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# CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
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by the Staff

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SUMMARY*

The overall impression conveyed by the District Banks' August Red Book reports is that business activity continues at a high level, but with some scattered indications of a tapering off in the rate of growth. Most Banks report a sustained high level of consumer spending, in part related to expectations of further price increases, but respondents in several Districts looked for a cooling off of consumer demand over the coming months. Business plant and equipment outlays remain at a high level, largely undeterred by the high cost of credit, and the demand for agricultural machinery is recording a sharp rise. However, shortages of raw materials, energy, and trained labor were frequently cited as possibly inhibiting further expansion in capital goods output and production generally. Moreover, private residential construction is generally reported on the decline, in good part because of the high cost and unavailability of mortgage funds, in turn traceable to the net outflow of deposits at thrift institutions. Commercial and nonbuilding construction has been faring better, although some reports indicate a tapering off in this sector. Against this background, there appears to have been little net change in the nationwide industrial production and employment situation. Crops are expected to be at, or near, record levels in most agricultural areas. Most Districts in varying degree reported dissatisfaction on the part of business over Phase IV, and controls generally. Continued strong loan demand was noted in most reports.

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*Prepared at the Federal Reserve Bank of New York.

San Francisco reports that consumer spending is clearly the leading sector in all areas of the District, in part reflecting anticipations of further price increases--a factor also mentioned by Minneapolis. St. Louis reports that consumer outlays are continuing to trend upward, and Chicago notes that sales of major appliances have surged since mid-June. Major retailers in the Richmond District, however, have found that while sales have continued to improve, the rate of growth has tapered off during the past month. A large nationwide retail firm headquartered in the Cleveland District, moreover, looks for an appreciable decline in the rate of expansion in consumer spending over the year ahead. Retailers in Minnesota, on the other hand, are reported to expect no slowdown in their sales growth during the remainder of 1973. The reports generally also point to a sustained high level of business plant and equipment outlays. Philadelphia thus reports that almost 45 percent of the manufacturers surveyed planned to increase capital investment in the six months ahead, while Cleveland and Boston report receipt by firms in their Districts of large capital goods orders. Chicago reports that business borrowers have shown little reluctance to borrow at the currently high level of interest rates and that a number of industries are moving vigorously to expand basic capacity. Atlanta lists a sizable number of large new plant announcements. A similar picture emerges from most other reports. However, a number of Banks--including Chicago, Cleveland, and New York--cite the growing list of shortages of raw materials and trained personnel as adversely affecting both capital goods and consumer products output.

Regarding construction activity, most of the Banks report an actual or prospective decline in private residential construction, reflecting the net outflow of funds from thrift institutions and the accompanying dearth and high cost of mortgage funds. Commercial and nonbuilding construction, however, with scattered exceptions, was generally reported to be holding up well.

A bright picture emerged from reports from agricultural areas. Kansas City thus expects a record wheat crop while Atlanta reports a record citrus fruit crop. Dallas, San Francisco, St. Louis and Richmond all anticipate above average or good to excellent agricultural production. Much criticism, however, was expressed over the continued "freeze" on beef prices.

More generally, a great deal of skepticism regarding the effectiveness of Phase IV in coping with inflation, and hostility on the part of businessmen toward the controls, was expressed by respondents in many Districts.

# FIRST DISTRICT--BOSTON

Our Bank directors report a sharp stiffening in recent lending practices. They are now making new loans rarely and only to good customers. Business conditions in the First District are reported as good, if not booming, but the seasonally adjusted unemployment rate in June remained at 6.2 percent.

Bank directors report that they have cut back sharply on new loan commitments. Our Bank directors say that they have ended all construction loans and that they are limiting other loans only to good customers.

A New Hampshire bank director says that he is only making new loans rarely and is making none for construction, new customers, expansion, or acquisitions. This director attributes monetary tightness to a loss of demand deposits, in part due to firms cutting down demand deposits and in part due to competition from "NOW" accounts which are allowed in his state. The new Fed ruling limiting four-year time deposits to 5 percent of time money prevents his bank from competing for funds. This banker reports that his tight loan policy is generally true throughout New Hampshire and that many savings banks are also very tight and mortgage rates are firming.

A large Boston bank director reports no trouble in getting additional funds, but that rates are too high to make profitable loans. He feels that the bank gains more goodwill by explaining to a potential borrower that the bank has no funds than to charge 12 to 13 percent for a loan. Instead, they are encouraging borrowers who can do so to go elsewhere, and they are not looking for new customers. They are currently combing their loan portfolio to get some loans out of the portfolio. They are also no longer building up their residential mortgage portfolio.

Business conditions are reported as pretty good in New England, although not booming. Machine tools and heavy capital equipment production are doing especially well. Unemployment still remains high in a number of areas. In Massachusetts, the seasonally adjusted unemployment rate in June was 6.9 percent, down from 7.3 percent a year ago, and in the Boston SMSA the unemployment rate remained at its year-ago level of 5.9 percent. With the exception of New Hampshire, all of the New England states have unemployment rates above the national average.

