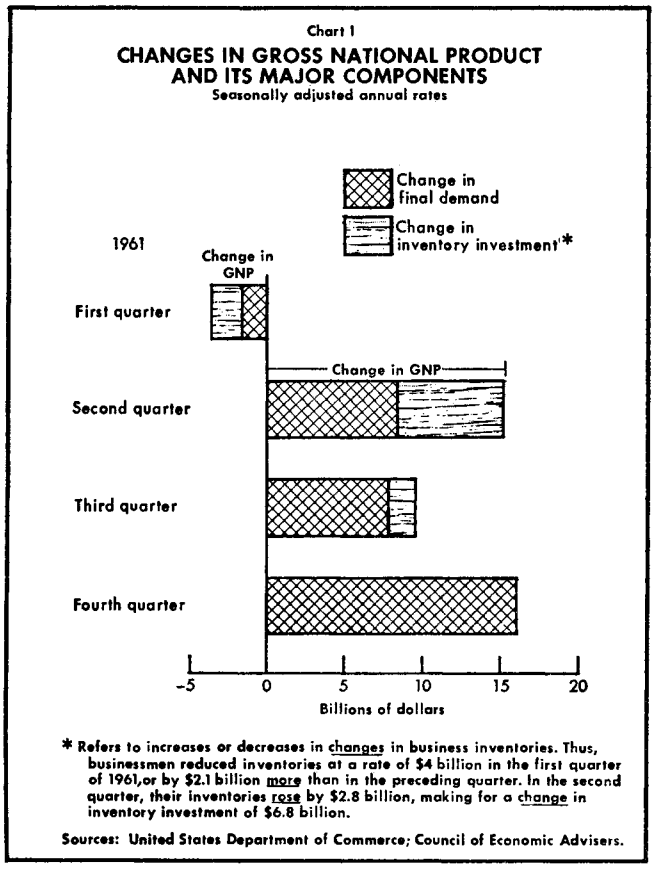
It is clearly desirable that wage contract negotiations in the steel and other industries be completed not only on a noninflationary basis, but also as soon as possible. This will avoid the unsettling effects on the economy that would arise from speculative stockpiling of inventories against the possibility of strikes or price increases. The importance of these considerations was pointed up by the President's announcement that he is urging labor and management in the steel industry to work out an early settlement consistent with continued price stability. It was further underlined by the attention that the *Annual Report* of the President's Council of Economic Advisers paid to the problem of developing guideposts for judging whether particular wage decisions are inflationary. The Council suggested that, to be noninflationary, wage increases should in general not exceed the trend of average productivity gains for the private economy as a whole.

THE ADVANCE IN GROSS NATIONAL PRODUCT

Gross national product rose by $16.2 billion (seasonally adjusted annual rate) during the final quarter of 1961, according to estimates by the Council of Economic Advisers. Significantly, all of the gain was in final demand, with the pace of inventory accumulation remaining unchanged. In each of the preceding two quarters, by contrast, the change in inventory investment had accounted for a significant portion of the over-all GNP advance (see Chart I). The fourth-quarter step-up in final demand was about twice as large as that in either of the two preceding quarters, with the most striking increases occurring in consumer purchases of durable goods ($3.2 billion), Federal defense outlays ($2.6 billion), investment in producers' durables ($2.0 billion), and net exports of goods and services ($1.4 billion). The only major component to decline was nonresidential construction, which edged off slightly for the second consecutive quarter. This was more than offset, however, by the rise in business investment in durable equipment.

A key feature of the October-December GNP change was the upsurge in personal consumption expenditures. Such outlays climbed by 2½ per cent in the October-December quarter, following a rise of 1½ per cent during each of the two previous quarters. While about half of the fourth-quarter advance in consumer spending reflected a very considerable step-up in purchases of durable goods, spending on nondurables also rose more rapidly than in the earlier quarters. Expenditures for services, which have been increasing steadily for many years, continued to advance at about the same rate as before.

The sharp rise in durable goods purchases during the quarter to a large extent reflected increased sales of new automobiles. Such sales rose 9 per cent in November, to



a seasonally adjusted rate of almost 7 million cars a year, partly on the strength of sales that had been deferred in September and October because of shortages stemming from strikes in the auto industry. In December, sales receded to a rate of 6 million cars, but this was still well ahead of the rate for any month prior to the fourth quarter. During the first three weeks of January, automobile sales continued at approximately the December pace, after allowance is made for the usual seasonal decline. Sales of appliances and most other durable goods, as well as of nondurables, continued to rise in December, while the ratio of total retail purchases to personal income, although down from November, was higher than in any other month since March.

Federal Government outlays on defense, as indicated earlier, provided a substantial lift to GNP during the fourth quarter. The $2.6 billion increase in such spending contrasted with a third-quarter rise of $0.2 billion, and was larger than any preceding quarterly increase during the ten years since the Korean war. Moreover, since Defense Department contract awards and obligations had risen sharply during the summer, and since it ordinarily takes many months before the full impact of new contracts on defense output is felt, this component of GNP is likely to rise further during the current and subsequent quarters. It is noteworthy, however, that according to the estimates in the *Budget* and in the *Annual Report* of the Council of Economic Advisers, Federal purchases of goods and services in 1962—including those for defense—will on average rise more slowly than in 1961.

A further advance in fixed capital investment by business also seems likely. Seasonally adjusted outlays for commercial and industrial construction turned up at the end of the year, and the volume of contract awards for such construction rose markedly in November-December. Moreover, while new orders for machinery and equipment declined in December, they had moved uninterruptedly upward during the four preceding months, probably indicating there will be a continuing rise in production of such items for some months ahead.

The outlook for investment in housing is more uncertain. Private nonfarm housing starts declined in December for the second month in a row, but new building permits for such construction rose strongly. While the permit series is less comprehensive than the starts series, it is also less erratic. Requests for Government-backed mortgage financing, moreover, showed a substantial advance in December. The divergent movements of these various indicators leave it unclear whether or not housing outlays, which gained markedly in January, will be moving up further.

Although inventory investment did not contribute to the fourth-quarter rise in GNP, this does not mean that inventories were not being accumulated. It rather signifies that business firms were adding to their stocks at the same rate as before. This rate could increase in the current quarter if final demand advances at a good clip. It is worth noting in this connection that a study by the Department of Commerce shows that manufacturers' stocks at the end of 1961 generally were at a comparatively low level relative to sales and new orders. Much will depend, of course, on the extent to which accumulation of steel inventories is spurred by anticipations of a strike. The heavy volume of steel orders in recent weeks suggests that such anticipations have already had some influence on steel buying.

PRODUCTION, EMPLOYMENT, AND INCOME

The Federal Reserve's seasonally adjusted index of industrial production advanced by 1 point in December, and gains in production continued to be widespread. Schedules for January auto production point to a slight decline from

the high December level, after allowing for the usual seasonal rise, but the adverse effect from this source on the over-all rate of industrial output may be more than offset by a continuing advance in the output of steel and other products.

Despite the December rise in industrial output, total employment declined slightly. In January, however, employment rose back to about the November level, and the unemployment rate, seasonally adjusted, fell below 6.0 per cent for the first time in sixteen months. Nonagricultural employment in December, as measured by the payroll survey, remained at about the November level. While employment in manufacturing continued to rise modestly, it fell in most other major industries. For the nonmanufacturing sectors that had been the hardest hit by the recession—construction, transportation, and mining—the December declines meant continuation of a downward drift that the business recovery has yet to reverse.

The lack of strength in employment held the rise of personal income in December to $2 billion (at a seasonally adjusted annual rate), the smallest advance in three months. Close to half of the increment came from a large increase in dividend payments, while the rise in wage and salary disbursements was only about one quarter as large as in November.

PRICE MOVEMENTS

After eleven months of economic expansion, prices have continued to show marked stability. The wholesale price index of all commodities, which has been generally stable since early 1958, was in fact lower in December 1961 than it had been at the February 1961 business cycle trough (Chart II). Wholesale industrial prices, moreover, were at about the same level in December as in February, after allowance is made for the seasonal decline between these two months. This was in contrast to earlier postwar expansions when such prices invariably rose during the first ten months. In the 1958-59 expansion, for example, industrial prices rose markedly, and only an offsetting drop in prices of farm products and processed foods kept the over-all index from rising.

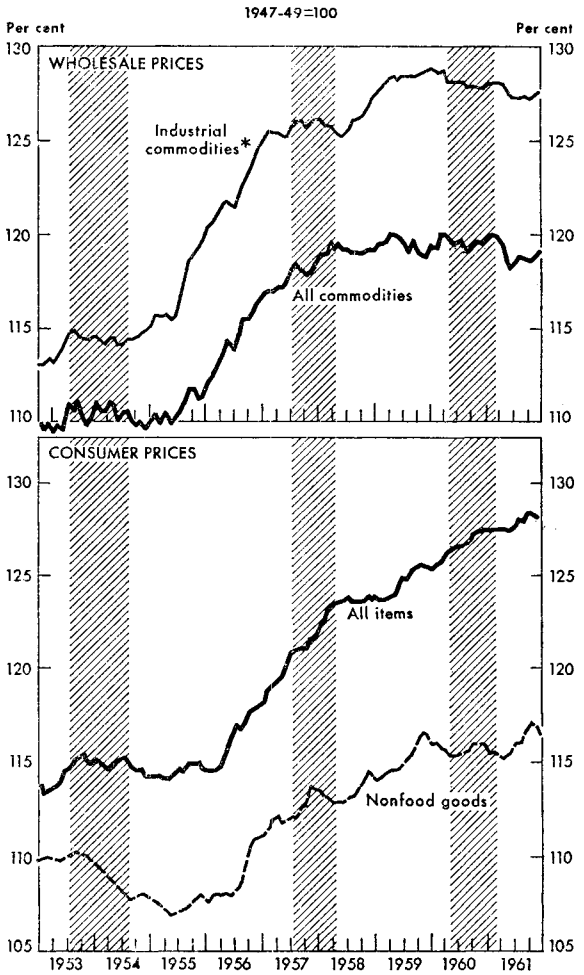
Consumer prices of commodities other than food rose moderately between February and December—slightly less than in the comparable phase of the 1958-59 expansion. The 1½ per cent rise in the price of services over the period also was slightly smaller than the advance in 1958-59 and compares with much larger increases in most other postwar years.

Many of the factors restraining price increases during 1961 also existed in the periods following the previous two recessions, including an easing of farm prices and excess industrial capacity. Some other factors probably have been more powerful in holding back price advances in the current than in earlier expansion periods. One of these is foreign competition—from actual imports and the ever-present threat of larger imports if domestic prices get out of line. Such competition has no doubt reinforced consumer resistance to higher prices on automobiles and other "big ticket" items. In addition, there has apparently been a growing awareness by manufacturers of such items that price increases in recent years have tended to limit sales. Finally, wage rates have not been rising as fast in recent years as they had earlier,

Chart II

WHOLESALE AND CONSUMER PRICES

1947-49=100



Note: Shaded areas represent business recessions according to the National Bureau of Economic Research chronology.

*All commodities less farm and food products.

Source: United States Bureau of Labor Statistics.

partly because of the greater difficulty of passing on higher production costs to consumers.

Raw materials prices have also come under more intense pressures. The growing overlap of uses for different raw materials, for example, has widened competition between aluminum and steel, steel and reinforced concrete, metals and plastics, and rubber and nonrubber synthetics. During last autumn, moreover, prices of many world-traded commodities sagged as manufacturers in a number of countries abroad curtailed their purchases—either because demand for their own products was weakening or because, as in Japan and the United Kingdom, balance-of-payments difficulties forced the adoption of fiscal and monetary measures that curbed imports.

The second year of business expansion is, of course, a more severe testing period for price stability than the first year. In the expansion following the 1954 recession, for example, the price rise was moderate until about a year after the trough. (The second year following the 1958 recession provides a poor reference because of the distortions introduced by the steel strike in the second half of 1959.) In 1955-56, bottlenecks developed in certain sectors and led to price rises that spread throughout the economy. Industrial capacity now, however, appears to be better balanced to meet an increase in demands, and foreign competition is more vigorous. While these elements in the price picture are relatively favorable, the course of prices over the coming year will in large measure depend on the pace of productivity gains, on policies followed on the fiscal and monetary fronts, and on the degree of restraint exercised by management and labor.

PERSPECTIVE ON 1961

The Federal Reserve Bank of New York has just published *Perspective on 1961,* a twelve-page review of economic and financial developments. Many businessmen and teachers find *Perspective* useful as a layman's summary of the economic highlights treated more fully in the Bank's *Annual Report.* Copies of *Perspective* are available without charge in quantity to teachers for classroom distribution and in limited quantities to others as long as the supply lasts. Requests should be addressed to the Publications Section, Federal Reserve Bank of New York, 33 Liberty Street, New York 45, N. Y.

The Money Market in January

The condition of the money market varied between moderate firmness and ease during January. A relatively firm tone prevailed in the early days of the month, in part reflecting the lingering effect of year-end firmness in the money market associated with strong credit demands which had built up over December. However, as these pressures receded, an easier trend was evident over the rest of the month. The effective rate for Federal funds thus remained close to the 3 per cent ceiling during the first few days of the month but generally fluctuated between 2 and 2½ per cent thereafter, save for two occasions toward the end of the biweekly reserve-averaging periods of country banks (January 10 and 23), when inflows of funds from these banks to the money centers and an unseasonally high level of float combined to push the rate as low as ¼ per cent. Similarly, dealer loan rates posted by the major New York City banks generally held in the neighborhood of 2½-3 per cent, but fell to the 1¼ per cent area during these intervals. In the market for Treasury bills, rates rose early in the month to 2.82 per cent and 3.07 per cent on three- and six-month issues, respectively, the highest levels reached in well over a year, but adjusted gradually downward during the balance of the period. Rates on both directly placed and open market commercial paper followed the same pattern.

In the market for Treasury notes and bonds, prices fluctuated narrowly during the month, and interest centered on the Treasury's refunding and "new money" borrowing operations. On January 9, the Treasury auctioned $2 billion of one-year bills, dated January 15, 1962, at an average issuing rate of 3.366 per cent. The proceeds of the bill issue were used to repay $1.5 billion one-year bills maturing January 15 and to raise $0.5 billion of new cash. The Treasury raised another $1 billion of new cash later

The Business Situation

A number of key economic measures receded slightly in January, and the fragmentary information thus far available for February indicates little if any improvement. While concurrent declines in several broadly based measures do of course raise doubts, temporary hesitations during a cyclical advance are not unusual. As Chairman Heller of the President's Council of Economic Advisers remarked recently, "every recovery has its sharps and flats, its spurts and pauses". Moreover, the early part of each year has more than its share of such lulls. This year, for example, severe snowstorms blanketed large parts of the country during January. Even though such an influence is essentially seasonal, it is not fully taken account of by the usual seasonal adjustment techniques (which only correct for the average effect of seasonal forces) and may have an appreciable impact on business sentiment.

The most notable declines in January were in industrial production, nonagricultural employment, personal income, and retail sales. For February, the reports so far indicate that automobile and steel ingot production declined, after allowing for the normal seasonal influences. At the retail level, the February information was mixed, with sales of new cars in the first twenty days of the month below seasonal expectations while department store sales moved up after seasonal adjustment.

In contrast to the declines in many economic series, new orders received by manufacturers of durable goods, a "leading" indicator, showed a marked and widespread increase in January; according to reports by purchasing agents, moreover, further gains in orders appear to have been registered in February. Government expenditures have also increased substantially so far this year and are expected to continue upward. This trend, as well as the stimulus exerted by the new orders for durables, would seem to suggest that the underlying forces of expansion continue quite strong. With the sudden break-off of steel wage negotiations last week, the possibility arises that the economy will receive a further boost through a sharp spurt in steel orders, unless the Administration succeeds in its announced intention of getting the bargaining going again soon. Such a stimulus would only be temporary, however, while rapid conclusion of a noninflationary settlement would clearly add to the long-run strength and stability of the economy.

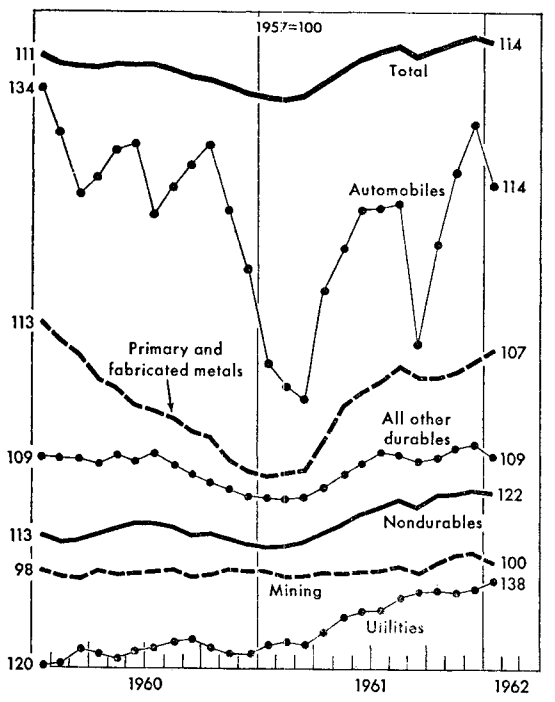
PRODUCTION DECLINES BUT ORDERS RISE

Industrial production receded from its record high in December. It fell back nearly 1 per cent in January to its November level (see Chart I), the first reversal since September 1961 when automobile output had been curtailed by strikes. In January it was again the auto industry that led the decline. Auto assemblies dropped 10 per cent from December's record annual rate of 7.3 million units (seasonally adjusted), as manufacturers sought to bring output more closely in line with sales, and during the first three weeks of February assemblies were cut back further. Autos were not, however, the only industry to show a decline in January. The total output of all other nonmetal durables fell 2 per cent. Nondurables output and mineral production also declined, although the decrease in the former was less than 1 per cent.

Chart I

RECENT DEVELOPMENTS IN INDUSTRIAL PRODUCTION

Seasonally adjusted



Source: Board of Governor of the Federal Reserve System.

The principal advance in January was in the output of primary and fabricated metals, which reflected a gain of almost 4 per cent in iron and steel production. Steel ingot production continued to move upward in early February but then declined slightly, probably reflecting the halt around midmonth in the upsurge of new orders for steel. Orders had been spurred by anticipation of a strike, but this influence was much moderated as intensive efforts by the Administration brought hopes of an early and non-inflationary wage settlement in the steel industry.

The continuing strength of demand was underscored by a jump in January in the volume of new orders received by durable goods manufacturers, a series that normally leads output. Such orders rose 2 per cent, seasonally adjusted, despite a decline in automobile orders (which actually represent auto manufacturers' deliveries to dealers) and little change in steel orders. This was the twelfth consecutive monthly advance in durables orders, and the first time in five months that the number of industries reporting gains increased. In December, when the value of new orders had risen 1 per cent, only ten of the twenty-one durable goods industries had shared in the gain, according to preliminary information, and the lion's share had gone to steel producers. In January, by contrast, fourteen of the industries reported increases.

Forward-looking indicators of construction activity are less buoyant. Private nonfarm housing starts fell slightly in January, for the third consecutive month of decline in this erratic series, and the volume of new building permits dropped sharply after a strong rise in December. The residential building statistics for January, however, were probably influenced by the storms that swept many parts of the country. Not only may housing starts have been delayed, but the storms made it difficult for enumerators to do their customary counting. In commercial and industrial construction, contract awards dropped sharply in January, following the mild decline a month earlier. This series, however, is also quite erratic.

PAUSE IN EMPLOYMENT, INCOME, AND RETAIL SALES

Total nonfarm employment (as measured by the Bureau of Labor Statistics payroll survey) declined slightly between December and January, as reductions in manufacturing, mining, and construction payrolls were largely offset by increases in Government and trade employment. This left nonfarm employment in January only 1.8 per cent above the level at the business cycle trough eleven months earlier, significantly less than the 4.5 per cent and 3.8 per cent increases during the comparable periods of the 1954-55 and 1958-59 expansions.

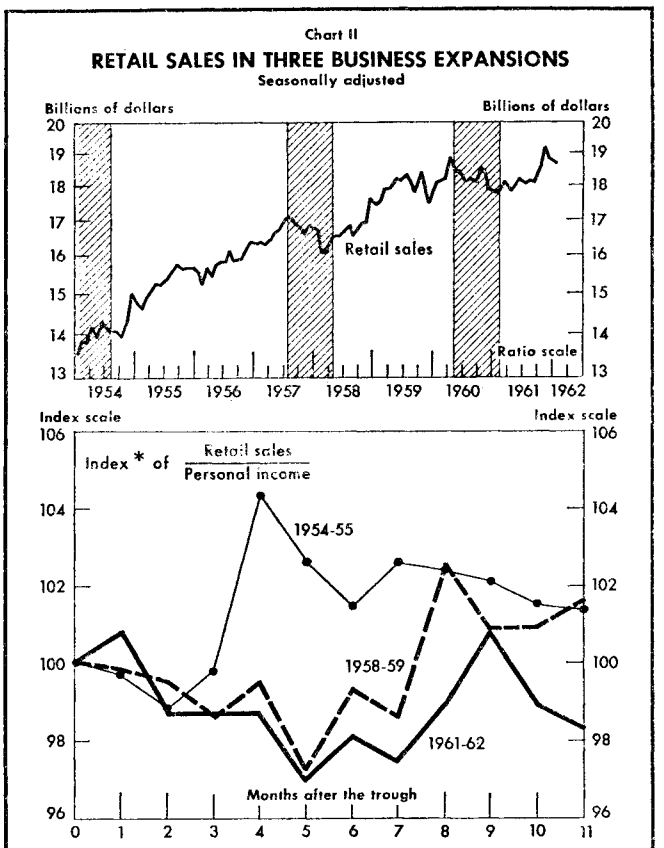


Chart II
RETAIL SALES IN THREE BUSINESS EXPANSIONS
Seasonally adjusted

* Index in trough month=100 in each case.

Note: Business-cycle turning points are those indicated by the National Bureau of Economic Research chronology. Troughs: August 1954, April 1958, and February 1961. Peaks: July 1953, July 1957, and May 1960.

Source: United States Department of Commerce.

The January slowdown in industrial production was accompanied by a more-than-seasonal reduction in average hours worked by production workers in manufacturing, and in their average weekly earnings. Part of this decline was attributable to the storms in the South and Midwest, but the major factor was the sharp cutback in overtime work in the automobile and a number of other industries. The decrease in average weekly earnings contributed to the January decline in personal income of $1.5 billion (seasonally adjusted annual rate). More than half of the decline in income reflected, however, the absence in January of the unusually large volume of corporate dividends that had been paid out at the end of the year and the special life insurance dividends that had been distributed in December to veterans of the Korean conflict.

Retail sales also decreased in January, for the second month in a row, to a level only slightly better than that reached last October (see Chart II). Moreover, in Feb-

ruary, auto sales in the first twenty days appeared to be running somewhat behind their January rate, and the decrease may offset the slight gain in department store sales during the month. The January decline in retail sales pushed the ratio of retail sales to personal income downward for the second consecutive month, with the result that the ratio remained below its level at the trough of business activity in February 1961. By contrast, at comparable stages of the two previous upswings, consumers had responded to the generally improved business situation by spending an increased percentage of their incomes for retail purchases. With retail sales relatively low in relation to personal income, there is apparently ample scope for a future expansion in such sales, if consumers feel so inclined—and their inclinations may become an increasingly strategic factor in the months ahead.

The Money Market in February

The money market was comfortable during February. The effective rate on Federal funds fluctuated in a fairly narrow range of 2½ to 2¾ per cent during most of the month, dropping occasionally to as low as 1½ per cent. Dealer loan rates posted by the major New York City banks held in the neighborhood of 2½-3 per cent on most days. In the Treasury bill market, rates tended to drop a bit early in the month, then edged up through mid-February to the highest levels in over a year. Subsequently, however, a strong demand developed and rates declined in the last auction to the lowest level for 1962. The market for Treasury notes and bonds was strengthened by the decline in a number of economic indicators for January, which generated expectations that interest rates might stay at current levels or even decline. Prices thus tended to move up during the month. In this atmosphere the Treasury's two large refunding operations, described below, were accorded good receptions.

MEMBER BANK RESERVES

Market factors absorbed member bank reserves during the first and final statement weeks and released reserves during the second and third weeks (see table). A drop in vault cash was the chief loss of reserves in the first week. Reserve pressures subsequently were eased by a decline in required reserves and then by a sizable rise in float. During the final statement week of February, a drop in float withdrew reserves once again.

System open market operations generally offset these fluctuations in reserves stemming from market factors. Thus reserves were provided during the first and last statement weeks of the month, and withdrawn during the second and third. Over the month as a whole, average System holdings of Government securities declined by $25 million. Between Wednesday, January 31, and Wednesday, February 28, System Account holdings of United States Government securities declined by $172 million to $28,360 million.

THE GOVERNMENT SECURITIES MARKET

In the market for Treasury notes and bonds, interest centered on the two large refunding operations held during the month. The first of these refundings was announced on February 1, and offered holders of four issues of Treasury notes maturing February 15 and April 1, 1962 the right to exchange these issues at par for either of two new securities: 3½ per cent certificates of indebtedness due February 15, 1963 or 4 per cent notes due August 15, 1966. The offering was very well received as the public exchanged $3.4 billion of maturing issues into the new certificates, and $2.9 billion into the new notes, leaving only $420 million, or about 6.2 per cent, to be redeemed for cash.

On February 15, the Treasury announced a large-scale advance refunding through which holders of nearly $19 billion of outstanding bonds could extend the maturity of their current holdings for additional terms ranging between 6½ and 26½ years and receive higher current rates of return. In the operation, the Treasury combined for the first time a "junior" advance refunding (in which holders of relatively short-term maturities were given an opportunity to exchange them for an intermediate maturity) and a "senior" advance refunding (in which holders of intermediate-term securities could exchange them for a longer term issue). In the junior refunding, holders of $3.9 billion of 3 per cent bonds of February 1964 and $6.9 billion of 2⅝ per cent bonds of February 1965 were offered new 4 per cent bonds maturing in August 1971.

A divergence between short-term and term loan rates has occurred during the later part of rate upswings, as in mid-1953, mid-1956 to mid-1957, and mid-1959 to mid-1960. Short-term rates advanced in step with the prime rate at these times, but term loan rates rose more slowly (Chart II). As a result, there have been periods of as long as a year in which the average rate on new term loans has been lower than that on even the largest ($200,000 or more) short-term loans.

NONRATE ASPECTS OF BANK-CUSTOMER RELATIONS

Although the present study was not directly concerned with the nonrate aspects of bank loan allocation, it provided some insights consistent with the results of other recent studies. In particular, a critical factor considered by banks in ruling on particular credit requests seems to be the past and expected profitability of the customer relationship as a whole, including prominently its deposit as well as its loan aspect. At one large bank, for example, the rise in the proportion of prime loans as money tightened was attributed partly to the fact that "many good customers [depositors], nonborrowers for years, seemed to come in for loans". Conversely, when deposits are abundantly available, the banks become less concerned about the deposit side of the customer arrangements and more willing to make loans to other credit-worthy borrowers. Much more investigation into lending terms and practices is needed, however, to justify any firm conclusions on these points. Indeed, there may be considerable differences in basic philosophy and policy among individual banks and among banks of different sizes.

It should be kept in mind that the prime rate originated as a floor to lending rates in a period of excess liquidity and slack bank loan demands. For many years thereafter, banks operated in an atmosphere of ample liquidity and historically low interest rates. Over the past decade, however, this liquidity has been largely used up, to the extent that some large banks may at times find themselves unable to accommodate fully the loan demands (including demands for advance commitments) of all their prime customers. Under these more recent circumstances, nonrate elements have gained importance in rationing bank credit among eager borrowers of highest credit standing.

It is vital to recognize, furthermore, that the importance of nonrate factors in individual transactions does not necessarily imply that rate changes play an insignificant role in the aggregate. Borrowers with access to several sources of funds, such as large utilities and finance companies, are often quite sensitive to rates and rate differentials. Their reaction to rate movements may at times substantially affect the over-all loan situation. Moreover, all borrowers may be marginally influenced by rate levels, and anticipations of rate changes, in the size of their bank loan requests. Since most loan proceeds are quickly spent on goods and services, even a relatively small response of the pace of loan extensions to a change in interest rates can have significant effects on total economic activity.

The Business Situation

Business expansion in the first quarter of the year apparently was less rapid than expected, and slower than at comparable stages of the two previous business cycles. To be sure, the major economic series that turned down in January had generally recovered their losses by February, and early indications are that additional gains in production and sales may have occurred in March. But the advances in these series over year-end levels that have been recorded so far have been quite moderate.

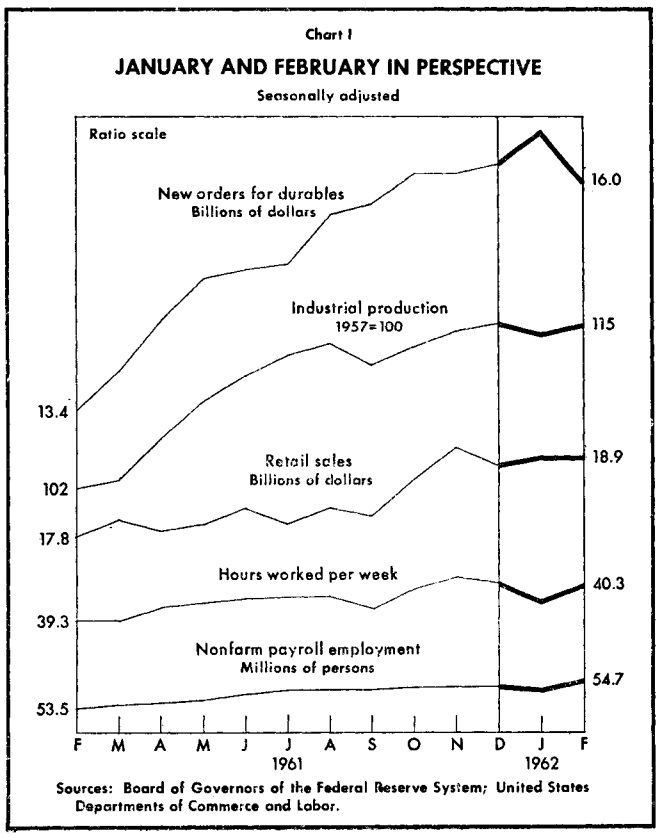
That the economy will continue to expand seems indicated by a number of developments. Federal spending is scheduled to increase throughout the months ahead. Personal income is rising, and while consumers have been somewhat hesitant in their spending during recent months, the brisk pace in automobile sales in March may mean that purse strings have now been loosened. The latest survey of businessmen's capital spending plans, moreover, points to increases in plant and equipment outlays throughout the year, although at a slower rate than during the comparable stages of both the 1954-56 and 1958-59 expansions. Finally, the steel wage settlement that was reached at the end of March should significantly add to the long-run strength of the economy. Not only does it remove the threat of erratic inventory movements, but its reported

terms definitely appear to enhance the prospect that business expansion will continue to take place against a background of relative price stability.

While on balance the various "foreshadowing" statistics suggest further economic gains, they do raise questions as to whether the pace of the advance will be sufficiently vigorous to meet the economy's requirements for growth. This is a particularly serious problem because of the possibility that increases in the labor force this year may be substantially larger than in 1961, thus greatly complicating the task of reducing an unemployment rate that still remains much too high.

JANUARY-FEBRUARY MOVEMENTS OFFSETTING

Industrial production in February (seasonally adjusted) recouped the loss suffered in January. Output moved up one point to 115 per cent of the 1957 average (see Chart I). Iron and steel production, which had been a major source of strength in each of the preceding three months, rose 5 per cent, and output of such final products as commercial and industrial equipment, television sets, and apparel also increased. Even with the February gains, however, total industrial production was only 1¾ per cent above the level attained six months earlier. Moreover, it was only 12½ per cent above the level at the beginning of the upswing in February 1961, contrasting with increases of 15 per cent and 22 per cent, respectively, during the comparable phases of the 1954-55 and 1958-59 expansions. Although the information thus far available for March is fragmentary, total production may have increased again in that month. Auto assemblies, for instance, appear to have shown a slight gain from the February level, and iron and steel production may also have moved upward.



New orders received by manufacturers of durable goods in February dropped by 2¼ per cent (see Chart I). While this represents the first decrease in this forward-looking series since the business cycle trough in February 1961, it is also true that the series tends to be somewhat erratic and a steady upward trend is unusual. Furthermore, the downward movement of the series in February was largely attributable to a drop in steel orders caused by the progress in the steel wage negotiations.

The rise in industrial production in February carried employment and hours worked to higher levels. Nonfarm employment, seasonally adjusted, rose by 269,000 persons, according to the Bureau of Labor Statistics payroll survey, and seasonally adjusted average weekly hours clocked by production workers in manufacturing increased from 39.8 to 40.3 (see Chart I). The Census Bureau's household survey indicated that agricultural employment also rose in February and that seasonally adjusted total employment (farm and nonfarm) reached a record level of 67.9 million. This gain in employment was greater than the large rise that occurred in the civilian labor force, so that the number of unemployed persons fell by 150,000 persons to 4.0 million (seasonally adjusted), the lowest level since July 1960. Consequently, unemployment as a percentage of the civilian labor force declined again, but at 5.6 per cent it still was above the levels at the comparable stage of the two preceding expansions—5.2 per cent in April 1959 and 4.3 per cent in August 1955. Partly in response to the continuing high rate of unemployment, the Administration in late March proposed a $600 million program of public improvements to provide jobs for workers in economically depressed areas.

Whether the unemployment total can be significantly lowered in the months ahead will depend primarily on the pace of future economic expansion, the gains in productivity, and the trend of the labor force. In 1961 the labor force showed virtually no net change, whereas in both of the two preceding years it had grown by more than a million. A variety of factors was responsible for

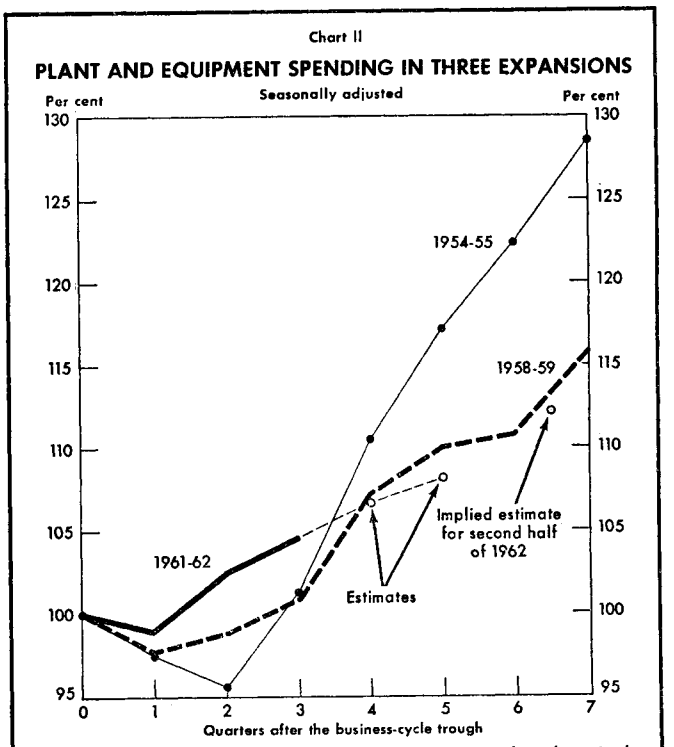
this lack of growth during 1961, including an increase in the number of students remaining in school, a large influx of persons into the armed forces, and the fact that changes in legislation permitted elderly people to choose earlier retirement with immediate social security benefits. Similar factors may not be present in as large a degree this year, and the labor force may well resume its more normal growth trend.

FORCES OF FUTURE EXPANSION

One factor that should contribute to expansion in coming months is consumer spending. Throughout the past year personal income has grown at a rate approximately in line with the patterns experienced during previous upswings, the most recent increase of $2.7 billion (seasonally adjusted annual rate) in February more than offsetting the January decline. Despite these higher incomes, consumer spending on goods (as opposed to services) has been somewhat hesitant in recent months. Thus, retail sales in February, according to preliminary indications, increased only ½ of 1 per cent, seasonally adjusted (see Chart I), with sales of durable goods declining. Some change in consumer attitudes in March, however, may be indicated by the sharp rise in automobile sales. The March data on department store sales similarly appear to show strength, although these statistics are difficult to assess because of the late date of Easter this year.

Business spending will, of course, also play an important part in determining the configuration of economic expansion in the months ahead. For a while it appeared that inventory accumulation, spurred on by steel stockpiling as a hedge against the possibility of a steel strike, might provide a strong push to the expansion. In part because of the early start of the steel wage negotiations, however, such a build-up of inventories seems to have been moderate. Even the two-week recess in negotiations early in March did not budge steel users from a wait-until-April attitude. Such an attitude had already been reflected by a Department of Commerce survey taken in February (i.e., before the break-off and resumption of negotiations). The survey showed that, although manufacturers planned to add $1.2 billion (seasonally adjusted) to their inventories during the first quarter of the year, they expected to accumulate only $0.8 billion in the second quarter. During the 1959 steel negotiations, by contrast, manufacturers' inventories had risen by $1.3 billion in the first quarter and by $1.7 billion in the second quarter.

Capital spending plans surveyed by the Commerce Department-Securities and Exchange Commission in January and February suggest that such spending will move up



Note: Business-cycle trough quarters=100. Trough quarters are those determined by the National Bureau of Economic Research chronology: III-1954, II-1958, and I-1961.

Sources: United States Department of Commerce; Securities and Exchange Commission.

steadily during 1962 (see Chart II). Estimated outlays in the first quarter of $36.1 billion (seasonally adjusted annual rate), although slightly below last November's expectations, represent a gain of almost 2 per cent over actual outlays in the final quarter of 1961, which had also been somewhat below earlier expectations. Outlays are expected to rise further to a $36.6 billion rate in the second quarter of 1962, bringing the average for the first six months to a level that would be 3¾ per cent above that attained in the last half of 1961. For the year as a whole, capital spending is expected to total $37.2 billion, implying that outlays during the second half of 1962 will rise to $38.0 billion, or 4½ per cent above the average for the first half. Such a gain, however, would still leave capital spending for the year at virtually the same volume as in 1957 when GNP was three-fourths as large as what is widely suggested for 1962.

While these quarterly estimates suggest that the rise in capital spending in the first five quarters of the 1961-62 business expansion (that is, through mid-1962) will fall slightly behind the increase during the comparable period in the 1958-59 upswing and substantially behind the

1954-55 performance, it is of course possible that actual outlays in 1962 will surpass the estimates. Such a better-than-planned performance was experienced in the 1954-55 expansion, although not in 1958-59 when outlays were held down by the steel strike. Assessment of the estimate implied for the second half of 1962 in terms of the experience in earlier business cycles is rather difficult. In part, this is because in each of the two previous business expansions such long-range estimates were made at a somewhat earlier stage of the advance. (It is worth noting, however, that these long-range estimates were surpassed by the volume of outlays actually rung up.) Moreover, this year there is a possibility that important changes in tax treatment of investments will be adopted—both through additional administrative rules and new legislation—and this could well provide an added stimulus to capital spending, even though pressure on available capacity is far from widespread.

The Money Market in March

The money market was generally comfortable during March, as the effective rate on Federal funds held to a narrow 2¾-3 per cent range virtually through the entire month. Rates on loans to Government securities dealers posted by major New York City banks also held to a fairly narrow range, fluctuating between ¼ point above or below 3 per cent. The money market took the midmonth tax and dividend period easily in stride, although the money market banks came under some reserve pressure in the latter part of the month as Federal Reserve float fell short of anticipated levels and as Chicago banks made preparations for the April 1 Cook County tax date.

Treasury bill rates fluctuated relatively little over the month. A rising supply of bills provided by $100 million increases in each of the regular three-month bill offerings in March was met by a growing demand. This demand was associated with the build-up of bill portfolios by financial institutions in Chicago in preparation for their tax date, and the reinvestment on March 23 of proceeds of tax anticipation bills held to maturity. To some degree, however, this demand may also have been related to the two reductions in the British bank rate, effective March 8 and 22, which reduced the attractiveness of investment in British Treasury bills. However, movements of short-term funds to the United Kingdom are not necessarily related to Treasury bill rate differentials alone, but can reflect rate relationships with a broader range of short-term instruments. Furthermore, a substantial rate incentive continued to exist for uncovered movements of funds to London on various types of instruments, including Treasury bills, although the covered arbitrage incentive in the case of Treasury bills was slightly in favor of New York after March 8.

A confident tone prevailed in the market for Treasury notes and bonds. Uncertainties concerning the strength of the business recovery, as well as the British bank rate reductions, gave rise to the view that longer term interest rates might continue to hold steady, or even edge lower in the period just ahead. The unusually narrow yield spread that developed by mid-March between Treasury obligations and high-grade corporate issues also tended to raise demand for Government securities. As prices of Treasury notes and bonds moved to highs for the year, the market continued without much strain the distribution of new and reopened bonds issued in the Treasury's regular and advance refunding operations in February.

MEMBER BANK RESERVES

Market factors (operating transactions, vault cash, and required reserves) absorbed $472 million of member bank reserves on balance over the four statement weeks ended March 28 (see table). Reserves fell during the first week, as vault cash declined sharply. A rise in vault cash along with a decline in required reserves largely offset reserve losses from operating transactions, particularly a rise in currency in circulation in the second week. In the third week, a substantial increase in required reserves associated with tax and dividend borrowing by corporations, while offset in part by an expansion in float, nevertheless produced some temporary reserve pressures in the money market banks. During the fourth week of March, a contraction in float again drained reserves on balance.

System open market operations in March generally offset reserve losses stemming from market factors. System operations supplied $394 million of reserves during the

The Business Situation

The economy displayed more vigor during March and early April than during the first two months of the year. Most encouragingly, consumer spending—especially on automobiles—picked up briskly. Residential construction seemed to be moving out of its recent doldrums. There were also signs of a somewhat faster growth in expenditures for plant and equipment for the balance of the year than had been indicated earlier.

Although the March gain in output helped to make some small inroads on unemployment, the unemployment rate was still significantly higher than at the comparable stage of the two preceding business expansions. At the same time, despite the drop in total unemployment the number of persons out of work more than half a year (the so-called "hard core" unemployment) increased further and stood well above the level at the trough of the recession in early 1961. And, despite the spurt in economic activity in March, gross national product in the first quarter of 1962 rose less than half as much as in the preceding quarter.

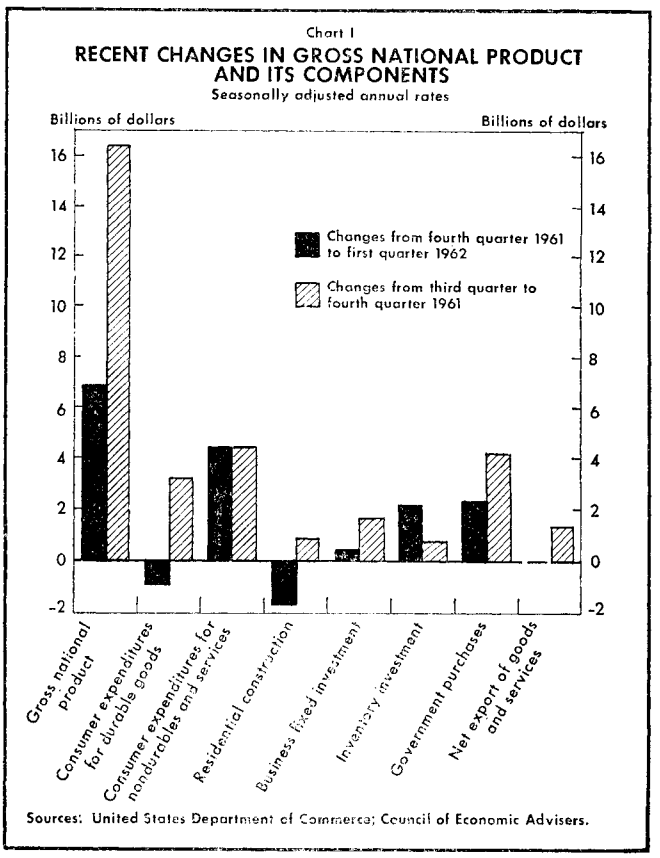
The expansion in economic activity continued to be accompanied by little change in prices. The wholesale price index was stable in March, as it had been in February, and remained below year-earlier levels. The consumer price index, after four months of stability, did advance in both February and March, but at least part of the rise could be attributed to increased food prices brought on by freezing weather in the South and by seasonally higher prices of apparel and used cars. The prevailing noninflationary atmosphere, which has been strengthened by the signing of the rather moderate steel wage contract at the end of March (from which, significantly, the cost-of-living escalation clause was eliminated), was only briefly disturbed in early April by the short-lived rise in the price of steel.

THE PATTERNS OF DEMAND

Through the final quarter of 1961 the growth in GNP in the current expansion had roughly paralleled its performance in the two preceding periods of upswing. However, with the relatively small advance of $6.8 billion to a seasonally adjusted annual rate of $549.0 billion in the first quarter of 1962 (see Chart I), the growth in GNP fell slightly behind the pace set in the earlier expansions.

The slowing-down in the first quarter stemmed largely from declines in consumer expenditures for durable goods, primarily automobiles, and in outlays for residential construction. In the comparable quarters of the two preceding upswings, demand in these two areas had continued to advance or had remained unchanged. In addition, the rate of increase in business expenditures for fixed investment slackened in the first quarter, whereas in the earlier expansion periods such spending had advanced rather sharply. Business investment in inventories, on the other hand, accelerated in the first quarter, putting total inventory accumulation in this expansion about midway between the two earlier periods; and government spending, although not increasing so sharply as a quarter earlier, continued to move ahead of both the 1954-55 and 1958-59 upswings.

Consumer behavior in recent weeks raised hopes that consumption spending in general may be on the rise.



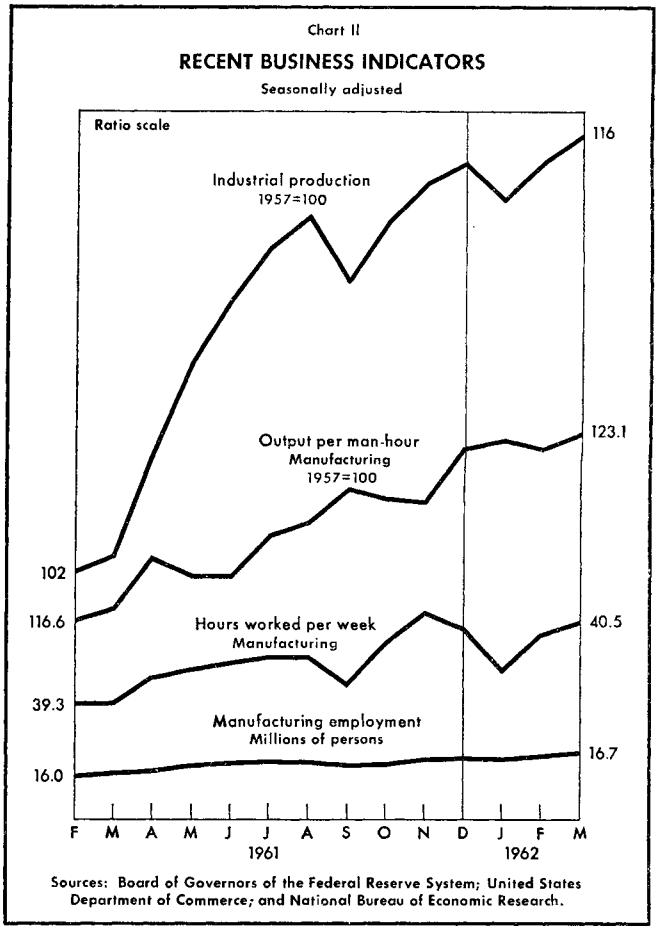
Total retail sales in March registered good gains for the second month in a row, and more than regained last November's high. The advance in March centered on automobile sales, which had been disappointingly weak in the first two months of the year. In April, auto dealers continued to chalk up sharp sales increases. Department stores sales in April may have slackened somewhat from the high March level, but the late date of Easter this year complicates analysis of movements between these two months. Taken together, the two months do represent a good gain over January and February, reflecting higher spending for both soft goods and household durables.

The home-building picture also appears to have improved since the end of February. The first quarter's decline in residential construction outlays may, at least in part, have resulted from adverse weather. While the number of new housing units started had fallen for four consecutive months through February, building permits—which reflect intentions to begin construction and which are less affected by weather—had moved generally upward. With better weather in March, the number of nonfarm housing starts jumped by one fifth to a seasonally adjusted annual rate of 1.4 million, only slightly below the October 1961 high. In addition, FHA applications plus VA appraisal requests rose for the second consecutive month in March and the mortgage market eased further.

In the business sector, the latest indications of fixed investment trends give some promise of a better showing after the rather sluggish pace set in the first quarter. The recent McGraw-Hill survey, taken in March and early April, found businessmen planning to increase their spending for plant and equipment in 1962 by 11 per cent above 1961 levels, somewhat more than the 8 per cent rise indicated by the Commerce Department-Securities and Exchange Commission survey taken two months earlier (see March *Monthly Review*). In comparable stages of previous cyclical upswings, the McGraw-Hill survey has generally shown a higher percentage gain than the Commerce-SEC survey, but both have tended to understate the volume of outlays actually rung up.

In contrast to consumer spending and business outlays on fixed investment, business investment in inventories rose more in the first quarter of 1962 than in the preceding quarter. A significant portion of the faster inventory build-up, of course, reflected steel stockpiling against the possibility of a strike. Steel inventories probably rose further in April, since the wage settlement at the end of March allowed little time for cancellation of April shipments. In the months following, however, steel users can be expected to work off at least part of their inventories.

Government spending also rose in the first quarter, as it had a quarter earlier. More than half of the increased spending in these two quarters was for national defense, reflecting the military build-up that started with the Berlin crisis last summer, and defense outlays are expected to rise further at least through midyear. State and local expenditures should continue their long-term upward trend.



PRODUCTION AND EMPLOYMENT

Industrial production in March advanced by 1 point for the second month in a row, reaching 116 per cent of the 1957 average (see Chart II). The March rise was widespread with no major sector showing a decline. In April, auto production was rising briskly and schedules pointed to a substantial increase for the month as a whole. The weekly figures for steel-ingot production in April, however, suggested a more-than-seasonal decline, as output was cut back following the steel wage settlement.

The further decline in March in new orders received by manufacturers of durable goods partly reflected the

special order situation in the steel industry. Since many of the heavy December and January steel orders were for shipments to be spread out over the whole first half of 1962, the need to place new orders for steel during February and March may have been somewhat reduced from what it would have been under more normal circumstances. Moreover, the early start of the steel contract negotiations may have dampened hedging demand for steel during those two months.

Total employment in March rose imperceptibly on a seasonally adjusted basis, the small increase being centered in the manufacturing, service, and government sectors. At the same time, the civilian labor force showed a slight decline. As a result, the total number of unemployed fell below 4 million for the first time since July 1960, and unemployment as a percentage of the civilian labor force edged off to 5.5 per cent; at the comparable stage of the 1958-59 and 1954-55 expansions, the unemployment rates were 5.1 per cent and 4.1 per cent, respectively.

As is usual during the early periods of business expansion, the rather sharp increases that have occurred during the past year in average hours worked and in productivity have tended to hold down the gains in employment. In manufacturing industries, average hours clocked by production workers in March rose close to the previous cyclical high set last November (see Chart II), when auto manufacturers were working overtime to make up for production lost during the strikes in September and October. Output per man-hour in manufacturing industries also rose in March, bringing the increase since the recession trough to more than 5 per cent (see Chart II). This is about in line with productivity gains in the comparable period of the 1954-55 expansion, although somewhat less than the gains experienced in 1958-59. Neither hours worked nor productivity can be expected to increase so rapidly in the months ahead as in the first year of the expansion; future gains in output may therefore begin to have a greater impact on employment. However, the extent to which this may result in a decline in unemployment will largely depend upon changes in the total labor force, which over the past year has shown almost no growth.

The Money Market in April

The money market was moderately firm during April, as reserve needs of money center banks, while not extreme, were fairly persistent throughout the month. New York City banks made substantial purchases of Federal funds, as their loans to brokers and dealers and their holdings of United States Government securities expanded at a brisk pace. Thus, except for three days, the effective rate on Federal funds stayed within a range of 2¾-3 per cent. Similarly, rates at major New York City banks on loans to Government securities dealers generally held within a 3-3¼ per cent range. Fluctuations in Treasury bill rates were minor during the month. An intermittent tendency for bill rates to decline, under pressure of fairly widespread demand, was offset in part by the continued additions of $100 million to the weekly offerings of three-month bills.

