A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1958 April

Contents

THE Trend OF BUSINESS

Employment, production and income have continued to drift downward. By most measures, the current recession now approximates the experience of 1948-49 and 1953-54. During February, wage and salary employment, seasonally adjusted, dropped to 51.2 million—off 600,000 from January and 1.4 million from a year earlier. Industrial production declined further and was 11 per cent below the year-ago level. Personal income, at an annual rate of 342 billion dollars, was still above last year, but was over 5 billion dollars below last September's record level. In the early weeks of March, some seasonal gains in construction employment were noted, and the approaching Easter Parade was helping to boost traffic in department stores. But the near-term trend of business remained uncertain.

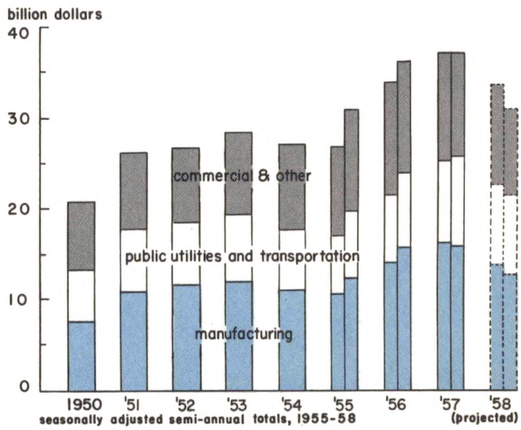
Inventory adjustments proceeding

Inventory liquidation accelerated sharply early in the current year and maintained a persistent downward pressure on most measures of activity. In fact, one evaluation of the rapidity of the inventory adjustment could suggest an early end to the depressing effects from that sector, assuming maintenance of buying for final use.

Total business inventories declined 600 million dollars on a seasonally adjusted basis during the fourth quarter of last year. January alone saw a further drop of about the same amount. Although the move to hold down inventories has been widespread, virtually all of the decline since September is accounted for by manufacturers of durable goods. It was those metal-using lines which had accounted for a large portion of the build-up of stocks in the two and one-half years prior to last September. The reason is simple. Hard goods production had risen most during the boom and has fallen off the most during the succeeding slowdown.

Steel production in the first quarter of 1958 totaled only about 19 million tons. This was 40 per cent below the same months of last year. However, steel pourings stabilized in March after a year-long decline, and orders have been improving since early this year. Significantly, the types of steel, mainly lighter products, which had been cut back

Capital expenditures boom passes its peak



earliest are now showing some signs of strengthening. The heavy items, such as structurals and plate, which had been in tight supply earlier have been readily available in recent months. The heavy plate outlook is clouded by a court decision on rate regulation which is causing a number of planned pipe line projects to be deferred.

The better tone noted in steel orders has also been evident in fabricated copper and aluminum products. However, inventories of copper and aluminum continue heavy, and further reductions in output of these metals may be indicated.

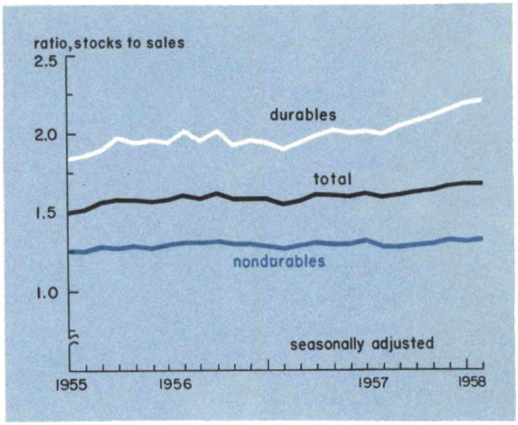
Another indication that some inventory reduction plans may have been largely completed is seen in an improvement in demand for minor capital goods and components, such as welding equipment, small electric motors, transformers and similar products. Inventory adjustments usually can be made most easily in products of this type.

The increase in defense procurement contracts is beginning to exert some influence. The evidence is most marked on the West Coast, but there has been some pickup in defense business in the Midwest also. Tool shops and suppliers of parts have reported some gain in orders from defense contractors.

Capital spending reduced

Business expenditure plans for new plant and equipment have been revised downward. A Department of Commerce—Securities Exchange Commission survey indicates that businesses expect to spend 32 billion dollars for new facilities in 1958, a decline of 5 billion dollars or 13 per cent from 1957. Spending by durable goods manufacturers is expected to be off 22 per cent. This prospect was not unforeseen. New orders for machinery of all types declined fairly steadily during 1957 and at year end were running 15 per cent below the rate of a year earlier. Machine tool orders in January showed a slight rise, but the amount of new orders was only one-third of the year-ago figure and one-fifth of the very high rate of two years ago.

Inventories of hard goods continue to rise relative to sales through January



The cutback in investment plans is reflected also in a survey of manufacturing firms' authorizations of capital spending, reported by *Newsweek* and the National Industrial Conference Board. This survey indicates that new plans approved in the fourth quarter of 1957 were one-third below a year earlier. Moreover, cancellations of spending plans approved previously had increased.

