

Economic Plateau or Downturn?

Data are not conclusive, but need for moderate economic stimulation is indicated.

SPENDING AND PRODUCTION have slowed in recent months. Total spending for goods and services, which rose 8 per cent during 1966, increased at an estimated 2 per cent rate from the fourth quarter last year to the first quarter this year. Government outlays continued to grow, but private spending, particularly by consumers, recorded some declines. Retail sales decreased at a 1 per cent annual rate from September to February after going up 8 per cent in the previous year.

The slower growth in spending has led to cutbacks in production and to an increase of unused capacity. Prices have moved up at a slower rate, but business inventories have risen to undesirable levels. Total real output of goods and services is estimated to have changed little since the fourth quarter compared with a rise of 4 per cent during 1966. Industrial production has declined at a 5.6 per cent rate since last October after rising 9 per cent in the previous year. New construction expenditures declined from \$79 billion (annual rate) early last spring to about \$72 billion in recent months. Employment has continued to rise, although average hours worked per week have decreased since September.

Interest rates have fallen markedly since early last fall. This decline reflects in part a contraction in the demand for credit accompanying the reduced demand for goods and services. Demands for credit and interest rates usually decline in the early months of a recession. In recent months, rapid monetary expansion may have contributed to the lower rates.

A full evaluation of the current trend in activity cannot be written for many months. Meanwhile, some insight may be gained by comparing recent developments in the chief economic measures and public policies with their behavior around known peaks in economic activity. The last three high points of economic activity, as selected by the National Bureau of Economic Research, are used; they were May 1960, July 1957, and July 1953. Such comparisons may be helpful in providing a perspective on recent developments, and may indicate an answer to the question of "plateau or recession."

Selecting a recent "peak" month for comparison is arbitrary at this time. A few indicators of economic activity, such as construction, reached a high about a year ago. Some measures turned down during the fall, and others have continued to go up. In this study October 1966 (fourth quarter for quarterly data) is used as a tentative peak. Any other month from last September to January might have been used with slightly different results.

Comparisons with Previous Cycles

Spending has shown considerably more strength than it did around the last three cyclical high points. In the year ending with the fourth quarter last year total outlays for goods and services rose 8 per cent (Table I). They averaged a 5 per cent increase in the

Table I
CHANGES IN PRODUCTION AND SPENDING

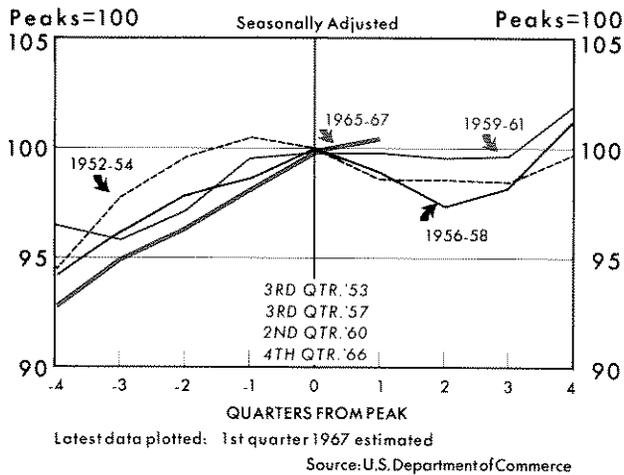
Peak Quarter of Economic Activity	Annual Rates of Change	
	Total Spending ¹	Total Production ²
	Year Before Peak	
Fourth 1966 (hypothetical peak)	7.8	4.1
Second 1960	3.7	2.0
Third 1957	6.1	2.4
Third 1953	5.9	5.0
Average of 1960, 1957, and 1953 peaks	5.2	3.1
Plateau in Economic Activity	Year Before Peak	
Third 1962	7.7	6.4
	Quarter After Peak	
Peak Quarter of Economic Activity		
Fourth 1966 (hypothetical peak)	2.0*	0*
Second 1960	— 0.4	— 1.9
Third 1957	— 4.2	— 6.0
Third 1953	— 5.3	— 4.7
Average of 1960, 1957, and 1953 peaks	— 3.3	— 4.2
Plateau in Economic Activity		
Third 1962	5.5	3.7

¹Gross national product in current dollars.