Professors Eckstein and Samuelson had very different orientations in their policy remarks. To Eckstein, the crucial issue for the monetary authorities is "whether or not to let disintermediation ruin housing". Traveling around the country talking to banks, thrift institutions, and life insurance companies, Eckstein found the supply of mortgage funds has dried up. Mortgage loans are available only at a few large banks to some established customers. Insurance companies were fully committed and now are having trouble with policy loans. California savings and loan associations face a situation like 1966. He feels monetary policy is misguided by focusing on monetary aggregate figures which suffer from technical problems. He cited various theories to explain the pattern of money growth in the first and second quarters, saying none had much to do with real economic growth. Interest rates are the only indicator one can go by at the present time, he argued, since no one understands the recent behavior of the monetary aggregates.

Samuelson felt it is still unresolved whether the economy has entered a growth recession. He suggested that the second-quarter real growth figures look too low and the third-quarter figures will look too high due to seasonal correction problems. He agreed that we are in a partial credit crunch and that mortgage money cannot be obtained in many areas. He feels, however, that a growth recession, even if it comes, would be "stagflation". Monetary policy could not choke off the commodity price explosion without choking off a lot more. Monetary tightness will not produce automatic, quick inflation abatement. In order to reduce the growth in the aggregates, he would allow interest rates to continue to rise so that the move toward ease could come faster later if it became necessary to ease. Citing the 1966 experience, he believes that policy can be successfully reversed. Eckstein also felt policy could be reversed if it backed off soon.

## SECOND DISTRICT--NEW YORK

The Second District directors and other business leaders who were contacted recently generally expressed doubts regarding the effectiveness of Phase IV in bringing about price and wage stability. Most respondents felt that the dollar-for-dollar cost pass-through provision would, with varying intensity, squeeze profit margins. Several directors reported that so far tightening credit conditions have had little effect on business spending plans of larger firms, but some noted it was having a dampening effect on smaller businesses. A marked tightening of the mortgage market was also indicated.

A note of skepticism marked the directors' initial assessment of the probable impact of Phase IV on the prospects for price and wage stability. Thus, one director characterized this part of the Administration's stabilization efforts as a "triumph of political expediency over economic reality". This view was shared by a number of other directors, who also felt that while the new controls might be partially effective as a "stop gap" measure in achieving price and wage stability, growing shortages--notably of agricultural products--would unavoidably lead to increases in the cost of living and in turn to heightened wage demands. The chairman of the board of one of the largest New York City banks stated that an assessment of the impact of the new measure was difficult, particularly because of the uncertainties surrounding the implications for wages of a prospective rapid rise in food and certain other prices. In this context, he felt that at this juncture the longer term outlook for wages and prices seemed closely linked to the extent of the increase in agricultural output and production and its stabilizing influence on the price level generally. The president of a large metal producing concern observed that the controls were causing severe domestic shortages of certain internationally traded key materials. He felt that the biggest problem associated with Phase IV was the 30-day pre-notification period for price increases applications by large firms, which he deemed much too long, making it "extremely difficult" for businesses to respond effectively to changing demand and/or cost considerations. The president of an upstate bank noted that, in contrast to the widespread support accorded Phases I and II, small businessmen in his area were "not at all pleased" with Phase IV, and that cooperation in the program was not likely to be forthcoming. On the other hand, an upstate manufacturer assumed there would be tolerance of and adherence to the Phase IV program for a reasonable period of time--at least through April 1974--and felt that the mandated controls were tough enough to enable a return to a more reasonable and acceptable rate of inflation.

With respect to the effect of the dollar-for-dollar cost pass-through limitation on profit margins, it was the consensus of the Buffalo branch directors that this proviso would result in some contraction of profit margins in the short run, at least as measured on a percent of sales basis. The reduction, however, was not expected to be significant, barring a substantial fall in demand. The New York banker felt, however, that this rule could create significant problems for certain firms and reported that his bank's research personnel estimated it would reduce after-tax profits by about $2 billion.

None of the respondents reported that the dollar-for-dollar pass-through would have an immediate effect on business spending plans. Views were mixed, however, regarding the impact of tightening credit conditions on such plans. The New York banker reported that he had not seen widespread evidence that capital spending plans were being deferred as a result of high interest rates and tightening credit conditions, although he felt that shortages of equipment and material could have a dampening effect on such outlays. A senior official of a large multinational firm said that not only have tightened credit conditions not had an appreciable effect on capital spending, but that there was evidence of a "spend-now" philosophy in the face of inflationary expectations. A similar view was expressed by the president of the large metal producing firm, while another director reported that executives of large firms with whom he had contacts had suggested to him that capital spending plans were not being materially affected by higher interest rates: cash flows were still sufficiently large to finance capital outlays and thus these firms were not especially sensitive to interest rate considerations. On the other hand, an upstate banker reported that in his area, the high levels of interest rates were starting to have a dampening effect on capital spending decisions. He reported that among smaller businessmen with whom he had contact, borrowing rates in the range of 7 1/2 percent or higher tended to have an immediate adverse effect on their willingness to commit funds. Similarly, most Buffalo branch directors felt tighter credit conditions were bound to have an impact on business spending plans. These directors cited instances where bank customers were postponing borrowing and spending plans, and reported that banks were rationing available funds by extending credit to their own customers first.

