The U.S. Economy in 1972

THE economic expansion in 1972 was broadly based and strong all year, in contrast to the hesitancy through much of 1971. Output increased very substantially from 1971 to 1972, with GNP in real terms up 6½ percent and the industrial production index up 7 percent. Employment registered one of the largest year-to-year increases on record but the unemployment rate declined only moderately because the civilian labor force also grew very strongly. In general, the rate of price increase slowed, but food prices, rising steeply, were a marked exception. Profits increased substantially, especially in durable goods manufacturing. Personal income also increased substantially, as the growth of wage and salary income accelerated.

Credit was amply available to support the economic expansion in 1972, though monetary policy tightened somewhat in the closing months of the year. Credit costs remained well below the levels reached in 1969 and 1970; short-term interest rates did move up rather sharply in the first half of 1972 as a reaction to the steep decline that had followed the institution of the "New Economic Program" in August 1971. The existence during 1972 of the control programs instituted under the NEP meant that the Federal Reserve was in a relatively favorable position for accommodating economic expansion, for the control programs carried some of the anti-inflationary burden that the monetary authorities would otherwise probably have had to carry.

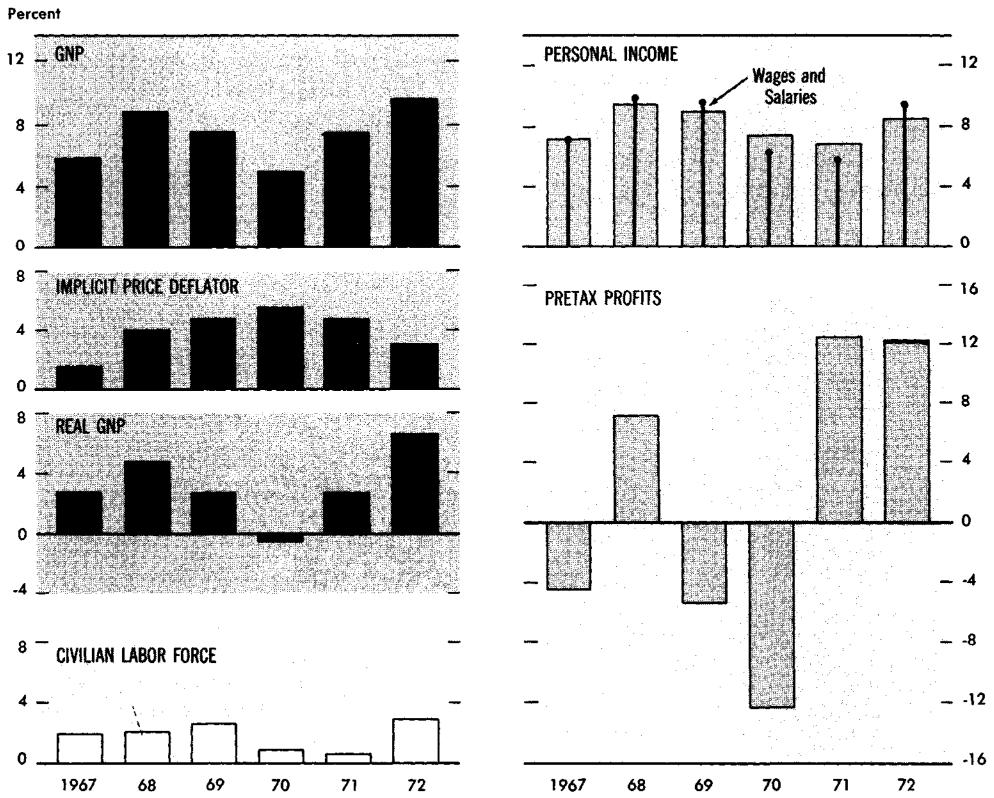
The control programs operating during 1972 consisted mainly of those administered by the Pay Board and the Price Commission, which set guidelines for wage and price behavior and reviewed wage and price actions. It is not possible to identify specifically the impact that these controls had on the behavior of wages and prices, for other economic forces were also at work. It is certainly true, however, that the average rate of wage increase provided under new labor contracts in 1972 was appreciably smaller than the average in any of the preceding 3 years. In manufacturing, new contracts negotiated in the first three quarters of 1972 provided an average wage-rate increase of 5½ percent over the contract life, compared with an average 7¼ percent negotiated in 1971. In nonmanufacturing industries, the figures were 7¼ percent in 1972 and 9 percent in 1971. Also, there was a noticeable deceleration of price increases, outside the agricultural area.

Gross national product

The Nation's total output of goods and services was $1,152 billion at market prices in 1972, up $101½ billion or 9¾ percent from 1971 (chart 6). The increase in real output was 6½ percent, the strongest full-year advance since

CHART 6

Output, Employment, and Income, Percent Change From Previous Year



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73-1-6

1966. The implicit price deflator for total GNP rose 3 percent, the smallest full-year advance since 1966.

Inventory investment accelerated during 1972 but was nevertheless small. Capital investment increased quite strongly, in line with the broad cyclical recovery of economic activity. Disposable income was dampened by overwithholding of Federal income taxes but consumption spending nevertheless increased strongly, led by autos and household durables. The housing boom persisted with surprising strength. Foreign demand for U.S. goods and services was quite strong, but U.S. demand for foreign goods and services was even stronger so that a sizable share of domestic demand was satisfied by foreign rather than domestic production.

International position

Two major goals of U.S. economic policy in 1972 were to achieve a strong rate of economic growth and to reduce the rate of inflation. A third major goal was to develop a stronger international position. In 1971, the long-term weakening in the U.S. balance-of-payments position had been augmented by massive speculative influences. There was a huge increase that year in outflows of short-term capital, while the trade balance moved into deficit and the long-term capital accounts showed very large outflows. These developments in the international position were a major consideration in the moves that launched the "New Economic Program" in August 1971. Convertibility of the dollar was suspended and a temporary import surcharge was imposed, while negotiations were undertaken for a general realignment of exchange rates and new trade arrangements. As 1972 began, the surcharge had been lifted and a devaluation of the dollar relative to most major currencies had been agreed on.

The merchandise trade balance nevertheless deteriorated sharply from 1971 to 1972. It showed a deficit of $7 billion (seasonally adjusted annual rate) for the first 3 quarters of 1972 compared to $2¾ billion for the full year 1971. This swing partly reflected the initial perverse effect on the value of imports of the devaluation itself, as well as the fact that economic activity was expanding faster in the United States than in most industrialized countries.

The long-term capital accounts, on the other hand, improved significantly from 1971 to the first 3 quarters of 1972. The outflow of long-term capital declined from $6½ billion in 1971 to $1½ billion (annual rate) in the first 3 quarters of 1972. This shift about offset the deterioration in the current account (which includes services and unilateral transfers as well as trade), so that the balance on current account and long-term capital (the "basic balance") was little changed. An important factor in the swing of long-term capital flows was the reversal of the expectations about dollar depreciation that had prevailed in 1971. Other influences were the relatively low level of capital spending in 1972 by U.S. firms' foreign affiliates, and a recovery in foreign purchases of U.S. stocks.

The most significant development in the U.S. international position in 1972 was the vast reduction of recorded and unrecorded outflows of short-term capital, from $20½ billion in 1971 to little more than $1 billion (annual rate) in the first 3 quarters of 1972. This partly reflected a favorable change in interest rate differentials after the first quarter of 1972. More important was the overall recovery of confidence in the dollar following the devaluation in December 1971 (although there was a flurry of speculation at midyear, associated with the floating of the pound). With the basic balance little changed from 1971 to 1972, the official reserve transactions balance improved by just about the same amount as the improvement in short-term capital flows. The official balance moved from a deficit of $29.8 billion in 1971 to a deficit of $11.6 billion—still a huge number—in the first 3 quarters of 1972.

Labor Force, Employment, and Unemployment

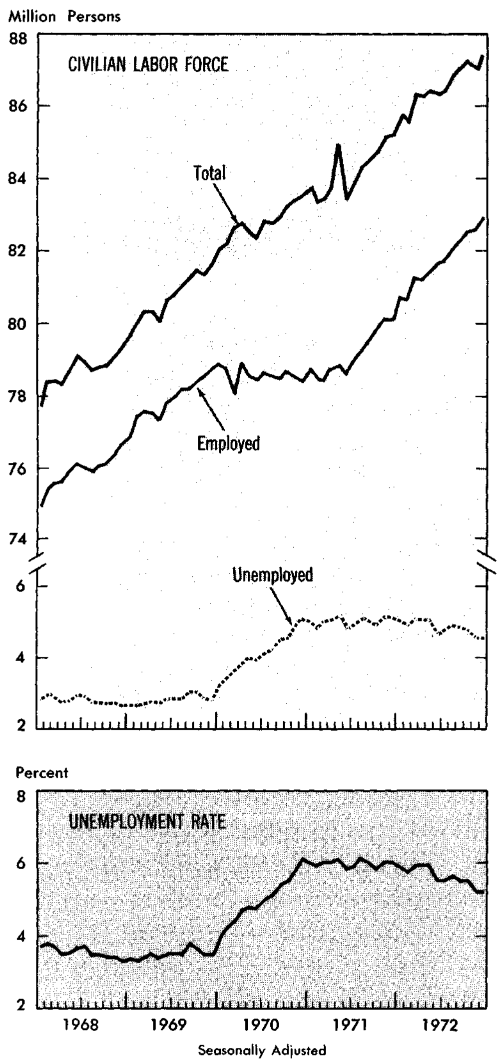
EMPLOYMENT in 1972 recorded one of the largest gains in the postwar period. The increase in the labor force was also substantial, but the rate of unemployment nevertheless declined during the year. The rate had held during 1971 at close to the level of 5.9 percent that marked the average for that year as a whole; it averaged 5.6 percent for the full year 1972, and in the fourth quarter was down to an average 5.3 percent. The improvement in 1972 stemmed in good part from a rebound of employment in cyclically-sensitive durable goods manufacturing industries; employment in those industries had fallen sharply in 1970 and 1971. However, most of the increase in 1972 occurred, as usual, in the service-producing sector, very largely in trade, services, and State and local government, all of which showed significantly larger increases than they had in 1971.

From the fourth quarter of 1971 to the fourth quarter of 1972, civilian employment increased by 2.3 million (chart 7). The total labor force increased by 1.6 million or 1.8 percent over this period, and the civilian labor force rose by 1.9 million, with the difference reflecting the reduction in the Armed Forces. The total labor force growth was about as much as normally expected, but considerably slower than the very rapid rise in the second half of 1971. For the full year 1972, employment increased by 2.3 million, compared to a gain of only 500,000 from 1970 to 1971, and the civilian labor force rose 2.1 million, compared with only 1.4 million in 1971. The cutback in the Armed Forces was about 370,000 in both years.

The composition of labor force change in 1972 reflected the resurgence of employment in industries that are heavy employers of men. In mid-1971, after a year and one-half of relatively small changes, the civilian labor force had begun to expand vigorously, but for the rest of that year the increase was nearly all among adult women and teenagers, whose rates of labor force participation moved up appreciably during the period. There was little change in the number of adult men in the civilian labor force, except for the growth resulting from the reduction of the Armed Forces. In contrast, adult men accounted for nearly half of the civilian labor force growth during 1972, while the rate of increase slowed markedly for women and teenagers. The percentage of the adult male population participating in the civilian labor force has a long-term downtrend. During 1971, the participation rate was drifting

CHART 7

Employment and Unemployment



Data: BLS

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-7

down in line with the trend. During 1972, however, adult men's participation was roughly stable, reflecting the strong rebound of demand for labor.

