CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

In May, as in April, the 12 Redbook reports paint a picture of an overheated economy that retains strong upward momentum. Concern over inflation and the impact that increases in the cost of living will have on union negotiations is reported by several banks. Shortages of materials and manpower are widespread and are growing worse. Agricultural areas in the Midwest and South have been hard hit by heavy rains and floods. Capital expenditure programs are gathering strength in all districts. Some banks reported views of respondents who believe that real GNP will rise at a slower rate in the second half because of declines in residential construction and in purchases of consumer durables. The business loan increase has slackened in major centers, but credit growth, overall, continues at a rapid pace.

Most banks found capital expenditures gathering strength. A group of Cleveland economists expects gains in capital outlays to continue in 1974, with the year as a whole up 10 percent from 1973. San Francisco found commercial aircraft orders up sharply. Atlanta listed major new projects in a variety of fields. Philadelphia could find no firm that was reducing capital outlays.

Most banks commented on growing stringency in local labor markets. Only Boston was worried about continued high rates of unemployment. In the Chicago district, employment standards have been lowered and training programs have been reactivated.

Shortages of materials and components were emphasized by Boston, Chicago, Richmond, New York, and Minneapolis. Tight supplies of oil

*Prepared at Federal Reserve Bank of Chicago.

products, steel, nonferrous metals, electricity, lumber, and components and shortages of freight cars were holding down increases in output. Cleveland, Richmond, and St. Louis reported that manufacturers' inventories of finished goods were being reduced to meet customer demands.

Consumer purchases remain at very high levels everywhere, but a number of businessmen in the New York and Cleveland districts believed that consumers were buying in advance to beat price increases. Sales of autos and appliances, at least, were thought to be at unsustainable levels.

Gasoline shortages were emphasized by Atlanta, Chicago, and Minneapolis. Dallas reports output of crude oil to be declining despite the elimination of controls. Persian oil has been brought to the Texas area for the first time.

Most banks appear to accept the view that residential construction will decline significantly in the second half. But a number of banks, including Minneapolis, New York, and Atlanta, found that the residential sector remains very strong currently.

The agricultural situation probably has never before received as much space in the Redbook reports. Heavy rains have slowed plantings in the Kansas City, St. Louis, Chicago, Dallas, and Atlanta districts. (San Francisco reports a drought in the Northwest!) Plantings of corn, soybeans, cotton, rice, and sugarcane all are behind schedule. In addition, beef supplies have been held down by losses of cattle, poor gains in weight, and the recent order to stop use of the DES hormone drug that stimulates growth. But farmers are generally optimistic about income prospects. Purchases of farm equipment are at very high levels, and farmland values in the Corn Belt have increased by a record amount in the past year.

Some banks reported slower growth in business loans, but loan growth, overall, continues at a rapid pace. Upward pressures on short-term interest rates continue. Funds for farm, consumer, and residential mortgage loans remain in good supply. One Boston professor expects continued strength in activity because of rising capital expenditures, while another expects slower growth because of reduced consumer demands. Both professors think the situation calls for a tighter monetary policy.

TABLE OF CONTENTS

FIRST DISTRICT--BOSTON

Our directors stress both that new orders are very strong and that there are difficulties in getting supplies because of the overheated economy. Industrial price increases are seen as reflecting a demand-pull overheating in those sectors of the economy outside of Phase III controls. Despite buoyancy in some sectors due to the national recovery, unemployment rates in New England averaged 6.2 percent, seasonally adjusted, in February.

The prime growth area is currently industrial capital goods. The machine tool industry is doing very well. The long lead times involved in this industry and the high orders and backlog levels ensure continued strong activity in 1974. One large conglomerate manufacturer notes that despite heavy orders, inventory levels have risen only about 7 percent over the last year.

Consumer durable manufacturers indicate excellent business, but there is some concern that the gloom in the stock market will affect buying in 1974.

A bank director from a large Boston bank reports that money is not as tight as it was a month ago and loans have been lower than projections since early April. This director felt that the 7 percent prime rate simply represented a catch-up and that the prime should be 7 1/4-7 1/2 percent. He did not foresee a credit crunch because he felt that there were plenty of long-term funds around. A director associated with an insurance company also expressed the opinion that there was a large amount of investment funds available, and that this would moderate increases in long-term rates.

The unemployment picture in New England is not improving at the same pace as nationally. In 1972, of the seven states with the highest unemployment rates, three were in New England. In Connecticut, the unemployment rate in March fell to 5 1/2 percent, but this was due to declines in the labor force which are not expected to be permanent. In Massachusetts, the unemployment rate in February was 6.7 percent, seasonally adjusted, and the unemployment rate in Boston, which has been rising for over a year, is 6.4 percent, up from 5.8 percent a year ago.

Of our regular academic correspondents, only Professors Samuelson and Eckstein were available for comment this month. Noting the strong first quarter and citing the very strong McGraw-Hill survey results, Samuelson expressed considerable skepticism about the consensus forecast of subpotential real growth by the fourth quarter. All of the risk lies on the upside. Thus, he explicitly rejected a policy of easing off now "as a prudent way of forestalling a mini-recession." Nevertheless, in light of the unanimity of the view that a significant slowdown in real growth will occur, and the view of some that there will be a recession in 1974, Samuelson suggested a moderation in the degree of tightness. In contrast to last month's recommendation of a monetary growth rate of less than 3 percent for the next two months, he advocated a rate of 4 percent for the next two months. He added that short rates should be permitted to rise and that the FOMC should remain ready to go back to a tighter policy should the signs of weakness not materialize. As a supplement to monetary restraint, he suggested serious consideration of direct qualitative controls on instalment sales credit. He also believed that some squeezing of the housing sector "would not be bad," and expressed the hope that monetary tightness would not be largely offset by FNMA and GNMA.

