

Regional Wrap-up '75: Downturn Ends, Recovery Begins

By Howard Keen, Jr.

Residents of the Third Federal Reserve District¹ were not spared the hard knocks that the national economy suffered in 1975. In some respects, the regional economy slumped even more than the U. S. economy. Not all was gloomy, but the bright spots were far from blinding. Prices rose at a slower pace in the District than in the nation and manufacturing workers finally experienced a gain in real earnings. At the same time, retail sales improved. But the big plunge in production and employment that hit the District economy early in 1975 was reversed only slowly. The total number of jobs in the region declined and the construction industry remained in the doldrums. Although the downturn did bottom out, by year-end the pace of further recovery was still a question mark and unemployment remained a severe problem.

¹The Third Federal Reserve District covers the eastern two-thirds of Pennsylvania, the nine southern counties of New Jersey, and all of Delaware.

INFLATION SLOWS, INCOMES IMPROVE

Developments on the inflation front were one of the bright spots of 1975. Few people can forget that 1974 was the year of double-digit inflation. Prices of consumer goods in the U. S. rose by more than 12 percent.² But as 1975 unfolded, soft aggregate demand, improved supplies of some commodities, and gains in productivity helped put the brakes on inflation.

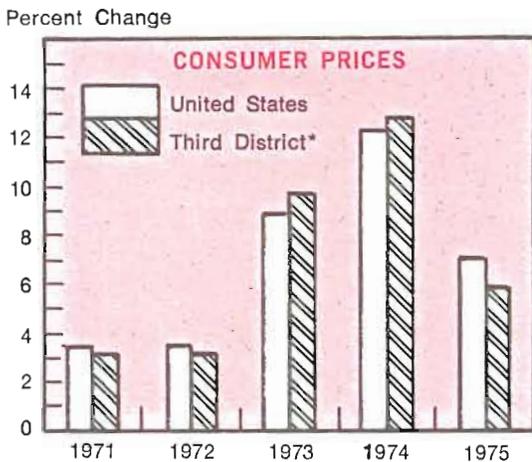
Prices climbed 7.0 percent nationwide, but consumers in the region saw a still slower rise of 5.8 percent.³ Food prices rose faster here

²Except where noted otherwise, growth rates for 1975 and other years represent December-to-December changes.

³The fact that prices rose at a slower pace in the region than nationwide doesn't mean that the *level* of prices in the District is below the U. S. average. The consumer price index can be used to show *changes* in the level of prices, but not the levels themselves. Estimates of household budgets can provide interarea comparisons of price levels. For the latest on this see E. B. Branch, "Urban Family Budgets Updated to Autumn 1974," *Monthly Labor Review*, June 1975, pp. 42-48.

than the national average, but District residents were less burdened by increases in the prices of housing, apparel, transportation and fuel and utilities. The advance in consumer prices in 1975 was still high by historical standards, but it was a considerable improvement over 1973 and 1974.

THE DISTRICT ENJOYED SOME RELIEF FROM INFLATION IN '75.

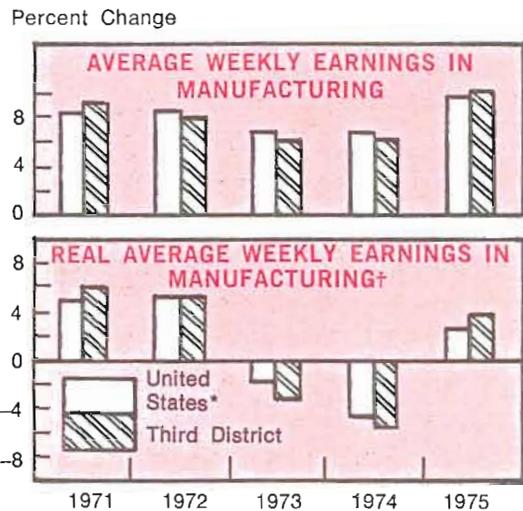


*The CPI for the Philadelphia SMSA is taken as representative of the Third District.
SOURCE: U. S. Department of Labor.