Nonfarm payroll employment

The number of workers on the payrolls of nonfarm establishments, which provides detail on employment trends by industry, increased by 2.7 million, or 3.8 percent, between the fourth quarter of 1971 and the fourth quarter of 1972—the sharpest gain since the Vietnam-related buildup in 1966. Payroll employment had been essentially flat during 1971. Close to one-fourth of the rise during 1972 occurred in durable goods manufacturing, where employment had declined sharply in 1970 and continued to drift down during most of 1971. The 1972 increase was 690,000, which offset more than half of the 1.2 million decline recorded from the end of 1969 to the end of 1971. The advance was widespread in durables manufacturing; the sharpest rates of gain, close to 8 percent, were in primary metals, machinery, and electrical equipment—in part a reflection of the rising demand for capital goods. In nondurables manufacturing, where employment at the end of 1971 was 330,000 below the end of 1969, there was little employment expansion in 1972. The only sizable advances were an 11 percent gain in the rubber and plastics industry, and 5 percent in textiles. The changes in other nondurable goods industries were generally small.

The manufacturing employment gains in 1972 were largely among production workers. White-collar employment in manufacturing had by year-end recovered only one-fifth of its sharp drop from the late-1969 peak to the end of 1971, while production-worker employment had retraced about three-fifths of its decline. The recession of 1970 was the first in the postwar period with sizable cutbacks in white collar employment. They were largely in the durable goods industries, and were related primarily to declines in defense and space programs.

The increases in weekly hours of work in manufacturing were largest in the industries with the greatest employment gains. The average for durable goods manufacturing at the end of 1972 was 41.9 hours per week, 1 hour longer than a year earlier and the longest since 1966. In nondurables, the workweek increased about one-half hour, to 39.9 hours—slightly longer than at any time since 1968.

Evidence of tightening in the supply of factory labor is provided by the fact that job vacancies in manufacturing numbered more than 150,000 in late 1972, 80 percent above the late-1971 low. Moreover, the layoff rate in manufacturing declined in late 1972 to a 20-year low, while the quit rate returned almost to its 1969 level, as alternative jobs became easier to find. Similarly, the data on long-term unemployment indicated that the least employable were finding jobs more easily in 1972. Unemployment of 6 months or longer fell sharply after April, accounting for nearly half of the total decline in unemployment to December. The drop probably reflected an increased willingness to hire workers previously turned away, along with improvement in long-depressed industries such as defense and capital goods.

Employment in the other goods-producing industries, mining and construction, showed little change of significance in 1972. Mining employment is normally steady, but construction had risen rather strongly in 1971, during the initial sharp expansion in residential building; during 1972 it held at about the level reached in late 1971.

In the service-producing sector, employment rose 1.8 million from the fourth quarter of 1971 to the fourth quarter of 1972, compared with 1.0 million in the preceding year. Within this sector, State and local government and services each rose by one-half million in the 1972, and trade by 600,000; increases in these sectors had been 300,000 to 400,000 in 1971. State and local government employment was affected in both 1971 and 1972 by the Public Employment Program, designed to place unemployed persons in jobs. Starting in August 1971, employment under the program reached 89,000 by December and a peak of 185,000 in July 1972, before tapering off to about 150,000 at the end of 1972.

Unemployment

The changes in unemployment by sex, industry, and occupation during 1972 were to a considerable degree a reflection of the varying trends in employment. Although the overall rate of unemployment held at 5.9 percent in 4 of the first 5 months of 1972, the same as the 1971 average, there were marked declines in the rates for manufacturing workers, especially in durable goods, and also in the rates for occupations where factory workers are concentrated—blue collar workers, particularly operatives. Unemployment rates in these categories continued to drop sharply through the rest of the year.

The rate for blue-collar workers, which during 1971 had remained close to 7.4 percent, fell steadily in 1972 to an average of 5.8 percent by the fourth quarter; the sharpest decline was in the rate for operatives. In contrast, the rate for white-collar workers, at 3.4 percent in the fourth quarter of 1972, was about the same as a year earlier, although within this grouping the rates for professional and technical workers and for clerical workers declined somewhat.

Unemployment data by industry show a drop in the rate for durable goods manufacturing workers to an average of 4.3 percent in the fourth quarter of 1972, from 6.6 percent 1 year earlier. The rate for nondurable goods manufacturing workers declined less, averaging 5.4 percent in the fourth quarter of 1972, compared with 6.4 percent 1 year earlier. On the other hand, there was no decline in the rates for trade and construction workers, and very little for service workers.

Partly reflecting the concentration of the unemployment decline in the blue-collar and heavy industry sectors, unemployment rates fell much more for adult men than for women. The rate for men of prime working age—25 to 54—was 2.7 percent in the fourth quarter of 1972, down a full percentage point from 1 year earlier, while the rate for women in this range declined from 5.3 percent to 4.7 percent. The decline in the rate for young men 18–24 became sharp after midyear, partly reflecting the fact that the cutback in the Armed Forces was completed by then. The overall unemployment rate for teenagers (ages 16 to 19), in contrast to that of adults, actually increased somewhat in the early months of 1972, probably because unemployed workers with experience were then still in plentiful supply. Later in 1972 the teenage rate fell somewhat, but it was still 15½ percent in the fourth quarter.

Most of the drop in unemployment in 1972 occurred among persons seeking work continuously since losing their jobs. This group declined early in 1972, and by yearend numbered nearly 20 percent fewer than 1 year earlier. In contrast, unemployment of those reentering the labor force declined very slowly until the final 2 months of the year, when they were 10 percent less than 1 year earlier. Unemployment of workers with no previous job experience remained somewhat above its level 1 year earlier until the final quarter of 1972, indicating the continuing difficulties of inexperienced workers in finding jobs.

Personal Income

PERSONAL income in 1972 was $935¾ billion, up 8½ percent from the 1971 total of $861½ billion. Although this advance was appreciably stronger than the gains in 1970 and 1971, it was smaller than those recorded in 1968 and 1969 (table 1). The composition of the 1972 income gain reflected the cyclical expansion of the economy. The increase in wage and salary income was far stronger in 1972 than in the previous 2 years but the expansion of other personal income components, in the aggregate, slowed down. The deceleration was especially sharp for unemployment compensation. That component accounts for only a small share of personal income but it had increased very sharply in 1970 and 1971; in 1972, it declined. Farm proprietors' income, on the other hand, is estimated to have risen very sharply in 1972 after 2 years of small gains.

Wages and salaries

Wage and salary disbursements in manufacturing increased 9¾ percent from 1971 to 1972, following 2 years of very small gains. The expansion of factory pay slowed in the third quarter but was strong the rest of the year, reflecting not only the growth of employment but also the lengthening workweek as well as higher rates of pay. In the fourth quarter, manufactur-

Table 1.—Annual Percent Change in Personal Income and Components

	1968	1969	1970	1971	1972
Personal income	**9.5**	**9.0**	**7.4**	**6.8**	**8.6**
Wages, salaries, and other labor income	**10.1**	**9.7**	**6.7**	**6.2**	**9.5**
Manufacturing wages and salaries	8.7	8.0	.4	1.3	9.7
Other private wages and salaries	9.9	11.1	8.3	7.6	9.4
Government wages and salaries	11.5	8.8	10.6	7.3	9.1
Other labor income	13.9	11.8	13.0	13.7	10.4
Nonlabor income	**8.3**	**8.0**	**8.8**	**8.8**	**7.3**
Business proprietors' income	4.7	1.8	−1.0	5.4	5.7
Farm proprietors' income	−.7	13.6	1.2	2.4	13.3
Dividends	10.3	3.0	2.0	2.4	3.9
Rent	.5	6.6	3.1	5.2	4.5
Interest	10.2	12.1	11.0	5.8	4.7
Social security benefits	17.9	8.9	16.7	15.6	12.8
Unemployment compensation	−2.6	4.3	81.1	46.0	−4.3
Veterans' benefits & other transfers	13.3	12.4	20.8	17.2	11.0

ing wages and salaries averaged about 13 percent above the level in the fourth quarter of 1971 (which had been held down by the freeze).

Wages and salaries in other private industries generally showed rates of increase during the year 1972 that were close to their year-over-year increases from 1971 to 1972. In line with the trends in employment, wage and salary expansion was strong in the distributive and service industries (up 9½ percent and 10½ percent, respectively, from 1971 to 1972) but modest in the nonmanufacturing goods-producing industries (construction, mining, and agriculture).

Government wages and salaries also recorded a large increase in 1972. For the year as a whole, they were up 9 percent, compared with an advance of almost 9½ percent in private wages and salaries. A Federal pay raise for military and civilian personnel boosted the level of wages and salaries about $1¾ billion (annual rate) in January. Apart from that, the increase in government pay last year was concentrated at the State-local level. This is in line with the trend of employment: Federal Government employment was essentially flat last year but State-local employment was rising at a substantial rate.

Special factors in 1972

One factor influencing income developments in 1972 was, of course, the control program instituted under the Administration's economic stabilization program. There was a rebound in wages and salaries in the first quarter, following the freeze in late 1971. Also, the process of Pay Board approval of changes in wage rates resulted during 1972 in a stream of retroactive wage and salary payments—i.e., payments of income earned in an earlier period. Such payments occurred throughout the year but were largest in the first quarter, when they added about $2½ billion (annual rate) to personal income.

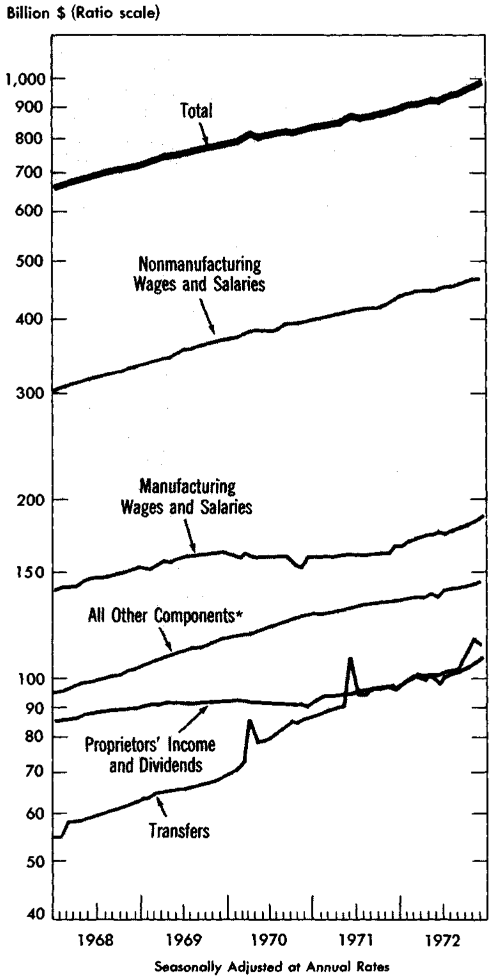
Social security beneficiaries received an across-the-board benefit increase of 20 percent in October. This boosted the level of transfer income about $8 billion (annual rate) when it went into effect, and thus swelled the income change that month and from the third quarter to the fourth. However, the increase occurred so late in the year that it had only a modest impact on the year-to-year rise in benefit payments. Working in the other direction—to slow the income expansion—was an increase in January 1972 in the maximum amount of wages subject to social security taxation, from $7,800 to $9,000. This boosted the level of personal contributions for social insurance—which are deducted in calculating personal income—by about $1½ billion (annual rate) at the start of 1972.

