

## The Business Situation

Business sentiment remained confident as the new year began. The pace of economic activity, however, appeared to show little change from recent months, and the demand for goods and services continued well below the economy's productive capacity.

In December, industrial production, nonagricultural employment, and retail sales had all held close to their levels of the previous month, while new orders for durable goods and housing starts had declined somewhat from their high November rates. Construction contract awards and residential building permits, on the other hand, had risen sharply to record highs. For January, production data at hand indicate that output of steel ingots moved up for the third consecutive month and that automobile assemblies continued at the high rate that had prevailed since July. At the same time, consumer spending seems to have strengthened slightly, despite the adverse influence of newspaper and transportation strikes in a number of major cities, with unit sales of new cars apparently registering a sizable gain.

The future course of the economy will, of course, be importantly influenced by Congressional and public reaction to the President's tax program. This program is designed to give a direct impetus to both consumer and business spending and to spark a more rapid rate of economic growth through its cumulative impact on incomes and expenditures as well as through a strengthening of incentives and expectations. In terms of current income levels, the President's proposals would cut annual personal and corporate income tax liabilities by about \$10 billion over a three-year period, after allowing for offsets of about \$3.5 billion through adoption of reform measures. In fiscal year 1964, according to Administration estimates, the proposed lowering of tax rates would reduce tax revenues by about \$5.4 billion, with half of the revenue loss to be recouped by the expected gains in economic activity, by a requirement that corporations pay their income taxes on a more current basis, and by the initial effects of the suggested tax reforms.

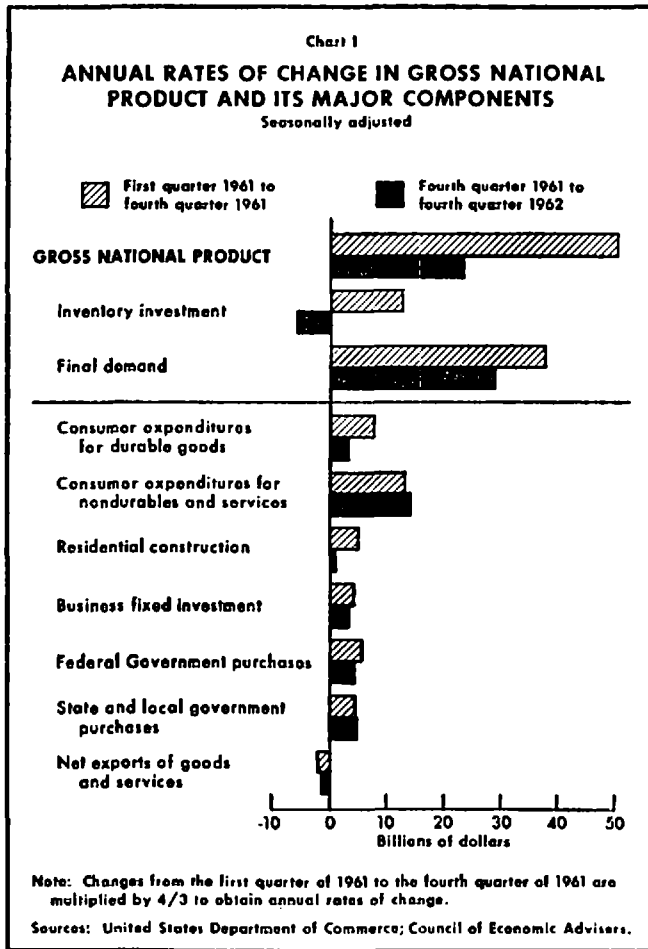
### THE SECOND YEAR OF EXPANSION

Gross national product in the final quarter of 1962 reached a seasonally adjusted annual rate of \$562 billion, according to estimates by the Council of Economic

Advisers. The \$6.7 billion increase was twice as large as the modest advance registered in the third quarter, though it was not so large as the gains scored in the earlier part of the current business upswing. The pickup in the fourth quarter largely reflected a substantial rise in personal consumption expenditures, as the near-record rate of automobile sales pushed total purchases of durable goods up sharply. Government purchases of goods and services also rose at a somewhat faster pace than in the third quarter, in part because of the salary increase for Federal employees that went into effect in October. Total private investment outlays, on the other hand, continued to decline. Inventory accumulation was less than in the preceding quarter, even though the working-down of steel stocks was apparently no longer particularly significant, and outlays for both residential construction and business fixed investment edged downward.

The rise in GNP in the fourth quarter of 1962 brought total output for the year to an estimated \$553.6 billion, 6.7 per cent above the 1961 level. Such a full-year to full-year comparison, however, obscures the marked slowdown in the advance that occurred during 1962. Thus, GNP in the fourth quarter was only \$23.4 billion (or 4.3 per cent) higher than a year earlier in contrast to the \$50.4 billion (or 10 per cent) annual rate of rise in the final three quarters of 1961 (see Chart I). It has, of course, been typical of postwar cyclical upswings that the pace of advance during the second year lags behind that of the first year. And while this tendency has been even more pronounced in the recent period than in earlier postwar upswings, the recent pattern could at least in some measure be attributed to a more orderly forward movement and relative freedom from speculative excesses. However, given the fact that little progress was made in 1962 to narrow the gap between the economy's actual and potential output, the rate of advance in activity was clearly not satisfactory.