The lower rate of inflation was a welcomed relief to consumers' pocketbooks, and the turnaround in earnings as the year progressed was an added boon to purchasing power. During the early months of 1975 weekly earnings in manufacturing fell sharply as the reduced pace of economic activity resulted in a shorter workweek. As the downturn bottomed out and recovery began, earnings started to improve as well. Overall, manufacturing workers across the nation saw their weekly earnings grow by 9.5 percent in 1975. After adjusting for the rise in prices, this left them with 2.3 percent more buying power—the first gain in three years.

Workers in this District's manufacturing plants shared in the turnaround in real earn-

AND WITH FATTER PAYCHECKS, REAL INCOME OF DISTRICT MANUFACTURING WORKERS WAS HIGHER . . .



*U. S. figures for 1973 and thereafter are adjusted to 1974 benchmarks and are not strictly comparable to prior data.

†U. S. figures deflated by CPI for U. S., and District figures deflated by CPI for Philadelphia SMSA.

SOURCE: U. S. Department of Labor and state departments of labor and industry.

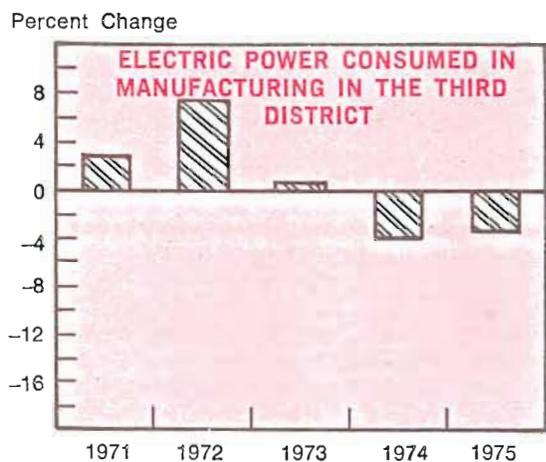
ings. Average weekly earnings in the District grew faster than those in the nation. In addition, local prices climbed at a slower rate than the national average. Thus, workers in the District enjoyed a bigger boost in real purchasing power than the rest of the country. Average weekly earnings in manufacturing advanced 9.8 percent in the region, and after adjusting for inflation, the gain was 3.8 percent. Despite this gain in earnings total area purchasing power was tempered by declining output early in the year and fewer available jobs.

OUTPUT: CLIMBING BACK AFTER A BIG PLUNGE

The U. S. economy was slumping in late 1974. The coal industry was slowed by a strike, the auto industry was in a depressed state,

consumer confidence dropped precipitously and businesses were faced with an unintended build-up of inventories. As 1975 began, sales sagged further, businessmen decided to liquidate their inventories and there was additional weakness in housing and automobile production. Output took a nose-dive in the first quarter when real GNP fell at an annual rate of more than 9 percent or \$28 billion. The downturn bottomed out in the second quarter and a recovery started to take shape in the third as the rate of inventory liquidation slowed substantially and personal consumption expenditures picked up. Overall, real GNP was down 2 percent in 1975.

INDUSTRIAL OUTPUT IN THE DISTRICT FELL AGAIN IN 1975.



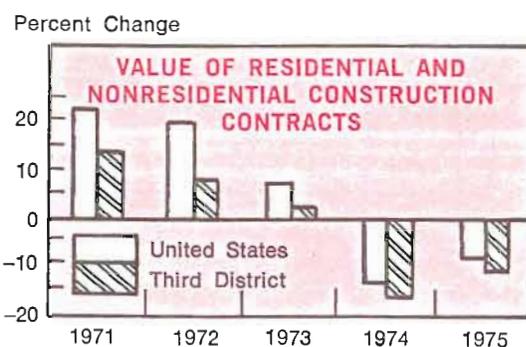
In the District, the drop in industrial activity followed a similar pattern as that in the U. S. A major indicator of industrial activity in the region is the index of electric power consumption in manufacturing. This index fell during the first two quarters of 1975 and then turned back up in the fall. Nevertheless, by year-end, this yardstick of local industrial activity was off 3.1 percent.⁴

⁴Part of this decline may be the result of attempts to economize on electricity usage in response to higher energy prices.

