Economic Expansion Continues

THE NATION'S PRODUCTION of goods and services increased slightly in April, after advancing markedly from the fourth quarter last year to the first quarter this year. From a short-run viewpoint, most indicators suggest that the pace of activity quickened in the first quarter and has since slowed. From a somewhat longer viewpoint, gains from September to April represent a continuation of the rapid pace of activity which has prevailed since mid-1963.

Since late last summer, there has been substantial fluctuation in the rate of economic gain. This pattern of uneven increase in recent months can be ascribed to two distorting factors: strikes in the automobile industry last fall and steel stockpiling in anticipation of a strike in the steel industry in the spring of this year. These factors have made difficult an interpretation of the course of the economy from month to month.

Prices, Wages, and Productivity

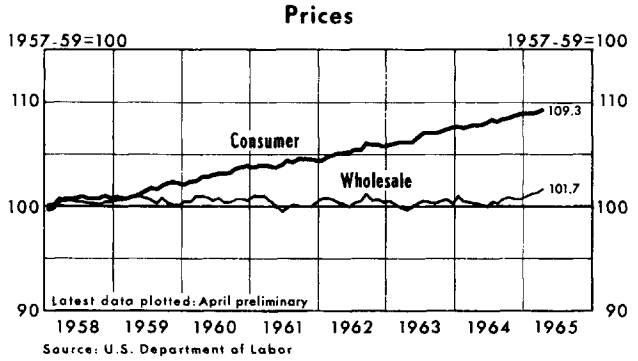
Since World War II, prices and wages have tended to increase in the later stages of periods of economic expansion. During the expansion since 1961 little increase in the average level of prices has appeared, compared with experience in previous periods of business expansion.

Labor cost-productivity relationships in the strategic manufacturing sector of the economy are sometimes measured by labor cost per unit of manufacturing output.[1] By this measure, productivity in manufacturing has exceeded increases in money wage costs during most of the recent expansion, i.e., average unit labor costs have been declining since 1961. In April this index was 94 per cent of its value in February 1961. These estimates suggest a lack of pressure on businesses to increase prices of products they sell.

Comparable measures are not available for nonmanufacturing, but conclusions may be inferred by examining labor cost per dollar of corporate gross product.[2] In addition to corporate manufacturing concerns, the following industries are included: construction, finance, trade, and transportation. By this measure, wage costs have been increasing about as rapidly as productivity. In the first quarter of 1965 labor cost per dollar of corporate product was 100.2 per cent of its value in the first quarter of 1961. To the extent that these two series are comparable, when viewed together they suggest that wage costs have been increasing more rapidly than productivity among nonmanufacturing concerns.

Prices reflect recent developments in wage costs, productivity, and total demand. Wholesale prices, particularly of industrial materials, were virtually unchanged from 1961 to mid-1964. From September 1964 to April 1965 wholesale industrial prices rose at a 1.7 per cent annual rate. This recent increase may reflect the special circumstances related to the uneven advance in production activity since September. Some bottlenecks appeared as firms attempted to accumulate inventories. It seems that such price increases as have resulted were caused by abrupt increases in demand rather than by increasing costs. Wholesale prices during the past year, for the first time in several years, have risen as rapidly as consumer prices.

The consumer price index has continued to rise at a steady rate. In view of the limitations of the index, it is not clear that prices have risen during the 1961-65 expansion. Especially difficult is the measurement of changes in the quality of services, which have been a major factor in the upward drift of the index.



Production, Employment, and Sales

Standard measures of economic activity have increased unevenly but, on the whole, quite rapidly since

[1] As computed by the Bureau of the Census of the Department of Commerce, this is the ratio of the index of compensation of employees in manufacturing to the Federal Reserve's index of industrial production. See the Bureau of the Census' publication, *Business Cycle Developments.*

[2] Ratio of compensation of employees in corporate enterprises to value of corporate product in 1954 dollars. See *Business Cycle Developments.*

September. When rates of change of various measures of activity for the period from September to April and for the year ending in April are examined, they indicate that the recent upswing in activity has been a continuation of the rapid rate of advance which began in mid-1963.