There has been a significant tightening in Second District mortgage market conditions according to the opinions expressed by a number of directors and major lenders in that market. Senior officials of thrift institutions reported that as a result of a net outflow of deposits, together with a sizable backlog of unclosed loan commitments, little or no funds were available for new mortgages in the 1- to 4-family home sector. A New Jersey savings bank thus reported it was making loans only to depositors, with a 40 percent down payment, and an official of a large New York savings bank claimed that at this time "there was no home mortgage market" and that his institution was entering into no new commitments for 1- to 4-family homes. Against this background, the respondents felt that the recent increase in the usury ceiling from 7.5 percent to 8 percent in New York and New Jersey (effective August 15 in New York) would have little or no effect at this time on the home mortgage market. Officials at the insurance companies, commercial banks, and mortgage companies who were contacted reported that construction loans and mortgages for commercial properties--apartments, shopping centers, office buildings--were available, but at very high rates. In this context, several respondents reported a drop in recent weeks in the demand for such loans, which they attributed in part to the high rates and in part to overbuilding in this sector.

## THIRD DISTRICT--PHILADELPHIA

The business advance of previous months is continuing at a slower pace in the Third District. Industrial activity showed gains on all fronts surveyed, and there was a slight improvement in employment reported this month. Plant and equipment expenditure plans are up at almost half the firms contacted. Retail sales are brisk. Loan demand at banks is very strong, but banks can only raise additional deposits by selling certificates of deposit (CDs). On the darker side, price increases are widespread.

According to this month's Business Outlook survey of manufacturers in the Third District, industrial activity is still rising. New orders, shipments, unfilled orders, and delivery times are continuing to increase slightly, but the six-month outlook isn't as favorable. Nearly 40 percent of the executives surveyed expect business to be below current levels, while only 25 percent anticipate further improvement.

At the present time, increasing business activity is having a slightly favorable effect on employment. Over three quarters of the respondents report no change in their number of employees and the length of their average workweek, but most of the remaining firms are experiencing increases in these categories. The employment picture isn't expected to change much in the next six months. The number of firms expecting layoffs equals the number of firms expecting to increase their hiring. However, more firms expect to cut the length of their workweek than to increase it.

The continued high level of business activity is causing area businessmen to increase their investment; almost 45 percent report plans to increase their plant and equipment in the six months ahead. In addition, the stock of inventory is increasing gradually.

Retail sales are strong in the Third District at the stores contacted. Fashionable clothing is selling very well at the department stores, and auto dealers report that sales are strong.

Not a single firm surveyed reported a decrease in the prices it pays or the prices it receives, but over half reported paying higher prices this month. Six months from now, over 65 percent of the firms expect to be paying and receiving higher prices.

Large city banks are experiencing very strong loan demand from all the major sectors, but deposits are not keeping pace. Time deposits increased, but are starting to flow out again now. As banks reach their legal limits on high interest saving certificates and disintermediation resumes, two bankers voiced strong resentment about Government pressure to keep the prime rate below the rates at which they are raising money. These bankers are filling lines of credit at the prime rate--but only reluctantly--because they feel they are losing money on the loans. Area bankers can still sell their short-term CDs if they pay high enough interest rates, but one banker said he thought that nonbank financial intermediaries were almost in a credit crunch now.

Corn and wheat prices continue to advance strongly in a commodity futures market in spite of the bumper harvests projected by the United States Agriculture Department. These rising prices are based at least partially on fears that large exports will deplete the harvest. In addition, the rising grain prices are pushing up the costs of raising cattle and chickens. As a result, future prices on beef and broiler chickens are rising sharply too. This is taken as an indicator that retail meat prices will skyrocket when the ceilings are removed.

FOURTH DISTRICT--CLEVELAND

Comments from our directors, businessmen, and economists indicate that the pace of business activity remains at a very high level. There are, however, numerous reports of distortions, including complaints of production bottlenecks stemming from capacity constraints and labor and materials shortages. A major retailing firm expects consumer spending to slow appreciably in the year ahead. In the financial area, some savings and loan associations in the District are experiencing heavy deposit losses as a result of interest rate differentials.

The comments of our industrial directors at a board meeting held on August 9 indicate that the pace of business activity remains strong, but shortages of certain raw materials, particularly in the chemical area, are becoming an increasing problem. Two directors, whose firms are important producers of consumer goods, reported that, while orders remain strong, shortages of raw materials are impeding production. One of these indicated that about 10 percent of the firm's facilities are idle because they cannot get raw materials and the other is attempting to secure foreign sources of supplies. A director whose firm is a large supplier of chemical products reported that their customers are on an allocation basis. Two other directors--one from a large diverse manufacturing firm and one from a large office equipment manufacturing firm--reported that new orders remained strong and that all of their production facilities were operating at full capacity. Both firms are viewing 1974 with caution, especially in the case of their capital spending plans. Finally, a large and diversified manufacturing and construction firm indicated that it expects a continuation of at least nine months of upward activity. As a result, its capital spending plans are on the upswing; it will not be borrowing to finance these additional outlays because of a strong internal cash flow.

Early returns from our monthly survey of manufacturers reveal considerable strength in certain key indicators and signs of stress in others. In July, the largest proportion of firms reported gains in new orders since January. Peak capacity operations and shortages of materials have limited the ability of many firms to increase shipments, however. Thus, backlogs are continuing to rise and delivery times are growing longer. Our survey also shows stepped-up inventory accumulation during July. Buyers in the Cleveland area say it is difficult to build inventories of finished goods, however, in the face of numerous shortages and limitations on production. Finally, it now appears that payroll employment in the District is leveling off following strong gains through the first quarter.

One of the District's capital goods producers received in July an order in excess of $275 million for six nuclear power systems. This is reported to be the largest order ever placed in the nuclear industry. To achieve economies in design, licensing, and construction, five electric utilities acted together (with Federal approval) to order standardized nuclear power plants.