Construction: Drop in Public Works Hampers District. The slump that hit the construction industry in 1974 continued through 1975. The overall value of private and public construction contracts awarded in the U. S. registered a small drop of 3.9 percent. This was an improvement over 1974 when this measure fell more than 5 percent, but it was anemic when compared to the previous three years. Construction in the District, on the other hand, dropped by more than one-third.⁵

The private sector of the construction industry experienced an off year. Despite improved availability of mortgage money in 1975, construction of housing remained in a slump. The year began with record high inventories of single-family homes and many

PRIVATE CONSTRUCTION WAS OFF FOR THE SECOND YEAR IN A ROW ...

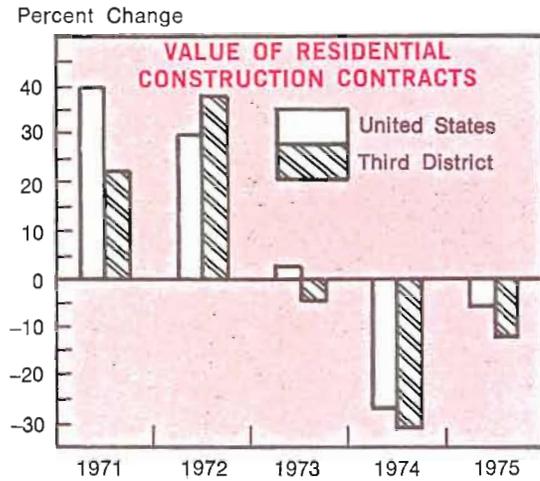


SOURCE: F. W. Dodge Division, McGraw-Hill Information Systems Company.

households were hesitant to undertake major financial commitments at a time of high unemployment. There was improvement as the year unfolded, but for the year as a whole, activity was still below 1974 levels. In the U. S. the value of residential construction contracts

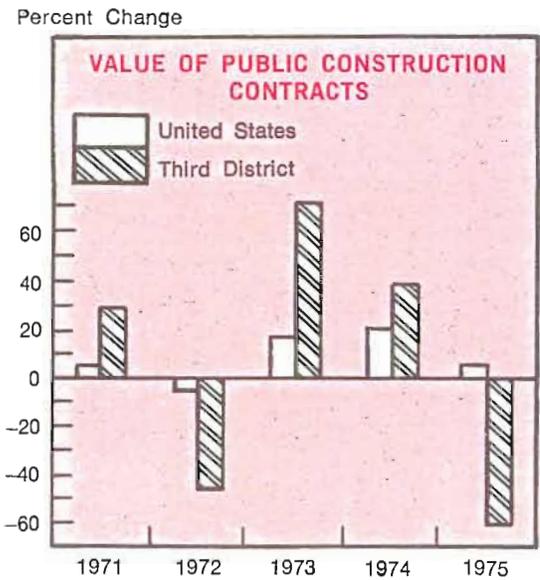
⁵The awarding of construction contracts represents the beginning of work on a building project. It does not tell us, however, how the resulting jobs and income will be spread out over the life of the project. As a result, some construction activity in any one year may be from contracts awarded in previous years.

AS RESIDENTIAL CONSTRUCTION REMAINED IN THE DOLDRUMS.



SOURCE: F. W. Dodge Division, McGraw-Hill Information Systems Company.