Much of the slowdown in the rate of expansion in 1962 reflected the sag in inventory investment after the first quarter. This was, of course, strongly influenced by the liquidation of steel stocks following the steel wage settlement, although generally cautious inventory policies were another major factor holding down the over-all rate of accumulation. There was also some deceleration in the advance of final demands. Outlays for residential construc-



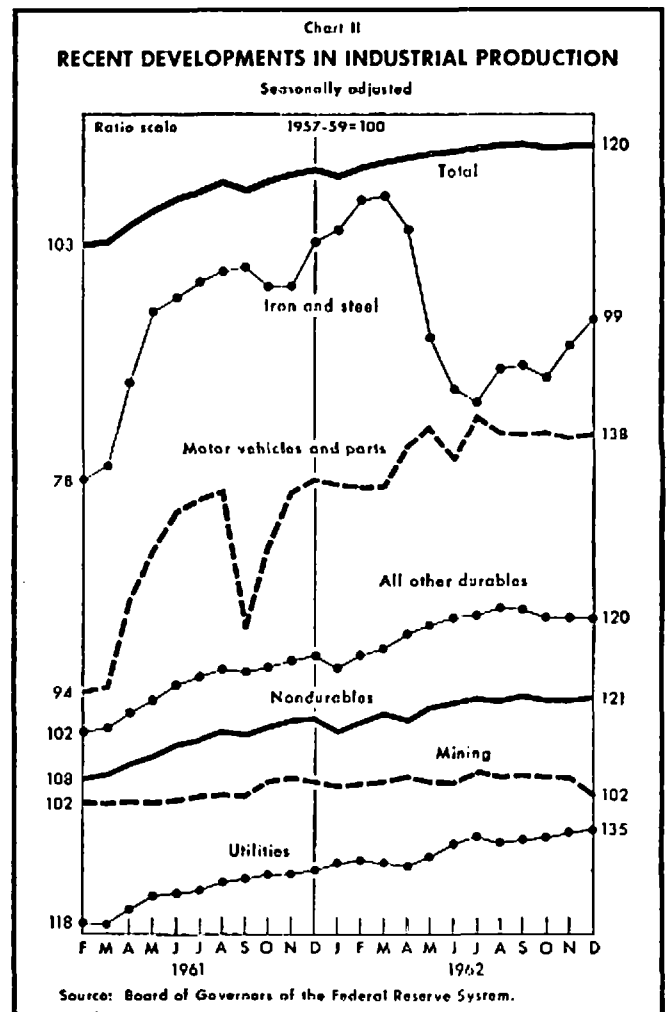
tion, for example, showed very little net increase during 1962 in contrast to a \$5 billion annual rate of gain during the final three quarters of 1961. The advance in government spending slowed slightly, and consumer purchases, limited by the slow growth in disposable personal income, rose by only \$17½ billion during 1962, compared with an annual rate of increase of nearly \$21 billion during the last three quarters of 1961. Business outlays for fixed investment in the fourth quarter of 1962 were \$3 billion higher than a year earlier. The rate of increase, however, slowed markedly after midyear. In the final quarter, as noted earlier, outlays showed a slight decrease.

**RECENT TRENDS IN KEY INDICATORS**

The index of industrial production, at 119.6 per cent of the 1957-59 average in December, continued to show virtually no change other than the usual seasonal variation. This index has fluctuated within a narrow range since July (see Chart II). In December, mining output—influenced

by severe weather conditions—registered a sharp decline, but this was offset by a sizable increase in steel production and by moderate, but reasonably widespread, gains in the output of other manufacturing industries. The continued rise in steel output would seem to confirm that the overhang of steel inventories, which had held back production for much of the year, has been largely—if not completely—eliminated. Indeed, there have been some reports that a few steel users are initiating plans to step up their rate of steel inventory accumulation in anticipation of a possible strike in August.

In January output of steel ingots rose further, largely in response to continued substantial ordering by automotive manufacturers. Automobile production (seasonally adjusted) remained close to the December level, as plants went on overtime schedules to make up for production time lost because of unusually severe weather. Whether the December decline in new orders for durable



goods—concentrated in industries other than steel—will significantly affect the production figures for subsequent months cannot as yet be determined. Month-to-month changes in the placement of new orders tend to be somewhat irregular, and thus the fact that the fourth-quarter average was quite high may have a larger impact on production than the December decline.

The employment situation also has shown little net change since mid-1962. Nonfarm payroll employment in December, according to the Bureau of Labor Statistics, remained at the level it had held since June. In January, the Census Bureau's series on seasonally adjusted total employment advanced for the second consecutive month, but still remained below the August record. Moreover, with the rise in the number of people looking for work, unemployment as a proportion of the civilian labor force went back up to 5.8 per cent. The unemployment rate

continues to be higher than at the comparable stage of any previous postwar business upswing.

The major stimuli to the economy continue to be consumer and government spending. Total retail sales in December remained at about November's record level, despite some seasonally adjusted decline in both automobile and department store sales. In January, weekly data on retail sales, available with year-ago comparisons for the first time, suggested a modest strengthening in consumer buying. Unit sales of new cars apparently rose significantly, while department store volume was somewhat below the high December rate, after seasonal adjustment. In the government sector, according to estimates made in *The Annual Report of the Council of Economic Advisers*, purchases of goods and services at both the Federal and the state and local levels are expected to increase this year at about the same rate as in 1962.