Construction is another capital goods sector which is showing less vigor than had been expected a few months ago. The value of construction put in place declined slightly on a seasonally adjusted basis in February, and the number of private housing starts nationally was estimated to have dropped to an annual rate of 890,000, somewhat below the reduced level of early 1957. Unfavorable weather conditions—heavy snows and low temperatures in many parts of the country—undoubtedly accounted for a part of this cutback, but apparently were not the sole cause.

Construction contract awards for January were 10 per cent below last year in the U.S. and were off 30 per cent in the Midwest. Moreover, all major categories participated in this decline, including the residential component. Construction outlays in 1958 may well exceed 1957 for the year as a whole, as estimated by the Department of Commerce and Bureau of Labor Statistics last November, but the industry will have to overcome a slow start.

Retail trade trends

In February, retail trade fell about 3 per cent from the January level, to an annual rate of 16.2 billion dollars. For the first time since October 1954, consumer takings at retail were below their year-earlier figure. Although most categories were affected by slower buying, the greatest impact has been in larger goods which often involve consumer credit. The following table indicates the variation in dollar volume results among retailing groups in the nation during February:

	Per cent change February 1958 from February 1957
Total	−1
Grocery stores	+8
Eating & drinking places	−4
General merchandise	−2
Apparel	−1
Furniture & appliance	−9
Lumber & hardware	−9
Automotive	−14
Service stations	+6
Drug stores	+10

New car deliveries for the first two months of the year, according to *Ward's*, were 26 per cent below the 1957 period and the lowest in six years. These results, too, undoubtedly were influenced by adverse weather conditions.

In early March, department stores were reporting some improvement in sales over the corresponding year-ago period. In part, this could be a reaction from a depressed February and, in part, it may reflect the earlier date of Easter this year. It is estimated that the earlier Easter could account for something on the order of a 6 per cent rise in department store sales in March relative to March last year.

As usual, sales trends of particular firms and products have not followed the same pattern as total retail sales. Producers of certain new models of refrigerators, washing machines and hot water heaters, for example, have reported excellent consumer acceptance. Some retailers have attributed unsatisfactory sales to inadequate inventories, particularly of moderately priced merchandise.

Despite the slackening of income, employment and spending which has occurred in recent months, the consumer price index continued to rise through January. The increase was due in part to reduced supplies of meat animals and fresh fruits and vegetables, the latter resulting from abnormal weather in areas of the South.

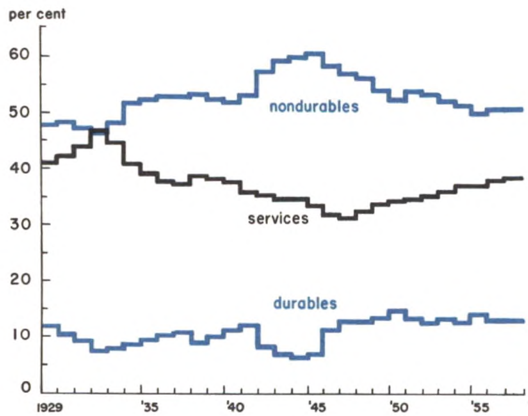
The Survey of Consumer Finances, released in March by the Federal Reserve Board, indicates that individuals are somewhat more uneasy about economic prospects than in other recent years. Substantially fewer families expect to buy new cars or new homes this year, and intentions to buy furniture and appliances are also down slightly. However, consumers are more flexible than businesses in their buying plans and may change more quickly.

The swing to services

During the final quarter of 1957, consumer spending for *goods and services* declined 1.2 billion dollars from the record summer pace. Although the decline represented only a small fraction of the 284 billion annual spending rate chalked up in the third quarter, it was the first since the recession months of late 1953.

In all three postwar recessions to date, the pattern of consumer spending has shown at least one notable similarity: While personal outlays for *goods* have declined in each business downturn, the decrease has been offset in part by a continued upward movement in spending on *services*. For example, combined purchases of consumer durable and nondurable goods dropped 2.3 billion dollars, at an annual rate, between the third and fourth quarters of last year, while service outlays rose 1.1 billion. This offsetting movement in spending for services reflects the robust and persistent growth of such expenditures throughout the postwar period.

Services capture increasing share of consumer dollar since 1947



Impressive gains

Today almost two out of every five dollars of consumer expenditures involve payment for services, including items which range from rent and railroad travel to haircuts and hospital care. Service expenditures include all those consumption outlays for which no physical product is received in return.

The growing importance of consumer spending for services is evident in both absolute and relative terms. Measured in dollar amounts, service expenditures have more than doubled in the past ten years. This compares with a 70 per cent increase in outlays for consumer durable goods and a 50 per cent pickup in spending for nondurables.