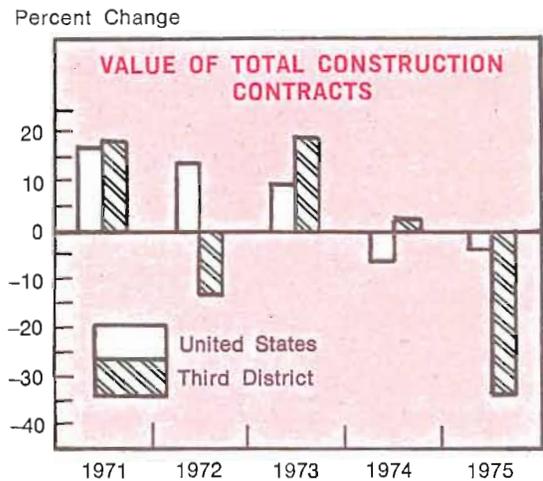
PUBLIC CONSTRUCTION ADDED TO THE WOES OF THE INDUSTRY . . .



SOURCE: F. W. Dodge Division, McGraw-Hill Information Systems Company.

declined 6.8 percent, and in the District, the drop was 12.2 percent. Nonresidential construction declined in both the U. S. and the region. The big difference, however, was in public works construction.

AND TOTAL CONSTRUCTION PLUMMETED SHARPLY.



SOURCE: F. W. Dodge Division, McGraw-Hill Information Systems Company.

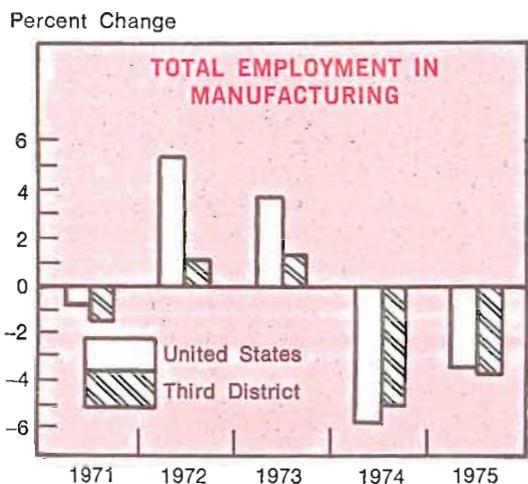
In the District, public works construction accounts for a larger proportion of total construction on average than in the U. S. At the same time, it is more volatile here than it is nationally. Consequently, construction activity in the public sector has a big impact on the overall performance of the construction industry in the region. In the U. S., growth in public works and utilities construction projects helped mitigate the weakness in private construction. In the region, however, public works construction fell 60 percent which exacerbated the weakness in private construction.⁶

⁶For a discussion of the current and projected developments in the construction industry in the metropolitan Philadelphia region see *Focus*, November 26, 1975, p. 35ff.

FEWER JOBS IN THE REGION

Sagging sales coupled with high levels of inventories in early '75 meant a reduced need for production. This, in turn, was translated into a reduced need for workers, and employment fell sharply in the beginning of the year. In the U. S., for example, there were almost a million fewer jobs available in March than there were just three months earlier. From

BOTH THE NATION AND THE THIRD DISTRICT LOST MANUFACTURING JOBS IN 1975.

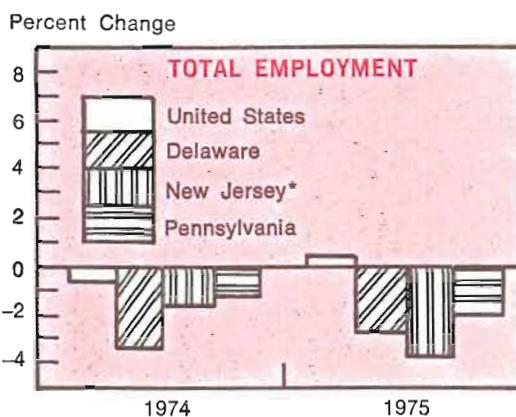


SOURCE: U. S. Department of Labor and state departments of labor and industry.

March on, however, there was steady but slow growth in employment so that by December total employment was 0.4 percent above its level of year-end '74. Jobs in manufacturing actually declined in 1975 by more than 3 percent.

