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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

October 11, 1972

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SUMMARY*

Comments from the District banks uniformly emphasize the strong pace of the current economic expansion. Near-term prospects for both consumer spending and business investment continue to be excellent. Strong income gains in the agricultural sector are bolstering retail trade and outlays for farm machinery and equipment. Construction remains at a high level in most Districts. Signs of overbuilding in certain areas, however, suggest an adjustment in 1973. Labor market conditions generally continue to show improvement, and some Districts are experiencing labor shortages. Businessmen and economists expressed concern over the possibility of renewed inflationary pressures in 1973, and over what public policy measures might be taken to counteract those pressures. Reports were mixed on the effectiveness of wage-price controls and their future prospects. Commercial banks are experiencing strong loan demand, especially from the consumer sector.

Concern about the reemergence of inflation during 1973 was the most frequently mentioned problem on the economic horizon. Banks specifically commenting on the problem of renewed inflation include Boston, New York, Philadelphia, Cleveland, and St. Louis. On the subject of controls, Atlanta mentioned that businessmen are concerned about the inadequacies of wage-price controls, while St. Louis reported reservations among businessmen regarding the future

* Prepared at the Federal Reserve Bank of Cleveland.

effectiveness of controls. A comment picked up by New York was that continued wage controls (but presumably not price controls) seem to be a "necessary evil" if the problem of cost-push inflation is to be solved. Chicago underscores the effectiveness of Price Commission rulings in many industries, and business economists in Cleveland maintain that sentiment among large firms is for a continuation of controls next year.

Banks generally reported that retail sales continued to register strong growth in recent weeks. Higher livestock and grain prices have contributed importantly to retail trade in Minneapolis and have stimulated sales of farm equipment. Chicago, Kansas City, Dallas, and San Francisco also commented on bright agricultural income conditions. In Richmond, however, the gain in agricultural income is below the national average.

There are signs that the upswing in business fixed investment is gaining momentum. Philadelphia reported businessmen's plans for capital spending are being stepped up, while Richmond noted an increased number of manufacturers whose current plant capacity is too low relative to desired levels. Atlanta mentioned heavy capital spending on projects for pollution control and that investment is being undertaken primarily to reduce costs rather than to increase capacity. In Chicago, excellent consumer demand for recreational vehicles has spurred producers to expand capacity. Farm machinery producers in the Chicago District are pleased with domestic and foreign demand and plan to operate at a higher level than normal during the winter. San Francisco sees plant and equipment spending rising strongly in 1973, with heavy outlays required for pollution control.

On the financial sides, commercial banks are experiencing strong loan demand, particularly for mortgages and consumer credit. Business economists in the Cleveland District do not expect a credit crunch to materialize in 1973, although they anticipate some edging up of interest rates. In Kansas City, bankers are concerned about the possibility of disintermediation. San Francisco reports that banks are reasonably liquid and in a position to meet increased loan demand without major increases in interest rates.

FIRST DISTRICT - BOSTON

For the first time in a long while, all our directors from manufacturing and construction firms reported that business was very good. New orders were reported rising in all sectors, and there were scattered reports of new hirings. No strong inventory building, however, was noted. The local fishing industry, which has been badly hurt by the red tide scare, is an exception to the generally improving pace of economic activity.

Our business directors had no bad news to report. Orders were up in all areas for consumer goods, industrial materials, capital goods, and aerospace. While capital goods and machinery orders are rising and backlogs improving, one broad-based manufacturer noted that the gains are much more moderate than the national statistics on capital spending would indicate. Our directors' firms are themselves, however, trying to expand capacity now, although they still have ample capacity in most lines. One director mentioned that his firm is building two new plants to manufacture campers, a product line where demand is very high. Another announced the construction of a $100 million facility to handle imported liquified natural gas. Capital spending to more fully automate plants was also mentioned.

All our directors mentioned that they were increasing their work force. Workers who were laid off in the machine tool division of one company have all been recalled. A bank director from Martha's Vineyard noted that young women were finding employment in new occupations like fishing and carpentry.

The red tide scare has severely depressed the entire New England fishing industry, not just firms selling infected shellfish. New England fish sales are reported 75 percent below normal levels. Our director from Martha's Vineyard reports that the island, which usually exports its fish heavily at this time of year, can find no market for its uncontaminated catch.

Our directors continue to show concern about a reemergence of inflation. They seem to be equally worried, however, that anti-inflationary measures taken by a reelected Nixon administration would clamp down hard on profits or cut spending to the point of bringing another recession. They noted that these fears are very widespread on Wall Street. They also show concern over the large budget deficit. In anticipation of higher interest rates, one of our directors has already undertaken his long-term financing needs now. One director mentioned that he felt more relaxed about inflation than he has in a long time because controls have worked so well. However, he strongly expressed the opinion that controls should not be removed before the end of next year, if inflationary expectations are to be effectively dampened.