Demand for long-term bonds increased further during most of the month, as investors, apparently abandoning expectations of higher interest rates in the near future, placed a substantial volume of funds in new and outstanding issues. Prices of longer term United States Government obligations rose further to record levels for the year, while the market readily absorbed the Treasury's cash offering on April 9 of $1 billion of 3¾ per cent bonds due in August 1968. Prices of corporate bonds also rose in April, with even those recently marketed issues that were initially regarded as closely priced advancing notably. In the market for tax-exempt securities, prices reached their highest levels in nearly four years, despite somewhat less aggressive buying by commercial banks. On April 26, the Treasury announced that it would offer holders of 3 per cent certificates of indebtedness and 4 per cent notes, both maturing May 15, 1962, and of 2¼ per cent bonds maturing June 15, 1962, altogether totaling $11.7 billion, the right to exchange them for any of the following securities, all dated May 15, 1962: 3¼ per cent Treasury certificates of indebtedness maturing May 15, 1963, priced at par; 3⅝ per cent Treasury notes maturing February 15, 1966, priced at 99.80 to yield 3.68 per cent; 3⅞ per cent Treasury bonds maturing November 15, 1971, priced at 99.50 to yield 3.94 per cent. Subscription books for the exchange would be open April 30 through May 2. Cash subscriptions would not be received.

The Business Situation

Economic activity scored widespread gains in April, and further advances appeared to be indicated for May. Final demand has also continued to show strength—particularly in the consumer sector. Retail sales and the number of housing units started both advanced again in April following their sharp spurts a month earlier, and in May automobile and department store sales pointed toward new highs. Information on consumer spending plans, moreover, suggests further advances in the months ahead—unless, of course, such plans are adversely affected by weakness in the stock market. These developments suggest that the improvement in consumer spending which began in March was more than a temporary reaction in the wake of a disappointing winter season.

Despite these gains, the over-all pace of economic advance is still moderate. Moreover, the latest survey of business plans for plant and equipment outlays in 1962 shows no increase in scheduled expenditures from those reported by the same group of firms in February. Unemployment —though down slightly in May—remains high, and the economy clearly has a considerable way to go before it can reach satisfactory levels of capacity utilization.

The pronounced weakness in the stock market during May contrasted markedly with the evidence of improvements in the business situation. Price-earnings ratios for many stocks had, however, been unusually high by historical standards, so that some re-evaluation of stock prices might well have been expected. It seems likely that recent developments in the market may, to an important degree, have reflected a belated recognition of the emergence of a noninflationary environment.

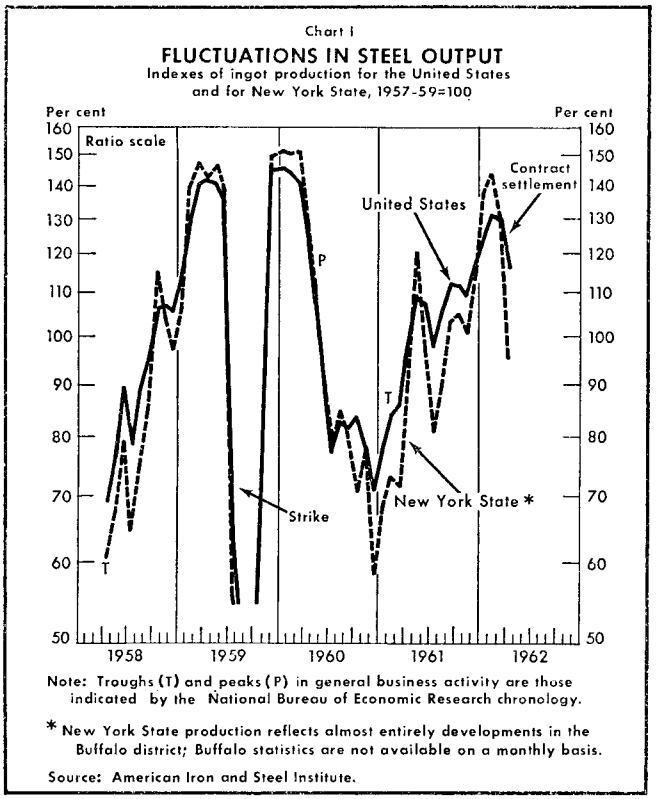
GAINS IN PRODUCTION AND EMPLOYMENT

Industrial production rose by 1 percentage point in April to 117 per cent of the 1957 average. The increase was somewhat more pronounced than that recorded in the preceding months, and reflected advances in output in a wide range of industries. The largest push came from automobile production, as 617,000 cars rolled off the assembly line; seasonally adjusted, this was 8 per cent more than in March. A further, larger-than-seasonal increase in auto output was scheduled for May, and actual production exceeded the target.

The April increase in total production would have been even larger had it not been for the drag exerted by the steel industry (see Chart I). As steel-using industries filled part of their needs from the excess inventories that had been accumulated earlier in anticipation of a strike, iron and steel output in the United States as a whole fell by about 5 per cent (seasonally adjusted) during the month, with further declines registered in May. At steel mills in some parts of the country, the decline in production was even more pronounced. Steel production in New York State, for example, which typically fluctuates more widely than in the nation as a whole, fell sharply in recent weeks (Chart I). As the over-all industry operating rate receded to around 55 per cent of capacity, utilization in the Buffalo area—where most of New York's steel production is concentrated—fell below 40 per cent. Industry reports suggested that large inventories combined with normal seasonal factors would continue to exert downward pressure on total steel production for several months more.

The rise in industrial production during April and an increase in construction activity were the major factors in the increase in the number of persons at work in the nonagricultural sector of the economy. A particularly sharp gain was scored by manufacturing industries where seasonally adjusted employment rose by 138,000 persons, according to the Bureau of Labor Statistics; this was the largest advance since May 1961. Moreover, average weekly hours tallied by production workers in manufacturing reached the highest level in more than five years on the strength of a third successive monthly increase. In durable goods industries such increases have, in the past, preceded an expanded rate of hiring.

Nonfarm employment continued to rise in May, according to the Census Bureau's household survey, and pushed up seasonally adjusted total employment by 432,000 persons to 67.9 million. At the same time, unemployment declined slightly, in spite of a substantial increase in the civilian labor force, and unemployment as a percentage of the civilian labor force moved downward again, after a pause in April, reaching 5.4 per cent in May. The increase in the labor force may well mark the



beginning of a significantly larger-than-usual influx of young people into the labor market which could compound the seriousness of the unemployment problem in the months ahead.

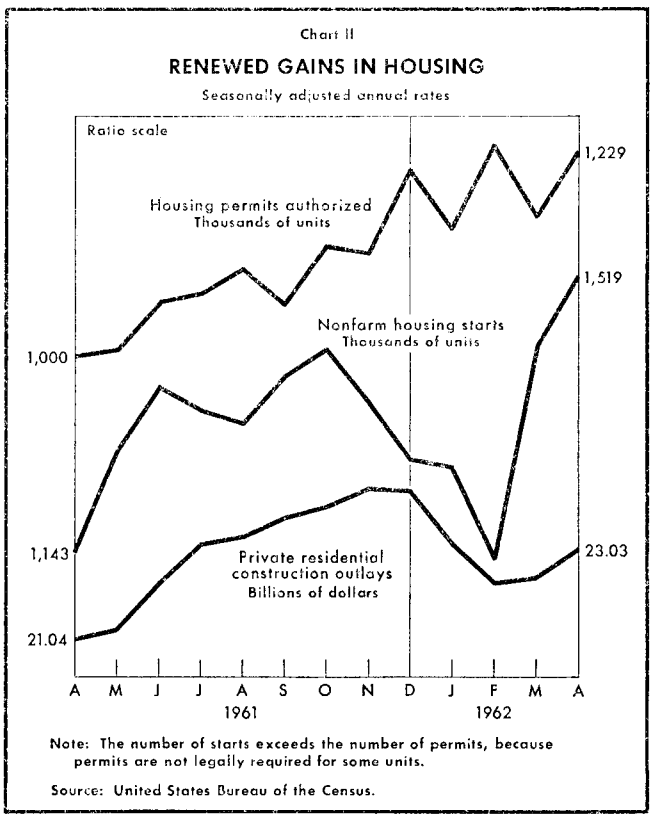
EXPANSION IN DEMAND

The impetus for the recent gains in activity has, to an important extent, come from greater strength in consumer spending. Retail sales again rose sharply in April, following the spurt recorded a month earlier. Durable goods sales were particularly strong and, whereas the March advance had been highly concentrated in automobile sales, the April gains were dispersed among a number of categories. The strength in some of these categories, including household appliances, lumber, and hardware, may be due in part to recent increases in spending for housing, including outlays for alterations and additions to houses. In May, consumer outlays seem to have risen further. Automobile sales during the first two thirds of the month appeared to be consistent with industry forecasts of some continued advance, while the strength of department store sales implied gains in other components of consumer spending.

According to the Federal Reserve Board's April survey of buying intentions, the number of consumers who plan purchases of durables in coming months has increased since three months ago. These more optimistic buying plans have been supported by continued gains in personal income, which provide both immediate purchasing power and the basis for increases in credit purchases. Extensions of consumer credit have accelerated recently, but their ratio to consumers' incomes has remained below historical highs.

The housing sector has also contributed importantly to recent gains in activity. The volume of residential outlays rose by more than $1 billion (seasonally adjusted annual rate) in both April and May, following a smaller rise in March (see Chart II). Further increases appear to be indicated by the dramatic 34 per cent jump in housing starts over the March-April period. Moreover, despite this sharp increase in starts, the backlog of unused building permits has remained at a high level. The mortgage market, meanwhile, has continued to make credit available on easy terms, partly owing to heavy acquisitions of mortgages by commercial banks.

The steady rise in consumer spending may help accelerate business outlays for fixed investment as the over-all



business expansion progresses. So far, however, the monthly data on spending for machinery and transportation equipment and for commercial and industrial construction have shown only moderate increases. Moreover, the survey of business capital spending taken in late April and early May by the Commerce Department and Securities and Exchange Commission found that actual outlays in the first quarter were somewhat smaller than had been planned. While spending plans for the current quarter were larger than reported last February, second-half plans were about what had been reported at that time. For the year as a whole, business plans still called for the same 8 per cent increase over 1961 as had been indicated in the February survey, in contrast to the 11 per cent increase which showed up in the intervening, but not entirely comparable, McGraw-Hill survey.

The Money Market in May

The money market was relatively easy during most of May, although country-wide reserve availability was much the same as in the March-April period when the atmosphere had been firmer. The easier conditions which prevailed during the month were traceable in part to heavy Treasury deposits in money market banks and the relatively slow rate of withdrawal of these deposits. The effective rate on Federal funds generally fluctuated within 2-2¾ per cent. During the period, rates posted by the major New York banks on loans to Government securities dealers moved within a 2¼-3¼ per cent range.

Treasury bill rates continued to move narrowly over the month, as a persistent investor demand absorbed the enlarged issues marketed by the Treasury. The market for intermediate- and long-term Government securities, after taking in stride the massive Treasury refunding in early May and registering further price gains through about mid-month, turned relatively weaker until near the end of the period when considerable strength re-emerged. The continued decline in stock prices contributed to the strength of both the Government and corporate bond markets early in the period and again to Treasury obligations toward the close of the month. Prices of corporate bonds rose on balance during May. Many seasoned issues reached their highest historical levels around May 10, but prices declined late in the period. The steady rise in prices of tax-exempt bonds since last December was reversed, as a heavy volume of new issues added to the already large inventories in dealers' hands.

MEMBER BANK RESERVES

A substantial quantity of reserves was absorbed by "operating transactions" in May, while required reserves declined on balance. The largest reserve drains stemmed from a seasonal decline in float. System Account open market operations largely offset these reserve losses over the month as a whole. From the last statement week in April to the final week in May, System Account average outright holdings of Government securities increased by $678 million, while average holdings under repurchase agreements declined by $151 million.

Over the five statement weeks ended May 30, free reserves averaged $434 million, as against $427 million in the four statement weeks ended April 25. Average excess reserves declined by $6 million to $495 million, while average borrowings from the Federal Reserve Banks contracted by $13 million to $61 million.

THE GOVERNMENT SECURITIES MARKET

Prices of Treasury notes and bonds continued to rise during the first half of the month, but fell during most of the second half on news of advances in important business indicators. The decline in prices was also influenced by the unprecedented accumulation of recently issued tax-exempt securities in dealer inventories, as well as by military developments in Southeast Asia.

As the month began, interest in the market was focused on the Treasury refunding operation, announced April 26, on which the books were open from April 30 to May 2. A firm tone prevailed, as offerings of issues carrying "rights" were light and the new securities attracted a substantial demand. Only $680 million of maturing issues, constituting 7.2 per cent of public holdings, was redeemed for cash. This outcome was about in line with expectations, tending to confirm confidence in the existing level of prices. Subsequently, the market strengthened further in response to sharp declines in stock prices and renewed advances in prices of corporate obligations.

The Business Situation

The pace of economic advance apparently slowed somewhat during May and June. Part of the slowdown can, however, be attributed to the continued decline in steel production reflecting the readjustment of steel inventories. This had a marked effect on industrial production, particularly in May, and probably also held down the gains in both manufacturing employment and personal income in that month. On the other hand, residential construction continued strong in both May and June, as did automobile production until an interruption by a strike in mid-June at a Ford parts plant.

The continued, though slower, rise in business activity contrasted sharply with the declines in the stock market which persisted in the first three weeks of June. Whether or not the stock market's behavior will lead to cutbacks in spending plans by consumers and businesses is a major element of uncertainty in the current business situation. Surveys of spending plans taken before the stock market break on May 28 generally indicated further advances in the months immediately ahead. The scaling-down of equity values by the amount recently experienced could, of course, lead to some downward revision in such plans, unless it is offset by other developments that might encourage spending — such as revision of depreciation schedules. However, a survey taken by McGraw-Hill after the stock market break indicates that business plans for capital outlays on balance remained unchanged. Some reports do suggest that consumer buying, particularly of certain luxury and big-ticket items, may have been disappointing in June, but evidence is still incomplete.

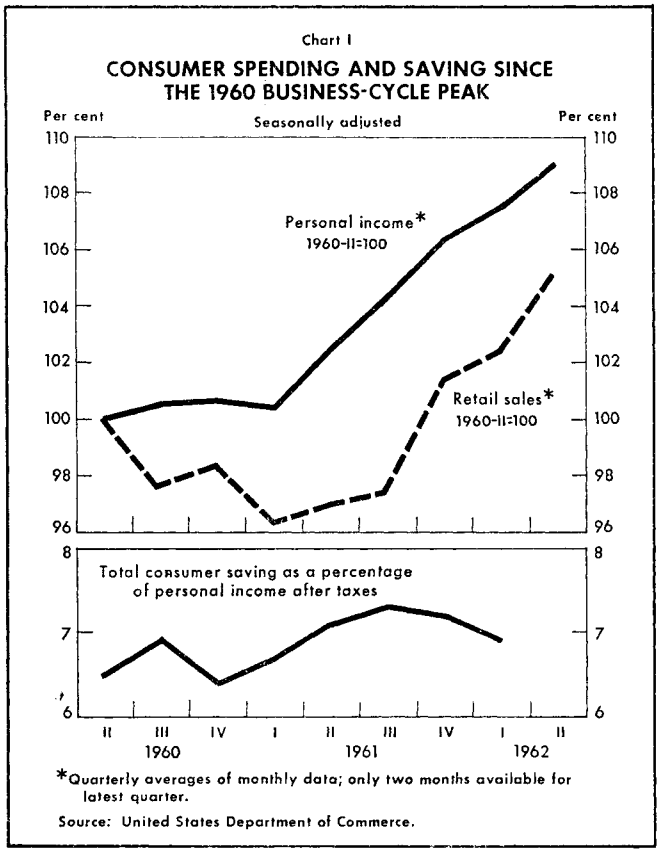
SLOWDOWN IN THE PACE OF ADVANCE

Industrial production rose again in May, reaching about 118 per cent of the 1957 average. The 0.6 point increase was somewhat smaller than the gains during the preceding three months. Excluding the effects of the decline in steel production, however, the rise in output compared favorably with the average increase between January and April. Moderate advances in production were registered by most capital and consumer goods manufacturers. Automobile output continued to rise sharply, although the 5 per cent seasonally adjusted increase was smaller than in the previous month. Assemblies in June were scheduled initially at a somewhat higher rate than in May (after seasonal adjustment), but a 2½-week strike at a Ford parts plant held total industry output below the May level.

Iron and steel output declined by 12 per cent in May (seasonally adjusted), as production continued to feel the effects of the large inventories that had been stockpiled in anticipation of a strike. The decline, however, brought steel output to a level well below estimated steel consumption, implying a substantial reduction in inventories. A further, but smaller, decrease in production appears to have occurred in June and industry reports suggest that some firms are planning longer-than-usual vacation shutdowns in July. About midsummer, steel inventories may well reach roughly normal levels, so that steel production may possibly be geared more closely to current consumption by the time of the usual fall upswing in manufacturing activity.

The rise in manufacturing employment during May (as measured by the payroll survey) was also considerably smaller than in April. Modest employment gains (seasonally adjusted) occurred in most nonmanufacturing sectors, but these were largely offset by a decline in construction employment stemming primarily from a strike which affected many areas in northern California. In June, the Census Bureau's household survey recorded a small decline of 28,000 persons in nonagricultural employment (seasonally adjusted), compared with the increase of 539,000 persons in May (which was considerably larger than that indicated by the payroll survey). Declines in the labor force and in total employment in June left the volume of unemployment little changed. The unemployment rate edged up to 5.5 per cent of the civilian labor force.

With total payroll employment increasing only moderately in May, the wage and salary component of personal income showed a similar small rise. As a result, total personal income increased by only $1 billion (seasonally adjusted annual rate), a relatively small increase compared with the gains in the preceding three months. This slower growth in incomes was accompanied by a small decline in the volume of retail sales (seasonally adjusted), which was more than accounted for by a decline in durables. Despite the encouraging increase in the number of new automobiles sold, the rise in dollar volume of total auto sales apparently fell short of the normal seasonal



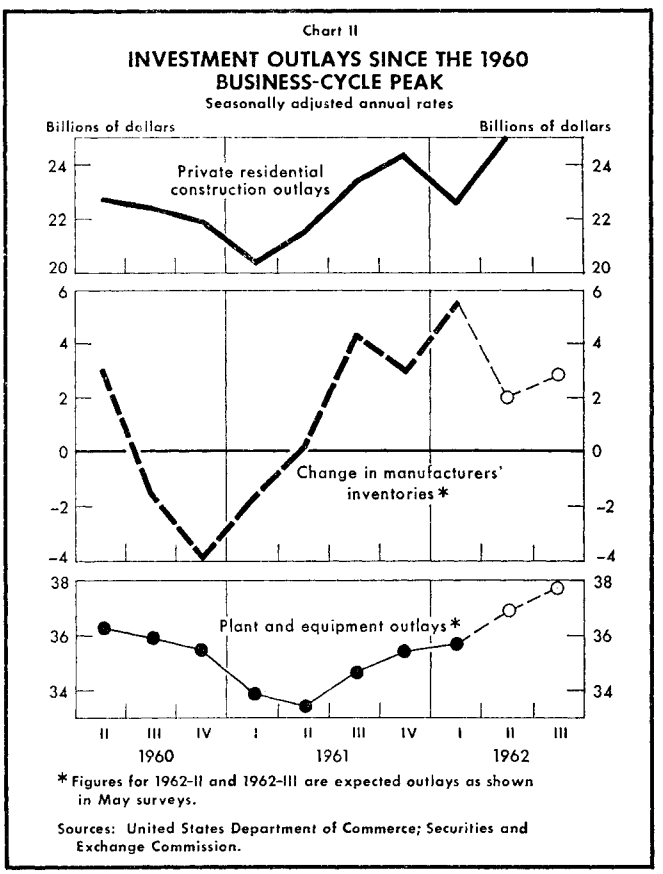
increase. In June, seasonally adjusted unit sales of new cars declined from the May level; in part, at least, this may have reflected the influence of the Ford strike. Department store sales also receded from the May peak.

A one- or even two-month decline in retail sales is, of course, not unusual and does not necessarily imply any general weakening in consumer spending. Surveys of consumer spending intentions taken in April and May had pointed to continuing strength in outlays. Moreover, the average level of retail sales during April and May was more than 2½ per cent above the monthly average during the first quarter (see Chart I). By contrast, personal income during the same period was only 1½ per cent above the first-quarter average. This suggests that the downtrend in the savings ratio during the fourth quarter of 1961 and the first quarter of 1962 may have continued during the second quarter. Future gains in spending could, of course, be dampened by losses resulting from the stock market decline. Consumers' holdings of highly liquid assets have been growing rapidly, however, and the flow of current income is likely to remain the dominant factor in their spending decisions.

INVESTMENT AND GOVERNMENT SPENDING

A particularly expansive sector of the private economy in recent months has been residential construction. The number of private nonfarm housing units started rose in May for the third consecutive month and stood nearly two-fifths above the February low. Residential construction outlays rose by $1.4 billion (seasonally adjusted annual rate) in June, carrying total outlays in the second quarter 10 per cent above the depressed first-quarter rate (see Chart II).

Business spending in recent months has been somewhat less buoyant than might be expected at this phase of the business cycle. Manufacturers invested in inventories at a declining rate during the first two months of the second quarter, partly as the result of the switch from accumulation to depletion of steel stocks which began to depress the already moderate over-all demand for inventories. Business spending for fixed investment, however, which edged up less than 1 per cent in the first quarter, apparently gained considerable strength in April and May. The total of outlays for commercial and industrial construc-



tion and sales by machinery and equipment industries averaged almost 3 per cent above the rate in the first three months of the year.

Surveys of business plans and Federal budget estimates imply further gradual increases in spending during the rest of this year. Federal Government spending and transfer payments are expected to show moderate increases in the months ahead, according to the January budget estimates. The May survey of manufacturers' inventory expectations pointed to a pickup in inventory investment in the third quarter (see Chart II), about in line with the anticipated higher level of sales. Expenditures for plant and equipment (see Chart II), according to the May survey by the Commerce Department and the Securities and Exchange Commission, were expected to increase by about 3½ per cent in the second quarter, and at a somewhat slower rate throughout the rest of the year.

While some upward revision in spending plans would not be unusual at this phase of the business cycle, the recent break in the stock market could influence spending adversely by introducing difficulties in financing investment through new stock issues or by creating uneasiness generally. On the other hand, the Treasury will soon announce the promised revisions in its depreciation schedules. These revisions are intended to stimulate investment by providing businesses with higher after-tax profits. It has been suggested that some commitments for capital spending were being delayed until the announcement of the revisions; thus the new schedules could have an immediate impact on such spending.

The Money Market in June

The money market was easy in the first half of June as the distribution of reserves tended to favor banks in the money centers, but firmed after the midmonth tax date as funds returned to country banks. Funds were moved to the money centers early in the month by corporations preparing to meet mid-June tax and dividend payments, and by country banks nearing the end of their reserve-averaging period. Around the middle of the month, the reserve positions of money market banks came under pressure. Corporations borrowed to pay taxes, and Government securities dealers required additional financing as repurchase agreements with corporations ran off and corporations and banks sold securities. In addition, net reserve availability was somewhat reduced in the latter weeks of the month.

Federal funds traded at effective rates of 1¾ to 2¾ per cent early in the month, and later on at 2¾ per cent to 3 per cent. Rates posted by the major New York banks on loans to Government securities dealers ranged between 2½ and 3½ per cent. Treasury bill rates fluctuated narrowly through the first half of June, and then rose in the latter part of the month as the Treasury continued to raise additional funds through its weekly bill auctions and as the money market turned firmer.

Prices of Treasury notes and bonds advanced moderately in the early part of the period, but weakened in the latter half. Demand for these issues failed to draw further strength from the stock market which continued to weaken until the final days of the month. Moreover, expectations in all sectors of the bond market were adversely affected by general uncertainty over the business picture and renewed concern over balance-of-payments problems, including the possible implications of such problems for monetary policy. The decline in prices of tax-exempt securities which began in May continued through most of June, as dealer efforts to reduce inventories were intensified. Corporate bond prices, however, rose over the first half of the period before declining over most of the rest of the period.

MEMBER BANK RESERVES

Operating transactions provided a substantial volume of reserves in June. A sharp midmonth expansion in float, together with week-to-week changes in "other deposits", more than offset the effect of a heavy early-month outflow of currency into circulation. This net supply of reserves was more than counterbalanced, however, by an increase in required reserves stemming from the expansion in bank credit around the June 15 quarterly tax date, and by System open market operations that absorbed reserves on balance. From the last statement week in May to the

Switzerland seeking the traditional "safe haven" of the Swiss franc. During June this flow was bolstered by the repatriation of funds by Swiss commercial banks seeking domestic liquidity for midyear statement purposes. Consequently, the Swiss franc rose to, and remained at or near, the Swiss National Bank's current buying rate for dollars, and a substantial volume of dollars was added to Swiss official reserves. Furthermore, a return flow of capital to the Netherlands had already produced a marked rise in the guilder rate early in the second quarter, with Dutch banks repatriating funds to ease a domestic liquidity shortage. Finally, the German mark began to rise to above par for similar reasons, and the French franc and the Italian lira remained at about their ceilings throughout the quarter. Thus, at midyear, sterling and the German mark were well above par while the other major Continental currencies were near or at their ceilings.

OTHER CURRENCY DEVELOPMENTS

The Japanese yen, under considerable pressure during the latter half of 1961, showed a firmer undertone, as Japan's balance-of-payments position improved markedly in the first half of 1962. Although the slightly higher rates for the yen recorded early in the year were not sustained beyond the first quarter, Japan's international reserves continued to increase through June, as the country's trade balance improved and there was a continued, though somewhat reduced, inflow of both short- and long-term capital. In Brazil there was a further depreciation of the cruzeiro, and three times during the period the Bank of Brazil raised its official buying and selling rates for dollars. As a result, the selling rate on June 30 was 365 cruzeiros to the dollar. Chile introduced a dual exchange rate system on January 15. The official market is open only to commercial banks and only for exports, imports, and some nonmerchandise transactions; the rate in this market—currently 1.053 escudos per dollar—is set by the central bank. All other transactions must be settled through the "broker's market" in which the rate is permitted to fluctuate freely (and in June was about 1.65 escudos to the dollar). Also during the first half of 1962 the Argentine peso began to fluctuate more freely and depreciated rapidly, reaching 130 pesos to the dollar in the open market before recovering somewhat in July under the influence of stringent measures to restrain imports.

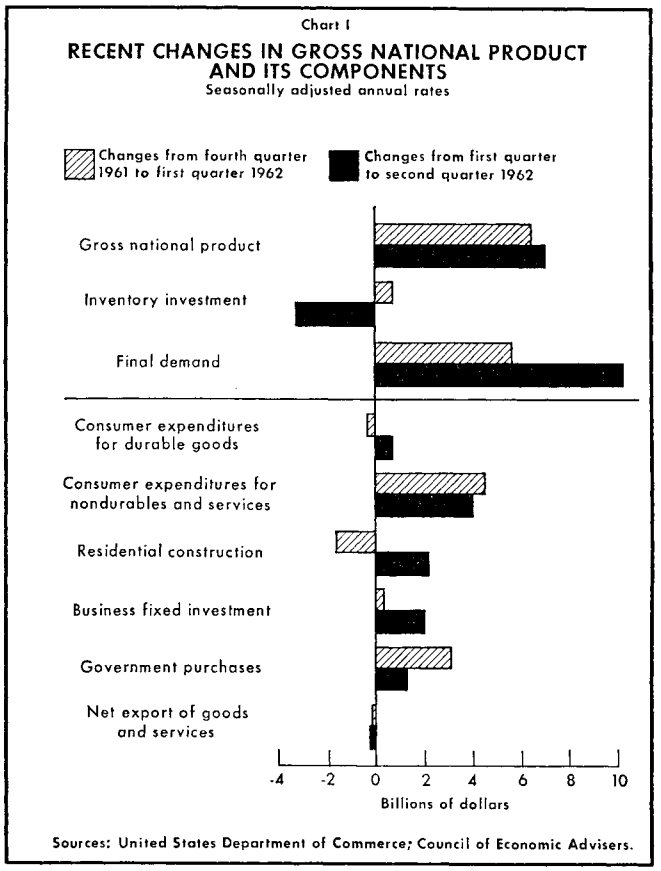
MONEY AND ECONOMIC BALANCE

The Federal Reserve Bank of New York has just published a 32-page booklet, *Money and Economic Balance*. Intended as an aid to high school teachers, it is also of interest to the layman seeking a simplified explanation of the role of money in our economy and how our money's value changes. It gives a capsule explanation of the business cycle and describes how the Federal Reserve System analyzes the business situation and uses its powers over bank credit and money creation to promote balance in our economy. Copies are available, free, upon request, from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York 45, N. Y.

The Business Situation

The rate of economic expansion slowed markedly in June, but early evidence pointed to some improvement in July. Part of the sluggishness in June reflected the temporary influences of a strike at the Ford Motor Company and a continued runoff of steel inventories that had been stockpiled in anticipation of a steel strike. In July, with the Ford dispute settled, auto assemblies advanced counterseasonally, and reports from the steel industry suggested that ingot production was bottoming out. In addition, consumer spending in July, including purchases of new cars, appeared to have strengthened.

The economy continues, however, to operate well below capacity levels. Moreover, some of the June figures—especially new orders for durable goods and the number of housing starts—raise questions about the strength of underlying demand in the months ahead. Some stimulus



may be provided by the Treasury Department's newly issued depreciation rules, and there has been increased discussion of an early tax cut that would encourage additional spending and that would be consistent with a general tax reform aimed at enhancing the long-term growth prospects of the economy.

SPENDING PATTERNS IN THE SECOND QUARTER

Taking the second quarter as a whole, gross national product rose by $7.0 billion to a seasonally adjusted annual rate of $552.0 billion, according to preliminary estimates by the Council of Economic Advisers.[1] The increase was only slightly larger than the relatively modest advance scored in the first quarter (see Chart I). This reflects, however, a sizable reduction in inventory investment, as steel users worked off the stocks accumulated early in the year before the wage settlement had been reached. The second-quarter increase in final demand (GNP less the change in inventories) was $10.2 billion, nearly double the first-quarter rise and the largest increase in the current upswing save for the fourth quarter of 1961. Moreover, the sharp advance occurred in spite of a relatively small rise in government purchases of goods and services.

About half of the increase in final demand was accounted for by higher consumption expenditures. The $4.8 billion rise in consumer outlays was somewhat greater than the first-quarter increase, largely owing to a reversal of the first quarter's decline in spending for durables. Despite some slowdown in May and June, purchases from automotive dealers—which are the most volatile component of durables consumption—were comparatively high for the spring as a whole.

Spending for residential construction turned around sharply from the first quarter's decline, as the better weather that began in March permitted building activity to shake off its winter doldrums. With a continued rise in apartment house building, total outlays for residential construction moved up by more than 10 per cent to the highest level since the second quarter of 1959.

Final demands by the business sector were also up markedly in the second quarter. Outlays for fixed investment increased by more than 4 per cent, in contrast to the first-quarter rise of less than 1 per cent. The advance was about in line with what had been expected from the May survey of plant and equipment spending plans taken by the Commerce Department and the Securities and Exchange Commission.

RECENT DEVELOPMENTS

Despite these rather impressive over-all gains during the second quarter, the pace slackened in June. The scant rise of 0.3 per cent in industrial production, for example, was smaller than in any of the preceding four months (see Chart II). Much of the slowdown reflected the two special influences noted earlier—a 7½ per cent decline in iron and steel production, resulting from the adjustment of steel inventories, and a 5 per cent decrease in the output of motor vehicles and parts stemming from the Ford strike. Outside the steel and auto industries, production rose by about 0.9 per cent. Although this increase was somewhat smaller than occurred in the preceding month, it was not very different from the average rate of gain since January. In July, production of steel ingots appeared to have declined only slightly, after seasonal adjustment. And, auto assemblies rose counterseasonally, with Ford stepping up its production schedules for both July and August.

[1] The usual midyear revision of the national income accounts has lowered the earlier estimates of GNP for each of the four preceding quarters by some $3-4 billion.

A somewhat disturbing development in June was the 4 per cent decrease (seasonally adjusted) in new orders received by manufacturers of durable goods. This forward-looking series has now declined in four of the past five months, following a continuous advance from January 1961 through January 1962 (see Chart II). In part, of course, both the rise and the decline reflect corresponding movements in steel orders, which swelled late last fall and early this year and then fell off sharply once the steel labor settlement was in sight. In June, however, declines were relatively widespread in industries other than steel, although part of this slack apparently was attributable to the failure of defense orders to show their usual fiscal-year-end bulge.

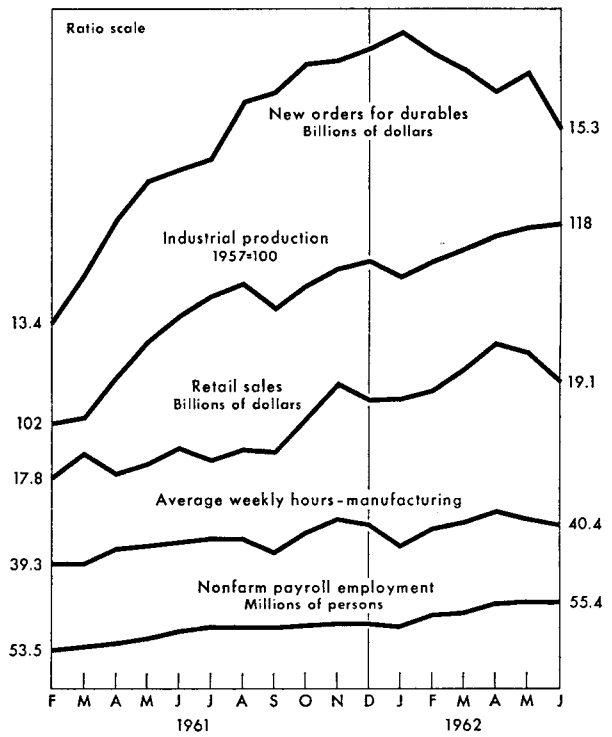
The diminished rate of advance in June was also apparent in nonagricultural employment (as measured by the payroll survey), which increased only slightly following a moderate gain in the preceding month. In manufacturing industries, employment was virtually unchanged, and average weekly hours (seasonally adjusted) clocked by production workers declined for the second month in a row (see Chart II). In July, according to the Census Bureau's household survey, total employment showed a little improvement, and the unemployment rate (unemployment as a percentage of the civilian labor force) fell to 5.3 per cent. However, a large part of this decline reflected a reduction in the labor force. Thus far this year, the civilian labor force has grown at a significantly lower rate than was implied in the Labor Department's long-term projections.

As a result of the shorter workweek in manufacturing industries, wages and salaries in these industries moved downward in June, the first decline since January. Payrolls in other industries continued to rise, but the increase in total personal income in June was only half the moderate gain of the previous month. At the same time, retail sales declined for the second consecutive month (see Chart II). Sales of durables fell by 2½ per cent, while volume in most types of nondurables stores also declined. Evidence on sales in July, however, suggests an improvement in consumer spending. Unit sales of new cars bounced back to, and may even have surpassed, their high spring levels, while department store sales increased by more than 3 per cent.

Chart II

RECENT BUSINESS INDICATORS

Seasonally adjusted



Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

The Business Situation

The pace of economic activity picked up somewhat after midyear. In July, industrial production, nonfarm employment, personal income, retail sales, and new orders for durable goods all increased. Early signs suggest little change in the over-all economic picture in August. To some extent, of course, the improvements which have recently been registered in various statistical series merely reflect the removal or lessened influence of special factors that had depressed the June results, such as the heavy liquidation of steel stocks, the Ford strike, slower Government ordering, and—possibly—reaction to the stock market decline. Relatively little progress has been made in recent months toward the goal of fuller utilization of the economy's capacity. Nevertheless, the currently available data do seem to confirm that the economy has, at least for the time being, weathered an unusual combination of adverse influences better than many people had expected.

New information on spending plans of consumers and businesses largely reflects views formed before the July improvement in the business situation had become evident, and before the President had announced that he would not seek a tax cut until early next year. Consumer spending intentions, according to the Federal Reserve's July survey, were well sustained but not buoyant. Businessmen have not revised upward their earlier plans for a moderate rise in capital outlays in the latter half of 1962, but neither have they cut them back, according to the Government's latest quarterly survey taken in early August. Thus, private spending plans have been maintained, despite the steep stock market decline in May and June and the probable tendency to postpone spending and investment decisions because of the uncertainties in the business and fiscal outlook.

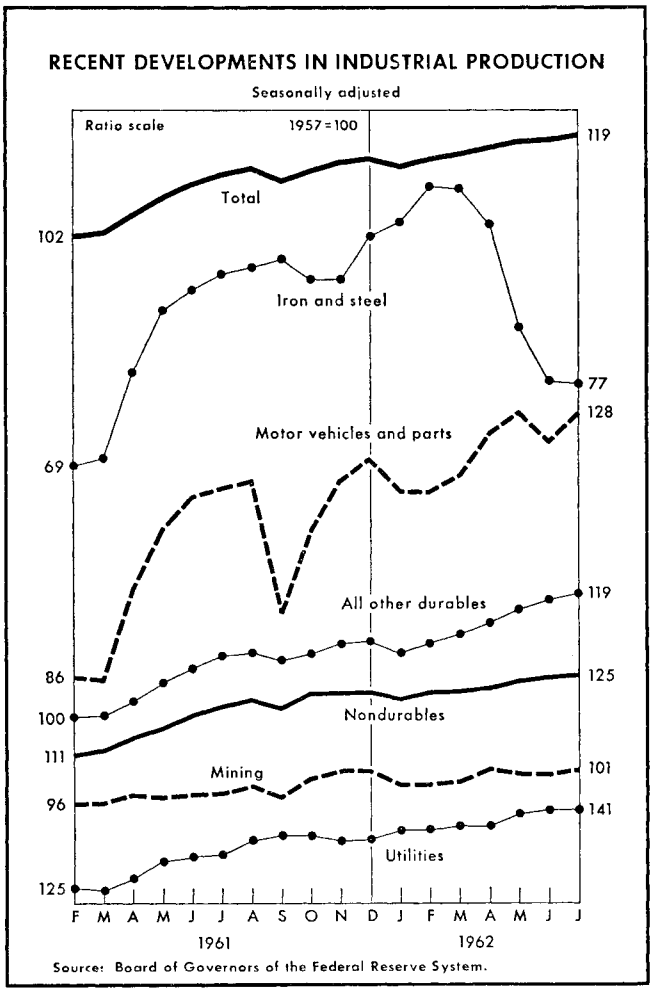
The Government sector is likely to provide increased support to total demand in the near-term future, even without an immediate tax cut. While the President has stated that he does not intend to ask for any increase in appropriations beyond those already requested from Congress, the fact remains that the budget already calls for some rise in Federal spending over the months ahead. Furthermore, the rate of outlays under the budget can to some extent be speeded up should economic conditions warrant. Finally, a substantial additional sum has recently been freed from trust funds for the highway program, which may permit the placing of contracts at a somewhat faster rate than had originally been scheduled.

GAINS IN PRODUCTION, EMPLOYMENT, AND ORDERS

The Federal Reserve's seasonally adjusted index of industrial production rose by almost 1 percentage point in July, somewhat more than in June. The better showing in July was attributable mainly to developments in the steel and automobile sectors, but gains continued to be scored in a wide range of industries. Output of motor vehicles and parts reversed the June decline (see chart), as Ford accelerated its schedules following the settlement of its labor dispute. Even more significant was the fact that steel production showed only a slight decline for the month as a whole, in contrast to the substantial decreases during the three preceding months. The weekly series on steel output actually started to move upward after the first week in July, and in August production of steel ingots appears to have risen substantially, after seasonal adjustment. According to steel industry reports, however, steel inventories, though down markedly from their levels earlier in the year, are still somewhat higher than desired and thus are likely to continue to restrain steel production for some time to come. In the auto industry, most assembly lines were shut down for at least part of August for model change-over, but production, after seasonal adjustment, was apparently not much below the high July levels.

Total nonfarm employment (as measured by the Bureau of Labor Statistics payroll survey) also advanced in July, on a seasonally adjusted basis, slightly bettering the moderate rise in the previous month. The gains, however, were centered in the service, trade, and construction industries —the improvement in construction mainly reflecting the termination of several major strikes in California. In the manufacturing sector, both employment and average weekly hours declined slightly.

An encouraging development during July was the 5 per cent (seasonally adjusted) rebound in new orders received by manufacturers of durable goods. This "leading" series had declined in four of the preceding five months. An



important part of this downtrend, however, had apparently been caused by the fall-off in steel orders and, in June, by a failure of Government orders to show their usual fiscal-year-end bulge. Although it is not known to what extent the July recovery merely reflected a "catching up" in military orders, the fact that gains were recorded by most major industries may indicate some strengthening in orders not related to military activities.

DEVELOPMENTS IN KEY DEMAND SECTORS

Recent data covering actual and planned spending by consumers and business firms present a mixed picture. Consumer spending rebounded in July, as retail sales rose more than 3 per cent, seasonally adjusted. The gain, which brought total retail volume to a level slightly above the previous all-time peak registered in April, largely reflected a sharp increase in sales by durable goods retailers. Automobile dealers had a particularly good month, and sales of most other durable items also moved upward. In the first twenty days of August new car sales appear to have declined from the high July rate, but August department store sales continued close to the previous month's near-record level.

The central question in the consumer sector is whether spending, after having increased considerably since early spring, can be expected to show much further forward push in the months ahead. According to the Federal Reserve's quarterly survey referred to earlier, buying intentions in July followed a mixed pattern. Since the survey was taken only shortly after the stock market low, it is encouraging that there was no significant evidence of any deterioration in purchase plans. Moreover, there was apparently more-than-usual strength in intentions to buy household durables. On the other hand, reports of plans to buy new cars within six months were unchanged from April to July of this year, in contrast to increases in the corresponding period of the expansion years 1959 and 1961. Plans to buy used cars declined in July, but they had been abnormally high in April.

In the private housing sector, demand has apparently fallen off somewhat from the high levels attained earlier this year. The number of private nonfarm housing units started declined sharply in June and failed to recover in July. However, the number of building permits issued, though below the high levels reached earlier this year, increased somewhat in both June and July, and there continues to be a sizable backlog of unused permits; normally, only a small proportion of permits fails to eventuate into starts. Furthermore, demand continues to be supported by a relatively easy mortgage market.

Perhaps the sector of demand most subject to uncertainty in the months ahead is business expenditures for new plant and equipment. The August Commerce Department-Securities and Exchange Commission survey of plans for business capital outlays points to a moderate rise in plant and equipment spending throughout the balance of the year. Spending plans for the second half of 1962 showed little revision, in the aggregate, from those reported three months earlier. In July, capital spending appears to have continued upward. On the other hand, new orders received by machinery and equipment manufacturers and contract awards for commercial and industrial construction (expressed in dollar terms) registered little change on a seasonally adjusted basis. Moreover, the National Industrial Conference Board's July survey showed a 14 per cent drop in net capital appropriations of large manufacturing corporations in the second quarter, the first decrease in the

current cyclical upswing. Past experience with this survey indicates that turns in the appropriations series tend to precede turns in capital expenditures by the same firms by six to nine months. Part of the spring decline in appropriations, of course, may have reflected the uncertainties created by the steel situation, the stock market break, and other factors that caused a "wait and see" attitude on the part of businessmen. It remains to be seen whether the stronger showing of the economy than many had expected, as well as the promulgation of new depreciation rules and a more definite prospect of tax reform next year, will bring about a strengthening of outlay plans.

The Money Market in August

The money market continued moderately firm over most of August. Federal funds traded mainly at 2¾ and 3 per cent, with the effective rate at 3 per cent on most days. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted within a 3 to 3½ per cent range throughout the period. Nationwide reserve availability was somewhat lower on average than in other recent months.

Prices of Treasury notes and bonds rose over the month, as market sentiment was influenced by the results of the Treasury's August refinancing and by the growing expectation that the Administration would not seek a tax cut this year, confirmed in the President's address of August 13. The market for Treasury bills was firm during most of August, but rate movements for the month as a whole were small, in part due to continuing additions to the supply of bills by the Treasury in the weekly auctions. The markets for corporate and municipal bonds strengthened in active trading, reflecting many of the same factors that were responsible for upward price movements in Treasury issues as well as a light calendar of new offerings.

The Treasury announced on August 14 that it was calling for redemption on December 15, 1962 the partially tax-exempt 2¾ per cent Treasury bond of 1960-65, dated December 15, 1938. There are about $1½ billion of these bonds—the last remaining tax-privileged Treasury issue.

MEMBER BANK RESERVES

Operating factors absorbed a substantial amount of reserves during the month, attributable mainly to a large decline in float, changes in "other deposits" (largely reflecting a midmonth Treasury interest payment to System Account), and movements through gold and foreign accounts. Reserve drains due to market factors were, how-

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, AUGUST 1962

In millions of dollars; (+) denotes increase, (−) decrease in excess reserves

Factor	Daily averages—week ended					Net changes
	Aug. 1	Aug. 8	Aug. 15	Aug. 22	Aug. 29	
Operating transactions						
Treasury operations*	+ 113	− 63	− 102	+ 51	+ 48	+ 47
Federal Reserve float	− 622	− 196	+ 129	+ 405	− 397	− 681
Currency in circulation	+ 90	− 127	− 121	+ 56	+ 133	+ 31
Gold and foreign account	− 114	− 3	+ 19	+ 8	− 38	− 128
Other deposits, etc.	− 28	− 37	− 55	− 74	+ 18	− 176
Total	− 563	− 425	− 130	+ 449	− 238	− 907
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 362	+ 602	− 34	− 270	+ 129	+ 789
Held under repurchase agreements	—	—	+ 17	− 5	− 12	—
Loans, discounts, and advances:						
Member bank borrowings	+ 11	+ 86	− 26	+ 26	− 83	+ 14
Other	—	—	—	—	+ 4	+ 4
Bankers' acceptances:						
Bought outright	+ 3	+ 1	− 3	− 3	− 3	− 5
Under repurchase agreements	− 3	− 1	—	—	—	− 4
Total	+ 373	+ 689	− 46	− 252	+ 35	+ 799
Member bank reserves						
With Federal Reserve Banks	− 190	+ 264	− 176	+ 197	− 203	− 108
Cash allowed as reserves†	+ 26	− 287	+ 176	− 4	+ 90	+ 1
Total reserves†	− 164	− 23	—	+ 193	− 113	− 107
Effect of change in required reserves†	+ 24	+ 78	+ 85	− 205	+ 45	+ 27
Excess reserves†	− 140	+ 55	+ 85	− 12	− 68	− 80
Daily average level of member bank:						
Borrowings from Reserve Banks	70	156	130	156	73	117‡
Excess reserves†	435	490	575	563	495	512‡
Free reserves†	365	334	445	407	422	395‡

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for five weeks ended August 29, 1962.

The Business Situation

Economic activity continued on a high level in August and September, but there was no conclusive indication of a significant movement one way or the other. Industrial production, payroll employment, and retail sales were little changed in August; however, such slight changes as did occur were downward. In September, scattered and fragmentary production figures suggest that changes were largely seasonal. Department store sales appeared to be on the rise in the early weeks of the month, but automobile sales continued to be limited by the short supply of 1962 models. The economy thus seems to be "marking time".

Indicators of future economic activity give little sign of any substantial change from recent levels. Business and personal incomes, according to the latest available data, have continued to rise moderately or at least to hold near peak rates, thus providing the purchasing power to support the current rate of economic activity. On the other hand, recent gains do not add up to the kind of enlargement of demand which might be expected to spark a general upsurge. Surveys of anticipations and projections with regard to business sales, inventories, and capital outlays suggest that businessmen expect only a moderate improvement over the balance of the year. Recent sales and new order figures accordingly reflect a "wait and see" attitude. On the other hand, there is no evidence of significant weakness developing in the economy.

PRODUCTION AND EMPLOYMENT

Industrial production (as measured by the Federal Reserve index) was virtually unchanged in August, after advancing for six consecutive months (see Chart I). There were declines in production by utilities and nondurables manufacturing industries, but these were largely offset by higher output of steel and by small gains in several other durable goods industries, particularly those producing business equipment. In the case of steel, the August gain was the first increase since last February.

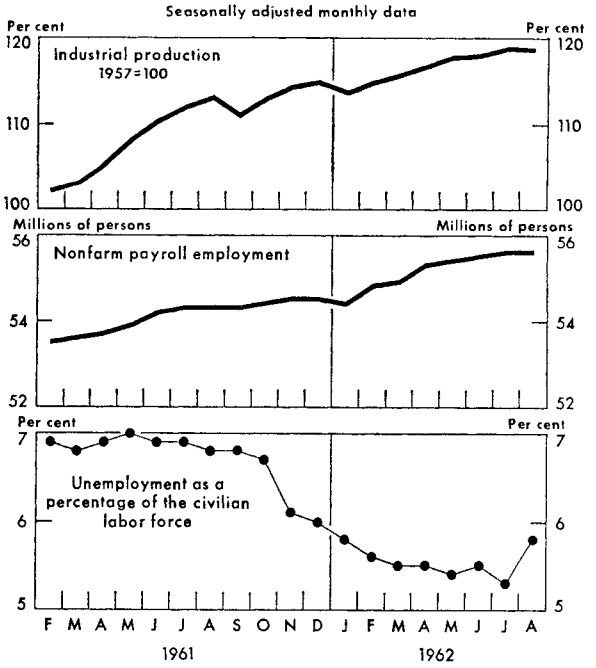
For September the weekly indicators of production generally show seasonal increases. Steel inventories continue to be a restraining factor and have so far prevented ingot production from rising much beyond 60 per cent of capacity. For the month as a whole, however, steel output appears to show a slightly more than seasonal gain over August. In the auto industry, all companies returned to full operation shortly after Labor Day, following the August shutdowns for model change-over. September schedules call for a seasonally adjusted assembly rate equivalent to more than 7 million cars annually, about equal to the August pace.

The employment situation worsened in August as nonfarm payroll employment declined for the first time since January. The household survey, in contrast, reported a sharp rise in nonagricultural employment, but also showed a substantial increase in unemployment. Indeed, the unemployment rate (unemployment as a percentage of the labor force) rose to 5.8 per cent (see Chart I). To be sure, these changes were partly traceable to special circum-

Chart I

PRODUCTION AND EMPLOYMENT IN THE CURRENT BUSINESS UPSWING

Seasonally adjusted monthly data



Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

stances. This year's model change shutdowns in the automobile industry were more heavily concentrated in August than in former years. Moreover, because of the later-than-usual date of the household survey during the month, a large number of women (possibly school teachers) were this year reported as waiting to begin work within thirty days and thus counted as unemployed. Reports for unemployment insurance claims in early September suggest some decline in unemployment in that month, but this may, of course, merely reflect the fact that the special circumstances which had affected the August statistics were no longer present. It apparently remains true that the rate of unemployment has shown little net change since the beginning of the year, despite the rise in production since that time.

INDICATORS OF FUTURE ACTIVITY

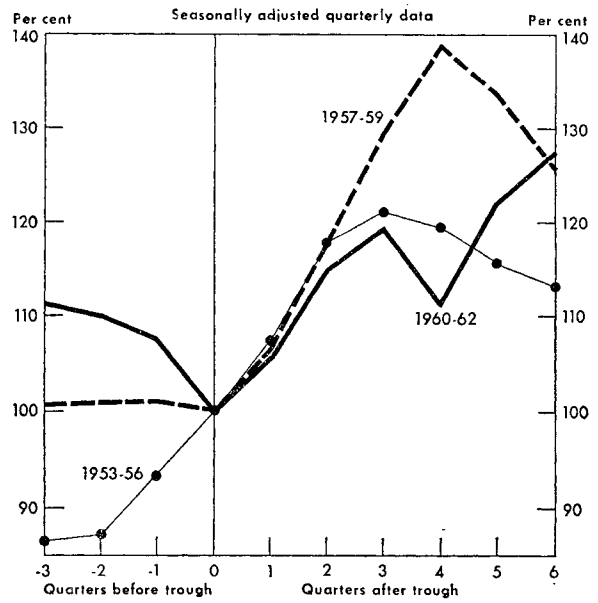
New orders received by manufacturers of durable goods failed to hold their July gains in August, decreasing by 3 per cent, seasonally adjusted. However, compared with the June-July average, total orders in August showed little net change. Most of the fluctuation in orders during the past several months was related to two phenomena, neither of which is necessarily indicative of business sentiment about the future. Government orders for defense purposes lagged in June and then bulged in July, and orders reported by automobile manufacturers rose sharply in July but then fell off markedly in August. (The statistics on new orders received by the automobile industry are based on deliveries of new cars, rather than on actual orders.) Nevertheless, given the fact that steel orders were no longer a drag on total orders—they actually rose in August for the second consecutive month—the over-all order picture shows little exuberance.

One area of business demand that could provide some new strength to orders is spending for inventories, particularly as steel inventories move down closer to desired levels. Although inventory targets may of course be revised on the basis of developments in business sales, manufacturers did expect in August to increase their inventories by $500-600 million per quarter between the end of June and the end of December, according to a Commerce Department survey. In the second quarter, net inventory purchases by manufacturers had amounted to only $300 million, reflecting the sharp cutback in steel stocks that had been built up in anticipation of a strike. Even with this somewhat sharper increase, inventories at the year's end are expected to be no higher in relation to sales than they were at midyear.