In the District, workers fared worse than their nationwide counterparts. Manufacturing employment dropped in line with the national average, but job opportunities in the region were poorer in such fields as wholesale and retail trade, services and government employment. On balance, total employment

BUT, OVERALL THE NATION REGISTERED A SMALL JOB GAIN WHILE THE TRI-STATE AREA FARED WORSE . . .



*There is currently disagreement between the New Jersey Department of Labor and Industry and the U. S. Department of Labor over the appropriate methodology for estimating labor force, employment and unemployment. New Jersey figures used here are those estimated by the state-preferred method. For a discussion of this issue see the September 4, 1974 issue of *New Jersey Economic Indicators*.

SOURCE: U. S. Department of Labor and state departments of labor and industry.

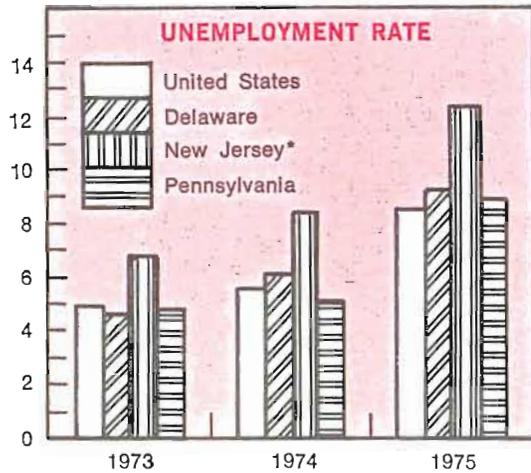
here was down for the year while nationally it was up slightly.

While total employment in the U. S. registered a small gain (0.4 percent) over 1974, the number of people seeking work grew more (1.6 percent). In the early part of 1975, dwindling jobs along with a growing labor force combined to push the unemployment rate up sharply — from 7.2 percent in December 1974 to 8.9 percent in May. As job growth picked up, the rate began to come down slowly, but by December it was still at 8.3 percent.

In the District, 1975 began with a higher proportion of the labor force unemployed than in the rest of the U. S. During 1975, the number of people seeking employment held steady, but with fewer jobs available, the regional unemployment rate was pushed upward. By December the proportion of the

PUSHING THE AREA UNEMPLOYMENT RATE UPWARD AND KEEPING IT ABOVE THE U. S. AVERAGE.

Percent (Annual Average)



*See note concerning New Jersey figures on previous chart.

SOURCE: U. S. Department of Labor and state departments of labor and industry.

regional labor force out of work remained above the U. S. average.⁷

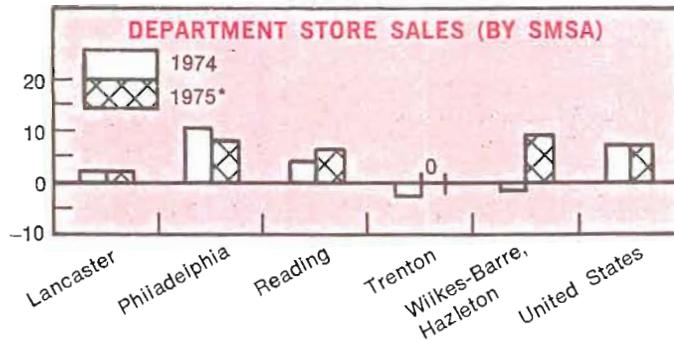
⁷The Federal Reserve Bank of Philadelphia is in the process of revising this regional data on total employment and labor force size. While encompassing a larger geographic area than the Third District, state data on total employment and the unemployment rate are presented in place of District figures.

