

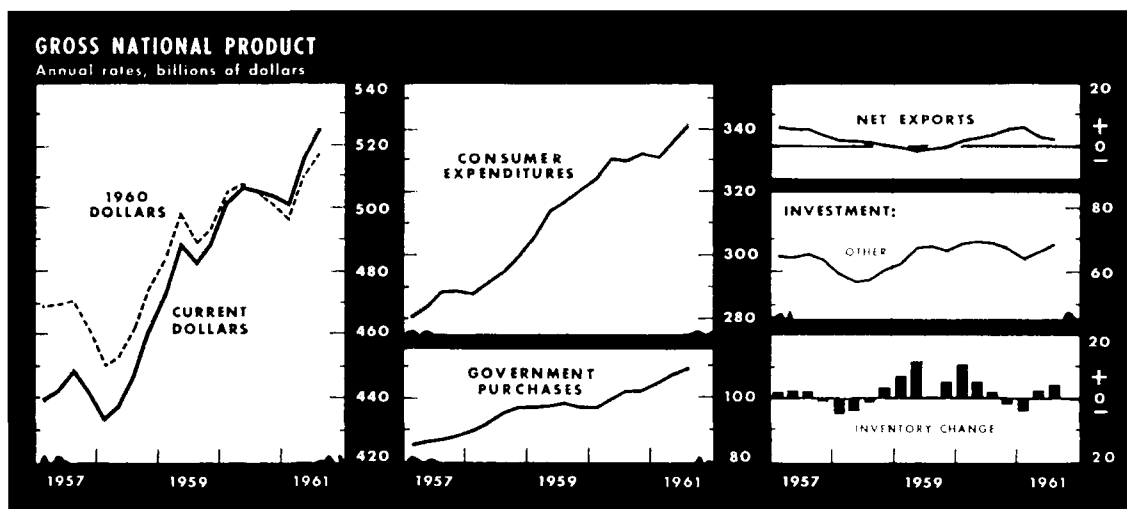
Expansion in Economic Activity

ECONOMIC ACTIVITY has increased sharply from its recession low last winter. Gross national product reached a new high in the third quarter, and after allowance for price changes, the total output of goods and services was about 2 per cent above the level in the spring of 1960, the peak period of the preceding cyclical expansion. A further gain is occurring in the current quarter.

Activity increased rapidly until midyear and then expanded at a slower pace. The slackening of the rise in employment, industrial production, income, and retail sales reflected in part model changeovers and work stoppages in the auto industry and abnormal weather conditions. By late October, output and sales of automobiles had recovered, and their high levels were reinforcing the expansion in other sectors of the economy.

The 1960-61 recession was moderate and short. Consumer incomes were maintained throughout the recession despite curtailments in employment and industrial production, and decreases in consumer demands were confined mainly to housing and durable goods. The decline in business investment in new plant and equipment was moderate. Government purchases of goods and services began to advance early in 1961. Net exports rose sharply during the contraction phase of the cycle, as imports declined while exports expanded in response to high levels of activity abroad. Altogether, final purchases of goods and services increased throughout 1960 and then showed only a slight dip in early 1961.

In contrast, the inventory adjustment was large. It began some months before the



NOTE.—Department of Commerce quarterly estimates, adjusted for seasonal variation, except for GNP in 1960 prices, which are estimates of Council of Economic Advisers. Other

investment includes producers' durable equipment and total private construction. Latest figures shown, third quarter.

upper turning point, as manufacturers curtailed sharply their accumulation of steel stocks. During the recession, stocks of durable goods were reduced by manufacturers and distributors, while stocks of non-durable goods increased somewhat.

CYCLICAL RECOVERY

General recovery was under way in March. As incomes began to rise sharply, consumer demands for new houses and durable goods turned up promptly. Housing starts, however, rose less rapidly than in 1958. Business soon responded to improvement in consumer and government demands by ending inventory liquidation and resuming inventory accumulation. Business outlays for new plant and equipment also began to rise earlier than usual in a cyclical recovery, but so far the amount of increase has been moderate.