Economists with three major steel firms in the District report no sign of any easing in the demand for steel. Customers' orders are being allocated because of capacity limitations, and orders are booked solid through the fourth quarter. Nevertheless, production and shipments during the second half of 1973 will not be so high as in the first half of the year. Approximately 4 million tons of the 56 million tons shipped in the first half came from steel mill inventories--something the steel companies cannot repeat. Production at a major steel firm in Cleveland is currently being cut back until October in order to reline blast furnaces. The tight steel situation is underscored by a comment from one economist to the effect that, for the first time since World War II, steel consumption (in the second half of 1973) will equal total domestic capacity plus imports. The world market for steel is similar to the United States situation. With steel prices generally higher abroad, there is now less incentive to import. In fact, steel imports in June dropped below the year-ago level for the first time this year.

The economist from a major retail food chain is extremely pessimistic with regard to near-term prospects for relief from rising food prices. He does not expect an immediate boost in beef supplies when the freeze is lifted because of the time it will take to get cattle off the farms into feedlots, processed, and distributed. He does not expect a drop in retail beef prices until January.

The economist from a major retailing firm with headquarters in the District reported that they have a pessimistic forecast for consumer spending for the next four quarters and that recent developments have increased their confidence in this projection. Their current view is that the peak growth rate for consumer spending was reached in early 1973 and that an appreciable decline in the rate of expansion in consumer spending will materialize between mid-1973 and mid-1974. Their outlook is based on a number of factors, including the rapid rise in prices, especially food prices, declining consumer confidence, the consumer credit situation, and high interest rates. All of these factors are thought to have a negative influence on discretionary expenditures.

On the financial side, the economist at one of the two Federal Home Loan Banks in the District reported that savings and loan associations in the area have suffered sizable withdrawals of funds since early July, and there are indications that the outflows have continued thus far in August. In the past month, mortgage rates have increased 25 to 50 basis points at both savings and loan associations and banks. In addition, mortgage loan demand is being discouraged by requiring larger downpayments and shorter maturities.

FIFTH DISTRICT--RICHMOND

Results of our most recent survey of businessmen and banks indicate that economic activity in the District is still expanding. Further increases were reported in employment, and retail sales remain robust throughout the District. Loan demand continues strong and mortgage markets have tightened further. Activity in the manufacturing sector appears little changed from last month, although the inflow of new orders may be weakening. Most businessmen and bankers expect business activity to stabilize at present levels.

Activity in the manufacturing sector is reported to be continuing at the recent high level, with little further change in shipments and backlogs. But for the first time in more than a year the number of manufacturers reporting a decline in new orders exceeded the number reporting an increase. Manufacturing inventories were reported unchanged from the previous month's survey, and manufacturing respondents appear generally satisfied with current inventory levels. One large manufacturer of synthetic fibers, however, reported that August-September production will be curtailed because of shortages of raw materials.

District employment has apparently increased since the last survey. Both manufacturing and trade and services respondents indicated net new hirings during the past month, and nearly a third of the banking respondents reported employment increases in their areas. Manufacturing respondents reported further increases in wages paid with little change in prices received. Trade and services respondents reported increases in both wages and prices received.

Retail sales in the District have continued upward in recent weeks. More than one third of the banking respondents reported that sales in their areas had increased during the past month. Major retailers report continued improvement in sales, although the rate of increase tapered off during the month. Retailers expressed some concern over the newly passed minimum wage legislation.

Loan demand remains quite strong in the District. More than two thirds of the banking respondents reported increases in the demand for consumer and business loans, while nearly 50 percent reported increases in mortgage loans. Bankers report further tightening in the mortgage markets. One banker observed that increased rates have reduced loan requests from small businessmen, while loan demand from larger businesses remains unabated.

Construction activity in the District may have moderated from the recent fast pace. On balance, banking respondents report no change in non-residential construction and a decline in residential building in their respective areas.

Generally larger crops than last year were indicated on August 1 for Fifth District crop prospects. Biggest gains were anticipated for: soybeans, up 25 percent; peaches, 18 percent; peanuts, 13 percent; tobacco, 11 percent; and feed grains, 7 percent. Exceptions to these expected improvements were lower forecasts for cotton, wheat, apples, Irish potatoes, and hay. In general, larger acreages and higher yields combined to produce the improved prospects.

In general, businessmen and banks expect economic activity in the District to stabilize at present levels. More than 50 percent of the banking respondents expect no change in business activity in their areas during the next three months.

SIXTH DISTRICT -- ATLANTA

Economic activity continues brisk and no letup is anticipated. Numerous new plant and plant expansion announcements have been noticed. Several major and many minor residential and commercial construction projects continue to be announced.

A steady flow of new plant announcements continues. A $400 million oil refinery is to be built near Mobile, Alabama. A railroad has broken ground on a $350 million expansion of its freight facilities in South Georgia. The same company is undertaking a $3.5 million expansion at a Florida freight yard. Permits have been granted for a $66 million natural gas pipeline to be constructed from the Louisiana coast to various locations in the Midwest and Southeast. Fiberglass insulation products will be produced at a $20 million plant to be built in northeast Georgia. A $12 million wood products facility will be built in south Alabama. A chemical company is spending $10 million to expand a south Louisiana plant that manufactures chemicals used in water treatment. A $6 million addition will be made to a central Tennessee plant manufacturing oil filters. Other announcements include: a $4.5 million electronics plant in Mississippi, a $4 million wood products plant in central Georgia, a $3.5 million lumber mill in southeast Alabama, a $2.5 million expansion of a building materials plant in Jacksonville, a $1.5 million meat-processing plant in Louisiana, a 150-man electronics plant northwest of Atlanta, and a chemical plant employing 50 people in central Georgia.