Professor Eckstein states unequivocably that "this cycle is at its top; it's just a question of how it will turn down." The downturn will center in the housing sector and in auto sales. By year-end, auto sales will be down to 11 million units and housing starts to 2 million. Eckstein argues the housing starts figures have been held up by unseasonably good weather in the north central and northeast areas; he feels there is now a glut of new single-family homes as attested by the high level of the stock which is unsold. He feels there is mounting risk of a credit crunch, and in fact suggested we may be two months into a crunch. Here he points to the outflows of funds from savings institutions and to the high volume of long-term commitments by life insurance companies. Life insurance companies report they are now as vulnerable as they were in 1966, i.e., more vulnerable than in 1969. Eckstein grants that the price outlook is "murky," but argues it is not primarily a matter of generalized excess U. S. aggregate demand since much is attributable to the worldwide boom. Eckstein finds no way to justify a restrictive policy at present. Policy actions must be based on some forecast, so that policymakers must either accept the unanimous forecast that the economy will slow, or base their policy on a pure guess. For the near term, Eckstein would focus attention on interest rates, where he feels to permit the federal funds rate to rise to 8 percent for a week or more would be "a colossal error."

SECOND DISTRICT--NEW YORK

According to Second District directors and other business leaders contacted recently, consumer spending continues strong, in part stimulated by expectations of higher prices. Residential construction also remains at a high level, on balance, although signs of tapering off have emerged. Shortages of raw materials, of energy, and of some semi-finished and finished products appear to be growing. The further recent devaluation of the dollar, combined with the previous devaluation, in general was expected to bring about an improvement in the country's international trade balance.

Most respondents reported continued strength in consumer spending despite increased consumer uncertainties regarding the economic outlook, notably a growing concern over inflation. It was the consensus of the Buffalo branch directors that the deterioration in consumer confidence had in fact been reflected in a "rather broad-based" increase in retail sales, which some of the directors viewed as an attempt by consumers to "beat" anticipated price increases. In the case of automobiles, the desire to avoid paying for the additional safety and pollution-control devices mandated for 1974 was noted as a factor pushing up current sales. The president of a large nationwide chain of retail outlets stated that despite surveys showing a decline in consumer confidence, retail sales continue very strong, with sales of durable goods leading the way. And the president of a chain of department stores in the New York City area similarly reported a good demand for durable goods, which he also linked to a desire to avoid paying anticipated higher prices. This respondent, however, felt that in general the pickup in business on the East Coast was lagging behind the national performance.

The respondents in general continued to find the homebuilding picture strong although a number saw some evidence of a tapering off. A Rochester banker, who reported construction in his area was still booming, said that there has been a significant shift from apartment building to condominium and town house construction, and that construction of single-family residences was proceeding at an active, but more selective pace. The chairman of the board of a multinational oil corporation and the president of a large nonferrous metal-producing corporation both reported they saw no evidence of a cutback in residential construction. A senior official of a large Rochester multinational firm, however, reported some decline in residential building, characterizing last year's national high housing start rate as "not sustainable." Another director felt that the housing boom gave indication of tapering off. In regard to nonresidential construction, an upstate banker mentioned the high level of commercial construction that was still related to the rebuilding of businesses destroyed by Hurricane Agnes last June. However, a New Jersey banker reported a glut of office space in his area, while the president of a New York City real estate firm reported that at least 20 million square feet of commercial and industrial building space was currently vacant in the city.

As in recent previous months, the respondents referred to a growing list of shortages of certain resources. The official of the Rochester multinational firm stated that raw material shortages were widespread, including such items as wood products, coal tar derivatives, and other products. A Buffalo manufacturer expressed concern that a period of tight supply was imminent, as evidenced by the fact that his firm was being confronted with 20- to 30-week lead times for many raw material items. A New Jersey banker reported inventories of firms in his area to be low, with six- to eight-month delivery times for new orders. The owner of a large upstate agricultural enterprise mentioned a shortage of protein in all forms, which was increasing the cost of feed items for poultry and livestock. A number of respondents commented on the petroleum products shortage. According to the chairman of the international oil company, worldwide supplies of crude oil remain tight, and U. S. production of fuel oil has peaked and is expected to decline. The recent relaxing of oil import restrictions should help, but he felt that environmental controls were hindering domestic output. Similar sentiments were expressed by a senior official of a firm producing a wide variety of petroleum products. The president of the nonferrous metals producer noted that power shortages in certain areas were adversely affecting aluminum output.

The dollar devaluation was viewed as likely to improve this country's international trade position, both on the import and export side. True, the higher dollar costs of oil and nonferrous metal imports were cited as adverse factors. The New Jersey banker, however, said that export sales have increased substantially--although he felt it was difficult to estimate the extent of the basic improvement due to price increases and sales to Russia and China. The Buffalo branch directors generally agreed that the exchange rate realignments would have a "positive" impact on our trade balance. One director specifically mentioned that a Rochester machine tool firm, which exports about 70 percent of its output, now expects its overall sales to increase substantially. On the import side, the president of the large nationwide chain of retail outlets expected the devaluation to slow the growth in the dollar amount of imports of his firm. He stated that in terms of cost, the balance had now been swung in favor of certain domestic goods, for example, some types of consumer electronics. Also, a Buffalo director felt the devaluations have made it easier for this country's automobile industry to compete with imported cars. He also noted that the domestic shortages noted above in part reflected a switch by many buyers from foreign to domestic sources.

