UNITED STATES DEPARTMENT OF
COMMERCE
NEWS
WASHINGTON, D.C. 20230

OFFICE
OF THE
SECRETARY

FOR RELEASE IN A.M. PAPERS MONDAY, DECEMBER 30, 1968 G 68-140

1969 OUTLOOK AND 1968 YEAR-END ECONOMIC REVIEW

The American economy achieved new records in income and production in 1968 and will show further growth but at somewhat reduced rates in 1969, the U.S. Department of Commerce announced today in releasing a review of 1968 .

The physical volume of production (GNP corrected for price change) rose approximately 5 percent this year, as employment rose to almost 79 million persons and unemployment fell to 3.6 percent. The average American experienced a rise in income of 3 percent after allowing for higher taxes and higher prices. The balance of payments showed a distinct improvement over the previous year.

These accomplishments, however, were marred by strong inflationary pressures that brought prices to new peaks. The prices of goods and services included in the GNP rose throughout the year and averaged about 4 percent over 1967. Consumer prices showed a comparable rise. For both, these increases were the largest since 1951.

At yearend, the economy was continuing to move ahead rapidly and showed no abatement in the price rise. Private investment demand -- for new plant and equipment and residential building -- was particularly strong. To judge from such advance indicators as businessmen's anticipations, new orders, starts, and capital appropriations, it was likely that investment would continue to rise in the months ahead.

The picture for consumers was less clear. There is some indication that the rise in consumer spending has mitigated in recent months. Automobile sales, for example, have flattened out since the summer. Although only partial data for the month of December are as yet available, it appears that the influenza epidemic has had a noticeable effect on Christmas buying. In the next quarter or so, higher Social Security taxes and heavier-than-usual final tax payments on 1968 incomes will limit increases in consumer incomes. But even allowing for some dampening in consumption due to tax increases, GNP as a whole will continue to advance sizably as 1969 unfolds.

/More/

The outlook for 1969 as a whole depends on many factors that cannot yet be foreseen -- such as the Vietnam war, international economic developments, and the course of events in our large cities. At this juncture there is no reason to question that 1969 will be another year of substantial economic progress provided that the Federal Government pursues adequate fiscal, monetary, and other economic policies, and business and labor cooperate in moving toward stability and balanced economic growth. The rate of expansion in real GNP should be reduced from this year's 5 percent. This rate is far in excess of the 4 percent that is consistent with the long-term increase in our labor force and productivity. Although price stability cannot be expected in 1969, significant progress in this direction should be possible.

The U.S. Economy in 1968

In 1968, the eighth straight year of rising economic activity, the American economy worked at full employment. Increased demands in all major markets, especially consumer markets, brought new records in production, incomes, and employment, while unemployment fell to its lowest level since 1953. The year was also one of improvement in the Nation's balance of payments position following the sharp deterioration in 1967.

The problem of economic growth with stability, which became prominent in 1965, remained in the forefront in 1968. The demands on the economy could not be satisfied at relatively stable prices, and price increases continued unabated. In a labor market that had little overall slack at the beginning of the year, the added demands of 1968 led to an acceleration in wage rate increases and further pronounced advances in labor costs per unit of production. Prices increased more than costs as buoyant demand conditions permitted an expansion in profit margins, which had contracted in 1967. Wholesale prices, which had changed little in 1967, were up considerably in 1968 while consumer prices continued to climb, scoring their largest advance since the Korean war. A recovery in farm prices was reflected in price increases in wholesale and retail markets.

The attempts that were made to contain the expansion and inflation met with little success, at least in 1968. The President's call in August 1967 for a surtax on personal and corporate incomes was not enacted into law until June 1968, when it was combined into a package containing limitations on Federal expenditures. Thus, during the first half of the year, the burden of restraint fell on monetary policy, which brought some tightening of credit with a visible but small effect on housing. During the summer, after the fiscal package became law, monetary policy became less restrictive and credit conditions eased considerably. However, in the fall, when it became apparent that consumer and business spending were not slowing, credit tightening was stepped up. Late in 1968 both short- and long-term financing costs reached their highest levels in several decades.

