

Economic Expansion in 1965

IN 1965, the American economy set records in production, sales, employment, income, and living standards, as the expansion that started in early 1961 was extended for the fifth year in a row. Most broad measures of economic activity showed impressive gains, which exceeded even the large advances of 1964 and surpassed by a wide margin the expectations for 1965 held early in the year by most businessmen and economic forecasters. Demand increased in most final markets and was especially strong for business fixed investment and consumption expenditures, notably durable goods.

Within the year, the advance in total output and sales was uninterrupted but somewhat irregular. In the early months of 1965, increases were unusually large as the economy recovered from the depressing effects of the automobile strikes of late 1964. Gains moderated in the spring months but accelerated after midyear under the influence of sharply rising capital outlays, the cut in excise taxes, the increase in Social Security payments in early fall, and particularly the step-up in defense expenditures that resulted from the increase in the fighting in Vietnam.

Prices rose somewhat more from 1964 to 1965 than in the other years of the current expansion, but for the year as a whole, the rise over 1964, as indicated by the comprehensive GNP deflator, could still be characterized as moderate. The most prominent price increases occurred in the first half of the year, for farm products and for food products at both wholesale and retail levels. Wholesale industrial prices rose in each quarter of 1965

and for the first time since 1959 showed a modest but noticeable increase for the full year; consumer prices rose somewhat more in 1965 than the year before. The cost of credit also moved up as the demand for borrowed funds

advanced even more rapidly than the substantially increased supply of credit.

Although the Nation's capacity to produce was considerably enlarged in 1965, the rise in output was still greater, and the gap between potential and actual output was lower than at any other time in the current expansion. Despite a large increase in the labor force, unemployment rose even more; unemployment declined steadily, and by yearend was close to the Administration's interim goal of a 4-percent unemployment rate. Unemployment rates were still high for teenagers and Negroes, but toward the end of the year, labor shortages were not uncommon in some occupations and industries. Even though businessmen made record capital outlays to expand and modernize their plant facilities, the utilization of manufacturing capacity increased and for the full year was about as high as it was in 1955.

Perhaps the outstanding development in 1965 was the change in the economic climate that emerged around the end of the year. It reflected the buoyant state of demand, the prospective large increases in spending, particularly for defense, and the growing pinch on resources. It was a dramatic shift from the spring months, when there was a widespread belief that the expansion might be slowing down. As the year came to a close, a basic question was whether the Nation's capacity to produce could accommodate the anticipated increase in aggregate demand with the moderate price increases that have thus far distinguished the 5-year expansion.

Table 1.—Key Economic Measures, 1962-65

	1962	1963	1964	1965 ¹
Gross national product...bil. \$.	560.3	589.2	628.7	675.6
Personal consumption expenditures...bil. \$.	355.1	373.8	398.9	428.5
Gross private domestic investment...bil. \$.	83.0	86.9	92.9	104.9
Net exports of goods and services...bil. \$.	5.1	5.9	8.6	7.2
Government purchases...do.	117.1	122.6	128.4	135.0
Gross national product in constant (1958) dollars...bil. \$.	530.0	550.0	577.6	609.0
National income...do.	457.7	481.1	514.4	554.6
Compensation of employees...bil. \$.	323.6	341.0	365.3	391.9
Corporate profits...do.	55.7	58.1	64.5	73.1
All other...do.	78.4	82.0	84.6	89.6
Personal income...do.	442.6	464.8	495.0	530.7
Disposable personal income...bil. \$.	385.3	403.8	435.8	465.3
Disposable personal income in constant (1958) dollars...bil. \$.	367.6	380.6	406.5	428.1
Retail sales...do.	235.4	246.4	261.6	282.7
Dealers' sales of new domestic cars...thous.	6,753	7,334	7,617	8,763
Expenditures for new plant and equipment...bil. \$.	37.3	39.2	44.9	51.8
Total construction...do.	59.6	62.8	65.8	68.1
Private nonfarm housing starts...thous. units.	1,439	1,582	1,530	1,481
Manufacturers' sales...bil. \$.	399.7	417.3	445.6	483.6
Industrial production 1957-59=100.	118.3	124.3	132.3	143.3
Steel ingot production...mil. tons.	98.3	109.3	127.1	131.2
Motor vehicles, factory sales...thous. units.	8,173	9,100	9,292	11,064
Employees in nonfarm establishments...thous.	55,515	56,602	58,156	60,432
Unemployed persons...do.	4,007	4,166	3,876	3,456
Consumer prices...1957-59=100.	105.4	106.7	108.1	109.8
Wholesale prices...do.	100.6	100.3	100.5	102.5
Loans and investments of commercial banks, end of period...bil. \$.	228.3	246.5	267.2	294.0
Consumer installment credit outstanding, end of period...bil. \$.	48.0	53.7	59.4	66.0

¹ Preliminary.