THIRD DISTRICT--PHILADELPHIA

General business conditions remain favorable in the Third District. Production activity is maintaining strength and is expected to keep on its present upward course. Employment opportunities are holding fairly steady this month but are expected to increase as production continues to rise. Inventory investment is stable at present levels, while increases in capital expenditures are planned at many firms. Bankers cite rapid growth of consumer loans as a bright spot in otherwise flat loan demand. Deposit levels remain unchanged at most banks. On the dark side, however, inflationary expectations remain high.

Continued strength is evident in production activity. Forty-seven percent of the respondents to this month's Business Outlook Survey of Manufacturers in the Third District report increases in their sales; 59 percent report increased shipments. Only a small minority of the local manufacturers are currently experiencing production cutbacks. On the six-month horizon, the increases are expected to continue, with over 40 percent of the respondents anticipating both increased sales and shipments. Employment in the Third District is generally holding steady. Over 70 percent of the firms surveyed report no change in their number of employees, and almost 80 percent said that their average workweek had not changed. Looking ahead, anticipated production increases in the months ahead are prompting a small but increasing minority of firms to plan increases in the average workweek.

Capital expenditures plans remain steady at last month's reported high level; over 40 percent of the firms contacted expect to increase outlays. No respondents intended to cut back plant and equipment spending.

Half of the area respondents are holding current inventory investment levels constant and anticipate no changes in the coming months. The remaining businessmen are equally divided between increasing and decreasing inventory for both the current month and six months from now.

Upward price pressures continue high, with virtually no relief expected by local businesses. Over two-thirds of the respondent firms cite increased raw materials costs. The majority reported no change from last month in the prices they charge. But during the next six months, over 65 percent of the firms contacted fear rises in both the prices they pay and prices they charge.

Area bankers report that overall loan demand continues near the same levels as in past months. Consumer loans are mentioned as the fastest growing category in the past month by several Philadelphia banks. Business loans and real estate loans are flat at the banks which were contacted. But business loan demand for plant and equipment spending is expected to increase in future months according to several bankers. Deposits at most banks are about flat. Checking accounts, low interest savings accounts, and other deposit categories which are not sensitive to interest rates are reported holding steady at most banks. But time deposits paying Regulation Q interest ceilings are being closed out to purchase U. S. Government bonds at some places. One banker said this disintermediation is not yet a real problem because loan demand is currently steady. However, he said strong loan demand would tighten credit rapidly and cause a credit crunch.

FOURTH DISTRICT--CLEVELAND

The consensus of about 40 economists--primarily from major industrial firms and commercial banks in the district--who attended the Fourth District economists round table meeting at the bank on May 4 is that both the rate of real growth and the rate of inflation will moderate beginning in the current quarter. The economists project real growth to be less than 4 percent during the second half of 1973 and the rate of inflation to average about 4 percent. Looking ahead to 1974, there was general agreement that there would be sufficient strength in capital spending to prevent an outright recession, although the consumer and housing sectors would weaken.

The median forecast of the economists indicates gains in GNP of $29 billion, $24 billion, and $23 billion during the second, third, and fourth quarters, respectively (and a GNP of $1,275 billion for the year). The projected slowdown in economic activity is based largely on the expectation of progressively smaller gains in personal consumption. Most of the economists hold the view that part of the exuberance in consumer spending during the first quarter reflected buying in anticipation of higher prices--particularly for autos, but for other durable goods as well--and therefore represented some borrowing against future quarters. Other factors suggesting a retrenchment in consumer spending include the waning impact of income tax refunds, a slowdown in real spendable earnings, the recent explosive rise of instalment credit which is increasing the burden of debt repayment, large stocks of durable goods in the hands of consumers, and the dramatic deterioration in consumer confidence that has occurred in the past few months. There was unanimity among eight economists whose firms depend heavily on the auto market that new car sales, both foreign and domestic, would decline during the second half. The median forecast for the year calls for total sales of 11.3 million units, compared with a rate in excess of 12 million units thus far this year. A projected decline in residential construction during the second half is expected to contribute to a slowdown in sales of appliances and household furnishings.

The business economists were conservative with regard to prospects for inventory investment; the median forecast calls for the change in business inventories to reach a $12 billion rate by the third quarter, and then level off. Economists from the steel industry reported that steel users have been accumulating inventories of steel products in recent months, but that some liquidation would occur during the second half in response to the projected slowdown in consumer durables.

Gains in nonresidential fixed investment are projected to slow somewhat during the remainder of the year. Current high operating rates in certain industries could begin to constrain the rise in plant and equipment spending. Although the economists discussed some negative factors in the investment outlook for this year and next (such as proposals to eliminate the investment tax credit, belief that monetary policy would remain tight through mid-1974, and poor prospects for equity markets which may adversely affect investment decisions), there was general agreement that the capital spending boom would continue throughout 1974. Recent environmental legislation and the Administration's energy policies should have a positive effect on manufacturers of pollution-control equipment and on domestic investment in the petroleum industry, and gas and electric utilities. (Economists with the rubber and steel industries, for example, noted that outlays for pollution-control equipment would absorb roughly one-quarter of capital spending in their industries next year.) The business economists projected a gain in capital spending on the order of 10 percent for 1974. (One of our industrialist-directors informed us that orders for machine tools produced by his firm are strong, but that some traditional big buyers--autos, steel-users, and firms producing equipment for public utilities--are not buying heavily. They appear to be keeping a strong hand on purchases of new equipment in view of their concern over the economy in 1974.)

