The Business Situation

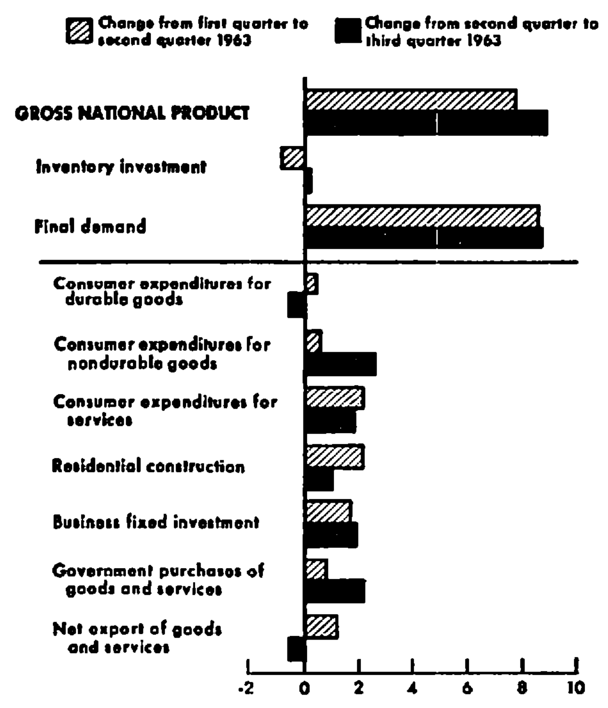
The economy posted another significant advance in the third quarter of the year. The rise in gross national product was the largest for any quarter in nearly two years, with a particularly heavy gain being scored by consumer purchases of nondurable goods. To be sure, there was some sluggishness in the statistical measures in August, but most September business indicators showed more strength, as the automobile industry experienced a pickup and the decline in iron and steel production virtually ceased. With the fourth quarter getting under way, moreover, available data suggest that retail sales, sparked by heavy sales of new car models, advanced substantially more than seasonally in October. At the same time, there appears to have been a significant increase in auto output in October—even after allowing for the normal seasonal rise—while steel output held about unchanged.

Prospects for the fourth quarter as a whole appear encouraging. The Department of Commerce-Securities and Exchange Commission's August survey of businessmen's plans for plant and equipment spending suggests a substantial further gain in such spending over the third quarter. The outlook for the realization of such a gain appears to have received support in September, both from a substantial rise in new orders for machinery and equipment following two months of decline and from a considerable advance in the output of business equipment. At the same time, some increase in spending by the Federal Government—due particularly to the military pay rise—and by state and local governments appears likely, while the sharp recovery of housing starts and new home permits in September has improved the outlook for residential building activity. One major area of uncertainty is the prospective strength of consumer spending, which has been increasing less rapidly this year than in 1962. According to a recent survey, however, consumer plans to buy houses, household goods, and cars remain strong.

GROSS NATIONAL PRODUCT IN THE THIRD QUARTER

According to preliminary estimates by the Council of Economic Advisers, GNP rose by a sizable $8.9 billion in the third quarter to a $588.5 billion seasonally adjusted annual rate (see Chart I). Only a small part of the advance was due to a rise in the rate of inventory accumulation, indicating that the expansion in final demand was a bit larger than the already substantial second-quarter increase. Most components of final demand contributed significantly to the rise in GNP. Major gains were scored by consumer purchases of nondurables, which had shown only a small increase in the second quarter, and by spending of state and local governments. Outlays by these governments, which normally show a fairly steady growth, had declined in the second quarter, owing to a temporary curtailment of some highway construction, but rebounded

Chart I
RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS MAJOR COMPONENTS
Seasonally adjusted annual rates

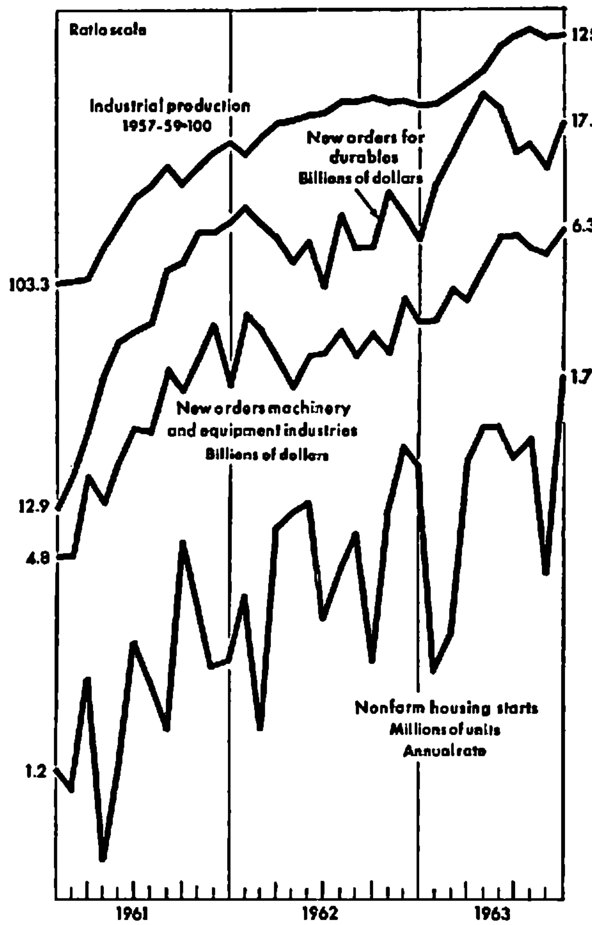


Sources: United States Department of Commerce; Council of Economic Advisers.