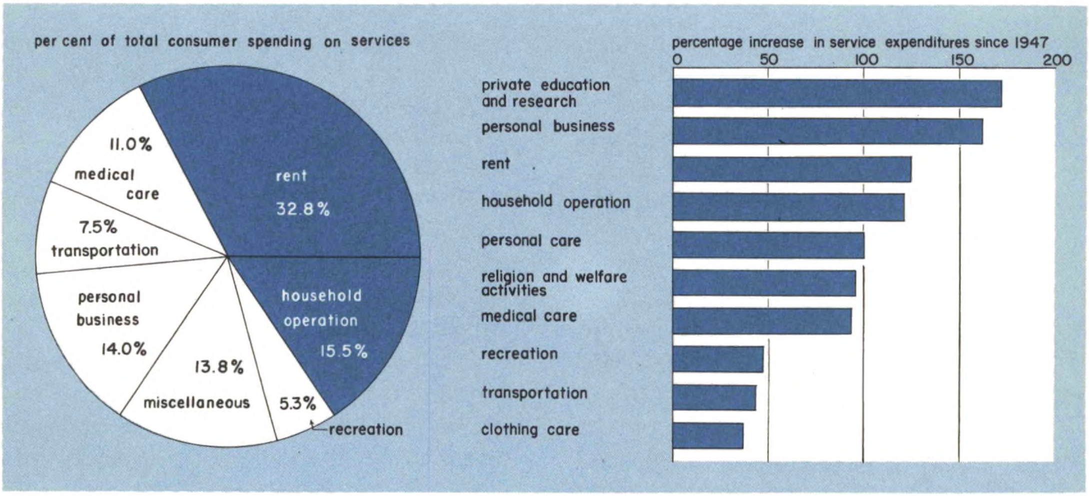
As a share of the consumer dollar, service outlays have moved from a low of 31 per cent in 1947 to almost 38 per cent in 1957. Immediately after the war, spending on durable goods jumped sharply as these goods became generally available again, though in subsequent years such outlays have taken a fairly stable fraction of consumer spending. On the other hand, the proportion of expenditures going for soft goods has been declining steadily since its wartime peak.

Prices show persistent rise

Concurrent with the increase in consumer spending for services has been a large in-

Rent and household operation account for half of "service" dollar . . .

but education and personal business show larger relative gains in consumer service outlays since 1947



crease in prices. Since 1947, service prices have climbed 38 per cent, while prices of nondurables rose 18 per cent and hard goods advanced 15 per cent. As measured by the Bureau of Labor Statistics' consumer price index, increases for individual service categories have varied widely (see chart). Hospital fees and transit fares have more than doubled, while residential gas and electricity rates have risen only about 16 per cent.

But even after adjusting for the effects of higher prices, expenditures for services have increased substantially. In terms of constant prices, consumer outlays for services have risen almost 50 per cent in the past ten years; spending for durables has increased almost as much, and nondurable spending has gone up about one-fourth. If adjusted further, for the growth in population, it appears that consumers have boosted their consumption of services by about 25 per cent per capita in real terms over the past decade.

Gains across the board

The increasing proportion of consumer spending allocated to services has not been the result of a spurt in outlays for any one or two categories. On the contrary, most of the major service groups show expenditure gains on the order of 100 per cent or more. Particularly notable increases have been scored by outlays for rent and personal business.

The "rent" category includes payments made by tenants and the imputed rental value of owner-occupied homes. The postwar trend toward homeownership has helped to boost the imputed rent item, although presumably at the expense of actual rent payments. Since 1947, the figure for imputed

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Another mild recession?

Three times since the end of World War II the American economy has receded temporarily from its fast postwar pace — first in 1948-49, then in 1953-54 and most recently in 1957-58. Perhaps the most pressing economic question in recent months has been how deep and how long will the current downturn be. There is, of course, no surefire answer. It is interesting, nevertheless, to compare today's developments with the earlier downturns, to note similarities and differences between the present and the past.

Comparisons with earlier periods are complicated by the fact that many changes have occurred during the intervening years. Productive capacity has been expanded greatly; the pace of technological advance has varied for the different sectors; and markets, of course, are always in a state of flux. Foreign competition in some sectors is now more effective than at any time since the end of World War II. Adjustments in defense spending continue to be made in response to reappraisals of needs. The backlog of demand for new construction—public and private—which helped pull some industries out of the earlier recessions, is now more fully satisfied. And new products and changing tastes have altered the competitive position of still other industries in their battle for profitable shares of consumer expenditures.

There is yet another difficulty in making direct comparisons between the present and past periods. Neither of the first two postwar downturns came at precisely the same time in the year as the present one. Since the economy is subject to seasonal as well as cyclical fluctuations, the differences in timing alone can result in accelerated (or retarded) rates of decline in individual measures of business activity. This problem is overcome in part by using data in the comparisons which are adjusted in such a manner as to eliminate "usual" seasonal changes. Notwithstanding these shortcomings, a review of the behavior of a number of the economic indicators during recent recessions helps to place current developments in perspective.

Selected economic indicators are plotted in the charts on pages 8 and 9 covering a time period of twenty-four months, twelve months preceding and twelve months following the dates when the economy as a whole appeared to reach peak levels of activity: November, 1948; July, 1953; and August, 1957.