Our four academic correspondents, Eckstein, Samuelson, Shapiro, and Wallich, agreed that the economic outlook, both domestic and international, is good. The latter, according to Shapiro "has never looked better." Professor Wallich expressed concern over the current rate of money growth in light of the 5.9 percent trend which prevailed over the inflationary period from late 1966 to late 1971. He granted that there may be a tendency for velocity to diminish along with inflationary expectations. Wallich and Shapiro would like to have monetary growth taper off to a 6 to 7 percent annual rate; Samuelson hoped for 7 percent for the rest of the year.

There was a general anticipation that neither the proposed budget ceiling nor the refunding of overwithholding would have a strong economic impact. On the other hand, Shapiro believed that the ceiling would have a favorable psychological impact on the financial markets. He felt that failure to enact the ceiling could add as much as 50 basis points to the 7 1/2 percent corporate new issue rate he expects to prevail by the end of 1973. He foresaw no credit crunch in 1973--a bill rate of 5 1/2 and a long-term government rate of 6 1/4 by year end.

Eckstein did not think there would be a budget ceiling. He regarded the proposal as only pre-election political maneuvering, although he granted that there is a budget problem. Eckstein was less concerned about the budget than about the future course of bank reserves. He advocated a "modest 6 to 8" percent rate of growth of RPDs. He argued that it would be dangerous at present for the monetary authorities to go outside of this range, regardless of the perceived degree of fiscal restraint or stimulus.

There were no strong opinions on discount rate policy, although Samuelson and Eckstein stressed the need for flexibility.

SECOND DISTRICT - NEW YORK

The relatively optimistic mood of this Bank's directors regarding the current general business outlook remained in evidence this month. The Directors felt that residential construction activity would remain at a high level in 1973 and that consumers' outlays would continue on the upswing. The consensus was that there had been little change in the rather conservative inventory buying practices, but this was largely attributed to more efficient management, with the help of computers. Concern, however, continued to be expressed over the inflationary implications of the Federal budget and labor unions' large wage demands.

Regarding the overall current economic outlook, the directors in general felt that the current and prospective business situation had undergone little change recently and reported a generally optimistic mood among themselves and their associates. Indeed, the president of an upstate bank reported some heightening of optimism in his area as a result of a reduction in local unemployment. And another upstate director noted that, apart from certain segments in agriculture and tourism that had been adversely affected by poor weather, all other economic sectors in his area looked "very strong." Concern, however, continued to be expressed over the inflationary implication of the fiscal and wage situation. A Rochester retailer thus noted the necessity for additional taxes to finance even current government expenditures, and another director referred to the urgent need to develop new federal budget controls. An upstate manufacturer remarked that continued wage controls seemed to be a "necessary evil" if the problem of cost-push inflation were to be solved.

Concerning residential construction, the directors expressing an opinion on the topic all felt that homebuilding would continue to be relatively strong in 1973. Some of the directors forecast a continuation of the popularity of multiple-dwelling units and strength in apartment building activity. One director noted that the damage caused earlier this year in his area by a hurricane and floods was generating an unusually large amount of construction of new homes and of reconstruction of existing structures. Another director reported that homebuilders in the Rochester Area felt that expected ample availability of mortgage funds would contribute sustained strength to home construction next year.

Regarding consumer outlays, most respondents characterized the picture as good but not spectacular, and about in line with expectations. One director--the president of a large container manufacturing firm--felt the situation was "very good." A senior official of a large upstate firm also felt that a boom in consumer spending, while not as yet evident, might materialize next spring.

The directors, however, in general saw little if any strengthening in the current inventory picture, in either trade or manufacturing. An upstate director associated with the automotive parts business did state he detected an upward trend, and the Rochester retailer also felt the overall pace of inventory spending looked a bit stronger. The latter director, however, suggested that some of the accumulation in the retail sector in the Rochester Area might be involuntary. Another director suggested that recent published statistics pointing to a climb in inventory spending might be misleading because such increases may, in part at least, reflect the impact on the book value of inventories of rising prices.

Another director stated that the high cost of carrying inventories was tempering the demand for additional stocks. Also, a number of directors noted that computer-based control systems enabled businesses to carry inventories at lower levels.

THIRD DISTRICT - PHILADELPHIA

Third District businessmen report that the regional economy is continuing its upward course. The latest business outlook survey of large manufacturers in the area shows that over half of those surveyed are chalking up advances in new orders and shipments. Retail sales are holding up well again this month. Banks are experiencing good load demand. Inventories are rising, and plant and equipment spending is on the increase. However, employment is almost flat, and expectations of rising prices continue. Industrial activity continues upward with just over half the firms contacted reporting increases in new orders and shipments. This expansion is expected to last at least the next six months for a majority of the firms canvassed. Employment in the Third District is practically level. Over three-fourths of the firms responding to our survey of large manufacturers report no change in the number of the employees or the length of the average workweek.