The bulk of the increase in the dollar value of gross national product achieved thus far represents an increase in physical volume. Prices of some industrial materials that typically show large cyclical fluctuations have increased moderately, but prices of industrial commodities as a whole have declined slightly this year. Wholesale prices of farm products and foods are also somewhat lower, and the wholesale price index for all commodities has declined 1 per cent since last winter. Consumer prices have risen, but the rise has been smaller thus far than in either 1959 or 1960.

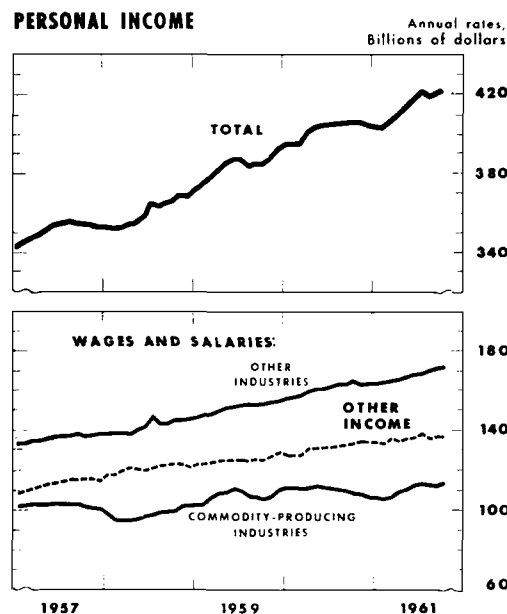
Relative stability in broad measures of prices despite the higher level of output reflects both continued high unemployment and the existence of a considerable amount of unutilized industrial capacity. Output per manhour has increased rapidly, as is usual in a recovery period, and this too has helped to restrain upward price pres-

ures. Although up considerably from its cyclical low last February, nonfarm employment in October was just about back to its preceding cyclical peak. Meanwhile, the civilian labor force has continued its steady growth, and the seasonally adjusted unemployment rate, at 6.8 per cent in October, has shown little change this year.

Stability of industrial prices has helped to maintain exports. But as economic activity here has advanced, imports have increased, and the U. S. trade surplus has narrowed appreciably in recent months.

PERSONAL INCOME

Personal income remained almost stable during the recent recession, as it had in other postwar recessions. Wages and salaries declined in the industrial sector but continued to rise slowly in service industries and government. Other income payments



NOTE.—Department of Commerce monthly figures, adjusted for seasonal variation. Other industries include distributive, service, and government. Other income includes all personal income except wages and salaries. Latest figures shown, October estimates of Federal Reserve.

increased moderately, mainly because of larger payments for unemployment compensation and increased Social Security benefits. Corporations maintained their dividend payments despite sharply reduced profits.

Personal income began to rise in March when industrial output and employment began to increase. In March, and again in July, advance payments of National Service Life Insurance dividends gave large temporary boosts to personal income in the form of transfer payments. In April a temporary Federal program was initiated, as in 1958, to extend payment of unemployment compensation to unemployed workers exhausting their rights under regular programs. And, effective in late summer, Social Security retirement benefits were liberalized.

Employment and wages and salaries rose in most industries through June. Between June and September, however, industrial payrolls leveled off. During this period, industrial activity was limited as a result of model changeovers and work stoppages in the auto industry, and, in September, also by a hurricane. Industrial activity began to increase again in October, and personal income rose to a new high, about 5 per cent above the recession low.