At the round table meeting, a number of economists spoke of a "Growth Recession" in 1974, but nobody forecast a classical recession. Median estimates of 21 economists submitting forecasts for 1974 showed real growth of 3.6 percent, a price rise of 3.8 percent, and an average unemployment rate of 4.8 percent.

A staff member from the CEA also attended the meeting and told the group confidentially that, whereas six weeks ago the council was forecasting close to a zero rate of increase in retail food prices by year-end, recent adverse developments have caused him to expect a 3 to 5 percent rate of increase by year-end.

FIFTH DISTRICT--RICHMOND

Results of our most recent survey of district businessmen and bankers show further advances in business activity during the past month. A majority of the manufacturing respondents reported increases in shipments, backlogs, and new orders. Inventory levels declined and are at somewhat lower-than-desired levels given current sales prospects. Loan demand continues at a very high level. In particular, banks appear to be experiencing a brisk demand for business loans. Survey results and other contacts with district businessmen indicate that a high level of optimism concerning the economic outlook prevails.

Responses from manufacturers indicate that the district economy continues to advance at the robust pace evident in recent months. Substantial gains in shipments, new orders, and backlogs were reported by survey respondents. The level of optimism among manufacturing respondents concerning the general economic outlook appears to be quite high.

Manufacturing inventory levels reportedly declined further since the last survey, and for the first time in several months inventories were reported to be at somewhat lower-than-desired levels. Retail respondents indicated that inventory levels were in line with sales prospects. Most manufacturing respondents believe that current plant and equipment capacity is inadequate in view of sales prospects.

The level of employment in the district continued at recent high levels, with a slight increase over last month. Reports from most areas of the district indicate that the labor situation remains very tight. Both trade and service and manufacturing respondents reported an increase in hours worked per week. New plants locating in the district continue to be a major factor providing employment. In Virginia, for example, plans for 28 new plants employing a total of approximately 3,000 people were announced during the first quarter of 1973. Labor unrest and stricter federal health and safety requirements have adversely affected employment and output in district coal mining. Wage and price increases were widespread, with more than one-third of manufacturing and trade and service respondents reporting increases.

Respondents from all areas of the district reported increases in retail sales. More than 50 percent of the banking respondents indicated that retail sales had increased in their areas, and all retail respondents indicated that sales were up.

Business and consumer loan demand is especially strong in the district, with more than one-half of the banking respondents reporting increases in these items. Increases in the demand for mortgage loans were also reported, but the demand for this type of loan does not appear to be as strong as that for business and consumer loans. Even so, more than one-third of the banking respondents reported that residential construction had increased in their areas. Activity in nonresidential construction also remains brisk.

Farm real estate values per acre jumped 12 percent during the year ending November 1, 1972, scoring the sharpest advance since 1951. Higher farm prices and delayed marketings of many 1972 crops combined to bring about a 25 percent increase in January-February cash receipts from farm marketings.

Businessmen and bankers remain optimistic about the general economic outlook. More than one-half of the banking respondents expect improvement in business conditions in their areas in the next two or three months.

SIXTH DISTRICT--ATLANTA

General economic activity is expanding rapidly, and businessmen are optimistic about the near-term outlook. A pickup in planned commercial construction and plant and equipment outlays continues. Adverse weather conditions have caused severe damage to some crops and have hindered planting.

The outlook for commercial construction continues to improve. Still another huge project has been proposed for downtown Atlanta. The $150 million project would include high-rise residential and commercial buildings and a 1,000-room hotel. Other recent announcements include: a $70 million commercial and residential complex in Nashville; a $25 million residential and commercial complex in Macon, Georgia; a $12 million civic center in Huntsville; a $10 million office tower and parking garage complex in Chattanooga; a $10 million naval training complex in Meridian, Mississippi; a 25-story hotel in Nashville; a 14-story hotel in an Atlanta office park; a $4 million bank building in Montgomery; three new shopping centers in middle Tennessee; and two $1 million motels and a $1 million shopping center in east Alabama.

The growth of residential construction may be slowing, but activity is at a very high level. A $100 million planned unit development is slated for the Miami area. A $2.5 million apartment complex is planned for east Alabama, and a $2 million apartment complex is planned for Jackson, Mississippi. In spite of a 63 percent gain in residential building permits in the Jackson area in 1972, interest in constructing additional units in that area is still reported to be strong. A Louisiana businessman reports that factory production of building materials such as cement and brick are up, and that the demand for lumber is causing some producers to plan new mills and expand existing ones.

There continues to be a large number of announcements of plans for new plants or expansions. The breadth of the recent announcements is indicated by the following list of projects: a new $50 million paper mill for north Alabama; $50 million in expansions of existing paper mills in north Alabama; an $18 million airplane maintenance facility in Atlanta; an $11 million plywood mill in north Alabama; a $10 million plywood plant in south Georgia; a $10 million soybean-processing plant in central Alabama; a $5 million expansion of a filter production plant in east Tennessee; a plant to make aluminum castings in Mobile, Alabama; a $4 million shipping container plant in Jackson; a $3.2 million expansion of an electrical equipment plant in Atlanta; a $2.3 million carpet finishing plant in north Georgia; and a $1.6 million plant that will manufacture components for automatic transmissions in central Alabama. A chemical firm has purchased an option to buy 1,500 acres on the Georgia coast as a site for a plant that would eventually employ 600. A vacant manufacturing facility in Alabama, purchased by a nationally known firm, will eventually employ 750 after conversion. Two companies are reportedly considering locating oil refineries in Lake Charles, Louisiana. Several large electrical generating plants have also been announced in the last month.