In its transactions with foreign countries, the American economy achieved mixed results in 1968. The overall balance of payments position was greatly improved following the pronounced rise in the deficit in 1967. However, much of this was a result of unexpectedly heavy purchases by foreigners of U.S. stocks and bonds. The merchandise trade balance plunged to its lowest level in almost a decade as imports rose much more than exports. Moreover, international business in 1968 was affected by a series of disturbances that had widespread repercussions both on trade and in financial markets.

Domestic Business

After a rise of 5-1/2 percent in 1967, the Nation's output of goods and services (GNP) rose 9 percent, or $70 billion, to a total of approximately $860 billion in 1968. The 9 percent increase represented a rise of about 4 percent in prices and an increase of about 5 percent in physical volume. The price rise was an acceleration over the increases of 2.7 percent in 1966 and 3 percent in 1967. The increase in physical volume this year was a considerable advance over the 2-1/2 percent gain registered in 1967 but fell short of the 6 percent increases in both 1965 and 1966.

Final sales--sales to consumers, business, government and foreigners--accounted for almost all of the increase in GNP, since inventory investment was approximately the same this year and last. (Final sales and inventory investment constitute the whole of GNP.) In dollar terms, the rise in final sales was a record and in percentage terms was last exceeded in 1951.

Spearheading the 1968 upsurge in sales was an exceptionally strong advance in consumer spending, which expanded almost as much in the second half of the year as in the first despite the step-up in withholding taxes on personal incomes starting in mid-July. Heavier flows of credit to the housing market permitted residential construction to show its best gain in many years. For the year as a whole, business investment in plant and equipment improved only moderately, but toward yearend it showed signs of a very supstantial pickup. All levels of government spent considerably more this year, although defense spending showed a distinct tapering after the first quarter. Among the GNP components, only net exports showed a deterioration compared with 1967, as an unusually large rise in imports greatly outstripped the advance in exports.

Personal income and spending

The large rise in production was accompanied by a comparable rise in the flow of income to individuals. Personal income went up $57 billion or 9 percent to a total of $686 billion as a result of gains in all major types of incomes. Increased employment and--more important--sharply higher rates of pay were responsible for an advance of almost 10 percent in wage and salary disbursements. Rising farm prices led to an improvement in farm income after a decrease in 1967, while higher interest rates and corporate profits led to increased personal income from interest and dividends. Transfer payments (which consist mainly of social insurance and veterans' benefits) rose $7 billion in 1968, chiefly as a result of increased Social Security payments and continued growth in Medicare.

Taxes on personal income were up $14 billion to a total of $97 billion. The rise was unusually steep because of the 10 percent surcharge imposed after midyear, which is estimated to have added $3-1/2 billion to calendar year 1968 personal taxes. The new tax limited the gain in disposable personal income (income after taxes) to almost 8 percent. Even so, this was nearly a full percentage point more than the 1967 gain and about as much as the increases in 1965-66.

Consumers were in a very free spending mood in 1968. For the full year, personal consumption expenditures were up more than $40 billion or almost 9 percent, a record advance in dollar terms and a considerable step-up over the 5.7 percent rise for 1967. Spending on durable goods, which had increased relatively little the year before, rose approximately 15 percent, in large part because of booming automobile sales. For the full year, dealers sold an estimated 8-3/4 million domestic-type cars and 1 million imports; the corresponding figures for last year were 7.6 million domestics and 0.8 million imports. Spending on nondurables rose 7 percent after a very modest gain in 1967, while services continued to increase somewhat more than their long-run upward trend.

Since the dollar increase in spending was as large as the dollar rise in income, the level of saving was unchanged from 1967. But because disposable income was higher than the year before, the saving rate declined--from a very high 7-1/2 percent in 1967 to about 6-3/4 percent in 1968. The shift occurred in the second half of 1968--from 7-1/4 percent in the first to approximately

6-1/4 percent in the second. By reducing their rate of saving consumers offset much of the intended dampening influence of the tax surcharge.

Business investment and profits

For the second year in a row business expenditures for new plant and equipment turned in a very modest performance. The 4-1/2 percent gain over 1967 was only slightly more than the rise in capital goods costs. All of the increase was confined to investment by nonmanufacturing industries, particularly the electric and gas utilities and airlines, where major expansion programs were underway. Expenditures by manufacturing firms were about unchanged after a dip in 1967.