There have been several announcements of large projects in the residential and commercial construction sectors. A $250 million "mini-city" is planned northwest of Atlanta. This project will contain seven major buildings, including three high-rise condominiums, two office buildings, and two hotels. Still another $200 million office and apartment project has been proposed for an area near Atlanta. Two condominium communities, one projected at $60 million and the other at $40 million, have been announced for Florida's northwest Gulf coast. A $5 million hotel is to be built in Pensacola, Florida. Condominium and single-family residential projects totaling $40 million are planned for the Nashville area. Plans have also been announced for a 440 residential homesite development near Atlanta. A high-volume, national home builder is moving into the Atlanta market for the first time with a 48-home development. A $3 million office building and a $1.5 million merchandise mart are also planned for the Atlanta area. Apartment building is reportedly growing at a rapid clip in Nashville and parts of east Tennessee. However, officials of savings and loan trade associations representing southeastern states have warned that the housing industry "is being brought to a schreeching halt" by higher interest rates.

A meat-packing plant in Jacksonville reportedly has laid off 200 workers because of the meat shortage. A shortage of propane gas used in heating chicken houses could hinder poultry production later in the year. The Florida citrus crop is the largest ever, but a shortage of labor has hindered harvesting. High school and college students from as far away as Texas have reportedly been recruited to harvest citrus.

A textile firm in northwest Georgia has signed a union contract calling for an immediate 9 percent increase in wages. Atlanta bus drivers have ratified a contract calling for a 16 percent increase in wages over a two-year period. The price of milk has risen sharply in Miami, and a dairy farming commission in Alabama has raised the wholesale price of milk.

SEVENTH DISTRICT -- CHICAGO

As seen from the Seventh District, demands for, and output of, virtually all consumer goods, building materials, and business equipment continue to rise or remain at very high levels. The number of housing permits issued in major Midwest centers declined sharply in June, and the downtrend almost certainly continued in July and early August as new mortgage commitments were curtailed. Scattered signs of softness in sales of mobile homes are reported. Sales and output of motor homes and other recreational vehicles have been well below expectations. With these exceptions, the momentum of the uptrend appears to continue unabated. Major new expansion plans have been announced for a number of industries. Labor markets are very tight, especially for skilled and experienced workers. There are widespread shortages, often critical, of materials and components. The frenzied activity and surging prices in the agricultural commodity markets are without precedent and difficult to analyze. Phase IV price regulations are commonly regarded as difficult to understand, as hard to administer, and in some cases as inequitable and "counter-productive".

The recent sharp rise in short-term interest rates to record levels was not foreseen in forecasts offered earlier in the year. Moreover, most experts did not expect high-grade corporate bonds to break through the 8 percent level. Very high rates have caused uneasiness and produced forecasts of recession by some bankers. (Those who emphasize changes in monetary aggregates are less concerned.)

Large net outflows of savings from savings and loan associations in July, compared with large gains last year, began after interest ceilings on savings accounts were raised on July 5. Ironically, some savings and loan association executives regarded the higher ceilings as harmful rather than helpful in preventing deposit drains. Outstanding mortgage loan commitments are very large and probably will support a continued high level of residential construction through the summer. In Illinois, under an 8 percent usury ceiling, new commitments have almost "dried up".

Only scattered effects of high interest rates have been reported on expanding plans for mortgage financing of commercial and industrial projects. Similarly, business borrowers have shown little reluctance to borrow at the higher prime rate, with an effective rate commonly about 10 percent.

Purchasing managers of manufacturers are "beating the bushes" to locate greater quantities of a long list of materials and components in short supply. Steel, nonferrous metals, cement, petroleum products, textiles, and paper, to mention only major areas, are all causing headaches. Various practices have developed that recall "gray market" situations. Equipment output has been held back by the availability of castings, forgings, bearings, motors, electrical controls, and other necessary parts. Some producers have gone to outside suppliers, often at 30 to 40 percent higher cost. Backlogs continue to grow, and lead times continue to lengthen. Escalator clauses of various types are written into longer term contracts. Many sellers refuse to enter into the long-term contracts that had been customary.

A number of industries are moving vigorously to expand basic capacity. Included are electric power, motor vehicles (assembly facilities and parts), chemicals, petroleum, mining (coal and metallic ores), farm tractors, and paper. Basic expansion plans in steel and cement, however, are not under way despite apparent long-term needs. (Incidentally, a new official measure of oil-refining utilization places operations recently at 100 percent, rather than at 95 percent, as indicated by the old series.)

Strength in orders continues for equipment used in agriculture, construction, earth moving, mining, quarrying, railroads, trucking, food processing, electrical generation, and materials handling. Demand for most types of machine tools continues very strong. (Most major airlines, however, have no plans to buy new aircraft.) Foreign demand is excellent, including orders from Russia.