Early in the year, transfer income was temporarily boosted by a one-time special payment of dividends on veterans' life insurance. In November, it was boosted by permanent increases in railroad retirement benefits—20 percent, or about $0.5 billion (annual rate)—and in veterans' educational benefits—$0.4 billion (annual rate); there was also a one-time speedup payment of the veterans' benefits that month, which put an extra $2.1 billion (annual rate) into November income.

The severe floods in the East in June also affected income expansion during 1972. Losses to plant and equipment and inventories owned by proprietors and to houses were written off in June, an action that cut very sharply into June income. The estimated amount cut from proprietors' income that month was $2½ billion and from rental income $4¼ billion (both figures at annual rates). In July, the income streams moved back up to roughly normal levels. During the second half of the year, some government subsidies were paid to homeowners who had suffered losses in the floods. These payments, which were in effect a recovery of some of the losses written off in June, swelled the rental income component.

CHART 8

Personal Income



*Rent, interest, and other labor income.

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-8

Disposable income

Disposable income expansion in 1972 was significantly dampened by the overwithholding phenomenon that resulted from introduction of new Federal income tax withholding schedules in January. For the year as a whole, disposable income increased $50¾ billion, or 6¾ percent, to a total of $795 billion. The increase in 1971 was $55 billion or about 8 percent. A rough estimate of the impact of overwithholding on disposable income in 1972, net of some related reduction in quarterly payments of estimated taxes, is about $9 billion. The available evidence suggests that the amount of overwithholding was fairly steady during the year; thus, essentially all of its impact on the growth of disposable income occurred in the first quarter, though its impact on the level of disposable income persisted through the year. The overwithholding far outweighed the effects of a reduction in Federal income taxes that went into effect January 1. The reduction, involving increased personal exemptions and deductions, is estimated to have cut personal tax liabilities in 1972 by about $5½ billion.

Consumption and Saving

IN 1972, growth of consumer spending accelerated and figured importantly in the faster growth of aggregate demand. The acceleration reflected a marked improvement in consumer confidence, and was associated with a record expansion of consumer credit. The saving rate declined from 1971 to 1972; a good part of the decline was the result of the extra bite taken from after-tax income by the overwithholding of Federal income taxes.

Personal consumption expenditures increased $56¼ billion, or 8½ percent, from 1971 to 1972, compared with $48 billion, or 7¾ percent, in 1971. In 1971, the dominant factor in the acceleration of spending growth was increased auto demand (partly the result of late-1970 auto strikes that shifted some purchases from 1970 to 1971). In 1972, the increase in spending on autos was smaller than in 1971 but the growth of other components of consumer demand was greater. In constant dollars, the advance in consumer spending in 1972 was far stronger than in 1971 for the rise in prices of most consumer goods and services except food products slowed appreciably.

Spending on furniture and household equipment recorded a much stronger advance in 1972 than in 1971, an acceleration presumably associated both with the continuing housing boom and with growth in the replacement demand for home appliances. Spending for mobile homes grew strongly in the first half of last year, fell back in the summer, and advanced again in the fourth quarter. Spending for food, which accounts for about one-third of total consumer outlays for goods, increased much more in 1972 than in 1971—in good part because of large price increases in 1972. The growth in expenditures on gas and oil was strong all last year and spending on tobacco rose much more than in 1971. The 1972 increases in consumer spending on other categories of goods and on services were about in line with the steady uptrends of recent years.

Auto sales

Automobile buying set a record in 1972. In unit terms, new car sales totaled 11 million units, up from 10¼ million in 1971; sales of domestic types totaled 9⅓ million, up from 8⅔ million in 1971, while sales of imports were essentially unchanged at 1½ million. Personal consumption spending on autos is estimated to have dropped slightly in the fourth quarter but registered sizable gains in the preceding three quarters (chart 9).

There are indications that sales volume would have been even stronger in 1972 had it not been for inventory shortages. Strong demand taxed dealer inventories of 1972 models as the model year was finishing, and caused shortages of 1973 models as well. Also, production losses due to scattered work stoppages cut into the supply of new cars in the fall. As a result of these factors, the manufacturers closed the year operating many plants on a 6-day week and with sharply reduced holiday shutdown periods.

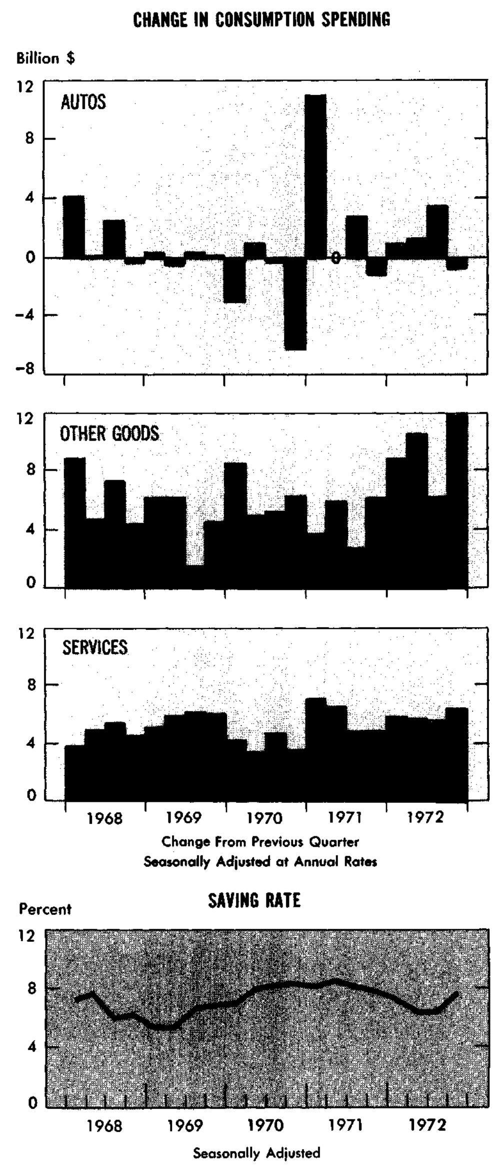
Unit sales of foreign models held in a narrow range around 1½ million units (annual rate) all year, and the market share for imports, measured in terms of unit sales, fell to 14½ percent from 15½ percent in 1971. There had been a steady uptrend in import sales prior to the latter months of 1971, when the temporary import surcharge and dock strikes apparently cut heavily into sales. By the first quarter of 1972 the surcharge was off and the strikes were over, but at the same time major currency realignments forced price increases on most import models. This factor in particular affected sales of the major low priced imports—VW, Toyota, and Datsun—that compete directly with domestic subcompacts—Pinto, Vega, and Gremlin. At least partly as a result of their improved price competitiveness, the domestic subcompacts enlarged their share of the low priced auto market in 1972, at the expense of the imports.

Sentiment, debt, and saving

The acceleration of consumer spending in 1972 was consistent with the evidence from sentiment surveys. The index of consumer sentiment compiled by the University of Michigan Survey Research Center increased more than 14 percent from the fourth quarter of

CHART 9

Consumption and Saving



U.S. Department of Commerce, Bureau of Economic Analysis 73-1-9

1971 to the third quarter of 1972, a stronger gain in those 3 quarters than the increase of 9 percent recorded in the 4 quarters immediately following the recession low in the fourth quarter of 1970. The increase in consumer optimism was presumably an important factor in the rapid growth of installment credit use (chart 10). The rate of increase in outstanding credit for autos and other consumer goods accelerated sharply during 1972, and the full-year increases in the outstanding amounts of both types were far larger than the 1971 increases. The "other consumer goods" category includes credit for furniture and appliances and also for mobile homes. The growth rate of personal loans was erratic in 1972 (chart 10), but the expansion for the year as a whole was nevertheless well above that for 1971.

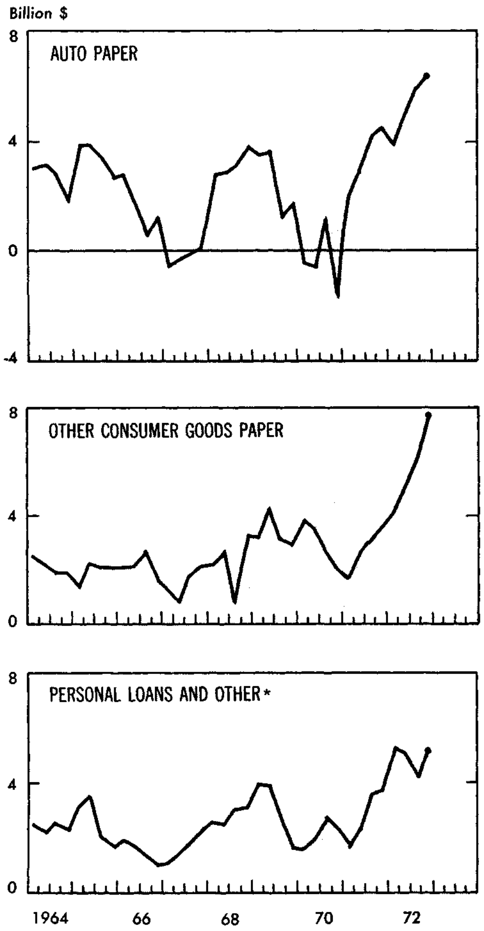
The saving rate—the share of disposable income saved—edged down in 1972 (chart 9). For the full year, the rate averaged 7 percent. It had ranged from 8 to 8½ percent during 1970 and 1971, a high level by historical standards, and a decline was generally expected when consumer sentiment improved. However, the drop in the rate in 1972 was probably due in large part to the impact of overwithholding; this cut into disposable income and likely was reflected in a cut in saving from what it otherwise would have been.

Withholding schedules were adjusted in January, and it was recognized that significant overwithholding would result if affected taxpayers did not offset some of the impact by increasing their exemptions for withholding purposes. It appears that relatively few taxpayers took the necessary action. As a result, most of the increase in tax payments in the first quarter of 1972 was due to overwithholding. Withholding in excess of the amounts needed to cover liabilities is a form of saving; while the overwithholding probably had an impact both on consumption spending and on personal saving, it is likely that the impact fell disproportionately on saving. In the absence of overwithholding, the saving rate probably would not have declined in the first quarter—it dropped to 7.2 percent, from 7.8 percent in the fourth quarter of 1971—and very likely would have increased.

Overwithholding in the rest of the year evidently continued at about the same level as in the first quarter, and thus had no substantial further effect on the growth of disposable income (though it continued to affect the level of income). The saving rate fell sharply to 6½ percent in the second quarter and remained at that level in the third. This decline would presumably have occurred in the absence of overwithholding, but the level of the saving rate would have been higher all year. In the fourth quarter there was a huge gain in pretax personal income and disposable income surged. Consumption spending also accelerated but less sharply than income, and the saving rate moved back up to 7½ percent at yearend.

CHART 10

Change in Consumer Installment Credit Outstanding



Seasonally Adjusted at Annual Rates

* Includes repair and modernization loans.

• October–November at a quarterly rate.

Data: FRB

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-10

Housing

THE residential construction boom continued in 1972, sustained by ready availability of mortgage credit and strong underlying demand. New private housing starts (chart 11) reached a very high rate early in the year, averaging 2.5 million units (annual rate) in the first quarter. The rate dropped somewhat in the spring and then ran at about 2.4 million units for the rest of the year, higher than had generally been expected. Expectation of more weakening was based on the fact that the starts rate, rebounding from the depressed levels of 1969 and 1970, had risen to a level higher than that which was thought sustainable for any period of time. At yearend, the rate was still very strong, but signs of softening in demand relative to supply had appeared in 1972 that signaled a future slowdown in housing activity.