Three broad measures of economic activity are shown in the top panel on page 8. Of these three, industrial production moved down slightly more rapidly in the six months from August to February than it did during the six months following the 1948 and 1953 peaks. Retail sales, though off almost 5 per cent from the summer high, had not deteriorated as much as in the 1953-54 recession. In the first postwar decline in business activity, retail trade traced a fairly stable sales pattern.

In all three periods *new orders* started to decline several months before the drop-off in most other indicators. To keep production going, firms whittled down their backlogs of *unfilled orders*. And *inventories* continued to rise for a while. Currently, unfilled orders are lower than they were in 1953, but new orders are higher.

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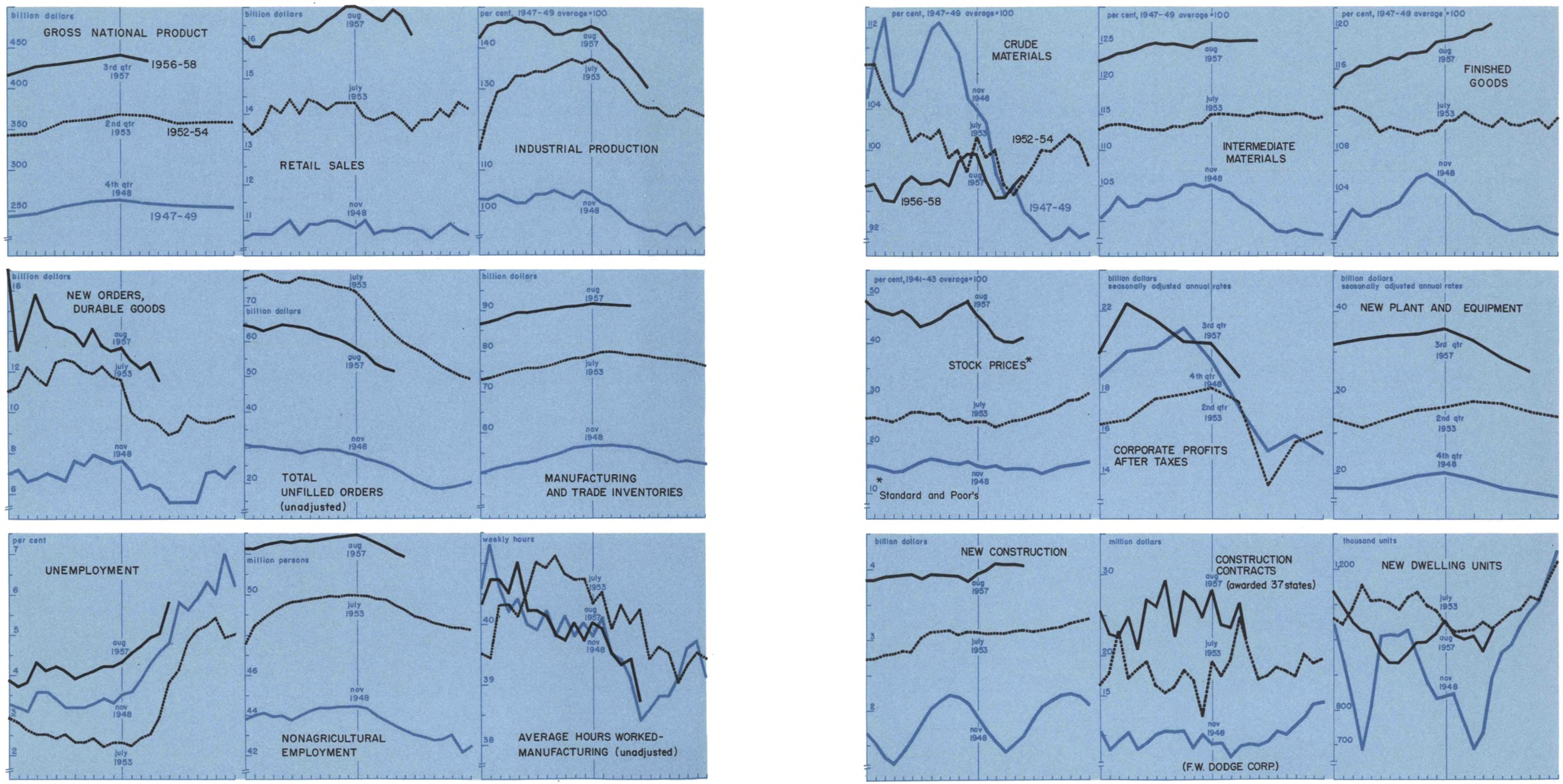
Postwar recessions compared—selected business indicators

(changes during twelve months preceding and following tops of booms)



Recession? *continued from page 7*

The level of *unemployment* was higher when the current recession began than it was in either 1953 or 1948. And the *average hours worked* was slightly lower. In February, unemployment exceeded the peaks reached in either of the preceding periods. As is usual in a cyclical adjustment, much of the unemployment is concentrated among the younger and relatively less skilled workers in durable goods industries. The number of people *employed,* reflecting the growing size of the labor force, has been at a higher level than it was during the earlier recessions.