Despite the small gain for the full year, there was a marked pickup in spending from the first to the second half, and a fundamental shift in the investment climate late in the year. The OBE-SEC survey conducted in November pointed to a very sharp rise in expenditures in late 1968 that was expected to carry into the first half of 1969--for both manufacturing and nonmanufacturing firms. The survey also indicated that starts of new investment projects by manufacturers showed a pronounced spurt in the summer of 1968 and that an increasing proportion of manufacturers felt the need for more capacity.

The buoyant demand conditions that prevailed in 1968 permitted a widening in profit margins, and with volume higher, book profits before taxes showed a sharp rise that more than made up for the 1967 reduction. Much of this rise, however, was absorbed by the surtax, so that the advance in after-tax profits was modest. Dividend payments rose nearly as much as after-tax profits; consequently, retained earnings were little changed from 1967 and remained considerably under the 1966 level. The continued rise in depreciation permitted corporations to enjoy a greater cash flow (retained earnings plus depreciation) than in 1967, a factor that undoubtedly contributed to the resurgence of investment late in the year.

Businessmen added about as much to their inventories in 1968 as they did in 1967. The course of inventory investment during the year was irregular, reflecting varying rates of expansion in sales, especially at retail, as well as the special influences affecting steel and autos. Stockpiling of steel against the possibility of a steel strike at the end of July bolstered inventory investment in the first half of the year; with a strike averted, steel consumers liquidated stocks in the second half. Auto dealers added heavily to their stocks in the first half of 1968 to make up for the deficiencies caused by the auto strike in late 1967.

In late 1968, total business stocks appeared to be generally lower in relation to sales than a year earlier, but they still seemed somewhat high gauged against the experience of the early 1960's. It is possible that expectations of continuing inflation were causing businessmen to hold larger inventories than they might under less inflationary conditions.

Ever since the credit squeeze of 1966, homebuilding has not kept pace with the requirements for new household formation and replacement demand. Vacancy rates have fallen to the lowest level in 10 years, the rise in rents has accelerated, and a sizable backlog demand for housing has built up. This year, the homebuilding industry experienced a considerable pickup, extending the advance that started in early 1967. The enlarged flow of credit to construction and mortgage markets was the principal factor activating the strong underlying demand. Outlays for residential construction in 1968 were up approximately one-fifth over 1967, following declines of 10 percent in 1966 and 1 percent in 1967. The improvement reflected a rise in housing starts from 1.3 million last year to about 1-1/2 million this year. A tightening of credit during the early part of the year led to a temporary interruption in the homebuilding recovery, but the somewhat easier credit conditions during the summer and early fall permitted a resumption of the forward movement.

Government expenditures and receipts

Purchases of goods and services by Federal, State and local governments rose approximately $19 billion in 1968 to reach a total of almost $200 billion. This rise accounted for more than 25 percent of the increase in total GNP in 1968, but the proportion was much less than the 53 percent of 1967, when private demand was less buoyant. Defense purchases rose much less than in either 1966 or 1967; nondefense purchases, on the other hand, showed a considerable step-up principally because of larger agricultural price supports and, to a lesser extent, government pay raises. State and local purchases rose about in line with recent annual increases.

Other types of Federal expenditures also advanced in 1968. Despite increases in Social Security benefits, transfer payments rose somewhat less than in 1967, which was the first full year of operation for Medicare. Rising interest rates caused a faster rise in interest payments, while a step-up in the increase of grants-in-aid reflected more funds for highways, welfare and other programs.

Federal receipts showed an unusual spurt in 1968 as a result of increased taxes and the higher yields of existing taxes on sharply higher incomes. Additions to receipts were especially large for personal and corporate taxes because of the surtax, but advances were also registered for indirect business taxes and contributions for social insurance.

With a somewhat slower growth in total expenditures and a considerable increase in receipts, the Federal deficit (national income accounts basis) narrowed as compared with 1967 but was still larger than in any year since 1958. Rising economic activity combined with the tax increase caused a pronounced reduction in the deficit from the first to the second half of the year--from an annual rate of $9-1/2 billion to roughly $2 billion.