Spending for new construction, which had fallen off in July, also showed signs of regaining strength, as total outlays rose in both August and September. Although outlays for commercial and industrial buildings decreased in September for the first time in three months, they still were at the second highest level ever reached, and the August rise in contract awards suggests the possibility of some further increase. In the residential sector, the increase in outlays in September nearly recouped the loss during the previous two months, and the July-August increases in the number of new housing units started may foreshadow some additional rise in expenditures in the months ahead. Such an increase would represent a departure from previous postwar cyclical experience. In the two preceding cycles, residential construction activity had already begun to decline in the fourth or fifth quarter of general business expansion (see Chart II).

In the consumer sector, demand continues to be supported by rising incomes and by the steady advance in consumer credit. The most recent gains in income and consumer credit have, however, been somewhat smaller than those earlier in the year. At the same time, retail sales, after spurting to a new record in July, fell off slightly in August. A major part of the decline came in the automotive group, as relatively low car inventories forestalled any

Chart II
RESIDENTIAL CONSTRUCTION OUTLAYS IN THREE RECENT EXPANSIONS
Seasonally adjusted quarterly data



Note: Business-cycle trough quarters=100. Trough quarters are those determined by the National Bureau of Economic Research chronology: III-1954, II-1958, and I-1961.

Source: United States Department of Commerce.

serious sales push, but department stores sales also were off a bit for the month. Department store sales did apparently again pick up somewhat with the cooler weather in September. It remains to be seen whether this reflects a general improvement in buying intentions. Evidence on consumer sentiment probably will not be conclusive for several months, and particularly until the 1963 model cars have been available long enough to permit an assessment of the public's reaction to the new styles. In any event, the reception of the new models will have to be quite favorable if car sales are to exceed, by any significant margin, the rapid pace set during the spring and summer months.

The Money Market in September

The money market continued moderately firm during September. Nation-wide reserve availability was about the same as in August, but was concentrated mainly at banks outside New York City. New York City banks experienced some reserve shortages, largely reflecting the continued effects of Treasury refunding operations and a seasonal corporate need for liquidity. Federal funds traded for the most part at 2¾ and 3 per cent, with the effective rate at 3 per cent during the first two weeks of the month and mainly at 2¾ per cent thereafter. Some temporary firmness developed again in the closing days, however, as float finally declined after remaining near its midmonth peak longer than usual. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted within a 3 to 3½ per cent range throughout the period.

Three Treasury financing announcements were made during the month. On September 5 the Treasury indicated that holders of six of its issues, maturing in February and May of 1963 and bearing coupons ranging from 2⅝ to 4 per cent, would be given the opportunity to exchange their securities for a new 3¾ per cent note maturing August 15, 1967 or a new 4 per cent bond maturing August 15, 1972. The effective offering yields of the new securities, taking into account the various cash payments to be made by the Treasury to subscribers, were from 3.80 to 3.83 per cent on the note and from 4.05 to 4.07 per cent on the bond. This refunding, involving issues considerably closer to maturity than had been the case in previous advance refundings, was intended by the Treasury to reduce the "congested maturity schedules of February and May 1963" as well as "to improve the structure of the outstanding debt". Of the $26.8 billion of these issues outstanding, $19.2 billion was publicly held. About 39 per cent, or $7.5 billion, of these holdings was exchanged during the subscription period from September 10 through September 12. On September 13 the Treasury announced that a new borrowing technique would be tested by the sale within the next six months of approximately $250 million of long-term bonds on the basis of competitive bidding by underwriting syndicates. Questions and suggestions from the public will be heard by Treasury officials at a meeting to be held on October 17 at this Bank. Finally, on September 20, the Treasury announced that on September 26 it would auction $3 billion 170-day tax anticipation bills, dated October 3, 1962 and maturing March 22, 1963. Commercial banks were permitted to make payment through credits to Tax and Loan Accounts.

The market for Treasury notes and bonds displayed a generally firm tone during most of the month and prices tended upward, with occasional interruptions. The various Treasury announcements noted above, although attracting considerable attention, had a comparatively minor price impact. New developments with significant effect on market psychology did not appear until the latter part of the month. At that time, the relatively confident atmosphere which prevailed at the international financial meetings in Washington, the good reception accorded the Treasury's advance refunding, and some fading of optimism concerning business activity all contributed to increased market strength.

The market for Treasury bills was also generally firm in September. Demand was particularly strong just prior to the advance refunding when some investors who did not wish to acquire the new longer term issues sought to capture the relatively attractive premiums at which rights were trading and to reinvest in bills. Corporate offerings associated with the approach of the midmonth tax and

The Business Situation

The economy entered the final quarter of the year with most key measures of aggregate activity continuing to mark time. Industrial production, payroll employment, and personal income all were virtually unchanged in September. Retail sales advanced moderately but did not fully regain the peak level reached two months earlier. The overall picture was reflected in the estimate of third-quarter gross national product which, after adjustment for price changes, showed only a very small increase from the preceding quarter. Fragmentary data for October suggest a seasonal rise in steel production and the possibility of a stronger than seasonal performance in the automobile sector following the introduction of the new models. Auto dealers reported a substantial increase in sales, and production totals showed a continued rise in assemblies. The Cuban crisis, of course, introduced new elements of uncertainty which could alter the underlying forces affecting the economy.

INDICATOR OF CURRENT ACTIVITY

Gross national product advanced by $3.5 billion in the third quarter to a seasonally adjusted annual rate of $555.5 billion, according to preliminary estimates by the Council of Economic Advisers. The rise was the smallest in the current upswing and, after adjustment for price changes, amounted to only $1.7 billion. As was true in the second quarter, a major factor holding down the rise in GNP was the marked reduction in inventory investment (see Chart I), in large part related to the decumulation of steel inventories. At the same time, the increases in the other major components of private demand were only about the same or somewhat smaller than in the preceding quarter. Outlays on consumer durables and net exports of goods and services even declined. Only in the government sector did expenditures rise by a larger amount than in the preceding quarter.

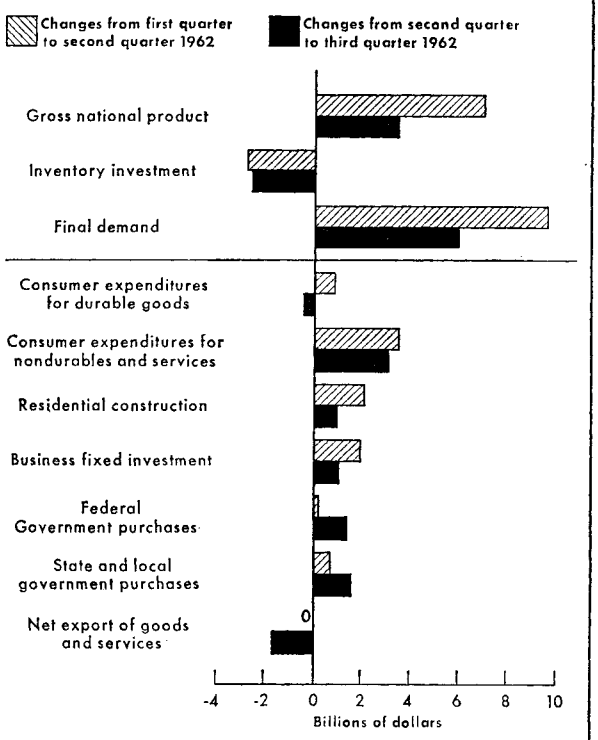
The various monthly measures of aggregate activity for the most part showed virtual stability during August and September. The index of industrial production, for example, showed no change at all in August, after adjustment for the normal seasonal influences, and rose by only 1/10 of a percentage point in September. However, while there was little strong upward push from any sector in September, the number of industries showing declines in production was not so large as a month earlier. Of the seventeen separate industries for which data are available, only two showed decreases in September, compared with eleven in August. In October, automobile production moved upward, as producers stepped up their original schedules in response to the record rate of sales. Steel ingot production continued to feel the effects of the overhang of steel inventories, and the weekly figures point toward only a seasonal movement upward.

Total nonagricultural employment also was virtually unchanged in September, according to the Bureau of Labor Statistics payroll survey. The near stability, however, primarily reflected a rise in state and local government employ-

Chart I

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted annual rates

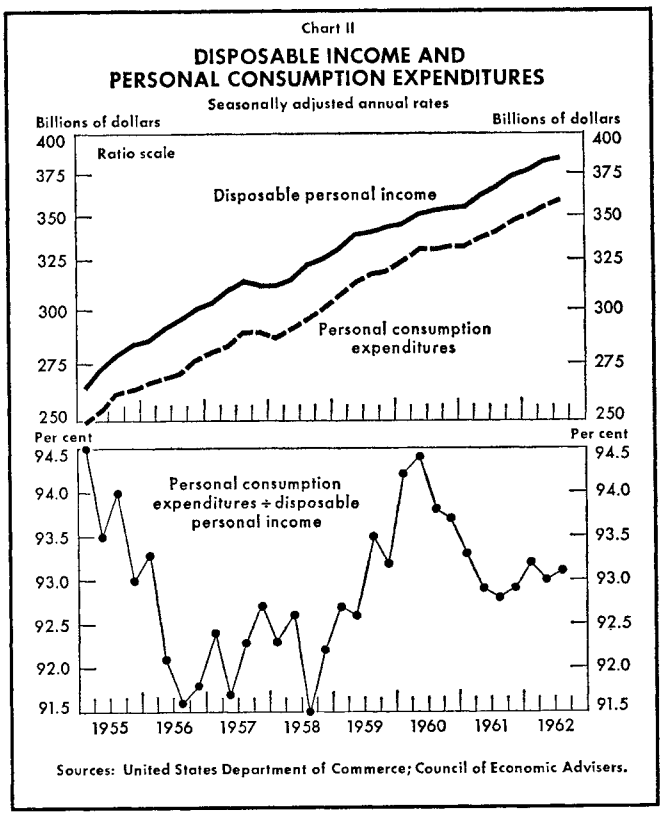


Sources: United States Department of Commerce; Council of Economic Advisers.

ment which about offset small declines in most other sectors. Moreover, in spite of the return of teachers to their classrooms and of automobile workers to the assembly lines for production of the new models—two groups that had shown higher than usual unemployment in August—unemployment in September remained at 5.8 per cent of the labor force. In October, the unemployment rate fell to 5.5 per cent, but this largely reflected a decrease in the number of persons looking for work rather than any marked improvement in the employment situation.

Proper interpretation of the employment figures requires taking into account the proportion of the population in the labor force. This proportion has declined rather steadily since 1956, with the result that the actual number of persons in the labor force has fallen more and more behind the Labor Department's long-term demographic projections. Part of the decline, of course, reflects the earlier retirement now permitted under social security legislation and the fact that students are remaining in school longer than in the past. To some extent, however, as has been noted by the President's Committee to Appraise the Employment and Unemployment Statistics, the decline may also reflect a lack of job opportunities, which would imply that the actual unemployment statistics may understate the magnitude of the current unemployment problem.

Indicators that tend to foreshadow future activity continue to present a mixed picture and by themselves give little sign of any substantial change from recent levels. Partly reflecting the unusually small number of working days this September, the number of new housing starts fell sharply, following two months of increase. New orders for durable goods increased by 1 per cent in September, with a large part of the rise caused by the sharp upswing in orders for motor vehicles associated with model changeovers. (Since deliveries of new cars to dealers are used as a proxy for new orders for automobiles, such a series has no necessary implication for the future course of automobile production.) On the other hand, it appeared that the Defense Department had placed a substantial volume of new contracts for space-related projects. Federal spending, according to budget estimates, is scheduled to continue upward throughout the current fiscal year. Developments stemming from the Cuban crisis could, of course, lead to some modification of earlier budget projections.



THE CONSUMER SECTOR

The performance of consumer spending will be a major determinant of the course of future economic activity. Aside from directly absorbing nearly two thirds of total output, changes in such spending can induce substantial changes in business spending both for inventories and for plant and equipment. To a great extent, the level of consumer spending is determined by the amount of income which consumers have left over after deduction for social security and payment of Federal, state, and local income taxes. (The rate at which consumers use credit to augment income is, of course, also an important factor.) The quarterly rate of consumer expenditures has varied between 91.5 and 94.5 per cent of disposable personal income during the past eight years, with the ratio in the most recent quarter at 93.1 per cent (see Chart II). The 3 percentage point spread, however, can be of crucial significance in that, at the current level of disposable income, it represents about $11.5 billion of spending.

Of the three main components of consumer spending, the one of least concern from a cyclical standpoint is spending for services, currently accounting for slightly more than two fifths of total consumption expenditures. Consumption of services has risen in every single quarter of the postwar period. To be sure, the rate of increase has tended to slow down somewhat during periods of slack over-all demand, but even so the smallest quarterly increase in any of the past three business downturns still amounted

to 1 per cent, or about $1.5 billion (seasonally adjusted annual rate) at the current level of spending.

In contrast to the rather steady upward trend in the consumption of services, expenditures for goods—and especially for durable goods—have been much more subject to fluctuation, and the variation in such expenditures has largely determined the over-all behavior of consumer spending. Among the major durable items, in turn, the dominant influence through most of the postwar period has been purchases of automobiles. For example, sales of new cars were off markedly in both August and September of this year and over-all durables consumption declined in the third quarter. At the same time, the swing in durables consumption from an increase in the second quarter to the third-quarter decline accounted for more than half of the slowdown in the growth of total consumer expenditures. While there have been periods when purchases of other items have tended to offset declines in consumption of automobiles, it appears that when consumers are in the mood to buy cars they are also quite likely to be in a mood to increase their total spending. Conversely, slackening in over-all consumer spending has tended to accompany weakness in purchases of automobiles.

Trade reports suggest that automobile sales in October were the best on record and substantially higher than the third-quarter average. While this in part probably reflects a bunching of retail deliveries as the 1963 models became available, recent surveys of consumer buying plans indicated that intentions to buy new cars remain relatively strong. The continued strength in buying intentions may in part reflect the fact that, in spite of the near-record automobile sales so far this year, the proportion of disposable income spent on automobiles has been below the ratios set in five of the past seven years. At the same time, although the recent substantial increase in consumer credit has been accompanied by some uptrend in the proportion of new cars bought on credit, this proportion remains below the levels set in the earlier peak sales years of 1955 and 1957. The surveys were, however, taken before the development of the Cuban crisis which could alter consumer attitudes and the whole pattern of their spending behavior.

The Money Market in October

The money market was relatively comfortable during October. Although firming somewhat during the midmonth period, when the Treasury raised $500 million in new money through enlarging its offering of one-year bills, the market did not tighten substantially at any time. Nationwide reserve availability was about unchanged, and member bank borrowing was moderate. Federal funds traded in a 2¾ to 3 per cent range, while rates posted by major New York City banks on call loans to Government securities dealers ranged between 2¾ and 3½ per cent. Rates on directly placed finance company paper, commercial paper, and bankers' acceptances were reduced by ⅛ to ¼ percentage point during the month.

Following the close of business on October 18, the Board of Governors of the Federal Reserve System announced a reduction from 5 per cent to 4 per cent in the reserve requirement against time and savings deposits. The reduction took effect on October 25 for reserve city banks and November 1 for other member banks, releasing an estimated $767 million total of required reserves. The Board's action was designed to help meet the heavy seasonal reserve needs that normally appear in the closing months of the year and to provide for the longer term growth of bank deposits. The announcement noted that "this method of supplying reserves will minimize downward pressures from System purchases upon short-term market rates, which is desirable in the present circumstances in order to keep incentives for short-term capital flows abroad from becoming stronger".

Treasury financing operations during the month included the auction on October 9 of $2.5 billion of one-year bills at an average issuing rate of 2.97 per cent to replace $2 billion of bills maturing October 15. In addition, the Treasury announced after the close of business on October 25 the offering of three new issues in exchange for four issues called for or maturing in November and December. The four issues eligible for exchange include the 3¾ per cent Treasury notes dated November 29, 1957 and the 3¼ per cent notes dated August 1, 1961, both maturing November 15, 1962, the 2¼ per cent bonds dated November 15, 1945 and maturing December 15, 1962, and the 2¾ per cent bonds dated December 15,

The Business Situation

Recent developments would seem to bear out earlier judgments that the underlying strength of the economy has been greater than many business analysts had thought. Indeed, the pronounced improvement in business sentiment that has occurred over the past month as fears of an imminent downturn have receded should in itself act as a stimulant to total spending. At the same time, it is important to recognize that even the more optimistic current business forecasts do not envision a rate of advance in activity during the coming year that will be sufficient to bring about a marked reduction in the unemployment rate. A need for tax revision consequently remains, not because the economy would otherwise slide into a recession, but because such action seems to be required to help strengthen the incentives for longer term economic growth. In this context, it is encouraging that growing support for a significant cut in income taxes has in the past few weeks been expressed by a wide range of groups and individuals. The prospect of a tax cut, in turn, makes restraint in Government spending all the more desirable.

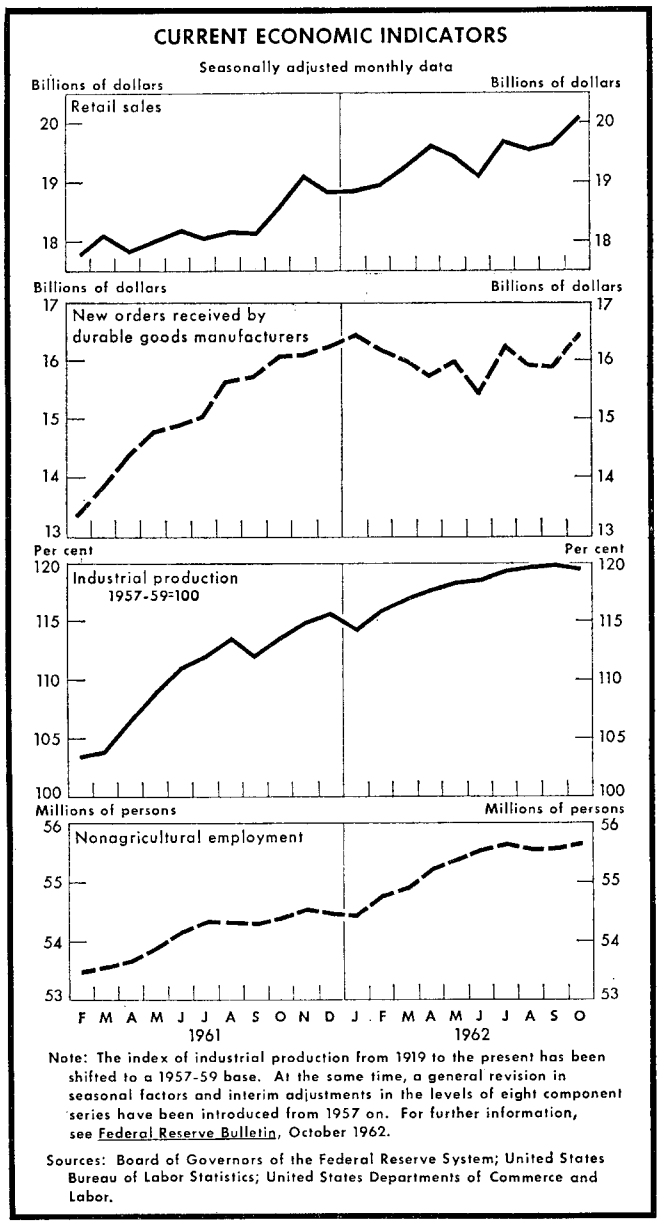
The recent improvement in business sentiment is in part explained by the firmer tone of many of the available economic statistics. To be sure, production and employment continued at virtually unchanged levels in October, and fragmentary November data suggest no marked improvement in that month. Recent automobile sales, however, have been at a very high rate, housing starts rebounded in October following the sharp September decline, and new orders received by durable goods manufacturers in October advanced after remaining virtually unchanged during the previous two months. Moreover, consumer plans to buy new automobiles and household durables have increased markedly since midyear, according to the Federal Reserve's October survey. In the capital goods sector, appropriations have picked up, and business plans for plant and equipment expenditures, while certainly not buoyant, do point to some increase in 1963.

PRODUCTION, EMPLOYMENT, AND SALES

Industrial production was virtually unchanged in October, remaining on the high-level plateau which it has held since July (see chart). Although automobile production showed strength and production of business equipment continued upward, these gains were offset by declines in the output of other consumer durable goods and of some nondurable materials. In November, steel output increased markedly, with the advance accelerating toward the latter part of the month. Steel ordering by auto manufacturers has finally been stepped up, following months of inventory liquidation. Automobile production remained at the high rate of the past several months.

The employment situation also has shown little change for several months. Nonfarm employment inched upward in October, according to the Bureau of Labor Statistics payroll survey (see chart), largely reflecting an expansion in state and local government hiring; gains in this sector have accounted for slightly more than half the total increase in nonagricultural employment thus far this year. In the manufacturing sector, employment was virtually unchanged in October, but average weekly hours tallied by production workers declined to a level near the year's low. In spite of the lack of improvement in employment, unemployment in October fell to 5.5 per cent of the civilian labor force from 5.8 per cent in the previous month, largely because of a decline in the number of women looking for work. Weekly data on unemployment insurance compensation claims filed in the first half of November, however, suggest little change in unemployment for that month.

The major element of strength in the over-all picture has been the performance of automobile sales in October and November. The unusually strong reception of the 1963 models pushed sales in October to an annual rate of over 8 million units. This more than offset a decline in nondurables sales and helped to raise total retail sales by 1 per cent to a new high (see chart). Auto sales continued strong in November, although in seasonally adjusted terms somewhat below the near-record October pace, and department store volume apparently recovered most of the previous month's loss. According to the recent Federal Reserve survey of consumer spending plans, intentions to buy new automobiles in October were the highest since October 1959 and showed a larger increase from July than in both



Note: The index of industrial production from 1919 to the present has been shifted to a 1957-59 base. At the same time, a general revision in seasonal factors and interim adjustments in the levels of eight component series have been introduced from 1957 on. For further information, see Federal Reserve Bulletin, October 1962.

Sources: Board of Governors of the Federal Reserve System; United States Bureau of Labor Statistics; United States Departments of Commerce and Labor.

of the two preceding years. Plans to buy household durables were also strong, showing a greater than seasonal rise.

New orders received by durable goods manufacturers advanced by 3.5 per cent in October (see chart). While the increase partly reflected the high rate of automobile orders, materials and defense-producing industries also recorded gains. New orders for capital equipment declined in October from their September high, but remained in the narrow range that has prevailed for the past year.

INVESTMENT ACTIVITY

Business investment in plant and equipment has advanced at a slow rate in the current expansion, lagging behind even the relatively weak 1958-60 upswing. Indeed, although the latest Commerce Department-Securities and Exchange Commission survey, taken in August, showed small net increases in planned business outlays on plant and equipment in the third and fourth quarters, the failure of manufacturers' sales in the third quarter to come up to expectations had raised some question whether even these relatively modest investment plans would be sustained.

Recent developments have tended to allay some of these doubts. Thus, the October McGraw-Hill survey of business capital spending plans for 1963 indicates that businessmen expect to increase their outlay rate slightly above current levels. For the last seven years, the McGraw-Hill surveys have correctly indicated the eventual direction of the year-to-year change in total spending for plant and equipment. The likelihood that such spending will be at least maintained is also supported by the third-quarter survey of capital appropriations taken by the National Industrial Conference Board which shows an 11 per cent increase in net appropriations, recovering two thirds of the second-quarter decline.

According to the McGraw-Hill study, business firms intend to increase their capital outlay rate in 1963 by 3 per cent over the 1962 average. To be sure, this is a very small rise, especially when measured against the current level of spending. On the other hand, the survey does not point to a decrease in capital spending for the year as a whole, as was the case in surveys taken in the fall of 1957 and 1960.

Service industries, as distinct from manufacturing, account for most of the projected advance in capital spending. Commercial firms and electric and gas utilities, which together are responsible for 40 per cent of total capital spending, plan 6 and 4 per cent increases, respectively. Transportation and communications industries (other than railroads) plan a 2 per cent increase.

For the manufacturing sector, the survey points to only a 1 per cent expansion in capital spending in 1963. Most individual manufacturing industries do, however, plan some rise in expenditures. Indeed, the industries planning the largest increases include some in which output is currently particularly far below capacity and which do not expect sizable sales gains. For example, the iron and steel and chemical industries are scheduling substantial increases in capital outlays, although in September of this year—according to the survey—they were operating at only 79 and 78 per cent of capacity, respectively, as against their preferred rate of 91 per cent. Moreover, the iron and steel

industry as a whole expects no change in the physical volume of sales in 1963, and the 4 per cent sales increase anticipated by the chemical industry would be much too small to push its capacity utilization to the preferred rate. Furthermore, those manufacturing industry groups which intend to reduce capital spending (electrical machinery; textiles; stone, clay, and glass; and miscellaneous manufacturing) plan to allocate a larger proportion of their spending than any other industry groups for the purchase of automated machinery and equipment.

Present capital spending plans thus in many cases seem to be related to product improvement and other responses to competitive pressures rather than to gains in demand. This, in turn, suggests that these plans may be relatively firm and would not be much influenced by any minor sales disappointments. Moreover, the current improvement in the tone of business news, coupled with the recent changes in the tax laws and the possibility of reductions in corporate profits tax rates in 1963, may well lead to an expansion of capital spending plans.

INDUSTRIAL PRODUCTION — 1957-59 BASE

The Board of Governors of the Federal Reserve System has just issued a new publication, *Industrial Production—1957-59 Base.* The booklet provides detailed statistics—covering the period 1947-61—for all series in the Board's index of industrial production on the new 1957-59 base, together with a description of the new seasonal factors and the changes made in some series and groups. The results of these changes in the index were also summarized in the October 1962 *Federal Reserve Bulletin.*

Copies of the new booklet are available from the Board of Governors of the Federal Reserve System, Washington 25, D. C., at $1 per copy up to ten copies and 85 cents each for ten or more copies in a single shipment.

Advance Refunding: A Technique of Debt Management*

In September, the United States Treasury completed its sixth advance refunding since the new technique was introduced in June 1960. In an advance refunding, the Treasury offers owners of a given issue that still has some time to run the opportunity to exchange their holdings for new securities of longer maturity. Largely through the use of this new financing method, the Treasury has achieved a more balanced debt structure and extended the average maturity of the marketable debt to five years, the longest it has been since September 1958.

The new technique has been particularly helpful in enabling the Treasury to coordinate its debt management responsibilities with fiscal and monetary policies that in recent years have had to take account of the problems of our balance of payments as well as the continuing objective of promoting domestic economic stability and growth. Because advance refunding has recently played such an important role, this article describes how it fits into the broader framework of Treasury debt management, reviews the reasons why the technique was adopted, and summarizes its accomplishments and limitations.

DEBT MANAGEMENT IN PERSPECTIVE

The Treasury is the largest and most active single borrower in the financial markets. Unlike most private borrowers who are usually in the market only infrequently, the Federal Government is necessarily engaged in a nearly continuous process of borrowing and refinancing. Some Treasury indebtedness although short term, as in the case of 91- and 182-day Treasury bills, is basically a "permanent" portion of the total debt and the maturities are so scheduled that the Treasury rolls them over at weekly bill auctions. In recent years, the amounts offered in these

* Ernest Bloch and Joseph Scherer had primary responsibility for the preparation of this article.

The Business Situation

Economic activity remained on a high plateau toward the close of 1962. Business sentiment continued to display an improved tone, but the major economic indicators showed little change after adjustment for the usual seasonal variations. Industrial production and employment remained steady in November. For December, currently available data suggest some increase in automobile and steel output, but new car sales and department store volume fell back somewhat from the high levels of the previous month. Among the more forward-looking indicators, the latest surveys of business spending plans for the first quarter of 1963 pointed to some reduction in expenditures for new plant and equipment and to some slowing-down in inventory building by manufacturers. On the other hand, new orders for durable goods and private housing starts were maintained at advanced rates in November. Of course, discussion about the prospects for a tax cut continues to loom large in the business outlook.

RECENT DEVELOPMENTS

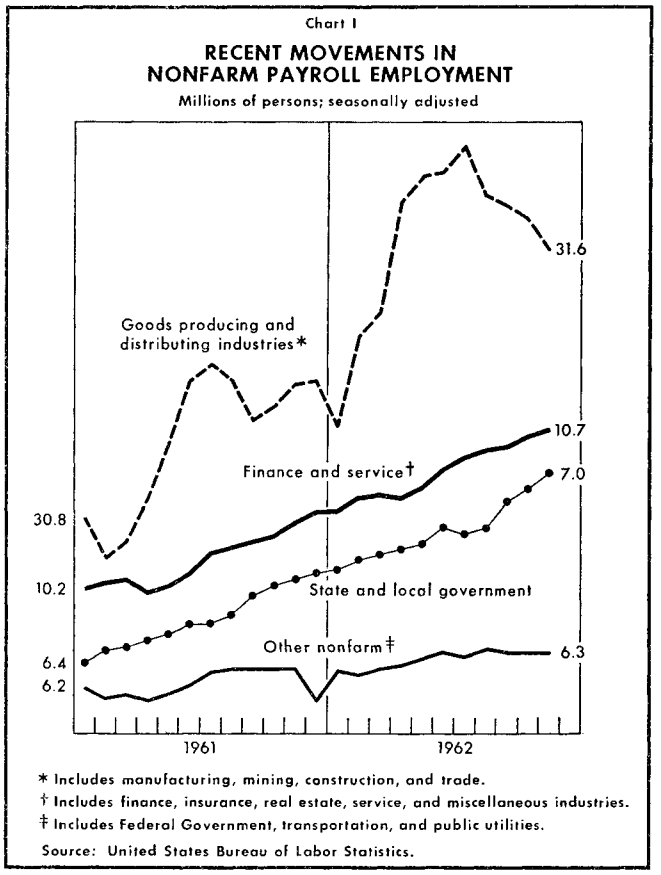
The index of industrial production remained at 119.5 per cent of the 1957-59 average in November, and thus continued to mark time at about the high level first reached last July. In contrast to earlier months, the overall stability did not mask crosscurrents but was shared by most major industries. The notable exception was the steel industry, in which ingot production moved up sharply in response to renewed strength in orders placed by automobile manufacturers. In the preceding months, the auto industry had drawn a significant portion of its steel needs from inventories that had been accumulated early in the year. In December, auto assemblies (seasonally adjusted) rose very slightly beyond the average of the past several months, and seasonally adjusted steel ingot production appears to have advanced further.

The employment situation has remained virtually unchanged. Indeed, total payroll employment, seasonally adjusted, showed no net change between June and November, the latest month for which payroll data are available. Gains in the service and financial sectors over this period and a particularly sharp rise in state and local government employment—mainly reflecting the increased hiring of teachers—have been offset by a decline of almost 250,000 in the number of persons employed in the goods producing and distributing industries (see Chart I). Unemployment climbed to 5.8 per cent of the civilian labor force in November, largely because many teen-age students were apparently unable to find part-time jobs before Christmas. Weekly data on unemployment insurance claims filed through mid-December suggest little change after seasonal adjustment in unemployment during that month.

Recent developments in the key demand sectors have been mixed and show little in the way of a clear trend. Consumer spending, which had picked up with the introduction of the new auto models in October, continued to boost the economy in November, as retail sales rose by over 2 per cent to an all-time high. The November increase, moreover, was achieved despite some lessening in the pace of auto sales following the bunching of deliveries in October. Sales gains among retailers other than automobile dealers were widespread, with seasonally adjusted department store sales reaching a record level. In December, however, department store volume fell slightly short of registering its usual Christmas surge; nevertheless, sales bettered the year-ago level despite the newspaper strikes in New York and Cleveland. The number of new cars sold in December (seasonally adjusted) was somewhat below the extraordinary pace that had been set in recent months by the 1963 models, but held fairly close to the average sales rate for the whole of 1962.

Business spending has not shown much buoyancy. To be sure, the recent Commerce Department-Securities and Exchange Commission survey, taken in late October and early November, suggested a higher level of capital expenditures in the second half of 1962 than had been projected earlier. However, plans for the first quarter of 1963 point to a 2 per cent decline in plant and equipment outlays from the projected fourth-quarter rate, largely because of anticipated cutbacks by durable goods manufacturers. If this decline materializes, it will be the first since the second quarter of 1961 when the economy was just pulling out of the recession.

The Commerce-SEC survey has missed projecting the



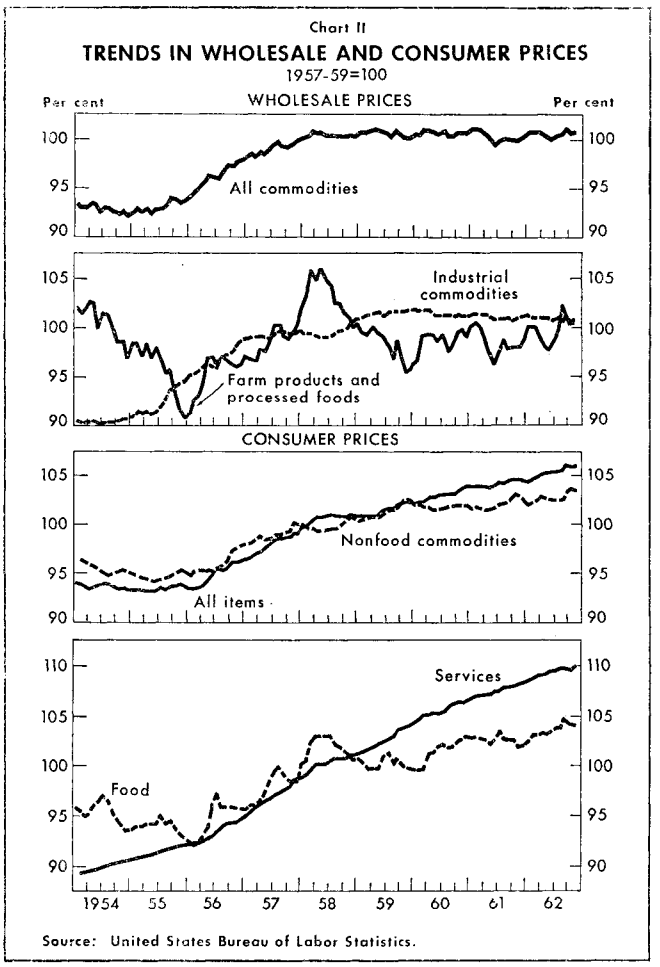
direction of change in capital expenditures in only three quarters since 1953. However, the recent survey may have been taken too soon to reflect fully the improvement in business sentiment that developed toward the end of October. Furthermore, recently developed investment plans—including some of those stimulated by the new investment credit legislation and the revised depreciation schedules—may not be reflected in actual disbursements until later in 1963. Thus, even if a dip in capital outlays does develop in the current quarter, it would not necessarily preclude achievement of an increase in capital spending in 1963 as a whole, as projected by the McGraw-Hill survey taken a month earlier.

Manufacturers' sales expectations and plans for inventory investment show a pattern rather similar to that for plant and equipment. Although the overhang of steel inventories has been pretty much worked off, manufacturers, according to the November Commerce Department survey, expected their inventory investment to increase only slightly in the fourth quarter and then to slip back somewhat in the current quarter. These plans appear to be closely geared to the expected trends in manufacturers' sales.

STABILITY IN PRICES

Price changes during the past year were rather moderate. Despite some increase in farm prices during the year, aggregate wholesale prices at the end of 1962 were virtually unchanged from a year earlier; indeed, such prices have hovered within a very narrow range since the beginning of 1958 (see Chart II). In the consumer sector, prices through November 1962 had increased slightly more than in 1961. The larger rise, however, was primarily attributable to food prices, rather than to those components of the over-all consumer price index which are more sensitive to general business trends.

The stability of wholesale prices during a period of economic advance of course reflects in part the more intense competition resulting from the failure of demand in this country to approach productive capacity. Other factors have also contributed to a more competitive climate, with competition from foreign producers, in particular, remaining strong, even though in the past two years prices



in other major industrial nations have risen more than in the United States. Increased competition has also played a role in the recent slowdown in the rate of increase in wages, which in turn has helped to hold down upward pressures on prices. Collective bargaining agreements negotiated last year in manufacturing industries tended to provide smaller increases than were obtained in earlier contracts. Since productivity also rose during the period, direct wage costs per unit of output remained virtually unchanged in 1962, and indeed at the end of the year were no higher (and possibly slightly lower) than the level reached more than five years earlier at the peak in business activity in 1957.

Among the important components of the price structure that are not greatly affected by cyclical changes in business activity are the prices of consumer services. These prices, which account for more than one third of the total consumer price index, have been rising continuously, in part because of the steady shift in demand to the service sector. In addition, productivity gains in many service sectors appear to be relatively hard to achieve or at least to measure. It is noteworthy, however, that even in this area price rises in most of the recent months have been more moderate than they had been for some time.

To some extent, furthermore, the magnitude of the rise in service prices over the postwar period is probably overstated because of the special difficulties of taking improvements in the quality of services into full account. For example, while the "medical care" component of the consumer price index has shown a much more rapid rate of advance than most other "service" components of the index, the price equivalent of higher quality medical care is exceedingly difficult to define, much less to measure.

Farm prices in recent years also have been largely insensitive to the over-all level of business activity. The chief cause of these fluctuations in the aggregate level of farm prices seems to be the livestock cycle. During the two upswings in general business activity preceding the present one, from mid-1954 to 1956 and from early 1958 to 1960, the timing of the livestock cycle brought to market a large increase in the supply of cattle and hogs and thus drove down food prices at both the wholesale and retail levels, offsetting rising prices for manufactured goods. In the current upswing, however, livestock production has stabilized at a fairly high level. As a result, wholesale prices of farm products and processed foods on balance have dipped only slightly since the business upswing began in early 1961, and retail food prices have risen. Food prices in general were stronger in 1962 than in 1961, reflecting increases in meat prices and continuing uptrends in cereal and bakery product prices.

Prices of goods other than food have not shown the sizable increases in the current business expansion that occurred in previous postwar upswings. Retail prices of nonfood consumer goods, to be sure, have risen somewhat since the upturn began (in February 1961), but the increase has been less than in the comparable period of the preceding economic expansion. At the wholesale level, moreover, industrial commodity prices (i.e., wholesale prices other than farm products and processed foods) have changed little since the last recession trough, in contrast to a mild rise in the previous cyclical expansion and a considerable advance in the 1954-57 upswing. In all major categories, industrial wholesale prices are currently below their peak levels of the late 1950's.

The Money Market in December

The money market was moderately comfortable in the first half of December but became firmer in the second half, as the distribution of reserves first tended to favor the money centers and then shifted toward the country banks. The shift in atmosphere was associated in good part with the midmonth tax date, as corporations sold securities to dealers, both outright and as a result of maturing repurchase agreements, while the dealers in turn resorted to heavy borrowing from the money market banks in New York to finance their enlarged inventories. Thus, the effective rate on Federal funds was generally 2⅞ per cent through December 13, but moved to 3 per cent thereafter while member bank borrowing from the Federal Reserve increased. Similarly rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were quoted within a 2¾ to 3¼ per cent range in the first half of December, and largely in a 3¼ to 3½ per cent range in the latter part of the month.

On December 20, the Treasury issued a public invitation for bids on $250 million of Treasury bonds. The operation represents the first sale of Treasury bonds through competitive bidding by underwriters for reoffering

The Business Situation

Business sentiment remained confident as the new year began. The pace of economic activity, however, appeared to show little change from recent months, and the demand for goods and services continued well below the economy's productive capacity.

In December, industrial production, nonagricultural employment, and retail sales had all held close to their levels of the previous month, while new orders for durable goods and housing starts had declined somewhat from their high November rates. Construction contract awards and residential building permits, on the other hand, had risen sharply to record highs. For January, production data at hand indicate that output of steel ingots moved up for the third consecutive month and that automobile assemblies continued at the high rate that had prevailed since July. At the same time, consumer spending seems to have strengthened slightly, despite the adverse influence of newspaper and transportation strikes in a number of major cities, with unit sales of new cars apparently registering a sizable gain.

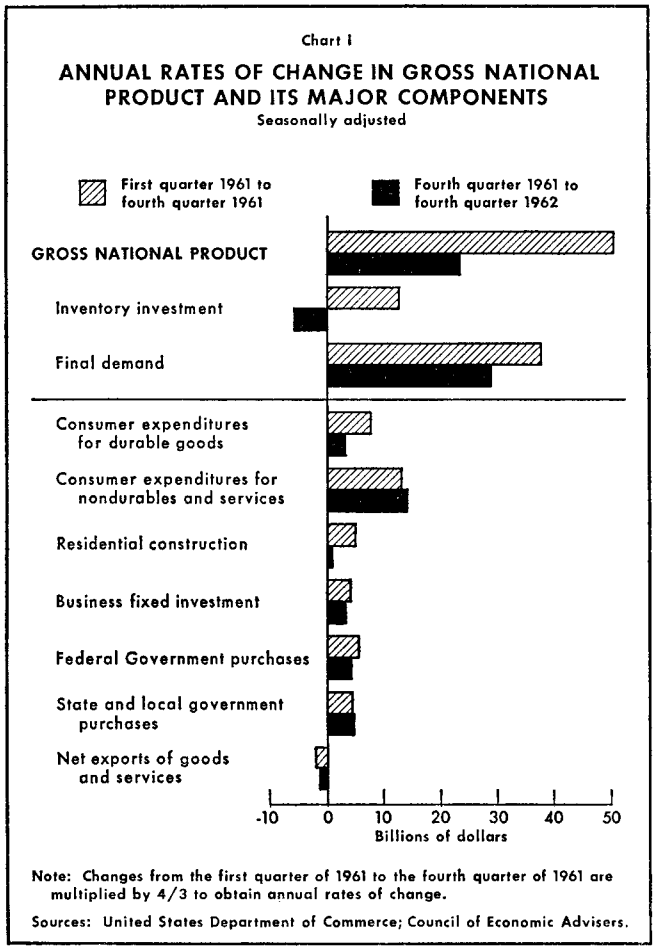
The future course of the economy will, of course, be importantly influenced by Congressional and public reaction to the President's tax program. This program is designed to give a direct impetus to both consumer and business spending and to spark a more rapid rate of economic growth through its cumulative impact on incomes and expenditures as well as through a strengthening of incentives and expectations. In terms of current income levels, the President's proposals would cut annual personal and corporate income tax liabilities by about $10 billion over a three-year period, after allowing for offsets of about $3.5 billion through adoption of reform measures. In fiscal year 1964, according to Administration estimates, the proposed lowering of tax rates would reduce tax revenues by about $5.4 billion, with half of the revenue loss to be recouped by the expected gains in economic activity, by a requirement that corporations pay their income taxes on a more current basis, and by the initial effects of the suggested tax reforms.

THE SECOND YEAR OF EXPANSION

Gross national product in the final quarter of 1962 reached a seasonally adjusted annual rate of $562 billion, according to estimates by the Council of Economic Advisers. The $6.7 billion increase was twice as large as the modest advance registered in the third quarter, though it was not so large as the gains scored in the earlier part of the current business upswing. The pickup in the fourth quarter largely reflected a substantial rise in personal consumption expenditures, as the near-record rate of automobile sales pushed total purchases of durable goods up sharply. Government purchases of goods and services also rose at a somewhat faster pace than in the third quarter, in part because of the salary increase for Federal employees that went into effect in October. Total private investment outlays, on the other hand, continued to decline. Inventory accumulation was less than in the preceding quarter, even though the working-down of steel stocks was apparently no longer particularly significant, and outlays for both residential construction and business fixed investment edged downward.

The rise in GNP in the fourth quarter of 1962 brought total output for the year to an estimated $553.6 billion, 6.7 per cent above the 1961 level. Such a full-year to full-year comparison, however, obscures the marked slowdown in the advance that occurred during 1962. Thus, GNP in the fourth quarter was only $23.4 billion (or 4.3 per cent) higher than a year earlier in contrast to the $50.4 billion (or 10 per cent) annual rate of rise in the final three quarters of 1961 (see Chart I). It has, of course, been typical of postwar cyclical upswings that the pace of advance during the second year lags behind that of the first year. And while this tendency has been even more pronounced in the recent period than in earlier postwar upswings, the recent pattern could at least in some measure be attributed to a more orderly forward movement and relative freedom from speculative excesses. However, given the fact that little progress was made in 1962 to narrow the gap between the economy's actual and potential output, the rate of advance in activity was clearly not satisfactory.

Much of the slowdown in the rate of expansion in 1962 reflected the sag in inventory investment after the first quarter. This was, of course, strongly influenced by the liquidation of steel stocks following the steel wage settlement, although generally cautious inventory policies were another major factor holding down the over-all rate of accumulation. There was also some deceleration in the advance of final demands. Outlays for residential construc-

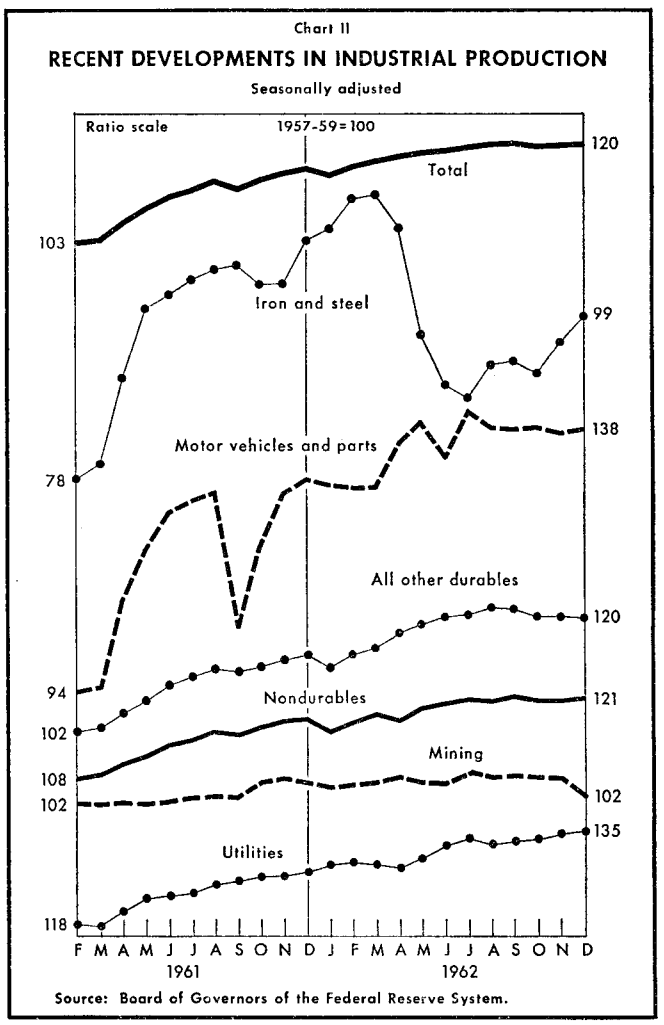


tion, for example, showed very little net increase during 1962 in contrast to a $5 billion annual rate of gain during the final three quarters of 1961. The advance in government spending slowed slightly, and consumer purchases, limited by the slow growth in disposable personal income, rose by only $17½ billion during 1962, compared with an annual rate of increase of nearly $21 billion during the last three quarters of 1961. Business outlays for fixed investment in the fourth quarter of 1962 were $3 billion higher than a year earlier. The rate of increase, however, slowed markedly after midyear. In the final quarter, as noted earlier, outlays showed a slight decrease.

RECENT TRENDS IN KEY INDICATORS

The index of industrial production, at 119.6 per cent of the 1957-59 average in December, continued to show virtually no change other than the usual seasonal variation. This index has fluctuated within a narrow range since July (see Chart II). In December, mining output—influenced by severe weather conditions—registered a sharp decline, but this was offset by a sizable increase in steel production and by moderate, but reasonably widespread, gains in the output of other manufacturing industries. The continued rise in steel output would seem to confirm that the overhang of steel inventories, which had held back production for much of the year, has been largely—if not completely—eliminated. Indeed, there have been some reports that a few steel users are initiating plans to step up their rate of steel inventory accumulation in anticipation of a possible strike in August.

In January output of steel ingots rose further, largely in response to continued substantial ordering by automotive manufacturers. Automobile production (seasonally adjusted) remained close to the December level, as plants went on overtime schedules to make up for production time lost because of unusually severe weather. Whether the December decline in new orders for durable



goods—concentrated in industries other than steel—will significantly affect the production figures for subsequent months cannot as yet be determined. Month-to-month changes in the placement of new orders tend to be somewhat irregular, and thus the fact that the fourth-quarter average was quite high may have a larger impact on production than the December decline.

The employment situation also has shown little net change since mid-1962. Nonfarm payroll employment in December, according to the Bureau of Labor Statistics, remained at the level it had held since June. In January, the Census Bureau's series on seasonally adjusted total employment advanced for the second consecutive month, but still remained below the August record. Moreover, with the rise in the number of people looking for work, unemployment as a proportion of the civilian labor force went back up to 5.8 per cent. The unemployment rate continues to be higher than at the comparable stage of any previous postwar business upswing.

The major stimuli to the economy continue to be consumer and government spending. Total retail sales in December remained at about November's record level, despite some seasonally adjusted decline in both automobile and department store sales. In January, weekly data on retail sales, available with year-ago comparisons for the first time, suggested a modest strengthening in consumer buying. Unit sales of new cars apparently rose significantly, while department store volume was somewhat below the high December rate, after seasonal adjustment. In the government sector, according to estimates made in *The Annual Report of the Council of Economic Advisers,* purchases of goods and services at both the Federal and the state and local levels are expected to increase this year at about the same rate as in 1962.

The Money Market in January

The money market was moderately firm in January, and the usual seasonal dip in short-term interest rates failed to materialize. Early in the month the market eased temporarily, as funds flowed to the money centers before the January 9 "country" bank settlement date. Subsequently the money market became firmer despite a modest expansion in nation-wide reserve availability, as reserve distribution shifted in favor of the country banks while dealer financing needs expanded. Later in the month, this firmness was maintained by a decline in reserve availability. The effective rate on Federal funds, which ranged from 2 per cent to 3 per cent through January 9, was generally 3 per cent over the remainder of the month. Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were quoted within a 2¾ to 3⅜ per cent range through January 11 and within a 3 to 3½ per cent range thereafter. During the month, dealers in bankers' acceptances raised their rates by ⅛ per cent. The new rate on 90-day unendorsed paper moved to 3¼ per cent (bid).

In the market for Treasury bills, rates fluctuated narrowly during the month, as the impact of a substantial investment demand and the January 3 reduction in the British bank rate were counterbalanced by the spreading market view that monetary policy had become somewhat less easy and by the firmer money market atmosphere during most of the month. The Treasury's announcement on January 22 that it would auction $1 billion of 138-day tax anticipation bills on January 30, without permitting payment by credit to Tax and Loan Accounts, also tended to keep rates from moving lower. The June tax bills elicited good bidding interest, however, and the average issuing rate was somewhat below initial market expectations. On January 31 the newest three-month bill was bid at 2.93 per cent, unchanged from December 31.

In the Treasury bond market, interest in the early part of the month centered on the Treasury's successful auction of $250 million of long-term bonds through competitive bidding by syndicates. Prices moved higher through mid-January in the wake of this successful sale. Around mid-month, a more hesitant atmosphere developed and prices declined, as market sentiment was affected by the prospect of large Federal deficits, by spreading concern about the balance-of-payments situation, and by the approach of the Treasury's February refunding. In late January a steadier atmosphere emerged in very quiet trading, as the market awaited the Treasury's refunding announcement.

After the close of business on January 30, the Treasury announced that holders of $9.5 billion of Treasury securities maturing February 15 will have the right to exchange

The Business Situation

As is frequently the case, economic activity got off to a relatively slow start in the new year. In January, industrial production, payroll employment, and retail sales were virtually unchanged, while housing starts dropped sharply. The lackluster performance was at least in part, however, attributable to unusually severe weather and to several major strikes. The more encouraging developments in January—a rise in new orders for durable goods following two months of decline and continued strength in consumer buying intentions—were registered in indicators that normally are not particularly sensitive to weather conditions. For February, fragmentary data suggest some rise in steel ingot production, a continued high level of automobile assemblies, and little change in retail sales.

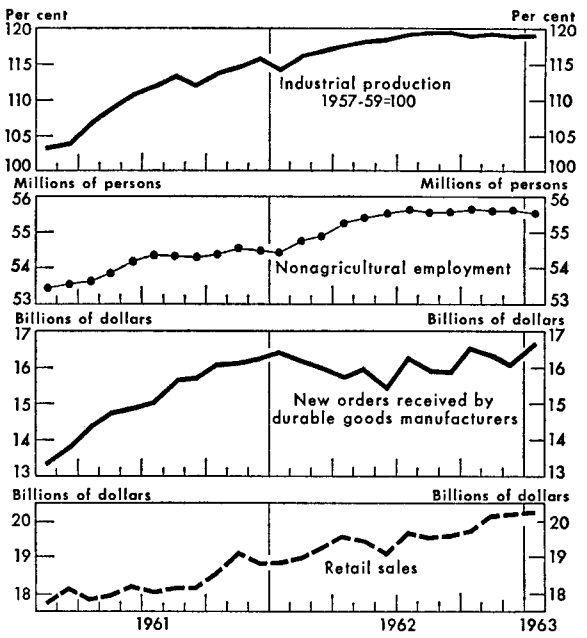
The prospects for tax reduction continue to dominate most appraisals of the over-all economic outlook. Although the Administration has continued to emphasize that it is not predicting an economic downturn for 1963 or even for 1964, the President noted in a recent speech he was "willing to venture" that without a tax cut the country would "in the not-too-far-distant future be struck by its fifth postwar recession". For this reason he indicated that he considers "the important thing" is to get a tax bill this year that would provide for a tax reduction of at least $10 billion over the next three years, even if this meant substantial modifications in the tax proposals he submitted to the Congress in January.