Of the remaining firms, about twice as many are experiencing increases and decreases in the number of employees. The six-month labor outlook is only modestly more optimistic. Retail sales continue strong again in September. Area retailers report sportswear and home furnishings were experiencing stronger than average gains. Auto dealers report another good month as well. Major banks in the Third District report continued strong loan demand from most of their departments. Mortgage and consumer credit plus loans to small businesses set the pace. Most major corporate borrowers, however, are not utilizing their lines of credit very heavily.

Business inventory investment is contributing a little strength to the economic advance in the Third District. Almost half the firms report no change in their inventories. But, among those reporting inventory changes, almost twice as many report gains as decreases.

Plant and equipment spending is turning up among those firms reporting changes in their capital expenditure programs. There were six times as many reporting increases as decreases, an improvement over last month. Over three-fourths of the firms responding to the Business Outlook Survey report no change in the prices they pay and the prices they receive this month. But, during the next six months the picture does not appear as favorable. Eight times as many manufacturers expect to receive higher prices as expect to receive lower prices for their products. And, over two-thirds of the respondents expect to be paying higher prices six months from now, while almost none expect their input costs to drop.

FOURTH DISTRICT - CLEVELAND

The consensus view of the business economists who attended the Fourth District Economists Round Table meeting held at the Bank on October 6 was that few signs of maturity are apparent in the current business expansion. There was general agreement among the Roundtable participants that there is sufficient upward momentum in the economy to sustain a real growth rate in GNP in the area of 6 percent or more through the first quarter of 1973. Thereafter, the pace of the economic expansion is expected to slow somewhat and move back toward the economy's potential rate of growth and more sharply below that by year end. Most of the economists expected a generally accommodative credit environment next year, but with some edging-up of interest rates.

The median forecast of the group of about 40 business economists calls for a $110 billion increase in GNP for 1973, with real growth of 5.8 percent and a price increase of 3.6 percent. According to this forecast, unemployment is expected to register only slight improvement during 1973, with the rate forecast at 5.2 percent for the first quarter and 5.0 percent for the fourth quarter. The pace of the economic expansion is projected to moderate beginning with the second quarter, primarily reflecting smaller gains in consumer spending and diminishing stimulus from business fixed investment and inventory building. The change in business inventories is expected to be about $10 billion per quarter in 1973. One bank economist noted that the forecasters have consistently been expecting inventory growth to accelerate because of low inventory-sales ratios. He believes the secular trend toward lower inventory-sales ratios is still with us, and, accordingly, he cautioned against overly optimistic forecasts of inventory accumulation for next year.

By the fourth quarter of 1973, the group projects real GNP to be rising at a rate of 3.1 percent and prices rising at a rate of 4.3 percent. Most of the economists assume that some form of wage-price controls will be maintained after April. Indeed, the sentiment of the group was that Tier I firms want controls to continue in view of the heavy schedule of labor negotiations for next year. One economist with a major retailing firm said management was nervous about the prospects for consumer spending in the second half of 1973 if the rate of inflation accelerates.

Among other reports submitted by the business economists, the median forecast of nine economists whose firms depend heavily on the auto market calls for new car sales of 10.8 million units in 1973, with imports of 1,575,000 units. One auto economists predicted a price increase for new cars in January, "probably not more than 3 percent." The effect of the current price freeze is estimated to add about 100,000 units to sales during the remainder of this year.

An economist from a major steel company predicted a price increase in his industry when the current self-imposed price freeze ends in January. The steel industry is expected to have a better year in 1973, with shipments estimated to rise from 92 million tons this year to a range of 94 to 100 million tons next year (depending on the intensity of the capital goods upswing).

An economist from the Federal Home Loan Bank reported that housing in at least a dozen major metropolitan areas is now overbuilt or is heading toward an overbuilt situation. An increase in multi-family vacancy rates next year is expected to trigger a decline in total new housing units, from an estimated 2.8 million in 1972 (including mobile homes) to 2.3 million in 1973.

There was considerable discussion by the business economists about their expectations with respect to monetary and financial conditions in 1973. Emphasis was on the concern being raised by some financial economists that credit conditions are likely to be considerably tighter and interest rates sharply higher in 1973. The Roundtable group, however, generally expects a better credit environment in 1973 than what was thought to be the commonly held view. As one economist put it, "we are not likely to experience a credit crunch in an underemployed economy in 1973." Another added that, "the probability of even a mini credit crunch in 1973 is extremely low." Although the Fed is expected to accommodate a substantial portion of the demand for funds in 1973, the economists still anticipate some edging up of interest rates.

FIFTH DISTRICT - RICHMOND

Our most recent survey of District businessmen indicates that economic conditions in the Fifth Federal Reserve District continue to improve. Manufacturers report increases in shipments, new orders, and backlogs. No change was reported in manufacturing employment, but there was an increase in hours worked per week. The demand for all types of loans remains strong, with consumer loan demand especially strong. Further increases in construction activity were reported. Businessmen and bankers continue to be optimistic about the Fifth District economy.

