The Business Situation

As winter gave way to spring, the improvement in business sentiment found confirmation in a variety of economic statistics. Profits have apparently remained near the record fourth-quarter level, and such measures of activity as industrial production, nonfarm employment, and private housing starts all increased significantly in March while retail sales continued upward. For the first quarter as a whole, gross national product increased at a seasonally adjusted annual rate of $8½ billion, or by slightly more than the rise of the previous quarter. Early returns for April suggest further advances in production and a continued high level of consumer spending. The latest McGraw-Hill survey, moreover, at least confirms earlier indications that capital spending may move up later in the year and suggests the possibility of a somewhat larger rise than had previously been estimated.

Despite these favorable signs, some caution is necessary in interpreting recent developments. Available data on actual business capital outlays and on orders and contract awards have not as yet shown the kind of pickup that is indicated in the surveys of spending plans. Unemployment in April remained higher than a year earlier—again pointing up the persistent underutilization of economic resources. Moreover, some of the improvement in other indicators reflected a removal of the temporary dampening influences of strikes and of unusually severe weather earlier in the year. In addition, part of the gain has come from efforts to build up steel inventories as a hedge against a possible steel strike—a process that is expected to be reversed later in the year. Finally, while the success of the steel industry in putting through selective price increases has undoubtedly given an immediate boost to business sentiment, the ultimate effects on demand, on prices generally, and on wages are still uncertain.

PICKUP IN PRODUCTION AND EMPLOYMENT

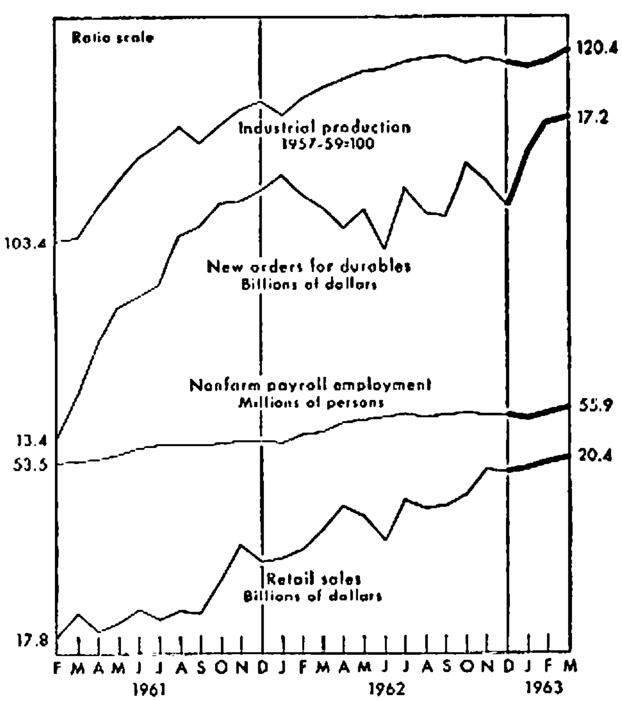
After showing little change since mid-1962, the index of industrial production advanced by one full percentage point in March to a record 120.4 per cent of the 1957-59 average (see Chart I). To be sure, the steel industry alone accounted for about one third of the over-all gain. At the same time, however, there were increases in the output of most other industries. In April, weekly figures for ingot production moved to the highest level in two years, with the total for the month as a whole registering a larger increase, after allowing for seasonal factors, than in February and March combined. Automobile assemblies in April remained at the high seasonally adjusted rate that has prevailed since mid-1962. Recent statements by some industry spokesmen indicate that they have raised their sights for the current year and now consider it possible that total output will reach seven million cars.

New orders received by durable goods manufacturers presented a mixed picture in March. While the total of such orders moved to a record level (see Chart I), orders received by manufacturers outside the steel and automotive industries remained at about the same level as in February. Steel bookings moved up substantially during the month, but this pace may, of course, not be sustained once the uncertainties surrounding the steel labor contract are removed. At the same time, there was a significant decline during March in "new orders for motor vehicles and parts". These are not really "orders" in the usual sense, however, since they mainly include manufacturers' deliveries to dealers and thus do not foreshadow future production.

Chart I

MONTHLY BUSINESS INDICATORS

Seasonally adjusted



Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

Accompanying the March pickup in production was a rise of 200,000 persons in nonfarm payroll employment, after seasonal adjustment. This was the biggest increase in almost a year and extended the advance begun in the previous month (see Chart I). Interestingly, most of the March gain was in manufacturing and trade employment, both of which had trended downward during the latter half of 1962. In April, total employment moved up still further, according to the Census Bureau's household survey. However, with the rise in the number of people looking for work, unemployment edged up to 5.7 per cent of the civilian labor force. This marked the third month in a row in which the unemployment rate exceeded its level of a year earlier.