PRODUCTION AND EMPLOYMENT

The Federal Reserve's index of industrial production remained at 119 per cent of the 1957-59 average in January, continuing at the level which has prevailed since June of last year (see Chart I). Relatively little change in production levels was also the characteristic pattern for most major industries, with the only sizable gains being shown by producers of consumer home goods and of electricity and gas. Of course, unusually severe weather probably accounted for much of the advance in the output of electricity and gas. On the other hand, part of the lack of vigor in over-all production was due to unusually cold weather and severe snow storms that blanketed large sections of the country in the latter days of the month and prevented some workers from getting to their jobs. Moreover, there is some evidence that the East and Gulf Coast dock strike, which was not settled until late in January, tended to curtail production in industries that depend on imports for their raw materials.

Weekly production figures for February suggest that new cars are continuing to come off the assembly line at a seasonally adjusted annual rate of about seven million units, close to the level that has prevailed since last July. The industry planned to have a record of slightly more than one million cars in dealers' inventories by the beginning of March, in preparation for the spring sales push. In the steel industry, ingot production continued upward in February and substantial bookings are said to be already in for March. While these orders undoubtedly included some destined for protective inventories being built up in anticipation of a possible steel strike or price rise, the amount

Chart I
CURRENT ECONOMIC INDICATORS
Seasonally adjusted monthly data



Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

was believed to be relatively small. A more substantial protective build-up does seem in prospect, however, unless labor and management reach a noninflationary settlement in the not-too-far-distant future.

The employment situation in January was also influenced by strikes and inclement weather. Total payroll employment remained virtually unchanged for the eighth consecutive month (see Chart I). Cold weather continued to impede outdoor work in construction and about 70,000 transport workers, according to Labor Department estimates, were out of work as a result of the longshoremen's strike. In manufacturing, employment and average weekly hours edged off slightly, largely reflecting cutbacks in the apparel and automobile industries. A decline in the number of initial claims filed for unemployment compensation in February suggests, however, that adverse factors may not have been so significant in that month.

INDICATORS OF FUTURE DEVELOPMENTS

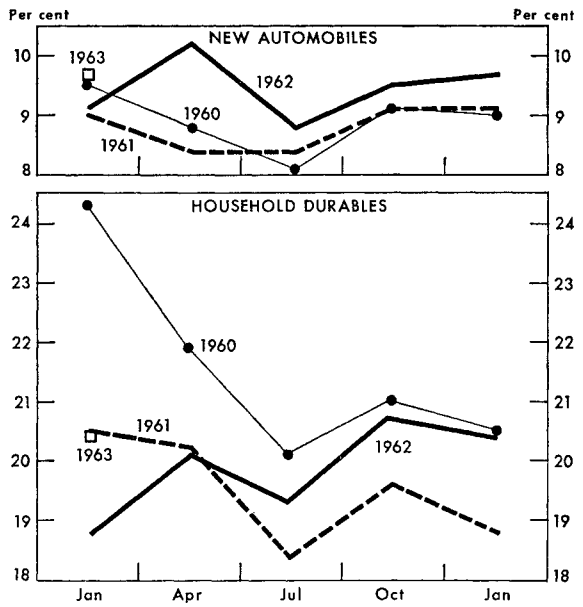
In contrast to the lack of change shown by measures of current activity, new orders received by durable goods producers rose by 4 per cent in January, following two months of decline (see Chart I). The bulk of the January advance came in the steel industry, but machinery and aircraft industries also reported modest gains. Although no conclusive data are available, there have been scattered reports that some firms are beginning to step up equipment purchases in response to the Treasury Department's revised depreciation schedules and the new investment credit legislation. Whatever the cause, however, orders for machinery and equipment have risen in three of the last five months and, in January, were 3 per cent higher than last June.

Forward-looking indicators of residential construction present a mixed picture but, on balance, imply no weakening from recent high levels. On the one hand, new building permits issued rose markedly in November and December and then held near the high December level in January. In contrast, private housing starts fell sharply in both December and January. Housing starts in January made their worst showing in the northeast and north central regions of the country where weather was particularly bad, whereas in the western region the number of new starts rose substantially. A similar siege of bad weather had curtailed starts at the beginning of 1962, but starts then spurted in the spring as weather conditions improved.

The consumer sector continues to be a major source of strength in the economy. While retail sales showed almost no change in January, they remained above $20 billion (seasonally adjusted), a level that has been exceeded in only three months since the series has been in existence (see Chart I). Moreover, this high level was maintained despite a weakening in the latter part of the month that may have been caused by adverse weather. In addition, of course, newspaper strikes in New York City and Cleveland made it difficult for stores in those cities to advertise their post-Christmas sales. Indeed, sales by New York City department stores so far this year have been about 7 per cent below the year-earlier volume in contrast to an increase in the rest of the nation. Partial data for February suggest little change in unit sales of new automobiles as well as in the volume of other retail sales.

That consumer spending may continue strong in the months ahead is suggested by the Census Bureau's latest quarterly survey of consumer buying intentions. Plans to buy new automobiles in the next six months were slightly above the levels of a year earlier, while plans to purchase household durables showed significantly greater strength than at the beginning of 1962 (see Chart II). While previous experience is, of course, no certain guide to future performance, it is noteworthy that the high level of buying intentions during 1962 was accompanied by rather sharp increases in total purchases of durable goods in both the first and second halves of the year.

Chart II
CONSUMER INTENTIONS TO BUY NEW AUTOMOBILES AND HOUSEHOLD DURABLES WITHIN SIX MONTHS



Note: Buying plans are expressed as the ratio of the number of families who say they intend to buy to the total number of families in the survey.
Sources: Board of Governors of the Federal Reserve System; United States Department of Commerce.

including the concentration of savings institutions and also the easy access to organized investment markets. But such specifically urban characteristics were by no means the only factors in the 1961-62 contrasts between the rates paid by large and small banks.

There is good reason to believe that the banks which posted the largest increases in rates on savings deposits were those with sound loan and investment opportunities that would go unsatisfied unless deposits grew more rapidly. The large banks' deposit growth had failed to keep pace with that of other banks during the postwar period, and their loan-deposit ratios, which were among the highest in the nation, indicated that the large banks were finding it more difficult to meet the entire growth of loan demand. Thus in 1961, dissatisfaction with Regulation Q among commercial bankers in New York State was found to be directly associated with bank size and with the level of loan-deposit ratios.[11]

On the other hand, there is no evidence that reluctance to bear the cost of higher interest rates (as measured by the ratio of interest-bearing to total deposits) played any significant part in determining which banks raised rates and which did not. Banks with a high proportion of their deposits in time and savings accounts raised rates with the same relative frequency, and by as much, as did banks with a low proportion.

Why were banks willing to accept large relative increases in their costs? Certainly, some banks—especially those subject to competition from New York City and Buffalo banks—considered the higher rates necessary to protect existing deposits from competitors. Nevertheless, the fact that rates were increased so quickly after ceilings were raised (in contrast to a much slower response to a previous change in the interest rate ceiling in January 1957) probably indicates that the desire to take advantage of lending opportunities was an important motive. Indeed, many District bankers are convinced that, with demand deposits growing relatively slowly, only active promotion of time and savings deposits can sustain the kind of growth of commercial bank resources that is needed to maintain or improve their profits prospects over the long run. It is worth noting that, despite sharply higher interest costs, net income of the average Second District commercial bank in 1962 actually was slightly higher than in 1961.

[11] New York State Bankers Association, *op. cit.*

SUMMARY

The growth of interest-bearing deposits in the Second District since the lifting of Regulation Q ceilings has been strongest at large banks in large cities, in both time and savings deposits. The response to the Regulation Q change was a broadly based, general rise in interest rate offerings, with the large deposit-seeking city banks making the greatest upward changes on savings accounts. A substantial effect of the higher rates was the renewed growth of negotiable time certificates of deposit, which at the end of 1961 had lost their competitive advantage over Treasury bills. Another result was an acceleration in the upward trend of commercial bank savings deposits, stemming mainly from the significant cut in the rate advantages of competing savings institutions. At the higher rate levels, time and savings accounts also became an attractive investment for a considerable flow of funds diverted or withdrawn from securities markets during 1962.

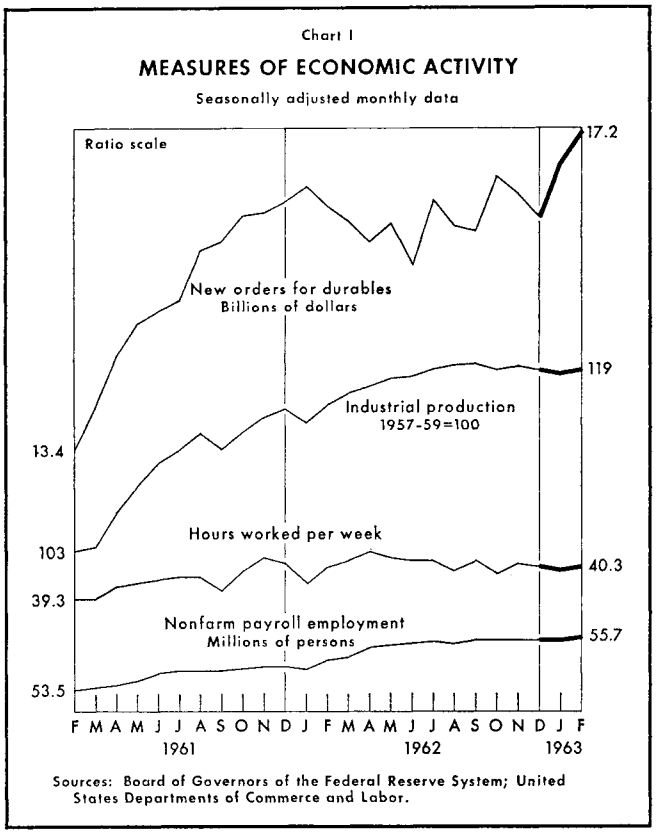
The Business Situation

The tone of business news has improved since the middle of the first quarter, although actual measures of activity have for the most part remained sluggish. To some extent, of course, this better tone merely reflects the fact that a number of indicators that had declined in January, for temporary reasons, ended up on the plus side in February. There are, however, other mildly encouraging signs of a possibly more substantial nature. Thus the major element of recent strength—consumer buying—has continued upward in January and February and, according to early signs, in March as well. Given the recent settlements of the newspaper strikes in New York and Cleveland, moreover, retailers in these cities will now be able to give full publicity to their Easter and spring offerings. Furthermore, recent Government surveys of business spending plans suggest that prospects for continued advance in economic activity now rest on somewhat firmer ground than was the case a few months ago. The unemployment rate, finally, fell back to 5.6 per cent of the labor force in March. Nevertheless, a significantly faster uptrend in activity will be needed to provide enough new jobs to keep up with the growing labor force.

MEASURES OF RECENT ACTIVITY

Industrial production remained virtually unchanged in February, as the Federal Reserve's index continued to fluctuate about the 119 per cent level for the ninth consecutive month (see Chart I). Output for most major industry groups showed only seasonal changes, a notable exception being a sizable rise in iron and steel production. Demand for steel has recently been rising rather steadily, in part reflecting the desire of some steel users to stockpile inventories as a hedge against a possible strike, with the result that steel producers have in recent weeks relit several previously idle furnaces. By the end of March, ingot production had risen to well over 70 per cent of capacity. At the same time, automobile producers maintained the high assembly rate of the past several months, partly in anticipation of brisk spring sales.

Although recent movements in construction activity have been slightly on the downward side, it appears that underlying demands have been well maintained. In the residential sector, for example, new housing permits issued in February remained at the high December-January level. There are reports that many of the recent authorizations are for large multifamily dwellings, construction on which typically does not get under way until late spring. In addition, of course, work on some projects has been somewhat delayed by the unusually bad weather in many sections of the country. Although construction outlays by the government sector registered a significant decline in February and changed little in March, contract awards figures suggest that the drop was temporary and that such outlays should rise somewhat further in the months ahead.

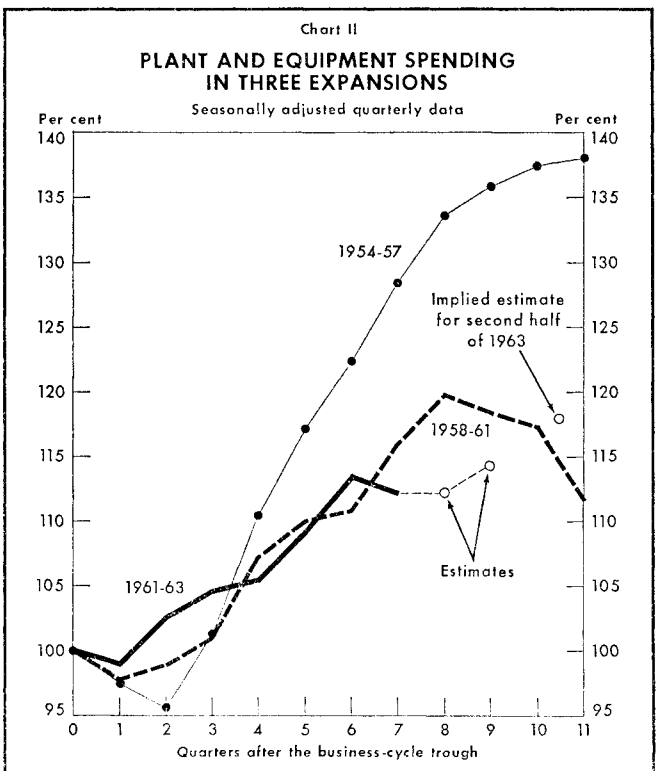


Consumer spending has continued to be a primary source of strength. Retail sales advanced by 1 per cent in February and, since November, have been maintained above a seasonally adjusted annual rate of $240 billion despite cold weather and newspaper and transit strikes. Moreover, weekly data for March, although difficult to assess because of the earlier date of Easter this year, on balance seem to suggest that consumer spending for goods remains buoyant. To be sure, unit sales of new automobiles slipped a bit in March, but advances in other retail sales were apparently more than enough to offset this slippage. Thus, retail sales in March will probably prove to have advanced over February, to attain a new high.

The most discouraging development in February had been a rise in the unemployment rate to 6.1 per cent of the labor force. In March, however, the unemployment rate declined to 5.6 per cent. It seems quite likely that the February rise in this rate had at least in part reflected the unusually severe weather that curtailed outdoor activity in that month. Employment statistics, on the other hand, had actually shown an improvement in February. Thus, seasonally adjusted total payroll employment—a series which tends to be less affected by weather—had risen by 182,000 persons. While nearly half of this gain in employment merely reflected the ending of the dock strike (which in itself would not have caused a reduction in unemployment since strikers are not counted as unemployed in the statistics), there were also sharp increases in the number of jobs in the trade and service sectors. Even in the manufacturing sector, which had been a source of weakness in the past several months, both employment and average weekly hours moved up slightly in February (see Chart I). In March, nonagricultural employment continued to expand markedly according to the Census Bureau's household survey, and there was also some pickup in the number of jobs on farms, with the result that unemployment fell by 400,000 persons. Nevertheless, the total amount of unemployment in March still remained above four million, which was higher than the level of a year ago despite the gains in economic activity since that time.

Unemployment figures are not necessarily accurate measures of hardship suffered because of the lack of jobs.

Some of the unemployed belong to families that may have other reasonably adequate sources of income. (Even such unemployment, of course, represents a loss of potential output.) Normally, however, sizable changes in the unemployment rate reflect sizable changes in joblessness among family breadwinners. For example, the unemployment rate for married men, according to a new seasonally adjusted series compiled by the Bureau of Labor Statistics, increased significantly in both January and February, and then fell back to the 1962 average in March—a movement that almost exactly paralleled the pattern traced out by the over-all unemployment rate.



Note: Business-cycle trough quarters=100. Trough quarters are those determined by the National Bureau of Economic Research chronology: III-1954, II-1958, and I-1961.

Sources: United States Department of Commerce; Securities and Exchange Commission.

BUSINESS SPENDING PLANS

Recent surveys of businessmen's spending plans suggest some increases in such spending over the balance of the year. For example, according to a February survey by the Department of Commerce, manufacturers plan to add about $850 million to their inventories during the second quarter of this year as against an estimated increase of only $200 million in the first quarter. The major part of this increased spending is in the durables sector and, of course, largely reflects the plans of steel users to hedge against the possibility of a steel strike at the end of July. Positive expression of these plans also shows up in the figures on new orders for durable goods, which advanced for the second consecutive month in February (see Chart I), with orders for steel posting the largest single rise. Such stockpiling is, of course, only temporary and liquidation of these inventories might be something of a drag later in the year. By that time, however, other demands—perhaps partly related to a tax cut—may be developing.

Indeed, the latest reports on businessmen's plans for capital spending are encouraging, particularly for the latter part of the year. When surveyed last fall by the Commerce Department and the Securities and Exchange Commission, such plans had suggested that expenditures for plant and equipment would decline in the opening quarter of 1963. According to the survey taken in February, however, it appears that this decline had already occurred in the final three months of 1962 and that no further weakening is expected. The more recent plans call for a sidewise movement in capital outlays in the first quarter of this year and a moderate pickup in the second quarter (see Chart II), which would bring the average of the first half of 1963 to a level slightly above that attained in the last half of 1962. The implied rate of gain in the second half of 1963 is about 4 per cent above the average for the first half. For the year as a whole, outlays are expected to total $39.1 billion, or 4.8 per cent above the 1962 level. This increase exceeds the 2.7 per cent rise indicated in last fall's McGraw-Hill survey.

While these plans could, of course, be sharply modified if the economic outlook became clouded for other reasons, they suggest that a downturn is unlikely to be initiated in this area. In this connection, it may be significant that, in four of the five years in which the Commerce-SEC survey has pointed to a larger increase than the fall McGraw-Hill survey, the actual year-to-year gain in capital expenditures was greater than indicated by either survey. Moreover, the solidity of these plans would seem to be confirmed by the National Industrial Conference Board's survey of capital appropriations which shows that net appropriations by large manufacturing firms rose by 16 per cent in the fourth quarter of 1962, following a similar sharp rise in the third quarter. These gains, thus, more than offset the decline in appropriations that occurred during the second quarter of last year when business sentiment and the stock market reached a low ebb. On the other hand, it is important to recognize that the gain in capital spending indicated by the Commerce-SEC survey, even if realized, is only about one half of the rise registered in 1962.

present or future. As the experience of the last four years seems to have shown, much depends on the nature of demand or cost-push pressures in the economy arising from the combination of all relevant factors, both public and private. Moreover, the means of financing the deficit can be crucial. The 1962 experience in this regard was reassuring, and I am sure that neither the Federal Reserve System nor the Treasury would countenance an inflationary method of financing whatever enlarged temporary deficits may result from tax reduction.

I believe a solution of our balance-of-payments problem can be found in some combination of actions along the lines that I have sketched this evening. A good start, of course, has already been made on most of these measures. The harder steps lie ahead of us, but they are no less urgent on that account. We cannot have a vigorous and expanding economy, nor can we play a role in world affairs worthy of the United States, if the dollar becomes a weak currency. We still have time for the right measures to become fully effective if we have the courage to see them through—and I firmly believe that we do.

FEDERAL RESERVE OPEN MARKET OPERATIONS IN 1962

The Board of Governors of the Federal Reserve System has published in its *Federal Reserve Bulletin* for April 1963 a report entitled *Federal Reserve Open Market Operations in 1962*. This report—which was prepared by Robert W. Stone, Manager of the System Open Market Account and Vice President of the Federal Reserve Bank of New York, assisted by associates on the Trading Desk—describes the open market operations of the Federal Reserve System against the background of broad System policy objectives, on the one hand, and money and capital market developments, on the other. The report is reprinted as an insert in this issue of the *Monthly Review*. Additional copies may be obtained from the Public Information Department, Federal Reserve Bank of New York, New York 45, N. Y.

The Business Situation

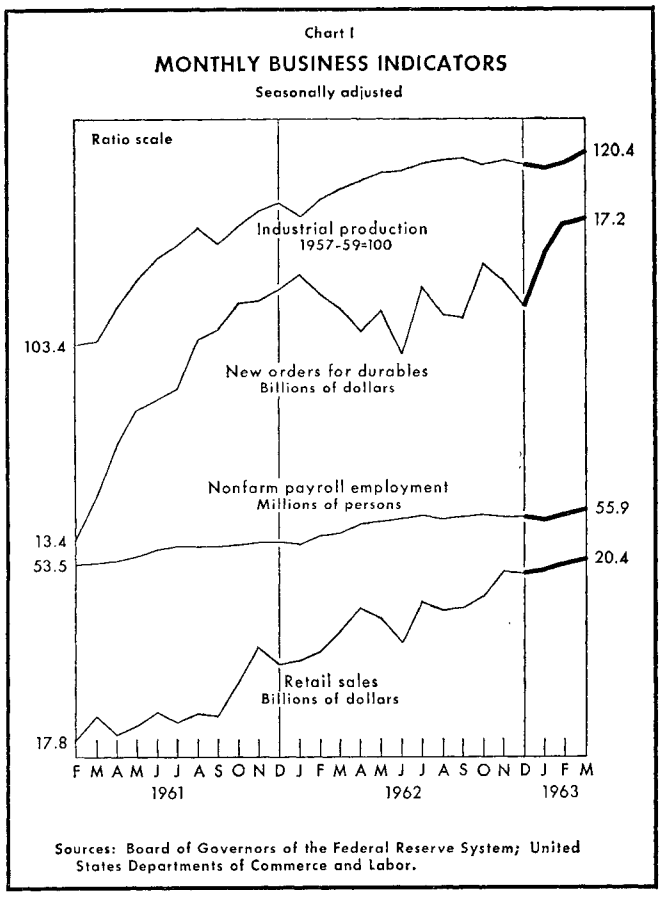
As winter gave way to spring, the improvement in business sentiment found confirmation in a variety of economic statistics. Profits have apparently remained near the record fourth-quarter level, and such measures of activity as industrial production, nonfarm employment, and private housing starts all increased significantly in March while retail sales continued upward. For the first quarter as a whole, gross national product increased at a seasonally adjusted annual rate of $8½ billion, or by slightly more than the rise of the previous quarter. Early returns for April suggest further advances in production and a continued high level of consumer spending. The latest McGraw-Hill survey, moreover, at least confirms earlier indications that capital spending may move up later in the year and suggests the possibility of a somewhat larger rise than had previously been estimated.

Despite these favorable signs, some caution is necessary in interpreting recent developments. Available data on actual business capital outlays and on orders and contract awards have not as yet shown the kind of pickup that is indicated in the surveys of spending plans. Unemployment in April remained higher than a year earlier—again pointing up the persistent underutilization of economic resources. Moreover, some of the improvement in other indicators reflected a removal of the temporary dampening influences of strikes and of unusually severe weather earlier in the year. In addition, part of the gain has come from efforts to build up steel inventories as a hedge against a possible steel strike—a process that is expected to be reversed later in the year. Finally, while the success of the steel industry in putting through selective price increases has undoubtedly given an immediate boost to business sentiment, the ultimate effects on demand, on prices generally, and on wages are still uncertain.

PICKUP IN PRODUCTION AND EMPLOYMENT

After showing little change since mid-1962, the index of industrial production advanced by one full percentage point in March to a record 120.4 per cent of the 1957-59 average (see Chart I). To be sure, the steel industry alone accounted for about one third of the over-all gain. At the same time, however, there were increases in the output of most other industries. In April, weekly figures for ingot production moved to the highest level in two years, with the total for the month as a whole registering a larger increase, after allowing for seasonal factors, than in February and March combined. Automobile assemblies in April remained at the high seasonally adjusted rate that has prevailed since mid-1962. Recent statements by some industry spokesmen indicate that they have raised their sights for the current year and now consider it possible that total output will reach seven million cars.

New orders received by durable goods manufacturers presented a mixed picture in March. While the total of such orders moved to a record level (see Chart I), orders received by manufacturers outside the steel and automotive industries remained at about the same level as in February. Steel bookings moved up substantially during the month, but this pace may, of course, not be sustained once the uncertainties surrounding the steel labor contract are removed. At the same time, there was a significant decline during March in "new orders for motor vehicles and parts". These are not really "orders" in the usual sense, however, since they mainly include manufacturers' deliveries to dealers and thus do not foreshadow future production.



Accompanying the March pickup in production was a rise of 200,000 persons in nonfarm payroll employment, after seasonal adjustment. This was the biggest increase in almost a year and extended the advance begun in the previous month (see Chart I). Interestingly, most of the March gain was in manufacturing and trade employment, both of which had trended downward during the latter half of 1962. In April, total employment moved up still further, according to the Census Bureau's household survey. However, with the rise in the number of people looking for work, unemployment edged up to 5.7 per cent of the civilian labor force. This marked the third month in a row in which the unemployment rate exceeded its level of a year earlier.

DEVELOPMENTS IN KEY DEMAND SECTORS

Buoyed by the brisk March gain, gross national product in the first three months of 1963 rose to a seasonally adjusted annual rate of $572 billion, according to preliminary estimates by the Council of Economic Advisers. The increase was slightly larger than in the fourth quarter of 1962 (see Chart II) and significantly greater than in the three preceding quarters. It also topped most Government and business forecasts.

Nearly two thirds of the first-quarter rise in total GNP reflected increased consumer expenditures. Purchases of durables advanced only moderately from the already high level attained in the fourth quarter of 1962, and the rise in expenditures for services was the same in both periods. There was, however, a sharp first-quarter pickup in spending for nondurable goods. As a result, the over-all ratio of consumption to disposable income rose to 94 per cent, the highest level in two years. Most of this gain in consumer spending occurred after midwinter. Thus, retail sales held at about the same level from November through January but then moved upward in the next two months (see Chart I). In April, auto dealers apparently delivered about as many new cars to customers as in March (after seasonal adjustment), and aggregate sales volume of

other retailers seems to have continued close to the record March level.

Government spending also contributed importantly to the rise in the first quarter, as it has throughout the current expansion. While there was some slowdown in the growth of state and local government purchases of goods and services, the increase in total government purchases in the first three months of 1963 was larger than in any of the three previous quarters.

Residential construction outlays declined for the second consecutive quarter. As in early 1962, however, unusually severe weather was a dominant force. The issuance of building permits is less affected by weather, and these were at a high level throughout the first quarter. With the coming of better weather in March, the number of private nonfarm housing starts jumped by 17 per cent to a seasonally adjusted annual rate of 1.5 million units. This was only moderately below the peak reached last November.

Business investment spending showed mixed trends in the first quarter. On the one hand, inventory investment increased significantly more than in the final quarter of 1962. For the current quarter an even faster build-up in inventories is likely. A Commerce Department survey in February had indicated manufacturers expected that their inventories alone would show a $3.4 billion seasonally adjusted annual rate of increase in the second quarter, with enlarged steel inventories the major factor in the advance (see April issue of this *Review*). The same survey also suggested a smaller rise in first-quarter factory sales than has now been realized, and this better than expected performance may have pushed up near-term inventory spending plans.

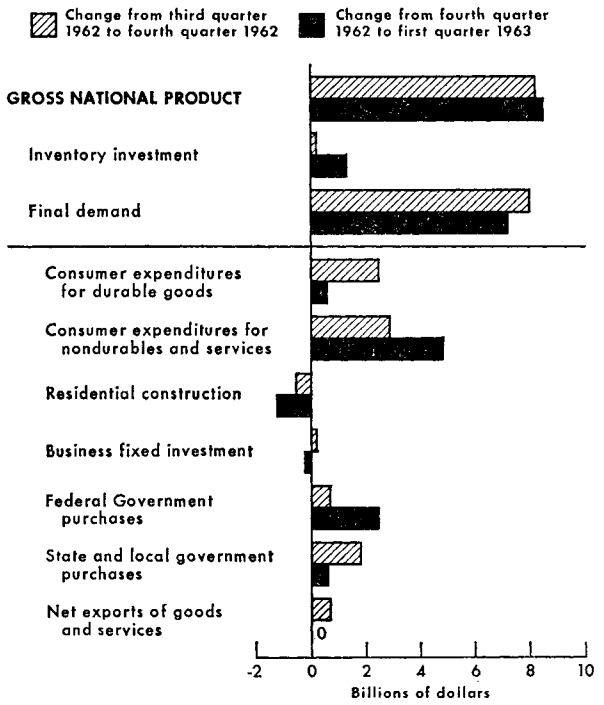
Outlays for new plant and equipment, on the other hand, edged downward in the first quarter, the first reduction in two years. Despite this decline, however, capital spending for the year as a whole is expected to exceed the 1962 level. Indeed, the recent McGraw-Hill survey, taken in March and early April, found businessmen planning to increase their spending for plant and equipment by 7 per cent over the 1962 level. About two fifths of this prospective gain was attributed to the revised depreciation rules and the investment tax credit, suggesting that these changes are exerting a greater impact than many businessmen originally anticipated.

The increase projected by this recent survey is somewhat larger than the 5 per cent rise indicated by a survey taken two months earlier by the Commerce Department and the Securities and Exchange Commission. To be sure, the McGraw-Hill spring survey has always shown more strength than the Commerce-SEC winter survey. Moreover, the latter survey has generally come closer in predicting actual spending levels. Nevertheless, in the majority of expansion years, the McGraw-Hill results have correctly pointed to the direction of later revisions in the Commerce-SEC series, and in this sense the latest report is encouraging. It is also noteworthy that preliminary plans for capital spending in 1964-66, according to McGraw-Hill's findings, are distinctly larger than plans for comparable future periods that were reported in previous surveys.

Chart II

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted annual rates



Sources: United States Department of Commerce; Council of Economic Advisers.

structure of the banking industry. Interest expenses have mounted as a result of both the enlarged volume of time and savings deposits and the higher rates paid on such deposits. In their annual reports to stockholders for 1962, many commercial banks pointed to higher deposit-interest costs as a significant factor contributing to higher bank expenses during the year. Certificate interest expenses, per deposit dollar, probably have been lower than those of savings deposits, since certificate rates, partly reflecting the value of the instrument's negotiability, are often lower than the rates paid for savings deposits. Certificate rates are also more flexible than those on savings deposits. They may be raised or lowered in response to money market rates and, most importantly, in response to the individual bank's desire for time deposit funds; by contrast, interest rates for savings deposits tend to be relatively inflexible. While certificate rates may demonstrate upward flexibility during a period of rising money rates, this trend probably will be resisted if deposit costs mount more quickly than the return on the bank use of these funds. Certificates can be offered aggressively when it is profitable to do so, and less eagerly when profitability declines. In the latter circumstances banks might permit issuing rates for new certificates to become noncompetitive, relative to other money market rates.

In addition to their implications for the operations of commercial banks themselves, certificates have exerted an influence on interest rates. By absorbing funds that otherwise would probably have entered the markets for other short-term instruments, they have exerted an upward pressure on short-term interest rates, thereby contributing to Treasury and Federal Reserve efforts to maintain these rates and to reduce incentives for short-term investments abroad.

The Business Situation

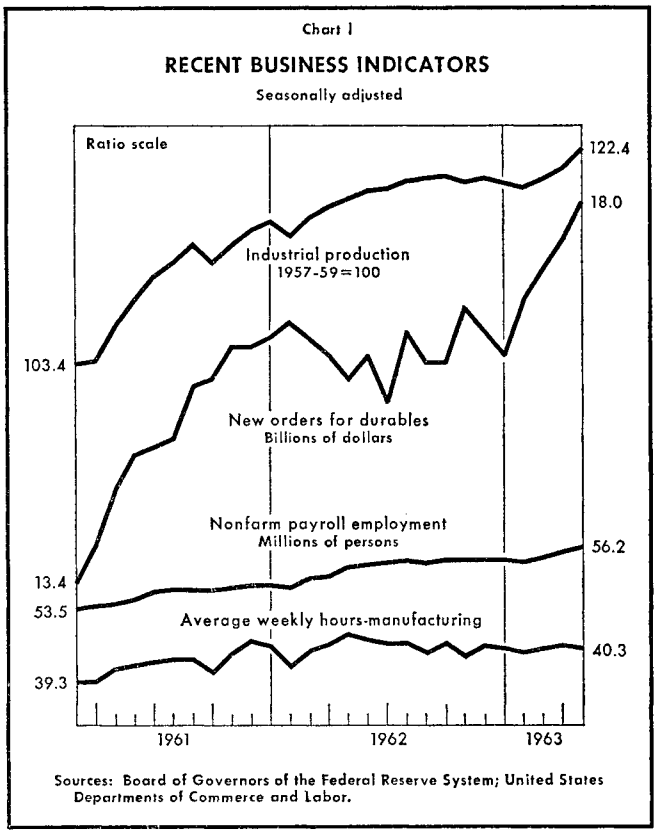
The pickup in the strength of the domestic economy that began in the first quarter has carried over into spring. Retail sales were maintained at a record level in April, and such other monthly measures as industrial production, nonfarm employment, personal income, housing starts, and new orders for durable goods all continued strongly upward. To be sure, a significant portion of the April gains in production and orders was attributable to the special situation in the steel industry. It is noteworthy, however, that there were also widespread increases in industries other than steel. For May, the data at hand point to gains in automobile assemblies and a continued high level of steel ingot production. Retail sales apparently declined, but the latest survey of consumer buying intentions—according to which plans to purchase new cars and household durables within six months were appreciably above the advanced January level—suggests some strengthening in the consumer sector in the months ahead.

While the available evidence would thus seem to indicate that the economy has gained renewed momentum, aggregate activity continues to run well below capacity levels. Indeed, few forecasts for 1963 envisage that the rate of unemployment will be materially reduced over the balance of the year. The unemployment problem is, of course, likely to become more troublesome in the weeks ahead, since the number of teenagers leaving their classrooms to enter the labor market at the end of the current school year will probably be significantly larger than in the past.

CONTINUED GAINS IN PRODUCTION AND EMPLOYMENT

The Federal Reserve's index of industrial production moved up by nearly 2 percentage points in April and thus registered its largest increase in almost two years. This latest gain represented the third consecutive month of advance and brought output to 122.4 per cent of the 1957-59 average (see Chart I). About a third of the over-all April increase was attributable to a continued sharp rise in steel production, reflecting efforts to build up steel inventories as a strike hedge as well as some step-up in the rate of steel consumption. Resumption of publication of New York City and Cleveland newspapers, by contributing to the rise in the printing and publishing component of the index, was an additional factor in the over-all production gain. Even apart from such special factors, however, output in most industries registered rather sizable increases.

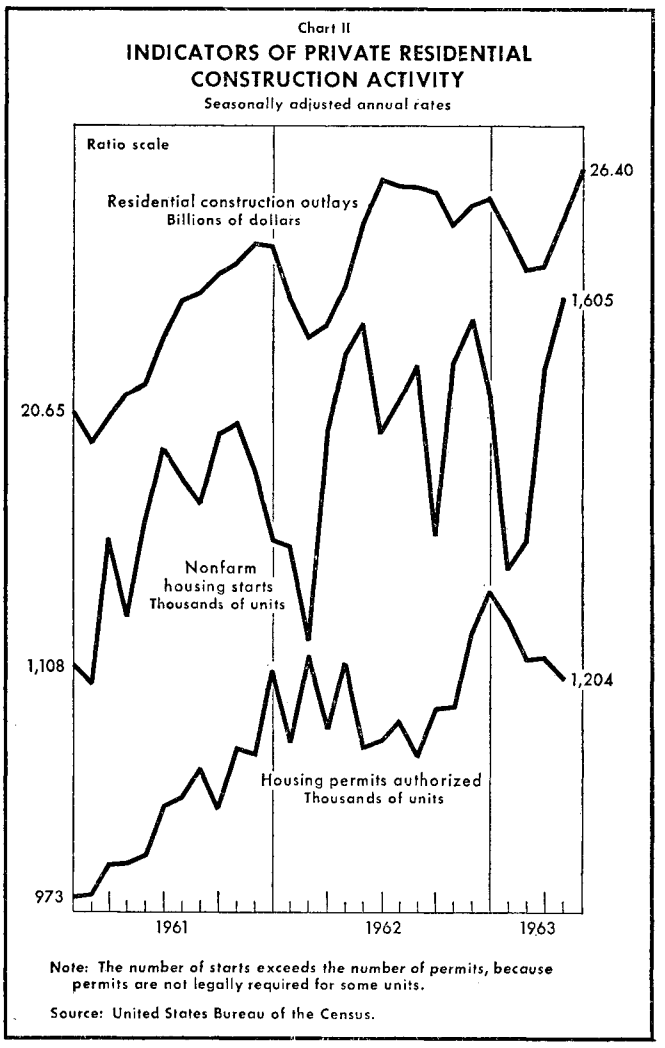
Fragmentary data on production in May suggest continued gains. Thus, although a strike-caused automobile



parts shortage temporarily cut back production on some assembly lines, May output in the automobile industry as a whole pushed somewhat above the high plateau of the previous ten months. At the same time, steel ingot production maintained its high April level. The delay of the steelworkers' union in reopening its labor agreement apparently led some steel users to reassess the need for a further build-up in steel inventories, but this occurred too late to have any significant effect on May ingot production.

Continued strength in production over the near term was suggested by the growing volume of new orders placed with manufacturers of durable goods. In April, such orders moved upward by 3 per cent (seasonally adjusted), marking the fourth consecutive month of advance (see Chart I). Backlogs of unfilled orders held by durables manufacturers also rose for the fourth month in a row. While the volume of new bookings received by the steel industry jumped further in April, this accounted for only about half of the over-all increase in new orders. Indeed, total orders received by durables industries other than steel moved up appreciably.

Paralleling the gain in production, seasonally adjusted nonfarm payroll employment rose by 276,000 persons in April, the third sizable advance in a row (see Chart I). Almost one third of the April increase was in construction employment, as warmer weather permitted some step-up in outdoor activity. Most of the rest was attributable to a strong rise in the number of persons at work in manufacturing. Indeed, factory employment has been restored to its high level of last July. In contrast to typical past experience, these gains in manufacturing employment were not foreshadowed by any particularly noticeable rise in the average workweek. Thus, average weekly hours in manufacturing have remained between 40.2 and 40.4 since last November and are somewhat below the April 1962 peak (see Chart I). Fragmentary data on claims filed for unemployment compensation in May suggest that employment in that month may at least have held near its advanced April level.



DEVELOPMENTS IN SELECTED DEMAND SECTORS

Like industrial production, activity in the housing sector has shown renewed buoyancy in recent months. After being curtailed by unusually severe weather during the winter—a factor not fully taken account of in the seasonal adjustment procedures—outlays for private residential construction rose by about $1 billion (seasonally adjusted annual rate) in April and by an even greater amount in May (see Chart II). A prospect of still further advances over the near term is suggested by the 28 per cent jump from February to April in the number of housing units started. Moreover, despite the sharp increase in starts and recent declines in the number of building permits issued, the backlog of unused permits has apparently remained at a high level.

In the area of capital spending, the winter survey of the Commerce Department and the Securities and Exchange Commission and the spring McGraw-Hill survey had pointed to increases in outlays for plant and equipment of 5 per cent or more for the year as a whole. A later reading of such plans will be available with the release of the second-quarter Commerce-SEC survey in early June. In the meantime, available monthly indicators related to capital spending show a mixed pattern. In April, output moved up in industries producing construction materials and business equipment, and orders placed with manufacturers of machinery and equipment edged somewhat above the plateau that had been maintained in the preceding five months. Despite their latest gains, however, these indicators are still below, or only slightly above, the high levels already attained during the second half of last year. Moreover, outlays for commercial and industrial construction continued sluggish in May, and were below their level at the end of 1962, having declined in three of the five months so far this year. The performance of these various indicators thus continues to raise questions as to the extent of the rise in actual plant and equipment spending that can be expected in 1963.

Developments in the consumer sector, on balance, appear to be encouraging. To be sure, in recent months the net increase in consumer credit outstanding has been somewhat below its rate in the fourth quarter of 1962, as repayments of existing loans have increased at a faster rate than new loan extensions. Moreover, retail sales apparently declined somewhat in May. Their volume remains at an advanced level, however, and consumer incomes have continued to expand—with the April gain the largest of any this year. In addition, consumer buying plans moved up in April, according to a survey conducted by the Census Bureau. Intentions to purchase new cars and household durables increased from their already high levels at the start of this year and were above the levels reported in April 1962.

The Money Market In May

The money market became somewhat firmer during May. Federal funds traded almost entirely at 3 per cent, and in the last half of the month the demand for Federal funds at that rate often exceeded their availability. Average member bank borrowings from the Reserve Banks—at $190 million—were accordingly somewhat higher than in other recent months. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted predominantly within a 3¼ to 3½ per cent range. Treasury bill rates moved up moderately after midmonth in the firmer money market atmosphere.

On May 15, approximately $9.0 billion of the $9.5 billion of Treasury notes and certificates eligible for conversion in the May refunding were exchanged for the two issues included in the offering. Subscriptions for the new 3¼ per cent certificates of May 1964 and for the reopened 3⅝ per cent notes of February 1966 totaled $5.7 billion and $3.3 billion, respectively. Only $0.5 billion of the three maturing issues was redeemed for cash, with redemptions by the public amounting to about 8½ per cent of its maturing holdings.

Prices of outstanding Treasury notes and bonds moved irregularly higher in the first half of May, as the market reacted favorably to the short-term offerings in the Treasury's May refunding. Demand was also buoyed by the market's feeling that there would be no further Treasury financing operations in the immediate future, by the lowering of the Canadian bank rate on May 7, and by a feeling that interest rates would change little over the near term, whatever might be their movement over the longer term.

The Business Situation

The domestic economy moved further ahead in May, and early returns for June suggest continued, though moderate, strength. In May, industrial production, nonfarm employment, and housing starts each registered its fourth sizable gain in a row, while personal income advanced appreciably for the third consecutive month. Retail sales, on the other hand, continued to fluctuate within a narrow range, with weekly data for June also showing no improvement over the level reached in February. June production figures indicate a substantial rise in automobile assemblies, but a decline in steel ingot production. The recent agreement on a steel labor contract, while enhancing the prospects for sound long-run growth, is expected to lead to some further slackening in steel production over the near term, as steel users bring their inventories down into better balance with normal needs. Although manufacturers' inventory expectations point to some slowdown in their over-all rate of stock accumulation in the third quarter, this slackening may be offset by increases in outlays for plant and equipment. According to the latest Government survey, businessmen's plans for capital spending for the last half of 1963 are somewhat stronger than had been indicated earlier.

The recent economic gains have not helped to ease the serious unemployment problem. Although the over-all unemployment rate fell off somewhat in June, it remained at a higher level than a year earlier for the fifth consecutive month, in large part reflecting a marked over-the-year rise in unemployment among young people. There are nearly a million more 16-year-olds in the population this year than last, and on average roughly a third of them are expected to be looking for jobs during the year. Various measures have been suggested to deal directly with the problems created by this large influx of teen-agers. An increase in the skills and training of the labor force will in itself contribute to economic growth, but, in turn, an expanding economy is required if direct measures are to be effective.

PRODUCTION ORDERS, AND RETAIL SALES

The Federal Reserve's index of industrial production advanced by another one percentage point in May to 124 per cent of the 1957-59 average. This was the fourth consecutive month in which the index has risen by one point or more. Gains in May were largest in the materials producing industries—notably iron and steel—but there were also widespread advances in other industries. It is noteworthy that output of business equipment rose by nearly 1½ per cent in May, the first increase in this sector since last December and the largest gain in over a year.

Production figures for June pointed to a substantial rise in the rate of automobile assemblies, as producers tried to end up the 1963 model run with enough cars in inventory to carry through the model change-over period. Steel ingot production, on the other hand, declined somewhat in June. The recently announced settlement of the steel labor negotiations is expected to bring about a reduced level of ingot production in the several months ahead. That the settlement was reached without any formal announcement of a strike deadline and that the contract falls well within the Administration's wage guidelines should, however, help to provide a sound basis for long-run growth in the industry as well as in the economy as a whole.

The prospect for continued near-term advances in production was reinforced in May by the fifth consecutive advance in the backlog of unfilled orders held by manufacturers of durable goods. The increase brought backlogs to the highest level in three years. Although the volume of incoming new orders for durables slipped a bit in May, it was still at its second highest level on record and was 4 per cent above the May rate of sales. Moreover, the decline in new orders was more than accounted for by a slackening in orders for steel. New orders for machinery, in contrast, increased in May after having shown virtually no change during the preceding seven months.

In contrast to the gains in production, consumer spending continued to mark time in May as retail sales remained on the high plateau reached last February. Sales of new cars declined slightly in May, but dealers still were selling at a seasonally adjusted annual rate of well over 7 million units, about 10 per cent higher than a year earlier. At the same time, retail sales of items other than automobiles and parts advanced to a new record. Weekly data for June suggest a continuation of the May pattern, with a further decline in auto sales being approximately

offset by gains in other categories. It is interesting that despite this edging-off in the rate of auto sales and despite the fact that recent surveys have reported some reduced buoyancy in consumers' attitudes about the over-all performance of the economy, these surveys indicate that consumers' intentions to purchase new cars have remained at the advanced levels shown earlier in the year.

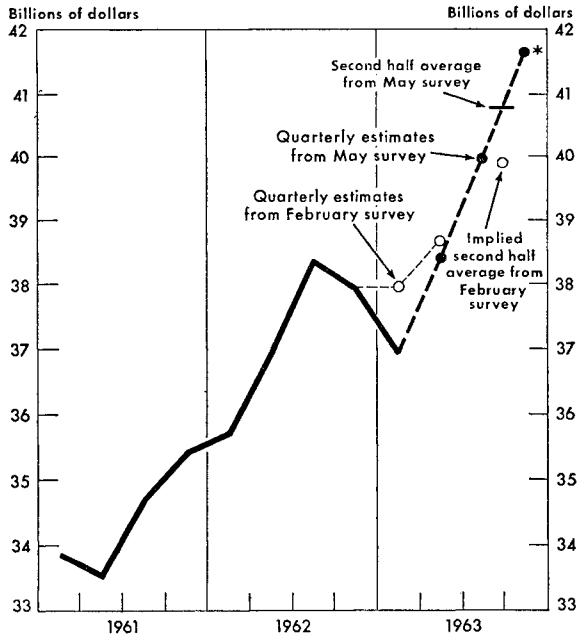
PROSPECTS FOR BUSINESS SPENDING

Recent information on manufacturers' inventory spending plans suggests some reduction in the planned rate of accumulation in the immediate months ahead. According to a survey taken by the Commerce Department in May, manufacturers expected their inventories to rise by $600 million during the third quarter, compared with an expected advance of $900 million in the second quarter. In a similar survey taken last February, manufacturers had expected only an $800 million increase in inventories in the second quarter. In part, the slowdown anticipated for the third quarter reflects the expectation of a cutback in steel stocks. Achievement of a higher than anticipated rate of sales could, however, cause manufacturers to make upward revisions in their over-all third-quarter inventory spending plans. Indeed, just such a factor may have been partly responsible for the upgrading in their second-quarter expectations. Last February, manufacturers had expected sales to decline in the second quarter. When surveyed in May, in contrast, they expected a 3 per cent increase in sales in the second quarter and another 1½ per cent rise in the third quarter.

Chart I

RECENT DEVELOPMENTS IN PLANT AND EQUIPMENT SPENDING

Seasonally adjusted, annual rates



*Implied

Sources: United States Department of Commerce; Securities and Exchange Commission.

The outlook for capital spending appears to be somewhat stronger than earlier. Thus, according to the May survey by the Commerce Department and the Securities and Exchange Commission, businessmen's plans now point to a 5.2 per cent increase in outlays for plant and equipment in 1963. This is a slightly larger rise than the 4.8 per cent advance shown in the Commerce-SEC survey taken last February. (A 7.4 per cent gain had been indicated in the McGraw-Hill survey taken in April and May. The McGraw-Hill survey, however, concentrates more heavily on large firms than the Commerce-SEC survey and, in the past, has always indicated a somewhat higher level of spending than the Government survey.)

To be sure, there still are uncertainties in the capital spending area. For example, the latest survey by the National Industrial Conference Board indicates that net new capital appropriations by large manufacturing firms declined by 22½ per cent in the first quarter, following the sharp increases in the third and fourth quarters of last year. At the same time, the Commerce-SEC survey indicates that actual outlays for capital equipment in the first quarter and the expected volume of spending for the second quarter turned out to be lower than the levels previously expected (see Chart I). Indeed, expenditures in the first quarter now show a $1 billion (seasonally adjusted annual rate) decline from the fourth quarter of 1962, marking the second quarter in a row in which outlays moved downward. On the other hand, the estimated rise from the first quarter to the second quarter of the year is now nearly twice as large as shown in the February survey, and an even larger rise is expected for the third quarter. From the first half of the year to the second half, businessmen now expect about double the increase that had been implied in the February survey.

RECENT DEVELOPMENTS IN UNEMPLOYMENT

Although most broad measures of economic activity have scored new records during the first half of 1963, unemployment has continued to be about as high and widespread as last year. To be sure, the seasonally adjusted unemployment rate in June edged off to 5.7 per cent of the civilian labor force from the 5.9 per cent level

reached the month before. The June level, however, still was either the same or higher than the rate in ten of the months of 1962, a year which in turn was marked by substantially higher unemployment rates than the period following the 1954 recession.[1] Indeed, unemployment rates were higher in 1962 than in 1957—and in most cases appreciably higher—for every age group (except 14- and 15-year-old girls) and for every industrial group for which the Labor Department publishes separate data (see Table I). Unemployment rates for every occupational group save farmers and farm managers were also higher in 1962 than in 1957 (Table II shows these rates for 1962).

While such detailed statistics are not available on a seasonally adjusted basis for 1963, it appears that each of these unemployment rates has continued at a high level so far this year. The seasonally adjusted data that are available indicate that in June the jobless rates for married men and for men over 20 years of age were somewhat below their 1962 averages, while the rate for women over 20 years of age was about the same as its 1962 level. The average for each of these rates in the first six months of this year was about the same as the average in 1962.

In contrast, the unemployment rate for workers under 20 years of age has so far this year averaged significantly higher than in 1962. Indeed, in May the seasonally adjusted unemployment rate for teen-agers rose to 17.8 per cent, the highest rate since the Labor Department started keeping such data in 1949. The rate fell back somewhat in June, but at 16 per cent was still at a level which until this year had been exceeded only during the 1958 recession. Whereas in 1962 teen-agers accounted for 20½ per cent of the total number of unemployed persons, their share of seasonally adjusted total unemployment in the second quarter of this year had risen to nearly 25 per cent. Less than 9 per cent of the seasonally adjusted labor force in the second quarter was under 20 years of age.

This rise in teen-age unemployment in part reflects a large influx of young people into the labor market this year, which in turn is an echo of the baby boom after World War II. Birth rates increased markedly in 1946-47. Fourteen years later, in 1961, as the first wave of these young people reached labor force age, the number of 14- and 15-year-olds in the population jumped by 913,000.

[1] After the 1954 recession, the over-all unemployment rate fell to near 4 per cent by May 1955 and remained at about this level until late 1957. The period following the 1958 recession was marked by a steel strike in 1959 and then by another recession beginning in May 1960, and thus is generally not considered an appropriate standard of comparison.

Table I

UNEMPLOYMENT AS A PERCENTAGE OF THE CIVILIAN LABOR FORCE, BY AGE AND INDUSTRIAL CLASSIFICATION 1957 AND 1962

Classification	1957	1962
Over-all unemployment rate	4.3	5.6
Unemployment rates by age group:		
14-15 years of age	7.6	7.7
16-17	12.5	16.2
18-19	10.9	13.7
20-24	7.1	9.0
25-34	3.9	5.1
35-44	3.1	4.1
45-54	3.3	4.0
55-64	3.4	4.2
65 and over	3.4	4.5
Unemployment rates by industrial group:		
Agriculture	6.7	7.3
Mining, forestry, and fisheries	6.3	8.6
Construction	9.8	12.0
Durables manufacturing	4.9	5.7
Nondurables manufacturing	5.3	5.9
Transportation and public utilities	3.1	3.9
Wholesale and retail trade	4.5	6.3
Finance, insurance, and real estate	1.8	3.1
Service industries	3.4	4.3
Public administration	2.0	2.2

Note: Figures represent the number of unemployed in each classification as a percentage of the civilian labor force in each classification.
Source: United States Department of Labor.