Responses from District manufacturers indicate increases in shipments, volume of new orders, and backlogs. On balance, manufacturing inventory levels were reported to have decreased, although inventories relative to desired levels remain high. There are indications that production is beginning to press on capacity in some industries as an increased number of manufacturers report that current plant and equipment capacity relative to desired capacity is too low.

A strong upward trend in retail sales continues to be reflected in reports from bankers and trade and services respondents. Increases in retail sales excluding automobiles and in automobile sales were reported by more than three-fourths of the banking respondents.

Manufacturers reported no change in employment, while hours worked per week increased somewhat. Industry reports indicate pronounced shortages of labor and growing overtime in the important furniture industry. Trade and service respondents indicated an increase in both employment and hours worked per week. On balance, both manufacturing and trade and service respondents reported an increase in wages paid, but no change in prices received.

According to reports from District bankers, residential and non-residential construction activity continues strong. Nearly one-half of the banking respondents indicated that construction activity has increased in their areas since the last reporting period.

Bankers report strong demand for all types of loans. The demand for consumer loans appears to be especially strong with more than 70 percent of the banking respondents indicating an increase in the demand for this type of loan.

District crop conditions improved slightly during August, but production prospects in early September were generally below those a year ago. Output of only three of the chief money crops--peanuts, soybeans, and corn--is expected to be sizably larger than in 1971. January-July cash receipts from farm marketings were 5 percent above a year ago, but the increase was below the national gain. Demand remains strong, and record breaking prices for better quality grades continue to prevail on flue-cured tobacco markets.

Businessmen and bankers in the District continue to be optimistic about the economic outlook. More than three-fourths of the banking respondents believe that business activity in their areas will increase in the next 90 days.

SIXTH DISTRICT - ATLANTA

The economic mood of businessmen and bankers is one of solid optimism. One Tennessee director actually described the prosperity in his area as "almost unbelievable." Boom conditions are reported throughout Florida. Nevertheless, many businessmen have grave doubts about the long-term economic health of the nation because of the Federal deficit and labor problems. The only weak spots in the District are areas of aerospace layoffs or work stoppages.

Construction continues to highlight economic prosperity in the District. Shopping center construction is strong in many areas. In Nashville, plans for two savings and loan buildings and for three major motels have recently been announced, and an existing hotel will undergo a $5-million renovation. Construction will also start shortly in Nashville on a $25-million Federal building. Final plans are being formulated for a $25-million convention center on the Mississippi Gulf Coast. In Atlanta, still another large hotel will be built, this one rising 70 stories. In South Florida, an unprecedented boom in residential construction may be slowed by a decision of the Florida Pollution Control Board to reject all sewer hookup applications in areas of Florida that do not provide adequate waste treatment. One Florida real estate economist has predicted that some areas of South Florida are over-building and due for a serious shakeout in 1973. Brick is in short supply in several areas of the District, with delivery taking at least two months. A survey of three New Orleans savings and loan associations indicates a shortage of mortgage funds in that city in the face of strong demands.

Manufacturing employment is increasing in many areas, and capable labor is scarce. A major electronics firm has increased its East Tennessee labor force from 7,000 to 12,000 in the past year. Numerous plant announcements and expansions should continue pressure on tight labor markets. However, aerospace layoffs are causing softness in the Huntsville, Alabama Area. Huntsville businessmen, however, are confident about their long-term economic prospects. Labor stoppages have slowed construction and depressed the economy in the Lake Charles, Louisiana Area. It has been reported that work on a large chemical plant addition in Lake Charles has been slowed intentionally because of uncertainty concerning the expiration of 17 separate construction-related labor contracts in the coming months. The huge tufted carpet industry in North Georgia is enjoying record production and shipments.

Business leaders attending a meeting in Birmingham expressed considerable concern about inadequacies of wage and price controls. One nonunion firm claims that it is experiencing a labor shortage because it can only raise wages 5.5 percent when union settlements have been negotiated at higher rates than permitted under the guidelines. A manufacturer of coal and coke reported being caught in a profit squeeze because raw material cost increases could not be passed through. This executive stated that, although the market for his product was taxing capacity, he did not anticipate opening any new coal mines since, under the present cost and price control structure, they would not be economically justified. This apparently was the opinion of bankers and others from whom the company had sought funds to finance expansion.

Plant and equipment expenditures are being undertaken by some firms predominantly to reduce costs rather than increase output. A representative of one firm manufacturing electrical equipment emphasized that his firm was engaging in capital expenditure programs specifically to improve costs, and these programs went to the extent of closing some plants and relocating production in lower cost areas. Capital expenditures are also heavy for projects to reduce pollution.