DEVELOPMENTS IN KEY DEMAND SECTORS

Buoyed by the brisk March gain, gross national product in the first three months of 1963 rose to a seasonally adjusted annual rate of $572 billion, according to preliminary estimates by the Council of Economic Advisers. The increase was slightly larger than in the fourth quarter of 1962 (see Chart II) and significantly greater than in the three preceding quarters. It also topped most Government and business forecasts.

Nearly two thirds of the first-quarter rise in total GNP reflected increased consumer expenditures. Purchases of durables advanced only moderately from the already high level attained in the fourth quarter of 1962, and the rise in expenditures for services was the same in both periods. There was, however, a sharp first-quarter pickup in spending for nondurable goods. As a result, the over-all ratio of consumption to disposable income rose to 94 per cent, the highest level in two years. Most of this gain in consumer spending occurred after midwinter. Thus, retail sales held at about the same level from November through January but then moved upward in the next two months (see Chart I). In April, auto dealers apparently delivered about as many new cars to customers as in March (after seasonal adjustment), and aggregate sales volume of other retailers seems to have continued close to the record March level.

Government spending also contributed importantly to the rise in the first quarter, as it has throughout the current expansion. While there was some slowdown in the growth of state and local government purchases of goods and services, the increase in total government purchases in the first three months of 1963 was larger than in any of the three previous quarters.

Residential construction outlays declined for the second consecutive quarter. As in early 1962, however, unusually severe weather was a dominant force. The issuance of building permits is less affected by weather, and these were at a high level throughout the first quarter. With the coming of better weather in March, the number of private nonfarm housing starts jumped by 17 per cent to a seasonally adjusted annual rate of 1.5 million units. This was only moderately below the peak reached last November.

Business investment spending showed mixed trends in the first quarter. On the one hand, inventory investment increased significantly more than in the final quarter of 1962. For the current quarter an even faster build-up in inventories is likely. A Commerce Department survey in February had indicated manufacturers expected that their inventories alone would show a $3.4 billion seasonally adjusted annual rate of increase in the second quarter, with enlarged steel inventories the major factor in the advance (see April issue of this *Review*). The same survey also suggested a smaller rise in first-quarter factory sales than has now been realized, and this better than expected performance may have pushed up near-term inventory spending plans.

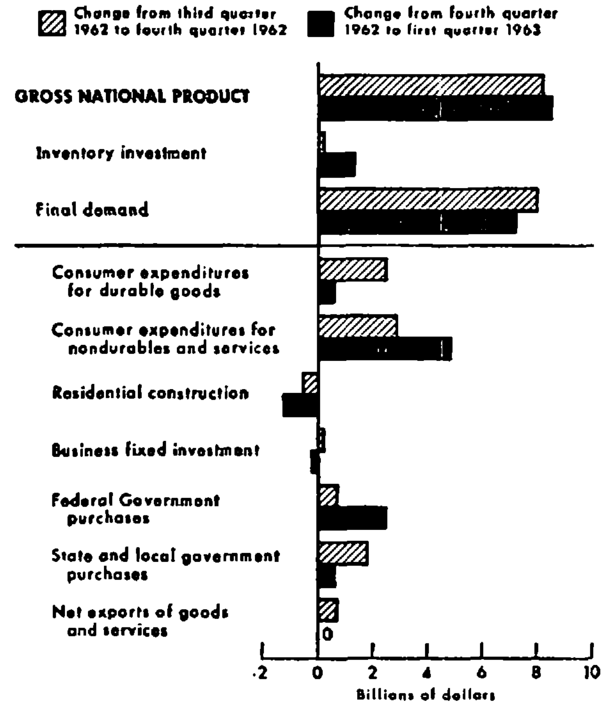
Outlays for new plant and equipment, on the other hand, edged downward in the first quarter, the first reduction in two years. Despite this decline, however, capital spending for the year as a whole is expected to exceed the 1962 level. Indeed, the recent McGraw-Hill survey, taken in March and early April, found businessmen planning to increase their spending for plant and equipment by 7 per cent over the 1962 level. About two fifths of this prospective gain was attributed to the revised depreciation rules and the investment tax credit, suggesting that these changes are exerting a greater impact than many businessmen originally anticipated.

The increase projected by this recent survey is somewhat larger than the 5 per cent rise indicated by a survey taken two months earlier by the Commerce Department and the Securities and Exchange Commission. To be sure, the McGraw-Hill spring survey has always shown more strength than the Commerce-SEC winter survey. Moreover, the latter survey has generally come closer in predicting actual spending levels. Nevertheless, in the majority of expansion years, the McGraw-Hill results have correctly pointed to the direction of later revisions in the Commerce-SEC series, and in this sense the latest report is encouraging. It is also noteworthy that preliminary plans for capital spending in 1964-66, according to McGraw-Hill's findings, are distinctly larger than plans for comparable future periods that were reported in previous surveys.

Chart II

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted annual rates



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