In all three recessions, the *prices of crude materials* declined before the downturn in general activity, though in 1957 the decline was relatively mild. *Prices of semi-processed and processed goods,* however, have shown quite different patterns in each recession period. In 1953, prices of these goods remained firm, while in 1957 they have continued to rise. This is in contrast with 1948 when such prices declined.

In both 1948 and 1953, *corporate profits* reached peaks at about the same time as general business. In 1957, however, corporate profits started to turn down before the overall level of activity receded.

New plant and equipment expenditures, have turned down sharply from their third quarter peak. Estimates for the second quarter of 1958 place the level of plant and equipment expenditures at 32.5 billion, roughly 5 billion below its peak level.

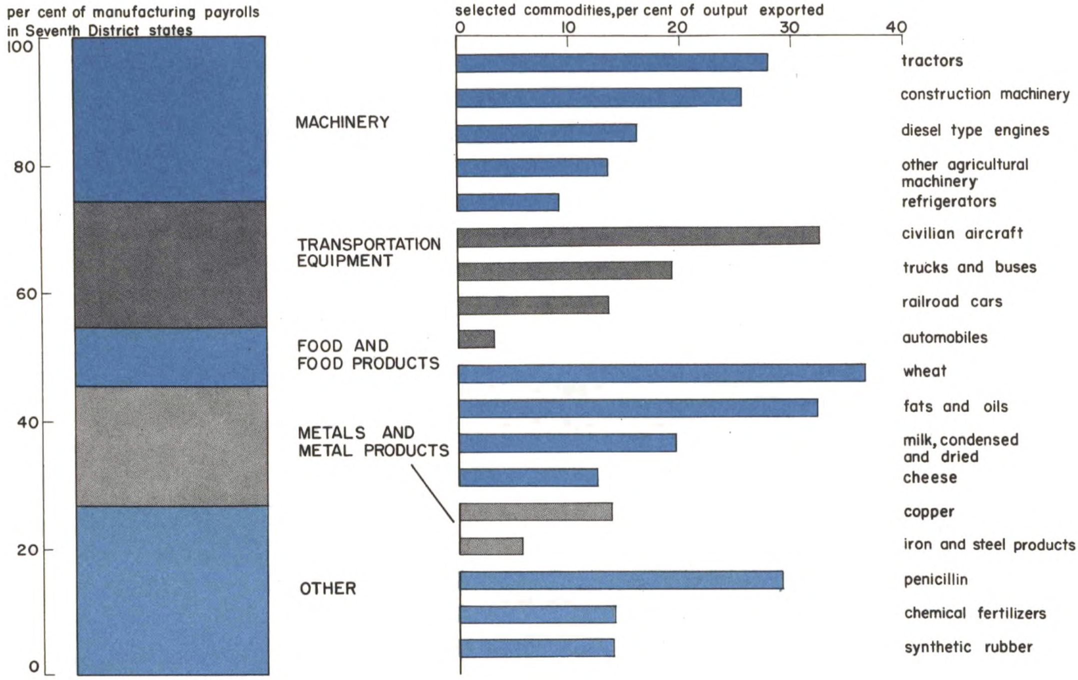
In both the 1948 and 1953 declines, *construction* recovered rapidly and gave a strong boost to the upturn in general activity. In recent months, the number of "new housing units" started has been running at a lower rate than in 1954. In dollar terms, however, the over-all construction activity is higher.

Midwest has big stake in foreign trade

Sales of goods and services to overseas customers increased in 1957 for the fourth consecutive year. Despite a decline from an exceptionally high level in the initial two quarters of last year, exports showed a 3 billion dollar gain over the 1956 level and accounted for more than a fourth of the rise in domestic output.

Although the 19 billion dollars of merchandise exports is equal to only 8 per cent of domestic output of movable goods, these shipments, together with the 5 billion in U.S. services bought by foreign customers, appear relatively large when compared with many important sectors of domestic demand. Export sales exceeded by a considerable margin consumer outlays on autos and auto parts and expenditures on residential construction. In addition, they nearly equaled business spending on new machinery and equipment. According to Department of Commerce estimates, 4½ million persons, 7

Many Midwest products heavily dependent on foreign markets



per cent of the labor force, gain their livelihood directly or indirectly from export trade and domestic distribution of imports.

In the Midwest . . .

The Midwest has a particularly big stake in U.S. export trade. First, a large share of industrial exports are produced in Midwest factories. Second, much of the agricultural exports are either grown or processed in this region. Third, as a major transportation center, many of the commodities exported are either shipped through the area to coastal ports or transferred directly to overseas carriers operating in the Great Lakes. These direct shipments will doubtless become increasingly important with the completion of the St. Lawrence Seaway.