The high figures for retail trade in July did not surprise large retailers headquartered in this region. They have been pleased with results all year. The rise in instalment loan delinquencies shown by the ABA series has not been evident in the experience of large chains. Sales of major appliances by distributors to dealers (equated with consumer demand) have surged since mid-June. Freezers and air conditioners have been in the lead, but all major appliances have performed well. Appliance inventories are significantly lower relative to sales than a year ago. Among the worst shortage items in retailing are wood furniture and wool clothing. But relatively tight supply conditions are reflected generally in the absence of heavy promotions and normal price cutting for sale merchandise.

Many informed businessmen now believe that the dollar is undervalued relative to other currencies. Domestic prices of steel, nonferrous metals, petroleum products, chemicals, and agricultural commodities average well below world prices. Moreover, prices of finished goods appear to be rising more rapidly abroad.

## EIGHTH DISTRICT -- ST. LOUIS

Business activity in the Eighth District continued to expand in July and early August. However, there are indications of a slower rate of growth of output, especially among suppliers to the construction industry. Retail sales at major District department stores continue upward. Factories are generally operating at full capacity, and backlogs of orders generally remain undiminished. Unemployment is at a relatively low rate throughout most of the District, and quality workers are reported to be scarce. The level of construction has apparently passed the peak and is declining moderately in some of the larger District cities. Loans and deposits of major District banks have declined in recent weeks, but loan officers report very strong credit demand and upward pressure on interest rates. Crop conditions are generally good over most of the District as a result of timely rainfall.

The uptrend in retail sales established about two years ago at major District stores has continued in recent weeks. Representatives of major department stores report that, after adjusting for inflation, sales in July and early August were well above year-ago levels.

Backlogs of orders generally have not increased in recent weeks, but large backlogs continue to exist at most District factories. Machinery orders continue to grow faster than shipments, but paper, paperboard and similar product backlogs have stabilized and backlogs of construction-related products have generally declined. A representative of the aircraft industry reported that passenger miles flown during recent weeks were well below expectations and that passenger plane orders were also less than anticipated. On the other hand, a representative of the shoe factory reported considerable improvement in domestic production as a result of the realignment of exchange rates in the past two years. Imports of foreign shoes have declined sharply.

Payroll employment continues to increase throughout the District, and the employment rate has remained stable for several months at a relatively low rate. A representative of a major manufacturing firm reported that its major problem was the large number of nonproductive workers on its payroll. Another firm reported problems in filling all the jobs with the type of people desired. Labor turnover has become a major complaint, with some firms reporting turnover at approximately double the normal rate.

Activity in the construction industry has diminished in some of the larger District cities in recent weeks, following a long period of relatively stable and high level operations. A representative of the paperboard industry reported some slight cutting-back on orders of materials related to housing. A number of St. Louis manufacturers of other construction supplies reported similar moderate declines in orders. A major commercial construction contractor in Louisville reported that he is now seeking construction projects.

As a result of the sharp increase in interest rates in recent weeks, loan rates are approaching the maximum permissible levels under the usury laws in many states, and such laws are becoming a major factor in credit allocation. An Arkansas spokesman reported that lenders in the state are finding that their funds can be used more effectively elsewhere than in Arkansas. A St. Louis savings and loan company reported that savings had picked up with the higher permissible rates in August but that rates on mortgages had also risen. Its rates charged on conventional loans are now 8 percent plus 3 points, up from 7 1/4 percent plus 2 points in May. A representative of a larger St. Louis commercial bank reported that it was turning down all loan requests except the older lines of credit. He noted that problems of arbitrage are making banking more difficult and expressed a desire for the elimination of all interest rate restrictions. Furthermore, most of the businessmen interviewed expressed hostility toward the wage, price,interest rate, and dividend restrictions in effect since mid-1971.

Crop production conditions are generally good to excellent throughout the District. Large crops of corn and soybeans were planted; the planting was somewhat later than average, but weather conditions have been favorable and yields are expected to average about normal for recent years.

Prices of livestock are probably sufficient to provide incentive for enlarging herds and flocks, and if feed supplies are forthcoming this fall, as anticipated, output of livestock products may begin to rise by mid-1974. There are some beef shortages in stores, but increasing concern is reported among cattle feeders that a holdback in marketings of fat cattle until September 12 will result in a sufficient number marketed at that time to drive prices down even below current levels.

## NINTH DISTRICT--MINNEAPOLIS

Many District businessmen disapprove of Phase IV and the continued price freeze on beef which has resulted in shortages. District economic activity continues to expand at a vigorous pace and, according to director responses, District businessmen generally look for business to remain good. Minnesota retail sales in July expanded at a vigorous pace, and no letup in sales growth is anticipated. Loan demand at District commercial banks is strong, and banks are being very selective in making loans.

Bank directors indicated that most District businessmen dislike Phase IV and that the continued price freeze on beef is producing shortages. A South Dakota director associated with the beef industry, however, revealed that the price ceiling on beef is being violated nationwide. In some areas beef producers are ignoring the price freeze, while in others they are placing "wind in the invoice", i.e., billing the customer for more beef than is actually shipped. Another alternative for avoiding the price ceiling on beef is "custom killing", where the meat-packing company's customers purchase the cattle and pay the meat-packing company to process it. A Minneapolis-St. Paul director indicated that businessmen disapprove of Phase IV and don't expect the new controls program to ease shortage problems. Petrochemicals, steel, and beef, he reported, are in short supply in the Twin Cities. Despite emerging shortages, a director disclosed that his area's grocers felt the Government had to do something to curb price increases. Another director expressed the view that Phase IV will hurt businessmen more than they realize if the regulations are enforced. Taking a different position, however, one director said that businessmen are shortsighted and evaluate

Phase IV only with regard to their own affairs and without considering how the new controls program can help achieve long-run price stability.