²Gross national product in constant dollars.

* Estimated by Federal Reserve Bank of St. Louis.

Total Spending on Goods and Services Gross National Product (Current Dollars)

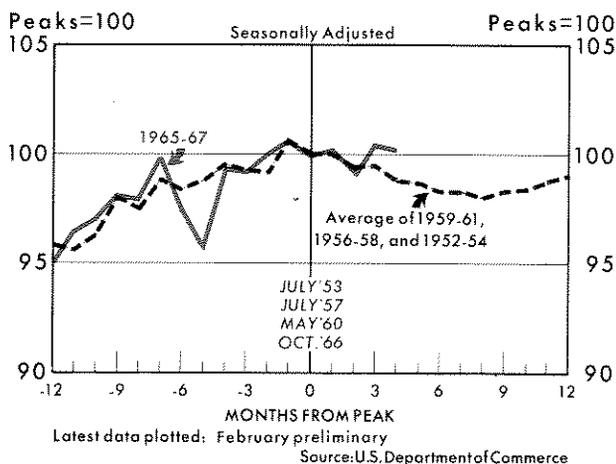


last year of the previous three economic upswings. From the fourth quarter last year to the first quarter of 1967 total spending rose at an estimated 2 per cent annual rate, while in the first quarter of the last three recessions spending declined at an average 3 per cent rate.

Government expenditures both for Vietnam and for welfare programs have bolstered total spending in the past two years. Retail sales have shown less strength. Since sales fluctuate widely from month to month, the recent movements in retail sales are compared with the average movements of the three previous cycles in the accompanying chart.

Retail sales rose at a 3 per cent annual rate in the eight months ending with October 1966 (Table II). By comparison, the upward trend in retail sales since 1947 has been 5 per cent per year. Sales rose at an average 3.7 per cent rate in the eight months before the last three business cycle peaks.

Retail Sales

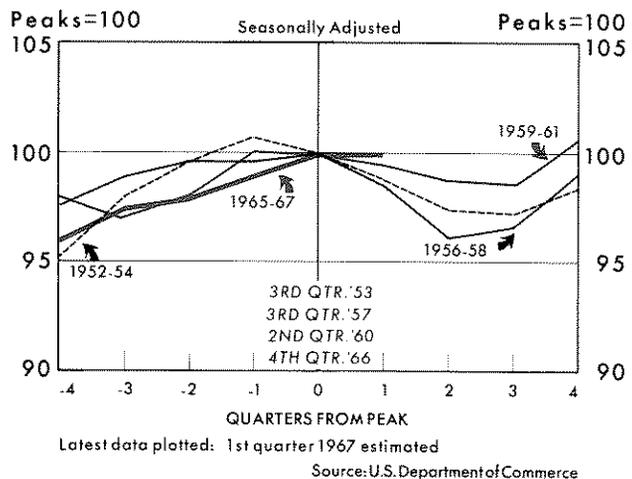


Retail sales increased at a 1 per cent rate from October to February. Declines were recorded in the first four months of the last three recessions.

Production has also been stronger in the past year than it was around the last three business cycle peaks. In the year ending with the fourth quarter of 1966 total real output of goods and services went up 4 per cent (Table I). By comparison, the average gain in real production was 3 per cent in the final year of the previous three economic expansions. Since the fourth quarter of last year little net change is estimated to have occurred in overall output, while in the comparable periods of the last three recessions output declined, on the average, at about a 4 per cent annual rate.