The strength of the district economy is reflected in state revenue collections. Florida sales tax collections in March were 16 percent above a year earlier, and Tennessee collections in the first three months of 1973 were 15 percent above a year ago. In the first ten months of fiscal 1973, Georgia's tax collections were running 14 percent above a year earlier.

Gasoline shortages have plagued independent retailers in Georgia; Sears stores in the Atlanta area have begun limiting sales to ten gallons per customer and have reduced the hours that pumps are open. The metropolitan Atlanta rapid transit authority has finally succeeded in obtaining a one-year fuel contract, but at increased cost. Fuel shortages are also reported to be responsible for reductions in fertilizer production.

Adverse weather conditions have caused severe damage to crops and hindered planting. Heavy rains and flooding severely reduced rice planting in Louisiana and will also reduce cotton, soybean, and sugarcane production in that state. Flood waters have also contaminated Gulf Coast oyster beds and forced the closing of hundreds of gas and oil wells. Weather conditions have destroyed one-half of Georgia's peach crop and one-third of its apple crop. Heavy rains in south Georgia have severely damaged corn and tobacco in some areas and have hindered the harvesting of pulpwood.

SEVENTH DISTRICT--CHICAGO

Virtually all sectors in the Seventh District are continuing to report rapid gains in orders, output, employment, sales, and profits. In many cases, these increases have been well above earlier projections that had been deemed optimistic. Many businessmen view the strength of demand as excessive and unhealthy. Output would be higher in a wide variety of hard and soft goods lines were it not for capacity and manpower limitations. Although meat prices have edged down, almost all other prices are rising and are expected to rise further. Capital expenditure plans are being revised upward. Some observers expect a slowing in economic growth in the second half, but these views are not generally supported by information on shipments and orders. Field conditions have slowed plantings to a marked degree. Business loan growth has eased significantly, but, overall, demand for credit remains very strong.

Two exceptions to the extremely robust picture are motor home output and airline traffic. The largest producer of motor homes (in Iowa) has cut production sharply because sales, although substantially above last year, have been below expectations. (This development is not to be confused with the situation in mobile homes where, in contrast to weakness expected by some analysts, shipments have been far above last year's record.) A major airline finds that growth in traffic this year has only been about half as great as the 10 percent year-to-year rise expected earlier.

Demand for labor continued to rise throughout the district,and labor shortages are reported almost everywhere--even in Detroit. Some firms have reopened training centers shut down in 1969 or 1970. In many factories, average weekly hours are about as long as can be scheduled effectively. Absenteeism and turnover have increased. Hiring standards have been lowered. New hires of many large firms include a large proportion of veterans, minority types, and women in an attempt to fill prescribed quotas ("quantified objectives").

Union demands are expected to go far beyond the guidelines in most negotiations. Six months ago, union leaders were telling truck drivers that little, if any, basic wage boost would be sought. Current demands are for an 8 percent rise in wages and a variety of other items that are said to add up to a 20 percent first-year boost. Steel industry executives appear to believe that the arbitration agreement will permit a settlement in 1974 without a strike or an inventory buildup, but this may simply mean that steel will follow the pattern set in the auto industry without a fight.

Responding to a special question, 40 percent of Milwaukee purchasing managers said recently that material shortages will severely reduce ability to produce by midsummer. The most serious problems involve fuel, electricity, steel, castings, fasteners, and wood. In all areas, buyers continue to report lengthening lead times, and in recent months they have noted a sharp deterioration in overall vendor reliability and in quality of items received. Almost all are paying higher prices each month for some major items.

The gasoline and fuel oil supply problem has worsened with supplies curtailed or shut off to independent dealers and distributors. State governors are calling for emergency measures to meet farm needs.

Lead times on all types of steel have lengthened further, and new orders for hot and cold rolled sheet are now scheduled for delivery in August and September. A Chicago-area mill that expects to operate at capacity through the year is attempting to arrange vacations to reduce the summer decline in output. There is no way to increase steel output in the near future because of limitations of basic facilities, especially slabbing mills. Steel users appear to be building inventories, while mills have reduced their holdings of finished and intermediate products.

Orders for most types of capital equipment are running 25-50 percent above last year's improved level. Orders would be even higher if all orders were accepted. Freight car shortages are widespread, and orders for new cars at last are rising significantly. Sales of all types of farm equipment are excellent and some types, especially large tractors, are in short supply. The motor vehicle industry, both autos and trucks, is operating at capacity. Expansion plans are being pushed, but availability of various components will limit output for some time to come. All major foreign markets for capital equipment are now vigorous again.

A recent survey by this bank shows that district farmland values rose nearly 6 percent during the first quarter and are up 11 percent from a year ago--the largest gains registered since this survey started in 1958. Farm mortgage loans are readily available. District rural banks are meeting strong loan demand from farm borrowers, especially for capital investments.

As of late April, only 35 percent of the corn and soybean acreage in Illinois had been plowed, as opposed to 78 percent a year ago and 95 percent in 1971. While these conditions could improve rapidly with drier weather, delayed plantings typically result in lower yields. Fuel, seed, and fertilizer continue in short supply. With more acreage to be planted, needs will be especially large. Many Midwest observers anticipate little further decline in livestock prices this year. Bad weather has boosted feed prices, and losses of calves, poor weight gains, and the banning of DES will hold down meat supplies.

EIGHTH DISTRICT--ST. LOUIS

Business activity continued to expand vigorously in April according to a group of businessmen in the Eighth District. The sharp uptrend in retail sales established in the first quarter of the year continued. Manufacturing activity maintained a high rate of expansion, and manufacturing inventories at current prices are declining as a result of strong demand. Construction activity on a seasonally adjusted basis was generally unchanged at the relatively high level of recent months. Employment continued to inch up. Farming operations are lagging behind their normal seasonal pattern because of excessive rainfall and flooding, but income prospects for farmers remain good except for the relatively small number who may not be able to plant crops because of flood water. Inflation remains a major worry among businessmen.