CONSUMPTION

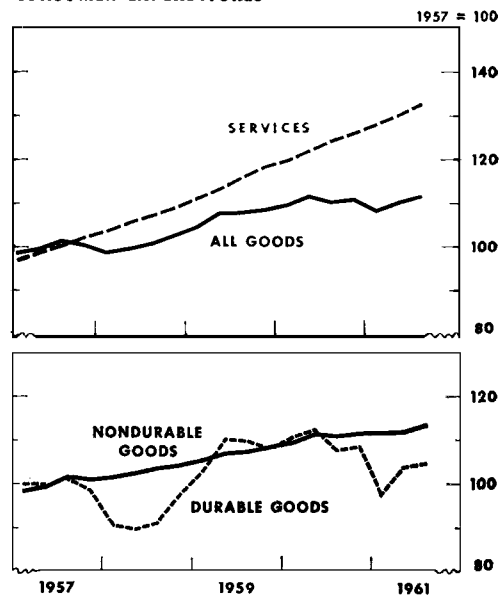
Consumer buying of goods rose more slowly than income in both the second and third quarters. Because of this lag, total consumption expenditures did not quite keep pace with income, and the rate of consumer saving continued to rise. The increase appeared primarily as a rapid build-up in consumer holdings of liquid assets.

In recent years, total consumption has increased about in line with income, but the proportion of income used for services

has been rising and that used to buy goods has been declining. After adjustment for price changes, the difference is less pronounced, as prices of services have continued to rise appreciably while average prices of goods have increased little—particularly since 1958.

Durable goods. Fluctuations in the demand for durable goods account for most of the cyclical fluctuation in total consumption expenditures. In the recent recession,

CONSUMER EXPENDITURES



NOTE.—Indexes based on Department of Commerce quarterly estimates, adjusted for seasonal variation. Latest figures shown, third quarter.

consumer outlays for such goods declined about as much as they did in the more severe 1957-58 recession. However, they turned up much more promptly in this recovery.

Sales of new domestic autos increased from a seasonally adjusted annual rate of 4.9 million units in the first quarter of 1961 to 5.6 million in the second. Dealer stocks were low at midyear, and, with output lim-

ited by an unusually early model changeover and work stoppages, sales declined during the third quarter to an average annual rate of 5.2 million. The work stoppages continued into early October, but following their settlement, output expanded sharply. In the month of October, sales rose to an annual rate of 6.2 million, about equal to the 1960 high. In early November, sales increased further.

The demand for used cars was strong throughout the year, and supplies were limited during the summer and early fall. Prices of used cars have increased 20 per cent from their cyclical low in January and are now about back to their high before the recession. New model cars were introduced this year at about the same list prices as those on 1961 models.

Sales of major home goods also turned up in early spring and have continued to rise since then. The steady rise reflected in part the larger volume of residential construction.

Nondurable goods. After the first quarter of this year, outlays by consumers for nondurable goods resumed the moderate upward trend that has prevailed throughout most of the postwar period. Such staple items as foods, beverages, tobacco products, drugs, and toilet articles bulk large in this broad aggregate. Demand for these staples tends to rise as the population grows.

Fluctuations in semidurable items, notably clothing and shoes, are generally responsible for whatever cyclical fluctuation appears in total consumer outlays for nondurable goods. Consumer outlays for clothing and shoes rose considerably during the 1958-60 expansion, were curtailed in the recession, and have increased again in recent months.

Services. Since 1954, consumers have been increasing their expenditures for serv-

ices by 7.3 per cent per year, on the average, while increasing their spending for goods by about 4 per cent. Total consumption expenditures and disposable personal income meanwhile have risen by about 5 per cent per year.

Throughout the postwar period, expenditures for services have risen steadily, even increasing during recessions when personal income leveled off. During the recent recession, the dollar amount of increase in outlays for services offset the decline in expenditures for durable goods, and as a result total consumption expenditures remained stable.

The consumer stock of durable goods has increased greatly, and outlays for the financing, insurance, and maintenance of these goods are an important part of the service total. Expenditures of this sort for housing, including the imputed rent of owner-occupied dwellings, now account for nearly one-third of total consumer service outlays.

In recent years, however, rent and other service expenditures for housing have been growing at a slower rate than certain other service expenditures, notably those for personal business, education, and medical and personal care. Private outlays for education have accelerated since 1957, in part because of the rapid increase in the number of youths of college age and the generally heightened interest in education. The longer life span and medical progress have contributed to the rapid growth in outlays for medical care.