Labor force participation rates in this age bracket have in recent years averaged only about 22 per cent for boys and 12 per cent for girls. This year, however, this same group is reaching the 16- to 17-year age bracket, at which point labor force participation becomes considerably higher—averaging about 45 per cent for boys and more than 25 per cent for girls. As a result, the number of 16- and 17-year-olds in the labor force in May (the latest month for which detailed data are available) was 265,000 (13.6 per cent) higher than last year. By 1965 the first crop of war babies will be 18 to 19 years old. If typical past experience is repeated, nearly three fourths of the boys in this age bracket and one half of the girls can be expected to participate in the labor market.

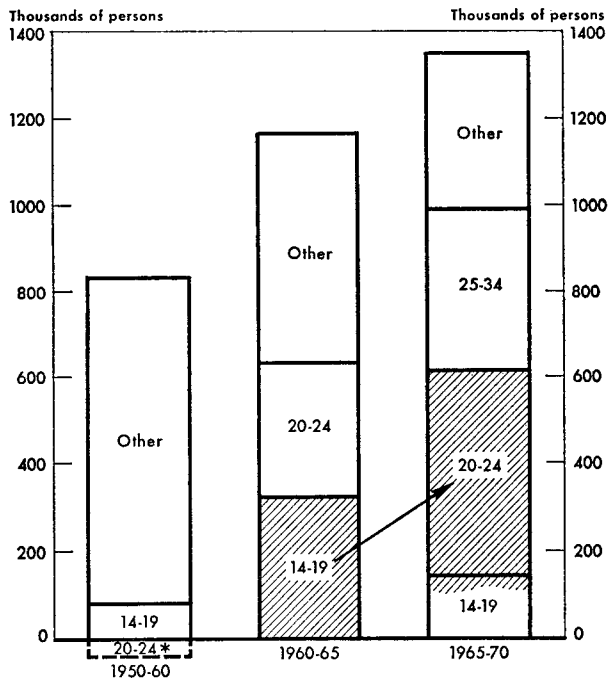
The net result of this increase in population, according to Labor Department projections, is that over the five-year period from 1960 to 1965 the number of 14- to 19-year-olds in the labor force may be expected to increase by about 320,000 persons per year (see Chart II). In contrast, the average annual increase of this group over the decade of the 1950's amounted to only about 75,000 persons. The projections indicate, moreover, that this initial group of young people will be followed by yet another wave during the last half of the present decade. Thus, from 1965 to 1970, the already large size of the 14- to 19-year-old bracket is expected to expand still further by about 140,000 persons per year. By 1970, therefore, the prospect is that there will be nearly 20 million persons

under 25 years of age in the labor force—an increase of 6 million persons, or 45 per cent, over the number in this age bracket in 1960. During the 1950's, the size of this age bracket grew by 360,000, or less than 3 per cent.

The sheer size of this group looking for jobs makes for at least a transitional unemployment problem of unusual magnitude. Most teen-agers are inexperienced and must compete for jobs with persons who in many cases have several years of experience behind them. In recent years, moreover, 30 to 40 per cent of all teen-agers have dropped out of school before completing high school. In view of the substantial upgrading of the general educational level of American workers over the past several decades, job opportunities for these dropouts are severely limited. According to a Labor Department study, of the 350,000 young people over 16 years of age who dropped out of school before graduation between January and October 1961, an estimated 27 per cent were unemployed in the latter month. In contrast, only 18 per cent of 1961's high-school graduates, who probably were slightly older on average than the dropouts, were unemployed that October.

Chart II

ACTUAL AND PROJECTED AVERAGE ANNUAL CHANGE IN THE LABOR FORCE, BY AGE GROUP



Note: The arrow indicates that those persons who are 14-19 years of age in 1960-65 will be 19-24 years old in 1965-70. However, since separate data on 19 year olds are not available, the shaded area for the 1965-70 period is only a rough approximation of the size of the 19-24 year old group. This area is larger than the shaded area shown for 1960-65 because labor force participation rates are higher for 19-24 year olds than for persons 14-19 years of age.

*The size of the 20-24 age group declined from 1950 to 1960.

Source: United States Department of Labor.

While most school dropouts have in the past eventually found at least some sort of job, the handicap of a limited education continues to affect their employment opportunities for the rest of their lives. Indeed, with rapid changes in technology that place higher and higher educational requirements on workers, it is open to question whether even graduation from high school will in the future prepare the worker for steady employment. In March 1962, nearly two thirds of the persons in the labor force who had completed less than four years of high-school education were in the blue-collar and service occupations (see Table II). These occupations had higher than average unemployment rates and, except for service workers, showed little or no growth in employment over the postwar period. In contrast, only 22 per cent of the persons who had not finished high school were able to find work in white-collar occupations, which have been growing more rapidly and had lower than average unemployment rates.

Some of the teen-agers—and a substantial portion of the school dropouts—are Negroes. In March 1962, only 31½ per cent of the nonwhite labor force 18 years of age and over had graduated from high school (90 per cent of the nonwhites are Negroes). In contrast, nearly 57 per cent of the whites had reached that level of educational achievement. The median number of school years completed by the nonwhites was only 9.6 years, compared with 12.2 years for the white labor force. This lack of education makes the nonwhite worker especially vulnerable to unemployment. Racial discrimination, of course, plays a role in this lack of training and, at the same time, adds to the burden faced by many nonwhites as they try to find jobs. Thus, the unemployment rate among nonwhites has in every year since 1954 been at least twice that for whites, and even in the immediate postwar period never fell below 1½ times the white unemployment rate. In 1962, nonwhites made up only 11 per cent of the civilian labor force, but accounted for 22 per cent of the unemployed.

To be sure, the social problems created by the high rate of teen-age unemployment are rather different from those associated with unemployment among other age groups. Relatively few of the younger workers are married and trying to support a family—though in May the unemployed of this age group did include about 10,000 married males and 46,000 married females. Many teen-agers, moreover, are looking only for summer or part-time jobs. In cases where parents have sufficient income, failure to obtain such jobs may involve no particular hardship. In other

Table II

DISTRIBUTION OF EMPLOYED PERSONS EIGHTEEN YEARS OF AGE AND OVER, BY OCCUPATION AND EDUCATION, MARCH 1962, AND UNEMPLOYMENT RATES, BY OCCUPATION, 1962

Occupation	Total employees	Years of school completed			Unemployment rates
		Less than four years of high school	Four years of high school	More than four years of high school	
Total:					
Thousands of persons	63,939	28,920	20,688	14,331	
Per cent	100.0	100.0	100.0	100.0	5.6*
White-collar workers	46.3	22.2	53.9	83.7	2.8
Professional and technical workers	12.8	1.9	6.7	43.3	1.7
Managers, officials, and proprietors, except farm	11.8	8.7	12.4	17.3	1.5
Clerical workers	15.6	7.3	27.3	15.3	3.9
Sales workers	6.1	4.2	7.5	7.8	4.1
Blue-collar workers	35.1	50.2	31.5	9.9	7.4
Craftsmen and foremen	12.9	16.1	13.7	5.0	5.1
Operatives	17.6	26.4	14.8	4.0	7.5
Laborers except farm and mine	4.6	7.6	3.0	0.9	12.4
Service workers, including private household	12.3	17.5	10.4	4.5	6.0
Farm occupations	6.4	10.2	4.2	1.9	2.2

Note: Because of rounding, figures do not necessarily add to totals.
* Includes unemployed persons for whom no occupational category is listed.
Source: United States Department of Labor.

families, however, failure to obtain a summer job may mean the loss of much-needed additions to parental incomes or of resources required to meet college expenses. Moreover, a large number of teen-agers "out of school and out of work" can always create an atmosphere of frustration and unrest—adding significantly to delinquency and other equally serious social problems. These could develop, as Dr. James B. Conant has stated, into "social dynamite". Finally, it must be remembered that the problem of teen-age unemployment is not necessarily a temporary phenomenon that will no longer exist once the young people who are now entering the labor force in large numbers grow somewhat older. The fact that the teen-age unemployment rate has itself risen substantially in recent months means that a larger proportion of youths than in the past will be moving into the older age brackets without some of the training that they should have acquired in order to have a satisfactory labor market experience.

Special government programs already initiated, or to be enacted in the future, can be a significant factor in the solution of the teen-age unemployment problem. Provisions for effective vocational training are certainly needed for some of these youths, as are measures that will cut down the rate of school dropouts and raise the over-all level of skills through the expansion of the quality and availability of general education. At the same time, the success of such measures will depend importantly on a more general recognition among teen-agers (and the population generally) that, to an increasing extent, the achievement of the rising income and consumption levels that they desire is dependent upon the extent of their training. And even special government programs will still leave some frictional unemployment associated with such factors as seasonal swings in business activity and the voluntary movement of workers from one job to another, as well as unemployment associated with situations where excessive wage demands in effect price the worker out of the market.

Better training and education, the elimination of job discrimination, and other steps designed to help overcome structural difficulties are not, of course, the only prerequisite to the solution of the current unemployment problem and of the potentially aggravated unemployment problem associated with a more rapidly increasing labor force over the next decade. A healthy rate of over-all economic growth, without inflation, is itself essential. Such growth can help to absorb into employment those unemployed who already have the needed skills and training. Moreover, adequate growth provides an environment in which the incentives to add to skills are high, since jobs are then available when training is completed. Indeed, without adequate growth, training can go to waste and even add to feelings of frustration. Job discrimination against members of minority groups is also minimized when their employment arises from additional job opportunities and thus does not jeopardize the positions of those presently employed.

the international financial system. IMF quotas are an effective addition to international liquidity, and these resources are capable of further expansion. Substantial parts of each country's quota can readily become part of its reserves when it runs deficits, and the entire quota can become available, as has been shown in several important cases. We do not feel ourselves competent to make any judgment on the profound policy questions involved in more or less automaticity in Fund drawings, but we feel confident that an appropriate blending of automaticity and discipline will in time be achieved. In any event, the swap network and the possibility of broader use of bilateral credits through issuance of special certificates and bonds can provide a most useful supplement to the Fund's activities.

In fact, there is no need to expect, or to seek to achieve, a uniform path along which debtor and creditor countries move as they receive or grant credits in the course of payments swings. For some countries, the IMF is and will continue to be virtually a first line of defense, while others may prefer to reserve its use for more protracted and generalized deficits. Whichever course may be taken, however, the very existence of the Fund and of its large resources will provide to all member countries continuing assurance of the type of international monetary cooperation that the Fund symbolizes and embodies.

The Business Situation

As the first half of the year came to a close, most measures of business activity were showing a continuation of the stepped-up rate of advance that had begun last spring, following the sluggishness which marked the second half of 1962. In June, industrial production, nonfarm payroll employment, and personal income all remained on their respective uptrends of the previous several months. For the second quarter as a whole, gross national product posted a substantial advance, and, with prices remaining relatively stable, most of the rise reflected real growth. Thus, contrary to the expectations of most business analysts at the beginning of the year, the gain in GNP in the first half of 1963 was slightly above the rise registered during the latter half of 1962. This better than expected performance of the economy helped to reduce the Federal budget deficit for the fiscal year ended June 30 to $6.2 billion, or $2.6 billion less than had been estimated in January.

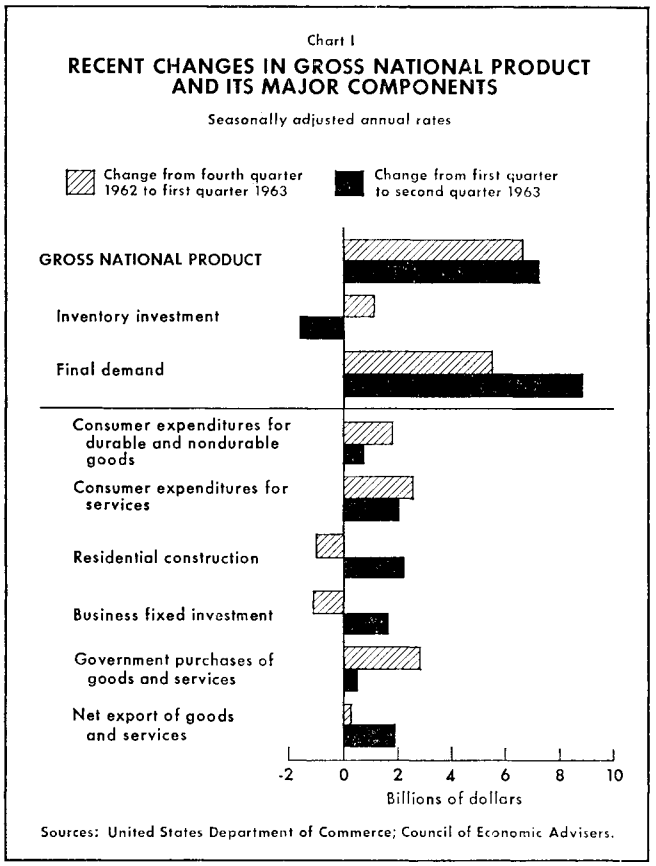
The usual difficulties of making proper allowance for seasonal factors during the summer months will probably complicate the evaluation of the economic outlook for the third quarter. An additional factor will be the drag on steel output due to the working-off of inventories. Indeed, weekly data for July do suggest a substantially more than seasonal decline in steel ingot production. Auto output, moreover, also appears to have fallen more than is normal for the end of the model year, but this drop must be evaluated against the very strong performance of the industry in June. At the same time auto sales recovered in July, and there were signs that total retail sales may have moved to new high ground.

GROSS NATIONAL PRODUCT IN THE SECOND QUARTER

According to preliminary estimates by the Council of Economic Advisers, GNP rose to a seasonally adjusted annual rate of $579 billion in the second quarter.[1] The $7.2 billion gain was slightly larger than the first-quarter advance (see Chart I) and was also above the average quarterly rise in 1962. The increase was particularly impressive in view of a slowdown in the rate of gain in inventory spending. Indeed, the second-quarter rise in final demand amounted to $8.8 billion, the largest advance in a year. This increase, moreover, was centered largely in the private sector, as government purchases of goods and services showed an appreciably smaller rise than in the two previous quarters.

Spending for residential construction and for business fixed investment rebounded sharply in the second quarter,

[1] The usual midyear revision of the national income accounts resulted in a lowering of earlier estimates of GNP for each quarter from 1960-I through 1962-I by some $0.2-1.3 billion and a raising of the 1962-II through 1962-IV estimates by some $0.4-1.7 billion.

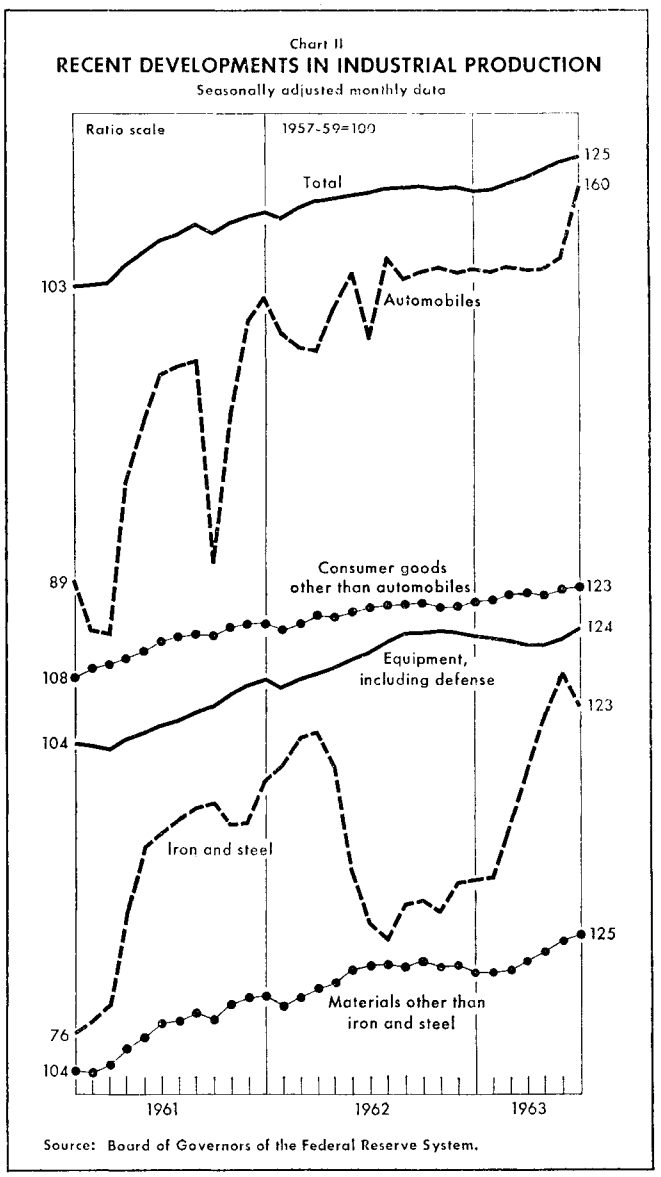


following declines in the opening quarter of the year. With the improvement in the weather that began in April, builders were able to begin or resume work on projects that had been delayed by the unusually severe winter. Partly as a result, the second-quarter gain in residential construction outlays was the largest of any quarter in the postwar period. The rise in plant and equipment spending, while of more modest proportions, was about as large as had been indicated in the Commerce Department-Securities and Exchange Commission survey of capital spending plans taken in May. The survey had also projected a 5 per cent gain in capital outlays for the year as a whole. With the second-quarter increase, this now appears to be somewhat closer to realization.

Consumer spending registered its smallest rise in more than two years. The second-quarter gains in outlays for both services and nondurable goods were smaller than in the first quarter, and spending for durables showed only a modest increase. The increase in durables consumption, however, occurred while new car sales of 7.2 million units (seasonally adjusted annual rate) were essentially unchanged from the first quarter.

DEVELOPMENTS IN JUNE AND JULY

The Federal Reserve's index of industrial production continued upward in June, reaching 125.1 per cent of the 1957-59 average (see Chart II). This marked the fifth consecutive month in which gains of a full point or more have been scored. The increase so far this year amounts to about 6 percentage points in contrast to a rise of 3.5 percentage points for the whole of 1962. Producers of consumer goods accounted for the greater part of the June advance—largely reflecting a 10 per cent rise in assemblies by the automobile industry, though output of



other consumer goods also moved up slightly. Production of business equipment advanced markedly for the second month in a row and finally topped the record set in September of last year. Despite a sharp fall-off in iron and steel production and a strike in the lumber industry on the West Coast, output of materials was unchanged. Weekly figures for July suggest that steel ingot production fell appreciably further (seasonally adjusted). At the same time auto assemblies, while at about the seasonally adjusted annual rate that was maintained from last October through May, were still no match for the better than 8.0 million unit rate in June.

A slightly adverse development in June was a 2.7 per cent decrease (seasonally adjusted) in new orders received by manufacturers of durable goods. This marked the second month in a row that this forward-looking indicator has declined, following four consecutive months of advance. A substantial part of these recent movements, however, reflects fluctuations in orders for steel, which rose appreciably in the first five months of the year before falling off sharply in May and June in anticipation of, and following, the settlement of the steel labor negotiations. In June, moreover, new orders for durable goods other than steel were virtually unchanged from the advanced level of the month before. At the same time, the backlog of unfilled orders for all durable goods, while down slightly in June, still was at the second highest level in the current expansion.

Seasonally adjusted nonfarm payroll employment moved up by 143,000 persons in June, marking the fifth consecutive month of advance. About one half of the June rise was due to an expansion in government employment, with an increase in service and trade jobs largely accounting for the rest. Employment in the manufacturing sector showed little change, despite a strike on the West Coast which reduced the number of persons on payrolls in the lumber industry by about 20,000. In July, nonagricultural employment posted a sizable rise, according to the Census Bureau's household survey, and there was some pickup in farm jobs. The advance in total employment was nearly paralleled by a 549,000 rise in the civilian labor force, and the unemployment rate at 5.6 per cent was essentially unchanged from the 5.7 per cent registered the month before. Thus, the total number of unemployed in July remained above four million persons, higher than the level of a year earlier, despite recent gains in economic activity.

In the consumer sector, demand appears to have been maintained. To be sure, three leading indicators of future spending for residential construction—contract awards, housing starts, and new building permits issued—all fell off slightly in June. However, there continues to be a substantial backlog of unused permits on which work was not initiated during the winter because of the unusually severe weather. And the fact that starts and awards were at a record level during the second quarter may point to strength in outlays for the near term. Moreover, there have been signs of some renewed strength in consumer retail spending for store goods. Thus, after having shown little movement from February through May, retail sales moved up in June to set a new record. Weekly data for July suggest that retail volume may have expanded somewhat further in that month, with an increase in sales of new cars providing much of the push. At the same time, trade sources report an unusually brisk sales pace for air conditioners, brought about by the sustained heat spell that apparently gave a boost to department store sales of other summer merchandise as well.

The Money Market in July

Financial markets were heavily influenced in July by expectations of, and reactions to, official moves designed to deal with the persistent deficit in the United States balance of payments. Discussion of the likelihood of an imminent increase in the discount rate—touched off by market advisory letters and newspaper stories—grew in intensity during the first half of the period. Expectations of such a move were reinforced prior to midmonth by news of further gold losses and by official testimony before a Congressional committee that an upward adjustment in short-term rates could play a significant role in combating the payments problem by discouraging outflows of short-term funds. Against this background, the July 16 announcement that the Board of Governors of the Federal Reserve System had approved an increase of ½ per cent to 3½ per cent in the discount rate of the Federal Reserve

The Business Situation

Most measures of economic activity posted significant gains in July, and incomplete information for August suggests continued strength. Particularly noteworthy among the July results was a further advance in industrial production, despite special factors pulling down automobile and steel output. In addition, nonfarm employment rose for the sixth consecutive month, and there were continued gains in two important areas of final demand—retail sales and private construction outlays. New orders for durable goods also moved up, after two months of decline. Weekly data for August point to further declines in automobile and steel production, as previously anticipated, but retail sales appear to have edged up despite a decline in new car sales caused partly by shortages of some models.

On balance, the performance of production and related indicators since midyear has been at least as good as most analysts had expected. Moreover, the upward revision of gross national product figures for the second quarter, now that fuller June data are available, suggests more strength than had been apparent earlier. To be sure, the near-term outlook is not without its normal quota of uncertainties. Prominent among these is the possible extent and duration of the drag on production currently being exerted by the overhang of steel inventories. There is also a question whether construction activity will maintain its buoyancy in the face of recent declines in some leading indicators. Other unknowns are the kind of reception that will be accorded the new car models and the nature and timing of Congressional decisions on tax legislation.

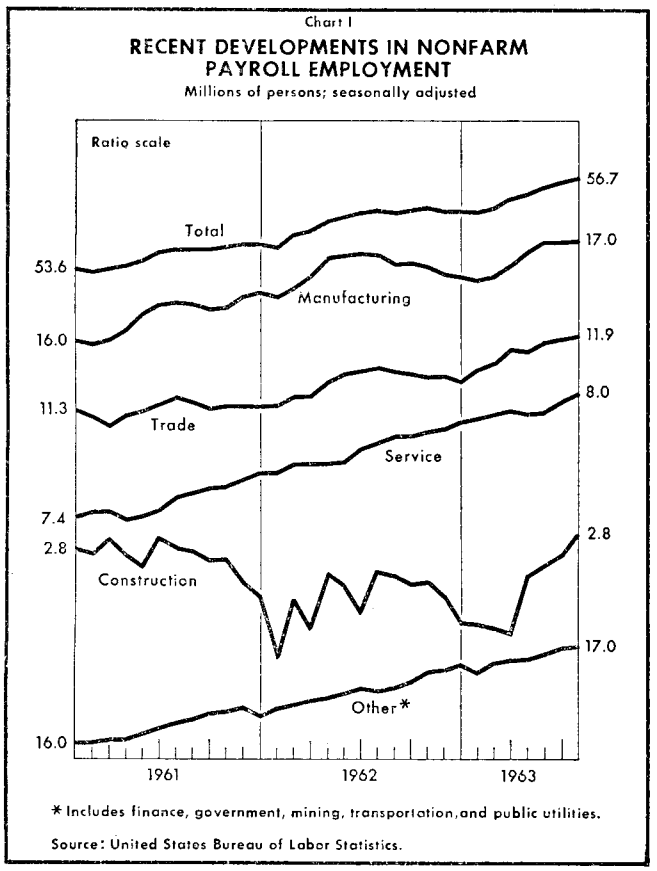
Despite these question marks, a number of factors seem to be working in the direction of further gains in economic activity. Consumer buying intentions have remained strong, and the expected passage of the military-pay-rise bill will provide a push to Federal spending in the fourth quarter of the year. The latest Commerce Department-Securities and Exchange Commission survey of businessmen's capital spending plans points to a sharp rise in such spending in the third and fourth quarters of the year—a rise that is about in line with earlier expectations. (Actual outlays rose in the second quarter, but not quite so much as had been expected.) Meanwhile, capital appropriations by large manufacturers in the second quarter recouped most of the first-quarter decline. Corporate profits also apparently increased in the second quarter, a development which may help to encourage the realization of plant and equipment spending plans over the balance of the year.

In assessing the outlook for the remainder of the year, Chairman Heller of the Council of Economic Advisers recently estimated that GNP for the year as a whole would reach $580 billion or "perhaps a bit more", which would be consistent with moderate gains in both the third and fourth quarters. It is noteworthy, however, that should such a rate of growth occur it would still be insufficient to bring about any marked reduction in the rate of unemployment from the high levels registered so far this year.

PRODUCTION, ORDERS, AND EMPLOYMENT

Although steel and automobile output each declined by about 5 per cent in July, the Federal Reserve's seasonally adjusted index of industrial production advanced by nearly a point, marking the sixth sizable increase in a row and bringing the index to 126.5 per cent of the 1957-59 average. Gains were fairly widespread; perhaps most significant, producers of business equipment tacked on an increase of one percentage point atop the two-point gains scored in both May and June. Although the sluggishness of output in this industry during the early part of the year had raised some concern, the recent surge in equipment production would seem to reinforce the belief that businessmen are in fact largely going through with their capital spending plans for 1963.

Fragmentary data for August indicate a continued decline in automobile production, with part of the decrease, however, reflecting the greater than usual concentration of model change-overs during the month. Preliminary schedules for the early part of the 1964 model run point to a recovery of production in September. In the steel industry, seasonally adjusted ingot production fell off in August for the third month in a row. However, weekly production figures appear to have leveled off since early August. Meanwhile, consumption of steel apparently has been well maintained. Thus, there exists the possibility that the inventories accumulated during the spring and early summer in anticipation of a possible strike may now be drawn upon.

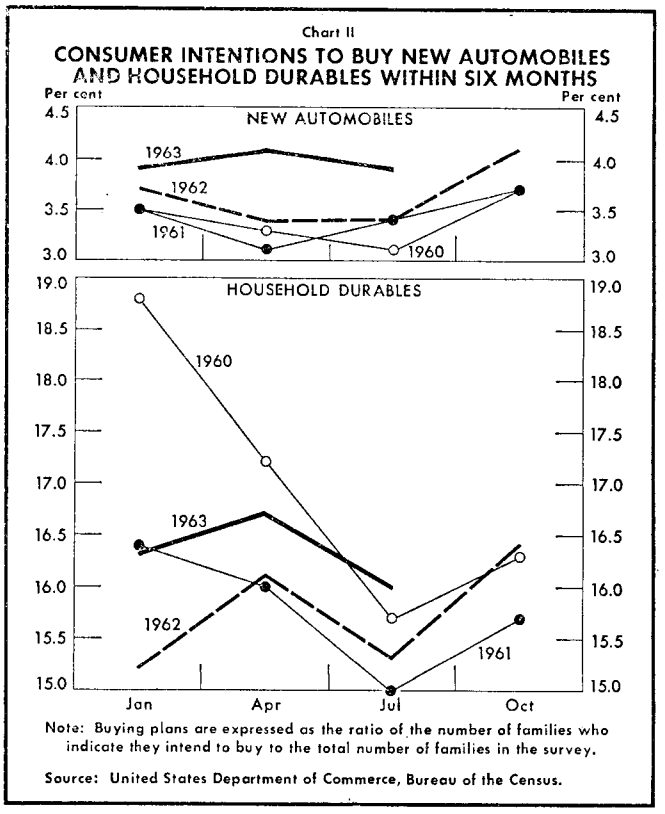


A more favorable factor in the near-term prospects for production is the July rise in new orders received by manufacturers of durable goods, following two months of decline. In particular, orders for industrial machinery—which tend to provide some clue to the future course of capital investment—recovered in July from the June decrease and remained above the volume of sales of such machinery for the fourth month in a row. Bookings received by the steel industry also increased somewhat, but were still below the levels prevailing just prior to the early-1963 surge in orders in anticipation of a possible strike.

Nonfarm payroll employment (seasonally adjusted) advanced for the sixth consecutive month in July. The total rose to 56.7 million persons, or nearly 1.2 million above the January level. The rate of increase in July, however, was only about half as large as occurred during the spring months. The slowdown largely reflected less push from manufacturing industries, among which only machinery and instrument producers registered employment gains as great as in earlier months. Outside of manufacturing, employment in the trade, service, and construction industries continued to expand appreciably (see Chart I). In August, according to the Census Bureau's household survey, employment was about maintained at its recent levels, while a greater than seasonal decline in the number of young persons looking for work helped to bring about a slight reduction in the amount of unemployment. The unemployment rate, at 5.5 per cent of the labor force, was at its lowest level for this year, but still was no better than in December 1962 and hardly better than the 1962 average.

CONSTRUCTION AND RETAIL SALES

Recent developments in construction show a somewhat mixed picture. After a strong performance during the spring, such leading indicators of private construction activity as contract awards and housing starts edged off in June and then declined further in July. Building permits also decreased in July. Since construction outlays tend to follow movements in these indicators with a lag of several months, however, the current level of outlays still reflects the high volume of contract awards in earlier months. Indeed, private outlays continued to move upward in both July and August, spurred by an appreciable pickup in work on commercial and industrial facilities following the



sluggishness shown in this sector during the earlier part of the year. Recent Government forecasts of the volume of private construction for 1963 as a whole imply little change from present levels over the balance of the year.

Spending by the consumer sector, on the other hand, appears to have taken on new vigor in the past several months. Thus, retail sales registered gains of better than 1 per cent in both June and July, and weekly data for August suggest a further small increase in that month. While new car sales fell off in August, this may in part have reflected a shortage of models most heavily in demand as the production of 1963 models came to a close. Department stores, in contrast, set a new sales record during August, as cooler weather reportedly brought on a rush to purchase back-to-school items and fall fashions.

The recent higher levels of spending appear to be amply supported by consumer incomes, which rose in July for the fifth consecutive month. Intentions to spend within the next six months apparently also remain favorable (see Chart II). Thus, according to the latest survey by the Census Bureau, consumers' new-car buying plans in mid-July were about the same as in January and April and were appreciably above the year-earlier level. Plans to buy household durables, though showing what appears to be a seasonal decline from the April level, were also higher than a year ago.

Consumer purchases of cars and durables, of course, often involve the use of consumer credit, the steady expansion of which has been one of the factors contributing to the strength in consumer buying throughout the current business upswing. Automobile credit, in particular, has shown a marked rise, reflecting the high rate of car sales, which was perhaps partly stimulated by the continuation of the trend toward lower downpayments and longer maturities. It is noteworthy that, despite this easing in the terms of credit, data available from banks on delinquency rates for consumer instalment credit have shown no discernible increase over the past three years. Indeed, such rates at a selected group of commercial banks surveyed by the American Bankers Association averaged slightly lower in the first six months of this year than in the corresponding period of 1962.

The Money Market in August

The money market was generally firm in August. Reserve distribution returned to the usual pattern of concentration in favor of banks outside the money centers during much of the month, and money market banks on occasion experienced substantial reserve pressures. As a result, these banks bid strongly for Federal funds, which were at times in rather limited supply, and the bulk of trading in Federal funds took place at 3½ per cent. The money market banks also had to acquire additional funds through sizable borrowings from the Federal Reserve Banks. Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were generally quoted within a 3⅝ to 3¾ per cent range during the period.

On August 21, the Treasury announced that it plans to offer one-year bills on a monthly basis, rather than quarterly as in the past. The first of the new series—$1 billion of one-year bills maturing on August 31, 1964—was auctioned on August 27, for payment on September 3. Subsequent issues are also expected to amount to about $1 billion a month, as compared with the $2 billion to $2.5 billion of one-year bills that had been auctioned quarterly in the past.

Treasury bill rates edged lower in early August in the face of strong nonbank demand and a very limited market supply of bills. Over the rest of the month, however, rates moved higher in response to both contracting demand and expanded offerings. During the month, the market came increasingly to feel that the trend of official policy was still in the direction of encouraging higher short-term rates and would seek to combat any pronounced decline in these rates. An upward adjustment in rates on several short-term money market instruments occurred during the month. Rates on ninety-day unendorsed bankers' acceptances rose by ⅛ of a percentage point to 3¾ per cent (bid); rates on prime four- to six-month commercial paper increased by ⅜ of a percentage point to 3⅞ per cent (offered); and rates on various maturities of sales finance company paper rose by ⅛ to ¼ of a percentage point. The offering rates for new time certificates of deposit

about equal to the rate of increase in the last half of 1962. Further impetus to the growth of time deposits and negotiable time certificates of deposit was given by the July increase to 4 per cent in the maximum rate banks are permitted to pay on such deposits and certificates under the Board of Governors' Regulation Q. The new maximum of 4 per cent for 90-day to one-year maturities compares with the previous limits of 2½ per cent for 90 days to six months and 3½ per cent for six months to one year.

These increases in the limits on shorter term time deposit rates permitted commercial banks to continue to compete strongly for short-term funds and thus played a part in the recent upward trend of money market yields. Moreover, because banks must relend these funds at interest rates exceeding the rate paid the depositor, they have tended to invest them in longer term credit instruments. This transfer of funds from the short- to the longer term financial markets has contributed to the reduced spread between short- and long-term interest rates. Indeed, in view of the substantial expansion of bank credit this year and its increased concentration in capital market instruments, it may well be that such advances as have taken place in long-term rates over the past nine months have been more a reflection of expectational factors than of any real change in the availability of long-term credit relative to demand.

The Business Situation

After several months of sustained advance, the economy's upward movement appears to have slowed in late summer, although fragmentary September data suggest the possibility of a renewed pickup. Industrial production and manufacturers' new orders for durable goods declined a bit in August, while nonfarm employment and retail sales showed little change and personal income posted the smallest gain in six months. In almost every case, these signs of hesitation could be traced in significant part to the operation of special factors in the auto and steel industries. These factors were also operating in July, and there was thus an element of surprise in the buoyancy of the economy in that month. As it turned out, production declines in the steel and auto industries were more pronounced in August than in the earlier month. And, with car makers retooling for the 1964 models in August, shortages of some lines were apparently responsible for a slackening in the pace of sales and new orders.

As the new car models began to come off the assembly lines in September, auto output received a more-than-seasonal boost. Steel production, moreover, turned slightly upward, following the three-month decline that had occurred in the aftermath of the industry's labor settlement. Auto sales continued to be adversely affected by shortages of some new models, however, and department store sales declined somewhat from the record August rate.

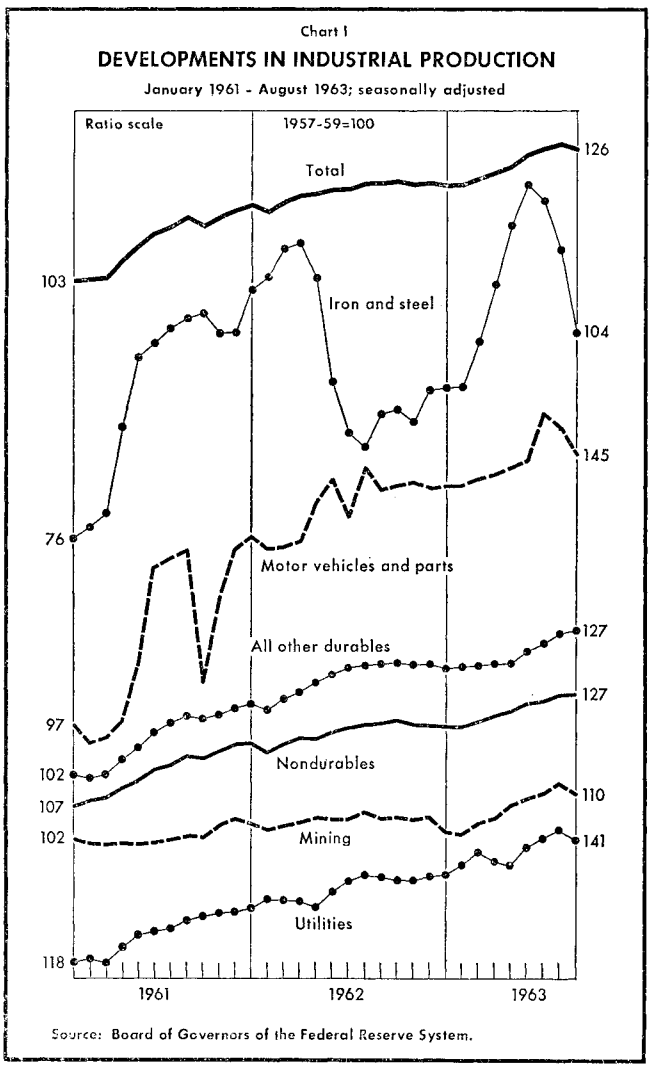
The broader questions with regard to the performance of the economy over the balance of the year of course remain—including the reception to be accorded the new auto models and the outcome of proposed tax legislation. Two positive factors are the anticipated rise in government spending—reflecting the recently enacted military-pay hike and a resumption of the uptrend in state and local government outlays—and the planned step-up in business plant and equipment spending. In any case, there continues to be little prospect of a significant near-term reduction of the current unemployment rate. In September, the rate edged up to 5.6 per cent of the civilian labor force (seasonally adjusted) and was just as high as the year-earlier figure.

PRODUCTION, EMPLOYMENT, AND SALES

After advancing by more than 7 percentage points in the previous six months, the Federal Reserve's seasonally adjusted index of industrial production fell by nearly a point in August to 125.6 per cent of the 1957-59 average (see Chart I). Most of the decline was attributable to a 12 per cent reduction in iron and steel output, the sharpest of the year, but production of motor vehicles and parts also dipped significantly from the unusually high July rate. Outside these two industries, rises and declines were generally small and just about offsetting, whereas in previous months there had been sizable gains on balance. Early data for September point to a moderate advance in automobile output (seasonally adjusted), with preliminary

schedules suggesting the possibility of a more substantial gain in October. Data on steel output for September indicate a small increase, after seasonal adjustment, from the August level. In the June-August period, declines in the iron and steel component cost the total industrial production index about 1.1 points, and a bottoming-out in the steel industry would thus remove a significant drag on over-all production. The strength of the industry for the near term, of course, depends in part upon how much longer it will take steel users to reduce their inventories to desired levels.

Reflecting dampened industrial production, nonfarm payroll employment (seasonally adjusted) showed a small decline in August, the first since February 1961. Gains in service and government employment failed to offset a reduction in manufacturing payrolls which was concentrated mainly in the transportation and primary metals fields and was therefore related to cutbacks in steel and autos. In other areas of the economy, however, payroll employment, like production, showed less buoyancy than in earlier months. In September, according to the Census Bureau's household survey, total employment moved up again, after seasonal adjustment, but a proportionately greater rise in the labor force resulted in a small increase in the unemployment rate.

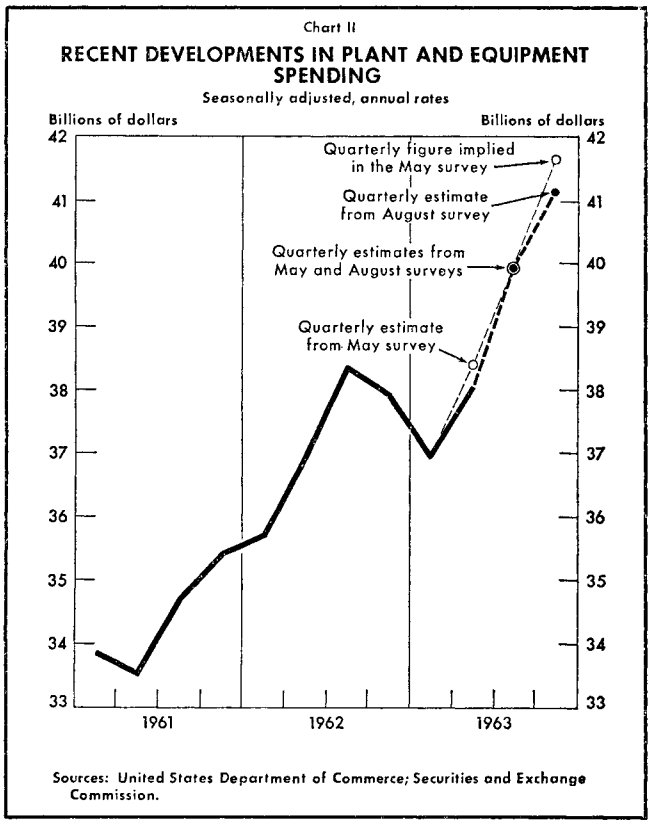


Total retail sales were about unchanged in August (seasonally adjusted), after climbing appreciably in the two preceding months. Excepting autos, however, sales continued to rise significantly, with advances posted particularly by stores featuring back-to-school and other fall items. Incomplete data for September suggest that over-all retail sales moved downward, in part reflecting continued limitations on new-car availabilities in some popular lines. Public response to the 1964 models cannot as yet be assessed with any confidence. Industry spokesmen have suggested that auto sales may reach or exceed 7 million units for the third successive year.

Since the statistics on new orders received by the automobile industry reflect mainly deliveries of new cars to dealers, the August decline in automobile sales also had a marked impact on new orders data. Thus, despite little net change in orders outside the motor vehicle industry, total new orders received by manufacturers of durable goods declined by 2 per cent in August (seasonally adjusted) to the lowest level since January. Total unfilled orders of durables manufacturers (seasonally adjusted) were virtually unchanged in August.

FIXED INVESTMENT

The latest survey of businessmen's plans for plant and equipment spending, taken in August by the Commerce Department and the Securities and Exchange Commission, points to substantial gains over the balance of the year (see Chart II). After declining in the first quarter, business fixed capital outlays rose by $1.1 billion in the April-June period to $38.1 billion (seasonally adjusted annual rate). While this was a bit below the levels businessmen were planning in May—mainly because of a shortfall in nonmanufacturing industries—the latest survey indicates no change from the earlier report in outlays planned for the third quarter. As a result, the second-quarter to third-quarter gain of $1.9 billion indicated in the latest survey is somewhat greater than had been suggested previously. Although the latest plans for the final quarter of the year indicate a somewhat lower level of spending than was



implied in the May survey, they nevertheless call for a further $1.2 billion advance from the third quarter. In appraising the likelihood that spending plans for the rest of the year may be realized, it is noteworthy that corporate profits (after taxes) rose to a twelve-year high in the second quarter of the year. Such a level of profits should help provide the financial resources and the incentive for a further expansion of plant and equipment spending.

Indicators of residential construction activity are continuing to ease off from their earlier exceptionally high levels. Private nonfarm housing starts moved slightly lower in August, marking the third consecutive setback in this monthly series. These movements appear to be in line with the Commerce Department's revised forecast for 1963, which implied a moderate reduction in housing starts over the last half of the year from their high spring levels. Although the backlog of unused permits remains substantial, new home building permits also moved down further in August, following an initial decline in July. Against the background of these declines in leading indicators, private residential construction outlays edged down slightly in September. Despite these declines, new home construction is still proceeding at a rapid pace. Moreover, the underlying demand for housing continues to be bolstered by a number of factors, including rising family incomes, an upward trend in new household formations, and the ready availability of mortgage credit at relatively low rates.

SECOND DISTRICT DEVELOPMENTS

In comparison with the many available indicators of national economic trends, statistical data for analysis of activity in the Second District are somewhat limited.[1] Data on employment and unemployment, sales, personal income, and construction activity are available for the region, however, and these series provide a fairly reliable measure of over-all developments within the District.

Since the first quarter of this year most measures of business activity in the Second District have kept pace with their national counterparts. Thus, both personal income and nonfarm employment advanced in the District during the April-July period at the same rate as in the nation, while department store sales, which had been adversely affected by the first-quarter New York City newspaper strike, showed a greater than national improvement. Unemployment in two of the District's three states—New York and Connecticut—averaged somewhat below the national rate during the recent period. The only notable exception to this generally good record is activity in the District's construction industry. While recent gains in construction employment have paralleled the national rate of advance, District employment in the industry is below a year ago. To a substantial degree, this reflects the combined effect of several large-scale construction strikes in upstate New York and the aftermath of last year's surge of activity in New York City, during which many builders "borrowed" from future projects in order to beat the deadline set under the City's new, more stringent, zoning law.[2] At the same time, however, several areas outside New York City also continue to report disappointing levels of building activity.

Total nonfarm employment in the District increased at the national rate of 1 per cent during the April-July period. Some divergences from the national pattern are noteworthy, however. Thus, in the apparel industry, which

[1] The Second District includes all of New York State, twelve primarily industrial counties of northern New Jersey (Sussex, Passaic, Bergen, Hudson, Essex, Warren, Morris, Union, Hunterdon, Somerset, Middlesex, and Monmouth), and Fairfield County, Connecticut.

[2] Although the actual deadline is not until the end of 1963, the surge in activity prompted by this deadline came in 1962.

employs more of the District's manufacturing labor force than any other, the employment increase was larger than in the nation as a whole. Trade sources, moreover, suggest the prospect of further gains during the fall and winter seasons. Employment in the transportation equipment industry, however, showed a smaller rise in the District than in the nation. The automotive segment of the industry apparently is still performing well, but shipbuilding and aircraft producers have been reducing work forces. An exception in the aircraft industry is Fairfield County, Connecticut, which has shown rising employment in recent months.

District employment in primary metals, particularly steel and wire production, also has shown slower than national growth since the first quarter—in part reflecting the temporary shutdown of some upstate operations and the closing of a plant in western New York that was attributed by the company to the impact of foreign competition. As a result of this closing and an over-all reduction in steel demand since just before the settlement of the industry's labor dispute, the Buffalo index of steel production during July and August averaged 80.7 per cent of its 1957-59 base, compared with a United States average of 99.7 per cent.

Unemployment in the District as a whole showed about the usual seasonal decline during the April-July period. In both New York and Connecticut, however, the total unemployment rate averaged lower than the national figure, while the New Jersey total unemployment rate was higher. As was true of the country as a whole, the unemployment rates in each of the District's three states were slightly above their year-earlier levels. Two of the District's major labor market areas—Newark and New Brunswick-Perth Amboy—have been removed from the national list of areas with "substantial" unemployment (6.0 per cent or more) and reclassified to the category of "moderate" unemployment (3.0 to 5.9 per cent). Heightened activity in the transportation equipment industry and the expansion of employment in the chemical and electrical equipment industries were the major factors bringing about the reclassification. As a result of these changes, only three of the District's thirteen major areas remain in the substantial unemployment category. In Rochester a reduction in unemployment, largely attributable to employment gains in the photo-optical industry, resulted in a reclassification of that area to the category of "relatively low" unemployment (1.5 to 2.9 per cent). Only fifteen other major areas out of 150 in the country currently are classified in this category.

District store sales advanced more rapidly during the April-July period than nationally, with notable gains recorded in New York City and Rochester. Much of the recent New York City gain represents merely a return to a more normal sales level following termination of the newspaper strike in March. The Rochester situation, however, reflects a generally expanding local economy, as measured by a local index of business activity which is now at a record high. District sales during the April-July period were 6 per cent higher than a year earlier. Nationally, the gain was 4 per cent.

Construction activity in the District, measured in terms of the average level of employment in the April-July period, equaled the national gain of 3 per cent over the first-quarter average. Nevertheless, construction employment and contract awards showed a decline from the year-earlier level, while nationally there was an increase. Some over-the-year decline in construction activity in the District, of course, reflects the slowing-down from an exceptionally high level of activity in the New York City area during 1962, when, as already noted, builders rushed work on projects in anticipation of the effective date for more stringent building regulations. During recent months, however, District construction has also suffered from several strikes in upstate areas—the largest one involving some 11,000 workers in twenty-eight New York State counties.

Reflecting these and other developments, the value of total construction contract awards in the April-July period was 9 per cent below the record 1962 level, while for the nation as a whole contract awards during the period were 12 per cent greater than a year ago. The District's volume of nonresidential building awards, which in the first quarter was still above the corresponding period of 1962, has recently joined the residential and heavy engineering categories in showing an over-the-year drop as a result of slackened activity in New York City. Through the first seven months of 1963, however, District awards have remained above their 1961 level and that of earlier years.

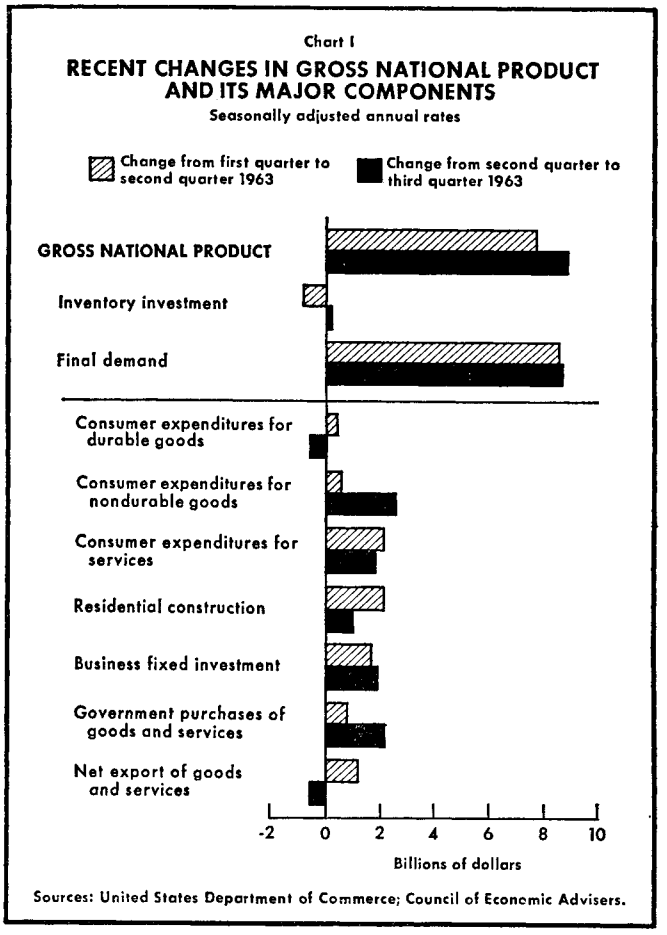
The Business Situation

The economy posted another significant advance in the third quarter of the year. The rise in gross national product was the largest for any quarter in nearly two years, with a particularly heavy gain being scored by consumer purchases of nondurable goods. To be sure, there was some sluggishness in the statistical measures in August, but most September business indicators showed more strength, as the automobile industry experienced a pickup and the decline in iron and steel production virtually ceased. With the fourth quarter getting under way, moreover, available data suggest that retail sales, sparked by heavy sales of new car models, advanced substantially more than seasonally in October. At the same time, there appears to have been a significant increase in auto output in October—even after allowing for the normal seasonal rise—while steel output held about unchanged.

Prospects for the fourth quarter as a whole appear encouraging. The Department of Commerce-Securities and Exchange Commission's August survey of businessmen's plans for plant and equipment spending suggests a substantial further gain in such spending over the third quarter. The outlook for the realization of such a gain appears to have received support in September, both from a substantial rise in new orders for machinery and equipment following two months of decline and from a considerable advance in the output of business equipment. At the same time, some increase in spending by the Federal Government—due particularly to the military pay rise—and by state and local governments appears likely, while the sharp recovery of housing starts and new home permits in September has improved the outlook for residential building activity. One major area of uncertainty is the prospective strength of consumer spending, which has been increasing less rapidly this year than in 1962. According to a recent survey, however, consumer plans to buy houses, household goods, and cars remain strong.