Employment and unemployment

The expansion in production brought employment to a record total of 78-3/4 million persons in 1968. Civilian employment increased by 1-1/2 million persons while unemployment decreased from 3 million to 2.8 million. In 1967, when the expansion in economic activity slowed down, the average level of unemployment rose slightly, for the first time since 1963.

The labor market in 1968 was very tight, and at 3.6 percent the unemployment rate was the lowest since the Korean war. Unemployment rates moved down for all major groups of workers. They continued to be extremely low for married men (1.6 percent) but remained far above the general average for teenagers (12-1/2 percent). Although unemployment rates for nonwhite workers were down noticeably from 1967, they were still about double those for white persons.

Both blue collar and white collar workers were able to win substantial increases in rates of pay this year. Average hourly earnings of nonsupervisory workers in private industries rose more than 6 percent over 1967, as compared with gains of 4.5 and 4.7 percent in 1966 and 1967. The increases reflected raises for unionized and nonunionized employees, as well as advances due to a boost in the Federal minimum wage.

Rising output in 1968 brought a gain in productivity that was a considerable improvement over the small advance registered in 1967, when the expansion in economic activity slowed down; however, the increase in rates of pay still exceeded the gain in productivity. Consequently, labor costs per unit of production advanced sizably for the third straight year, although apparently not as much as in 1967.

Prices

Widespread and substantial price increases characterized the full-employment economy of 1968 with prices under pressure from both rising demand and costs. The consumer price index rose in each month and averaged 4.1 percent above 1967, the largest annual increase since the extreme rise during the Korean war year of 1951. Prices in wholesale markets increased 2-1/2 percent from 1967 to 1968, after little change the preceding year. Prices of industrial and agricultural commodities showed near-equal gains, in contrast to 1967 when a moderate price rise for industrial products was about offset by declines in farm products and foods.

The price rise for consumer goods was double that of 1967, largely because food prices increased 3-1/2 percent as compared with a year-earlier increase of less than 1 percent. Among nonfood commodities, apparel prices rose 5-1/2 percent with higher tags on clothing and shoes, and new car prices were up about 2.7 percent--their most substantial advance since 1959.

As in other recent years, the rise in prices of consumer services generally outstripped the gains in the prices of consumer goods. On an overall basis, service prices rose more than 5 percent in 1968 while goods were up less than 4 percent. The respective advances in 1967 were 4.4 percent and 1.8 percent.

Among the services, the largest increases in 1968 were for medical care (more than 7 percent) and household services excluding rent (almost 6 percent). The substantial rise in prices for medical care trailed the 8.7 percent year-earlier advance, but the advance in household service prices--and other service categories as well--exceeded that of 1967.

Wholesale industrial prices, after rising sharply early in the year, changed little from March to August and thereafter advanced at a rapid pace. The rise over 1967 was the largest in a decade and was broadly based. Of the 12 major industrial categories, 10 recorded price advances over 1967--ranging from a modest 1 percent for pulp and paper to 12 percent for lumber and wood products. Exceptions were chemicals, which were about unchanged, and fuels, which declined. Prices of farm products and processed foods reversed their 1967 decline with increases in both crops and livestock.

Financial markets

Financial markets in 1968 were strained by heavy demands for credit. Corporate business, although borrowing somewhat less than the record amounts in 1967, remained greatly dependent on credit markets as the rise in cash flow failed to keep pace with the increase in investment spending. State and local governments, on the other hand, issued new securities in unprecedented volume, while new issues by the Federal Government were at their highest level since World War II.

These strains in credit markets were accentuated by a monetary policy that varied in its restrictiveness at different periods within the year. The monetary authorities moved gradually toward tightening early in the year and more aggressively in the spring, let up noticeably in July and August, tightened again in September and apparently more so toward the end of the year.

Although credit policy was restrictive relative to the very heavy demands for funds in 1968, it nonetheless permitted an expansion in member bank reserves that provided an increase of nearly 11 percent in commercial bank credit. This was little different from the increase in 1967 when the authorities were following expansive credit policies in a less buoyant economy; it was substantially larger than the 5-1/2 percent increase in 1966, the last experience with credit restraint. The pattern of bank credit expansion was uneven during the year, rising at a 6-1/2 percent annual rate from January to June, accelerating very sharply to a 19 percent annual rate in the summer and tapering to a rate less than half as large in the recent October-December period.