RETAILING: NOT BOOMING, BUT BETTER

In the fall of 1974 retail sales in the U. S. began to slip as real spendable income declined and more workers were added to the unemployment lines. For that year as a whole, retail sales at department stores grew 7 percent. But prices climbed at a faster clip and unit sales declined. Thanks in part to the boost in real spendable income from Federal income tax rebates along with some nonrecurring social security bonuses, retail sales began to recover in 1975. To be sure, high unemployment and general uncertainty about the recovery in the economy were a

THE RETAIL SECTOR GENERALLY EXPERIENCED GAINS OVER 1974.

Percent Change



*First 11 months of 1975 compared to first 11 months of 1974.

SOURCE: U. S. Department of Commerce.

shackle on sales. Nevertheless, there was progress in 1975.

Based on the first eleven months of the year, retail sales at department stores in the U. S. were 7 percent above the same period in 1974. After adjusting for price increases this translates into a level of unit sales that is about even with the level in 1974. In short, department store sales last year were on their way back from the beating they had taken in 1974.

In a like manner, retail sales at department stores in the region improved in 1975. Except for Lancaster and Philadelphia, dollar sales grew at a faster rate than in '74. After removing the effects of inflation, department stores in all major SMSAs including Lancaster and Philadelphia fared better in 1975 in unit sales.⁸

CREDIT DEMANDS SLACKEN, BANKERS BUILD LIQUIDITY

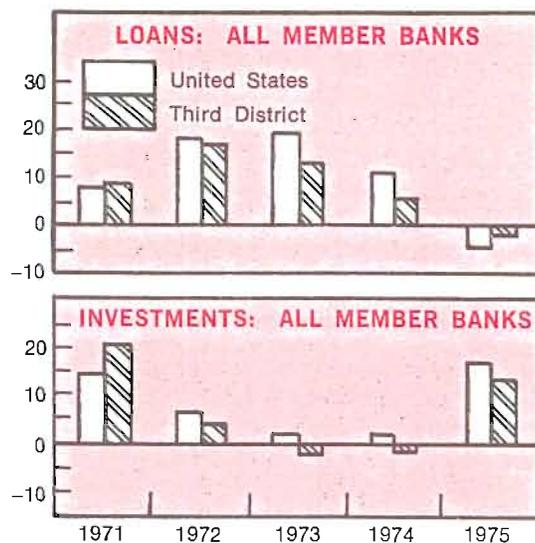
Unlike 1974 when banks faced burgeoning demands for loans, the weakness in the economy in 1975 resulted in reduced demands for bank credit. Substantial liquidation of inventories lowered the needs of businesses for short-term financing. At the same time, corporations raised large amounts of cash through long-term debt and equity issues and used part of the proceeds to repay short-term borrowings from commercial banks.⁹ Nationally, bank loans made by Federal Reserve member banks fell 3.4 percent during 1975 and loans at members banks in the region dropped by 1.0 percent.

While loan demand sagged, the relatively restrictive lending policies adopted by banks

in 1974 continued to some degree. Instead of aggressively making concessions in order to stimulate loan volume, banks took advantage of weakened demands for credit to rebuild their liquidity by increasing their holdings of U. S. government securities. Investments by all member banks grew by 17.2 percent in 1975, and member banks in the District increased their holdings by more than 13 percent.¹⁰

LOANS OUTSTANDING FELL, AND BANKS INCREASED THEIR INVESTMENTS.

Percent Change



BUSTLING BUSINESS FOR BICENTENNIAL?

In short, 1975 was a year of severe curtailment in economic activity followed by some

⁸When firm figures for December 1975 are available, retail sales may show an even larger improvement for the year. Available information suggests that retailers had a strong Christmas season.

⁹See, "Financial Developments in the Second Quarter of 1975," *Federal Reserve Bulletin*, September 1975, pp. 539-545.

¹⁰Investments consist primarily of securities of the U. S. Treasury, other U. S. Government agencies and corporations, and obligations of states and subdivisions.

recovery. But while the fall was sure and swift, the climb back has been slow and uneven. On the plus side, department store sales in the region made creditable improvement over 1974, and slower rising prices here made economic life a bit easier. In addition, real earnings (in manufacturing) advanced for the first time since 1972. But in terms of output and employment, the area economy had by no means fully recovered from the downturn. At the end of 1975, measures of output and employment were still below year-end '74

levels. The decline in the total number of available jobs in the District economy resulted in unemployment for a substantial proportion of the regional labor force.