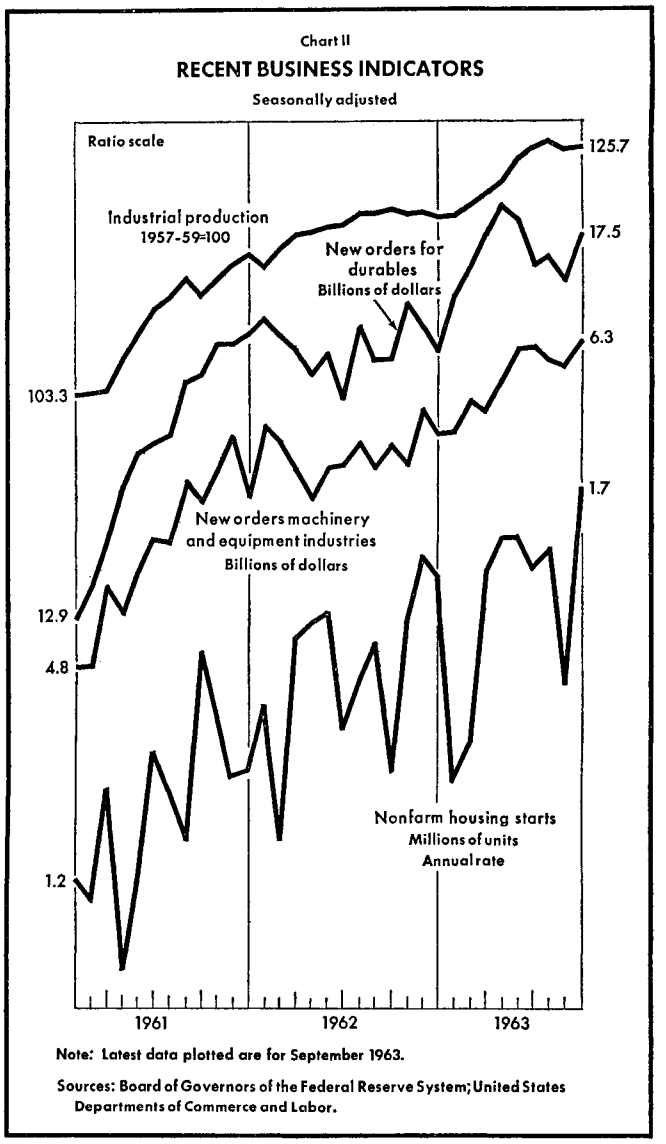
GROSS NATIONAL PRODUCT IN THE THIRD QUARTER

According to preliminary estimates by the Council of Economic Advisers, GNP rose by a sizable $8.9 billion in the third quarter to a $588.5 billion seasonally adjusted annual rate (see Chart I). Only a small part of the advance was due to a rise in the rate of inventory accumulation, indicating that the expansion in final demand was a bit larger than the already substantial second-quarter increase. Most components of final demand contributed significantly to the rise in GNP. Major gains were scored by consumer purchases of nondurables, which had shown only a small increase in the second quarter, and by spending of state and local governments. Outlays by these governments, which normally show a fairly steady growth, had declined in the second quarter, owing to a temporary curtailment of some highway construction, but rebounded



sharply in the third quarter. Total spending for goods and services by the Federal Government, on the other hand, was virtually unchanged, and two components of GNP—net exports and consumer purchases of durable goods—edged down. As regards consumer purchases of durable goods, a concentration of car model change-overs and the relatively low remaining inventories of 1963 models resulted in reduced automobile sales in the latter part of the third quarter.

In line with businessmen's plans as reported in the Government's plant and equipment spending survey, business outlays on fixed investment during the third quarter showed one of the sharpest advances of recent years, actually exceeding somewhat the large second-quarter gain. The rise in nonfarm residential construction in the third quarter, on the other hand, was only about half the second-quarter increase—a slowdown which had been clearly apparent in the monthly data on construction activity.



DEVELOPMENTS IN SEPTEMBER AND OCTOBER

The Federal Reserve Board's index of industrial production was virtually unchanged in September at 125.7 per cent (seasonally adjusted) of the 1957-59 average (see Chart II). It will be recalled that during August sharp declines in the production of both steel and new cars had resulted in a drop of nearly a point in the over-all index. In September, on the other hand, a further small reduction in the iron and steel component was about offset by a small rise in the output of motor vehicles and parts. Gains and losses in the output of other goods also about offset each other in September, whereas there had been some rise on balance in August and fairly sizable increases in most earlier months of the year. Incomplete data for October point to little change in steel ingot production, after allowing for seasonal factors, but auto output rose sharply and very preliminary production schedules for November appear to suggest continued strength. Large car production and sales are in turn supporting steel production, although steel inventories remain fairly high.

One particularly favorable factor in the near-term outlook for production is the 4 per cent September rise (seasonally adjusted), to the highest level since May, in new orders received by manufacturers of durable goods. The August decline in these orders had largely reflected reduced deliveries of automobiles, which are recorded as new orders when delivered to dealers. To be sure, a substantial part of the September gain was due to renewed heavy deliveries as new car models came off the assembly lines. Nevertheless, orders of other durable goods also posted a good advance. With new orders exceeding sales in September, the backlog of unfilled orders received by manufacturers of durable goods increased by 1.1 per cent (seasonally adjusted), after declines in the three preceding months, while total orders received by all manufacturers advanced to record levels.

Following a slight August decline, nonfarm payroll employment resumed its upward movement in September, but the increase of 100,000 persons was small and was concentrated mainly in the public sector. Payroll employment in manufacturing recouped less than half its August decline. In October, total employment showed virtually no

change after seasonal adjustment, according to the Census Bureau's household survey, nor did the seasonally adjusted unemployment rate, at 5.5 per cent, change significantly. One encouraging development in the unemployment picture is the reduced rate of unemployment among married men. Unlike the aggregate unemployment rate, which has shown little net change in the past year, the unemployment rate for this group has trended generally downward throughout most of the current business expansion. At 2.9 per cent in September and October, it was at its lowest level since August 1957.

Recent gains in residential construction represent a marked improvement from the summer performance. Following a substantial decline in August, the seasonally adjusted annual rate of private nonfarm housing starts advanced by 17 per cent in September to the highest level since the current series became available in January 1959. Large—and quickly reversed—movements in housing starts are, of course, not uncommon. Nevertheless, the September gain was sufficient to pull the third-quarter average to within less than 2 per cent of the very high second-quarter average and is an encouraging development. Moreover, the seasonally adjusted index of new home permits, after two months of decline, also rose sharply in September and reached a new high. In October, outlays on residential construction rose only slightly—a leveling-off in activity associated with low housing starts in August.

Total retail sales dropped 1½ per cent in September. Although shortages of new cars were responsible for some of the weakness, there were declines in other groups as well—in contrast to some growth, apart from auto sales, in August. Preliminary data suggest that retail sales in October may have substantially recovered these losses.

Consumer spending on durables, which has remained relatively sluggish so far in 1963, is receiving support from a rising level of disposable income. The favorable outlook for such spending is supported by a study made in August and early September by Michigan University's Survey Research Center, which indicates that consumer plans to buy houses, household goods, and cars are strong. Heavy sales of new cars in October suggest, moreover, that the public's initial reaction to the new models was favorable.

The Money Market in October

The money market continued to exhibit in October about the same degree of firmness as in August and September. Federal funds traded largely at the 3½ per cent ceiling (equal to the Federal Reserve discount rate), with a sizable margin of demand for reserves being satisfied by member bank borrowings at this rate from the Federal Reserve Banks. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted in a 3⅝ to 4 per cent range during the month, but dealers found financing from nonfinancial corporations readily available at more attractive rates much of the time. Over the first two thirds of October, rates on Treasury bills maturing in 1964 moved generally higher, as the market adjusted to enlarged supplies and as some uneasiness developed over the near-term outlook for interest rates, while rates on scarce shorter maturities declined. Later in the month, bill rates generally declined on strong corporate demand in a more confident atmosphere, although in the final days rates edged up again to close not far from their earlier high points. The increased availability of corporate money apparently also prompted the major sales finance companies to reduce their rates during the month by ⅛ to ¼ of a percentage point on various maturities of their directly placed paper, but rates were increased again by about ⅛ of a percentage point near the month end. Leading New York City banks increased during the month their offering rates for new time certificates of deposit, while the range of rates at which such certificates were offered in the secondary market rose from 10 to 15 basis points and from 10 to 20 basis points on three- and six-month maturities, respectively.

After the close of business on October 23, the Treasury announced that it would offer at par about $7.6 billion of eighteen-month 3⅞ per cent notes dated November 15, 1963 and maturing on May 15, 1965, replacing a corresponding amount of certificates and notes maturing on November 15. Subscription books for the refunding were open only on October 28, with payment in the form of either cash or the two maturing securities due on November 15. The new offering was well received with sub-

The Business Situation

The full impact of the change in the Presidency on November 22 cannot, of course, be assessed as yet. Nevertheless, it appears that at the time of the change the economy had already developed sufficient momentum to assure further expansion over the months ahead. The reaction of various economic groups to the change in the Presidency conveys the impression of continued confidence in the working of our institutions, in the strength of the economy, and in the prospect for future economic gains.

This confidence partly reflects the fact that, with the final quarter of the year well under way, most measures of activity were continuing to post new advances. In October, industrial production, nonfarm payroll employment, personal income, and retail sales each rose more than seasonally. Among the various leading indicators, both housing starts and building permits rose sharply from already high levels, while new orders for durable goods also scored a good gain. Fragmentary data for November show a modest pickup in steel ingot production and a further rise in the rate of automobile assemblies. Retail sales appear to have held up well, except for a few days following President Kennedy's death.

On the other hand, assessments of the longer term picture had been somewhat mixed even before the President's assassination, with uncertainties relating particularly to the timing of a Congressional decision on tax legislation. It is thus heartening that President Johnson in his November 27 address to a joint session of Congress announced his full support of an early enactment of the proposed tax cut.

One recent study bearing on the prospects for next year, the McGraw-Hill October survey of businessmen's capital spending intentions for 1964, suggests that current plans call for no further increase in outlays beyond the annual rate of spending estimated for the final quarter of 1963 in the August survey of the Department of Commerce-Securities and Exchange Commission. On the other hand, the National Industrial Conference Board reports that capital appropriations by large manufacturing corporations were higher in the third quarter of 1963 than at any time since the first quarter of 1956. Capital appropriations for these firms have tended to lead capital outlays by six to nine months. The high third-quarter level of appropriations, following a substantial rise the quarter before, would seem to indicate more strength in capital outlays during 1964 than is suggested by the McGraw-Hill survey. The likelihood that actual spending will exceed this survey's levels would be further increased if other forces continued to push the economy upward. In this regard, it is encouraging that the Census Bureau's latest survey of consumer buying intentions, taken in October, shows that plans to purchase durable goods within six months are above the relatively high levels of a year earlier.

PRODUCTION, EMPLOYMENT, AND CONSUMER SPENDING

After declining in August and showing little change in September, the Federal Reserve's index of industrial production moved up by 0.7 percentage points in October to reach 126.6 per cent (seasonally adjusted) of the 1957-59 average. This figure very slightly surpasses the previous all-time high, reached in July. The automobile industry provided the largest single source of strength in October, as assembly of the new models moved into full swing. At the same time, producers of business equipment posted their sixth consecutive increase in output (see Chart I). It is also worth noting that iron and steel production was essentially unchanged in October, following the appreciable declines registered in the previous several months. Although steel users apparently still have some surplus inventories of finished steel products, which probably will be worked down over the balance of the year, recent reports from the trade suggest that new orders are being placed in sufficient volume to support a moderate increase in steel production in the near term (on a seasonally adjusted basis). Ingot production in November did indeed score about a 6 per cent advance over October. Auto production also posted a modest rise in November, despite a series of work stoppages.

The employment situation showed further improvement in October, as the number of persons on nonfarm payrolls rose by 92,000 (seasonally adjusted). Most of this rise was centered in the government sector—particularly

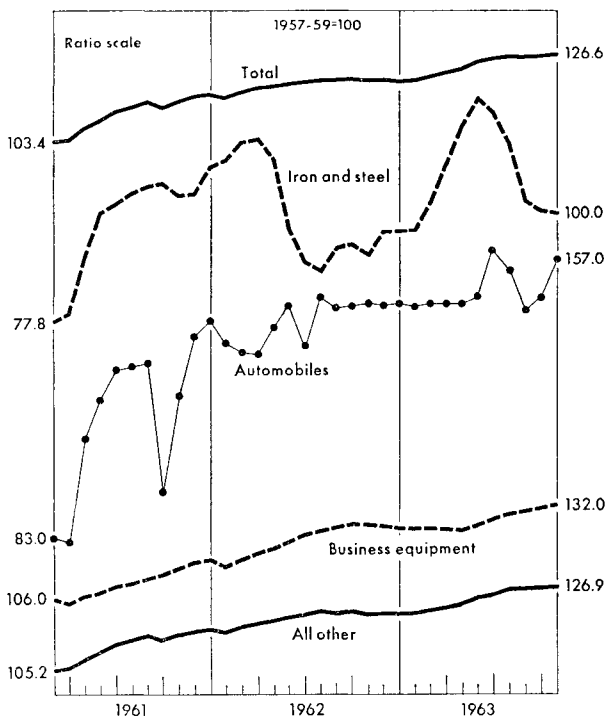
at the state and local levels—with some increases in employment in the trade and service industries as well. In contrast, employment in the manufacturing sector showed relatively little change, despite the increase in output in the month. In November total employment remained about unchanged, according to the Census Bureau's household survey. Because of an increase in the number of persons looking for work, however, the unemployment rate rose to 5.9 per cent of the civilian labor force. The number of unemployed persons has remained at 4 million or more for thirteen consecutive months.

Recent indicators of consumer spending, on balance, are more encouraging than was the case several weeks ago. Thus, after faltering in August and September, retail sales turned around in October and rose to a new record. Fragmentary data for November suggest a possible weakening of total sales. This apparent slippage, however, was probably in some part related to a few weak shopping days following the assassination of the late President Kennedy. (Most retail outlets, of course, did not open for business November 25, a day of national mourning for the late President.) Also, sales of new automobiles probably fell slightly during November. Dealers reported that the new models have been well received but that sales had been held up early in the month by shortages in popular lines. These reports on continued strength in the market for automobiles seem to be corroborated by the Census Bureau's October survey of consumer buying intentions (see Chart II). To be sure, consumer intentions surveys do not correlate very precisely with later data on actual purchases—an imprecision that appears to be even more marked for the October surveys than for those taken in other months of the year. Nevertheless, it is noteworthy that plans to buy new cars within six months were in October significantly above the level recorded in the fall of 1962 and only slightly below the all-time high reached in October 1959, while intentions to purchase used cars also showed strength. Plans to buy household durables and new homes likewise continued at a high level.

Chart I

RECENT DEVELOPMENTS IN INDUSTRIAL PRODUCTION

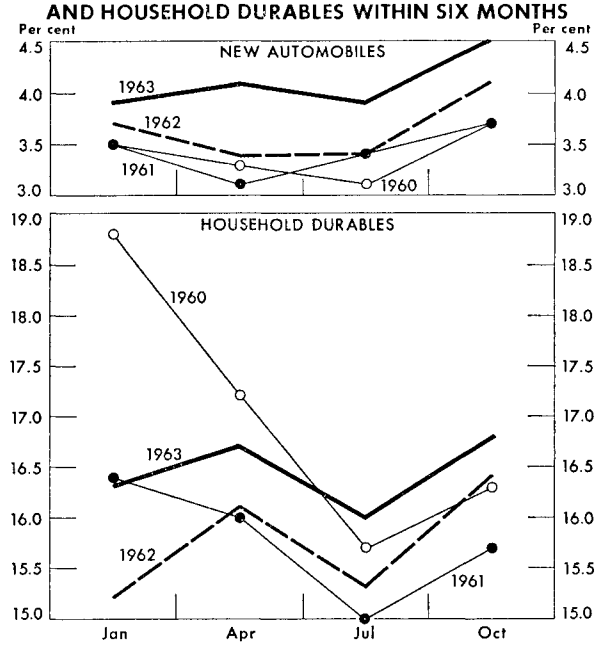
Seasonally adjusted monthly data



Source: Board of Governors of the Federal Reserve System.

Chart II

CONSUMER INTENTIONS TO BUY NEW AUTOMOBILES AND HOUSEHOLD DURABLES WITHIN SIX MONTHS



Note: Buying plans are expressed as the ratio of the number of families who indicate they intend to buy to the total number of families in the survey.

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

PLANT AND EQUIPMENT SPENDING IN 1964

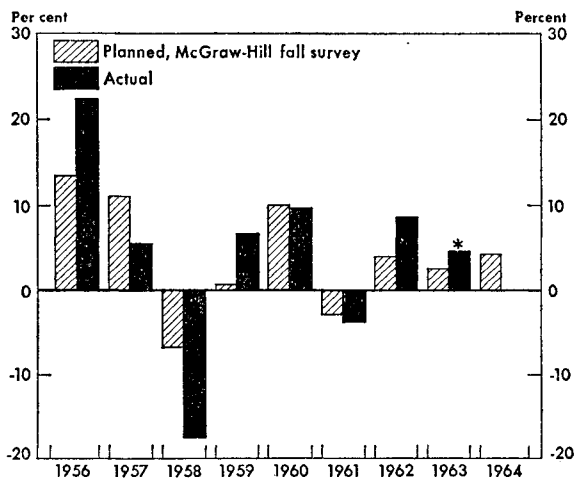
In assessing the prospects for continued over-all economic expansion in 1964, much attention has been focused on the likely course of spending for new plant and equip-

ment. The first impression of capital spending plans for next year, derived from the October McGraw-Hill survey, appears to have been one of disappointment to many observers. The survey indicated that businesses in the aggregate were planning to spend only about $41 billion for plant and equipment in 1964—4 per cent more than the estimated amount of such spending for 1963 as a whole, but actually slightly below the planned rate of spending for the current quarter adjusted to an annual rate basis.

Upon closer examination, however, the picture is somewhat more encouraging. Past experience suggests that the McGraw-Hill fall surveys have tended to be very reliable in predicting the direction of change in capital spending but have tended to understate the amount of increases by considerable margins. Thus, in each of the years since 1955 for which the McGraw-Hill fall survey pointed toward a rise in capital spending an increase was in fact realized (see Chart III). However, the rate of increase actually rung up in such years exceeded the projected advance by an average of about 2½ percentage points. The difference between the actual amount of gain in capital outlays, compared with that shown by the survey, is even more pronounced in years of continually rising over-all economic activity. Some respondents to the survey have already indicated that their capital outlays will probably exceed present plans if the proposed tax cut is passed. It is also worth noting that this year's survey included a much larger representation of smaller firms in the sample than had been the case in previous years. There is some evidence that small firms do not tend to make very definite long-range plans for capital spending, which suggests that the latest survey may have had an even larger downward bias than those taken in some past years.

Chart III

YEAR-TO-YEAR PERCENTAGE CHANGES IN PLANNED AND ACTUAL CAPITAL SPENDING



* Estimated by United States Commerce Department and Securities and Exchange Commission.

Sources: United States Department of Commerce, Securities and Exchange Commission, and McGraw-Hill Publishing Company.

About 80 per cent of the McGraw-Hill survey's projected increase in capital spending for 1964 is accounted for by the manufacturing sector, where the largest push is expected to come from the iron and steel industry. Although utilization of over-all capacity is relatively low in this industry at present, there may be some need for additional finishing mill capacity. Furthermore, competitive pressures—both from foreign steel producers and from alternative products—have increased the need for modernization. It is also possible that several industries which in September were already very near to their preferred operating rates—most notably textiles and petroleum and coal products—may find it necessary to revise upward their relatively modest 1964 capital spending plans should sales turn out well. The only industries that reported significant reductions in planned capital outlays in 1964, compared with 1963, were the railroads and manufacturers of transportation equipment. However, the railroads have frequently noted a shortage of modern rolling stock and other equipment, which in the past several weeks has become even more pressing. This development, in turn, could cause some upward revision in their planned 1964 capital spending.

factor that normally provides strength to the lira during the summer months. Until they diminished in September, these influences essentially offset the large underlying Italian trade deficit, which was widening during the year partly as a result of price and wage pressures in that country. In September and October, a significant capital outflow from Italy occurred, primarily in connection with continued domestic political uncertainties, and the lira rate began to decline. The rate soon steadied—at some cost in official Italian reserves—and the capital outflow gradually diminished toward the year end after the new cabinet had been formed.

OTHER CURRENCIES

The Japanese yen remained close to its lower limit against the dollar throughout the second half of the year. Small fluctuations in the rate reflected mainly variations in Japanese borrowing abroad to help finance both new domestic investment and the country's current-account deficit. During the period, a considerable part of these borrowings was effected through the Euro-dollar market, but when that market tightened late in the year some Euro-dollar funds were withdrawn from Japan. In response to this development and to domestic inflationary pressures, the Bank of Japan in December permitted selective increases in ceiling rates on Euro-dollar borrowings and imposed higher reserve requirements against domestic demand and savings deposits. In response to these measures, the yen strengthened toward the year end.

In October, the government of China (Taiwan) unified the Formosan exchange rate system by abolishing the complicated system of exchange certificates and by establishing an official selling rate of NT$40.10 to the dollar; the official buying rate was held at NT$40.00 to the dollar, which had been in effect since early 1961. Also in October, the Government of Thailand established a par value for the baht—B20.80 to the dollar—in agreement with the International Monetary Fund. The new par value corresponds to what had been the prevailing rate against the dollar for over a year. In November, the Republic of the Congo (Leopoldville) devalued the Congolese franc from CF64 to the dollar to buying and selling rates of CF150 and CF180, respectively. The spread between the buying and selling rates is designed to provide additional revenue to the Congolese government.

The Business Situation

Economic activity continued to advance as 1963 came to a close. Industrial production and nonfarm payroll employment both edged up in November. Steel and automobiles continued to show strength in December, and retail sales appear to have recovered following the small decline a month earlier. The December evidence is, of course, still fragmentary. Nevertheless, the statistics now available confirm the view that the change in the Presidency has had little effect on underlying business performance and expectations.

Prospects for further gains in business activity in 1964 remain good. At the same time, however, the business outlook is not completely unequivocal. Housing starts and new orders for durable goods both fell off in November; however, movements in these series are often erratic, and the November declines were from very high levels. One factor boosting payrolls in the fourth quarter—the rise in military pay scales—will not, of course, provide any further upward push in 1964. The latest Department of Commerce-Securities and Exchange Commission survey of businessmen's capital spending plans is also somewhat disappointing, since it implies a leveling-off in outlays for plant and equipment in the first quarter of the new year. On the other hand, the survey points toward a marked increase in such expenditures during the second quarter, which may indicate that there has been some upward revision in over-all spending plans for 1964, compared with those reported by the McGraw-Hill survey a month earlier. The outlook for such an upward revision would be improved if consumer spending

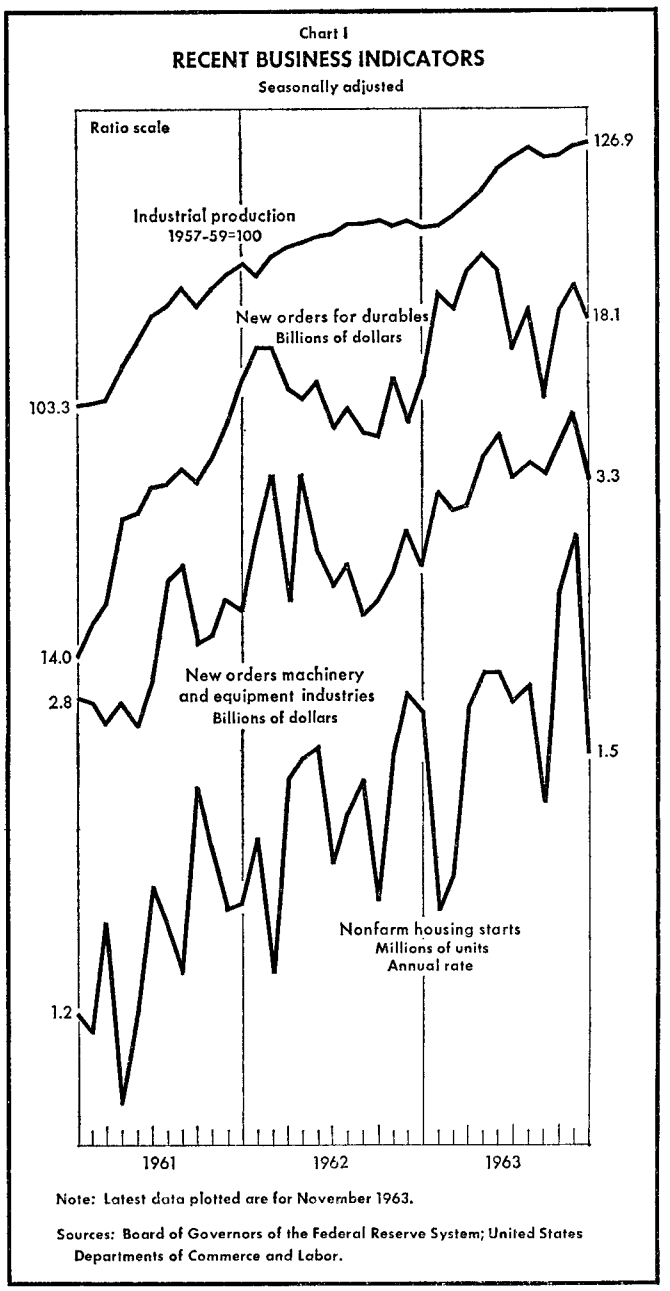
turns out to be as strong as current buying intentions suggest and, of course, by an early enactment of the proposed tax reduction.

PRODUCTION, EMPLOYMENT, AND RETAIL SALES

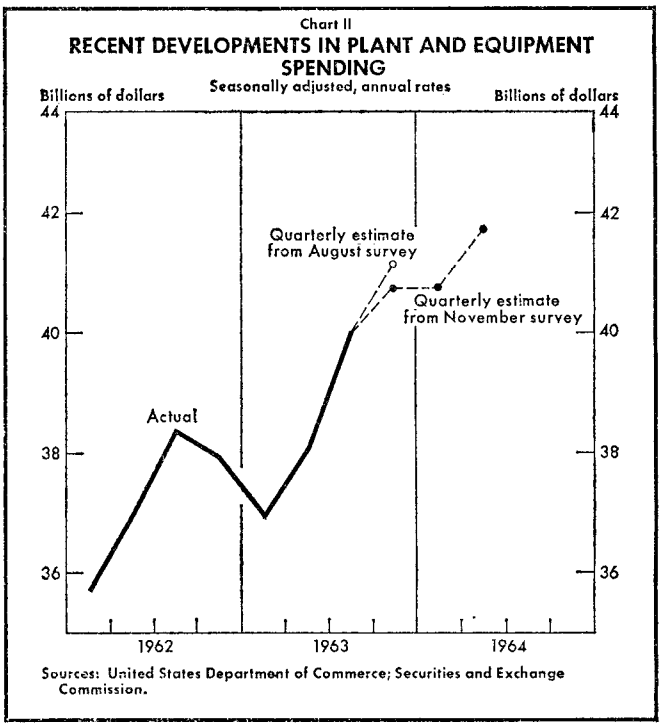
Industrial production, as measured by the Federal Reserve's index, edged further ahead in November (see Chart I) to 126.9 per cent of the 1957-59 average (seasonally adjusted). Steel provided most of the push, as output in this industry moved up for the first time in six months, but other durable goods industries—including those producing business equipment—also showed some gains. Steel ingot production advanced further in December and, for the year as a whole, is estimated at 109 million tons. This level of output—higher than any year since 1957—was reached despite record steel imports in recent months. Moreover, steel inventories appear to be about in line with desired levels and only a little higher than a year earlier, and industry reports suggest that the orders picture is strong. Thus, prospects would seem to be favorable for a prolonged high level of steel output in the months ahead. December automobile assemblies remained at the high November level on a seasonally adjusted basis. This brought total 1963 output to 7.6 million units, the best year since 1955. Preliminary schedules for January point to some decline in output from the high December level.

In November, one indicator giving some information on future production—new orders received by manufacturers of durable goods—did decline. Most of this fall off, however, was attributable to a drop in orders for transportation equipment. Orders received by other durables industries edged down only slightly, on balance. These orders had shown an unusually large gain in the previous month and therefore were still at relatively high levels in November. The November decline in orders for durables was offset in part by a recovery in orders for nondurables to record levels, following three months of decline.

Nonfarm payroll employment (seasonally adjusted) rose by 41,000 persons in November, largely reflecting increases in the number of persons at work in the trade, finance, services, and government sectors. At the same time, there was some contraction in manufacturing employment despite increases in industrial production. During the first eleven months of last year, unemployment averaged 5.7 per cent of the civilian labor force, a level that was slightly above the 1962 average. Indeed, the only previous postwar years to show such a high over-all unemployment rate were years directly associated with economic recession. The rise in over-all joblessness in 1963 reflected somewhat higher unemployment among adult single males and adult women, and a substantial rise in unemployment among teen-agers. On the other hand, the employment situation for married men improved fairly steadily throughout 1963 despite a November setback; the unemployment rate for this group through November thus averaged 3.3 per cent, compared with 3.5 per cent in 1962. This suggests that cases of pressing economic hardship may possibly have been somewhat less widespread than a year earlier.



In contrast to the November gains in production and employment, retail sales slipped about 1 per cent on a seasonally adjusted basis in that month. This decline, however, was in large part attributable to the sluggishness of sales in the several days immediately following President Kennedy's assassination. Most stores were, of course, closed on November 25, the national day of mourning, and total retail sales in that week fell 8 per cent below the comparable period a year earlier. Weekly totals during the early part of December suggested a virtually complete recouping of the late November declines, and sales for December as a whole appear to have risen about 3 per cent (seasonally adjusted) from November while also setting a new Christmas season record. Part of the December push came from a rise in sales of new automobiles that brought total car sales in the United States (including imports) for the year to more than 7½ million units, an all-time high.



HOUSING AND PLANS FOR CAPITAL SPENDING

In the housing sector, a decline in the number of starts in November appears to be at least in part simply an aftermath of the surge that occurred in September and October. Unusually warm weather permitted outdoor work to continue at more than the normal pace, with the result that some September and October starts were probably "borrowed" from later months. In spite of the sharp drop in November, the average level of starts for the last three months was at a record for any three-month period, suggesting that residential construction activity over the next few months should be at a high level.

The latest survey of capital spending plans, conducted in November by the Commerce Department and the Securities and Exchange Commission, shows a somewhat mixed picture. Although the survey reported an estimated rise in total outlays for plant and equipment of $750 million (seasonally adjusted annual rate) in the final quarter of the year—from $40 billion to $40¾ billion—this was appreciably less than the amount of increase for the fourth quarter that had been indicated by the August survey (see Chart II). The downward revision in fourth-quarter outlays planned earlier is largely attributable to a shortfall in spending by commercial and communications firms. This category includes outlays for construction of new shopping centers, which according to some observers is now passing its peak. Manufacturers' estimated capital spending in the fourth quarter, however, was also slightly less than planned earlier.

The survey also pointed toward a leveling-off in total capital outlays in the first quarter of the new year, with sluggishness rather widespread among all industries. A more encouraging sign, on the other hand, is the fact that preliminary plans for the second quarter call for about a $1 billion increase in total capital expenditures over the first-quarter level. To be sure, manufacturers anticipate only a small rise in outlays in the second quarter—an increase that appears to be about in line with their full-year plans as reported in the recent McGraw-Hill survey. This survey, it will be recalled, suggested that manufacturers were planning 1964 outlays about 8 per cent over the 1963 average, but had indicated marked weakness in capital spending by the nonmanufacturing sector for 1964 as a whole. The new Commerce-SEC survey, in contrast, found that the nonmanufacturing sector is planning on a sharp rise in the second quarter following a first-quarter decline. This latest survey would thus seem to suggest that the capital spending plans of the nonmanufacturing sector may have been revised upward since the McGraw-Hill survey was taken. It must be recognized, however, that the Department of Commerce and the Securities and Exchange Commission have for the first time undertaken to release projections of spending plans so far into the future. There is as yet limited experience for assessing the outcome of this welcome attempt to extend a key statistic in the appraisal of business prospects.

an extremely flexible and informal manner, so as best to achieve the Gold Pool's objectives.

As the accompanying table shows, the Gold Pool has stabilized prices within the range that had been customary before the October 1960 flare-up. Such price stability and the maintenance of orderly market conditions have brought substantial benefits to the entire international financial system. Speculative demand has diminished and more gold has gone into official reserves than would otherwise have been the case. The main point, however, is simply this: the very fact that the central banks are working together in the gold market, as well as in the foreign exchange markets, has strongly reinforced confidence in the existing international financial structure.

The Business Situation

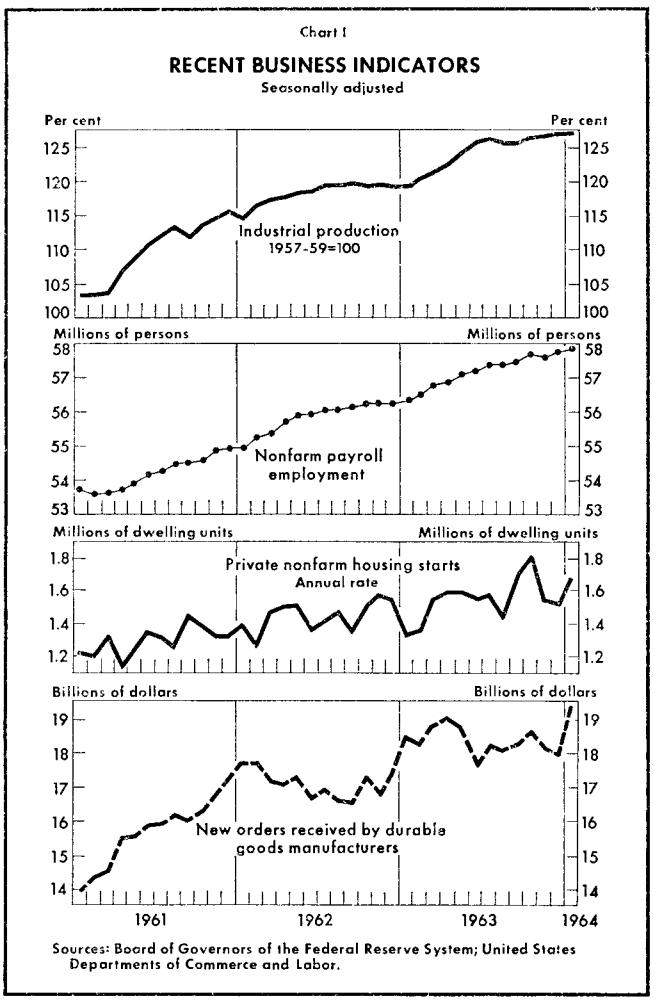
The economy continued to operate at a high level in early 1964, and the existing uncertainties in the business outlook related mostly to the likely pace of future advance. To be sure, industrial production and retail sales were about unchanged in January and nonfarm payroll employment rose only moderately. Personal income moved up, but mainly because of a concentration into January of veterans' annual insurance dividend payments and the effects of the second stage of a Federal pay increase. Partial data for February suggest only slight increases in auto and steel production and little change in new-car sales or over-all retail volume. On the other hand, the tax cut has finally been enacted, with the reduction in withholding rates becoming effective on wages and salaries paid on or after March 5, and some of the leading business indicators point toward increased strength. In particular, nonfarm housing starts and new orders for durable manufactured goods rose substantially in January, and a Census survey taken that month suggests that consumer buying plans were generally stronger than a year earlier. Moreover, a special McGraw-Hill survey conducted in January confirmed impressions that prospects for a substantial rise in plant and equipment spending by business were decidedly better than had been indicated in plans reported last fall.

PRODUCTION AND EMPLOYMENT

The seasonally adjusted index of industrial production in January remained at the record level of 127 per cent of its 1957-59 average (see Chart I). Output declined slightly in the case of nondurable goods, but climbed a bit in utilities, mining, and durables manufacturing. The rise in the durables sector largely reflected a sizable step-up in steel ingot production—to the highest level since June—and expanded output of furniture and television sets (for which the continued widening of interest in color receivers may account in part). Equipment production also moved up again, bringing to 7 per cent the increase in this component since the 1963 low of last April. On the other hand, the rate of auto assemblies declined somewhat in January, although it remained substantially above the year-ago pace.

Preliminary data for February indicate that cars were rolling off the assembly lines at a modestly higher rate than in the previous month. Seasonally adjusted steel ingot production continued to rise, reflecting broadly based increases in customer demand. The Commerce Department has estimated that steel manufacturers may produce 114 million tons of ingots in 1964—well above the 1963 figure of 109 million tons but about in line with early 1964 rates of output.

Nonfarm payroll employment showed a moderate expansion of 87,000 in January, after adjustment for normal seasonal variations (see Chart I). This was a somewhat smaller rise than in December, mainly because payroll employment in the building trades fell by some 70,000, influenced by snowstorms during the survey week in January. On the other hand, employment in trade, services, and



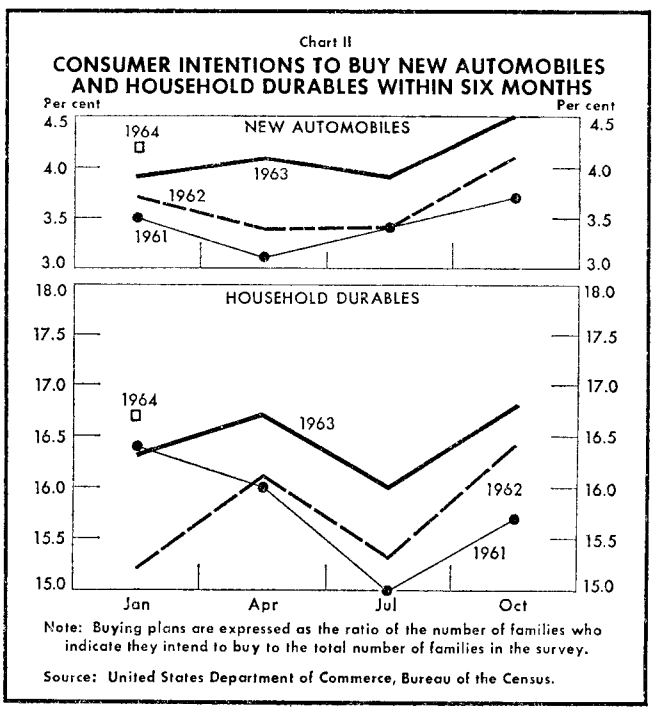
state and local government—the sectors in which job growth has been greatest during the past year and, indeed, during the past decade—continued to rise significantly. State and local government payrolls have shown a sharp over-the-year increase, primarily as a result of the increased hiring of educational personnel to meet the needs of the expanding school population.

INDICATIONS OF FUTURE DEMAND

After a sizable rise in December, retail sales remained about the same in January and apparently also in February. The likelihood of future strength in consumer spending is suggested by the latest quarterly survey of consumer buying intentions taken by the Census Bureau in January, when the tax cut appeared likely but may not yet have been viewed as a certainty. That survey indicated that the proportion of respondents planning to purchase a new car within six months was somewhat above the already high rate reported in the January 1963 survey (see Chart II). Intentions to buy household durables also showed some rise from a year earlier, but plans to buy used cars fell below the high level reached in January 1963. Buying intentions are, of course, never a precise predictor of sales in the months ahead. Nevertheless, they do at times suggest the direction of year-to-year changes in sales. This was the case in the January 1963 survey, although the estimated degree of rise over the year earlier turned out to be somewhat conservative for new-car purchases and a little optimistic for household durables.

The near-term outlook for residential construction also appears rather favorable in view of a considerable increase in January in the number of nonfarm housing units started (see Chart I). Such an advance was not totally unexpected in light of the very high fourth-quarter rate of building permits issued, which largely reflected the continued uptrend in planned apartment construction. Although permits for new apartment houses fell off somewhat in January—more than offsetting the slight increases for smaller structures—the backlog of unused permits apparently continues to be quite sizable.

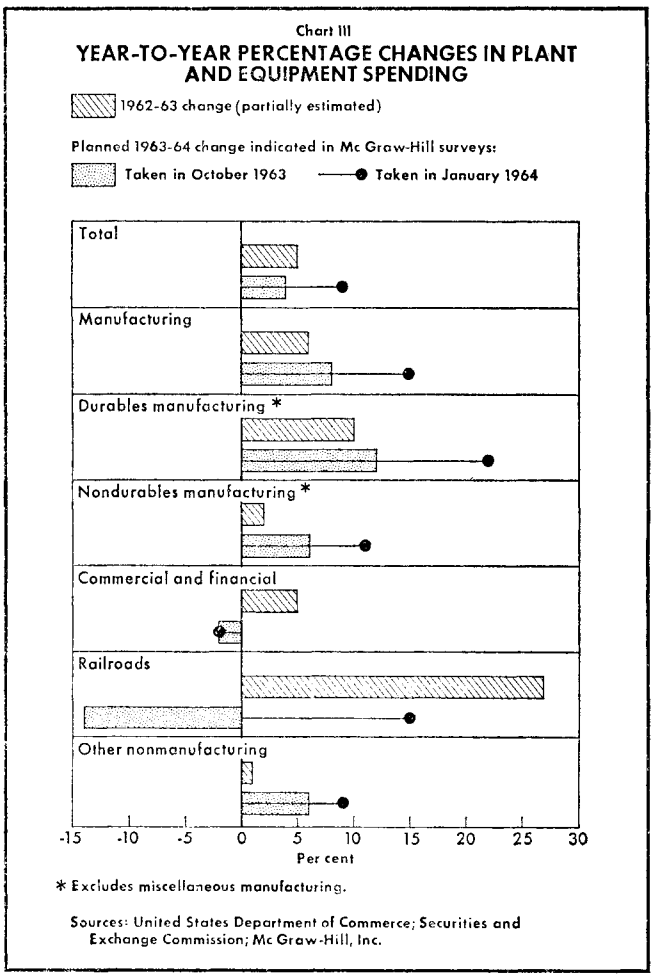
New orders received by manufacturers of durable goods advanced substantially in January, thus more than recoup-



ing the declines of the preceding two months (see Chart I). The January rise was widespread, although much of the gain came in the aircraft industry—which had experienced a rather sharp decline in the preceding three months—and in the primary metals industry. Orders received by machinery and equipment manufacturers were about maintained at December's record level, following a sizable advance from November. This strong showing, coupled with the December-January strengthening in contract awards for commercial and industrial construction, points to impending rises in plant and equipment expenditures.

A strengthening in the outlook for capital spending this year appears to be corroborated by a special McGraw-Hill survey, conducted in January, which shows that businessmen's capital spending plans have been revised substantially upward since last fall. Thus, it seems likely that business fixed investment may provide more push to the economy this year than it did in 1963 (see Chart III). The new survey indicated that businessmen plan an 8.7 per cent year-to-year increase in plant and equipment expenditures in 1964, rather than only the 4.2 per cent rise suggested in McGraw-Hill's fall survey taken last October. The upward revisions were widespread, with the largest step-ups occurring in the durables manufacturing sector and the railroad industry. In the commercial sector, however, plans continued to point to some weakness, with outlays here scheduled to slip slightly below 1963 levels. The over-all rise now planned for 1964 compares favorably with the increases in capital spending actually achieved in most recent years of economic expansion, though it falls far short of the 22 per cent advance registered in the investment boom year of 1956.

While the results of the latest McGraw-Hill survey are encouraging, it is difficult to assess precisely what they mean for capital spending in the year ahead. Some step-up in over-all plans since last October might have been expected, given the generally optimistic business sentiment associated with the tax cut and rising corporate profits as well as the above-noted recent strengthening in machinery and equipment orders and in construction contract awards. Indeed, when the fall survey has pointed to an increase in capital expenditures, it has tended to underestimate the actual extent of the rise—and at times by a sizable amount. On the other hand, the other regular McGraw-Hill survey—usually taken in March and early April—has generally been somewhat too optimistic. Since this year's January survey is the first conducted in that month, it has no antecedents to suggest its performance as a predictive guide.



The need for some continued caution in interpreting the outlook for capital spending is highlighted by the fourth-quarter decline in capital appropriations of large manufacturing corporations, as reported by the National Industrial Conference Board. Even with the decline, however, appropriations were still at the second highest level reached in recent years, though somewhat below the 1955-56 record. Additional information on plant and equipment spending prospects will be provided in the quarterly survey by the Commerce Department and the Securities and Exchange Commission, taken in February, which is to be released shortly.

ernors of the Federal Reserve System might prescribe. The enactment of this legislation would minimize the possibility that banks might not be able, for want of collateral, to borrow at the regular discount rate to meet legitimate needs.[3]

There is a risk, however, that another obstacle to the use of customer paper as collateral might arise from the reluctance of many banks to use such paper. This attitude was highlighted on occasions in the recent past when certain Second District banks, short of Government securities but holding eligible paper, reportedly refrained from using such paper—either to obtain accommodation at the discount window in times of legitimate reserve needs, or to serve as collateral for Tax and Loan Accounts.

The reluctance appears to have been caused by some concern on the part of the banks that their customers might react unfavorably to the use of their paper as collateral. Customer paper is usually made payable to the order of the lender; and to be effectively pledged in negotiable form, either as collateral for an advance or for a Treasury Tax and Loan Account, "order paper" must be endorsed. This endorsement, in turn, eventually indicates to the bank's customer that his paper has been used as collateral. Some bank customers reportedly have indicated that they would tend to question the managerial capacity of a bank that might find itself in a position of being required to use their paper as collateral.

In actual fact, such a conclusion is entirely unwarranted. If the use of the discount window is appropriate by Federal Reserve standards, it is immaterial whether the advance is secured by Government securities or by eligible paper. Similarly, the securing of Treasury Tax and Loan Accounts by commercial and agricultural paper does not in any way reflect unfavorably on the management or financial position of a bank which thus employs it. For convenience, the bank is merely using customers' notes in lieu of some other form of collateral.

Prior to accepting a given piece of customer paper as collateral for an advance, Federal Reserve Banks also consider the financial condition of the original borrower. As a result, in earlier years, when it was common for a customer's paper to be discounted or used as collateral, the acceptance of such paper by the Federal Reserve was traditionally regarded as indicative of that customer's favorable credit standing. This implication is apparently overlooked by the borrowing bank's customer who today objects to the transfer of his paper.

The discount mechanism plays an important role in facilitating member bank operations and in the smooth implementation of monetary policy. Possible misconceptions on the part of banks and their customers regarding the implications of using eligible paper as collateral should not interfere with the proper functioning of this mechanism.

[3] Actually, under Section 10 (b) of the Federal Reserve Act, any Federal Reserve Bank may make advances to any member bank on that bank's note secured to the satisfaction of the Federal Reserve Bank, but at a rate not less than ½ of 1 per cent per annum higher than the discount rate in effect.

The Business Situation

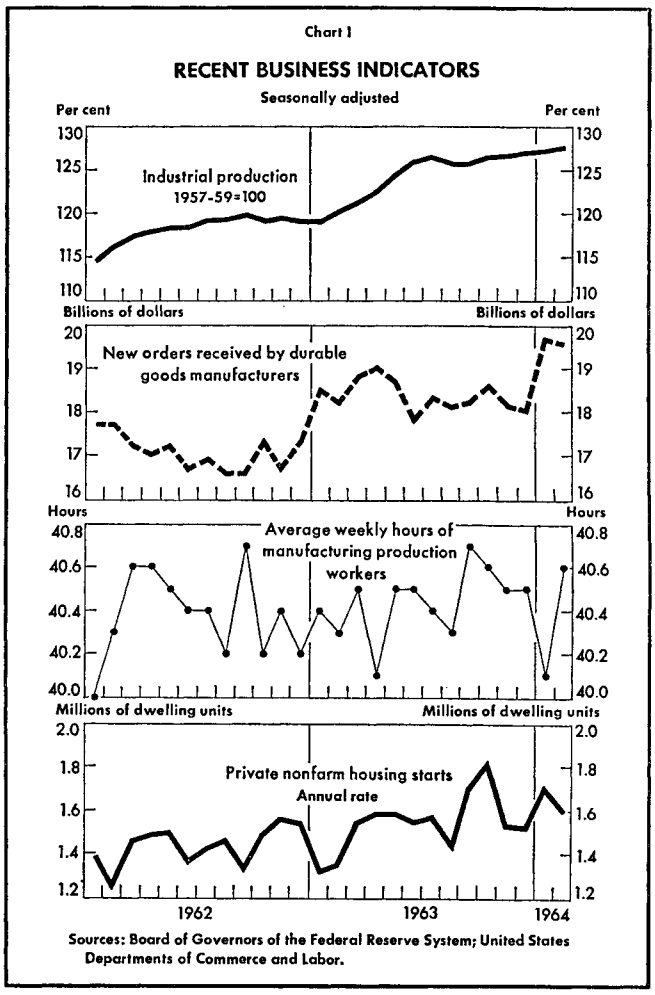
Economic activity was continuing to expand as the first quarter drew to a close, and business sentiment remained confident of substantial further gains in the months ahead. Industrial production inched ahead in February, payroll employment rose considerably, and average hours worked recovered to the advanced December level. Although still high, the unemployment rate edged down in February to its lowest point in over a year and was maintained at that rate in March. Retail sales appear to have fallen off somewhat from their record February level, while preliminary production data for March are somewhat mixed.

One key factor in the current strong business outlook is the prospect for capital spending. Expanded capital spending programs have recently been announced by several large firms, and—according to the latest Government survey—businessmen as a group plan to increase their outlays for plant and equipment by 10 per cent in 1964. This figure confirms (indeed, slightly exceeds) the year-to-year increase in planned spending reported by McGraw-Hill following a special survey taken in January.

Manufacturers' inventory plans for the second quarter call for a rate of accumulation higher than in the first quar-

ter and about the same as achieved in the final quarter of 1963. Although new orders received by durables manufacturers in February only about matched their January record, they were still above sales, so that the backlog of unfilled orders rose for the second month in a row.

Price-wage developments thus far in 1964 have continued to be highlighted by a number of announcements of price increases for certain industrial commodities, as well as by preliminary discussion of bargaining positions to be taken in key labor negotiations later in the year. Developments in these areas will clearly bear close watching in a generally expansionary economic environment. As in 1963, however, movements in the over-all price indexes have been moderate; indeed, the over-all consumer price index actually edged downward in February. Wholesale food prices fell off in February and apparently were about unchanged in March, while the index for industrial wholesale prices has remained stable since December.



PRODUCTION, EMPLOYMENT, AND RETAIL SALES

The Federal Reserve Board's seasonally adjusted index of industrial production edged upward in February to a record level of nearly 128 per cent of the 1957-59 average (see Chart I). A strike in the farm machinery industry during most of February caused a decline in equipment production, and mining output also fell slightly. These decreases, however, were more than offset by relatively sizable gains in automobile assemblies and iron and steel production, combined with somewhat smaller increases in output of nondurables manufacturers and utilities. With dealer inventories of new cars at a record level, preliminary data for March, after making allowance for seasonal factors, suggest that automobile producers are cutting back assemblies somewhat from their exceptionally high February level. Steel ingot production, on the other hand, remained as strong in March as in February. The outlook for additional increases in over-all industrial production was strengthened by the continued advance in February in the backlog of unfilled orders held by manufacturers of durables. Although the volume of incoming new orders actually slipped a bit in February, it was still at the second highest level on record, with the January-February average for new orders well above the level reached in the final quarter of 1963 (see Chart I).

Nonfarm payroll employment rose by 280,000 persons in February (seasonally adjusted). This gain, the largest in nearly two years, in large part reflected a substantial rebound in construction employment following a January decline. At the same time, however, employment in all other major sectors save mining showed some increase in February. In the manufacturing sector, for example, payrolls rose by 55,000 persons, while the average workweek clocked by production workers moved up to 40.6 hours (seasonally adjusted). This increase raised the average workweek once more to the high level that, except for January, has prevailed in the last six months (see Chart I). Hours of overtime are reportedly above the year-ago level in many manufacturing industries, and it is possible that further output gains may to an important extent be translated into increased hirings. Such a development, of course, would tend to reduce unemployment, which according to the Census Bureau's household survey edged down to 5.4 per cent of the civilian labor force in February and remained at that level in March. This rate is at the lower end of the range of unemployment that has prevailed during the past two years. The decline from January reflected small but rather widespread improvements among the vari-

ous groups in the labor force; in particular, unemployment among married men edged down, and teen-age unemployment reached its lowest level in over a year.

Retail sales increased substantially in February, with most of the push coming in sales of durables. Preliminary data suggest a possible drop in over-all retail sales volume in March, though there have been reports of good pre-Easter sales of apparel and other spring merchandise. The tax cut affected consumer take-home pay during the month, since it went into effect with the first pay checks received on and after March 5, but it is too early to appraise the impact of this factor on retail sales. Furthermore, the variability of the date of the Easter holiday always makes assessment of sales figures at this time of the year somewhat difficult.

Despite what appears to have been a slight decline in March, sales of domestically produced cars for the first quarter as a whole were at a seasonally adjusted annual rate of about 7.8 million units—a level somewhat above the pace that most manufacturers had forecast. With auto sales already at such high levels, some observers have expressed skepticism as to the possibility of substantial further gains even with the tax cut. Nevertheless, a Census Bureau survey of consumer buying intentions taken in January showed that plans to purchase new cars within the next six months, and within the next twelve months, were both higher than at the start of 1963 (see March *Review*). The results of the latest University of Michigan survey of consumer buying attitudes—conducted about the same time as the Census Bureau survey but covering a different (and smaller) sample of households—suggest that consumers generally regarded the next six months as a good time to buy. The Michigan survey also indicated, however, that plans to purchase new cars within twelve months were noticeably lower than a year earlier—a result at variance with that of the Census survey.