Retail sales at major department stores in the Eighth District rose sharply from March to April on a seasonally adjusted basis. Some of the inner-city stores in St. Louis had month-to-month sales gains in April for the first time in several years.

Most lines of manufacturing activity have continued to gain momentum in recent weeks. Among those manufacturers in the Eighth District reporting gains in output and orders were producers of steel, aluminum, paint and coatings, clothing, machine tools, and synthetic fibers. Some firms reported that the pace of shipping cannot be maintained at current levels as inventories are being pulled down to meet orders. A representative of the synthetic fiber business reported that fiber demand is "unrealistically" high.

Lack of capacity is a common complaint, and, in response, a strong upward movement in capital spending is apparently under way.

Those firms interviewed reported further moderate increases in employment and "tighter" labor markets than earlier in the year. Most representatives reported that both skilled and unskilled workers were in very short supply and that those workers who can be hired at current wage rates are less efficient than their current employees.

Extremely wet weather and floods have retarded farming operations over most of the central Mississippi Valley. The situation is not yet serious except for those individual farms that are under water and are likely to remain flooded for several more weeks. If the rains continue for another week, it could become critical for the 1973 corn and cotton crops, as further delays in land preparation and planting could lead to a reduction in output. Significant freezing damage has occurred in a number of apple and peach orchards in the district, but the impact on national output is difficult to assess at the moment. Farmers, however, remain optimistic about their 1973 income prospects. Livestock and livestock products are being sold at profitable prices, and the outlook is for relatively high prices for the current year's crop.

Inflation remains one of the major concerns of businessmen in the district. They invariably reported "excessive" demand at current prices for both final product and productive resources. Typical comments were "inflation is getting worse," "the price increases are alarming," "the FPC is causing or contributing to the 'energy crises' because they suppress incentive to explore for gas and the prices of alternative sources will be higher," and "buildings are being revalued for insurance purposes by 20 percent due to rising costs."

The quantity of credit demanded continued to expand faster than the supply of loan funds at current interest rates. Banks, savings and loan associations, and insurance companies all reported a strong loan demand. Consequently, interest rates on all types of credit instruments and with all maturities are apparently rising.

NINTH DISTRICT--MINNEAPOLIS

Bank directors expressed dissatisfaction with Phase III, but their views varied on how to contend with the economy's current inflationary pressures. Gasoline rationing has begun in the district, and businessmen fear fuel shortages could hamper district economic activity. Although some overbuilding exists in the Minneapolis/St. Paul metropolitan area, bank directors generally indicated that in their areas the outlook for residential and nonresidential construction was favorable. District agricultural loan demand was strong in the first quarter and is expected to remain vigorous in the second quarter.

Bank directors expressed various views on how to control the inflationary pressures currently confronting the economy. Several directors advocated eliminating the investment tax credit, while others favored retaining it. A variable investment tax credit, which could be adjusted in response to changing business conditions, was favored by some directors. A South Dakota director indicated that his area's farm implement dealers would oppose eliminating the investment tax credit which has significantly boosted their business. Another opinion was that abolishing the investment tax credit would not dampen consumer demand and would have a delayed effect on the economy. Bank directors felt that an increase in the personal income tax was not politically feasible, and one indicated that his area's businessmen believed increased taxes would only result in increased government spending. A cutback in government expenditures was advocated by several directors, and one director spoke out for tighter monetary policy. Allowing interest rates to reach their own level, one director stated, would help dampen economic activity. Directors generally felt Phase III had not been effective and favored firmer controls. Although one director welcomed the Administration's recent move to strengthen Phase III, he felt it may not be sufficient to curb inflationary pressures.

Although no director reported any disruption in business activity due to fuel shortages, businessmen are concerned about a lack of gasoline dampening district economic activity. Two major oil companies have begun rationing gasoline at the retail level in Minnesota, and in March 104 Minnesota independent gasoline stations were forced to close because of gasoline shortages. Also, two oil companies plan to stop servicing Minnesota customers. Furthermore, several large Minnesota fuel users have reported difficulties obtaining fuel supplies, and Minnesota's state civil defense department estimated that Minnesota's gasoline supplies may be about 10 percent short of anticipated needs by the end of 1973. Another director reported gasoline rationing in South Dakota and indicated dealers were taking steps to prohibit gasoline hoarding. Also, dealers have stopped giving trade discounts which has noticeably increased fuel costs. A North Dakota director disclosed concern over fuel shortages in his state and revealed his firm recently had trouble purchasing diesel fuel. Directors from Minnesota, North Dakota, and South Dakota indicated gasoline shortages could curb their areas' tourist business this summer. Montana directors and a director from the upper peninsula of Michigan, on the other hand, revealed that gasoline shortages are not yet a problem in their areas.

With the exception of the Minneapolis/St. Paul metropolitan area and Duluth, the outlook for residential and nonresidential construction in the district is quite favorable. In the Minneapolis/St. Paul area, overbuilding exists in both residential and nonresidential markets. Single-family construction, however, has remained quite strong but could be curtailed by rising prices. Two directors located on the fringe of the Minneapolis/St. Paul metropolitan area indicated strong construction activity in their areas. In Duluth, a director disclosed a lack of new construction projects, and some construction material shortages. A Montana director reported strong construction activity throughout his state but indicated that the Administration's impounding of highway funds has hurt highway construction. Many directors indicated that rising prices had not discouraged new home purchases, but one director revealed that his area's residents were turning to prefabricated homes in order to hold down new home prices.