The growth in the money stock and time deposits was also strong during 1968. The money stock (currency and demand deposits) increased nearly 6 percent this year, almost as large as the increase in 1967. Growth in the money stock was very pronounced during the first half of the year, slackened noticeably in the summer and early fall, and picked up again toward the year's end. Time deposits at commercial banks rose about 10-1/2 percent in 1968, which was considerably below the 16 percent advance a year earlier.

Financing costs in 1968 were at their highest annual level in several decades. Long-term rates, which advanced in 1967, rose further this year; short-term rates, after declining in 1967, rose to new peaks. Interest rates and bond yields exhibited erratic patterns during the year as they responded to the uneven impact of credit restraint, to the gold crisis in the spring, to the uncertainties associated with the passage of the program of fiscal restraint, to anticipations of continued inflation, and to the shifting prospects for peace in Vietnam. On balance, financing costs rose over the first five months of 1968, and by the end of May, had exceeded their highs. Following the passage of tax legislation and the ensuing relaxation of credit tightness, financing costs fell noticeably through midsummer but were again rising in the fall. The escalation in financing costs gathered momentum in December when commercial banks twice raised their prime rates, and the Fed, reversing its mid-August action, raised the discount rate to 5-1/2 percent. By yearend, most interest rates and bond yields were at their highest levels in several decades.

International Transactions

A series of major disturbances affected international financial transactions and the U.S. balance of payments in 1968.

Late in 1967, the British pound was devalued, after repeated and intensive efforts to support the previous exchange rate proved insufficient. The failure to maintain the exchange value of the pound also heightened doubts among some foreign financial interests about the ability of U.S. authorities to maintain the current exchange rate and unrestricted convertibility of the dollar in terms of gold and other currencies. Indirectly, the experience with the pound and the concern about the dollar raised questions about the future of the international monetary system as such, which to a large extent is based on the use by other countries of these currencies as international reserves, as standards of value in debt obligations, and in international transactions.

These considerations, together with an exceptionally large adverse balance in the international transactions of the United States (partly reflecting heavy liquidations of dollar assets by the British authorities) resulted in U.S. gold losses of over $1 billion dollars in the fourth quarter of 1967.

In order to improve the balance of payments, to restore confidence in the dollar and in the international monetary system, and to dampen the large foreign demand for gold, the President on January 1, 1968, announced a broad program. This program involved the replacement of the voluntary limitations on capital outflows for direct investments by compulsory constraints, further restrictions on capital outflows through banking transactions and on Government expenditures, a reduction in expenditures for foreign travel, and a step-up of various efforts to increase receipts from exports.

Foreign purchases of gold resumed, however, in the first quarter of the year and accelerated sharply in March. In order to prevent large diversions of gold from official reserves into private hands, the representatives of the major countries engaged in international financial operations agreed to stabilize the total of official gold reserves by limiting official gold transactions to transfers between official agencies only. They also decided not to intervene in the private gold market, but to permit private demand and supply (including new production) to determine the price of gold traded there.

The separation between official and private gold transactions calmed the large-scale shifts of funds between the major currencies and gold in international financial markets. However, the calm was short-lived. In the spring, France was swept by social unrest, and the progress of the United Kingdom in restoring a balance of payments equilibrium was felt to be disappointingly slow.

Pressures against the franc and the pound continued during the summer. They intensified greatly in the fall when large amounts of funds were withdrawn from France and the United Kingdom and shifted to Germany in anticipation of a general realignment of currency values. This realignment did not take place, but additional measures were taken by France and the United Kingdom to improve their respective balances of payments, and by Germany to reduce her large surplus on merchandise trade.

Our own balance of payments reflected partly these developments and partly domestic pressures: the rapid increases in domestic demand, particularly in the first half of the year, and in domestic costs of production and prices.

Merchandise trade

The balance on nonmilitary merchandise trade, which started to drop sharply in the last quarter of 1967, declined to about zero in the second quarter of 1968. Although it recovered slightly in the third quarter, the trade balance remained far lower than it had been in recent years. Some of the decline can be attributed to larger imports to compensate for actual or anticipated shortages resulting from strikes. Some, however, reflected more lasting developments, including a rise in domestic demand for various types of goods produced abroad, and a rise in foreign capacity to produce and to compete in U.S. markets.