RESIDENTIAL CONSTRUCTION AND INVENTORIES

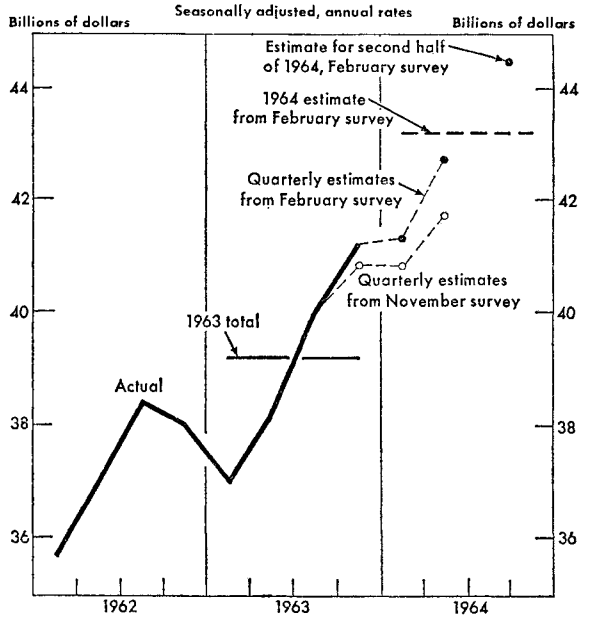
Activity in the housing sector has continued at a high level, as residential construction outlays edged up for the third month in a row in March. For the first quarter as a whole, outlays were 1 per cent above the advanced level reached in the fourth quarter of 1963. Although housing starts fell off by 6 per cent in February (see Chart I), the average for the first two months of this year was actually above that in the final quarter of last year—a quarter that included a record level of starts in October. Some further gain in outlays may therefore be in prospect, a view supported by a sharp rise in the number of new building permits issued in February.

As regards business inventories, a Commerce Department survey taken in February suggests that manufacturers planned an inventory increase of only $300 million in the first quarter of 1964, a substantial drop from the $1 billion recorded in the last quarter of 1963. Plans for the second quarter, however, call for an accumulation once again of $1 billion. These planned additions to stocks are about in line with manufacturers' sales expectations, and point to a second-quarter inventory-sales ratio that is virtually the same as that prevailing at the end of 1963—a level that manufacturers holding 85 per cent of the inventories covered in the Commerce survey judged to be about right. Except for a good part of 1962, manufacturers' inventory-sales ratios have declined rather persistently throughout the current expansion. Earlier cyclical expansions, in contrast, showed some recovery in inventory-sales ratios following an initial period of decline.

CAPITAL SPENDING

The economic outlook has received a major boost from evidence of developing strength in businessmen's capital spending plans. The February Commerce Department survey (undertaken jointly with the Securities and Exchange Commission) points toward a rise in plant and equipment

Chart II
ACTUAL AND ANTICIPATED PLANT AND EQUIPMENT SPENDING
Seasonally adjusted, annual rates



Sources: United States Department of Commerce; Securities and Exchange Commission.

outlays in 1964 that is larger in both absolute and percentage terms than any of the actual annual gains since the advance recorded in the investment boom year of 1956. A special McGraw-Hill survey taken in January already had confirmed that spending plans had been revised upward substantially since first reported last fall, and these findings are now reinforced by the 10 per cent rise shown in the Government survey.

Actual spending in the fourth quarter of 1963 turned out to be somewhat higher than had been indicated in the Government's survey taken last November (see Chart II). A similar upward revision is evident in the estimated level of spending for the first quarter of this year, but this revision still implies little change over the fourth-quarter level. Plans for the second quarter of 1964 call for an increase in outlays of nearly $1.5 billion, or 3½ per cent over the first quarter; and, if the projected full-year total is to be reached, outlays in the second half of 1964 will have to climb about 6 per cent above the first-half average. The record of this survey in previous years suggests that plans reported at the beginning of the year are in large part carried out—indeed bettered in years of business expansion. The understatement in the February survey was, however, rather small for 1962 and 1963.

The Money Market in March

The money market remained generally firm in March, handling smoothly the large flows of funds associated with the quarterly corporate tax and dividend payment dates and the impending April 1 Cook County, Illinois, personal property tax date. Although the reserve positions of banks in the leading money centers came under moderate pressures at times during the month, these banks were able to satisfy a large part of their reserve needs in the Federal funds market—where a 3½ per cent effective rate generally prevailed—and member bank borrowings from the Federal Reserve Banks declined slightly over the period as a whole. Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were mainly in a 3¾ to 4 per cent range. Offering rates for new time certificates of deposit issued by the leading New York City banks moved slightly higher in March, as did the range of rates at which such certificates were offered in the secondary market. Rates on some maturities of directly placed finance company paper also rose moderately over the month as a whole.

In the Treasury bill market, demand expanded in March and bill rates receded somewhat from the levels to which they had risen in late February in the wake of the British bank rate increase. Prices of Treasury notes and bonds, on the other hand, declined during most of the month, reflecting market expectations that interest rates would trend upward during the remainder of the year if economic expansion continued and rates moved higher in foreign countries. The same sentiment was evident in the corporate and tax-exempt bond markets, and prices in these markets also moved downward during the period.

After the close of business on Thursday, March 26, the Treasury announced the terms of a new cash borrowing operation. An additional $1 billion of the outstanding 3⅞ per cent notes due August 13, 1965 was offered at a price of 99.70 to yield approximately 4.10 per cent. Subscriptions were received only on Tuesday, March 31, with payment due April 8. Payments may be made through credit to Treasury Tax and Loan Accounts. (At the same time the Treasury announced another in the series of one-year bills—$1 billion of bills maturing March 31, 1965, to be auctioned April 3 for payment April 8, with commercial banks permitted to pay for 50 per cent of their purchases through crediting Tax and Loan Accounts.)

After the close of business on April 2, the Treasury announced that early reports indicated subscriptions for the reopened 3⅞ per cent notes of approximately $10.2 billion. The Treasury will allot in full subscriptions of $50,000 or less. Larger subscriptions will be subject to a 9 per cent allotment (with a minimum of $50,000).

BANK RESERVES

The month was characterized by sizable week-to-week movements in aggregate free reserve levels. These reserve fluctuations were not accompanied by any similar swings in

The Business Situation

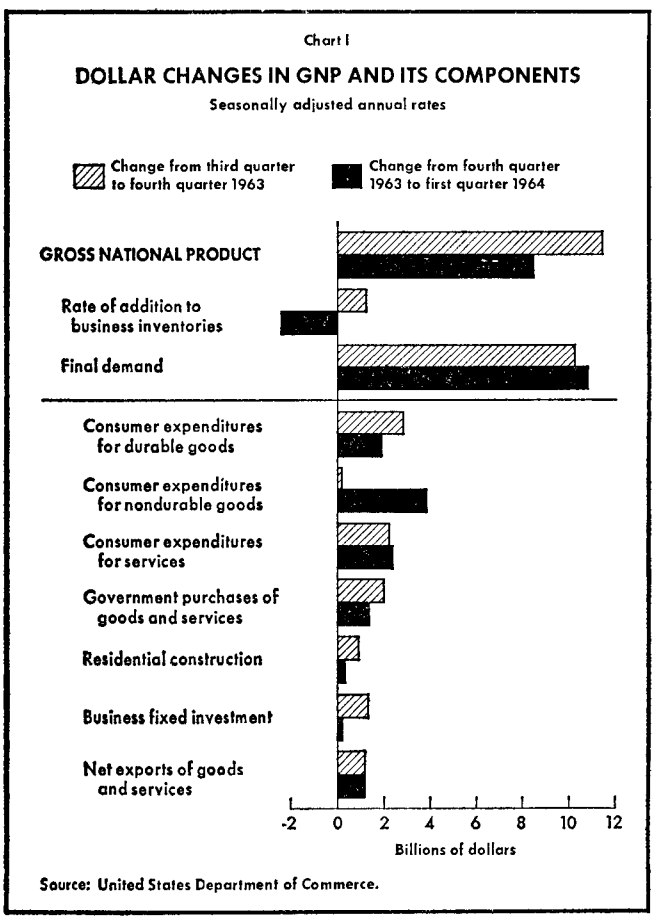
As the economy moves into the seasonally active spring months, the prospects remain good that further business gains will extend the duration of what is already the longest expansion since the Korean War. Industrial production and nonagricultural employment both advanced further in March in an economic atmosphere that remained essentially free from inflation. Indeed, broad price measures have remained virtually steady in spite of a recent upturn of some sensitive materials prices. For the first quarter as a whole, total output of goods and services reached a seasonally adjusted annual rate of $608.5 billion, higher than had generally been expected. Retail sales apparently edged off again in April, but both steel ingot production and automobile assemblies recorded considerable gains. Business sentiment, as reflected in plans for capital spending, continues to be optimistic: the regular spring McGraw-Hill survey reports a 12 per cent rise in planned capital outlays this year, slightly more than the increases reported by surveys taken earlier this year.

The recent settlement of the long railroad industry dispute has removed one of the major uncertainties in the economic outlook. Other important labor negotiations, however, still lie ahead—most notably in the automobile industry in August—and their results will have an important influence on the outlook for price stability and on the pace of economic advance. With a generally expansionary economic environment, there will be a continued need for businessmen and labor unions to exercise restraint in wage and pricing decisions.

RECENT DEVELOPMENTS IN KEY DEMAND SECTORS

Gross national product rose by $8.4 billion in the first quarter of 1964, according to preliminary estimates of the Department of Commerce (see Chart I). This gain was only a little less than the sizable increases in the last two quarters of 1963. In fact, final demand—the rate at which business, government, and consumers purchased newly produced goods and services for purposes other than inventory accumulation—registered its sharpest advance since late 1961 when the economy was still in the initial phase of the cyclical upswing. The slight slowdown that did occur in GNP growth thus reflected a decline in the rate of inventory accumulation, implying a continued tight alignment between stocks and sales.

Consumer spending accounted for most of the strength in final demand and registered its largest quarterly upsurge since the first quarter of 1951 (during the Korean



War). Automobile sales, after allowing for seasonal variation, climbed only slightly from the very high rate that had prevailed in the fourth quarter of 1963, but consumers spent quite heavily on appliances and furniture and also increased substantially their outlays on nondurable commodities such as apparel. Most of this rise in spending reflected the continued advance in consumers' disposable incomes, but the proportion of income spent on consumption also rose. The push in consumption came largely before the tax cut started to go into effect in the first week in March: retail sales during that month actually fell off a bit from their record February pace. Retail sales volume may also have edged downward in April—though the problems of adjusting the figures for the earlier than usual date of Easter make it difficult to assess the underlying trend of sales during the last two months. In any case, too much significance should not be attached to minor variations in the retail sales series, which tends to fluctuate erratically from month to month.

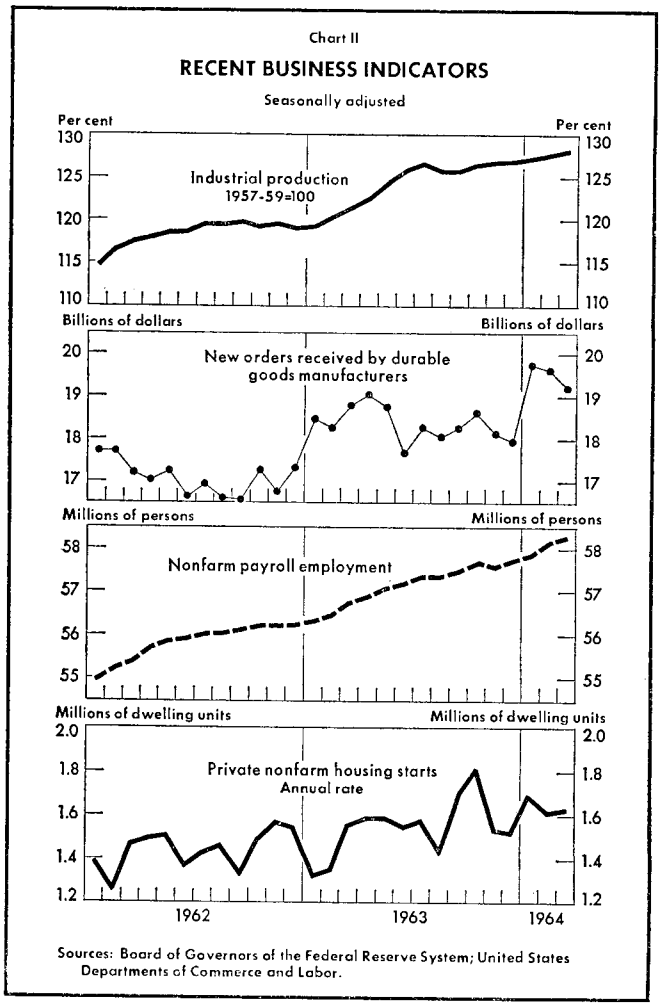
The government spending component of GNP also moved up somewhat in the first quarter, although the increase was a little smaller than in the preceding two quarters. The Federal Government's purchases of goods and services for national defense purposes rose at an annual rate of only $200 million. Defense outlays are scheduled to show a somewhat larger increase in the current quarter, but there are indications that such outlays for the fiscal year as a whole may fall short of the total projected last January.

Outlays for residential construction, after a sharp rise in the last three quarters of 1963, showed only a very slight gain in the first quarter. Even this small increase, however, was contrary to the expectations of those observers who have been predicting an end to what is the longest building boom since World War II. Moreover, the high level of housing starts throughout the first quarter suggests that residential construction outlays may be well sustained in the months immediately ahead.

As had appeared likely on the basis of earlier surveys of capital spending plans, business outlays for fixed investment showed little push in the first quarter. Orders and contract awards in the first quarter as a whole were well above the average levels of the previous quarter, however, suggesting that the advance in capital spending anticipated for the last three quarters of the year may now be in progress. The latest survey of spending plans, conducted by McGraw-Hill in March and April, suggests that manufacturers, particularly auto firms, have raised the total of their planned outlays for 1964 even above the intentions expressed at the beginning of the year. The McGraw-Hill survey points to a 12 per cent rise in over-all plant and equipment expenditures this year, compared with the 10 per cent gain indicated by the Commerce Department-Securities and Exchange Commission survey conducted in February and the 9 per cent rise reported in a special January McGraw-Hill survey. It should be noted that in years of over-all economic expansion the McGraw-Hill spring survey has tended to be on the high side, and the Commerce-SEC spring survey on the low side, of the actual final capital spending figures.

PRODUCTION, EMPLOYMENT, AND PRICES

The Federal Reserve Board's seasonally adjusted index of industrial production edged ahead in March for the sixth month in a row, reaching 128.2 per cent of the 1957-59 average (see Chart II). So far in 1964, total industrial



production has shown only modest gains, in contrast to the substantial increases in the first halves of 1962 and 1963. In both of the past two years, however, anticipations of a midyear steel strike had helped spur the rise in overall output. For most industry groupings, changes in output during March were small. Equipment production, however, moved ahead after two months of decline, a fact that may reflect the start of the anticipated rise in capital spending. Preliminary data for April point to a sharp increase in steel ingot production (on a seasonally adjusted basis), the gain being the largest since April 1963. Automobile assemblies, which slipped somewhat in March after allowing for seasonal influences, also appear to have advanced considerably in April, with producers apparently continuing to be encouraged by reports on dealer sales.

New orders for durable goods edged off for the second month in a row in March. Nevertheless, such orders remained close to the record January high and were still somewhat above durables shipments. The slight backing-away from the January peak in total new bookings probably reflects reduced defense ordering rather than a decline in private orders, which continue to be substantial.

Total nonfarm payroll employment moved further ahead in March and was 1.5 million persons higher than a year earlier, despite a reduction in the number of workers in the construction and trade sectors. In manufacturing, employment moved up to a total only 200,000 persons shy of the post-Korean War high recorded in 1957, and average weekly hours also increased. The recent improvement in the employment situation has apparently been geographically widespread: only 40 of the nation's 150 major labor market areas were classified as having "substantial labor surplus" (an unemployment rate of 6 per cent or more) in March, compared with 48 such areas a year earlier.

Broad indicators of price developments continue to show no inflationary uptrend. The consumer price index, although edging ahead in March after a February decline, has registered little net increase so far this year. Wholesale food prices have remained about unchanged in March and April after a February decline. Average industrial wholesale prices, moreover, have drifted down very slightly this year, in spite of quite a few price increases in sensitive raw industrial materials. Special supply factors in world markets appear to be a major, although not the sole, factor in explaining the movements in sensitive commodity prices. Nevertheless, any such concentration of price increases underscores the need for paying particularly careful attention to price developments in a period when most observers foresee rapid gains in economic activity.

The Money Market in April

The money market continued generally firm in April, although Federal funds traded in volume a shade below 3½ per cent on a number of occasions. Nation-wide net reserve availability expanded slightly in April, while average member bank borrowings from the Federal Reserve Banks declined somewhat. Banks in the money centers were under considerable reserve pressure in the first half of the month, partly reflecting a drawing-down of Treasury deposits in such banks. Subsequently, the reserve positions of these banks improved, as a portion of Federal individual income tax receipts from all parts of the country was redeposited in Treasury Tax and Loan Accounts at Class C banks.[1] Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers generally moved in a 3⅝ to 4 per cent range.

In the Treasury bill market, where good investor demand persisted and the redemption of $2.5 billion of April 15 bills reduced outstanding supplies, rates declined 7 to 20 basis points in April. Both offering rates for new time certificates of deposit issued by the leading New York City banks and the rates at which such certificates traded in the secondary market declined somewhat in April. Rates on prime four- to six-month commercial paper were lowered

[1] In the Treasury's classification of the commercial banks that are depositaries of Tax and Loan Account funds, Class C banks are the largest ones—those with *total* deposits of $500 million or more. These banks are subject to Treasury Tax and Loan Account calls or redeposits on only a few hours' notice.

the management of the local bank to serve its community better, while at the same time providing the additional benefits associated with size that the holding company is able to offer.

My second observation is a word of caution. The formation of a holding company and the acquisition of a bank by a holding company require the approval of the Federal Reserve Board. In reviewing a holding company application, the Board must consider whether the proposal would expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking. Also pertinent in this field are the criteria used by the courts in deciding cases that arise under the Clayton Act dealing with acquisitions which may substantially lessen competition or tend to create a monopoly, or that arise under the Sherman Act dealing with acquisitions which may unreasonably restrain trade. The Supreme Court of the United States has equated excessive concentrations of banking resources in the relevant markets to undue lessening of competition, as well as to unreasonable restraint of trade. The Board will approve only those applications which, in the light of the competitive factors and the applicable banking factors, it finds to be in the public interest.

We would expect, therefore, that those banks which choose to band together to improve their potential of service to the public will seek to do so in ways that will enhance competition rather than reduce it.

CONCLUSION

In conclusion, I would revert to President Wilson's inaugural address. "We shall deal with our economic system as it is and as it may be modified, . . . and step by step we shall make it what it should be. . . ." These words, spoken fifty-one years ago, were truly prophetic of the years since then, and I trust of the years ahead. When these words were uttered, no one would have dreamed of the challenges our nation and our banking system would have to face. No doubt the challenges that lie ahead are beyond our imagination today. But whatever our respective challenges, we must be ready to meet them—and meet them well. Our success and your success in meeting them will be related to the extent that each of us realizes that the success of any governmental body and of any private organization rests on its service to society.

The Business Situation

The economy posted a good advance in April, and fragmentary data for May suggest that these gains have been at least maintained in recent weeks. Leading indicators such as new orders for durable goods, the backlog of business appropriations for capital spending, and consumer buying intentions add support to the widespread expectation of further gains in output and employment in the months immediately ahead. The limited data so far available, however, do not provide an adequate basis for assessing the ultimate impact of the tax cut on economic activity.

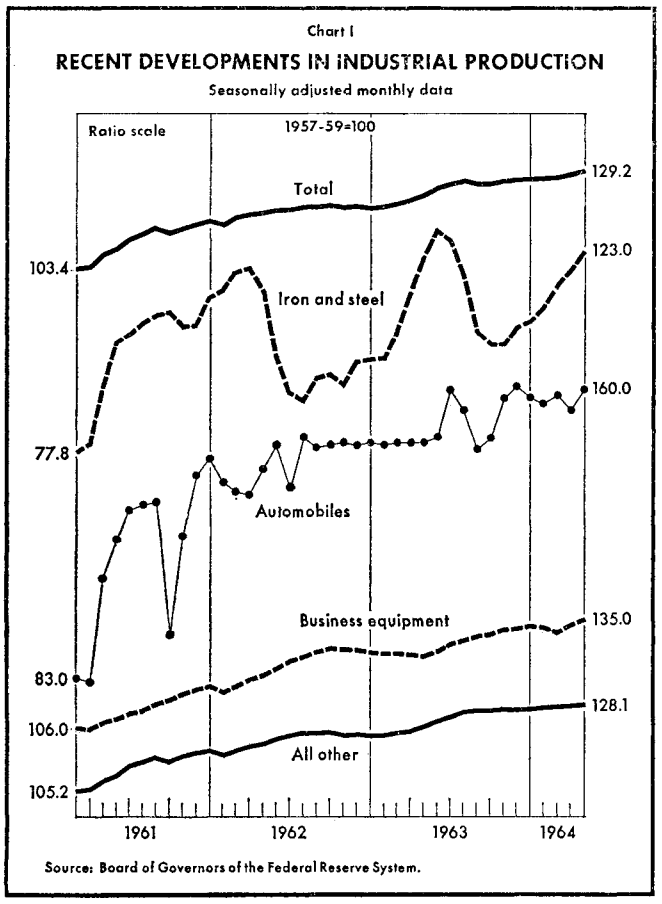
In April, industrial production, employment, and personal income showed the largest rises in several months. Retail sales, to be sure, edged down for the second month in a row, but such sales often show erratic movements, and appear to have risen somewhat in May after allowance for seasonal factors. Steel production in May appears to have been maintained at the already high April level, and weekly data suggest that auto output also remained about unchanged.

The prevailing atmosphere of confidence has not been accompanied, so far at least, by either a general speculative inventory build-up or by over-all inflationary price developments. Indeed, the broad indexes of prices have continued to exhibit substantial stability—a fact that may to some extent reflect continued excess capacity in several lines as well as unemployment still in excess of 5 per cent of the labor force. If further gains in economic activity cut

into these unused resources, price and wage stability may face a more severe test in the months ahead than has been experienced up to now.

PRODUCTION, ORDERS, AND EMPLOYMENT

After showing only relatively small month-to-month movements for almost a year, industrial production—as measured by the Federal Reserve Board's index—moved up a full percentage point in April to a record level of 129 per cent of the 1957-59 average (see Chart I). Increases in the production of two major components—iron and steel, and motor vehicles and parts—accounted for almost half the April gain, although all major sectors of the industrial economy shared in the advance. Output of business equipment climbed more than a point, suggesting rising outlays by business for capital goods, as overtime operations in the machinery industry reached their highest level in seven years. Production of consumer goods also rose in April, more than offsetting the small March decline.



The general gains throughout manufacturing production in April, moreover, were also reflected in higher output of electric and gas utilities and in the mining industry.

Partial May data suggest that, on a seasonally adjusted basis, steel ingot production as well as assemblies of new cars held at about the advanced April rate. Even with dealer inventories at record levels, automobile production schedules do not point to any decrease in the rate of assemblies in June. However, the assessment of possible additional gains in industrial production in the months ahead will be complicated by the relatively early completion—scheduled for July—of output of 1964 model cars. The steel industry has already experienced a slowdown in new orders from the auto industry, but over-all steel orders remain strong as a result of heavy broad-based demand, particularly by the construction industry and by manufacturers of heavy equipment.

Prospects for future gains in industrial activity received a strong boost from a rise to a record in new orders received by manufacturers of durable goods. The aerospace and primary metals industries contributed substantially to this advance, but gains were widespread throughout all major industries. In particular, new orders for machinery and equipment, a series closely related to business capital spending, posted a good rise. Moreover, with orders exceeding shipments, the backlog of total durable orders on the books of producers grew in April for the fourth month in a row.

The National Industrial Conference Board reported that new capital appropriations of major manufacturing companies edged a bit lower in the first quarter, but that such appropriations nevertheless remained at a very high level. Taking into account a sharp upward revision in the figure earlier reported for the fourth quarter of 1963, new appropriations have now been maintained for three quarters at levels not exceeded since the first quarter of 1956. The backlog of funds appropriated but not yet spent is continuing to mount, and since appropriations of manufacturing firms have tended to lead capital outlays by about six to nine months, prospects are excellent that the substantial gains in planned business spending for plant and equipment in 1964 reported by recent surveys will, in fact, be achieved.

Partly reflecting the April rise in industrial production, nonagricultural employment showed a further advance in that month: all major sectors of the economy, except construction and services, added to payrolls. The Census Bureau's household survey reflected the improved employment picture by recording a seasonally adjusted increase of 750,000 in the total number of persons employed, the largest monthly increase since April 1960. The gain, how-

ever, was primarily the result of increased part-time employment of women and reflected additions to the labor force. The number of unemployed also rose, although only slightly. Consequently, the April unemployment rate remained at the March level of 5.4 per cent. However, the long-term unemployment rate (fifteen weeks or more) declined to 1.2 per cent, the first clear movement below the 1.5 per cent level in two years.

CONSUMER SPENDING, RESIDENTIAL CONSTRUCTION, AND PRICES

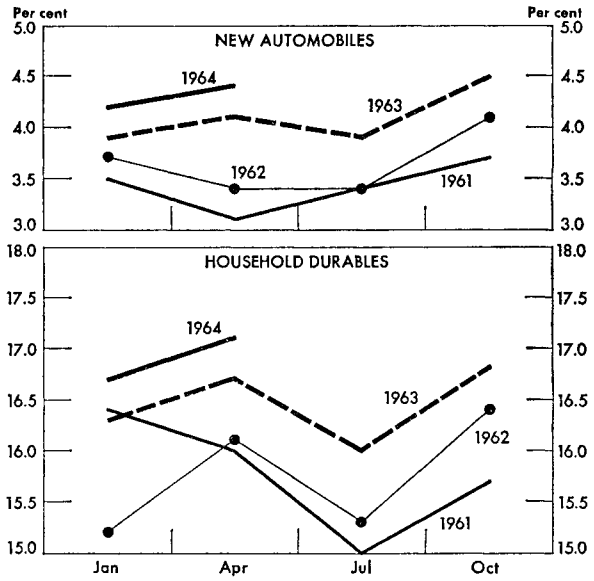
Retail sales, which had declined in March, receded slightly further in April but nevertheless remained close to the record February level. The April decline was concentrated entirely in nondurables, with sales of durable goods actually rising somewhat. Seasonally adjusted sales of domestically produced automobiles moved ahead in April, and preliminary data suggest no slackening in May. Rising disposable income in the hands of consumers—reflecting income gains as well as smaller Federal tax withholdings since the March tax cut—lend strong support to the prospect for further gains in consumer spending in the months ahead. This prospect is supported by the April Census Bureau Survey of Consumer Buying Intentions: plans to buy new cars and household durables were once again ahead of the previous year (see Chart II). Preliminary weekly data for May do, in fact, suggest some pickup in retail sales.

Residential construction activity remained as high in April as it had been in March and thus continues to be a factor of strength in general economic activity. The level of housing starts and new building permits likewise remains high, although both of these indicators fell in April. While month-to-month changes in these two series are highly volatile, the declines do underscore the need for caution in assessing the outlook for residential construction.

Broad measures of price behavior continue to exhibit near stability. Wholesale prices of commodities other than farm and food products were unchanged in April at below end-of-1963 levels and, on the basis of weekly data, appear to have remained unchanged in May. Wholesale prices of farm and food commodities declined in April and, on balance, may have edged down a bit further in May. A recent substantial decline in the Bureau of Labor Statistics index of spot raw industrial prices, moreover, ended more than six months of advance in that sensitive but somewhat erratic series. At the retail level, the consumer price index has continued to inch upward, climbing by 0.1 percentage point in both April and May. The over-all rise so far this year, however, has been only 0.2 per cent—well within the range of the moderate increases for similar periods experienced in recent years. Most recently, moreover, announcements of price reductions for specific goods (including color TV sets, some steel products, and aluminum sheets and plates) appear to have become more frequent than those of price advances. The business attitude on the pricing outlook is indicated by a recent survey of purchasing executives: many of these buyers do anticipate some upward price movement, but virtually all who see such a trend project only a slight to moderate updrift and expect price increases to be selective rather than general within various industries.

Chart II

CONSUMER INTENTIONS TO BUY NEW AUTOMOBILES AND HOUSEHOLD DURABLES WITHIN SIX MONTHS



Note: Buying plans are expressed as the ratio of the number of families who indicate they intend to buy to the total number of families in the survey.

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

The Business Situation

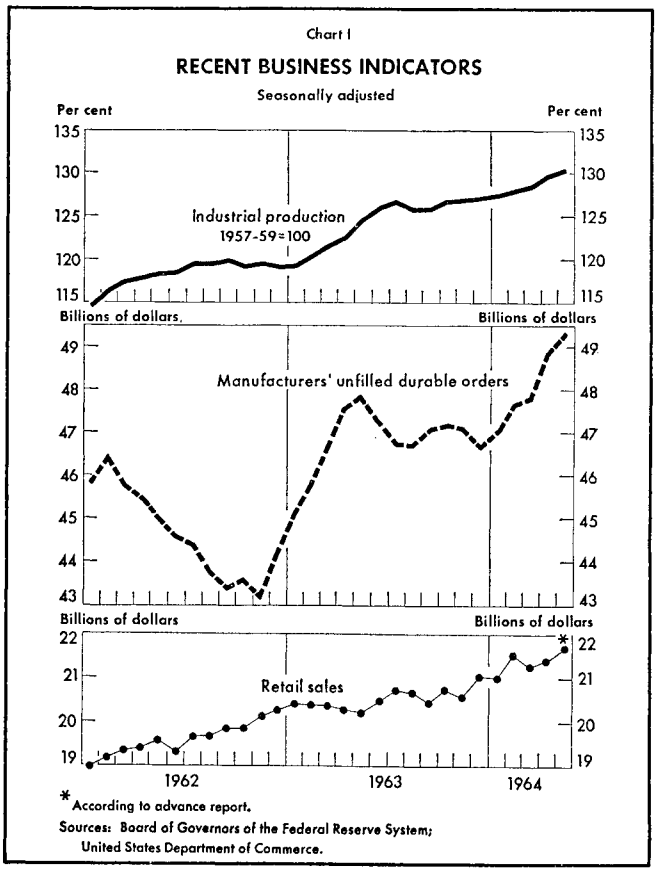
The economy's gradual but solid advance has continued in the past few weeks. Employment, production, and retail sales posted good gains in May, while backlogs of unfilled orders rose to the highest levels since around the end of the steel strike in early 1960. Auto output apparently rose slightly on a seasonally adjusted basis in June, while steel ingot production moved down. Although the unemployment rate rose in June after a sizable decline in May, there has been a distinct improvement in the labor market situation as a whole during the second quarter as compared with the first quarter and with a year ago. Incomplete data on retail sales in June suggest a slight weakening from the May level, underscoring the fact that, although such sales have shown a good gain since the tax cut went into effect, there have been no signs of a rapid surge in consumer spending. Furthermore, the broad price indexes have changed little.

The steady pace of the expansion so far and the most recent showing of several important leading indicators continue to point toward an orderly rise in business activity over the near term. Recent surveys of business plans for capital spending still indicate a substantial gain in 1964, but do not suggest the type of sudden spurt in capital outlays that characterized the 1955-56 investment boom. Businessmen also plan to step up their rate of inventory accumulation over the next few months, but only at a pace well in line with expected gains in sales. At the same time, recent developments in the residential construction industry suggest that demand may have leveled off in that sector of the economy.

PRODUCTION, ORDERS, AND EMPLOYMENT

The Federal Reserve's index of industrial production posted its eighth consecutive monthly advance in May, rising by 0.7 percentage point to reach 130.3 per cent of the 1957-59 average (see Chart I). The advance brought the over-all gain since December to nearly 3 per cent. This is not so large as the 4.5 per cent rise recorded in the first five months of 1963, but it will be recalled that part of last year's increase was attributable to the strengthening effects on steel output of fears of a possible midyear strike. The May rise this year was centered largely in materials and equipment-producing industries, although consumer goods output also posted a modest pickup.

In June, steel ingot production declined slightly, but producers in the automobile industry raised the already high rate of automobile assemblies a bit further in an attempt to end the 1964 model run with sufficient inventories for the model change-over period. Seasonal inventory needs have been enlarged this year as a result of



plans by most major producers to make extensive styling changes, which will entail a somewhat longer shutdown period than is usually required. Another factor that may be influencing inventory demand is the imminence of labor negotiations. The present contracts expire at the end of August, and bargaining on new contracts is scheduled to start in July.

The prospects for future strength in production were reinforced in May by the fifth consecutive monthly advance in unfilled orders held by manufacturers of durable goods (see Chart I). The volume of incoming new orders for durables, to be sure, slipped somewhat, but it was still at the second highest level on record. The small month-to-month decline that did take place in May, moreover, largely reflected a slackening in steel orders, which was probably induced by the earlier-than-usual summer shutdown in the automobile industry.

After substantial increases in April and May, total employment fell in June. Large month-to-month movements in this series are not unusual, however, and it is encouraging that for the second quarter as a whole total employment averaged more than 800,000 above the average for the quarter before. The second-quarter increase in the civilian labor force was also quite sizable, perhaps reflecting in part the entrance into the job market of persons who had previously felt that jobs would not be available for them. A more-than-seasonal rise in unemployment among college students and recent college graduates contributed to a 0.2 percentage point rise in the unemployment rate, to 5.3 per cent, in June. The second quarter nevertheless ended with a rate somewhat below the 5.4-5.6 per cent range which prevailed early this year and for much of 1963.

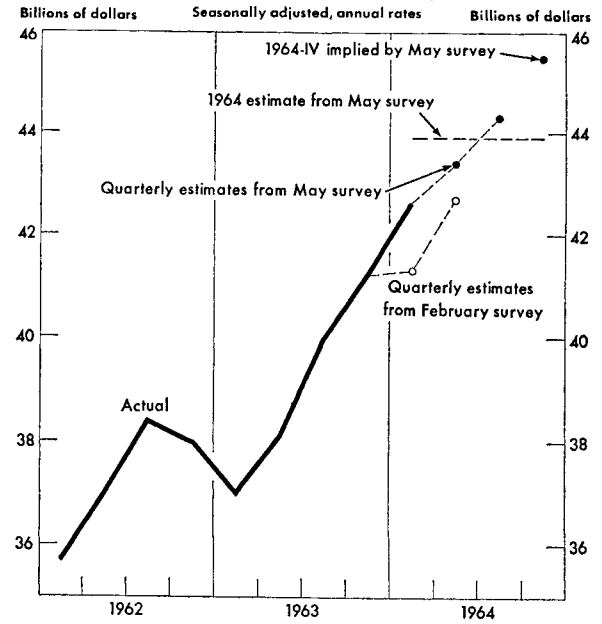
CONSUMER SPENDING AND RESIDENTIAL CONSTRUCTION

Consumer spending at retail outlets registered a good gain in May, moving up by 1.4 per cent to reach a record $21.7 billion, seasonally adjusted (see Chart I). The May advance, following a small April increase, was largely attributable to a substantial rise in sales of nondurable goods, which had been somewhat sluggish in the previous four months. Sales of durable goods were essentially unchanged in May, despite a slight advance in new automobile sales. Fragmentary data for June suggest that total retail sales may recently have edged off a bit, although automobile sales apparently continued strong.

On the basis of present evidence, the rate of gain in retail sales in the April-June quarter appears to be somewhat less than the January-March advance, despite the fact that the tax reduction was in effect for the entire second quarter. The absence of an accelerated gain in sales, however, does not mean that the tax cut has been without an impact on consumer spending. It is quite possible that the considerable strength of retail sales early in the year may have reflected consumer anticipations of the tax cut. Furthermore, it is by no means certain that the tax cut has as yet had its full effect on consumer spending.

In the residential construction sector, activity has continued at a high level but without providing much additional stimulus in recent months. After moving up slightly in April, outlays on housing declined substantially in May and June. Moreover, the recent behavior of leading indicators in this sector does not suggest a renewed upward push in such expenditures for the near future. The seasonally adjusted value of residential contract awards, to be sure, was slightly above April in May, but April had declined markedly below March, so that awards in both April and May were significantly under the first-quarter average. Furthermore, the level of nonfarm housing starts in May was virtually unchanged from April, and the April figure was revised downward to a level distinctly below the first-quarter average. Similarly, the number of new building permits issued in May was about the same as in April, and both months were significantly below the first-quarter average.

Chart II
ACTUAL AND ANTICIPATED PLANT AND EQUIPMENT SPENDING, 1962-64



Sources: United States Department of Commerce; Securities and Exchange Commission.

BUSINESS SPENDING PLANS

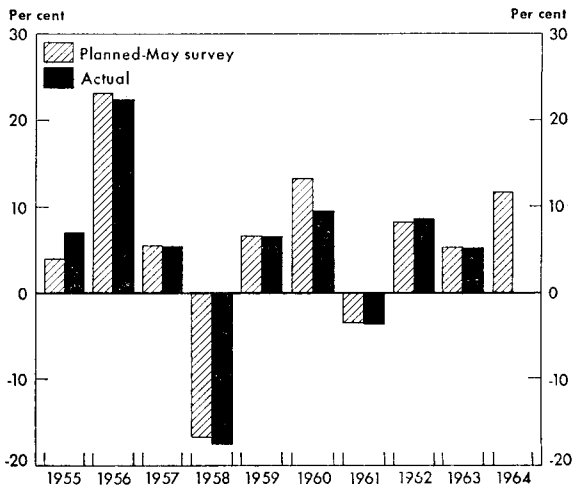
Recent surveys of businessmen's spending plans reinforce widely held expectations of strong support for the economy from this sector over the balance of the year. According to a May survey by the Department of Commerce, manufacturers plan to add $700 million to their inventories during the third quarter of this year as against an expected increase of $400 million in the second quarter. Much of the planned additions to inventories are in the durables sector, where producers are looking forward to a substantial sales gain. Despite anticipations of a stepped-up rate of inventory accumulation, therefore, the expected rise in sales, if realized, will be sufficient only to maintain the inventory-sales ratios of both durables and nondurables manufacturers at roughly the low levels that have recently prevailed, suggesting that over-all inventory policies remain cautious.

In another May survey, taken by the Department of Commerce and the Securities and Exchange Commission, business plans for capital spending in 1964 were reported at a level 12 per cent above 1963 outlays (see Chart II). This increase was somewhat above the 10 per cent advance reported in the February Commerce-SEC survey and was about in line with the rise reported in the spring McGraw-Hill survey taken in March-April. The latest survey, of course, is still not necessarily an accurate forecast; however, in previous years of business expansion—such as 1959, 1962, and 1963—the May survey has proved to be highly accurate (see Chart III).

The upgrading in spending plans for 1964 as a whole in the May, as compared with the February, Commerce-SEC survey represents in part a substantial ($1 billion) upward revision in the first-quarter estimate. Planned outlays reported for the second half of the year are about $0.5 billion higher than had been indicated in the February report but, because of the first-quarter revision, the expected increase between the first and second halves of the year is slightly smaller than had been estimated in February.

Chart III

YEAR-TO-YEAR PERCENTAGE CHANGES IN PLANNED AND ACTUAL CAPITAL SPENDING



Sources: United States Department of Commerce; Securities and Exchange Commission.

The Money Market in June

The money market once again demonstrated in June its capacity for accommodating without undue strain the large flows of funds and securities associated with heavy corporate dividend and tax payments. Aided by the expansion of bank credit to securities dealers and to nonbank financial institutions, corporations managed to shift Government securities to dealers and to redeem finance company paper. In addition, business corporations borrowed from commercial banks to meet their quarterly obligations. The money market retained a steadily firm tone throughout the month, with Federal funds trading almost exclusively at 3½ per cent. Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were generally in a 3¾ to 3⅞ per cent range. Treasury bill rates edged upward around midmonth, but declined subsequently when demand reappeared. Offering rates for new time certificates of deposit issued by the leading New York City banks held generally steady during the month, reflecting in part steps taken by the banks in May to compensate for certificates

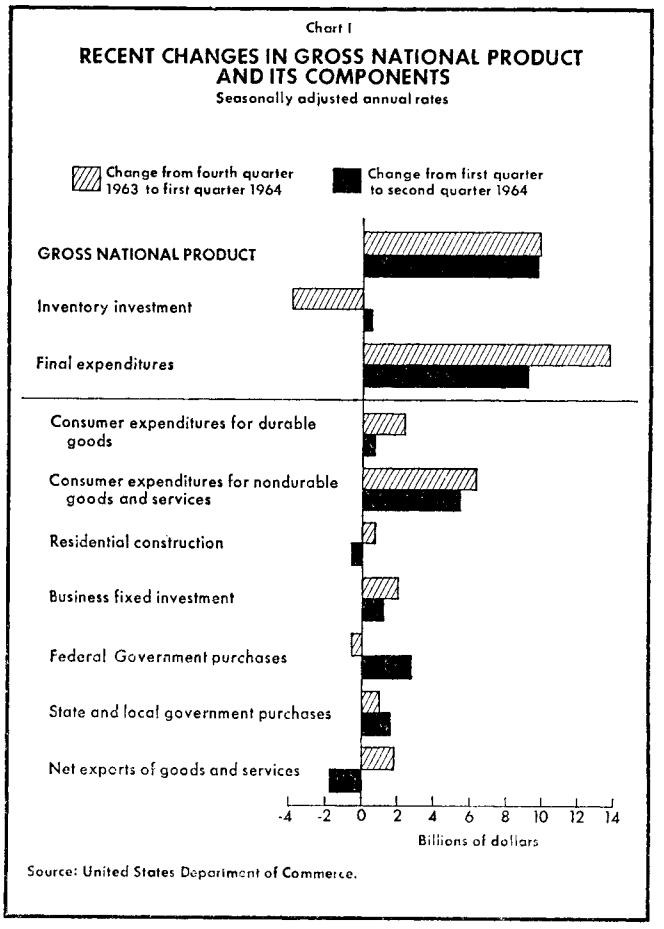
The Business Situation

As the second half of the year began, the economy continued to show a solid advance. In June, industrial production, nonfarm payroll employment, and personal income all rose, while retail sales were only slightly below the record May level. For the second quarter as a whole, gross national product moved substantially upward and, with prices remaining relatively stable, most of the rise reflected real growth. Fragmentary data for July suggest that after adjustments for seasonal changes—adjustments which are especially difficult at this time of year—auto and steel ingot production and retail sales apparently increased somewhat. In the residential construction area, leading indicators of activity recovered part of their April-May losses in June, but remained below their average levels of winter and early spring.

The business expansion continues to be accompanied by a substantial degree of over-all price stability. The wholesale price index actually tended slightly downward during the first half of this year, reflecting some easing in the prices of farm products and processed foods and essentially no change in the index for industrial goods. At the retail level, the consumer price index has advanced very little in 1964, with the June figure only 0.4 per cent higher than six months earlier as compared with an 0.8 per cent rise during the first six months of 1963.

RECENT PATTERNS OF DEMAND

Gross national product rose by $9.7 billion in the second quarter to a seasonally adjusted annual rate of $618.5 billion, according to preliminary estimates of the Department of Commerce (see Chart I).[1] This gain was about equal to that scored in the previous three months, but moderately smaller than the very large increase recorded in the final quarter of 1963. Virtually all the April-June advance was in final expenditures—that is, in GNP exclusive of the influence of inventory changes. Inventory accumulation rose only modestly, after having dropped



[1] The usual midyear revisions of the national income accounts resulted in changing the previous estimates of quarterly GNP back through the first quarter of 1961 by as much as plus or minus $2.2 billion, with the figure for 1964-I revised upward by $0.8 billion.

significantly in the first quarter. With stocks remaining conservative in relation to sales, it appears likely that future rises in demand will be readily reflected in higher output.

Consumer spending accounted for about two thirds of the increase in final demand. As noted in a more detailed discussion below, the $6 billion rise in such expenditures during the first full quarter of the tax cut was somewhat less than the huge advance scored in the first three months of the year. However, the latest gain was larger than most of the quarterly increases achieved during the current business expansion. Purchases of nondurables and services were again stepped up strongly, while buying of durable goods rose moderately after a considerable surge in the first quarter. Weekly retail sales data suggest that consumers may have further increased their spending in July, despite the retarding influence on auto sales of a strike by new car haulers in the eastern states.

In the government sector, expenditures at the state and local level during the second quarter continued on their long-term uptrend and Federal purchases also rose significantly. In a somewhat longer perspective, however, it is noteworthy that Federal spending has added much less to aggregate demand in the past year than in the earlier portion of the current business upswing. Continued paring of defense outlays, moreover, is expected to result in lower levels of Federal spending over the rest of the year than were projected in the Budget last January.

Business fixed investment also registered an appreciable rise in the second quarter, continuing the notable strengthening in this sector. Furthermore, the prospect of a sizable advance in capital spending over the balance of the year —indicated in the May survey of businessmen's plans taken by the Commerce Department and the Securities and Exchange Commission—is receiving some confirmation in the strong showing, over recent months, of indicators on contract awards for commercial and industrial construction and new orders for machinery and equipment.

The two components of GNP which fell off in the second quarter are net exports of goods and services and outlays for residential construction. The drop in net exports reflected a substantial increase in imports from an unusually low first-quarter level. As for housing expenditures, the moderate decline was associated with some weakening in April and May in the number of new housing starts and building permits issued as compared with their very high rates during the previous several months. In June, both starts and permits rose by 5 per cent, but remained 6 per cent and 4 per cent below their respective first-quarter averages.

PRODUCTION, ORDERS, AND EMPLOYMENT

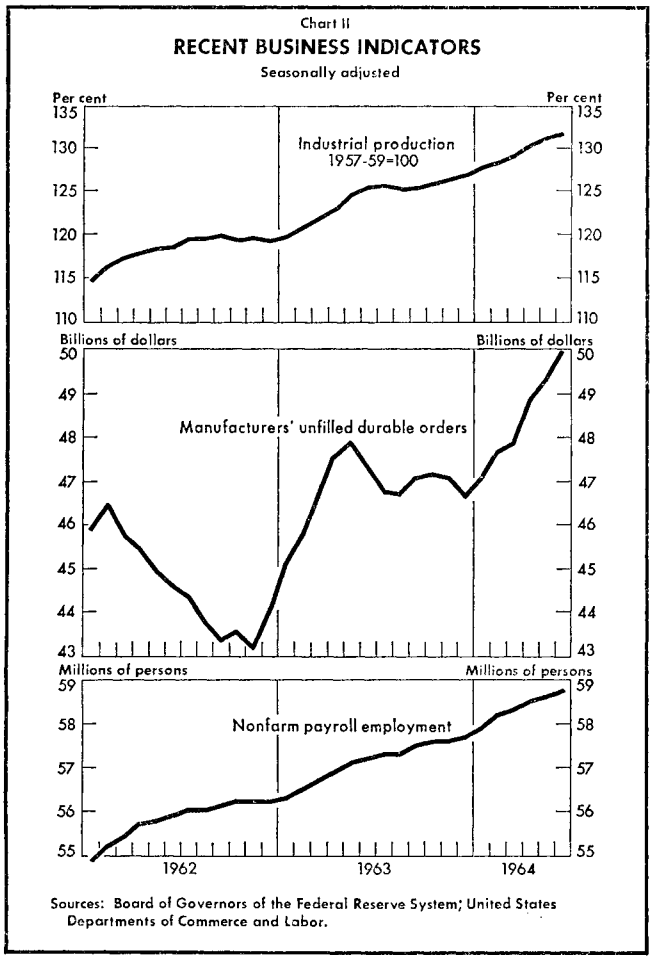
The Federal Reserve's seasonally adjusted index of industrial production moved up in June for the tenth successive month, rising by 0.6 percentage point to 131.8 per cent of its 1957-59 average (see Chart II).[2] While the June rise, like the one in May, fell short of the large increase registered in April, it brought the total increase for the first six months of the year to 4 per cent—substantially above the 1 per cent rise in the previous half year, though somewhat less than the large gain achieved in the first half of 1963. The advance in June was rather widespread, encompassing most major market and industrial sectors. Steel and motor vehicle production, however, which contributed significantly to the boost in the index earlier in the year, held about unchanged at very high levels.

In July, steel ingot output—which normally shows a sizable seasonal decline—held about unchanged, reflecting continued strong demand from a broad range of customers. Some trade sources are projecting a record production level of 120 million tons for the year. In the automobile industry—which is currently involved in important labor negotiations—factories were operating at a high rate, as they closed out production of their 1964-model cars in preparation for a longer than usual retooling period to permit substantial styling changes in their 1965 models.

A factor bolstering industrial production has been the steady rise in the backlog of unfilled orders received by manufacturers of durable goods. In June these order backlogs moved up by 1 per cent, to register the sixth consecutive monthly gain (see Chart II). To be sure, the value of new orders received by producers of durable goods remained about unchanged after a moderate decline in the previous month. However, this series would have increased by 2 per cent in June if not for a sharp drop in bookings placed with the defense-oriented aircraft industry, which follow an erratic month-to-month pattern. The over-all level of durables orders, moreover, remained high.

In line with the upward course of economic activity, nonfarm payroll employment (seasonally adjusted) continued to rise moderately in June, increasing by 114,000

[2] The series is in the process of being revised back through January 1961, with the revision largely reflecting the application of newly computed seasonal adjustment factors. Revised totals are available monthly, starting with January 1963; figures for earlier months will be released in the near future. While the data plotted in Chart II are therefore on the revised basis only for January 1963 on, it is not expected that revision of the earlier data will result in any significant change in contour.



persons, following an advance of only 49,000 the month before (see Chart II). Most of the June increase occurred in service industries and in state and local government employment. Since the end of last year, the number of nonagricultural jobs has increased by a little over 900,000 —appreciably more than in the previous six months, though slightly less than in the first half of 1963.

RECENT CONSUMER BEHAVIOR

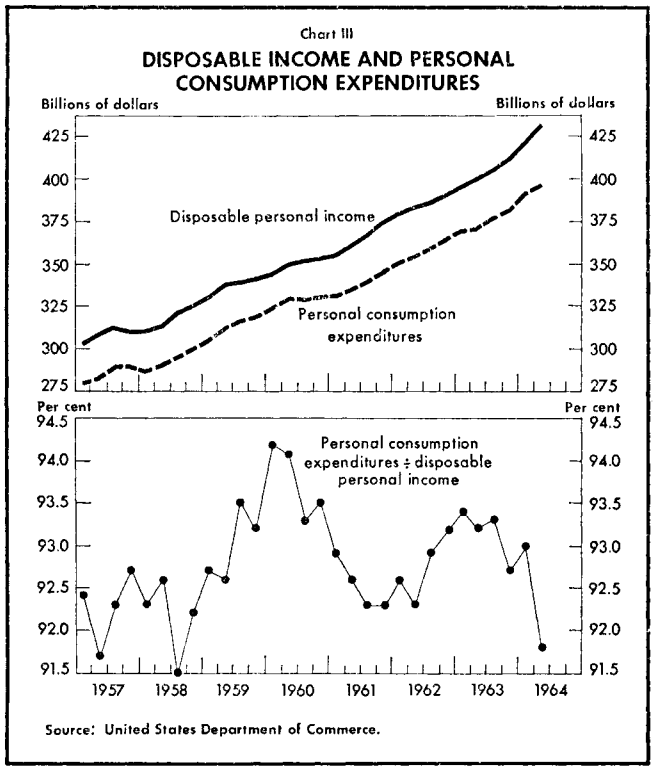
As noted earlier, the American consumer continued to provide a major stimulus to the sustained expansion of the economy in the second quarter. Consumption spending directly absorbs the bulk of the economy's output and indirectly supports business investment in inventories and plant and equipment. While consumption is subject to a wide variety of influences, its most important single determinant in normal times is the level of income available to consumers after taxes—so-called disposable income. One of the main aims of the recently enacted tax legislation was the stimulation of economic activity by increasing disposable income in the hands of consumers; observers of the business scene in recent months have, therefore, been trying to assess the impact of the tax cut on spending.

Certainly there can be little question that the tax cut has given a psychological boost to the economy. And it is reasonably clear that the concrete support given to consumer incomes will—at least after a time—result in higher consumer spending than would otherwise take place. Nevertheless, with data available for only a few months, any attempt to measure the immediate impact of the tax cut on consumer spending is bound to be somewhat frustrating. The relevant economic time series are subject to short-term fluctuations, some of them erratic, and these fluctuations can be large enough to obscure underlying trends. Moreover, no statistical data are completely free of error, and data that must generally be used in analyzing the most recent developments are frequently only preliminary estimates.

The initial estimates for the April-June quarter, the first quarter in which the tax cut was fully in effect, show a sharp $12 billion increase—see Chart III—in disposable income (seasonally adjusted annual rate), the largest quarterly increase on record. Since before-tax personal income rose by only $7 billion, roughly $5 billion of the increase in disposable income between the first and second quarters is attributable to a decline in tax receipts.[3]

The sizable $6 billion increase in consumption spending in the second quarter was all the more impressive coming after a near-record rise of almost $9 billion in the first quarter. The second-quarter gain, however, amounted to only about 50 per cent of the increase in disposable income. To be sure, if the ratio of additional spending to additional disposable income is measured over the first half of 1964 as a whole, the result is a markedly higher 73 per cent. Yet even this figure is substantially below

[3] Actually, the $5 billion figure probably understates to some extent the difference between actual disposable income in the second quarter and what disposable income would have been had there been no tax cut. First, part of the effect of the tax cut was already felt in the first quarter, since the cut became effective on March 5. Second, in the absence of the tax cut, total income tax collections (which include state and local tax collections as well as Federal personal income taxes) would actually have shown some increase. If this increase is deducted, the estimate of the total effect of the Federal income tax cut on disposable income would be somewhat higher than $5 billion. Finally, it is possible that before-tax incomes would not have been so large in the absence of the generally stimulating effects of the tax cut on the economy as a whole.



the usual proportion of disposable income that has been spent on consumption in recent years.

