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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Reports of sustained current strength continue to coexist with expectations of a future slowdown. Consumer spending and the demand for consumer loans have maintained their recent pace of growth. Business investment and foreign demand are buoyant and are expected to remain strong into the future. Only residential construction has weakened, though business and public construction has partly offset housing declines. Shortages of material, skilled labor, and mortgage funds are widespread. The unavailability of some materials is traced to the economic controls program. Small changes in employment have occurred. With a few exceptions, business loan demand has strengthened. With thrift institutions experiencing deposit losses, some loans have been made to nonbank intermediaries. Despite damages due to Delia and drought, agricultural output, prices, and income are reported to be high. Greater stability in food prices is expected in the future.

With the exception of large automobiles, consumer demand has been brisk in most Districts. Minneapolis and Atlanta report that controls have not produced the feared curtailment of planned business investment, but St. Louis and Chicago suggest controls may be hampering capacity expansion in sectors such as the paper industry. San Francisco and Kansas City report inventories generally below desired levels but reports from the Richmond, Philadelphia, and Cleveland Banks do not expect major inventory buildups in the future. The Cleveland and Chicago Districts have experienced intense foreign demand for steel and many "bargain" U. S. materials. Lack of mortgage funds has reduced residential construction

*Prepared at the Federal Reserve Bank of Boston activity in most Districts.

Shortages are reported by the New York, Atlanta, Chicago, St. Louis and Kansas City Banks. In the Kansas City District, lead times are considerably above normal, and lengthening. In St. Louis, manufacturing is at or near its capacity levels. Chicago, which has been experiencing strong demand for a wide variety of goods, indicates that price controls have restricted the supply of petroleum and paper products. Atlanta reports that material shortages have led to plant closings. New York has experienced shortages of skilled labor. In Chicago and Atlanta, the labor shortage includes unskilled labor as well. Nevertheless, most Districts reported only minor gains in employment.

A near-term slowdown is expected by the Directors and businessmen in the Boston, New York, Philadelphia, Cleveland, Richmond, and Minneapolis Districts. A Boston director notes a convergence of opinions on the economic outlook very close to the consensus view of the business economists in the Fourth District--a "growth" but not "classical" recession. New orders have started to level off in the Philadelphia and Richmond Districts, though they continue to rise in other areas. According to the reports from New York, Cleveland, and Minneapolis, the tapering will center in the consumer spending area.

The outlook for agricultural incomes and crops, particularly soybeans, remains good. Drought in the West and tropical storm Delia in the Gulf have destroyed some of the wheat, rice, cotton, and soybean crops. High poultry prices have stimulated supply in the Southeast. The Dallas Bank notes that the number of cattle and calves on feed in the Southwest was down from July but well above last year. Cattle placements and slaughter were, however, down from last month and last year. The Kansas City Bank indicates that "on balance, food prices should tend to stabilize in coming months, but hoped-for declines of a significant magnitude are still sometime off."

Business loan demand was strong in most districts. Both Dallas and Kansas City, however, report some decreases. The pace of disintermediation is widely reported to have accelerated in August. Except in St. Louis, where most prospective home purchasers can obtain mortgage credit, mortgage availability and terms have become increasingly stringent.

FIRST DISTRICT--BOSTON

Our business directors report that new orders are continuing at a strong pace. Despite this, the seasonally adjusted unemployment rate in New England in July was 6.2% and in Massachusetts it was 6.9%. Our bank directors note that loan demand is strong despite money's increasing cost and credit restrictions by banks. The mortgage market is especially stringent, with mortgage money often not available at savings banks, even at very high rates of over 8 1/2 percent.

High order rates are increasing backlogs, but firms are not generally operating at capacity. One director of a large conglomerate which manufactures carbon black, specialty metals and superalloys reported that orders in August, while good, were not as hectic as during April and May. This manufacturer is actually working off inventory in filling orders. Another director, also connected with a large manufacturing conglomerate, reports that new orders for general aviation aircraft and industrial machinery have picked up during the last month. This director reported that the aircraft manufacturer is requiring dealers to put down 5% of the sale price when the dealer places an order. This is to ensure that the dealers are not too optimistic about their sales forecasts for 1974. So far, this has not affected the manufacturer's sales. Order backlogs for industrial machinery are reported so high - and lead times are so long - that present backlogs mean that the current high sales rate will continue in 1974.