² End of November.

Source: Automobile Manufacturers Association, American Iron and Steel Institute, and U.S. Government.

Government policies

Economic activity during the year was influenced in many different ways—apart from the rise in defense programs late in the year—by Government policies adopted both during and before 1965. The 1964 reduction in personal and corporate income taxes continued to stimulate personal consumption expenditures and business spending on new plant and equipment, and the cut in corporate taxes at the beginning of 1965 provided a further stimulus to business investment. The reduction in excise taxes around midyear lowered prices on a wide variety of consumer goods and provided an additional fillip to consumer spending. Personal income was directly increased by the rise in Social Security benefits. Some of the rise in employment, notably among teenagers, was a reflection of special Government programs associated with the war on poverty. Under the wage and price guidelines, the Government increased pressures against excessive wage and price increases in particular industries. A significant part of the reduction in the balance of payments deficit was a result of the Administration's voluntary program aimed at lowering private capital outflows.

The Federal Reserve permitted a record expansion in bank credit in 1965 but exerted moderate pressure on bank reserves during the year. In December, Reserve authorities raised the discount rate by one-half of 1 percent and permitted member commercial banks to pay up to 5½ percent on time deposits held more than 30 days.

Yearend Position and Outlook

Total production and sales showed a large increase in the closing months of the year. According to preliminary data, fourth quarter GNP was up \$13 billion (annual rate) over the third quarter. Among the major markets, the most noteworthy development was the large advance in government purchases—more than \$4 billion—about half of which represented increased outlays for defense, particularly military pay.

Personal consumption expenditures continued their vigorous rise with a fourth quarter gain of about \$7½ billion; the change in durable goods purchases, however, was very small. The strong expansion in business fixed investment continued with an increase of almost \$2 billion, but investment in residential structures edged down for the second successive quarter.

Activity rose rapidly throughout the fourth quarter. In December, personal income increased by \$4½ billion over November and reached a seasonally adjusted annual rate of more than \$550 billion. Payrolls rose in most industries as employment and rates of pay increased; hours of work continued unchanged at peak postwar levels.

The December rise in employment in nonfarm establishments was close to 400,000, after seasonal adjustment, two-thirds larger than the average monthly increase since December 1964. Unemployment showed another improvement, and the unemployment rate fell to 4.1 percent of the labor force. The unemployment rate for married men, at 1.8 percent, was the lowest since 1953.

Industrial production in December increased over a broad range of indus-

tries and on an overall basis rose almost 1½ percent, after seasonal adjustment. One feature of the month was the pickup in steel output after 4 straight months of decline. The steel industry seems to be preparing for a resurgence of steel demand in the near future and is apparently building up its own inventories. Stocks of steel held by steel consumers have been cut sharply since September; with consumption moving higher, the inventory adjustment by steel users seems to be moving rapidly toward completion.

Holiday trade appeared to be very buoyant, and retail sales showed a good-sized increase over November, according to advance reports.

Wholesale prices in December rose 0.6 percent over November because of large increases in the prices of farm and food products. Industrial prices were unchanged over the month.

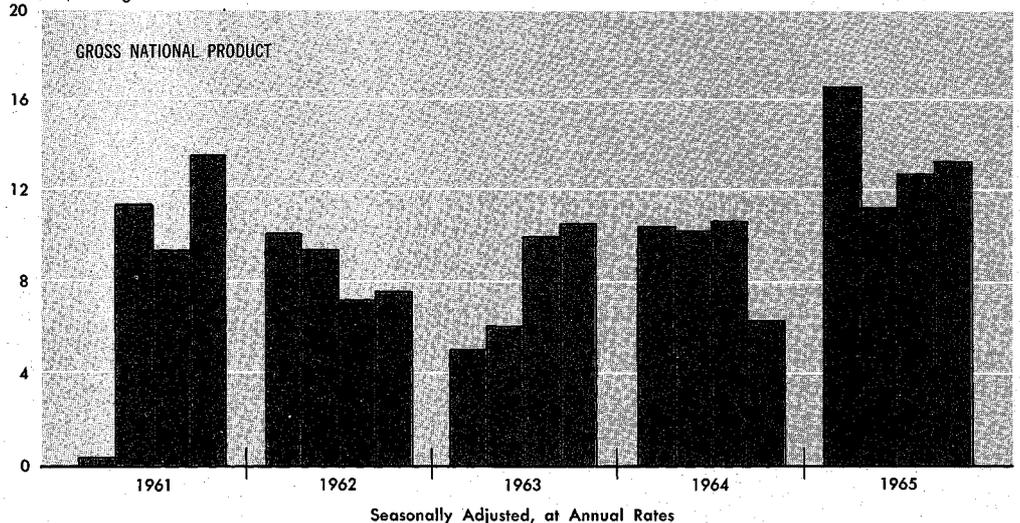
Outlook for 1966

At no other time since the start of the expansion did prospects for rising output in the year ahead appear so certain as they did at the end of 1965. With a resolution of the Vietnam con-