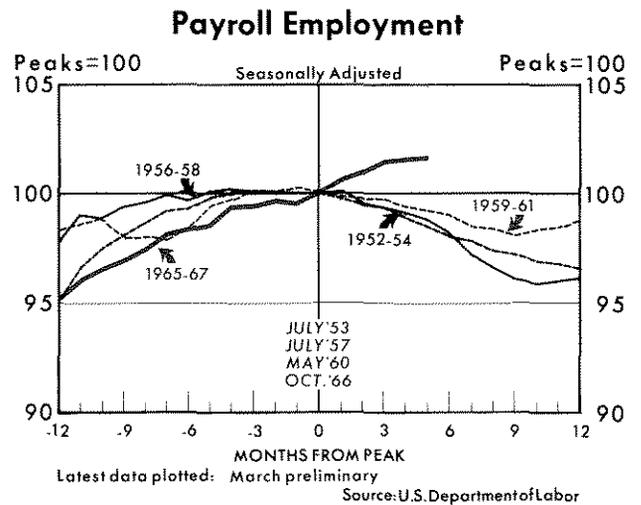
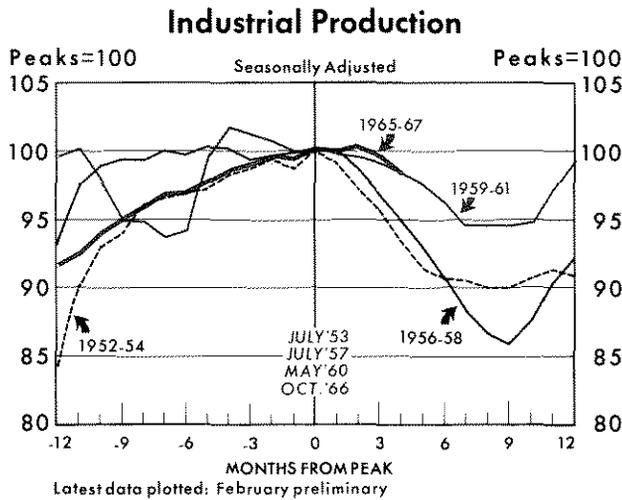
Real Output

Gross National Product (Constant Dollars)



Industrial production, about one-third of total production of goods and services, rose at a 6.5 per cent rate in the eight months ending October 1966. The increase was faster than the 4.7 per cent per year growth trend in production since 1947. The gain was virtually the same rate as in the eight months preceding the July 1953 peak in business activity (Table II). By contrast, output rose little on balance in the last phase of the two more recent upswings in economic activity. Industrial production was virtually unchanged in the eight months before July 1957. Production did fluctuate before the May 1960 peak, but most of the movement resulted from the steel strike which occurred in the fall of 1959.

Although production has slowed since last October, the decline has been more moderate than was the average in the first few months of the last three recessions. Industrial production decreased at a 5.6 per cent annual rate from October to February. By comparison, it fell at an average 13 per cent rate in the corresponding periods of the last three recessions.



Employment trends have been much stronger in the past year than around the upper turning points of the past three business cycles (Table II). From February to October of last year payroll employment rose at a

4 per cent annual rate, double both the trend since 1947 and the average growth in the eight months preceding the last three peaks in economic activity. Four to six months before each of the last three recessions employment reached a high level and moved on this plateau until the turning point or later; during the past year there has been no significant pause in the upward trend of employment.

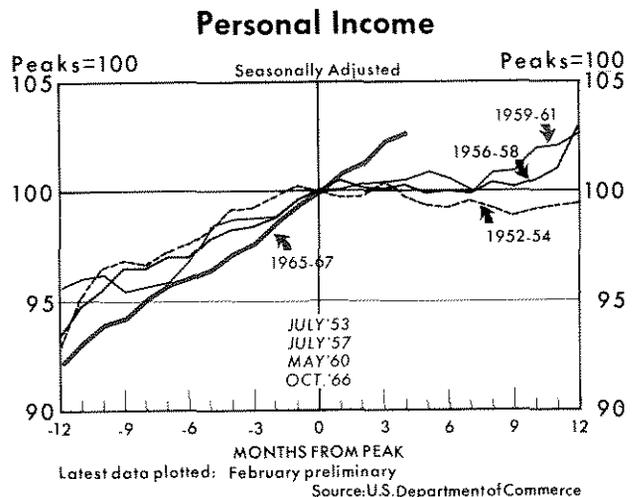
Table II
CHANGES IN SELECTED ECONOMIC INDICATORS