One director reports that he notes a division between top management who are pessimistic about the economic outlook in 1974 and marketing personnel who are optimistic. Another director notes a convergence of opinion towards a growth recession: those who had foreseen a major downturn are raising their forecasts, and those who had not forecast a significant slowing are much less sure. Our business directors are looking for a growth recession.

One business director noted that tight money markets had led to more nervousness in his company than actual stringency. This director reported that he had not heard of business firms having trouble getting money, although the cost was high. Another business director reported that he had heard that the latest boost in the prime has begun to affect demand, and that there is less talk of a 10 1/2 percent prime now than there was a few weeks ago. This was confirmed by a director from a Boston bank.

Our bank directors continue to ration credit, by restricting loans to old customers. A New Hampshire bank director reports that his demand deposits have declined, in part because corporate treasurers are keeping balances very low. In fact, he notes that some corporations which used to have sizable balances have been overdrawing their accounts, and his bank has taken to charging them. A director from a large Boston bank reports that his lending officers say that high rates are not deterring borrowing anywhere except in real estate. Borrowing for new commercial projects has virtually halted. The bank has had in effect a vigorous program for the past 5 months to control its loan portfolio. There has been a 5 percent run-off in loans since the June peak, but it is not clear whether this can be attributed to slackening demand or the internal control program. This bank director asserts that they are still telling customers that there is no shortage of funds. It's just that funds are costly.

The savings banks in Massachusetts had a big run-off of deposits in August. Mortgages are often unavailable at any price and the best rate quoted is 8 1/2 percent with some banks charging 9 1/2 percent.

Only two of our academic respondents, Professors Samuelson and Wallich, were available for comment this month. Professor Samuelson noted that the belief in the inevitability of a genuine recession next year has diminished. He saw a ray of hope on inflationary prospects in the recent declines in the futures markets, pointing out that commodity inflation would have to recede at its own micro-economically determined pace. His main concern was with the impending auto negotiations, which could either disrupt production or usher in an era of higher wage settlements. As to current policy, Samuelson would not "fight" to reduce money growth below a 4 to 5 percent annual rate. Only if it were to come in lower for several months would he attempt to accelerate money growth.

In contrast, Professor Wallich believes that the economy could use a few quarters of zero money growth. Fear of a crunch is wholesome for the economy, he said, although an actual crunch would not be. He believes that the Fed must keep money supply growth at zero for some time after the peak in the business cycle if we are to beat inflationary expectations. If, however, we are going to live with 3-5 percent inflation, then we have to accept higher interest rates. Given the present inflation rate, present monetary policy is not very restrictive because real interest rates are not so high. Wallich argues that high interest rates work with a longer lag than non-availability of funds. He believes, however, that it is non-availability which really provides restraint.

SECOND DISTRICT--NEW YORK

Second District directors and other business leaders who were contacted recently reported that economic activity remains very brisk, but that a number of problems plague businessmen. Particular concern was expressed over shortages of raw materials, rising costs, the high level of short-term interest rates, and the uncertainties surrounding the Government's economic program. Little change was reported in labor market conditions, with continued reports of shortages of skilled technical and managerial personnel. Views regarding the outlook for retail sales were mixed, but the respondents on balance looked for some tapering in the rate of growth of consumer demand over the coming months. Consumer resistance to high food prices was not generally expected to have a lasting effect on such prices.

Concerning the retail sales outlook, the president of a large chain of retail stores anticipated a slowdown in business over the coming months, notably with respect to consumer outlays on durable goods. The chairman of the board of a large New York City bank also expressed concern over the outlook for retail sales in the fall and winter of this year. In his view, sales have been stimulated partly by expectations of higher prices. He felt that the currently high rate of consumer spending is unsustainable and that the heavy burden of instalment indebtedness would lead to some "consolidation." On the other hand, a New Jersey banker reported that retailers in his area expected an "excellent" fall season. Most of the Buffalo Branch directors also regarded the sales outlook as good for the rest of the year and well into 1974, but a number of these directors expected a somewhat slower rate of growth in 1974 than in 1973, and looked for weakness developing in big ticket durables--notably automobiles. A senior official of a large multinational firm headquartered in Rochester characterized the retail sales outlook as "bleak," in good part because the increase in food prices will leave consumers with less to spend on nonfood items.

