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THE BUSINESS SITUATION

The strike at General Motors Corporation resulted in the loss of a very substantial amount of output in the quarter just ending, and distorted most major indicators of economic activity. The Commerce Department's Office of Business Economics states in the December issue of the Survey of Current Business that the distortions will continue this winter as at least some of the strike loss is recouped. Thus, in the closing months of 1970 and the early months of 1971 it is far more difficult than usual to assess the basic trends in the economy.

It seems certain that the real volume of production is down in the current quarter because of the strike. The value of national output in current prices will show some expansion, however. The one sector showing clear strength is residential construction. As financial conditions have turned markedly easier in recent months, the strong underlying demand for new residences has been evidenced in a rapid increase in housing starts. In addition, the available evidence on consumer demand suggests a moderate strengthening, abstracting from the effects of the strike. Capital investment is sluggish, however, and governments at all levels seem to be contributing only modestly to overall demand expansion.

Credit stringencies in 1969 were responsible for a severe contraction in homebuilding, which added to the already large backlog of demand for new housing. Vacancy rates, which declined sharply from 1965 to 1968, have since held at very low levels. Given these conditions, it took only some mild easing in financial conditions earlier this year to launch a strong recovery in housing starts. The recovery continued in November as starts rose nearly 8 percent to a seasonally adjusted annual rate of 1.69 million units. The October-November average was 1.63 million units, nearly one-third higher than the rate last April and May. The recovery has been somewhat more pronounced for starts in multifamily structures than for single family homes, but starts of both types are back close to the rates recorded about 2 years ago.

Capital spending, on the other hand, is not expected to provide any thrust to economic expansion over the near term. The latest survey taken by OBE and Securities and Exchange Commission indicates that aggregate spending in the first half of 1971 will be equal to the figure in the current half year, which is up about 3 percent from this year's first half. The outlook beyond next year's first half is unclear, but excess capacity is widespread and this will militate against any marked boost in the spending rate.

Spending by manufacturers, which declined from the first to the second half of 1970, is expected to drop a bit more in the first half of 1971. Declines are expected throughout manufacturing. Aggregate nonmanufacturing spending will be up very modestly in the first half. The utilities, which account for about 25 percent of the nonmanufacturing total, plan to continue to raise spending, but the air and surface transportation industries plan substantial cuts.

#### Recent Financial Developments

The prime rate was cut again on December 22 to 6-3/4 percent, following reductions from 8 to 7-1/2 percent in late September and to 7 percent in November. The closing months of this year have been marked by one of the most dramatic declines in interest rates and bond yields in the postwar period. The easing in financial market conditions reflects the cumulative impact of several factors -- a moderately stimulative monetary policy; the weakening of consumer and business loan demand resulting from the general slack in the economy; and an apparent lessening of inflationary expectations in market participants' assessment of the financial outlook.

Until quite recently, the easing of credit costs was essentially confined to the short-term markets, where the decline in rates accelerated very sharply after mid-October. Although conditions became much less strained in long-term markets also, the dominating factor in that area has been the tremendous demand for funds by both corporations and State and local governments.

The Survey of Current Business is available from Field Offices of the Department of Commerce, or from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402, at an annual subscription price of \$9, including weekly supplement; single copy, \$1.