Peak Month of Economic Activity	Annual Rates of Change			
	Retail Sales	Industrial Production	Payroll Employment	Personal Income
Eight Months Before Peak				
October 1966 (hypothetical peak)	3.0	6.5	4.0	8.0
May 1960	2.4	8.6 *	3.1	7.0
July 1957	6.5	1.0	0.6	5.5
July 1953	2.2	6.2	2.1	5.2
Average of 1960, 1957, and 1953 peaks	3.7	5.3	1.9	5.9
Plateau in Economic Activity				
July 1962	6.8	5.4	2.9	5.2
Four Months After Peak				
October 1966 (hypothetical peak)	1.0	5.6	4.7	8.0
May 1960	-2.8	5.6	-1.7	1.6
July 1957	-1.8	-14.2	-2.7	0.8
July 1953	-4.8	-18.5	-3.3	-0.7
Average of 1960, 1957, and 1953 peaks	-3.1	-12.8	-2.6	0.6
Plateau in Economic Activity				
July 1962	7.2	2.0	1.1	4.8

* Reflects primarily a recovery from a steel strike.

Payroll employment has gone up at a 5 per cent rate since last October, whereas the number of workers on payrolls declined in the first four months of each of the last three recessions. The average rate of decline for the three four-month periods was 2.6 per cent.

Other indicators of economic activity tend to confirm the evidence emerging from the above measures that economic activity in the past year has probably been stronger than at periods around the three most recent cyclical peaks. While construction activity has been relatively weak in the past year, other indicators, such as personal income (Table II), have continued to rise at rapid rates, according to latest data available.



Fiscal and Monetary Conditions

A brief review of recent Government economic stabilization actions compared with those around the peaks of the three previous recessions may also be helpful in evaluating recent business developments. Fiscal conditions, as measured by the high-employment budget,¹ were restrictive around some peaks and stimulative around others. Monetary actions, as measured by changes in money supply,² were generally restrictive.

1960—Both fiscal and monetary conditions as conventionally measured were very restrictive before the May 1960 peak in business activity. In the year ending with the second quarter of 1960 the high-employment surplus rose from \$8 billion to over \$14 billion, a very high level by historical standards. Monetary contraction was quite pronounced (3 per cent annual rate) during the ten months ending May 1960. Fiscal conditions remained restrictive for over a year after the recession began. Money, however, began rising within two months after the recession commenced. The 1960-61 recession was probably the mildest of the three periods of adjustment considered here.

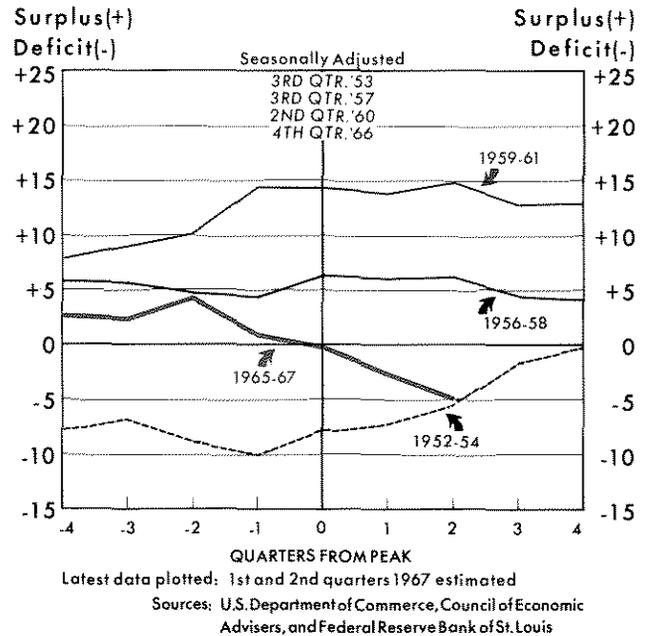
1957—During the six or seven months before the July 1957 peak both fiscal and monetary conditions were restraining forces, and they continued to be restrictive for a period after the downturn. The high-employment surplus moved up about \$2 billion in the two quarters before the peak and remained at about this level during the following two quarters. Thereafter, the budget became somewhat less restrictive.