In this connection, the respondents in general felt that consumer resistance to high food prices would have little lasting impact on food prices. The New York banker noted that consumer boycotts might actually have a perverse impact by discouraging farmers from increasing production. He did feel, however, that shifts in consumption patterns induced by high prices of certain items--such as beef--might keep some prices from rising as high as they otherwise might. Similarly, the president of the retail chain felt that consumer resistance to high food prices has had some short-term effect, and that in the future consumers were likely to show a greater tendency to adjust buying habits in response to sizable price movements. The Buffalo Branch directors observed that food had first priority in the consumer's budget and that any stabilizing effect on food prices would have to stem more from the supply side--where shortages now prevail--than from the demand side. In their view, food price increases reflect higher production costs and food prices are finally "catching up" with the rise in other prices.

Concerning the employment picture, the majority of the respondents saw little change over the past month. With scattered exceptions, most of the directors noted a continuing shortage of skilled labor. The president of a large retail chain thus noted a tightening in the market for various types of positions in the retailing industry, and felt that in general competition had increased for managerial and technical personnel in many areas, including real estate and the computer field. Similarly, the New York banker reported hearing about shortages of skilled labor in the machinery and textile industry. The Buffalo Branch directors noted the continuation of the tight labor market conditions that have prevailed for some time in western New York, particularly in the machine tool trade, and in seasonal farm labor. A major exception was the Buffalo area, which apparently has not been significantly affected by labor shortages.

Among the major economic problems foreseen for the balance of 1973 and in 1974, a senior official of a large chemical firm cited the shortage of raw materials and fuel, and the disruptions and uncertainties surrounding Phase IV as his firm's main concern. Similar sentiments regarding Phase IV, growing shortages, and rising costs were also expressed by several other directors and businessmen. The New York banker looked for some decline in economic growth. The retailer mentioned slackening consumer demand and rising interest costs as the problems most concerning his firm. And several of the bank directors also felt the "high cost" of money to be one of the major problems from the standpoint of their operations.

THIRD DISTRICT--PHILADELPHIA

Executives in the Third District report that business activity is still increasing, but at a slower rate. Manufacturers' new orders, shipments, unfilled orders and delivery times are all up again this month. Employment rose slightly. Plans for larger investment expenditures are contributing to the advance. And domestic economy cars are selling very well. However, on the darker side, reports of price increases are widespread and disintermediation is a serious problem at savings institutions.

This month's business outlook survey of manufacturers in the Third District indicates activity is rising more slowly than in previous months. The majority of firms responding to the survey report no change in their new orders, shipments, backlogs of unfilled orders and delivery times since last month. Of the minority of firms reporting changes, most are experiencing increases in these measures of business activity. Looking ahead six months, the executives report expectations of slight reductions in their level of manufacturing activity. Employment opportunities are increasing at a few firms. Thirteen percent of the responding executives report increases in the length of the average workweek of their employees and 17 percent of the firms report increases in the number of people employed this month. The longer run outlook isn't as favorable. Although most firms expect no changes in the next six months, a few more firms are expecting the length of their employees' average workweek to decrease than are expecting it to increase.

The continued high level of business activity in the Third District is causing businessmen to increase their investment spending plans. Inventory investments are expected to increase slightly in the six months ahead. The number of firms that plan to increase their plant and equipment outlays is more than double the number planning reductions.

Auto dealers in Philadelphia are experiencing strong demand for autos and trucks. Demand for medium-sized and compact cars is strongest. However, one dealer reports an excess inventory of what he called "the tank-sized cars" because people wouldn't buy them. He attributes this to consumers' increasing dislike for "big polluting gas-hog" models. Department stores are experiencing strong seasonally adjusted sales. The new conservative men's clothes and consumer durables are selling well.

Inflationary expectations are high; 65 percent of the respondents reported paying higher prices than they were charged for the same goods last month. Thirty percent of the firms reported charging their customers higher prices. The six-month outlook is even worse, since well over 70 percent of the responding firms expect to pay, and to receive, higher prices.

Area bankers report that strong loan demand is exceeding deposit inflows, forcing them to buy funds in the money markets and at the discount window to keep from turning away valued customers. Several banks report that loans to nonbank financial intermediaries are at record highs; disintermediation and seasonal property-tax withdrawals have reduced savings institutions liquidity. One banker said the savings and loan associations were in a credit crunch, but that banks were not.