For the year as a whole, investment in residential construction rose about $11¼ billion, or 26½ percent, to a level of $54 billion. This increase was about the same, in dollar terms, as the increase in 1971, when residential investment was the strongest component of demand expansion.

Housing starts totaled 2.4 million units for the year, up from the previous record of 2.1 million started in 1971. Single family starts increased about 15 percent over 1971 to 1.3 million units, and the number of units in multifamily structures rose about 19 percent to 1.1 million. Mobile homes are an important source of low cost housing but are at present treated in the national income and product accounts as durable goods consumption and not as residential investment. Shipments of mobile homes rose about 17 percent from 1971 to

1972, to 570 thousand units. Mobile home shipments and housing starts together totaled just under 3 million units in 1972, compared to 2.6 million in 1971.

The strength of the housing boom in 1972 is all the more remarkable in light of the drop in the level of support provided to private housing by Government subsidy. In 1970 and 1971, roughly one-fourth of all new privately owned housing units were started under one of several Federal subsidy programs (rent supplements, mortgage interest subsidies, etc.). Last year, some of these programs were cut back. For full year 1972, federally subsidized housing starts are estimated to have totaled only about 340 thousand units compared to 430 thousand units in 1971, and comprised only about 14 percent of total private housing starts. (These figures refer to the subsidy programs of the Agriculture Department in addition to those of the Housing and Urban Development Department.)

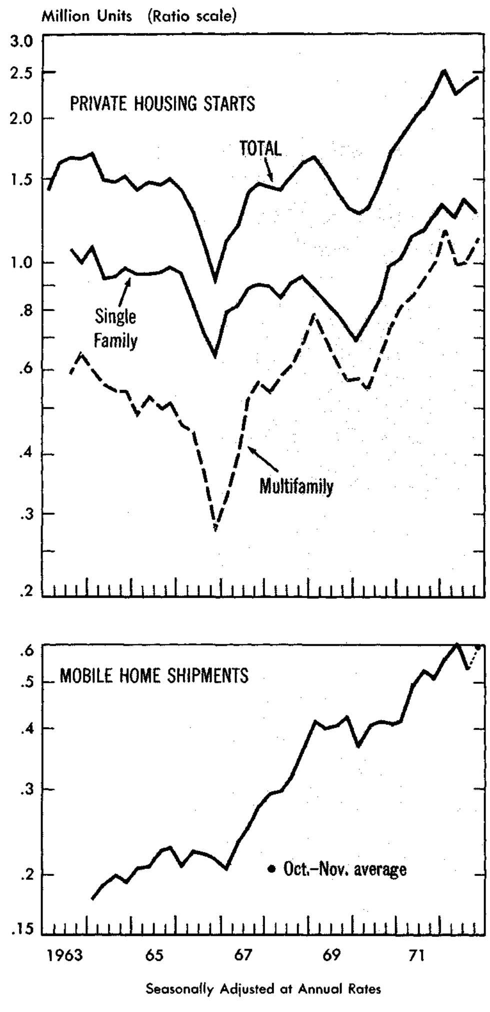
Regionally, the starts expansion in 1972 was strongest in the South and the Northeast, with gains of 23 percent and 30 percent, respectively. The 1972 increases in starts in the North Central and Western regions, which had both recorded increases around 50 percent in 1971, were 5 percent and 9 percent, respectively.

In the rental market, vacancy rates rose noticeably during the year, particularly in the West and North Central regions of the country. Vacancy rates had been fairly stable at low levels in 1971 but began to rise early in 1972. By the third quarter, the rental vacancy rate for the Nation as a whole had risen to about 5¾ percent. This was not especially high by historical standards, but the vacancy rate was expected to continue to rise for some time because of the very large number of units started but not finished in multiunit buildings. (Most multiunit structures are for the rental market. Though increasingly popular, cooperatives and condominiums are estimated to have accounted in 1971 for no more than 10 percent to 12 percent of units in new structures with 5 or more units. No estimate is available for 1972, when the share may well have increased.)

There were also some signs of softening in the market for single-family homes, as the ratio of new one-family homes for sale to homes sold—an inventory-sales ratio—rose sharply in the year. In the first quarter of 1972, this ratio averaged about 5½—i.e., homes for sale averaged 5½ months of sales. By late in the year the ratio was averaging over 6, the highest since early 1970.

CHART 11

Residential Construction and Mobile Homes



Data: Census

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-11

Nonresidential Fixed Investment

THE strengthening demand for output, some reduction of excess capacity, and the accelerating growth of cash flow (which was stimulated by the investment tax credit) were factors contributing to the recovery of nonresidential fixed investment in 1972. Following very small increases in 1970 and 1971, outlays rose 13¾ percent from 1971 to 1972 to total $120½ billion. The recovery in investment outlays occurred during a period when price increases were abating, and fixed investment in real terms increased for the first time since 1969.

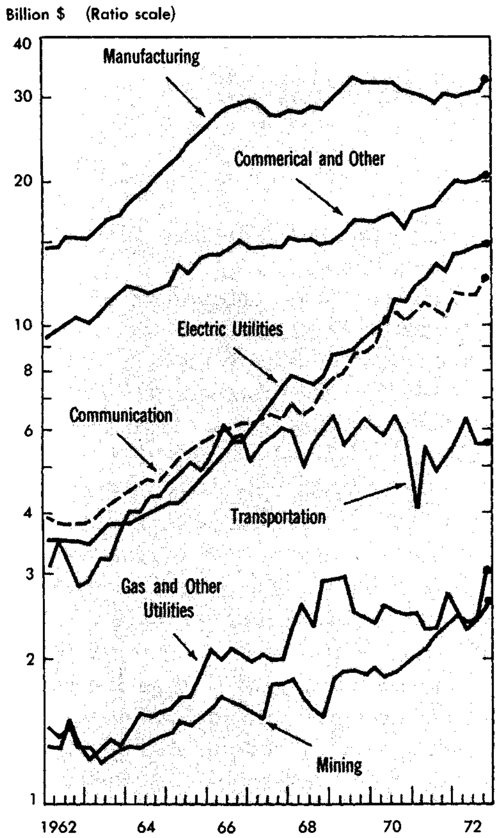
Most of the recovery was in spending for producers' durable equipment. These outlays rose steadily during 1972 and for the year as a whole were up 16 percent, or $10¾ billion, from the level in 1971. Prices for producers' equipment are estimated to have risen little in 1972, and roughly four-fifths of the spending increase represented increased real purchases.

The structures component of nonresidential fixed investment rose 10 percent ($3¾ billion) from 1971 to 1972, but much of that increase is estimated to reflect higher costs. The spending pattern was mixed during 1972: outlays were up fairly sharply early in the year, showed little net change in the second and third quarters, and were again on the upswing in the fourth. Spending for industrial buildings declined for the thiid consecutive year, and most of the spending growth was for commercial, hospital and institutional, and privately owned public utility structures. The difference in behavior between structures and producers' durables in 1972 was probably due in part to the stimulative impact of the investment tax credit, which was restored in late 1971. The credit applies to equipment but not to structures. Also, capital investment in 1972 was oriented toward modernization as distinguished from expansion, and this would tend to channel spending more toward equipment than toward plant.

The investment recovery got underway at a time when there appeared to be a significant amount of excess capacity on hand. The Federal Reserve estimate of the capacity utilization rate in manufacturing was only 74½ percent in the fourth quarter of 1971. However, as 1972 progressed, the utilization rate moved steadily higher and stood at almost 80 percent in the fourth quarter. The manufacturing utilization rate calculated by McGraw-Hill increased from 76½ percent in November 1971 to 83 percent in November 1972; for durables manufacturing, the increase was from 70½ percent to 80 percent. Similarly, the evaluation of manufacturers' capacity reported in BEA's quarterly surveys showed a clear tightening during 1972 (chart 13).

CHART 12

Plant and Equipment Expenditures



Seasonally Adjusted at Annual Rates

• Expected

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-12

Plant and equipment survey results

BEA's regular quarterly survey of plant and equipment spending, which provides industry detail on capital investment, shows spending up 9 percent from 1971 to 1972. According to the survey, outlays rose sharply early in the year, barely at all in the second and third quarters, and were expected in November to increase sharply again in the fourth quarter.

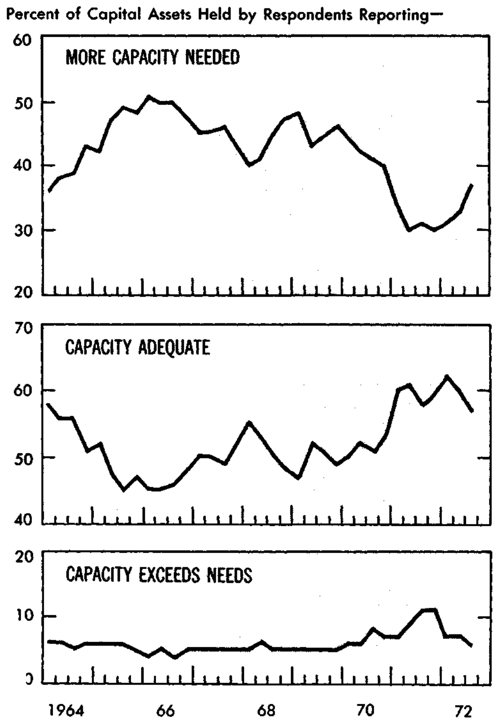
Nonmanufacturing industries undertook stronger investment expansion in 1972 than did manufacturing industries. Outlays by nonmanufacturing industries rose 12 percent in the aggregate and, as chart 12 shows, all major industry groups contributed to the advance. Most industries recorded year-over-year increases about in line with that of nonmanufacturing as a whole. Within the transportation group, however, there was sharp diversity: investment by the airlines rose 34 percent—a turnaround from a decline of similar magnitude in 1971—while investment by the railroads rose 7½ percent, and outlays of the other surface carriers (trucks, ships, pipelines, etc.) only 2 percent.

Assuming that the spending expectations for the fourth quarter of 1972 were realized, the increase in investment by manufacturers last year was 4 percent, only about one-third as large as that by nonmanufacturing industries. Spending by producers of nondurable goods declined about 1 percent from 1971 to 1972, but spending by the more cyclically sensitive durables producers rose about 9½ percent—a turnaround from the 1971 decline of 10½ percent. Within nondurables manufacturing, increased outlays by the rubber, textile, and paper industries were more than offset by cutbacks in the petroleum, food-beverage, and chemical industries. In durables manufacturing, all major industries recorded increases in investment spending in 1972 with the exception of the steel industry, where the downtrend that began in 1968 continued.

A curious aspect of the plant and equipment survey findings last year was the shortfall of actual from expected spending in the second and third quarters. Plans reported in May indicated a $4 billion (annual rate) advance in outlays in the second quarter, and plans reported in August indicated an expected gain of $3¼ billion in the third, but spending in fact changed little in either quarter. It is rather surprising to find sizable shortfalls during a period of accelerating economic activity. However, the shortfalls apparently do not reflect a scaling back of investment programs; businessmen revised up their expectations for the quarters immediately ahead, suggesting that the shortfall amounts were at least partly shifted into the near future. Moreover, as the year progressed, measures related to current and prospective capital spending—new and unfilled orders for capital

CHART 13

Manufacturers' Evaluation of Existing Capacity*



* Relative to prospective operations during the ensuing 12-month period.