Seven months before the 1957 turning point the money supply reached a plateau and remained at this level until two months after economic activity began contracting. From the second to the sixth month of the recession money contracted at a 3 per cent rate. After the sixth month of recession, however, money rose at a sharp 5 per cent rate in the following five months. Although the 1957-58 recession appears to be the most pronounced of the three examined, its subsequent recovery was also the sharpest.

¹ See "The Federal Budget and Economic Stabilization" in the February 1967 issue of this *Review* for a description of the high-employment budget and an analysis of its movements.

² A complete study would relate changes in money supply to changes in the demand for money to hold as an asset; demand has not been discussed here since it has apparently risen at a fairly constant rate. Other measures might have been used with similar results, such as the relation of actual interest rates to the high-employment equilibrium rates or of total credit extended to the demand for credit. However, equilibrium interest rates and demands for credit have fluctuated, making such analyses much more complicated.

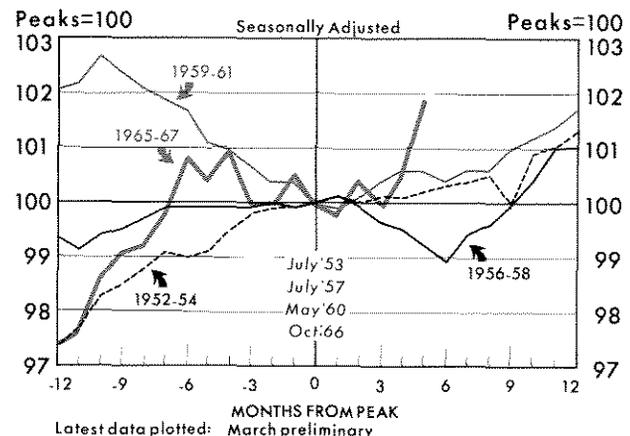
High-Employment Budget



1953—Around the 1953 turning point in business activity fiscal action was quite stimulative while monetary conditions were moderately restrictive. The budget was in large deficit as a result of the Korean conflict, but in the quarter of the downturn it was slightly less stimulative than in the previous quarter. Thereafter, Government actions became less expansionary, with cutbacks in spending after the Korean War more than offsetting lower tax rates.

The money stock went up at a 1.6 per cent rate in the seven months before the July 1953 peak. This was only slightly slower than the 2.2 per cent per year trend in money since 1947 but was down considerably from the 5 per cent growth from 1950 to 1952. After the peak in business activity money fluctuated without much net increase for nine months before it began rising. The economic recession of 1953-54 was the longest of the three considered and illustrates that a

Money Stock



downturn can occur despite a strongly stimulative Federal budget.

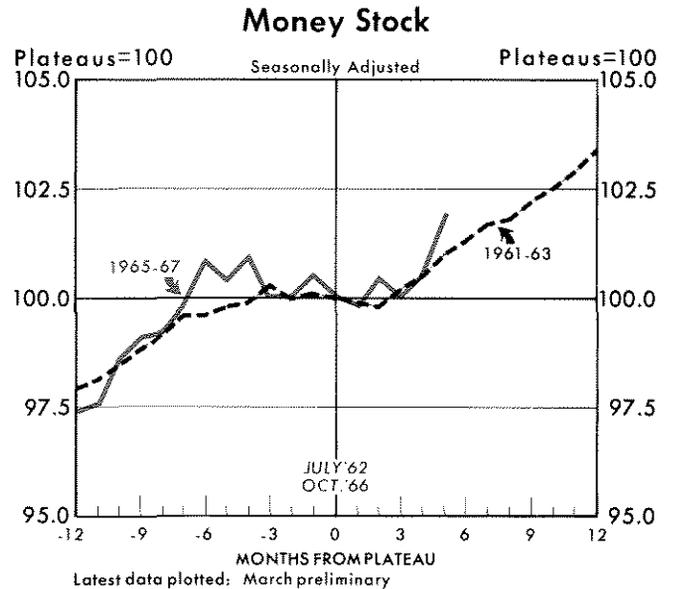
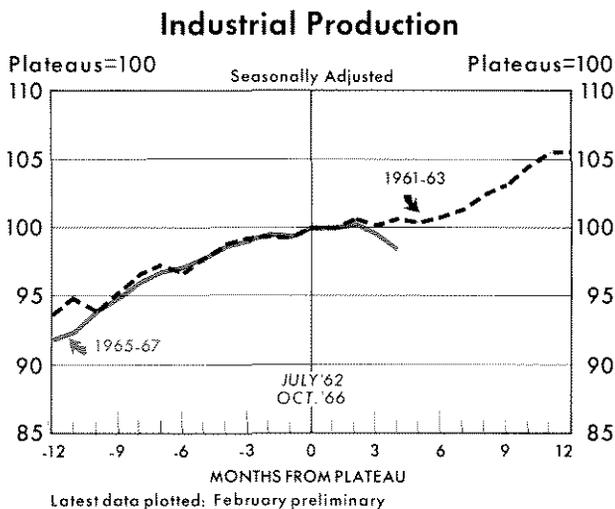
1966—Fiscal action was stimulative before October 1966 and has become even more stimulative since then. Monetary conditions were restrictive in the six months before October and continued to be tight for a time thereafter, but most recent figures indicate marked monetary expansion.