Economic activity was characterized as strong throughout the District and, although some exceptions were cited, District businessmen generally expect business to remain good. In South Dakota, gains in agricultural income are spurring that state's economy, and bumper crops are anticipated this fall. The tourist business in northeastern Minnesota was also described as good. One director reported favorable business conditions in his area but indicated that residential construction will probably taper off as mortgage funds become unavailable. A director from western Montana reported that lumber producers fear a lack of mortgage funds may dampen their business. In addition, because of uncertainty about forest service regulations, lumber producers are hesitant to make capital expenditures. A Twin Cities-area director indicated that economic activity continues strong but that the recent decline in housing starts, combined with a slowdown in automobile sales and an increase in consumer savings, hint at the possibility of a business slowdown. Although no slowdown has occurred in another director's area, local businessmen have expressed some pessimism about the future.

Most Minnesota retailers surveyed in a recent newspaper article disclosed that their July sales gains slightly surpassed the 12 to 15 percent year-to-year increases achieved during the first half of 1973. Part of the recent strength in retail spending, some merchants felt, stemmed from consumers' desire to avoid price increases permitted by Phase IV. Nevertheless, Minnesota retailers do not look for a slowdown in their sales growth during the remainder of 1973. Although prices are expected to continue to rise, survey respondents indicated that Phase IV may help curb price advances.

Bank directors described current loan demand at District commercial banks as strong. Many District banks are being selective in making loans and are not soliciting new business. Two directors indicated, for example, that their areas' banks were refusing applications from marginal customers for real estate loans.

TENTH DISTRICT--KANSAS CITY

Tenth Federal Reserve District home builders report a noticeable decline in activity relative to last year and earlier this year. Although some exceptions were noted, most respondents indicated difficulty in securing mortgage funding as a key reason in dampened building activity. District savings and loan associations report that new and higher costs for mortgages have discouraged demand and that the new rate ceilings, while serving to reduce the rate of outflow, have substantially added to their cost of doing business without significantly affecting their ability to attract funds. The agricultural situation in the Tenth District is marked by record or near-record crops, with prices up substantially over past years as a result of strong domestic and foreign demands. A number of commercial banks throughout the District report continued tight credit conditions. These banks have been net buyers of Federal funds, had raised their prime lending rate to 9 percent as of last week, and have increased their time and savings rates to the new ceiling levels.

In a telephone survey of a number of Tenth District home builders and home builders' associations, a pronounced softening in activity relative to last year or early this year was noted by nearly all respondents. Looking ahead to the remainder of this year, the outlook for building activity was pessimistic, with one respondent observing that "builders are spooked by the money situation". In fact, the "money situation" relating to the high cost and difficulty in securing mortgages was cited as the major reason for the weakness in residential construction in the Tenth District. Where state usury limits preclude mortgage above an 8 percent level, anywhere from 2 to 4 points are being assessed on mortgage loans of 80 percent or over. The 95 percent loan has been largely discontinued, as have been FHA and VA loans. The savings and loan associations contacted were nearly unanimous in indicating that the new rates for savings had not added to their ability to attract funds, but rather had aided in reducing their rate of savings outflow, albeit at a significant cost to them.

A particularly bright spot within the Tenth District economy is the agricultural sector. Wheat production is forecast at record levels, and as of August 1, corn and soybean production was headed for record harvest, with the expectation that grain sorghum production would be only 1 percent below the 1971 record. Despite the huge grain harvests anticipated, prices have continued to push on to new highs. Wheat prices recently moved into the $4 to $5 range, a historic high. This price strength for wheat and for grains generally is the result of unusually strong domestic and foreign demand, combined with very tight carry over conditions for food and feed grains.

Tenth District banks contacted report tight credit conditions continue to prevail. Faced with heavy business loan demand, major banks raised their prime lending rate to 9 percent in the past week. Related to the strong agricultural situation noted earlier, banks in Kansas City, Omaha, and Tulsa reported large increases in agricultural loans resulting from box car shortages and increased grain and storage costs. Nearly all survey banks have been net buyers of Federal funds, have raised rates payable on savings and consumer time deposits to new ceiling levels, have offered a four-year certificate paying either 7 percent or 7 1/2 percent, and have maintained CD rates at levels quoted by New York City banks. As a consequence, several bankers reported that the increased cost of funds has significantly reduced their profit margins in the past month. Rather than curtail their lending activity, these banks have felt obligated to accommodate the heavy demands of regular customers, even though it has become increasingly less profitable to do so.

ELEVENTH DISTRICT -- DALLAS

The economy of the Eleventh District continues to expand, but some major economic indicators are beginning to show signs of weakness. Industrial production in Texas grew substantially in June, and weekly department store sales in the District advanced during July. However, total employment and new automobile registrations for the District declined during June, and the value of construction contracts fell. Moreover, the unemployment rate increased for the fourth consecutive month. A survey of our directors who are bankers revealed that they expect business conditions to be unchanged or slightly weaker by the end of the year.

Most of the responding directors indicated that business conditions in their communities are about the same or slightly stronger than three months ago, but a majority feel that conditions will be moderately weaker by the end of the year. Almost all of the respondents revised upward their expectations of price increases as a result of the introduction of Phase IV. They now feel that the growth rate in consumer prices will accelerate in the three months ending in September but will slow down later in the year.