SEVENTH DISTRICT - CHICAGO

The strong momentum of the business expansion and the improved psychology of businessmen, lenders, and the public are increasingly evident in the Seventh District. The job market continues to improve gradually, consumers are spending and using credit more freely, order backlogs are rising, and output of some industries will not show the usual seasonal decline in the winter months. Capital expenditures are advancing further. Inventories continue under tight control, but apparently are increasing at a faster pace.

Employment has not increased as fast in the District as in the nation. Moreover, employment in the Chicago Area, almost 30 percent of the District total, is estimated by state agencies to be no higher than a year ago, while the manufacturing sector is below last year. In this expansion, some smaller plants have been closed in the central or near suburban areas of large cities. Commonly, output is expanded, and new facilities are located in remote suburbs or smaller centers far from the headquarters. The implication for the future of the large cities is ominous.

Despite slower than average growth in employment, unemployment in most areas is estimated to be below last year. Local employment service offices frequently refer to withdrawals from the labor force since last year. But these views may not be based on adequate evidence.

Demand for appliances, furniture, television sets, motor homes, snowmobiles, and other "recreational vehicles" has been excellent. A number of producers of these items have announced plans to expand capacity in new, or existing, facilities. Consumers are continuing to use instalment credit freely. Nevertheless, savings inflows, especially at S&Ls, continue at a high level.

Sales of mobile homes remain very strong, and local experts contradict reports that the market is softening. HUD acquired thousands of mobile homes for disaster relief following floods in South Dakota and Pennsylvania. As a result, mobile home producers, who customarily keep abreast of demand, now have order backlogs. (Some smaller mobile home producers are not sharing in this prosperity, however.) Modular housing, on the other hand, is doing poorly, and some District plants have been closed.

Huge new shopping centers are accounting for a substantial share of the increase in retail sales, particularly in the Chicago Area. In recent months, many stores have lengthened their hours to include Sundays and/or evening operations to 9 or 12 P.M. They report widespread use of these extended hours, especially on Sundays.

In the capital goods sector, farm machinery producers are very pleased with demand, here and abroad, and are planning to continue output at a higher level than normal in the winter months. Producers of components for capital goods--including dies, forgings, electrical apparatus, drives and couplings, and controls--report orders up 20 to 50 percent from last year's level, which was still quite depressed in some sectors. In part, this reflects the need to build inventories. Other strong areas include forklift trucks, used machinery, solid waste disposal systems, and safety equipment. Capital goods producers are hampered in expanding output by shortages of skilled workers, especially for second shifts.

The strength of the auto and truck markets is well publicized. Shortages of truck engines and other components have spurred expansion plans.

Steel orders are proceeding at a good pace, with demand for sheets especially good. Lighter structural steels also are showing strength. Ford is expanding its steel capacity at Dearborn.

Among the weaker capital goods sectors are coal mining equipment (which had been excellent), railroad equipment, the oil industry, and pipelines. Paradoxically, these are among the sectors where needs are the greatest.

Prospects for another record year in construction in 1973 are excellent, although the pace of residential construction is expected to be down--perhaps by 10 percent. Housing permits surged again in the Chicago Area in August after slowing earlier in the year. Commercial construction (other than office buildings), manufacturing buildings, and water and sanitary facilities are expected to provide strength.

Price Commission rulings are quite effective in many industries. Firms unable to justify price increases commonly notify suppliers that they must also hold the line. In some major industries where the leading firm cannot justify price increases because of the profit margin rule, competitors who could justify increases must also hold back.

Private forecasters now estimate midwest soybean and corn production at somewhat higher levels than the recent government estimates. These private estimates take into account heavy rains that have damaged some crops and delayed harvesting.

EIGHTH DISTRICT - ST. LOUIS

Businessmen in the Eighth Federal Reserve District report vigorous economic growth. Retail sales at major stores continue up on a seasonally adjusted basis. The construction industry maintains its high rate of activity established late last year. All types of manufacturing are expanding. Employment continues to expand, and shortages of qualified labor are reported on a wide front throughout most of the District. However, fears that inflation is likely to accelerate in the near future have increased. Demand for credit is rising rapidly, causing upward pressure on interest rates. A larger number of firms are now planning for additional capital investments. However, there appears to be less optimism than during the summer that the inflation is under control.

Major stores report a sharp increase in sales during recent weeks. Part of the gain is attributed to cooler weather, but part is attributed to generally rising consumer demand. Stores in the central cities were losing sales and operating at a loss last year and early this year, but reports indicate that sales in these stores have now stabilized and they are operating at a profit.

Construction continues at a high rate throughout the District with the exception of the St. Louis Area, where excessive labor costs and numerous labor disputes have been a significant retarding factor. In most of the District, construction activity and output in the lumber industry is at 100 percent capacity. Directors of the Little Rock Branch report that in a recent week there were 110 job openings in Stuttgart for unskilled laborers and only four jobs were filled. They further reported that excess demand for building materials is causing prices to rise to the top of the permissible range. Suppliers of building materials are unable to keep pace with demand, and allocation by rationing has resulted. Current brick orders are for spring delivery. Prices in the future market for plywood and lumber have jumped the permissible percentage on opening trade in recent months.