Merchandise exports benefited from a large rise in deliveries of commercial aircraft, but were adversely affected by the stagnation in foreign demand for agricultural products. Acceleration in business activity in some of the leading industrial countries, which began late in 1967, did not affect U.S. exports until the second quarter of 1968.

Capital transactions

The sharp decline from 1967 to 1968 in the merchandise trade balance was largely offset by an unprecedented drop in the net outflow of capital through private transactions. Data on these transactions are available only for the first three quarters of 1968, and do not reflect possible yearend shifts connected with the operations of the foreign direct investment program.

Starting in 1967, especially after the middle of the year, foreigners increased their purchases of U.S. stocks. The rise continued in 1968 reaching a total of $1.2 billion in the first three quarters. In addition, foreigners sharply increased purchases of bonds issued by U.S. corporations to finance their foreign investments. In the first three quarters of 1968, such purchases amounted to more than $1.6 billion as compared with about $450 million in all of 1967. Most of the bonds issued this year are convertible into stocks. The large increase in bond sales by U.S. corporations can be attributed to the restrictions on capital outflows under the January 1 program.

The upsurge in foreign investments in U.S. securities coincided with growing uncertainties, inititally over investments in assets denominated in sterling and later over those denominated in French francs. It may have reflected also economic and political developments that increased the attractiveness of investments in U.S. corporate equity or convertible securities relative to investments in other countries.

Some of the increase in foreign investments in U.S. securities may reflect, however, developments that will continue even after the financial upheavals of 1968 have subsided. Among these developments is the growth in international capital markets in Europe; a change in financial investment patterns abroad toward increased holdings of equities, either directly or through intermediary financial organizations; and a greater desire by foreign investors for portfolio diversification.

Transfers of capital from the United States to foreign residents were close to $4 billion during the first three quarters of 1968. This corresponds to an annual rate of $5.2 billion, which was roughly equal to the capital transfers in 1967. Transfers for direct investments, including the transfers to foreign affiliates of funds that had been borrowed abroad, were at a slightly higher rate than in 1967. This indicates that the restrictions on net capital outflows imposed under the Government's program did not reduce the transfers of capital for direct investments. However, the adverse effect of these investments on the balance of payments was reduced because these investments were financed to an increased extent with funds borrowed abroad.

U.S. banks reported a decline in foreign assets in 1968, after an increase in 1967. This turnaround reflected the tightened restrictions on capital outflows announced on January 1. The shift in bank-reported assets was largely offset, however, by changes in corporate assets abroad other than direct investments. These assets include the temporary investment of funds that had been borrowed abroad through the issue of new securities; the 1968 rise reflects the large increase in such borrowings. Other funds held abroad by U.S. corporations were reduced as requested in the January 1 program.

A rise in receipts from special financial transactions by U.S. and foreign official agencies was a major change contributing to the improvement from 1967 in the balance measured on the liquidity basis. In the first three quarters, such transactions netted about $1,450 million, as compared with about $950 million for all of 1967. In 1968, receipts included large purchases by Canada of nonmarketable, medium-term securities, which are convertible prior to maturity only under special conditions. This had the effect of converting U.S. liabilities to foreigners from liquid into nonliquid form.

Changes in balances

Principally because of the larger inflow of foreign private capital to the United States and the increased receipts from special financial transactions, which together outweighed the decline in the trade surplus, the 1968 balance measured on the liquidity basis was considerably improved from 1967, when the balance was adverse by about $3.6 billion.

Official reserves increased during the year, but their composition changed: Official holdings of gold declined--although some of the losses sustained in the first quarter of the year were recovered later--but holdings of convertible currencies increased. This increase reflected mainly the counterpart of the dollars the United States lent to other countries to support their currencies on the exchange markets.

The financial disturbances of 1968 also contributed to substantial shifts in foreign holdings of liquid dollar assets on the books of U.S. banks--from the accounts of foreign official agencies to those of foreign banks. Because of this shift, the balance measured on the official reserve transactions basis was in surplus for the first three quarters and is likely to remain in surplus for the full year. This balance showed a $3.4 billion deficit in 1967.

- end -