With idle productive capacity and with inventories pared down from earlier in the year, any pickup in business should eventually be translated into gains in production and employment. And according to area businessmen, the prospects for such expansion in the regional economy during the Bicentennial year are bright. (See Box.)

BOX

THIRD DISTRICT BUSINESSMEN ASSESS '76

The Federal Reserve Bank of Philadelphia conducts a monthly business outlook survey. This survey is designed to gain insight into prospective economic conditions in the Third Federal Reserve District, an area that includes the eastern two-thirds of Pennsylvania, the southern half of New Jersey, and Delaware. Executives of manufacturing firms with 500 or more employees are polled regarding their readings of local business activity.

Since its inception at the request of the regional business community almost eight years ago, the Business Outlook Survey has become a useful source of economic intelligence both for business and public policymakers. Copies of the monthly summary of the Outlook Survey may be obtained by writing to Research Department, Federal Reserve Bank of Philadelphia, P. O. Box 66, Philadelphia, PA 19105.

OUTLOOK FOR 1976

Area executives, responding to the December "Business Outlook Survey," are optimistic about business prospects during the first half of 1976. Seventy percent of the businessmen surveyed see a higher level of economic activity in the next six months. Almost three out of four respondents expect their new orders to be higher by mid-year and a third anticipate a build-up of inventories. At the same time half of the manufacturers polled plan to hire additional employees. Along with the pickup in economic activity, area manufacturers are looking for higher prices. A little more than 90 percent of those surveyed expect to be paying more for their supplies by summer while 74 percent anticipate higher price tags for the products they sell.

In short, Third District businessmen expect expanding output and employment in the region at least through the first half of 1976. At the same time, they anticipate higher prices to accompany the recovery. 

RESEARCH PAPERS AVAILABLE

The Philadelphia Fed's Research Department occasionally publishes RESEARCH PAPERS dealing with a wide range of banking and economic issues. Most of these papers are of a highly technical nature and for the professional researcher.

- *Intradistrict Distribution of School Resources to the Disadvantaged: Evidence for the Courts*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe
- *Branching Restrictions and Commercial-Bank Costs* by Donald J. Mullineaux
- *Economies of Scale of Financial Institutions* by Donald J. Mullineaux
- *Required Reserve Ratios, Policy Instruments, and Money Stock Control* by Ira Kaminow
- *The Information Value of Demand Equation Residuals: A Further Analysis* by James M. O'Brien
- *Equality of Educational Opportunity Quantified: A Production Function Approach*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe
- *Pennsylvania Bank Merger Survey: Summary of Results* by Cynthia A. Glassman
- *Manual on Procedure for Using Census Data to Estimate Block Income*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe.
- *Block Income Estimates, City of Philadelphia: 1960 and 1970*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe
- *Optimal Capital Standards for the Banking Industry* by Anthony M. Santomero and Ronald D. Watson
- *A Unified Model of Consumption, Labor Supply, and Job Search* by John J. Seater
- *Utility Maximization, Aggregate Labor Force Behavior, and the Phillips Curve* by John J. Seater
- *Economies of Scale and Organizational Efficiency in Banking: A Profit-Function Approach* by Donald J. Mullineaux
- *On the Role of Transaction Costs and the Rates of Return on the Demand Deposit Decision* by Anthony M. Santomero
- *Spectral Estimation of Dynamic Econometric Models with Serially Correlated Errors* by Nariman Behravesh
- *Empirical Properties of Foreign Exchange Rates under Fixed and Floating Rate Regimes* by Janice Moulton Westerfield

Copies of these are available from the Department of Research, Federal Reserve Bank of Philadelphia, Philadelphia PA 19105.



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