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-13

goods, manufacturers' capital appropriations and backlogs, new project starts and carryover, construction contract awards—all were strengthening, and the evidence at yearend strongly indicated that a major capital spending recovery is underway, and that it will carry well into 1973.

Inventories

THE expansion of business inventories accelerated sharply during the last three quarters of 1972, but the advance fell considerably short of matching the exceptional rise in sales. Inventory accumulation as measured in GNP declined from the fourth quarter of 1971 to the first quarter of 1972; then it rose from an annual rate of only $400 million in the first quarter to a rate of $10 billion in the fourth quarter—the largest dollar gain over a 3-quarter span since 1961. Inventory accumulation accounted for about 11 percent of the increase in GNP from the first quarter to the fourth, a higher proportion than in recent years but considerably less than in the recoveries after the 1954, 1958, and 1961 recessions, when it constituted about 25 percent of the GNP increase.

Despite the acceleration during 1972, the accumulation rate at yearend was nevertheless still quite moderate. The $10 billion rate in the fourth quarter was equal to only about 0.8 percent of total GNP, compared with 1 percent on the average during the decade ending with 1970. For the year as a whole, accumulation amounted to just under $6 billion, about one-half of 1 percent of GNP.

Book values

The book value of inventories in manufacturing and trade, at $192¼ billion in the fourth quarter of 1972, was $10 billion or 5½ percent higher than 1 year earlier, with about two-thirds of the rise coming in the second half of the year (chart 14). The increase was less than half as great as the increase in manufacturing and trade sales, which rose 14¼ percent from the fourth quarter of 1971 to the fourth quarter of 1972 with sharp gains in all major sectors but especially in durable goods.

Manufacturing inventories increase $5 billion, or nearly 5 percent, during 1972. The gain was very unevenly distributed. About four-fifths of it, or $4 billion, occurred in durable goods industries; nearly $3 billion consisted of durable goods in process of manufacture, of which about $2 billion was in transportation equipment manufacturing and probably reflected the boom in motor vehicle production and significant recovery in the aircraft industry. In soft goods manufacturing, the increase in goods in process was about twice as large in percentage terms as the expansion in either finished goods or materials and supplies. A sharp rise in output normally entails an increase in the volume of goods in process of manufacture.

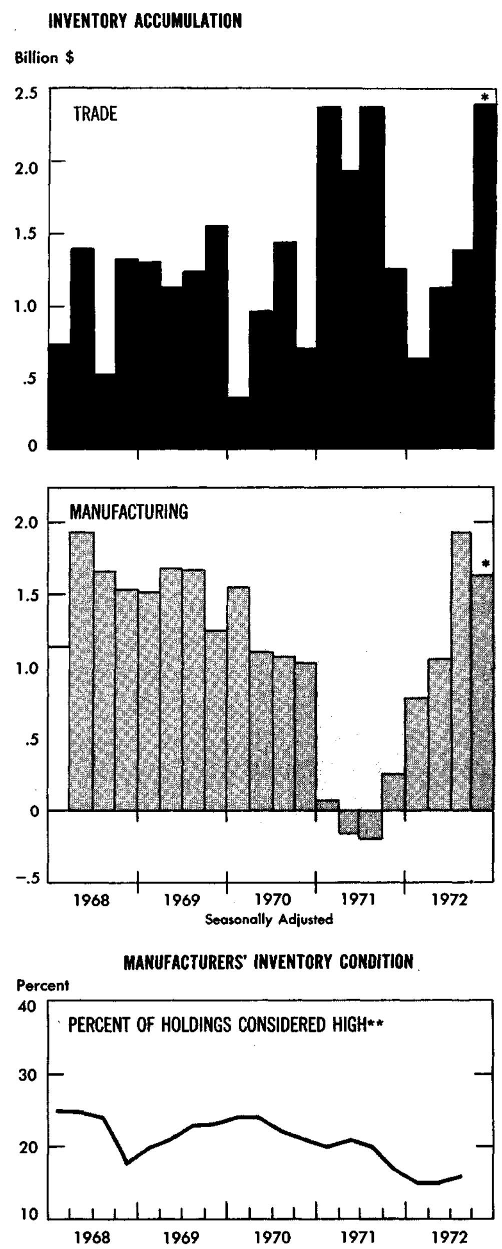
The expansion of finished goods stocks was probably held back in some sectors by the strength of sales. Inventories of automotive retailers in particular declined during most of 1972, as sales outran even the high level of production. Late in the year, inventories increased somewhat, but dealers' stocks of new cars were still low in relation to sales.

The ratio of stocks to sales in manufacturing and trade recorded in 1972 its sharpest decline since 1950. In November 1972, the ratio was 1.46, down from 1.58 at the end of 1971 and about equal to the 17-year low reached in 1965 and early 1966. The 1972 decline in the ratio for manufacturing alone was steeper. The ratio of manufacturers' finished goods to sales was about the same in late 1972 as in 1965, but the ratio for materials and supplies was lower while the ratio for work in process was significantly higher, at least in durable goods.

An associated development was the decline in the proportion of manufacturers' inventories held by companies that considered their stocks as "high." It fell to about 15 percent at the end of the first quarter of 1972 and was little changed in the next two quarters—holding a level about the same as in 1965. In the same quarters of 1971, the proportion was 20 percent (chart 14).

CHART 14

Inventories



*Accumulation in Oct. and Nov. expressed at a quarterly rate.
**Percent of total inventory book value held at end of quarter by companies characterizing their inventories as high relative to sales and unfilled orders.

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-14

Exports and Imports

FOREIGN demand for U.S. goods and services increased substantially from 1971 to 1972 but there was an even stronger gain in U.S. demand for foreign output. The preliminary estimate shows exports of goods and services at $73¾ billion for the year, up $7½ billion, or 11½ percent, from 1971. Imports of goods and services are estimated at $77¾ billion, up $12½ billion or 19 percent. The balance on goods and services deteriorated from a narrow surplus of $¾ billion in 1971 to a deficit of $4 billion in 1972.

Merchandise trade accounted for the bulk of the deterioration in the goods and services balance. For the first 11 months of 1972, merchandise trade (calculated on the basis that BEA uses for the balance of payments and GNP accounts) was in deficit by $6¾ billion at a seasonally adjusted annual rate. The deficit for the year 1971 was $2¾ billion. The deterioration reflected not only the fact that economic expansion in 1972 was more rapid in the United States than in most industrialized countries, but also the initial perverse effects on the value of imports of the appreciation of leading foreign currencies against the dollar. Also, there was an upsurge of shipments early in 1972 following the lifting of the import surcharge and settlement of late-1971 dock strikes; the post-strike surge was apparently stronger for imports than for exports.

For the nonmerchandise elements of exports and imports, detail is available only for the first 3 quarters of 1972 at the time this review is being prepared. Relating those data, expressed at an annual rate, to data for the full year 1971 shows some decline in the surplus on investment income, a sharp increase in the deficit on military transactions, and a small increase in the deficit on travel and transportation transactions.

The surplus on investment income declined from 1971 to 1972 as income payments on foreign investments in the United States increased somewhat more in dollar terms than income receipts from U.S. investments abroad. In percentage terms, the increase in U.S. payments was far larger than the increase in receipts. The sharp growth of income payments in 1972 centered in payments on U.S. liabilities to foreign official agencies. This reflects the huge rise in foreign central banks' holdings of dollars during 1971 as they attempted to hold exchange rates stable in the face of market expectations that rates would change (as they in fact did).

Direct defense spending abroad—an import item—was little changed from 1971 to 1972. However, U.S. exports under military agency sales contracts dropped steeply, in good part because of reduced aircraft deliveries. The result was that the deficit on military transactions increased sharply from 1971 to 1972. The deficit on travel and transportation transactions increased slightly as the dollar increase in U.S. payments for travel and transportation was larger than the dollar increase in U.S. receipts. In percentage terms, however, the increase in payments was smaller than the increase in receipts.

Export and import shares

The deterioration of the balance on goods and services in recent years reflects the fact that while the share of U.S. national output (GNP going to fill export demand has edged up only slightly, there has been a marked increase in the role of imports in filling domestic demand in the United States.

In 1972, on the basis of data for the first 3 quarters, the share of exports in total U.S. production of goods and services (GNP) held at the 1971 figure of 6.3 percent (table 2). The share of goods exports in total U.S. production of goods moved up modestly following a decline in 1971. The current values of both share figures are only moderately above their values in the first half of the 1960's.

Aggregate domestic demand is estimated by subtracting gross exports of goods and services from GNP—for exports go to fill foreign, not domestic, demand—and adding gross imports. In terms of the GNP, aggregate domestic demand is the sum of the components other than net exports. Table 2 shows the share of imports in selected categories of domestic demand.

Table 2.—Exports as Share of U.S. Production, Imports as Share of U.S. Domestic Demand

[Percent]

	Average		1970	1971	1972*
	1960–64	1965–69			
Exports:					
1. Goods and services	5.5	5.8	6.4	6.3	6.3
2. Goods	7.6	7.8	8.9	8.6	8.9
Imports:					
3. Goods and services	4.6	5.3	6.1	6.2	6.7
4. Goods	4.8	5.9	7.0	7.5	8.2
5. Autos	2.1	5.9	11.4	11.8	12.8
6. Nonautomotive capital goods	3.0	5.6	7.4	8.0	9.3
7. Food	4.2	4.3	4.7	4.7	5.0
8. Nonfood, nonauto consumer goods	2.4	3.5	4.6	4.9	5.9
9. Industrial supplies and materials	2.5	2.6	2.7	2.8	2.9

*First 3 quarters.

NOTE.—Export and import data used in lines 1-4 of this table are as published by BEA in lines 1, 2, 15, 16 of table 2 of the regular balance of payments tables. The imports used to calculate lines 5-9 of this table are, respectively, those shown on lines 94, 80, 61, 97 and 66 of balance of payments table 4. The denominators of the ratios shown here are, by line number: (1) GNP; (2) goods component of GNP; (3) GNP less net exports; (4) goods and structures components of GNP less net merchandise exports; (5) gross auto product less its net export component; (6) producers' durable equipment less autos, trucks, buses; (7) personal consumption spending on food; (8) personal consumption spending on goods except food, autos, and gasoline; (9) goods and structures components of GNP less net merchandise exports.

Total imports of goods and services were 6.7 percent of domestic demand for goods and services in 1972, up from 6.2 percent in 1971. The increase in share was sharper for goods alone—calculated as merchandise imports divided by domestic demand excluding services. The import shares in domestic demand for autos, nonauto capital goods, and nonauto nonfood consumer goods all showed sizable increases. Imports of foods-feeds-beverages are related in the table to personal consumption spending on food, and imports of industrial supplies and materials are related to total domestic demand excluding services. These two shares show only small increases in recent years, but the other share figures reflect a clear long-term growth in U.S. preference for foreign output. (The categories of merchandise imports for which shares are calculated in table 2 comprise about 90 percent of total merchandise imports.)

Federal Government

FEDERAL purchases of goods and services amounted to $106 billion in 1972, a gain of over $8 billion from 1971. Defense purchases, which had been declining since 1969, increased nearly $5 billion and nondefense purchases were up about $3½ billion (chart 15). Other Federal expenditures increased $18 billion and receipts $29 billion, and the deficit on the national income accounts basis declined from $21¾ billion in 1971 to $18½ billion in 1972.

