The Business Situation

As the first half of the year came to a close, most measures of business activity were showing a continuation of the stepped-up rate of advance that had begun last spring, following the sluggishness which marked the second half of 1962. In June, industrial production, nonfarm payroll employment, and personal income all remained on their respective uptrends of the previous several months. For the second quarter as a whole, gross national product posted a substantial advance, and, with prices remaining relatively stable, most of the rise reflected real growth. Thus, contrary to the expectations of most business analysts at the beginning of the year, the gain in GNP in the first half of 1963 was slightly above the rise registered during the latter half of 1962. This better than expected performance of the economy helped to reduce the Federal budget deficit for the fiscal year ended June 30 to $6.2 billion, or $2.6 billion less than had been estimated in January.

The usual difficulties of making proper allowance for seasonal factors during the summer months will probably complicate the evaluation of the economic outlook for the third quarter. An additional factor will be the drag on steel output due to the working-off of inventories. Indeed, weekly data for July do suggest a substantially more than seasonal decline in steel ingot production. Auto output, moreover, also appears to have fallen more than is normal for the end of the model year, but this drop must be evaluated against the very strong performance of the industry in June. At the same time auto sales recovered in July, and there were signs that total retail sales may have moved to new high ground.

GROSS NATIONAL PRODUCT IN THE SECOND QUARTER

According to preliminary estimates by the Council of Economic Advisers, GNP rose to a seasonally adjusted annual rate of $579 billion in the second quarter.[1] The $7.2 billion gain was slightly larger than the first-quarter advance (see Chart I) and was also above the average quarterly rise in 1962. The increase was particularly impressive in view of a slowdown in the rate of gain in inventory spending. Indeed, the second-quarter rise in final demand amounted to $8.8 billion, the largest advance in a year. This increase, moreover, was centered largely in the private sector, as government purchases of goods and services showed an appreciably smaller rise than in the two previous quarters.

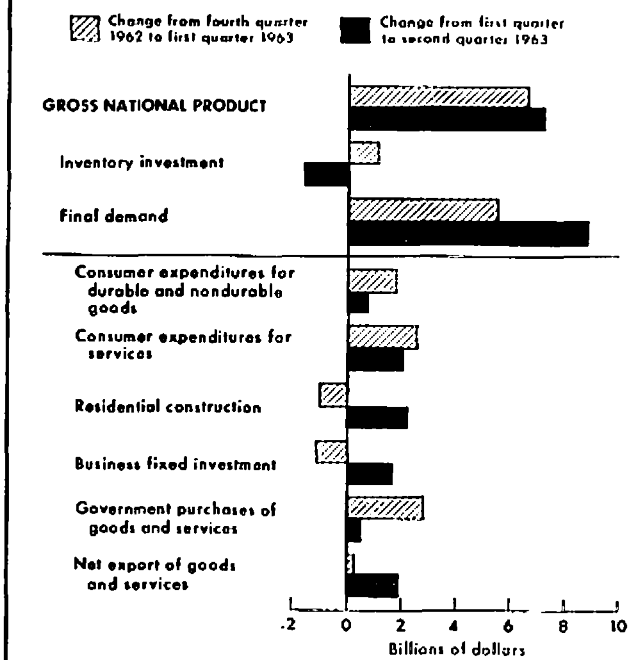
Spending for residential construction and for business fixed investment rebounded sharply in the second quarter,

[1] The usual midyear revision of the national income accounts resulted in a lowering of earlier estimates of GNP for each quarter from 1960-I through 1962-I by some $0.2-1.3 billion and a raising of the 1962-II through 1962-IV estimates by some $0.4-1.7 billion.

Chart I

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS MAJOR COMPONENTS

Seasonally adjusted annual rates



Sources: United States Department of Commerce; Council of Economic Advisers.

following declines in the opening quarter of the year. With the improvement in the weather that began in April, builders were able to begin or resume work on projects that had been delayed by the unusually severe winter. Partly as a result, the second-quarter gain in residential construction outlays was the largest of any quarter in the postwar period. The rise in plant and equipment spending, while of more modest proportions, was about as large as had been indicated in the Commerce Department-Securities and Exchange Commission survey of capital spending plans taken in May. The survey had also projected a 5 per cent gain in capital outlays for the year as a whole. With the second-quarter increase, this now appears to be somewhat closer to realization.

Consumer spending registered its smallest rise in more than two years. The second-quarter gains in outlays for both services and nondurable goods were smaller than in the first quarter, and spending for durables showed only a modest increase. The increase in durables consumption, however, occurred while new car sales of 7.2 million units (seasonally adjusted annual rate) were essentially unchanged from the first quarter.