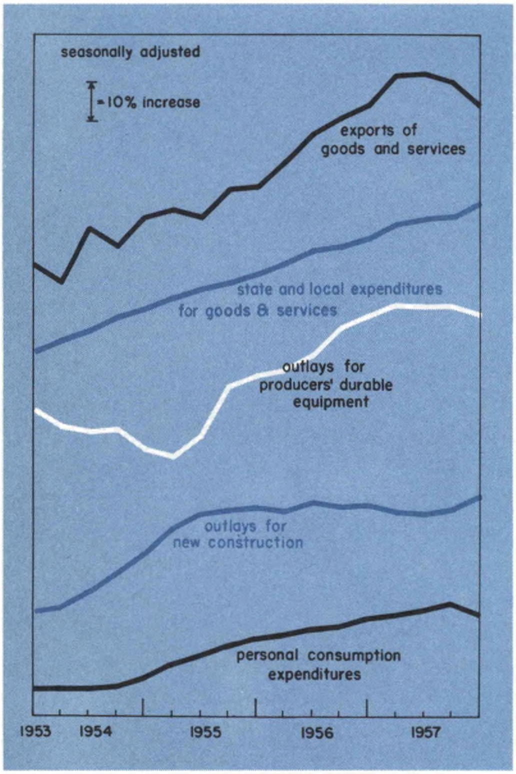
Exports bulk particularly large in many of the hard goods lines produced in the Midwest. For example, the latest annual figures indicate that one-fifth of all motor truck sales are made to overseas customers. Over a quarter of the tractors produced in the U.S. are exported, and foreign purchases of other farm machinery represent about 13 per cent of over-all demand. Shipments abroad of construction equipment aggregate 26 per cent of total production, and overseas sales take 11 per cent of the output of machine tools.

In each of these industries, Midwest firms predominate. The five Seventh District states account for 35 per cent of the total payroll of machinery manufacturers in the U.S., 35 per cent for transportation equipment producers and 29 per cent for metals and metal products firms. During 1957, these industries exported almost half of total U.S. nonagricultural overseas shipments.

Among the agricultural products, the top spot in value of exports has alternated in recent years between cotton and wheat. While virtually none of the cotton is produced in the Midwest, a good part of the wheat is grown and processed in this area.

Corn and fats and oils also provide substantial volumes of exports. Foreign purchases of U.S. fats and oils totaled 600 million dollars in 1957, largely soybean oil and animal fats. Over 50 per cent of U.S. soybeans are grown in Illinois, Indiana and Iowa, and Midwest farms and meat packing plants are important sources of animal fats.

Export sales show larger relative gains than most other sectors since 1953



Noncompetitive imports

Any form of commercial trade, whether it be between states, regions, or nations, cannot be a one-way street. American exporters generally want to be paid for their merchandise or services in dollars, a currency that can be spent domestically. The major source of dollars to overseas buyers of U.S. products is, of course, their earnings on goods and services sold to this country. A dollar spent for imported goods will in the normal course of events return as a purchase of U.S. products by foreign customers.

The preponderant share of imports entering the United States do not compete directly with the output of domestic producers. Three-fifths of total merchandise imports consist of crude and semimanufactured raw materials. A large share of these materials are virtually nonexistent in this country: tin, nickel, natural rubber, jute and flax fiber, raw silk, diamonds, manganese and bauxite, for example. In other cases, such as newsprint, imports supplement inadequate domestic supplies. The continued efficient production of many important industrial commodities is dependent on foreign sources. For instance, all of our manganese—essential to steel output—and three-quarters of the bauxite from which aluminum is produced, are imported.

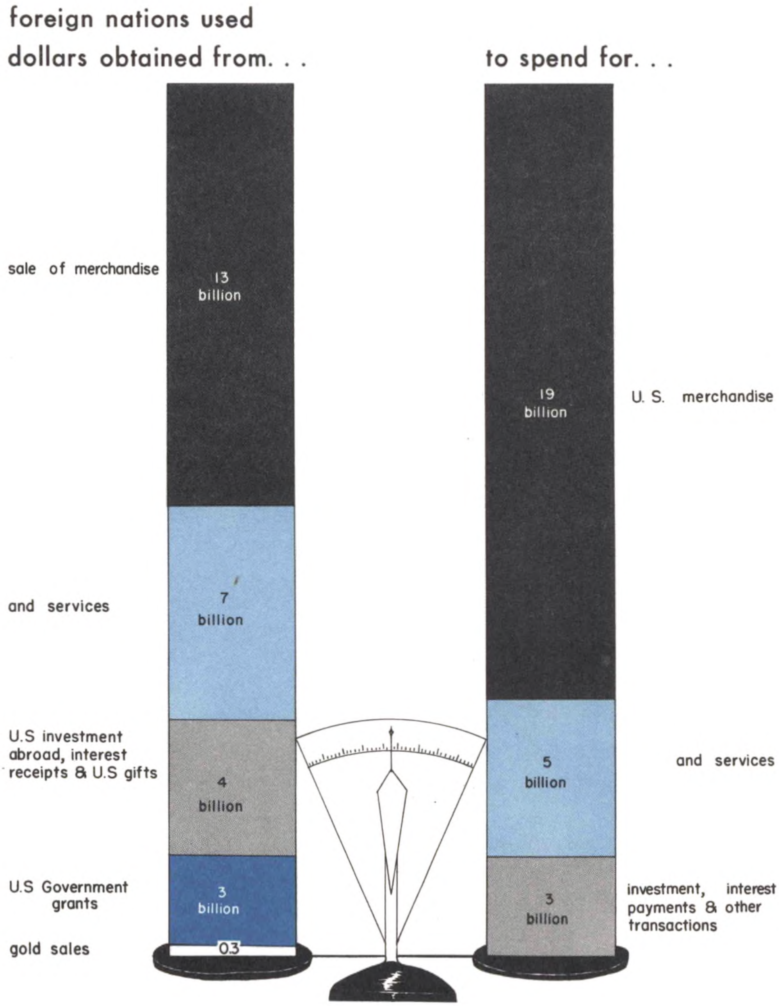
An additional one-fourth of U.S. imports represent foodstuffs, a large part of which are commodities that cannot be economically grown domestically. Of the 3 billion dollars in food imports in 1957, coffee accounted for 1.4 billion and tea, cocoa, bananas and spices an additional 400 million. The United