Industrial production increased at an 8.7 per cent annual rate from September to April, compared with 7.9 per cent in the year ending in April. Increases were largest among durable goods, particularly automobiles and steel.

Outlays for new construction in April were up at a 2.2 per cent annual rate from September and 1.2 per cent from a year earlier. Business construction has shown the largest increase over the past year, while private residential construction has changed little.

Payroll employment rose at a 4.3 per cent annual rate from September to April, above the rate of increase since April 1964. Employment gains were widespread among the major industries. Total employment is estimated to have increased at a 3.1 per cent annual rate from September to May. Population aged 18 to 64 is estimated to have been increasing at a 1.6 per cent rate during the past year. Thus the comparative rate of growth of employment is very strong. Unemployment has also declined; in May unemployment of married men was 2.5 per cent of their labor force, compared with about 2.8 per cent a year earlier.

Retail sales were up at a 4.3 per cent annual rate from September to April, significantly below the rate since April of last year. Sales have declined from the very high level attained in February.

Personal income in April was up at a 5.7 per cent annual rate from September, the same rate as from April 1964.

Monetary and Fiscal Developments

Some variables strategic to the determination of total demand for goods and services have been less stimulative in recent months than in most of 1964. The rate of expansion of the money supply has slowed somewhat since late last fall, and Federal Government receipts have been increasing more rapidly than expenditures.

Preliminary data show that money was virtually unchanged from November to May, compared with a 4.2 per cent average annual rate of increase from September 1962 to November 1964. New seasonal adjustment factors currently are being computed for money, and it appears possible that when the new factors are applied to the period since November there will be some moderate expansion in money.

Member bank total reserves rose at an 8.2 per cent annual rate from November to the month ending May 15. Most of the addition to reserves was absorbed by increases in time deposits and Government demand deposits. Reserves available for private demand deposits increased at a 0.7 per cent annual rate from November to the month ending May 15.

Interest rates changed little from November to May, a period of rapid expansion in business activity. Associated with these conditions has been a very rapid growth of commercial bank loans. Business loans expanded at a 23 per cent annual rate from November to April. To expand their loans, banks have reduced their holdings of U. S. Government securities, borrowed funds (both from the Federal Reserve and from other banks), and attracted more time deposits.

Federal Government receipts (national income accounts basis) rose sharply in the first quarter, and expenditures increased only slightly. As a result, the national income accounts budget showed a deficit of $0.1 billion (annual rate) in the first quarter, compared with about a $5 billion deficit in the second half of 1964. The full employment budget surplus, which adjusts the national income accounts budget for cyclical variations in economic activity, is estimated to have increased to about $5 billion from about $2 billion in late 1964.

Current estimates indicate that the budget situation will be more stimulative in the second half of 1965 than in the first half. Reductions in excise tax rates are expected, along with increases in social security pensions retroactive to January 1, 1965. Beginning January 1, 1966, however, Government receipts are expected to rise because of proposed increases in social security tax rates.

Balance of Payments

The recent trends in U. S. monetary-fiscal policy mix can be compared with those in other major foreign economies. Stabilization policies are implemented by relying on some combination of fiscal and monetary action. The relative weights attached to these can be described as the "policy mix." A given stimulus to aggregate demand can be attained by a variety of fiscal and monetary combinations, but the implications for credit availability and interest rates differ. "Liberal" fiscal measures tend to raise interest rates and "tight" fiscal measures to reduce them, while "easy" money tends to lower rates and "tight" money to raise them. Accordingly, in deciding on the policy mix to be followed, the question of appropriate interest rates *vis a vis* other countries cannot be overlooked.