Manufacturing in the District continues to expand vigorously on a wide front. Production of capital goods such as machinery, big motors, and power transmission is picking up. Production of plastics, fibers, and agricultural supply manufactures is also higher in recent weeks than heretofore.

Employment expanded further in recent weeks at most reporting firms. A shortage of qualified labor is developing on a wide front throughout the District. Department stores in St. Louis report that good labor is hard to get despite the fact that the City still shows a relatively high rate of unemployment.

Lending agencies report that demand for loans is rising, while the rate of savings remains unchanged. Negotiated CD rates have moved up in recent weeks, but inflows of savings are still at a lower rate than credit extension. Large St. Louis banks recently announced a prime rate increase, but upward pressure on most rates continues.

Concern for inflation, which had subsided somewhat earlier in the year, is beginning to revive. A larger proportion of repondents expressed reservations as to the future of wage-price controls in view of the rising demand for and higher prices of goods and services in the uncontrolled sector. In many instances, the increased prices in the uncontrolled sector become higher input costs to the larger firms in the controlled sector of the economy.

NINTH DISTRICT - MINNEAPOLIS

Higher livestock and grain prices this year have stimulated District economic activity and helped spur third quarter retail sales. However, no significant reduction is expected in District unemployment.

According to Bank directors, this year's higher livestock and grain prices are stimulating District economic activity. A Montana director revealed that recent high wheat prices will increase Montana farm income by $16 million and result in greater farmer spending. In a North Dakota director's opinion, almost every businessman in his state will benefit from this year's high grain prices, and a South Dakota director was optimistic about the prospects for retail spending in his state. Furthermore, Bank directors unanimously expect an increase in farm machinery sales. A Twin Cities banker also believes that this year's improved farm income will increase the cash inflow to country banks this fall and increase correspondent balances at his bank. Although the Port of Duluth did not benefit from the recent wheat sales, a Duluth director believes additional sales to Russians would aid his area.

Partially reflecting the improved farm income situation, District consumer spending advanced in the third quarter, and District retailers look for further gains in the fourth quarter. Four out of five Twin Cities Area retailers revealed that their third quarter sales were quite good, two noted a definite pickup in August and September. In addition, Gamble Skogmo's business economist indicated that their business in the District's rural areas had improved in the third quarter. These retailers revealed that their third quarter sales had generally matched earlier expectations, although one Twin Cities discounter stated that his third quarter sales only matched last year's level. These retailers unanimously expected good to excellent business in the fourth quarter.

The anticipated stimulus from farm spending, however, is not expected to significantly reduce District unemployment. A survey of State Employment Security Offices in 16 of the District's largest labor areas revealed that, although employment growth is expected to improve in many areas, no substantial reduction in unemployment is anticipated. When asked to characterize the outlook for employment growth during the next 90 days, two respondents termed it "excellent," seven called it "good," six considered it "fair," and one referred to it as "poor." Nine of the respondents foresee job openings in their areas to be up from a year ago--seven said only "slightly,"--while five respondents expect employment opportunities to match last year's level and two anticipate drops. Since most respondents also look for normal to above normal labor force growth in the fourth quarter, no significant reduction in unemployment is expected. Seven respondents look for fourth quarter unemployment to be down slightly from a year ago, three foresee no change, and six anticipate some increase in joblessness.

In the Minneapolis/St. Paul Metropolitan Area, which accounts for a third of District employment, job openings are expected to be up from a year ago, and a modest fourth quarter increase in employment is anticipated. However, unemployment is only expected to be down nominally from a year earlier.

Bank directors' opinions varied with regard to the labor market outlook in their respective areas. In Northeastern Minnesota, unemployment is up, and no significant reduction in joblessness is foreseen. Lacrosse, Wisconsin's unemployment rate, however, is at its lowest level since September 1969, and further improvement is expected. And in the Upper Peninsula of Michigan, the construction of an iron mining facility is expected to stimulate employment growth next spring. Furthermore, a South Dakota director anticipates a modest gain in his area's employment, and a Montana director attributes more jobs in his area to a pickup in construction activity. In North Dakota, meanwhile, the employment situation was characterized as "pretty good," with few married men out of work. One director revealed that his firm is finding common laborers plentiful, but not skilled workers. Another director indicated that employers are advertising for additional workers but are being very selective in hiring them.

TENTH DISTRICT - KANSAS CITY

Vigorous economic acitivity in the District is being bolstered by strength in the agricultural and construction sectors and in automobile sales. Overall activity is being supported by strong demands in all major loan categories at commercial banks. At the same time, growth in savings inflows and in mortgage loans and commitments is sustaining a high level of residential construction. Recent developments surrounding the export of farm products are also contributing to an improved income situation in the important agricultural sector of the District's economy.