States is in these instances completely dependent on foreign sources of supply.

But not all imports are so clearly noncompetitive. In some cases, there is keen competition between domestic and foreign producers in specific industries, just as there is between individual domestic producers in the same industries. And there are instances when imports have caused domestic unemployment, although the area of competition is relatively small. The Department of Commerce estimates that only 2 out of the 13 billion of merchandise imports compete directly with the products of U.S. producers. But, such competition becomes more apparent during periods of declining domestic output and employment. With full employment and rising output, resources released as a result of increased imports may quickly shift into other uses. In periods of excess capacity, however, the adjustment process is more difficult.

It is in this type of setting—one in which capital and labor is not fully employed—that Congress is again reviewing U.S. trade policy. Over the course of the past two and a half decades, U.S. tariffs have been reduced considerably. The average rate on dutiable imports has been cut in half, with the majority of the decline coming in the recent postwar period. Furthermore, the reductions have been widespread—the minimum aver-

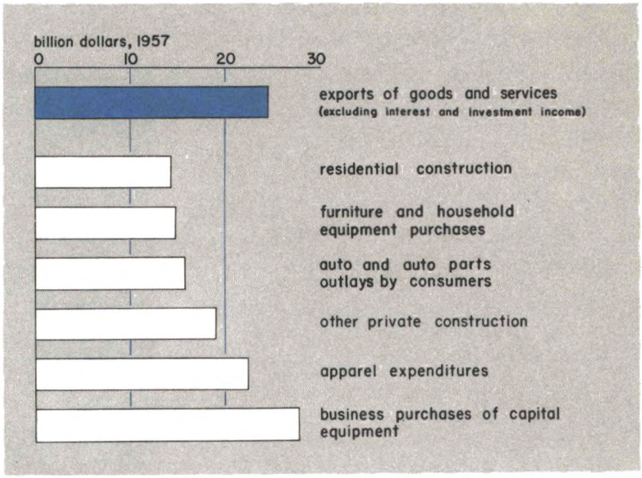
U. S. balance of payments, 1957



age drop in rates on the sixteen tariff groupings being about 40 per cent.

Tariffs still average 12 per cent of dutiable imports. Thus, there is considerable room for further reduction if such action should be deemed desirable. While it is very difficult to pinpoint the increase in imports that might result from any specified reduction of tariffs, it was recently estimated that complete suspension of all duties would mean a rise in U.S. merchandise imports on the order of 8 to 17 per cent. At the higher figure, this would represent about one-half of 1 per cent of U.S. production of goods and services.

Income from exports exceeds important sectors of domestic outlays



Any increase in imports resulting from a reduction in tariff or other cause, however, would probably be concentrated in particular industries and initially would, at least in part, be at the expense of competing domestic producers. But a rise in U.S. payments for imported goods and services should ultimately stimulate an equivalent boost in exports, or foreign investment here, the alternative being a persistent buildup of idle foreign dollar balances. Moreover, wage rates tend to be highest in the major export industries, reflecting greater use of productive capital equipment and the resulting high output per worker.

As an important agricultural and manufacturing area for many of the products in demand in both the industrialized and the underdeveloped nations of the free world, the Midwest is in a key position to benefit from any expansion of foreign commerce. The completion of the St. Lawrence Seaway is expected to further augment Midwest employment and investment opportunities in overseas commerce and its related services.

Services *continued from page 6*

rent of owner-occupied dwellings has increased almost 2½ times, compared with a doubling in the dollar amount of rent paid by tenants.

Among the major items in the personal business group are interest payments on consumer debt, and financial, legal and life insurance services. Interest payments rose the most in this group, reflecting the postwar trend toward increased credit buying of consumer durables such as autos and household appliances.