BUSINESS INVESTMENT

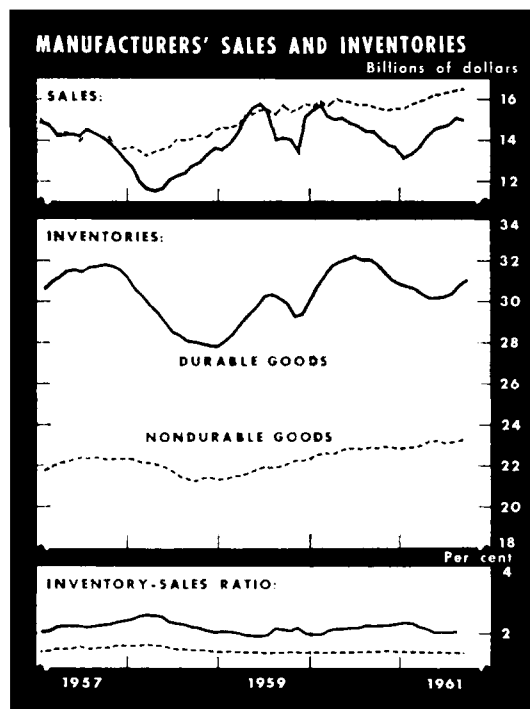
Business inventory and equipment demands picked up unusually promptly in this recovery period, and rising business outlays have made an important contribution to the increase in gross national product.

Inventories. Changes in business inventory buying have been unusually large over the past two years. The rate of accumulation in early 1960 was very high, and the decline in the rate of accumulation during the first half of 1960 was unusually rapid. Although inventory liquidation was moderate, the shift from accumulation at an annual rate of \$11 billion in early 1960 to liquidation at a \$4 billion rate in the first quarter of 1961 represented a contractive influence of \$15 billion. However, because most other major components rose, total gross national product declined only \$1 billion.

Demands for inventory picked up in early spring, and the shift from net decumulation in the first quarter of 1961 to net accumulation in the third quarter contributed \$8.5 billion to the \$25 billion rise in the annual rate of gross national product. This was a much larger contribution from inventory buying than usual for the early stages of a recovery and reflects in part the mildness of the preceding downturn in activity and the relatively low level of inventories in a number of industries when the recession began.

The decline in book value of business inventories from June 1960 to March 1961 was concentrated in materials and goods in process held by durable goods manufacturers and in consumer durable goods held by distributors. During the recovery period through September, retail stocks of durable goods remained near their March levels. Meantime, inventories held by durable goods manufacturers stabilized and then increased. In the third quarter the increase in inventories held by durable goods manufacturers accounted for nearly all of the total increase in manufacturers' stocks.

Manufacturers' sales have about kept pace with inventories in recent months, and the inventory-sales ratio has been fairly stable for manufacturers of durable goods as well as for those manufacturing non-durable goods. According to the most recent Commerce Department survey, manufacturers expect the book value of their inventories to increase in the fourth quarter



NOTE.—Department of Commerce monthly figures, adjusted for seasonal variation. Figures for inventories are book values. Latest figures shown, September.

by the same amount as they increased in the third quarter. Stocks held by durable goods producers are expected to account for two-thirds of the rise.

Plant and equipment. Outlays for new nonfarm plant and equipment in the fourth quarter are now expected to be up 7 per cent from the second quarter, almost to the mid-1960 high, according to the latest Commerce-SEC survey. The cyclical swing in

total outlays since mid-1960 reflects primarily fluctuations in purchases of equipment; construction outlays increased moderately during the recession and recovery period.