Loan demand continues strong at District banks, with heavy demands being experienced in all major loan categories. Most District banks surveyed increased their prime rate to 5 3/4 percent during the first week of October reflecting both heavy business loan demand and national financial developments. The recent run-up of short-term interest rates, which has increased the cost of short-term funds, has also put upward pressure on the prime rate at District Banks. Despite the upward adjustment of offering rates on CD's, the volume of CD's has declined substantially at District banks since the end of August.

Several District bankers expressed concern about the possibility of disintermediation, even though present inflows of time and savings deposits have been strong. Rates on consumer-type time deposits are generally at ceiling levels. No consensus has developed regarding market rate levels that will trigger deposit outflows, but many bankers feel that both consumer-type time deposits and large CD's will be affected if present trends continue. In anticipation of this prospect, several banks are actively attempting to extend deposit maturities.

Savings inflows to District savings and loan institutions were reported to be down a bit from last year by respondents in Kansas City and Oklahoma City, but from "surprisingly steady" to "coming in strong" by institutions in Wichita, Topeka, Omaha, and Denver. On the whole, rates offered for savings remain the same, but average effective rates paid have risen as increasing numbers of depositors have been switching from passbook to certificate accounts.

Mortgage commitments and loans of savings and loan institutions have apparently stabilized somewhat, with slight declines noted in some areas. However, respondents from Omaha and Oklahoma City emphasized that the small declines left loan activity very strong because of the phenomenal pace of lending earlier. Much the same thing was said about construction activity--continued strength in building in most areas, though somewhat reduced from earlier peaks. Some further slowing down was anticipated in residential building in the Kansas City Area and in apartment starts in Omaha. Respondents from Omaha and Denver were a little apprehensive about possible overbuilding.

The dollar value of residential construction contract awards so far in 1972 continues to be well above the 1971 level for the District and for most of its larger cities. Speculative building of single-family dwellings continues strong in the Kansas City Area, according to home construction firms surveyed. Most contractors are not concerned with overbuilding at this point, although several mentioned "hearsay" comments that demand is slowing. Nearly all of the homebuilders were of the opinion that there were plenty of funds available to both builders and buyers.

Contract awards for nonresidential building and for public works and utilties have also shown increased strength across the District this year, except for Western Missouri. General contractors in the Kansas City Area are expecting an improvement in 1972, however, partly due to an expected increase in highway construction activity in both Kansas and Missouri.

Sales of domestic automobiles by District dealers are very strong. Introductory sales of new models are reported to be better than last year, almost without exception. "Hold-the-line" pricing on 1973 models is given some of the credit, because many customers believe that higher prices are just a matter of time. Many dealers, however, are convinced that price increases will not retard sales increases very much. Nearly all dealers expect 1973 model-year sales to be outstanding. At the same time, clean-up sales of 1972 models have gone exceptionally well, and inventories of 1972 cars are very low. Sales of imported autos are not sharing the buoyancy in domestic car sales, although later introduction of new models is undoubtedly a factor.

Net farm income for the United States for 1972 is now expected to reach $18.6 billion, or $500 million more than reported earlier, according to the U. S. Department of Agriculture. The change is due primarily to the huge grain sales to the Soviet Union, amounting to roughly $1 billion. The projections for wheat and feed grain exports have also been revised sharply upward for the 1972-1973 marketing year. District states produce approximately 40 percent of the wheat and 20 percent of the feed grains that are exported from the United States each year. Thus, these new developments in the farm income picture should boost the final figures for 1972 District farm income, although many farmers forfeited higher incomes by selling their wheat before the sharp price jump in August and September. However, historical records in Kansas indicate that, even after allowing for heavier than usual marketings in June and July, probably 50-60 percent of the new crop was still under farmer control when the full magnitude of wheat sales to Russia became apparent.

ELEVENTH DISTRICT - DALLAS

Indicators of economic activity in the Eleventh District were mixed in August. Although the Texas Industrial Production Index eased slightly from its revised record level in July, the unemployment rate for the five District states declined, and employment continued to increase. Department store sales in the District also continued strong, and construction activity rebounded sharply. However, the rate of new car registrations declined slightly.

A decrease in the production of nonmanufactured goods was primarily responsible for the slight decline in the seasonally adjusted Texas Industrial Production Index in August. The decline was centered in public utilities and crude oil mining. Nevertheless, production in both these industries was well above its level of a year ago. The Index for manufacturing industries remained essentially unchanged.

Seasonally adjusted total nonagricultural employment in the five Southwestern states rose to a record level in August and helped to push the unemployment rate down slightly. Both manufacturing and nonmanufacturing employment increased, with employment in durable goods manufacturing and mining showing particularly notable gains. Government employment and employment in service industries also increased in August. Slight employment declines were reported in construction and transportation and public utilities. However, all industry groups posted year-to-year gains.