Our second-quarter Agricultural Credit Conditions Survey showed that the demand for farm loans increased substantially during the first quarter and is expected to remain strong in the second quarter. Stronger first-quarter loan demand was due to greater spending by farmers and to difficulties in selling wheat in currently clogged marketing channels. An inability to market wheat postponed income and forced farmers to borrow to meet current operating expenses. Greater spending was primarily associated with this year's planned increased crop plantings and a general expansion in farm operations. District farmers' outlays for machinery, land, and cattle were up noticeably. Higher prices for cattle, fertilizer, seed, and equipment also raised agricultural borrowing this spring. Survey respondents look for these same factors to result in strong second-quarter agricultural loan demand, especially as some items, such as fuel and fertilizer, become increasingly costly.

TENTH DISTRICT--KANSAS CITY

The present state of the economy is very strong, and the outlook for the remainder of the year is for continued strength, according to a number of the home office and branch directors of the Kansas City Federal Reserve Bank. However, these opinions were tempered by concern over recent price behavior and the prospects for further price inflation and excessive wage demands during the course of this year. Expectations of a temporary dip in meat animal prices (reported in the April Redbook) were corroborated by the most recent farm price report, but severe weather resulting in heavy losses of cattle and calves and substantial impairment to weight gains, as well as the recent banning of "DES," may further aggravate the rise in future feed costs. District banks continued to report heavy business loan demand in April. They expect loan demand to remain strong over the next three months, with commensurate upward pressure on loan rates.

Telephone interviews with a number of Tenth District nonbank directors of the home office and its three branches elicited a general consensus as to the present and expected future strength of the economy. Despite their generally optimistic views, however, a number of the directors expressed concern over present and expected inflation, particularly insofar as it would affect the terms of settlement of future collective bargaining agreements. At the same time, expressions of concern were voiced as to the longevity of the present boom beyond this year, given the rapid pace of present activity, and given what a number of directors viewed as a general uneasiness on the part of the public which might impair consumer confidence. Thus, while present signs in the district, particularly the strength of the agricultural sector, all tend to encourage optimism regarding the outlook, the directors were almost unanimous in tempering their optimism in looking much beyond the end of this year.

Farm prices dropped 1.5 percent during the month ended April 15, the first decline in 12 months. But prices still averaged nearly one-third higher than a year ago. More recently, meat animal prices, which led the downturn last month, have been steady to weak, while grain prices have been generally stronger. Smaller-than-anticipated grain stocks as of April 1 and continued uncertainty about spring planting have sparked a new round of speculation in the grain markets. Weather conditions within the district appear to be somewhat more conducive for field work than in many other regions. Some planting has occurred, and with favorable weather the prospects are reasonably good that most crops will be planted on a timely schedule. The wheat crop reportedly is in excellent condition, particularly in Kansas where a record harvest is expected.

The weather, however, continues to plague the livestock industry. An April snowstorm resulted in heavy losses of cattle and calves in localized areas of the district. A recent survey of five counties in southeast Colorado showed death losses this winter of 40,000 head, of which more than one-half were young calves. When compared to the January 1 inventory, however, this represents a loss rate of less than 2 percent. More serious is the effect that the adverse weather has had on weight gains. Rates of gain have been reduced significantly in many feedlots, and the recent banning of "DES" will probably further aggravate the rise in costs as well as the slowdown in beef supplies. However, while death losses and slow gains may seriously impinge on individual producers, there may be a tendency to overestimate the effect on total meat supplies in the United States.

District banks continued to report heavy business loan demand during April. Reflecting this demand, and in accordance with the guidelines announced by the committee on interest and dividends for the dual prime rate, all survey banks joined with the nation's larger banks in raising their prime rate to 6 3/4 percent.

Moreover, with current business loan demand being exceptionally strong, most bankers felt that the prime rate would more than likely rise to 7 percent in the next few weeks. District bankers also expected loan demand to remain strong over the next three months, thereby resulting in continued upward pressure on bank loan rates. Because deposit growth had not kept pace with loan demand, most banks contacted were relying heavily on borrowings from the Federal Reserve banks, purchases of federal funds, and sales of CDs to supply additional loanable funds. A few banks also had permitted investments to decline to levels where most of their remaining securities were pledged to match public funds.

ELEVENTH DISTRICT--DALLAS

The economy of the Eleventh District continues to expand at a fairly rapid pace. Although industrial production in Texas fell slightly in March, employment in the five district states continued to rise. Construction activity rebounded sharply in March, and new automobile registrations increased substantially. Sales of district department stores continued to advance in April. Furthermore, a recent survey of business economists in district states revealed them to be quite optimistic about economic conditions in the second half of 1973.

Our respondents generally expected economic activity in the second half of 1973 to be higher for their states than for the nation as a whole. They were particularly optimistic about the prospects for consumer spending and plant and equipment investment. They also felt that inventory investment would continue strong.

In line with this general optimism, the majority of the respondents expected further employment gains in the second half of the year. Most expected growth in employment to be greater in the district than in the nation. The respondents anticipated particularly strong employment advances in the retail trade and service industries, and in state and local government. Despite the outlook for rising employment, less than half saw the unemployment rate declining significantly.

Most of the respondents viewed prospects for corporate profits in the second half of 1973 to be about the same as in the first half. And although there were wide differences of opinion among the respondents, the majority felt that consumer prices would rise at least as fast in the second half of the year as in the first half. Consequently, there was unanimous agreement that there would be a continuation of wage-price controls throughout 1973, and a number of respondents expected some further strengthening in the controls program.