A majority of the directors felt that both long- and short-term market rates of interest will continue to move upward over the next four to five months. Most did not expect that by the year-end the prime rate charged to large business firms would rise much higher than the early August level. Furthermore, they anticipated this rate would be below its present level by the end of March next year. Very little change is anticipated in the prime rate charged on small business loans between now and the year-end.

Most of the respondents have not altered their willingness to make consumer and agricultural loans in comparison to the preceding three months. However, a majority expressed less willingness to make large business and mortgage loans, indicating a concern over the availability of funds at their bank. Over the next six months, almost all of our bank directors expect disintermediation in savings and time deposits. At the same time, a majority thought that the July increase in Regulation Q interest rate ceilings would help prevent a substantial loss of funds.

The seasonally adjusted Texas industrial production index advanced sharply in June, the third consecutive monthly gain. Manufacturing and mining were responsible for the entire increase, while utility activity remained unchanged. The continuing high level of Texas oil and gas production is drawing down reserves. At this time, new discoveries are replacing only about 10 percent of production, but some production may be curtailed by the proposed Phase IV rollback in crude prices.

The value of construction contracts in the District states decreased in June. Residential building contracts were at their lowest level since December 1972, and residential building awards fell slightly. But nonbuilding awards reached the highest level in a year. Seasonally adjusted total employment slipped slightly in the district states during June. At the same time, the unemployment rate rose to 4 percent.

July department store sales in the District continued to be above the year-ago figures. For the first half of this year, new-car registrations in the four largest Texas cities exceeded those for the corresponding period last year by almost 20 percent. However, in June, the number of new registrations dropped below that for the preceding month.

Prospective crop yields in the Southwest appear to be above average, as weather conditions have been favorable in the growing season. The harvest of grain sorghum in south Texas is making excellent progress, and farmers are receiving prices as much as double those obtained last year.

The livestock industry reflects the uncertainty that has resulted from economic controls and the cost price freeze. Ranchers are keeping cattle on pasture rather than placing them on feed, and feed-lot operators are holding cattle to heavier weights. As a result, fewer animals are reaching market. Broiler chicken placements in July were nearly 15 percent less than in the same period last year, and the number of hogs and pigs in Texas have dropped sharply from a year ago.

## TWELFTH DISTRICT--SAN FRANCISCO

Economic activity in the Twelfth District continues to be led by heavy consumer spending on durables and automobiles. Strong demand is keeping most industries operating at full capacity, and agricultural prospects are excellent except in areas affected by drought. The only sign of weakness is in residential construction, and this weakness is beginning to affect timber production. Banks report strong loan demand, but no major liquidity problems at the moment.

Consumer spending is clearly the leading sector in all parts of the District, and to some degree this spending is thought to be in anticipation of more inflation. Accompanying this spending is a heavy demand for consumer credit at District banks. Declines in consumer durables purchases are expected by some directors later this year, and the heavy automobile sales of this year might cut into demand for the 1974 models. Fears of gasoline rationing may also hurt new car sales,according to one director. Our directors in agricultural areas report that farmers expect high prices and good crops this year, except in those areas of eastern Washington and Oregon affected by drought. High farm income is stimulating heavy purchases of new farm equipment, and deliveries from manufacturers are not keeping up with this demand. Crop prospects in California and fruit crops in western Oregon are excellent.

The major problem for agriculture is the continuation of the price freeze for beef. Beef producers are apparently reacting by withholding deliveries until the freeze ends. The result is a growing shortage of beef supplies on the retail level. Business investment expenditures are increasing both to purchase plant and equipment and to build up inventories. Environmental controls are cited as one factor in stimulating new equipment orders. High interest rates are not having a significant impact on this demand, and several banks reported that they are revising their lending guidelines in an effort to cut back. On the other hand, some directors report that business investment plans are being hampered by slow deliveries and capacity limitations.

Residential housing starts are reported to be lower in several areas--Oregon, Washington, and California--but apparently other kinds of construction are maintaining a good level of activity. A major manufacturer of builders' hardware reports order backlogs sufficient to keep at full capacity throughout the rest of 1973.

The weakness in housing starts, combined with reduced exports to Japan, has caused lower prices and reduced activity at Oregon and Washington timber mills. Pulp production remains high, but producers are described as reluctant to expand capacity because of uncertainty over profit-margin controls and the strength of demand over the next two or three years.

Increased supplies have apparently ended the gasoline shortages that had developed in some localities. Apart from some reduction in hours, dealers are able to operate normally. One director views the situation as having been "over-advertised". Nonetheless, the temporary shortages have been a factor in cutting tourism in the Pacific Northwest, but there has been no similar impact on tourism in California.

Drought in the Pacific Northwest is causing an energy problem in that region. Metallurgical industries, such as aluminum refineries, which are heavy users of electricity, are being forced to curtail production. Hydro-electric shortages may prevail in this region into the coming winter.

District bankers feel that the recent increases in interest rate ceilings for time accounts are of mixed value. Some think that the regulation changes have merely increased customers' confusion and perhaps have made them more aware of nonbank market instruments. Although problems may develop, none of the banking directors have reported major difficulties for their own institutions in holding time accounts, but several remained concerned about the longer term liquidity situation of banks. Savings and loan associations, in contrast to banks, are experiencing deposit losses despite the higher rates.