From the second to the fourth quarter last year, the high-employment budget went from a \$4 billion surplus to an even balance—a very stimulative action by conventional standards. This budget probably became about \$2 billion more expansionary in the first quarter of 1967. Estimates based on data contained in the *Economic Report of the President* indicate that the deficit will rise about \$2 billion more in the second quarter of 1967.

The stock of money declined from last April to October at a 1.5 per cent annual rate and changed little on balance from October to January. From January to early April money rose at a 6 per cent rate, but the influence of monetary expansion on economic activity generally operates with some lag, possibly four to six months. The change from sharp monetary expansion to monetary contraction in the spring of 1966 probably contributed to the limitation of total demand for goods and services later in the year. Resumption of monetary growth early this year may contribute to an increase in total demand later this year.

Conclusions

Is the economy in a recession or in a pause before a resumed upturn? The answer to this question cannot be conclusively settled at this time (early April) but will depend on developments in the next several months. The present is determined by the future. A



review of economic measures through the month of February indicates some similarities between the current situation and the three previous downturns, but most yardsticks indicate that the slowdown has been smaller than in the early months of the last three recessions. Some important economic time series have not turned down.

The current hesitation in economic activity is greater than the 1962 plateau in activity, according to most measures. Both personal income and employment are exceptions. However, recent developments come closer at this point to paralleling the 1962 plateau in activity than they do the three recessions. During 1962 there was a marked slowing in the expansion, but after a brief period of adjustment the economy resumed its upward movement.

Last spring and summer the economy became overheated. Prices were working up, there was a shortage of productive workers (with many on overtime), key items were in short supply, and bottlenecks were developing. A period of economic pause was probably desirable, assuming it could be held to proportions not much greater than that of 1962. Latest data indicate that even with the contraction in sales and production, employment is still relatively high. Prices have tended to stabilize, and goods are more readily available.

Whether economic activity continues to contract or resumes its upward thrust depends on many factors, including developments in Vietnam. A shift in consumer attitudes or tastes could be a dominating factor. Since last fall consumer spending, particularly on credit, has declined, yet the burden of repayments on consumer debt relative to incomes after taxes has changed only slightly. Business investment, usually a dynamic force in cyclical fluctuations, does not appear

propitious. Inventories are high relative to sales, a situation calling for further cutbacks in output. Declining sales and production also provide less incentive to build new plants and install new equipment. On the other hand, the reinstatement of investment tax credit and accelerated depreciation allowances may be some stimulus to investment.

The course of developments in the economy over the next few months will probably be influenced greatly by Government economic stabilization actions. Fiscal actions have been and are expected to continue to be stimulative, but such actions in the past have not

assured economic expansion. Monetary actions were quite restrictive from April 1966 to January. Since these actions usually operate with a lag, the economy may feel their restraining effect for a time even after money rises. Since January money has been expanding much more rapidly than in late 1962. Within a few months after the resumption of growth in money in 1962, economic activity, which had been on a plateau, resumed its upward trend with little pressure on prices. The task of monetary authorities at this time is to stimulate resumed growth in economic activity without putting undue pressure on prices.



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