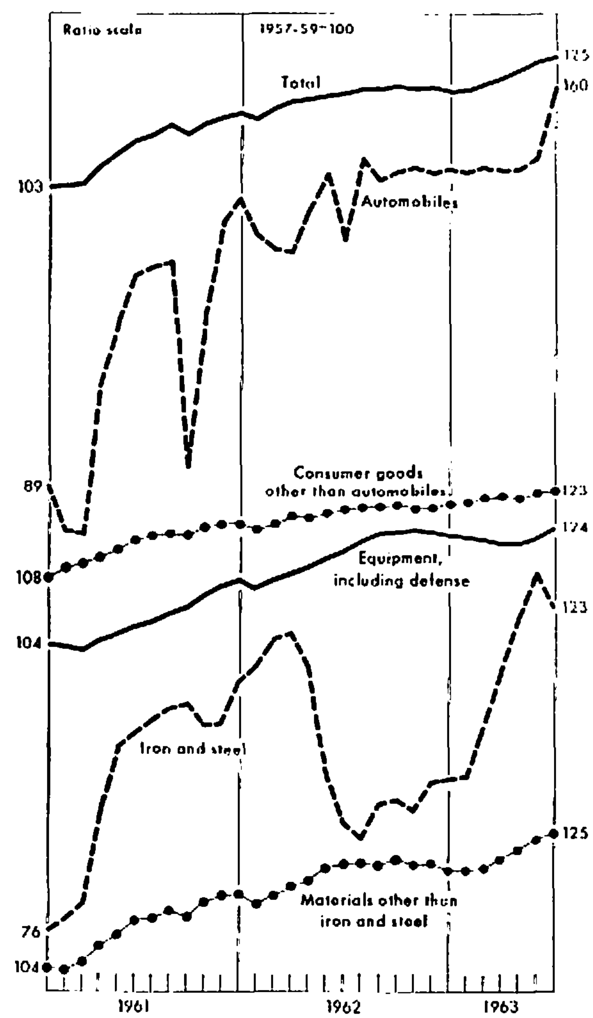
DEVELOPMENTS IN JUNE AND JULY

The Federal Reserve's index of industrial production continued upward in June, reaching 125.1 per cent of the 1957-59 average (see Chart II). This marked the fifth consecutive month in which gains of a full point or more have been scored. The increase so far this year amounts to about 6 percentage points in contrast to a rise of 3.5 percentage points for the whole of 1962. Producers of consumer goods accounted for the greater part of the June advance—largely reflecting a 10 per cent rise in assemblies by the automobile industry, though output of

Chart II

RECENT DEVELOPMENTS IN INDUSTRIAL PRODUCTION

Seasonally adjusted monthly data



Source: Board of Governors of the Federal Reserve System.

other consumer goods also moved up slightly. Production of business equipment advanced markedly for the second month in a row and finally topped the record set in September of last year. Despite a sharp fall-off in iron and steel production and a strike in the lumber industry on the West Coast, output of materials was unchanged. Weekly figures for July suggest that steel ingot production fell appreciably further (seasonally adjusted). At the same time auto assemblies, while at about the seasonally adjusted annual rate that was maintained from last October through May, were still no match for the better than 8.0 million unit rate in June.

A slightly adverse development in June was a 2.7 per cent decrease (seasonally adjusted) in new orders received by manufacturers of durable goods. This marked the second month in a row that this forward-looking indicator has declined, following four consecutive months of advance. A substantial part of these recent movements, however, reflects fluctuations in orders for steel, which rose appreciably in the first five months of the year before falling off sharply in May and June in anticipation of, and following, the settlement of the steel labor negotiations. In June, moreover, new orders for durable goods other than steel were virtually unchanged from the advanced level of the month before. At the same time, the backlog of unfilled orders for all durable goods, while down slightly in June, still was at the second highest level in the current expansion.

Seasonally adjusted nonfarm payroll employment moved up by 143,000 persons in June, marking the fifth consecutive month of advance. About one half of the June rise was due to an expansion in government employment, with an increase in service and trade jobs largely accounting for the rest. Employment in the manufacturing sector showed little change, despite a strike on the West Coast which reduced the number of persons on payrolls in the lumber industry by about 20,000. In July, nonagricultural employment posted a sizable rise, according to the Census Bureau's household survey, and there was some pickup in farm jobs. The advance in total employment was nearly paralleled by a 549,000 rise in the civilian labor force, and the unemployment rate at 5.6 per cent was essentially unchanged from the 5.7 per cent registered the month before. Thus, the total number of unemployed in July remained above four million persons, higher than the level of a year earlier, despite recent gains in economic activity.

In the consumer sector, demand appears to have been maintained. To be sure, three leading indicators of future spending for residential construction—contract awards, housing starts, and new building permits issued—all fell off slightly in June. However, there continues to be a substantial backlog of unused permits on which work was not initiated during the winter because of the unusually severe weather. And the fact that starts and awards were at a record level during the second quarter may point to strength in outlays for the near term. Moreover, there have been signs of some renewed strength in consumer retail spending for store goods. Thus, after having shown little movement from February through May, retail sales moved up in June to set a new record. Weekly data for July suggest that retail volume may have expanded somewhat further in that month, with an increase in sales of new cars providing much of the push. At the same time, trade sources report an unusually brisk sales pace for air conditioners, brought about by the sustained heat spell that apparently gave a boost to department store sales of other summer merchandise as well.