The seasonally adjusted Texas industrial production index eased slightly in March, receding from its record February level. Output in both the manufacturing and mining sectors declined slightly, while utilities rose. In manufacturing, durable goods production continued to rise mainly as a result of increases in fabricated metal products, furniture and fixtures, and lumber and wood products. Nondurable goods output fell in March due primarily to decreases in food and food products, apparel, and paper and paper products. Mining also fell as declines in crude petroleum and natural gas production more than offset small increases in the mining of metal, stone, and earth minerals and natural gas liquids. Utilities increased in March as both electricity and gas distribution surpassed February levels.

Although state oil regulatory agencies continue to permit maximum production consistent with conservation limitations, district oil-producing states are still pressed to meet all demands for their oil and gas. As buyers have not been able to find all of the domestic crude they need, some refineries have had to operate at less than full capacity. To fill part of the supply gap, Persian Gulf oil was imported into Texas and, for the first time, piped inland to be refined.

Seasonally adjusted total employment in the five district states rose in March for the ninth consecutive month. Nevertheless, the monthly increase in the labor force outpaced the employment growth, and the unemployment rate edged up to 3.7 percent from 3.6 percent in

February. Both manufacturing and nonmanufacturing employment rose in March as significant increases were reported in finance, construction, transportation and public utilities, and government services. Mining was the only industry group to show a decline. All industries reported year-to-year employment gains.

The value of construction contracts awarded in the five district states rose sharply in March after falling slightly in February. While all three major types of construction increased, nonresidential building showed the largest gain, reaching a record high. The cumulative value of contracts awarded through March of this year reached a level over 17 percent higher than the corresponding period last year.

Sales of department stores in the district continued to rise above year-ago levels in April. Cumulative sales for the first four months of the year were significantly above the level for the corresponding period last year in all five metropolitan areas for which data are regularly published. The total number of new automobile registrations for the four largest metropolitan areas of Texas--Dallas, Fort Worth, Houston, and San Antonio--rose sharply in March over February's level, as Houston and San Antonio reported increases of more than 40 percent. Cumulative new car registrations through March were over one-fifth higher than in 1972.

Weather continues to slow all agricultural activities in the Eleventh District. Field preparation and planting activities have been severely limited and the situation is becoming critical. Cotton planting is barely under way in Texas and Louisiana, a situation much different from this time last year, when about one-third of the planting in these two states had been completed. Soybean, sorghum, and rice plantings are also lagging. Widespread livestock losses due to the severe weather have also been reported, and Arizona has had numerous losses from poisonous weeds. However, the number of cattle and calves on feed in the four western states on April 1 was still nearly one-fifth larger than a year ago.

TWELFTH DISTRICT--SAN FRANCISCO

Economic expansion throughout the Twelfth District continues to be paced by consumer spending and business fixed investment. Strong demand is keeping production near capacity in most industries, but investment expenditures appear to be directed more toward modernization of existing equipment than toward construction of new plants. In some cases, such as forest products, new capacity is not being added because of an expected turndown in demand later this year. Banks report strong loan demand and upward pressure on interest rates.

Consumer spending is maintaining the high levels established in the first quarter, but a few directors expect that spending for durables will be lower in the second half of the year. The other major source of demand is fixed investment by industry. Many industrial firms are not able to keep up with new orders, and the backlog of orders continues to grow. Aerospace and forest products are facing particularly strong demand. In Washington, Boeing continues to expand its work force due to increased orders, and the forest products industry is running at full capacity. Other industries operating at capacity include electronics, pollution-control equipment, and recreational vehicles.

In agriculture, increased production of most crops and livestock is expected, despite such local problems as lack of rain (eastern Oregon) and cold weather (Idaho). The wheat crop is expected to be near record. In the opinion of one director, world demand for exports, rather than domestic demand, will determine final wheat prices. Both grain and food crop production should be higher this year and prices somewhat lower, although weather conditions may adversely affect prices of individual crops. Current high prices should stimulate pork and poultry production and bring about lower prices this fall. On the other hand, it will take another year to increase the number of cattle, and two years to have greater numbers available for slaughter. None of our directors expects any major decline in beef prices this year.

Against this expansionary background, loan demand has been very strong, and has resulted in upward pressure on interest rates. Opinion is divided, however, whether large increases in long-term rates are likely. Generally, the commercial banks have been able to hold their deposits, and in some areas have even gained funds. However, they have had to rely heavily upon CDs with maturities under 90 days, and some bankers foresee difficulties in holding these funds if short-term rates continue to rise. Savings and loan associations, which have been unable to match market rates, apparently are losing deposits, and have raised their mortgage lending rates.

Our directors were asked to describe local industries facing capacity limitations and those that are making major additions to plants. The most commonly cited industry operating at capacity is the timber industry. Yet in this district, the industry is not building new plants. Lumber demand is expected to fall later this year in response to an expected slowing of construction; hence investment in forest products is being directed at modernization of existing plants and at installation of pollution-control equipment. Builders' hardware manufacturers are following a similar policy for much the same reason. On the other hand, capacity is being enlarged by such consumer-oriented businesses as manufacturers of mobile homes and recreational vehicles.

Insufficient capacity is not the only limitation on production in the Pacific northwest. Lack of rain has forced power rationing, causing the aluminum industry to cut production. A shortage of boxcars also has impeded shipments of timber to eastern markets. Pollution-control and other environmental factors are forcing heavier investment in some cases, but are also preventing other projects from being initiated.

On balance, the consensus is that expansion will continue through the rest of 1973, with the principal slowdown expected in construction. The major policy concern of our directors continues to be inflation control.