



Business Trends

Prepared in the Research Department of the
FEDERAL RESERVE BANK OF CLEVELAND
 Serving the Fourth Federal Reserve District

1962, WHAT KIND OF YEAR FOR BUSINESS?

One year ago this month, business activity in the U.S. started expanding from the trough of the mildest recession since the first World War. This February, after a year of rising business activity, the Federal Reserve Board Index of Industrial Production was approximately 13% higher than in February 1961 (based on a preliminary estimate for February 1962). In comparison with first-year progress in other recovery periods, the recent 12-month increase in the FRB index was one of the mildest expansions since World War I. The very mildness of the expansion, accompanied by the setbacks of several widely watched economic figures during January has given rise to the question of whether or not business activity during 1962 will actually be maintained at a high level.

Since the major elements in the expansion may sometimes be obscured by the myriad of economic data that floods the business news today, a brief examination of several of the major forces which have been determining the course of business recently might possibly sharpen one's perspective on this question.

The pattern of business activity, particularly in recent months, appears to have been largely determined by the nature of the last business contraction and by the output patterns of the steel and automotive industries since last fall. An analysis of these three factors leads to the tentative conclusion that the expansion is likely

to remain a moderate one over the year (for which there is ample historical precedent) and that a slowing of the rate of increase in business activity at this stage is by no means a signal of an immediate business downturn.

The Past as Prologue. As previously mentioned, the past year has seen a milder expansion in the FRB Index of Industrial Production during the first year of recovery than at any similar time since the first World War. That such an event also followed the mildest business contraction since 1920 is not entirely happenstance. The National Bureau of Economic Research in its studies of business cycles has observed that there is a recurring tendency for recoveries in output to be faster after severe depressions than after mild recessions. An analysis of this tendency, including the most recent business upswing, supports this tentative conclusion of the Bureau and further shows that the 13% increase in the industrial production index which has occurred since February 1961 is well within the range of probability as established by relating each contraction in the FRB index since 1920 to its succeeding expansion. (For those who are interested in the technical aspects of this relationship, it may be stated that the coefficient of correlation between previous downswings in the FRB index and its succeeding expansions after one year is on the order of .81.)

Broadcast by Noel A. McBride, Senior Economist, Federal Reserve Bank of Cleveland,

over WGAR, Cleveland, with Charles Day, News Editor, WGAR, Sunday, March 18, at 10:15 p. m.

Thus, it may be inferred that the mild expansion in the physical output of goods that has occurred during the past year is to a large extent directly attributable to the mildness of the decline in production which occurred during the last period of contraction.

A Moderating Outlook. Again, a significant argument for an even more moderate upswing during the remainder of 1962 may be found in the history of previous expansions after one year and their relationship to the severity of the previous contraction. Once more there is an apparent tendency for expansions in the second year of recovery to be strong following severe contractions, and less strong following moderate contractions; and in all instances the forces of expansion are less during the second year of recovery than during the first year. Nonetheless, the average period of business expansions in peacetime as far back as 1854 has been 26 months; and the average expansion since 1945 has lasted 32 months. The possibility of an imminent decline in business activity, therefore, would not appear to be as reasonable an assumption at this time as would be an assumption that the balance of 1962 will see a continued, but slow, expansion.

In addition to the evidence for moderation during 1962 provided by the history of business expansions, the developing pattern of output in the steel and automotive industries also indicates a more moderate level of production in coming months.

Steel Production Levels. Steel output, which rose vigorously during December and January, leveled off during February. (January ingot production was 10.4 million tons, an annual rate of approximately 119 million ingot tons.) The advanced level of steel output reached around the turn of the year was in sharp contrast to the average forecast of 105-110 million tons for the year 1962. It would appear quite likely, therefore, that after steel inventories held by the users of steel are increased to

desired levels, a more moderate rate of production might be anticipated for the balance of 1962, regardless of whether or not there is a steel strike.

Auto Production Geared to Sales. Moreover, the level of automobile production during the balance of 1962 will be geared more closely to sales than it was during January and February. It is still too early to say how high the spring buying surge will be or how long it will be sustained. However, two general observations on the pattern of output may be made now.

First, the high level of output reached by the auto industry during the fourth quarter of 1961 (production during November and December was at an annual rate of approximately 6.9 million cars) means that further increases in total industrial production will not be abetted by further large increases in the automotive component of the industrial production index.

Second, the need for a level of car production in excess of car sales in order to increase dealer inventories is nearing an end. Dealers' new car inventories increased from the 821,000 level at the end of December to 1,006,000 on the first of March and were in close approximation to the all-time month-end high of 1,063,000 reached July 31, 1960.

Thus, the already high level of automotive output together with diminished inventory requirements indicate that future increases in the level of automotive output may be of a moderate nature.

Taken together, then, it would appear that the course of business expansion, while it is not up to some expectations, is not passing through entirely uncharted waters. Moreover, the forces of moderation which the steel and automotive industries are presently exerting on the production index are largely technical adjustments to inventory demands which have been fulfilled for the present.