Total construction contracts awarded in the five Southwestern states were up sharply in August. All major types of construction increased, but residential building continued to provide the primary impetus. The cumulative value of contracts awarded during the first eight months of this year is almost a third higher than in the corresponding period last year.

Department stores in the Eleventh District continue to post good monthly and year-to-year increases in sales. September sales were equally strong in the major metropolitan areas of Texas; however, cumulative figures through September show Houston and Dallas to have the largest sales increases over the corresponding period last year. New car registrations in the four largest metropolitan areas fell slightly in August, as declines in Dallas and Houston more than offset increases in Fort Worth and San Antonio.

District oil allowables for October were again set at their maximum rates. However, District production continues to fall behind domestic demand, and refiners are increasing their reliance on foreign oil. With the traditional year-end pickup in drilling adding to the already strong demand, drilling contractors in East Texas and sections of the Gulf Coast are operating at close to full capacity. Regional drilling equipment manufacturers and sellers are consequently experiencing a surge in new orders.

Agricultural production in the five District states is expected to show marked improvement over output in 1971. A substantial increase in crop production, resulting mainly from the prospect of a bumper cotton crop, is expected to account for virtually all of this output gain. Although livestock production is expected to be slightly below its year-earlier level, the cattle feeding industry continues to grow, with most of the increase occurring in Texas.

With gains in production and improved average prices for both crop and livestock products, cash receipts from farm marketings in the District states rose sharply in the first seven months of this year over the same period in 1971. Even though a recent drop in the spot price of cotton is of major concern to cotton producers, prospects for farm income continue bright.

Total credit at weekly reporting banks in the District rose moderately in September, following a rapid advance in August. Total loans increased more rapidly, however, as commercial and industrial loan demand continued strong. The demand for business loans was especially strong from nondurable goods manufacturers and the construction and service industries. The rate of investment by weekly reporting banks declined from August. Banks also made some adjustments in their portfolios, increasing their holdings of municipal securities and decreasing their holdings of U. S. Government securities.

TWELFTH DISTRICT - SAN FRANCISCO

Recent sales of wheat to Russia and China have created a very favorable situation for growers; with no crop carry-over, good wheat prices are expected to hold next year also.

Retail spending is maintaining its previous rate of advance and is now well ahead of the same period last year. Retailers are optimistic that this trend will continue for the rest of the year. Automobile dealers are very optimistic for sales of the '73 models, although current sales are being held down by slow deliveries. Even in those areas where unemployment remains a problem, consumer spending is described as noticeably stronger.

District bankers report stronger loan demand by business. One large Oregon bank, despite a slight downturn in commercial loans last month, expects further growth over the next few weeks on the basis of the present volume of loan applications. Commercial banks generally report good demand for loans, along with steady growth in deposits. Time-deposit rates have climbed somewhat, and the prime rates of most banks have been raised in accord with national trends. Also, conventional mortgage rates in Southern California are reported to have risen 1/4 percent or higher. Banks are reasonably liquid and are in a position to meet increased loan demand without major increases in interest rates.

Our directors report that economic activity is continuing to register solid gains in most sectors of the Twelfth District. Investment expenditures should rise strongly during the rest of this year and into 1973. Retail sales in most areas are maintaining a steady growth. Construction is holding up well despite certain signs of weakness, and this in turn is contributing to a high demand in the District's forest-products industry. Agriculture similarly has experienced a good crop year.

Against this background of activity, our directors report that investment expenditures are expected to be higher in the rest of this year, and that they will grow further in 1973. In forest products, high demand for housing justifies modernization and expansion of capacity. In aircraft, rising demand for air-transport equipment will stimulate further investment. Pollution control is requiring heavy expenditures; in Washington, for example, one company is planning $22 million in control facilities, and a smelting company will spend $18 million to reduce smoke emissions. General manufacturers in Los Angeles and machinery producers in Oregon are expanding to meet increased consumer demand, expenditures by public utilities to expand capacity will be important in maintaining construction spending. Although some directors again report overbuilding of apartments and office buildings, construction generally shows no serious signs of weakness.

Assisting these higher levels of investment are favorable cash flows and recent tax changes, particularly the investment tax credit. The latter was singled out as a major factor influencing current investment plans in both industry and agriculture.

Our directors (except in Utah) generally expect a sizable and broadly-based rise in investment expenditures. A major California bank forecasts a 14-percent increase in business fixed investment in 1973. Associated with this spending on fixed capital will be a higher rate of inventory accumulation, above the current sluggish pace, through the first half of 1973.

Agriculture has had an excellent year, and the high income received by farmers has led to heavier investment in new equipment and facilities. Many farmers are turning to larger machinery and are also spending to improve their irrigation systems. According to a Washington director, the rising cost of farm labor is another factor generating higher investment. Efforts to reduce labor costs have led to expansion of capacity in hydroponic grown crops, as well as more efforts to mechanize in field crops. Even where there is no expansion, there is at least constant replacement of equipment.