Defense spending was boosted by increased military personnel costs, which reflected the full-year effect of the military pay raise effective in mid-November 1971, and a 5 percent pay increase for military and civilian personnel effective January 1, 1972. The effect of these pay raises was partly offset, however, by a year-to-year decline of about 300,000 in the size of the Armed Forces. Other types of defense spending also increased in 1972, particularly procurement of hard goods and research and development.

Nondefense purchases, which increased nearly $5 billion in 1971, recorded another large gain in 1972, rising $3½ billion. Continued increases in payroll costs and accelerated spending for other goods and services by most civilian agencies were major factors in the advance. Net interest payments to foreigners were also a major factor, increasing by nearly $1 billion in 1972. (Government interest payments to foreigners are treated as a government purchase but also as an import, and thus their amount has no effect on the size of GNP.) Offsetting these gains was a large decline in the net purchases of agricultural commodities by the Commodity Credit Corporation largely because of generally higher market prices and the Soviet wheat sale.

Other types of Federal expenditures—transfers, grants, interest, and subsidies—increased nearly $18 billion from 1971 to 1972, to a level of nearly $141 billion. Transfer payments and grants accounted for about $17 billion of the increase.

Table 3.—Federal Nondefense Purchases

[Change from previous year, billions of dollars]

	1970	1971	1972
Total	1.1	4.8	3.4
CCC Purchases	-1.8	1.2	-.6
NASA Purchases	-.3	-.2	-.1
Net Foreign Interest Paid	.2	.8	.8
Other	3.1	3.0	3.3

Transfer payments to persons rose $8½ billion to $80¾ billion in 1972—an amount $4½ billion higher than total defense purchases. The largest transfer category, OASDI benefits, advanced by over $4½ billion, of which about $2 billion resulted from the 20 percent benefit increase paid beginning in October. Unemployment benefits, which had increased nearly $2 billion in 1971, fell slightly in 1972, as the average number of insured unemployed declined about 300,000. Other transfer icnreases occurred in veterans' benefits ($1½ billion), medicare ($1 billion), civilian pensions ($½ billion), and food stamps ($⅓ billion).

Grants-in-aid to State and local governments advanced a record $8½ billion to $37¾ billion. Of this increase, $2.6 billion came from the initial payment of general revenue sharing in December. Public assistance grants (including grants for medicaid and social services) were up nearly $3½ billion; other increases were in emergency employment assistance ($1 billion) and education ($½ billion).

Subsidies (net of the current surplus of government enterprises) advanced nearly $1 billion to more than $6 billion. The largest subsidy category, payments to farmers, had declined in the past few years but increased more than $¾ billlon in 1972. A temporary program to aid homeowners and businesses who suffered losses in Hurricane Agnes added about $½ billion to subsidies in 1972, but there was a $½ billion decline in the postal deficit. Net interest paid showed little change in 1972 after declining by $1 billion in the previous year.

Receipts

Federal receipts increased in 1972 by a record amount of over $29 billion as a result of (1) rapid growth in employment and incomes, (2) overwithholding of personal taxes, and (3) a higher social security tax base. Higher incomes in 1972 accounted for nearly $26 billion of the gain in revenues while the net effect of tax changes (including overwithholding) added $3½ billion (table 4).

Table 4.—Breakdown of 1972 Change in Federal Receipts, NIA Basis

(Change from previous year, billions of dollars)

Increase in total receipts (NIA basis)	**29.1**
Amount due to higher incomes	25.6
Amount due to tax changes	3.5
Personal tax and nontax payments	19.3
Amount due to higher incomes	14.3
Amount due to tax changes [1]	5.0
Corporate profits tax accruals	2.9
Amount due to higher incomes	5.3
Amount due to tax changes	-2.4
Indirect business tax and nontax accruals	-.4
Amount due to higher incomes	1.8
Amount due to tax changes	-2.2
Contributions for social insurance	7.4
Amount due to higher incomes	4.3
Amount due to tax changes	3.1

1 Includes impact of overwithholding.

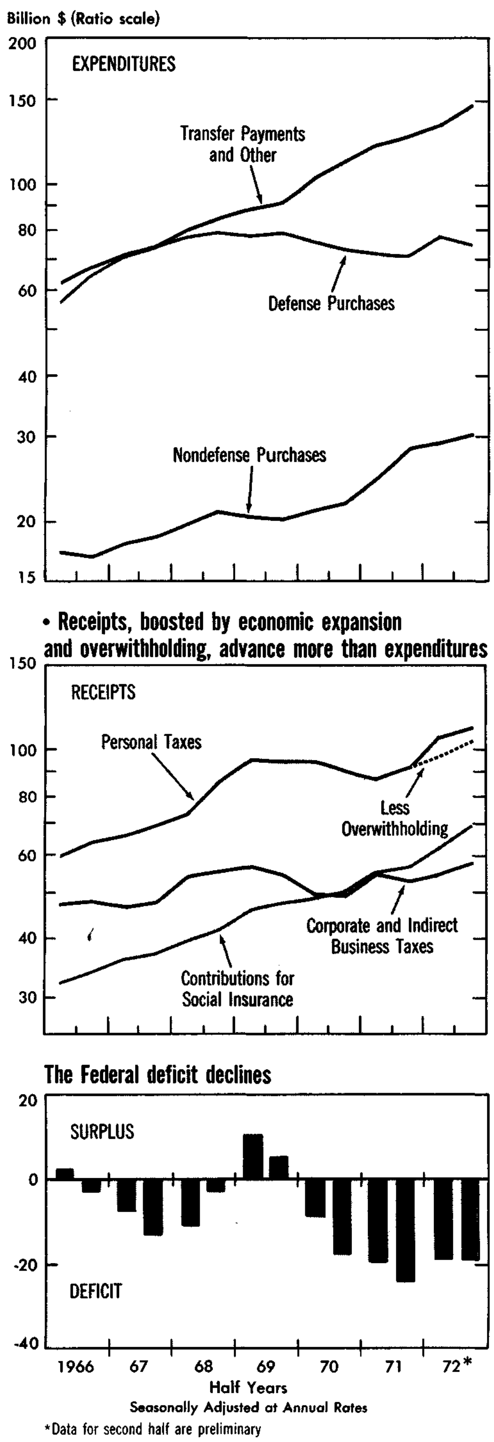
Source: Estimates by Bureau of Economic Analysis.

Personal tax receipts increased nearly $19½ billion, despite the fact that liabilities were reduced under provisions of the Revenue Act of 1971. This Act also provided for a new withholding schedule, effective January 1, 1972, which was designed to eliminate the underwithholding that occurred in 1971. Individuals were expected to adjust their exemptions in order to match their withholdings under the new schedule with their liabilities. However, it appears that most individuals failed to adjust, resulting in $9 to $10 billion of overwithholding in 1972. Final settlements paid in 1972 (on 1971 liabilities) were also up, reflecting the increase in capital gains realized in 1971. Estate and gift tax payments continued to increase rapidly.

CHART 15

Federal Budget (NIA Basis)

• Defense purchases move up, civilian spending continues to increase



*Data for second half are preliminary

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-15

Corporate tax accruals rose about $3 billion, the net result of a gain of about $5½ billion from higher profits and a $2½ billion reduction due to tax changes, such as the investment credit, liberalized depreciation rules, and the "Domestic International Sales Corporation" provision that is intended to promote exports.

Indirect business taxes were slightly over $20 billion in 1972, a decline of about $½ billion from 1971 reflecting the full-year effect of the auto excise tax repeal and the fact that a customs surcharge was in effect for the final months of 1971 but not in 1972.

Social insurance contributions recorded another large gain last year, up $7½ billion to about $63½ billion. The increase in the taxable wage base for social security from $7,800 to $9,000, effective January 1, 1972, accounted for over $3 billion of the advance.

State and Local Government

PURCHASES by State and local governments increased $14 billion in 1972 to almost $149 billion. This was a larger dollar increase than in 1971 (table 5), but about the same percentage gain—slightly over 10 percent—as in the last several years.

Employee compensation, which accounts for over one-half of total purchases, rose $8½ billion (10½ percent), the smallest growth rate since 1965. Compensation increased nearly 13 percent in 1970 and over 11 percent in 1971. Total State-local employment increased nearly 4 percent in 1972 compared with 3.7 percent in 1971. Available data show an acceleration of growth in educational employment, especially at the local level, after 3 years of deceleration. Other employment rose only slightly.

Data now available indicate that 1972 purchases of structures were only slightly above the 1971 total of $26¼ billion. Spending in the first and fourth quarters, seasonally adjusted, was considerably above the 1971 rate but declines in the second and third quarters held down the annual average.

The stability in aggregate State-local construction activity was contrary to the general expectation a year ago, when an upsurge in 1972 was expected. Most classes of new construction showed little change from 1971 to 1972, including sewerage and water constuction, an area in which major increases were generally expected. Public housing construction fell considerably. However, preliminary data indicate that educational construction, which declined steadily in the 1968–71 period, increased slightly in 1972.

Other purchases rose $5½ billion in 1972. Among the important factors contributing to this large increase were: (1) higher spending on social services, particularly in the first half, largely financed by expanding Federal grants; (2) outlays made necessary by Hurricane Agnes; (3) a 20 percent rise in purchases by these governments of medical services on behalf of medicare/medicaid recipients, an increase roughly as large as the 1969 and 1970 increases taken together; and (4) spending by some governments in anticipation of revenue sharing.

Transfer payments rose only $1¾ billion, well below the $2½ billion increase in 1971. Welfare payments increased only about half as much as in 1971; the economic expansion and more stringent administration of programs contributed to this slowdown. However, other major types of transfer, such as pensions and injury compensation, rose somewhat faster than in 1971.

Interest receipts exceeded interest paid once again in 1972, resulting in negative net interest payments. Negative net payments over the past few years are largely a reflection of the relatively strong financial position of State and local government in the aggregate. Until 1969, interest expenditures had exceeded interest receipts in every year since 1929 (the first year such data were compiled in the national accounts). However, since 1969, the situation has reversed. In part, the reversal reflects the growing stock of assets held by retirement and other social insurance funds, but general government holdings of financial assets have also risen rapidly in recent years.

Receipts

State and local government receipts increased about $23 billion in 1972, with almost $14½ billion coming from their own sources, and $8¾ billion from Federal grants-in-aid. The initial revenue sharing payment in December accounted for $2.6 billion of these governments' 1972 receipts. The 1971 advance in receipts was $16¾ billion, with Federal grants responsible for $4¾ billion.

The spectacular increase in grant receipts, which reached almost $38

Table 5.—State and Local Government Purchases, Other Expenditures, and Receipts

[Change from previous year, billions of dollars]

	1970	1971	1972
Expenditures	**13.1**	**14.8**	**15.4**
Purchases of goods and services	11.3	12.5	14.0
Compensation	7.9	7.7	8.5
Structures	.1	1.1	.2
Other	3.4	3.7	5.5
Expenditures other than purchases	1.8	2.3	1.4
Receipts	**15.2**	**16.8**	**22.7**
Less: Federal grants-in-aid	4.2	4.7	8.3
Contributions for social insurance	1.0	1.1	1.4
Equals: Tax and nontax revenues	10.1	10.9	13.1
Personal income taxes	1.1	1.6	3.0
Amount due to higher incomes	.6	.9	2.2
Amount due to law changes	.5	.7	.8
General and major selective sales taxes	3.1	2.8	3.9
Amount due to higher incomes	2.2	2.1	3.0
Amount due to law changes	.9	.7	.9
All other tax and nontax revenues	5.9	6.5	6.2
Surplus or deficit	**2.1**	**2.0**	**7.3**

billion in 1972, has diverted attention from the very large increases in revenues raised directly by State and local governments. In every year since 1968, these governments' revenues from their own sources have risen more than 10 percent, reflecting the imposition of new taxes as well as changes in rates and bases of existing taxes.