Most major industry groups have shared in the current increase in plant and equipment outlays, although at different rates. In 1959 and 1960, outlays for fixed capital by industries manufacturing durable goods remained moderately below the highest levels

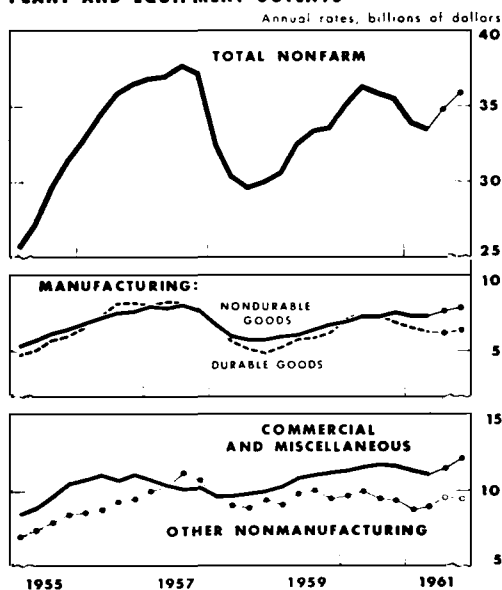
spite these cuts, total outlays by the mining, transportation, and utility industries are now increasing, but planned fourth-quarter outlays are below the high levels reached in 1957.

By early 1960, outlays for fixed investment by industries manufacturing nondurable goods had not recovered to 1957 levels mainly because of much smaller outlays by the petroleum industry. After showing little decline during the recent recession, outlays by these industries are now increasing at a substantial rate. For all nondurable goods industries except petroleum, total outlays planned for the fourth quarter are nearly 10 per cent above the highest level reached in the 1955-57 expansion.

Business concerns in the commercial and miscellaneous sector brought their outlays to record levels in 1960, and after a moderate decline in the first half of 1961, their plans call for outlays to increase in the fourth quarter to a level that will exceed the previous record by 4 per cent. This sector, which includes the communications, trade, service, finance, and construction industries, now accounts for about one-third of all fixed-capital investment by nonfarm business. The upward trend in expenditures has been associated with the large volume of construction of office buildings, shopping centers, and other commercial and service facilities.

According to the recent McGraw-Hill survey of business plans for fixed investment for the year 1962, outlays for plant and equipment will be 4 per cent higher than the 1961 total. The indicated 1962 level is about the same as the rate expected to be reached in the current quarter. It may be noted, however, that anticipation surveys taken in the autumn of 1954 and 1958 understated substantially the amount of in-

PLANT AND EQUIPMENT OUTLAYS



NOTE.—Department of Commerce and Securities and Exchange Commission quarterly estimates, adjusted for seasonal variation. Other nonmanufacturing includes mining, transportation, and public utilities. Third and fourth quarter figures are anticipated spending.

reached in the 1955-57 investment boom. Thus far this year outlays by durable goods producers have shown only a slight tendency to expand. In most of these industries rates of capacity utilization remain low.

Railroads reduced their outlays one-third from mid-1960 to mid-1961, and at the time of the late summer Commerce-SEC survey they were planning further cuts. De-

crease that actually developed in 1955 and 1959.

Current rates of capacity utilization are above those at the recession low but considerably below those at the preceding cyclical peaks. Although unutilized capacity is large, outlays for further expansion are likely to increase. Expansion will be needed to meet production needs for new products already on the market and to permit the development and marketing of other new products. Incentives will remain strong to modernize equipment in order to meet domestic and foreign competition. Large and increasing expenditures for research and development are providing both new product opportunities and new ways of cutting costs. The larger volume of internal funds available to businesses from growing depreciation allowances and retained earnings are favorable to business plans for increased outlays for new plant and equipment.

GOVERNMENT

Total government purchases of goods and services in the third quarter this year were 7 per cent above the fourth quarter 1960

level. State and local government outlays continued the steady rise that has prevailed throughout the postwar period, and with the heightening of international tensions, the Federal Government stepped up its defense expenditures this year after several years of little change.

Nearly half of the increase in government purchases of goods and services over the first three quarters of this year reflected larger Federal defense expenditures. The Federal budget estimates prepared this fall suggest a large further increase by mid-1962.

State and local government outlays have increased faster in recent years than those of any other major demand sector to meet the needs of a rapidly growing population for schools, highways, and other public facilities and services.

As a result of their sustained expansion, State and local government outlays now account for about 10 per cent of gross national product, compared with 7.5 per cent in 1955. Purchases of goods and services by the Federal Government account for about 11 per cent of the total, about the same as the 1955-60 average.