Transportation and recreation, on the other hand, are two service categories for which expenditures showed relatively small

The "why" of imputed rent

Consumption expenditures for shelter, which are included in service outlays, consist of the actual rent paid by tenants for residential housing and an "imputed rent" for owner-occupied dwellings. Imputed rent is the estimated amount of rent a home owner could obtain if he rented out his home instead of living in it himself. This imputation provides comparable treatment between tenant-occupied and owner-occupied housing in the national income and expenditure accounts. In 1957, about 10 billion dollars was paid out for shelter by tenants, whereas about 21 billion was estimated by the Department of Commerce to be the rental value of owner-occupied dwellings.

increases. While airplane and auto travel have grown rapidly in popularity in the postwar period, most other forms of transportation have not fared as well. Consumer spending for air travel and auto repairs and insurance rose substantially, but outlays for local and intercity public transportation have shown very little increase. Even though transit fares have more than doubled since 1947, total consumer expenditures for local bus-and-railway travel have remained stable.

Technological change, in the form of television, appears to have had a profound impact on expenditures for recreation. The yearly bill for radio and television repairs rose from 140 million dollars in 1947 to perhaps 850 million last year. Meanwhile, admissions to motion picture theaters dropped roughly 300 million dollars or 18 per cent in the face of a 33 per cent rise in movie ticket prices and a 19 per cent gain in the nation's population. Over-all, service expenditures for recreation held fairly stable in relative importance, after declining from the high levels established during the war and early postwar years.

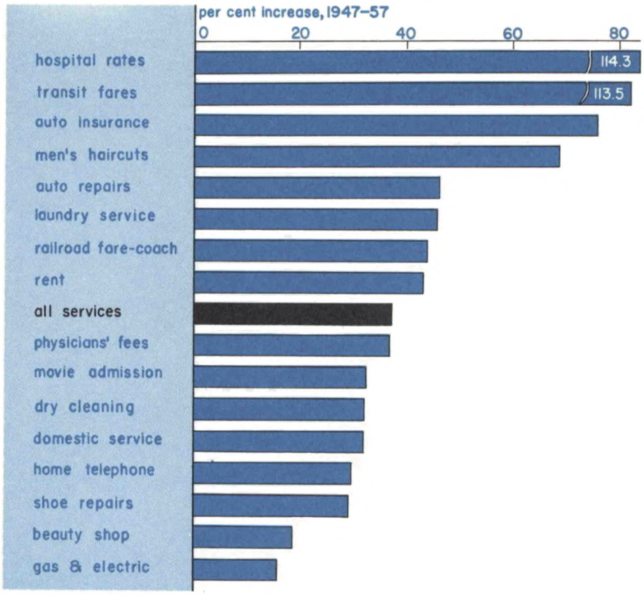
In other ways, too, technological change has left its imprint on the do-it-for-me boom. For instance, the washing machine has done much to slow spending for laundry services. Yet, more clothes are probably getting more washing than ever, thanks to the tremendous increase in purchases of automatic washers and the continued annual renewal of the large population of "kids in three-cornered pants." Also, advances in food processing, preservation and packaging have greatly reduced preparation time in the home. Ready to stir and bake, brown and serve, thaw and eat foods have helped to slow the growth in service outlays for hired domestics, while expanding outlays for goods.

The service growth in perspective

Though service outlays have gained markedly in importance during recent years, they still account for a somewhat smaller proportion of personal consumption expenditures than in 1929, and a substantially smaller proportion than during the early Thirties. In one-third of the years since 1929, services have taken a larger share of the consumer dollar than in 1957. Thus, service outlays — while having undergone sustained growth since 1947 — do not now account for an unprecedented share of consumer expenditures.

Behind the relatively mild cyclical changes in outlays on services is the fact that both prices and consumption of many components of the service group are fairly insensitive to short-term changes in disposable income. This is in contrast to many other consumption outlays, especially purchases of hard goods. As might be expected, current outlays for shelter, household utilities, hospital care

"Do-it-for-me" boom marked by sharp but varied price gains over past decade



and expenditures for religion seem to be least affected by changes in total personal income.

Some of the "insensitivity" of service expenditures springs from the regulated character of service prices. Transit fares, auto insurance rates, railroad fares, residential telephone and gas and electricity rates, for example, are all regulated by government agencies. Rents, too, were largely under government control during the early postwar period.

When weighing the likelihood of a further advance in spending on services, it seems evident that there are strong forces which may continue to bolster this consumption category. In the past decade, price increases have figured prominently — though by no means exclusively — in the rapid and persistent rise in consumer spending for services. The rise in service prices has been to some extent a "catching up" process. Prices of service items rose much less between 1939 and 1945 than prices of goods.

Also helping to explain the persistent rise in service prices is the large proportion of labor relative to other costs. In some instances — haircuts, shoe repairs and physician's care, for example — the service is essentially a personal one, with manpower virtually the sole resource used. In others, such as auto repairs and hospital care, the potential for mechanization appears to be small. Hence, in providing many of the services demanded by American consumers, there has been only limited opportunity to offset the rise in wage rates with productivity gains, as in manufacturing. This does not hold true for all services, however. Electric power, gas and telephone, for example, have experienced a large rise in consumption and with relatively small price increases. Nevertheless, it appears that prices of services (and goods) which are not readily susceptible to advances in mechanization may continue to experience an upward trend in prices relative to prices of other goods and services.

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