Indirect business taxes rose more than $8 billion in 1972, somewhat more than in 1971. About $1 billion of the 1972 increase was due to increases in general or selective sales tax rates enacted in 1971 or 1972 (table 5). Many of these rate increases occurred during 1971, with their full impact felt in 1972. There was a significant slowdown in 1972 in legislative action increasing sales tax rates.

Fiscal position

The aggregate fiscal position of State and local governments improved markedly in 1972. On a national income accounts basis, which consolidates operating funds and social insurance funds, a $12 billion surplus was recorded, up from surpluses of $5 billion in 1971 and $3 billion in 1970.

The 1972 improvement centered in operating funds, which showed a surplus for the first time since 1947. The $3½ billion operating surplus in 1972 followed deficits of $2¾ billion in 1971 and $3¾ billion in 1970. Nearly half of the swing to surplus is attributable to the December revenue sharing payment which added $2.6 billion to 1972 receipts, but had little impact on 1972 expenditures. Social insurance funds had a surplus of more than $8½ billion in 1972, up more than $1 billion from 1971.

The movement toward a surplus position for operating funds can be attributed both to very rapid growth in Federal grants-in-aid, and consistent growth in State and local tax and nontax revenues. In percentage terms, growth in these revenues matched or exceeded gains in expenditures in four of the last 5 years.

Prices

ON the whole, prices rose substantially less in 1972 than in 1971 (chart 16). The major indexes indicated widespread moderation in price increases for industrial products and services, but an acceleration of agricultural price increases.

The implicit price deflator for the private economy—which measures the prices of the goods and services comprising GNP excluding the government sector—rose 2.6 percent from 1971 to 1972, the smallest annual increase since 1966. (The overall GNP deflator, which is heavily affected by government pay raises, rose 3 percent for the year.) With the farm sector excluded, the private deflator rose even less, about 2.1 percent. Within the year, the private deflator rose 4¼ percent (annual rate) in the first quarter, partly as a result of the lifting of the late-1971 price freeze, about 1¾ percent in the second quarter, 2¼ percent in the third, and 2¾ percent in the fourth quarter.

The implicit price deflator is an index based on shifting weights and its changes reflect both price changes and the changing mix of the goods and services in GNP. A measure of price change for private GNP based on fixed weights rose more rapidly than the implicit deflator throughout 1972, and for the year as a whole was up 3.2 percent, compared with a 4.5 percent increase from 1970 to 1971. The difference between the 3.2 percent increase in the fixed weight index and the 2.6 percent increase in the implicit deflator is due to the decreasing importance in 1972 of certain products with relatively high deflators and the increasing importance of products with relatively low deflators. Most important was a shift of output composition away from nonresidential construction and toward durable goods, especially automobiles.

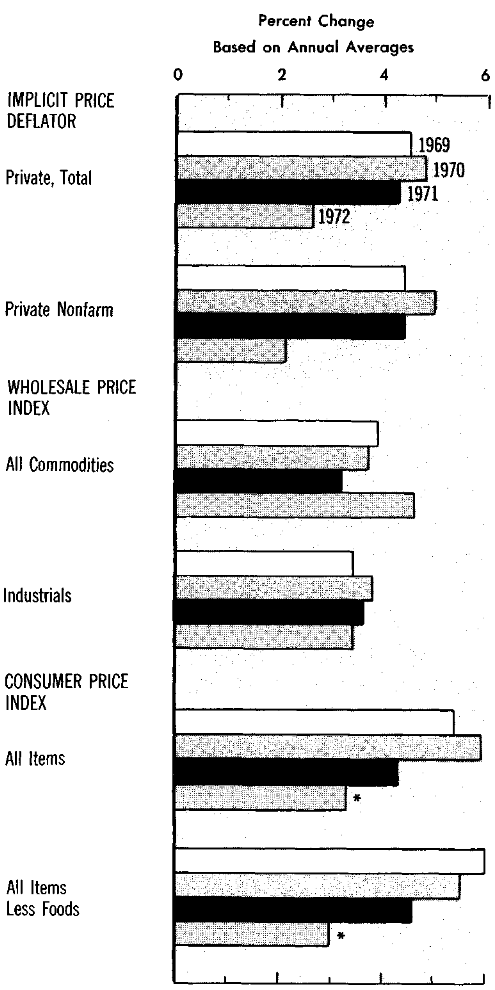
Consumer prices

Consumer price increases were generally slower last year than in 1971. The overall consumer price index was up 3.3 percent for the year, compared with a 4.3 percent rise in 1971. The increase in prices for food accelerated in 1972, however. With food prices excluded, the consumer price index increased about 3 percent for the year. Food price increases were concentrated in the meats-poultry-fish group and the fresh fruits and vegetables group. Strengthening demands pushed meat prices up strongly early in the year, and again in the early summer. In an attempt to increase supplies and ease price pressures, import quotas were lifted at midyear; price increases did slow in the late summer, but by yearend prices were rising strongly again. The increases for fruits and vegetables were due in large part to the effects of adverse weather conditions.

Prices for nonfood commodities were up 2.3 percent for the year 1972, compared with an advance of 3.8 percent in 1971. The deceleration was mainly in apparel prices (but not footwear), and in prices for new cars and household durables. Services prices rose 3.8 percent for the year, well below the increases of other recent years. This deceleration was due mainly to smaller increases in prices of transportation, medical care, and household services other than rent (which include maintenance and repair, mortgage interest rates, utilities charges, and property taxes).

CHART 16

Price Changes



*Based on Jan.-Nov. average for 1971 and 1972.

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-16

Wholesale prices

The rate of wholesale price increase accelerated in 1972, both for the year as a whole relative to 1971 and during the year, but the acceleration was due entirely to increases in prices of agricultural products. Prices of livestock were responsible for much of the rise in the spring, and vegetable prices were increasing rapidly in the spring and the summer. Grain prices were rising sharply in the second half of the year; this was due both to the large wheat sales negotiated with the Soviet Union early in the summer and to wet weather which seriously delayed harvesting in the fall. Processed foods and feed prices also rose sharply late in the year, partly as a result of increased costs of animal feeds.

The industrial wholesale price index rose 3.4 percent from 1971 to 1972, about the same as the increase in 1971. Most industrial commodity groups showed small or moderate price increases over the year. There were, however, two major exceptions to this generalization all year—lumber and wood products, and hides-skins-leather. Demand for lumber was strong all year as a result of the housing boom, and shortages developed, patricularly for softwood lumber. Late in the summer, the Price Commission imposed controls on many lumber companies which had previously been exempt because of their small size, and salvage operations in National Forests were stepped up to increase the supply of lumber and ease price pressures.

Prices in the hides-skins-leather group also increased at a very rapid rate in 1972. The major reason for the rise was the shortage of raw hides and skins throughout the world, and the consequent rising prices in world markets for which the United States is a major supplier.

Corporate Profits

THE recovery of corporate profits and cash flow, which began in early 1971, continued in 1972 (chart 17). In the third quarter (the latest for which data are available) book profits were at a seasonally adjusted annual rate of $95¾ billion. At that rate, profits stood $12½ billion above the fourth quarter of 1971 and $6¾ billion above the previous peak reached in late 1968 and early 1969. Book profits increased $5 billion in the first quarter; $3½ billion in the second, and a little more than $4 billion in the third.

Profits in the second quarter were affected by writeoffs of physical assets lost in the June floods. BEA has estimated those losses at about $1¾ billion (annual rate) in that quarter, as a result, the second quarter profits increase was $1¾ billion less than it otherwise would have been and the third quarter increase was swelled by $1¾ billion.

Cash flow—undistributed profits and capital consumption allowances—continued to surge in 1972. From the fourth quarter of 1971 to the third quarter of 1972, cash flow rose nearly $10 billion to a seasonally adjusted annual rate of $95¾ billion.

Profits last year and in 1971 would have been higher had it not been for the liberalization of rules for calculating depreciation introduced in 1971 (the ADR system). The effect of that change was to raise depreciation and reduce profits: 1971 profits were $1 billion lower because of the introduction of the ADR system and 1972 profits $2½ billion lower. There were consequent reductions in corporate tax liability, amounting to a little less than $½ billion in 1971 and $1¼ billion in 1972.

The Revenue Act of 1971 also reinstituted a 7 percent tax credit for investment in machinery and equipment. That tax action lowered corporate taxes by $1¼ billion in 1971 and $3 billion in 1972.

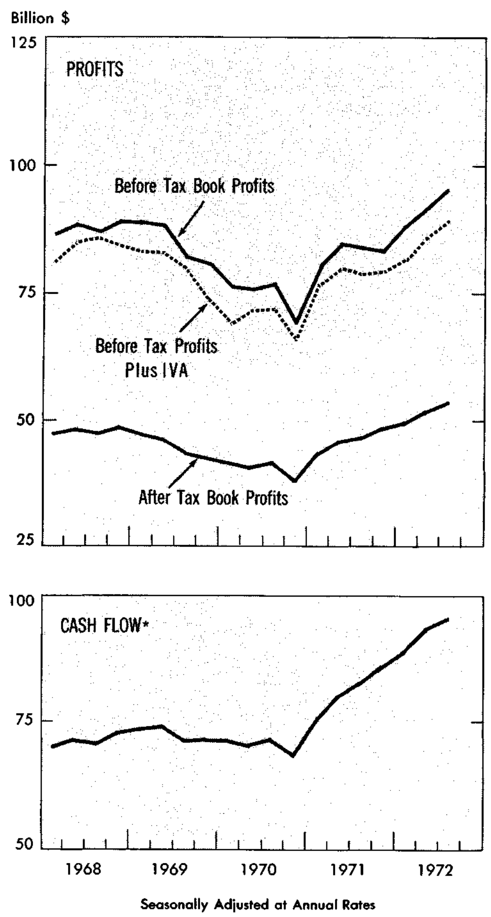
Book profits include gains or losses due to differences between the replacement cost of goods taken out of inventory and the cost at which these items are charged to production. The national income profits figure measures only incomes arising from current production and, consequently, inventory gains or losses are excluded. The recovery of profits on the national income basis was less than the recovery of book profits; from the fourth quarter of 1971 to the third quarter of last year, national income profits rose $10¼ billion to $89½ billion.

Profits of financial institutions were up $1¾ billion during the first 3 quarters of last year to a seasonally adjusted annual rate of $18¼ billion. Nonfinancial corporations' profits increased $8½ billion to an annual rate of $71¼ billion. The profits of durable goods manufacturers rose fairly sharply in the first half of the year but declined slightly in the third quarter, mainly because of weakness in auto producers' profits. On the other hand, profits of nondurables producers increased only a little in the first half of 1972 but rose sharply in the third quarter as a result of big gains in the petroleum and chemical industries. In industries outside manufacturing, profits declined in the opening quarter of the year but increased fairly strongly in both the second and third quarters.

The growth of profits of nonfinancial corporations in 1972 was the result of increases both in the volume of real output and in profit per unit of output—i.e., profit margin. The 1972 rise in profit per unit reflected moderate growth in unit price and very little change in unit cost. Unit labor cost increased a little in the first quarter and showed virtually no change in the second and third. Nonlabor cost per unit declined slightly during 1972 as expanding volume spread fixed costs over more output.