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GNP Showed Large Increases in Each Quarter of 1965

Billion \$ Change From Previous Quarter



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an annual total of \$73 billion. In both relative and absolute terms, this was the sharpest calendar-year rise since 1959. Four-fifths of last year's gain was scored in the first quarter and was heavily influenced by the spurt in automobile production. Profits continued to rise in subsequent quarters, but the rate of increase was not as great as the extraordinary first quarter rise.

Most industries shared in last year's advance in profits. The rise was especially marked in durable goods manufacturing, and in the transportation industries, where increases in volume had a considerable effect on earnings. Profits remitted from the rest of the world also rose rapidly last year, as companies stepped up the repatriation of earnings from abroad to conform to the Administration's voluntary program to improve the balance of payments.

After the initial recovery phase of the earlier postwar expansions, there was a tendency for profit margins to fall as the expansion progressed. In contrast, since the sharp rise in profit margins that accompanied the early recovery period of the current economic expansion, margins either have been stable or have risen slightly. Last year, corporate profits were 18 percent of corporate output, as compared with 17 percent in 1964. Margins rose sharply in the first quarter of last year and apparently changed little thereafter.

Profits after taxes rose 19½ percent last year to reach a total of about \$44½ billion. The sharper rise in after-tax profits than in before-tax profits stemmed from the second phase of the 1964 income tax cut. Corporate dividend payments did not match the rise in after-tax profits: At \$19 billion, dividends were only 9¼ percent above a

year earlier. The combination of a marked increase in after-tax profits and a more moderate one in dividends was reflected in an unusually large gain—28 percent—in undistributed corporate profits. This rise, together with the long-term growth in corporate capital consumption allowances, helped boost internal funds 14¼ percent.

Farm income higher

Last year featured a rise of about one-fifth in the income of farm operators (chart 14). This brought total farm proprietors' income to over \$14 billion—the highest level since 1952, when there were roughly 50 percent more farm operators than there are today.

The increase in farm income reflected principally an upsurge in prices received by farmers for meat animals. These prices moved up sharply in the second quarter, eased moderately thereafter, and then jumped sharply again in December. For the year as a whole, the rise in meat prices over 1964 was

almost 20 percent. The volume of farm output was up 4 percent from the previous year, and there was little increase in the unit operating expenses of farms.

Economic Expansion in 1965

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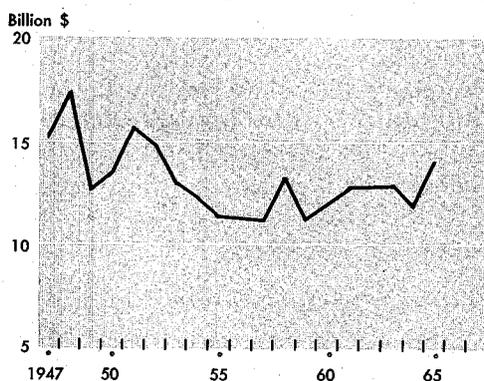
flict not in sight, by far the dominant factor, of course, was the prospective increase in defense purchases. Outlays by State and local governments could be expected to continue their strong upward trend.

As pressures on capacity mounted and the need for modernization continued, business was planning to make sizable increases in plant and equipment expenditures. It was not likely that residential construction would show much change in 1966; if anything, the tightening in interest rates was likely to dampen new starts by homebuilders. Business inventory demand was, as usual, an uncertain quantity. Because of longer delivery times and the possibility of shifts in price expectations, it was not clear that businessmen would continue the relatively conservative inventory policies generally pursued throughout the current expansion. A more rapid rate of increase in production abroad seemed likely, this would stimulate some growth in exports over late 1965 levels. Consumer income and spending could be expected to show further large gains in 1966.

In the above setting, continued increases in employment and decreases in unemployment could be anticipated. The main uncertainties regarding 1966 concerned the adequacy of supplies and stability of costs and prices.

CHART 14

Farm Proprietors' Income in 1965 Was Higher Than in Any Year Since 1952



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