FOURTH DISTRICT--CLEVELAND

The consensus forecast of about 35 economists--primarily from major industrial firms and commercial banks in the District--who attended the Fourth District economists' round table meeting on September 7 is that the economy will experience sharply reduced real growth late this year and throughout next year; unemployment is expected to rise throughout 1974. (Only two economists forecast a classical recession.) The group projects a temporary rebound in the growth rate of real GNP during the third quarter, followed by a slowing in the fourth quarter, and remaining in the range of 2 percent to 2.5 percent during 1974. Unemployment is projected to remain at 4.8 percent for the balance of this year, and to rise to 5.3 percent by the end of 1974. The rate of increase in the GNP price deflator is expected to slow to 4.3 percent by the end of 1974, largely because agricultural prices are unlikely to rise as much as in 1973.

Forecasts of a reduced rate of real growth during the near term stem largely from an expected weakening in the consumer sector, partly reflecting a projected decline in housing that will slow sales of appliances and home furnishings. New car sales are expected to decline sharply. The median forecast of seven economists whose firms depend heavily on the auto market shows a decline in new car sales on the order of one million units in 1974 (to 10.8 million). An economist with a major retailing firm headquartered in the District said they had already begun to see evidence of a softening in non-automotive retail trade. The consensus of the round table economists is that consumer spending would be weakest in the fourth and first quarters (with gains in personal consumption expenditures averaging only about $13 billion), and would remain depressed until late 1974.

The reduced growth in economic activity forecast for next year also reflects the group's projection of less stimulus from the net export balance. Following an estimated swing of more than $6 billion in the net export balance between 1972 and 1973, the economists forecast further improvement of only $1 billion in 1974. Discussion during the meeting, however, indicated that this estimate may be on the conservative side. Some economists held the view that the round table group may be underestimating future benefits to our trade balance stemming from new exchange rate relationships.

The business economists were conservative with regard to prospects for inventory investment, with the median forecast calling for the change in business inventories to reach a $9 billion rate by the fourth quarter of this year, followed by a cutback to a $6 billion rate by year-end 1974. Capital spending is expected to be strong for the balance of this year, and the projected rates of increase during 1974 suggest only a moderate easing. Following a gain of $18.8 billion this year, nonresidential fixed investment is projected to rise $15.2 billion in 1974. (There was general agreement that with the pressing need to expand capacity in so many industries, capital spending was unlikely to be choked off next year.) It was noted that with corporate profits at or near a peak, and with Phase IV and reduced growth in the economy expected to dampen profits in 1974, corporations would be forced to rely more heavily on external sources of funds to finance their capital outlays. Sentiment was that the supply of funds next year would be adequate enough (albeit at a high price) to sustain the capital spending boom.

An economist with a major steel firm reported that most steel companies continue to have their customers on an allocation basis (i.e., they are rationing new orders). One factor contributing to the tight steel supply situation has been a very sharp rise in foreign steel prices. Recently, steel imports have been either unavailable or available only at premium prices. It was ironically noted that only a few years ago there was much talk about relying on cheap foreign steel for our domestic uses. The economist also pointed out that the domestic steel industry could have exported perhaps 15 million tons in 1973 instead of an estimated 3.5 million tons, but it concentrated on supplying the domestic market first. The steel industry is expected to remain at or near peak capacity operations until mid-1974 at least.

Current savings flows at S & L's in Ohio SMSA's are characterized as dreadful by industry sources. During August, the largest S & L's in the Cleveland area (our sample includes 57 percent of S & L deposits in Cuyahoga County) incurred deposit outflows equal to 1.9 percent of their savings deposits. For comparison, these institutions lost 1.1 percent of their savings deposits during July and experienced a 5.4 percent increase in their deposits during the first half of 1973. A large share of the August withdrawals coincided with the Treasury's offering of the 8 3/8 percent notes. Primarily as a result of the publicity afforded this offering by the Cleveland newspapers, the Cleveland office received $42 million of noncompetitive tenders, or 75 percent of the total received. In response to the poor deposit experience, several Cleveland S & L's have moved aggressively to attract depositors by offering the 4-year wild card certificates with current rates ranging from 8 to 10 1/4 percent. Preliminary results for the first ten days of September from two of these S & L's indicate that the higher yielding certificates have generated a net inflow of funds.