sharply in the third quarter. Total spending for goods and services by the Federal Government, on the other hand, was virtually unchanged, and two components of GNP— net exports and consumer purchases of durable goods— edged down. As regards consumer purchases of durable goods, a concentration of car model change-overs and the relatively low remaining inventories of 1963 models resulted in reduced automobile sales in the latter part of the third quarter.

In line with businessmen's plans as reported in the Government's plant and equipment spending survey, business outlays on fixed investment during the third quarter showed one of the sharpest advances of recent years, actually exceeding somewhat the large second-quarter gain. The rise in nonfarm residential construction in the third quarter, on the other hand, was only about half the second-quarter increase—a slowdown which had been clearly apparent in the monthly data on construction activity.

Chart II
RECENT BUSINESS INDICATORS
Seasonally adjusted



Note: Latest data plotted are for September 1963.

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

DEVELOPMENTS IN SEPTEMBER AND OCTOBER

The Federal Reserve Board's index of industrial production was virtually unchanged in September at 125.7 per cent (seasonally adjusted) of the 1957-59 average (see Chart II). It will be recalled that during August sharp declines in the production of both steel and new cars had resulted in a drop of nearly a point in the over-all index. In September, on the other hand, a further small reduction in the iron and steel component was about offset by a small rise in the output of motor vehicles and parts. Gains and losses in the output of other goods also about offset each other in September, whereas there had been some rise on balance in August and fairly sizable increases in most earlier months of the year. Incomplete data for October point to little change in steel ingot production, after allowing for seasonal factors, but auto output rose sharply and very preliminary production schedules for November appear to suggest continued strength. Large car production and sales are in turn supporting steel production, although steel inventories remain fairly high.

One particularly favorable factor in the near-term outlook for production is the 4 per cent September rise (seasonally adjusted), to the highest level since May, in new orders received by manufacturers of durable goods. The August decline in these orders had largely reflected reduced deliveries of automobiles, which are recorded as new orders when delivered to dealers. To be sure, a substantial part of the September gain was due to renewed heavy deliveries as new car models came off the assembly lines. Nevertheless, orders of other durable goods also posted a good advance. With new orders exceeding sales in September, the backlog of unfilled orders received by manufacturers of durable goods increased by 1.1 per cent (seasonally adjusted), after declines in the three preceding months, while total orders received by all manufacturers advanced to record levels.

Following a slight August decline, nonfarm payroll employment resumed its upward movement in September, but the increase of 100,000 persons was small and was concentrated mainly in the public sector. Payroll employment in manufacturing recouped less than half its August decline. In October, total employment showed virtually no change after seasonal adjustment, according to the Census Bureau's household survey, nor did the seasonally adjusted unemployment rate, at 5.5 per cent, change significantly. One encouraging development in the unemployment picture is the reduced rate of unemployment among married men. Unlike the aggregate unemployment rate, which has shown little net change in the past year, the unemployment rate for this group has trended generally downward throughout most of the current business expansion. At 2.9 per cent in September and October, it was at its lowest level since August 1957.

Recent gains in residential construction represent a marked improvement from the summer performance. Following a substantial decline in August, the seasonally adjusted annual rate of private nonfarm housing starts advanced by 17 per cent in September to the highest level since the current series became available in January 1959. Large—and quickly reversed—movements in housing starts are, of course, not uncommon. Nevertheless, the September gain was sufficient to pull the third-quarter average to within less than 2 per cent of the very high second-quarter average and is an encouraging development. Moreover, the seasonally adjusted index of new home permits, after two months of decline, also rose sharply in September and reached a new high. In October, outlays on residential construction rose only slightly—a leveling-off in activity associated with low housing starts in August.

Total retail sales dropped 1½ per cent in September. Although shortages of new cars were responsible for some of the weakness, there were declines in other groups as well—in contrast to some growth, apart from auto sales, in August. Preliminary data suggest that retail sales in October may have substantially recovered these losses.

Consumer spending on durables, which has remained relatively sluggish so far in 1963, is receiving support from a rising level of disposable income. The favorable outlook for such spending is supported by a study made in August and early September by Michigan University's Survey Research Center, which indicates that consumer plans to buy houses, household goods, and cars are strong. Heavy sales of new cars in October suggest, moreover, that the public's initial reaction to the new models was favorable.