(Continued on page 16)

years, the rate of return on capital was highest for the group with greatest assets per farm. For example, the eight largest farms in the sample, with assets averaging $175,498 in 1963, had an average return on capital of 6.9 per cent in the four years 1960-1963 (Table X). This compares with an average return of 1.3 per cent for the seven smallest farms.

Table X

AVERAGE RATE OF RETURN ON FARM CAPITAL
Typical Commercial Farms in the United States
Classified by Value of Assets

Group	Assets per Farm, 1963	Average Return on Capital 1947-49	1950-54	1955-59	1960-63
1	$175,498	10.9%	7.3%	6.0%	6.9%
2	98,111	10.1	7.0	5.3	6.0
3	58,003	10.1	4.7	2.8	3.2
4	31,080	0.6	0.1	0.4	1.3

Note: The total number of farms in the array includes all the typical farms having consistent data throughout the period. Returns to capital are based on net farm income for owner-operated farms, less deduction for operator and family labor at average U. S. farm wage rates without board or room.

Source: USDA, *Farm Costs and Returns: Commercial Farms by Type, Size, and Location,* Agricultural Information Bulletin No. 230, June 1964 and preceding issues.

The data indicate that the spread in returns to capital between the large and small farms was not so great in recent years as in 1947-1949 and the early 1950's. The spread in returns to capital between the largest farms and the smallest farms in the three years 1947-1949 was 10.3 percentage points, whereas in the periods 1955-1959 and 1960-1963 it averaged only 5.6 percentage points.

Summary

Since 1950, credit used by farmers has grown at about the same rate as credit used by other major sectors of the economy. Credit per farm and per farm worker has increased sharply. Relative to farm assets, farm debt has almost doubled, with the greatest increases in the nonreal estate portion.

Farm mortgage debt held by the Federal Land Banks expanded more rapidly than that held by any other class of institution. Production credit associations showed the greatest rate of gain in nonreal estate credit.

Major forces contributing to the growth of farm credit include the bidding up of land values, higher operating costs, reduced liquid assets of farmers, greater investment in the industry, and adjustments of farm resources into fewer and larger operating units.

The increase of farm credit has played an important part in the greater productivity of agriculture. It has aided readjustment of the nation's farm resources into more efficient and more highly capitalized units, thereby contributing to more efficient use of the nation's supply of labor. In turn, these trends have brought consumers lower food costs. Credit has thus aided in releasing labor from production of food and other agricultural products to the production of nonfarm goods and services and contributed to a rapid increase of total real product in the nation.

Economic Expansion Continues—*(Continued from page 11)*

Varying policy mixes have implications for capital movements among countries. For example, a mix of "tight" monetary policy and "easy" fiscal policy may reduce an outflow of funds and consequently reduce a deficit in the international accounts of a nation. "Easy" money and "tight" fiscal policy may help to slow inflows of capital to a country and reduce an inappropriate surplus in a country's international accounts.

It may be that a major correction of imbalance in the world pattern of international accounts could be achieved by appropriate change in the mix of monetary and fiscal policies in various countries. "Tighter" fiscal policies in surplus countries combined with "easier" fiscal policy and "tighter" monetary policy in deficit countries might facilitate a high rate of economic activity generally along with less discrepancy of interest rates among leading industrial nations.

The U. S. balance of payments in the first quarter showed marked improvement over the fourth quarter, despite adverse effects stemming from the dock strike and heavy foreign lending prior to the announcement of the Voluntary Credit Restraint Program. The deficit of $3.1 billion per annum was half that of the fourth quarter. The trade surplus fell from over $7.1 billion per annum to around $3.9 billion, chiefly because of the strike. However, U. S. private capital outflow fell sharply from over $8.0 billion (annual rate) in the fourth quarter to around $4.0 billion, with most of the gain reflecting reduced short-term flows abroad. Available data, highly tentative, indicate that the U. S. international payments accounts have been in surplus since the end of March.