FIFTH DISTRICT--RICHMOND

Results of our most recent survey of businessmen and bankers suggest that business activity in the District continued to expand during the past month. Manufacturing shipments were up while backlogs and new orders remained unchanged. Further advances in retail sales were reported and employment has increased in recent weeks. Reports from bankers suggest that residential construction activity has declined because of tight mortgage markets, while nonresidential construction activity continues to increase. Banking respondents indicate that the demand for mortgage loans did not change in the past month, while the demand for consumer and business loans increased further. Most businessmen and bankers expect business activity to stabilize at present levels.

Survey responses indicate that economic activity in the manufacturing sector continues to expand. Nearly one-half of the manufacturing respondents reported that shipments increased during the past month while none reported decreased shipments. On balance, the volume of new orders and backlogs of orders were unchanged. Increased shipments were reported by important producers in such industries as chemicals, paper and synthetic fibers. Manufacturing inventories were reported little changed from the previous month's survey, and most manufacturing respondents believe that current inventory levels are about in line with sales prospects.

Survey responses suggest a slight increase in District employment during the past month. Nearly three-fourths of the manufacturing respondents reported that employment was unchanged, while most of the remaining firms reported that employment had increased. The majority of trade and services respondents reported that employment was unchanged. Both manufacturing and trade and services respondents reported increases in wages and prices received.

Retail sales in the District continue strong. Nearly a third of the banking respondents reported further increases in retail sales in their areas. Information from major District retailers and other sources also indicates gains in retail sales during the past month.

In general, loan demand in the District remains strong. Demand for consumer loans is particularly strong with more than 50 percent of the banking respondents reporting an increase in the demand for this type of loan. Mortgage loan demand is reported to be little changed from recent high levels and numerous respondents expressed concern about the unavailability of mortgage funds.

The shortage of mortgage funds is being reflected in residential construction activity. More than 50 percent of the banking respondents indicated that residential construction in their areas has declined. In general, banking respondents report that nonresidential construction activity continues to increase although at a slower rate than in recent months. Michelin Tire Corporation recently awarded a $175 million contract for the construction of two manufacturing plants in South Carolina.

A sharply improved farm income situation continued throughout the first half of 1973, with cash receipts from farm marketings recording a 27 percent gain over a year ago.

Season average prices are running below year-earlier levels on all flue-cured tobacco belts except the border belt.

Despite concern over high interest rates and the unavailability of funds for residential mortgages most businessmen and bankers expect business activity in the District to stabilize at present Levels. Nearly

80 percent of the banking respondents expect no change in business activity in their areas during the next three months.

SIXTH DISTRICT--ATLANTA

Reported shortages of money, men, and materials are putting a damper on the District's economic growth. While announcements of new plants continue brisk, there is growing uncertainty about future spending plans and economic activity partly related to the controls program. Sharp declines in residential construction have been noted. Despite gasoline shortages, Florida's tourist traffic remains excellent.

Tight money markets are curtailing residential construction, particularly in the Florida area. Savings and loans are currently being sapped for funds as investors turn to Treasury bills and other higher-interest investments. Florida bankers are receiving loan requests from savings and loan institutions. One banker is lending to them at the Fed funds rate. One Florida banker notes that interest rates are running up against state usury laws and that the small investor is feeling the brunt of the current money shortage. According to one Florida businessman, high interest rates have stimulated the purchase and resiting of older homes. Many of these old homes have been relocated from sites near interstate highways. Home-building in Atlanta and areas of Louisiana, Mississippi, and Alabama is also down from year-ago levels. Reports of shortages of mortgage money from savings and loans have been received from all of these areas.

Businessmen also report shortages of labor and materials. Apparel producers, particularly in the Miami area, indicate that it is virtually impossible to find workers, skilled or unskilled. Cotton shortages have limited the supply of denim fabric and forced a switch to man-made fabrics, according to two Georgia apparel manufacturers. Other material shortages have forced the closing of plants in some areas of the District. In Florida, a shortage of Portland cement has caused the closing of six ready-mix plants. Natural gas shortages had temporarily closed a number of paper products plants as well as a paper mill in Louisiana. Because of the paper shortage, partly the result of the Canadian strike, two of Florida's larger newspapers are cutting back on the size of their publications.

Poultry producers apparently are expanding flocks as a result of today's high poultry prices. In late August, broiler placements in Georgia increased sharply. One local poultry equipment manufacturer indicated a strong pickup in demand. Recent rains from tropical storm Delia have damaged the rice and soybean crops in southwest Louisiana. Less than one-half of the crop has been harvested. High meat prices have caused an increased slaughter of milk cows in Georgia; some reports indicate a critical milk shortage may result.