CHART 17

Profits and Cash Flow



*Capital consumption allowances plus undistributed profits.

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-17

Financial Developments

MONETARY policy in 1972 accommodated economic expansion, and credit was readily available at an average cost a little below that in 1971 and well below the levels of 1969 and 1970. Nearly $159 billion (annual rate) was borrowed in financial markets during the first 3 quarters of 1972, a little more than the record volume raised in the full year 1971. (Fourth quarter data are not available as this issue of the SURVEY goes to press.)

Credit demands

The composition of borrowing last year differed from that in 1971 in a number of important respects. First, there were noticeable shifts in the volume of funds raised by major borrowing groups, as governments (especially the Federal Government) and foreigners did less borrowing than in 1971 while nonfinancial corporations stepped up their borrowing moderately and households significantly (table 6). Second, the reduction in Federal borrowing last year was slightly more than offset by an acceleration of private borrowing, comprising a modest increase in the volume of funds raised in long-term markets and a sizable step-up in short-term borrowing. Third, the increase in private long-term borrowing was due entirely to growth of mortgage debt of households and nonfinancial corporations, as the volume of new bond issues fell below that in 1971. New issues by State and local governments fell slightly, partly because, on a consolidated basis, these governments ran

Table 6.—Total Funds Raised in Credit Markets by Nonfinancial Sectors

[Billions of dollars]

	1968	1969	1970	1971	1972[1]
Total	**97.8**	**91.7**	**101.6**	**156.3**	**158.8**
Nonfinancial business	39.1	50.8	49.5	63.0	68.3
Short-term debt	15.8	23.9	10.5	9.1	16.2
Corporate bonds	12.9	12.1	20.3	19.4	12.6
Mortgages	11.3	10.4	12.0	20.9	26.7
Stocks	−.8	4.3	6.8	13.4	12.8
Households	31.9	32.6	22.3	41.6	60.2
Mortgages	16.0	17.5	13.9	25.9	36.9
Other	15.9	15.1	8.4	15.7	23.3
U.S. Government[2]	13.4	−3.6	12.8	25.5	11.2
State and local governments	10.4	8.7	13.9	20.6	16.8
Foreign	3.1	3.3	3.0	5.6	2.2

1. First three quarters expressed at seasonally adjusted annual rates.
2. Does not include federally sponsored credit agencies.

Source: Federal Reserve Flow of Funds Accounts.

big budget surpluses. New corporate bond issues were well below the peak volume recorded in 1971, as corporations had apparently ended the practice of borrowing at long term for the purpose of rebuilding liquid asset holdings that had been depleted during the credit stringency of 1969 and early 1970. Fourth, corporations were willing to increase their short-term liabilities in 1972 and money market borrowing increased significantly for the first time since 1969. The strengthening of short-term credit demands that occurred last year also reflected a marked step-up in consumer borrowing, particularly in the use of installment credit.

Credit costs

The year opened with interest rates continuing the steep decline that began with the introduction of the New Economic Program in mid-summer 1971. By late winter and early spring, however, the accelerating pace of economic activity resulted in a strengthening of short-term credit demands, and money market rates began to move up (chart 18). The rise in short-term rates accelerated somewhat after mid-summer and especially so toward year-end, as credit demands intensified and as the monetary authorities moved toward a less accommodative credit policy posture. As the year closed, the prime commercial loan rate—the rate banks charge their most creditworthy borrowers—was raised from 5¾ percent to 6 percent. The prime rate was 5¼ percent in July and August and 4½ percent at its low from mid-February to mid-March.

The rise in interest rates during 1972 was confined to short-term markets as long-term yields showed very little net change. At year end, yields on corporate and State and local government bonds were a little lower than they had been early in the year, yields on long-term Government securities virtually unchanged, and those on FHA-insured new home mortgages were a bit higher.

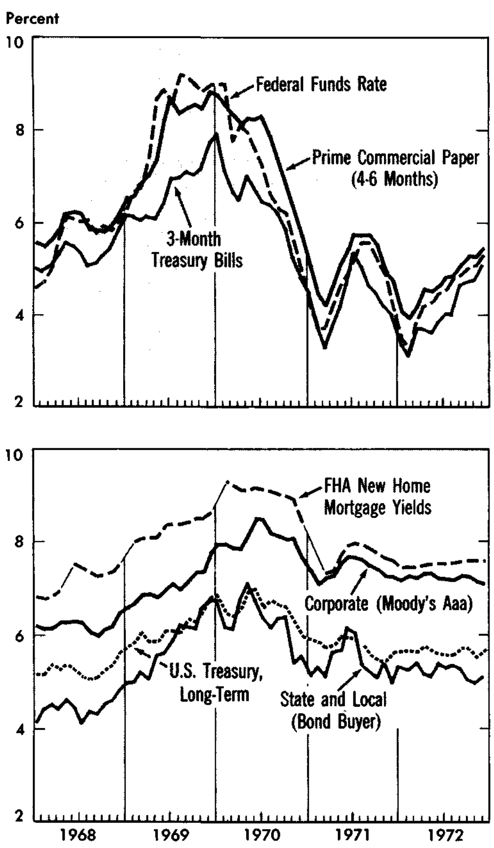
Monetary policy

The general guidelines for monetary policy in 1972 were made clear early in the year: The monetary authorities did not intend to allow the recovery of economic activity to falter for want of money or credit, nor did they intend to release the forces of a renewed inflationary spiral. The year began with the monetary authorities pursuing a stimulative policy, but by the spring the policy statements of the Federal Open Market Committee indicated that the objective of policy had become somewhat less accommodative. By mid-summer, some tightening in money and credit markets was evident and, as the year drew to a close, that tightening appeared to be intensifying.

The impact of monetary policy on the economy is only crudely reflected by the behavior of the monetary aggregates. However, as may be seen from table 7, most of the aggregates grew at a faster pace in 1972 than in other recent years except the easy credit year 1968. Moreover, most of the aggregates grew at a fairly rapid rate throughout the year with the exception of the third quarter, when growth of total reserves slowed and nonborrowed reserves declined slightly. (In table 7, the calculations of percent changes in reserve measures for the fourth quarter were made with an adjustment to account for regulatory changes affecting reserve requirements (Regulation D) and check collection (Regulation J) that became effective in early November.)

CHART 18

Short- and Long-Term Interest Rates

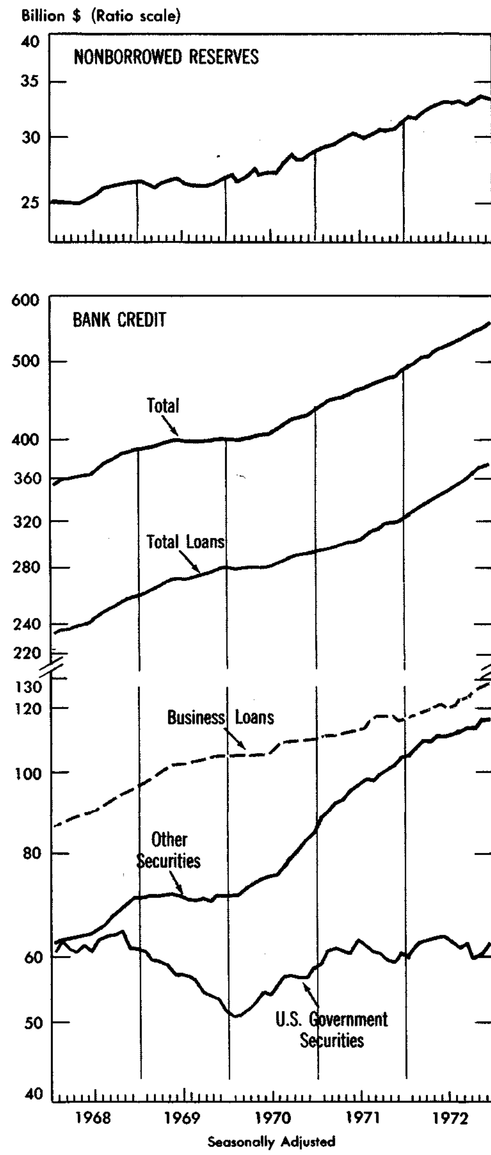


Data: FRB, HUD, Moody's, Bond Buyer & Treasury

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-18

CHART 19

Bank Reserves and Bank Credit



Data: FRB

U.S. Department of Commerce, Bureau of Economic Analysis 73-1-19

Bank credit

The expansion of total loans and investments at commercial banks amounted to $68½ billion from the end of 1971 to the end of 1972, a marked acceleration from the previous record gain of a little less than $50 billion in 1971. All of the acceleration in bank credit expansion last year was due to a strengthening of loan demand, as the growth of the investment component slowed sharply, particularly after midyear (chart 19).

Bank loans increased $56 billion during 1972, nearly twice the advance in 1971, with all major loan categories recording big gains. Lending was noticeably stronger in the second half of the year than in the first, mainly because of an acceleration of growth in consumer and business loans. Borrowing by consumers increased $6 billion in the second half of 1972 as compared to $4 billion in the first half and business loans rose $8½ billion as compared to $5½ billion.

The investment component of bank credit rose nearly $12½ billion during 1972, appreciably less than the $21¼ billion growth in 1971. Banks added about $11 billion to their holdings of State and local securities but added only $1¼ billion to their holdings of U.S. Government securities, all of which occurred in the first half of the year. In order to accommodate the strengthening of loan demands, banks liquidated about $1 billion of U.S. Government securities in the second half of 1972.

Savings and loan associations

Records were also set last year for the growth of savings flows to the savings and loan associations and their mortgage commitments and mortgage lending. Savings flows to the S&L's totaled $32½ billion last year, some $4 billion more than the record flow in 1971. Inflows were strongest in the first quarter ($10¼ billion, seasonally adjusted) and weakest in the fourth quarter ($6½ billion).

Mortgage debt holdings of the S&L's increased $31½ billion last year, compared with $24½ billion in 1971. Mortgage commitments also recorded a record advance, increasing $5¾ billion to $18½ billion by yearend. However, the rate of increase slowed appreciably as the year wore on; commitments increased about $2 billion (seasonally adjusted) in the first two quarters of 1972, $1¼ billion in the third, and only about $½ billion in the fourth.

Table 7.—Percent Change in Selected Monetary Aggregates [1]

[Seasonally adjusted]

	1968	1969	1970	1971	1972	1972			
						I	II	III	IV [2]
Total reserves	10.0	2.7	4.1	7.3	10.6	2.5	3.2	0.9	3.6
Nonborrowed reserves	8.0	1.4	7.2	8.1	7.5	2.7	3.3	−.5	1.9
Reserves available to support private nonbank deposits [3]	10.9	1.2	5.9	7.8	10.2	2.7	1.8	2.5	2.8
Money stock (M_1)	7.8	3.2	5.4	6.2	8.2	2.3	1.2	2.1	2.2
Money stock plus time deposits at commercial banks other than large CD's (M_2)	9.3	2.3	8.1	11.1	10.7	3.3	2.1	2.3	2.5

1. Change calculated from end of period to end of period.
2. Percent calculations for reserves measures based on adjustment made for change in Federal Reserve Board Regulations D and J, which became effective November 9, 1972.
3. Total reserves less reserves needed to support Government deposits and interbank deposits.

Source: Federal Reserve Board.