After a burst of spending following the end of World War II, the consumer has consistently tended to spend in the neighborhood of 93 per cent of his after-tax income on goods and services. In individual quarterly periods during the last ten years, this ratio has been as low as 91.5 per cent and in the first quarter of 1955 as high as 94.5 per cent. In the current economic expansion, the ratio—until the second quarter of this year—moved within a narrower range of 92.3 per cent to 93.4 per cent (see Chart III). Small as this 1.1 percentage point range of variation may appear to be, it amounts to nearly $5 billion of spending at current income levels, a not inconsiderable amount relative to the size of other potential influences on the magnitude of changes in GNP.

The consumption ratio fell in the second quarter to 91.8 per cent, about 0.5 percentage point under the low end of the recent range and the lowest value recorded for this ratio since the third quarter of 1958. In dollar terms, if the consumption ratio in the second quarter had fallen merely to the low end of the recent range, instead of to the still lower value actually recorded, $2 billion (on an annual rate basis) would have been directly added to the $6 billion increase that actually took place.

Since personal saving as measured in the national income accounts is simply the difference between disposable income and estimated consumer spending on goods and services, the apparent fall in the consumption ratio during the second quarter had as its counterpart a rise in the ratio of current saving to income. In other words, it thus appears that a relatively large proportion of the initial effect of the tax cut has been on saving. A rise in saving may take the form of a stepped-up rate of acquisitions by consumers of financial assets or repayments of outstanding indebtedness, or both. Data from the national income accounts showing a rise in the saving ratio in the April-June period are thus consistent with evidence of some increase in the rate of consumer debt repayments. (Credit extensions to consumers also rose somewhat, but growth in credit outstanding was below the first-quarter rate.) In addition, a substantial rise in the volume of new securities issues during the quarter—highlighted by the $1.2 billion American Telephone and Telegraph issue of common stock—may have absorbed some of the increased saving.

It must be remembered, however, that even a substantial rise in current saving, when spread out over the many forms which it can take, is unlikely to cause dramatic movements in specific financial series. Moreover, increases in holdings of particular financial assets may reflect shifts in the forms in which existing wealth is held as well as net additions to wealth through current saving. For these reasons, attempts to associate changes in holdings of any specific type of financial asset with a rise in saving stemming from the tax cut should be viewed with some degree of skepticism.

The tendency for the ratio of current saving to disposable income to rise when disposable income shows the sort of very rapid advance experienced in the second quarter has historical precedents. Indeed, the hypothesis that consumers respond to changes in their income with some lag has been supported by a number of econometric studies.[4] For a variety of reasons, many consumer purchases, particularly in the service component, can be expected to respond only very slowly to increased income. Thus, outlays on rent and interest charges on debt reflect decisions made in the past, while medical and legal expenses are not closely related to income. Moreover, a

[4] See, for example, Albert Ando and E. Carey Brown, "Lags in Fiscal Policy", in the Commission on Money and Credit's volume of papers, *Stabilization Policies*, 1963, pages 97-163.

significant portion of spending on nondurable commodities, particularly food, probably reflects long-established habits, and thus such expenditures too are not likely to show sharp variations as income moves ahead. Nevertheless, the increases in disposable income stemming from the tax cut can certainly be expected to exert long-run support to consumer spending, and some recovery in the consumption ratio would seem to be a reasonable expectation. Consumer buying plans remain strong, and record levels of expenditures on durables, the most volatile component of the consumer budget, indicate a continued willingness to spend.

The Money Market in July

The money market remained generally firm in July, though there were some variations in tone during the period which reflected mainly changes in reserve pressures on banks in the money centers. The market handled with facility the heavy financial flows associated first with the movements of currency around the Independence Day holiday period and later with the Treasury's advance refunding and repayment of maturing one-year bills. Substantial reserve pressures converged upon the major reserve city banks—especially during the second and third statement periods of the month—as these banks bore the brunt of the expanded financing needs of Government securities dealers that stemmed from the Treasury's massive advance refunding. For the most part, however, the money market banks were able to fill the bulk of their enlarged reserve needs in the Federal funds market, increasing only moderately their borrowings from the Federal Reserve Banks. Subsequently, there was a shift in reserves toward the money center banks, in part because of a decline in dealer financing needs, and the tone of the money market became somewhat more comfortable.

Against this background, Federal funds traded predominantly at 3½ per cent though there was some trading at lower rates on a number of days during the period when reserves shifted to the money centers. Similarly, rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were generally in a 3¾ to 3⅞ per cent range, although the rate dipped at times to 3⅝ per cent. Offering rates for new six- to nine-month time certificates of deposit issued by leading New York City banks ranged from 3.90 per cent to 4 per cent in July. The rates at which three- and six-month certificates of deposit traded in the secondary market tended to decline late in the month.

In early July, the major finance companies increased their offering rates on 30- to 89-day paper by ⅛ of a per cent. Later in the month, the finance companies made two downward adjustments of ⅛ of a per cent in their rates on 30- to 89-day paper and lowered their rates on 90- to 239-day paper by ⅛ of a per cent. Commercial paper dealers also reduced their offering rates by ⅛ of a per cent. Bankers' acceptances, with rates unchanged, attracted a strong demand, and dealers' portfolios declined sharply during the latter half of the month.

Treasury bill rates rose slightly at the beginning of the month. Subsequently, however, a considerable reinvestment demand for bills developed as a by-product of the Treasury's advance refunding operation and the pay-down of $2 billion of maturing July 15 bills, and rates moved lower through midmonth. In the latter part of July, a more cautious tone emerged in the bill market following the Treasury's announcement of the sale of a $1 billion "strip" of bills. Rates moved higher only briefly, however, and then steadied and edged lower once more.

The market for Government notes and bonds was dominated during the month by expectations of, and subsequent reactions to, Treasury financing operations. In the opening days of the period, prices of outstanding Government notes and bonds moved narrowly higher in quiet trading as the market awaited word of the Treasury's plans. Market reaction to the Treasury's July 8 refunding announcement was quite favorable, and lively trading ensued as investors adjusted their portfolios in response to the new investment opportunities presented by the complex exchange operation. Despite the considerable expansion in the market supply of intermediate- and long-term securities expected to result from the refunding, market participants remained confident in the outlook for general stability in interest rates. Contributing

Table IV

UNITED STATES NET MONETARY GOLD TRANSACTIONS WITH FOREIGN COUNTRIES AND INTERNATIONAL INSTITUTIONS

January-June 1964

In millions of dollars at $35 per fine troy ounce; United States net sales (—), net purchases (+)

Country	First quarter	Second quarter
Austria	— 32.1	— 23.2
Brazil	— 1.0	+ 28.1
France	— 101.3	— 101.3
Germany	— 200.0	—
Italy	+ 200.0	—
Switzerland	—	— 30.0
Turkey	— 1.2	+ 15.0
United Kingdom	+ 109.3	+ 220.9
All other	— 1.2	— 14.5
Net sales or purchases	— 27.5	+ 95.0

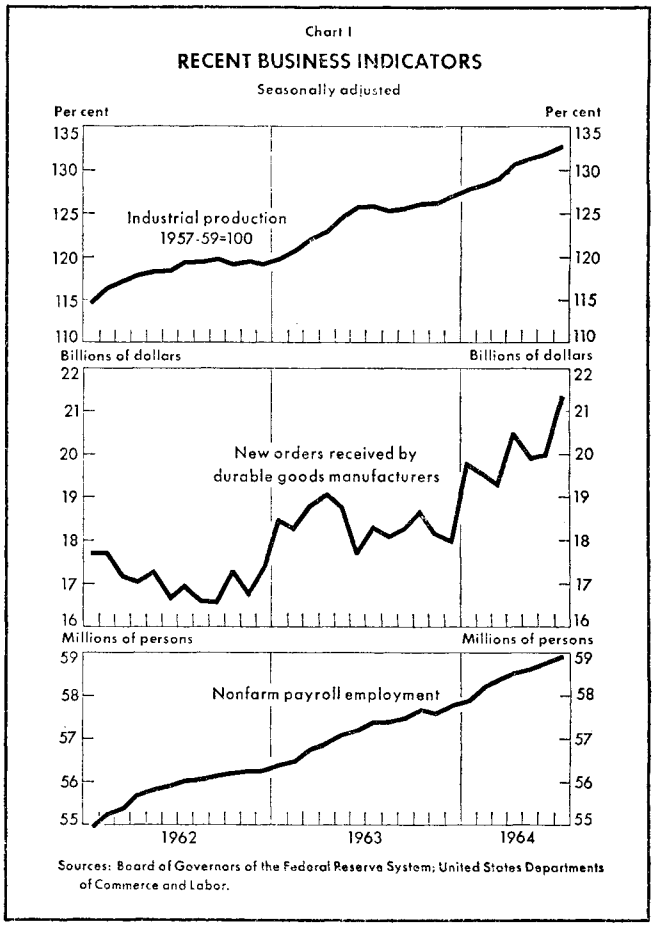
ary, for example, private demand for gold picked up in large part because of unsettled conditions in Cyprus and Viet Nam. Early in March, these pressures were reinforced by buying from Italy and gold-fixing prices advanced to a high of $35.0986. The pressures quickly abated, however, and in the latter part of March, when the Soviet Union again appeared in the market as a seller of gold in connection with renewed grain purchases from the West, the price receded to $35.0586. Although the Soviet Union withdrew from the market by the end of April, market supply generally continued to exceed demand. Early in August the military flare-up in Viet Nam and Cyprus again touched off a brief surge of speculative buying, but these tensions also faded quickly.

During the first half of the year, the United States continued to acquire sizable amounts of gold through the operation of the London Gold Pool. Such acquisitions are included in net gold purchases from the United Kingdom, indicated in Table IV, though the Gold Pool component in this figure will vary from one period to the next. Also shown in the table is the triangular gold transaction mentioned earlier, in which $200 million of gold sold to the United States by the Bank of Italy was immediately resold to the German Federal Bank. France, which had a continuing surplus in its balance of payments, remained the largest purchaser of gold from the United States; during the first half of the year French reserves rose some $280 million. On balance, after taking account of sales to domestic users of about $40 million, total United States gold holdings—including Stabilization Fund holdings as well as the Treasury gold stock—increased by $27 million during the first six months of the year.

The Business Situation

The economy has posted a further good advance since midyear and most newly available evidence continues to be consistent with widely held expectations of further gains to come. In July, industrial production and retail sales each registered rather substantial gains, while significant rises also took place in nonfarm payroll employment and in personal income. At the same time, new orders received by manufacturers of durable goods rose sharply and unfilled orders climbed again. The unemployment rate showed a substantial decline in July to the lowest level since February 1960, but a part of this improvement was reversed in August. Fragmentary data for August show little change in steel ingot production, a slight rise in the rate of automobile assemblies, and an apparent further expansion in retail sales. Several recently completed surveys point to continued strength in two sectors of demand. The Commerce Department-Securities and Exchange Commission's August survey of business capital spending plans over the balance of the year shows a further slight rise from the considerable increases over 1963 projected earlier, and the National Industrial Conference Board's survey of capital appropriations by large manufacturers reveals a substantial second-quarter rise. In addition, a Census Bureau survey taken in July indicates that consumer buying plans were stronger than a year ago. In the residential construction area, however, leading indicators continue to suggest a slippage from earlier peak demands.

Although negotiations in the automobile industry for a new labor contract remain unsettled, the old contract has been extended by a few days to September 9, which may enhance the possibility of a settlement without a work stoppage. Such a development would, of course, remove one of the significant uncertainties from the economic horizon. The contract terms which finally emerge from the present negotiations will have an important influence on over-all price stability and thus on the pace and orderliness of economic expansion. With regard to the recent past, the index of wholesale prices, after trending downward over the first half of the year, moved up by 0.4 percentage point in July, but early indications for August on balance suggest little further change. In the retail sector, the consumer price index in July edged up by 0.3 percentage point to reach 108.3 per cent of the 1957-59 average. So far this year, the consumer price index has advanced by 0.8 per cent from the average for the final quarter of 1963, compared with a rise of 0.9 per cent in the corresponding 1963 period over the final quarter of 1962.



PRODUCTION, NEW ORDERS, AND EMPLOYMENT

Industrial production, as measured by the Federal Reserve's seasonally adjusted index, advanced by a full percentage point in July, marking the eleventh month in a row in which a gain has been registered and bringing the index to 132.7 per cent of the 1957-59 average (see Chart I). The over-all gain since December amounts to 4.7 per cent, compared with about 5.5 per cent in the comparable period a year earlier. In July, gains were scored by all major industry groups except utilities, where there was a slight decline. The durables sector, however, provided the largest push, mostly reflecting a markedly better than seasonal performance in steel ingot production and stepped-up activity in equipment-producing industries. Production data for August pointed to a modest rise in the rate of automobile assemblies after allowance for seasonal influence, as producers pushed hard to stock dealers with an adequate supply of the 1965 models which will go on sale in late September. The better than seasonal performance in steel ingot production may also have continued into August.

One favorable factor in the near-term outlook for production was the substantial 6.6 per cent rise (seasonally adjusted) in new orders received in July by manufacturers of durable goods, following some slippage in May and an essentially unchanged June figure (see Chart I). The June sluggishness in these orders had reflected reduced bookings in the aircraft and parts industry, which are heavily defense oriented and tend to show erratic month-to-month movements. This decline in June almost counterbalanced gains posted by most other industries. In July, on the other hand, new orders received by the aircraft and parts industry jumped, accounting for over two thirds of the gain in new durables orders. Sizable advances were also posted, however, in the steel and electrical machinery-producing industries. With new orders above shipments in July, the backlog of unfilled durables orders rose by 2.8 per cent (seasonally adjusted) to mark the seventh consecutive month of advance.

According to the August Commerce Department-Securities and Exchange Commission survey, business plans for plant and equipment spending for the year as a whole are now projected at a level 12.7 per cent above such outlays in 1963, while the corresponding May survey had indicated a gain of 12 per cent. Most of the small upward revision in spending is planned for the final quarter of the year. Also, the National Industrial Conference Board reports that capital appropriations of large manufacturing corporations rose sharply, by 21 per cent, be-

tween the first and the second quarters. This advance more than offset a first-quarter decline and pushed the level of capital appropriations to a record high. The backlog of such appropriated but unspent funds, moreover, also rose strongly, for the third consecutive quarter.

Nonfarm payroll employment, seasonally adjusted, advanced by 138,000 persons in July, the eighth consecutive monthly gain (see Chart I). The rate of increase in July was somewhat below the average monthly advance for the first half of the year—a slowdown that partly reflected less push from manufacturing industries and the government sector. Nevertheless, in combination with a decline in the labor force, the unemployment rate dropped in July to 4.9 per cent from 5.3 per cent in June. This was the first time that the rate had gone below 5 per cent since October 1957, except for February 1960, and all major unemployment rate categories shared in the July improvement. In August, according to the Census Bureau's household survey, total farm and nonfarm employment registered a modest decline, while the civilian labor force rose slightly. As a result, the unemployment rate increased to 5.1 per cent; nevertheless, the August rate continued within the range that has prevailed over the previous three months, which in turn represents a distinct improvement over the earlier months of the year.

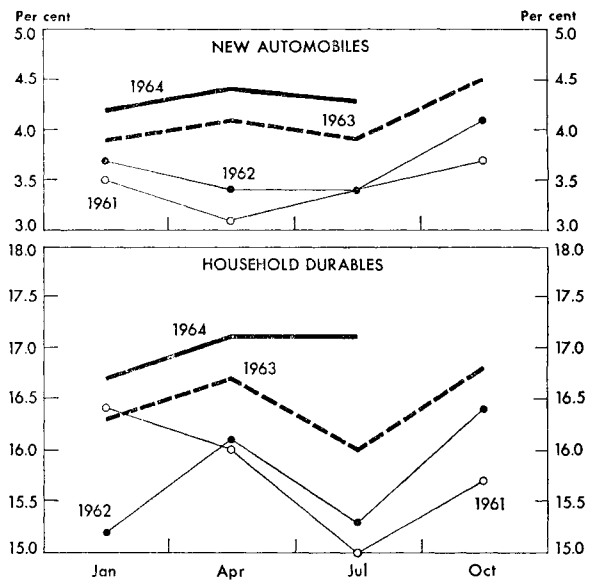
RESIDENTIAL CONSTRUCTION AND RETAIL SALES

Recent developments in residential construction continue to suggest some leveling-off in demand in this sector. After a strong performance in the first quarter, such leading indicators of residential construction activity as nonfarm housing starts and building permits moved substantially lower in the second quarter. Moreover, both nonfarm housing starts and building permits also declined in July, with starts off by 4.8 per cent to the lowest level since August 1963 and permits down by 6 per cent. Reflecting the recent movements in starts and permits, outlays for residential construction in the second quarter, at an average seasonally adjusted annual rate of $26.9 billion, were significantly below the average of $27.5 billion for the first quarter. The seasonally adjusted annual rate for July-August was about equal to the average for the second quarter.

After moving down by 0.5 per cent in June, retail sales showed renewed strength in July, rising 1.2 per cent to reach $21.9 billion (seasonally adjusted), a new high. Durables sales recouped a good part of their June decline to account for nearly three fifths of the July advance in total retail sales, largely on strength from the automotive group. Fragmentary data for August suggest that sales in that month may have moved up further, as new car dealers strove to liquidate an unusually high inventory of 1964 model automobiles.

With regard to near-term prospects for further expansion in retail sales, it is noteworthy that consumer intentions to spend within the next six months continue to appear strong (see Chart II). According to the latest survey by the Census Bureau, the proportion of consumers planning as of mid-July to buy new cars was essentially the same as in January and April, and appreciably above July of 1963. Plans to buy household durables, moreover, were above the reading of a year ago, and July 1964 marked the first time since 1959, when the survey was first taken, that such plans did not show a decline between April and July. The continued, though moderate, expansion in personal income, which rose by $1.5 billion in July, combined with the relatively high rate of personal savings and slower rate of increase in consumer instalment credit, would seem to suggest that consumers have the financial support to carry out their current buying plans.

Chart II
CONSUMER INTENTIONS TO BUY NEW AUTOMOBILES AND HOUSEHOLD DURABLES WITHIN SIX MONTHS



Note: Buying plans are expressed as the ratio of the number of families who indicate they intend to buy to the total number of families in the survey.

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

The Business Situation

The economy came through the summer months with few of the signs of hesitation that had marked that season in 1962 and 1963, and in spite of unsettled labor disputes in some sectors business was continuing its brisk advance as the autumn began. Industrial production and retail sales moved ahead in August, and although nonagricultural employment held at about the July level, hours worked in manufacturing—particularly in durable goods industries—moved up. Weekly data for September suggest that steel production continued to rise, while auto production and retail sales edged down from their August levels.

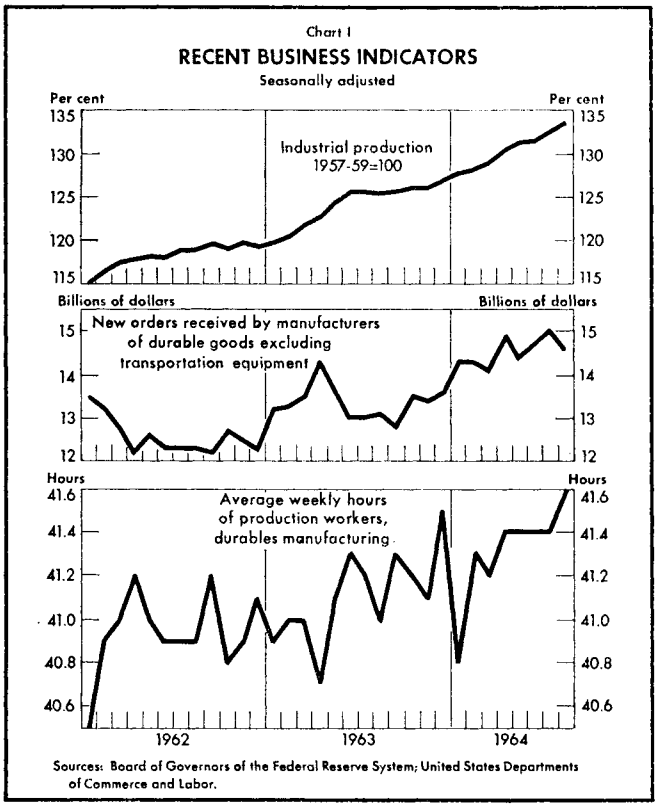
It is probably too early to assess the eventual impact on the economy of the conclusion of labor negotiations between the United Auto Workers and Chrysler and Ford in September and the signing of a national agreement with General Motors early in October. The terms of these agreements, to be sure, included increases in wages and fringe benefits in excess of the economy's average productivity gain in recent years, but the current exceptionally good level of profits in the auto industry, together with the industry's above-average rate of productivity increase, provides a cushion with which to meet the cost increases. Hence, the labor settlement apparently raises no immediate threat to the stability of automobile prices. Yet, there is the possibility that similar wage adjustments may spread to other industries, including those less able to absorb higher costs. The agreements also have a potential psychological impact on pricing decisions and could become an inducement to increased inventory building. On the other hand, productivity growth over the past two years has been unusually rapid for an expansion more than a year old. The continuation of such rapid growth, while it should not be taken for granted, would of course be of substantial help in offsetting the cost-price pressures arising from wage settlements.

While the auto settlements and the sustained economic advance have served to focus attention on the behavior of prices, there is still no sign of any immediate change in the relative stability that has generally characterized broad indexes of price behavior for several years. The consumer price index held virtually steady in August, and the increase in percentage terms so far this year has been somewhat smaller than the moderate rises in the first eight months of 1962 and 1963. A decline in food prices was too small to cause any significant movement in the overall wholesale price index in August, as average prices of commodities other than farm and food products held steady at a level about equal to those prevailing at the end of 1963 and the beginning of 1964. Weekly data indicate little change in this broad indicator of industrial commodity prices in September. At the same time, however, prices of some sensitive industrial commodities, particularly nonferrous metals, pushed up the Bureau of Labor Statistics index of thirteen raw industrial commodities in September. The advances in this index in recent months, which have totaled about 11 per cent since the beginning of the year, partly reflect special supply situations in individual commodities, but may also indicate some tendency toward generally increased demand pressures both in the United States and abroad.

PRODUCTION AND EMPLOYMENT

Industrial production (as measured by the Federal Reserve's seasonally adjusted index) rose by 0.8 percentage point in August, the ninth consecutive monthly gain, to reach 133.5 per cent of the 1957-59 average (see Chart I). So far in 1964 industrial production has risen 5 per cent, about equal to the advance during the comparable months of 1963. The August gains were widespread; equipment production registered a rise of 1 per cent, while output of both durable and nondurable materials advanced. Automobile production—drastically curtailed by the model change-over and the lack of any continuation of 1964 model production—actually recorded a small increase, after a necessarily rough allowance for these seasonal influences. Steel production showed a less-than-seasonal rise in August, but weekly data point to some seasonally adjusted advance in September. Auto output declined somewhat in September, reflecting the General Motors' strike during the last days of the month.

Prospects for further production gains remain good, although a 9 per cent August decline from the record July level in new orders received by manufacturers of durable



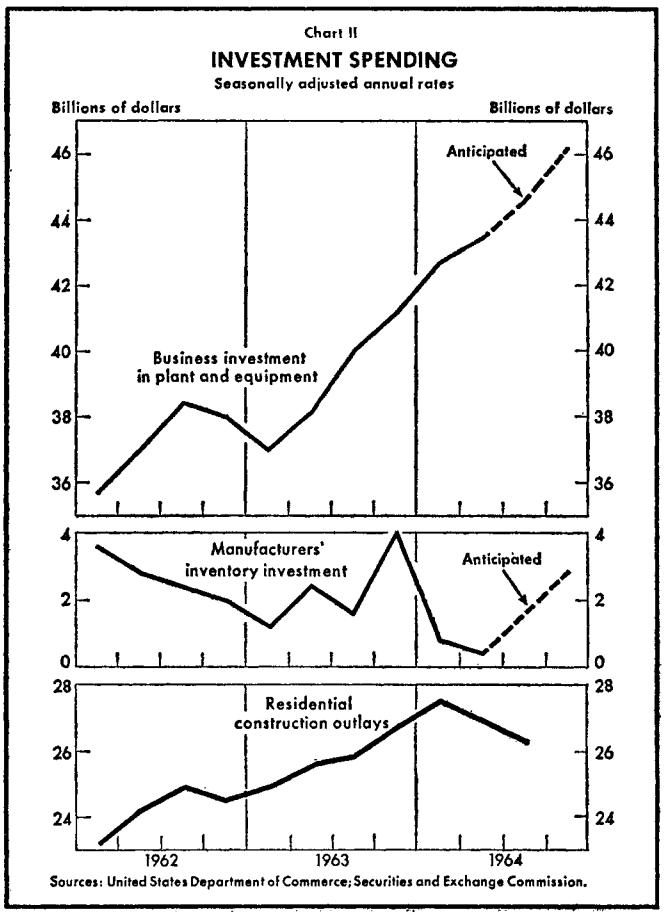
goods does provide a cautionary note. Most of the August fall in orders reflected a sharp drop in the erratic aircraft orders series; new orders for durable goods excluding transportation equipment fell only 2.9 per cent in August (see Chart I). Even at the reduced August level, new orders continued to run ahead of shipments, and the backlog of orders on the books of durables manufacturers thus climbed for the eighth month in a row.

Total nonagricultural employment in August held at about the July level, although in the manufacturing sector employment (along with mining and construction employment) showed a small decline. Average hours worked per week by manufacturing production workers, however, moved up by about ½ per cent to 40.7 hours, seasonally adjusted. Average hours in the durable goods industries—at 41.6 hours (see Chart I)—in fact reached a peak for the current expansion. The increases in average hours worked may indicate that employers are utilizing existing employees to the fullest before hiring new workers and also that the sustained pace of the expansion has quite possibly now come close to creating labor shortages in some lines.

According to the Census Bureau's household survey, total farm and nonfarm employment moved down a bit in August while unemployment edged up, reflecting primarily a failure of unemployment among teen-agers to show the normal seasonal drop. As a result, the over-all unemployment rate increased to 5.1 per cent from 4.9 per cent in July. In September, a fractional advance nudged the rounded unemployment rate up to 5.2 per cent. Unemployment among teen-agers registered some drop, but the rate for married men rose to 2.9 per cent. On a quarterly average basis, the unemployment rate in the third quarter was at its lowest level since October-December 1957.

BUSINESS AND CONSUMER SPENDING

While spending for plant and equipment is strong and expected to show a good advance at least through the remainder of the year (see Chart II), business spending for additions to inventories remains moderate. According to an August Commerce Department survey, manufacturers estimate that stocks of goods on hand will rise at a seasonally adjusted annual rate of $1.6 billion in the third



quarter of the year and by $2.8 billion in the final quarter (see Chart II). According to the same survey, however, shipments are also expected to advance over the remainder of the year at such a rate that the inventory build-up will serve only to maintain the generally tight relationship between stocks and sales that has characterized the current economic expansion.

Residential construction activity continues to slip back from the advanced levels reached earlier in the year. With some further decline in September, outlays for the third quarter as a whole—at a seasonally adjusted annual rate of $26.3 billion—were about 4 per cent below the advanced first-quarter rate (see Chart II) and 2 per cent below the second quarter. Housing starts declined again in August, putting the July-August average of starts 14 per cent below the first-quarter rate, while new housing permits issued moved up only slightly from the relatively low July level.

Apart from housing, the consumer continues to provide a major push to economic activity. Retail sales, rising almost 1 per cent in August, reached a record high of $22.1 billion, seasonally adjusted. Sales of automobiles contributed substantially to the advance, and dealers substantially cut their inventories of 1964 model cars. Nondurables sales, particularly apparel, also contributed to the August advance. Data for the early weeks in September suggest that retail sales declined somewhat from their August record. As noted in last month's *Review,* consumer intentions to buy are reported to be strong and, with the March tax cut continuing to provide an incentive for increased spending, further strength in the consumer sector can indeed be expected.

The Money Market in September

The money market remained generally firm in September. Federal funds traded predominantly at 3½ per cent, although there was trading at rates below that level on occasion. Member bank borrowing from the Federal Reserve Banks was temporarily high prior to the Labor Day holiday, and after the midmonth quarterly corporate dividend and tax payment dates which brought relatively heavy pressures on reserve positions at banks in the leading money centers.[1] Rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were in a 3⅝ to 4 per cent range during the first half of the month but most frequently in a 3⅞ to 4⅛ per cent range thereafter.

Offering rates for new time certificates of deposit issued by the leading New York City banks remained virtually steady, while the range of rates at which three- and six-month certificates of deposit traded in the secondary market edged slightly higher. Several upward adjustments in the rates of other short-term money market instruments occurred during the month. Thus, at the end of September, the major sales finance companies were quoting a 3¾ per cent offering rate on 30- to 89-day directly placed paper as against a 3⅝ per cent rate at the end of August. Similarly, at the month end commercial paper dealers posted a 4 per cent offering rate on prime 4- to 6-month paper, compared with a 3⅞ per cent rate at the end of August.

Treasury bill rates worked irregularly higher in September. This trend reflected additions to the supply of bills, seasonal pressures over the quarterly corporate dividend and tax dates, and the spreading view that monetary policy had shifted slightly toward less ease. Dealer holdings of bankers' acceptances rose sharply in September, as seasonal influences brought about increased bank selling of these instruments and a contraction in demand for them. Rates on bankers' acceptances, however, remained unchanged throughout the month.

The gradual downward drift in prices of Government notes and bonds which began late in August extended into early September, as market participants continued to react with caution to the uncertainties in the balance-of-

[1] As announced in the August issue of the *Federal Reserve Bulletin,* the Board of Governors is now releasing on a weekly basis a new set of statistics giving information on reserve positions and purchases and sales of Federal funds by forty-six major money-center banks, eight of which are in New York. Certain information on the financing of Government securities dealers by these banks is also provided. The *Bulletin* gives data for the period September 1959 through July 1964, and subsequent data can be obtained from the new current release and from future *Bulletins.* An analysis of the historical data and other related material will be published by the Board this fall in a special monograph.

The Business Situation

The firm upward course of economic activity has continued. Despite a drop in the pace of inventory accumulation, gross national product registered another substantial rise in the third quarter. Most of this gain reflected a strong rebound in the rate of increase in consumption expenditures following a lag immediately after the March tax cut. Among the monthly indicators, appreciable increases were scored in September in personal income, nonfarm payroll employment, and in the backlog of unfilled orders for durable goods. To be sure, the industrial production index barely edged forward in September, but this modest showing was largely attributable to the General Motors strike, which started on September 25. That strike, lasting four weeks or more at the various company installations, dampened business activity again in October, as sharp declines in the automotive sector inhibited over-all production and retail sales. With all the General Motors labor disputes now settled—and the very recent strikes at a number of Ford plants expected to be of short duration—activity should intensify to meet the pent-up and continuing demands for automobiles.

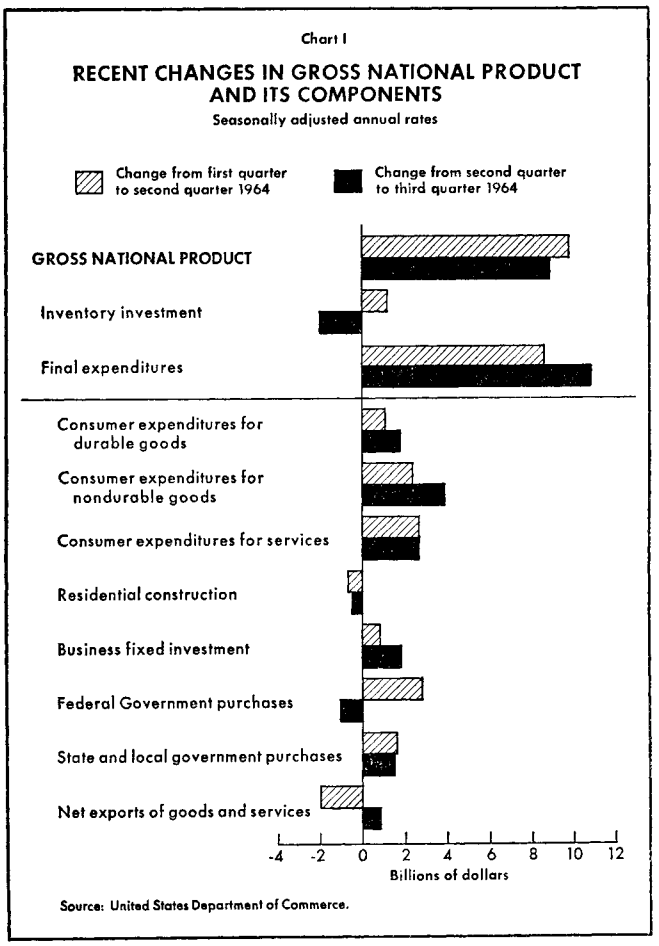
As the economy continues to move ahead, attention is being increasingly focused on the possibility that upward pressures on prices may become more intense. The broad price indicators have continued to reflect a substantial degree of over-all stability. Thus, the consumer price index has increased somewhat less so far this year than in the comparable period of 1963, and weekly October data suggest that the industrial component of the wholesale index was only faintly above its year-earlier level, in part reflecting a slight rise since mid-September. Yet, announcements of specific price increases have become more numerous of late, affecting such important products as sulphuric acid, zinc, lead, reinforcing steel bars, and steel pipes. With very high operating rates in a number of industries, reports of shortages of several types of skilled labor, and the possible spread of labor cost pressures spurred by the substantial gains obtained by the auto workers, price stability may now be approaching a period of testing.

RECENT DEVELOPMENTS IN KEY DEMAND SECTORS

Gross national product rose by $8.9 billion in the third quarter to a seasonally adjusted annual rate of $627.5 billion, according to preliminary estimates of the Department of Commerce (see Chart I). The increase was slightly less than the gain achieved in each of the first two quarters of the year, but a bit higher than the average quarterly advance since the end of 1962. Indeed, excluding inventory changes, the third-quarter advance in expeditures was the second largest quarterly increase since 1961. Furthermore, the $2 billion decline in the rate of inventory accumulation—on top of an already conservative ratio of stocks to sales at midyear—makes it even more likely that a continued rise in demand in the current period will be accompanied by increased output.

The most important factor in the rise in over-all spending in the third quarter was the $8.4 billion expansion in consumer outlays. The consumption increases were widespread among durables, nondurables, and services. At the start of the fourth quarter, however, spending on durables was retarded when strike-induced shortages caused October new-car sales to decline by 30 per cent. With cars now rolling off the assembly lines at an improved rate, trade sources expect the automotive sector to contribute significantly to retail volume in the final two months of 1964.

Business fixed investment has continued to be a major source of strength in the economy, rising at a seasonally adjusted annual rate of $1.8 billion in the third quarter. A further substantial increase in plant and equipment expenditures is expected in the current quarter, according to the August Commerce Department-Securities and Exchange Commission survey of businessmen's plans (made public some two months ago). Two surveys bearing on capital spending next year have recently been released. According to one, taken in July by the National Industrial Conference Board, major manufacturing corporations estimated that their third-quarter appropriations for plant and equipment



would be 14 per cent higher, after seasonal adjustment, than the record rate achieved in the previous three months. In the past, appropriations have tended to be reflected in actual expenditures some two to three quarters later. The second recent survey, taken by McGraw-Hill in October and early November, indicated that businessmen plan to raise their plant and equipment spending next year by 5 per cent over the level for 1964 as a whole. A year ago this survey pointed to a 4 per cent rise from 1963 to 1964, far less than the 13 per cent increase that is now expected to be realized. Indeed, all the previous McGraw-Hill fall surveys which preceded a full year of business expansion underestimated the extent of the rise in capital spending that actually occurred. On the other hand, the survey has tended to be on the high side for those years when the economy turned down.

Residential construction has weakened somewhat of late. Private housing outlays declined by $0.5 billion in the third quarter, following a $0.7 billion drop in the preceding quarter (both at seasonally adjusted annual rates). The latest forward-looking indicators of housing activity, moreover, do not suggest any near-term strengthening in this area. Thus, in September nonfarm housing starts were only moderately above August's nineteen-month low, and the number of building permits issued dropped to its lowest rate since February 1963. Over the longer term, of course, the continued rise in family formation makes it likely that residential construction will show renewed vigor.

In the government sector, spending at the state and local levels continued on its long-term uptrend in the third quarter. This increase was almost offset, however, by a sizable decline in Federal purchases of goods and services. Over the past year as a whole, the rate of increase in Federal expenditures has been substantially less than in the previous several years, and current estimates suggest that this sector will provide little further push to economic activity over the next few quarters.

PRODUCTION AND EMPLOYMENT

The Federal Reserve's seasonally adjusted index of industrial production inched up by 0.2 percentage point in September to a record 133.9 per cent of its 1957-59 average. This was the smallest monthly advance since last November, but the smallness of the advance of course reflected the special impact of a 12 per cent drop in automobile assemblies associated with the General Motors strike. Had that large concern been able to meet its original production schedules, the over-all index would have registered about the same sizable gain as in August. Iron and steel production edged up again, to its highest rate since the period of inventory accumulation just after the long strike in 1959, and output of most nondurable goods also increased. Moreover, business equipment output remained at an all-time high despite the reduced production of General Motors trucks. Partial data for October indicate a further 44 per cent cut in automobile assemblies but an additional rise in steel ingot production. The strength in steel output may well in part have reflected some hedging against the possibilities of a price boost and a strike which, under the terms of the steel labor agreement, could take place after April 30, 1965.

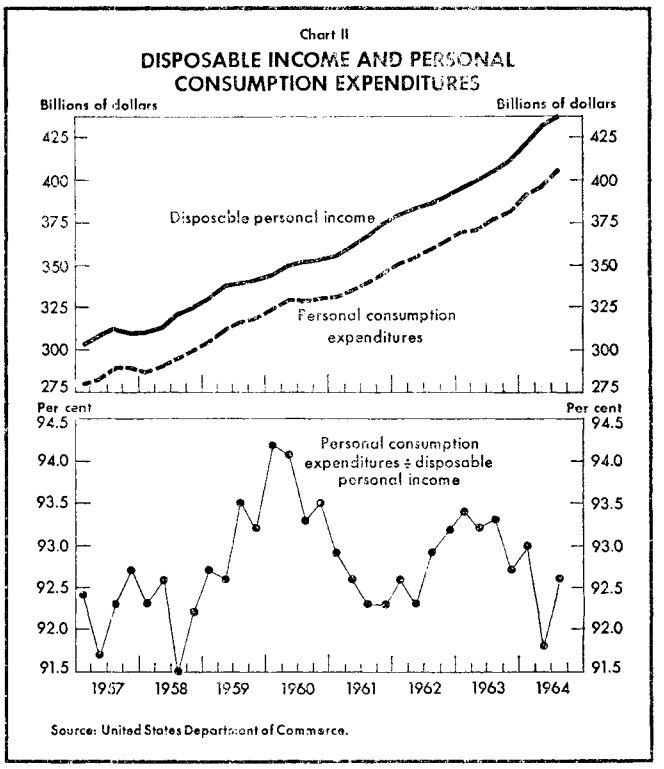
The number of persons on nonfarm payrolls increased by a moderate 103,000 in September (after seasonal adjustment). A rise in manufacturing employment and the increased hiring of teachers to instruct the expanding school population more than offset the drop in construction jobs. Compared with a year earlier, nonfarm payroll employment was up by 1.6 million persons, a somewhat greater gain than in the previous twelve-month period. In

October, total employment (as measured by the Government's household survey) was unchanged, and the unemployment rate remained at 5.2 per cent. Over the past four months the rate has averaged 5.1 per cent, or 0.5 percentage point less than in the comparable period of 1963.

RECENT CONSUMER BEHAVIOR

The large third-quarter increase in personal consumption outlays noted earlier suggests that the additional income provided by this year's tax cut is now being used more freely for consumption purposes. One of the aims of the new tax law was the stimulation of consumer buying through an increase in the amount of disposable income in the hands of the public. The results for the April-June quarter—the first full quarter in which the tax cut was in effect—suggested that its immediate impact on spending had been relatively limited. During that period, disposable personal income increased at a seasonally adjusted annual rate of some $12 billion—roughly $5 billion of which was directly attributable to a decline in tax payments—while consumer spending rose by $6 billion. Thus, only about half of the additional income was used to purchase goods and services, and the ratio of consumption expenditures to disposable income dropped to 91.8 per cent, the lowest level for any quarter since 1958 and significantly less than at any other time during the current business expansion (see Chart II). In the third quarter of 1964, however, consumer spending rose by $3 billion more than disposable income, and the consumption ratio increased to 92.6 per cent, very close to the 92.8 per cent average of the past ten years.

The behavior of consumption in relation to disposable income over the past two quarters should not have been totally unexpected. As indicated in the August 1964 issue of this *Review*, empirical studies suggest the existence of a historical tendency for the consumption ratio to decline over the short run when disposable income is advancing very rapidly. It is still too early to attempt a definitive evaluation of the effects of the tax cut on consumer spending. Nevertheless, the third-quarter experience is at least consistent with the view that increases in disposable income stemming from tax reductions are having much the same impact on consumer spending as do increases in after-tax income stemming solely from an expansion of economic activity.



The Business Situation

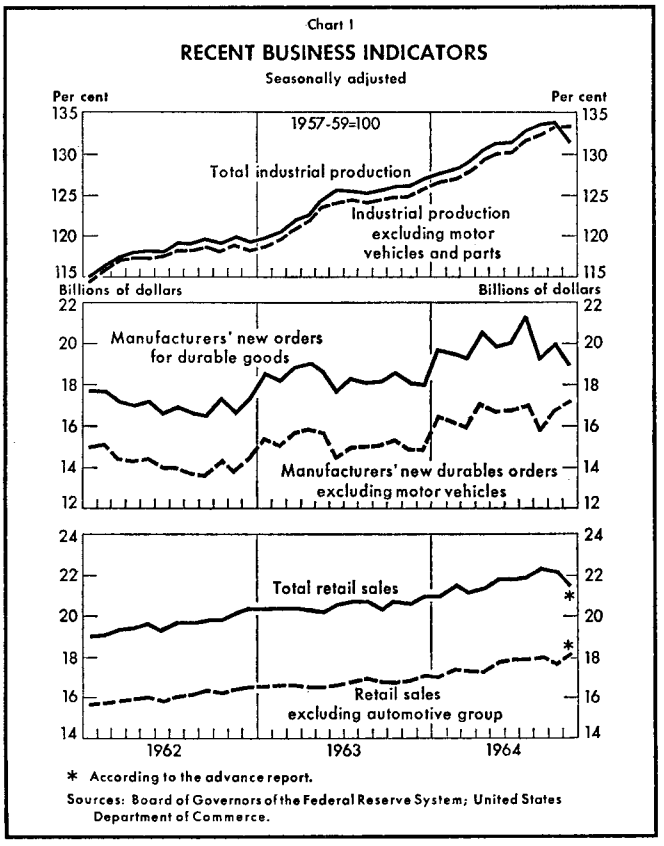
Strikes in the automobile industry had a significant impact on most business indicators in October and November, but these are now settled and the underlying strength of the domestic economy appears sufficient, on balance, to support further expansion. Work stoppages arising out of labor-management disputes are always difficult to evaluate in terms of their impact on business trends, current and future. While strikes are in progress, output, sales, and payrolls in the industry involved are of course lower than would otherwise be the case, and when settlements are finally reached there may be attempts to make up for lost production; only after some passage of time are these distortions gradually removed. In addition, both the strikes and developments after their settlement may influence production and employment in other industries not directly involved, and these influences may have secondary effects on prices, inventory behavior, and expectations.

Whatever the net effect of all these forces may be, it remains true that with the settlement of the strikes at both General Motors and Ford the entire automotive industry is now producing cars and allied products at peak rates and should provide a substantial push to economic activity in the months to come. At the same time, the economy is moving into the Christmas season amid expectations of record sales even after allowing for seasonal influences. The Census Bureau's October survey of near-term consumer buying plans, moreover, would generally seem to support the outlook for further improvements in sales performance at retail outlets over the coming weeks. Aside from strike effects, personal income and employment have continued to advance. Leading indicators of activity in the residential construction industry in September and October, moreover, appeared somewhat stronger than had been the case in earlier months. The latest Department of Commerce-Securities and Exchange Commission survey of businessmen's capital spending plans, conducted in November, also points to further near-term strength. In particular, the survey indicated that total business spending for plant and equipment for the first half of 1965 would reach $48.7 billion at an annual rate, up $2.0 billion from the rate now expected for the final quarter of 1964.

While the settlements in the automobile industry have removed some significant uncertainties from the economic picture, other problems—including important labor negotiations—still lie ahead. The most immediate question concerns the possibility of an East and Gulf Coast dock strike on December 20. In the somewhat more distant future, there is, of course, the possibility of a strike in the steel industry after April 30. The results of these various negotiations are certain to have an important bearing on the outlook for a continued orderly economic advance and for price stability. With regard to recent price movements, the consumer price index in October edged up by 0.1 percentage point to reach 108.5 per cent of the 1957-59 average. For the year through October, the consumer price index advanced by 1 per cent from the average for the final quarter of the year before, compared with a rise of 1.2 per cent in the corresponding 1963 period. Specific price announcements related to industrial commodities continue mostly on the up side, and weekly data for November suggest that the industrial component of the wholesale price index moved up further in that month, following a modest advance the month before.

PRODUCTION, NEW ORDERS, AND EMPLOYMENT

Reflecting the lost production at General Motors, the Federal Reserve Board's seasonally adjusted index of industrial production dropped by 2.3 percentage points in October to 131.7 per cent of the 1957-59 average (see Chart I). Excluding the substantial drag exerted by the motor vehicles and parts component, however, the overall index would have shown a slight rise. Iron and steel production rose by 1.3 per cent, reflecting broadly based demands. Despite the decline in truck production, total output of business equipment advanced by 1 per cent to a new high. Weekly data for November suggest that auto-



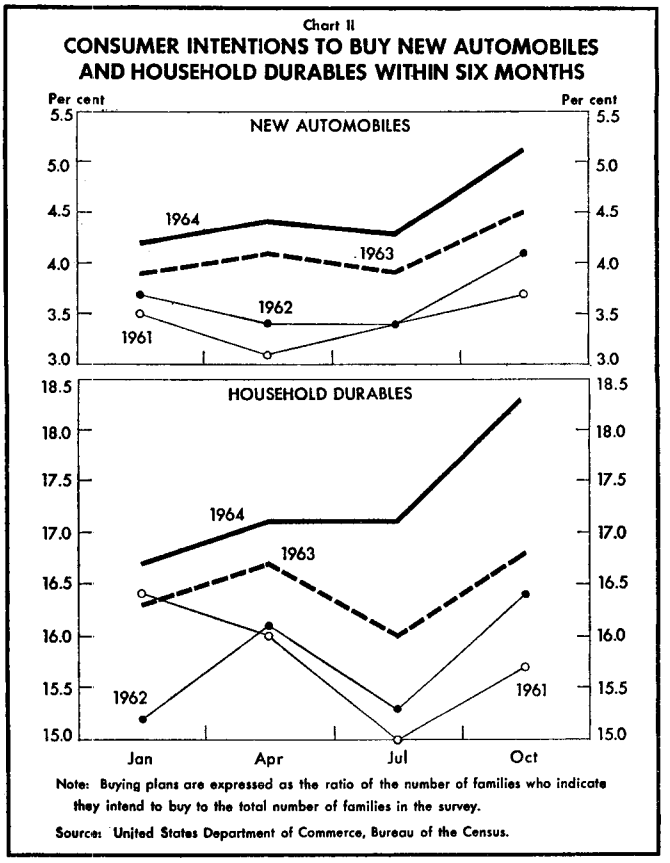
mobile assemblies made a strong recovery toward the end of the month and that steel ingot production continued to expand at a modest rate.

New orders booked by durables manufacturers registered a 2.1 per cent decline in October, following a modest 2.9 per cent gain the month before (see Chart I). The October fall in these orders reflected a sharp drop in orders for motor vehicles and parts, also attributable to the labor disputes at General Motors. Excluding the motor vehicles component, new orders edged up slightly, largely however on strength from the aircraft and parts component which tends to show somewhat erratic month-to-month movements. With new orders above shipments in October, the backlog of unfilled durables orders advanced by 1.9 per cent (seasonally adjusted) to mark the tenth month in a row in which an increase has been posted.

Nonfarm payroll employment in October moved down by 66,000 persons, seasonally adjusted, to 59.0 million. The October decline represented the first time since November 1963 that this series had turned down. The substantial 252,000 drop in manufacturing employment, which accounted for the fall in the total, was for the most part centered in the transportation equipment producing industry, again reflecting the wider impact of the strike at General Motors. Meanwhile, employment with state and local governments continued its long-sustained advance, and the service and trade groups also showed further moderate gains. In November, according to the household survey, both total employment and the civilian labor force rose, with the gain in the number of people finding jobs considerably larger than the expansion in the civilian labor force. As a result, the aggregate unemployment rate fell to 5.0 per cent, which has been bettered only once since February 1960. The unemployment rate for married men also showed marked improvement in November, dropping to 2.5 per cent. Teen-agers, however, remain a serious problem; their unemployment rate stood at 14.9 per cent in November, compared with 14.4 per cent the month before.

RESIDENTIAL CONSTRUCTION AND RETAIL SALES

Outlays for residential construction in November declined by 0.4 per cent (seasonally adjusted), thus continuing the weakening first noted in the second quarter. The latest



forward-looking indicators of housing activity, however, suggest the possibility that the downtrend of the past several months may now be leveling out. In September, nonfarm housing starts posted a modest 2.3 per cent gain after having moved down for two months in a row. In October, moreover, nonfarm housing starts rose by 8.9 per cent and building permits issued posted a slight increase following a considerable September decline.

Retail sales in October fell by 2.9 per cent, following a much smaller movement on the down side the month before (see Chart I). The October decline was fully accounted for by a 25 per cent drop in the automotive component, which in turn reflected the limited availability of new cars. As is also apparent from the chart, retail sales excluding the automotive group posted a good gain (2.7 per cent). Unit sales of new automobiles did appear to recover somewhat in November, but it will take a few more weeks to assess fully the post-strike strength of automobile demand. Consumer buying plans, at any rate, suggest strength. The Census Bureau's mid-October survey of such plans shows that the proportion of consumers planning to buy new cars within the next six months was markedly above the proportion for the second quarter as well as considerably above the corresponding 1963 period (see Chart II). The chart also shows that the proportion of consumers planning to purchase household durables within the next six months was even more substantially above earlier readings than in the case of cars.

The Money and Bond Markets in November

The high points of interest in the money and bond markets in November were important monetary policy changes on both sides of the Atlantic, and a massive cooperative international effort in defense of the pound sterling—all of which occurred in the week beginning November 23. The pound sterling had been under pressure in the international markets for some time, and this pressure became particularly intense on Friday, November 20. Against this background, the Bank of England on Monday morning, November 23, raised the bank rate from 5 per cent to 7 per cent in order to stem further speculative pressures. Yields in United States markets promptly rose on Monday as market participants, taken by surprise by the British action, generally anticipated that the Federal Reserve would follow sooner or later with an increase in the discount rate.

After the close of business that afternoon, the Board of Governors of the Federal Reserve System announced approval of actions by the Boards of Directors of the Federal Reserve Banks of New York, Boston, Philadelphia, Chicago, and St. Louis in raising these Banks' discount rates from 3½ per cent to 4 per cent, effective November 24. On subsequent days, the other seven Federal Reserve Banks followed suit: the Federal Reserve Bank of Atlanta on November 25; the Federal Reserve Banks of Dallas, San Francisco, Richmond, and Cleveland on November 27; and the Federal Reserve Banks of Minneapolis and Kansas City on November 30. The discount rate change was the first since July 1963, when Federal Reserve discount rates were raised from 3 per cent to 3½ per cent. The Board of Governors also announced that effective November 24 it was increasing the maximum rates that member banks are permitted to pay on savings deposits and time deposits, while the Federal Deposit Insurance Corporation stated that these new ceilings would also apply to insured nonmember banks.

The Board noted that these actions were taken "to maintain the international strength of the dollar". The moves were "aimed at countering possible capital outflows that might be prompted by any widening spread between interest rates in this country and the higher rates abroad and also at ensuring that the flow of savings through commercial banks remains ample for the financing of domestic investment". (See box below for the full statement.)

On Tuesday, November 24, yields on Treasury bills, notes, and bonds rose further early in the day but then steadied at the higher rate levels. The increase in the Bank of Canada's rate to 4¼ per cent from 4 per cent had no perceptible effect on the United States Government securities market. Sizable speculative pressure against the pound sterling reappeared on the same day, however, and early on Wednesday yields again increased in the United States Government securities market as investors sold on a mod-