In assessing the results of the President's economic controls program, several businessmen and bankers report that the resulting uncertainty will probably dampen business intentions for plant and equipment expenditures. However, this expected decline has not as yet been noted. Announcements of new plants continue brisk. Texaco plans to build a $300 million crude oil refinery in Louisiana. An American subsidiary of a large international chemical company with headquarters in Germany may locate a new plant in Louisiana which will initially employ approximately 1,000 workers. There appears to be a growing international flavor to many investments taking place in the District. One-half interest in a large plot of Louisiana riverfront property has recently been sold to an Italian investor. Georgia state officials have reported that since December of 1972, the Japanese have either put into operation or announced 10 manufacturing facilities in Georgia. One local banker indicated that a southeastern cotton grower has contracted his entire production for the next five years to a Japanese firm.

New announcements of commercial and public projects also continue to roll in. In Louisiana, a long delayed new north-south superhighway costing $500 million has been announced, and a new shopping mall which will employ 2,000 workers has recently opened. Other announcements include a $150 million office park-hotel-regional shopping center complex and a $50 million truckstop complex, both in the Atlanta area.

Florida's summer tourist season has been excellent. The Pensacola area reports tourist traffic up nearly 22 percent over last year. Central Florida has enjoyed a strong summer business, despite fears of a gasoline shortage. A survey of the Georgia Oilmen's Association indicates that independent jobbers and distributors had either been shut off completely from their usual sources of supply or had been placed on strict allocation limits.

SEVENTH DISTRICT--CHICAGO

The region of the Seventh District has not yet witnessed any letup in the extremely vigorous demand for metals, chemicals, fuel, consumer goods, business equipment, and building materials. Very hot weather in the second half of August cut production of steel, motor vehicles, and other products, but these developments are presumably associated with extending the period of shortages. Foreign demand for many U.S. materials and products at "bargain prices" is intense and would take up any domestic slack in the near future. Orders for capital goods continue in heavy volume. Manufacturers are concerned with shortages, delayed deliveries, and quality problems. Declines in farm prices in recent weeks have about wiped out the surge recorded in the August indexes. Labor markets remain very tight. New commitments for mortgages on single-family homes are very difficult to obtain, but the volume of total construction activity remains very high.

Large firms generally appear to be following the price guidelines, and in many cases prices have not been raised as much as would be allowed by the Cost-of-Living Council. Most smaller firms are raising prices freely. Price controls have restricted availability of some goods, including petroleum products and certain grades of paper. Charges for services--utilities, maintenance work, and medical care--have increased sharply in the past month or so. For example, some home furnace maintenance fees in the Chicago area jumped 55 percent in the summer, and the city of Chicago intends to raise water prices to city customers and 67 suburbs by

34 percent. (All this suggests that John Galbraith's theory that the general price level can be controlled merely by controlling prices charged by giant firms is not valid.)

Availability of labor, skilled and unskilled, poses a problem for many employers in the District. The job situation was aggravated in the last two weeks of August as students left summer jobs in manufacturing, trade, and recreational activities to return to schools that opened before Labor Day this year. Help-wanted advertising has increased sharply, and help-wanted signs, full or part time ("hours arranged"), are a very common sign at manufacturing, trade, and service establishments.

The order surge continues in the capital goods industries (apparently across-the-board), and the volume of new construction contracts for manufacturing buildings is very large. Design firms are swamped with new work. Various hard and soft goods industries see a need to push capacity expansion programs for the next two to five years--with short supplies predicted for the intervening period. Expansion programs for small cars and trucks are in full swing. The chemical, petroleum, public utility, and paper industries are all pushing expansion plans more-or-less vigorously. The blowup of order backlogs in machine tools, freight cars, construction and farm equipment relates to lags in increasing output caused by limited availability of materials, parts, components, and skilled labor. A very large construction equipment producer has announced a five-year program with capital expenditures far above the level of recent years.

Steel output was restrained in the summer by hot weather, labor shortages, equipment failures, and electricity cutbacks. Smaller firms which used to buy steel from warehouses on a month-to-month basis have been forced to negotiate nine months or more in advance of needs. Shortages of steel and various other materials are increased by the fact that some users have increased inventories beyond normal levels to insure supplies (although inventories overall are relatively low). U.S. steel firms are sorely tempted to sell steel abroad in volume at premium prices, but, thus far, have not done so.

Gasoline supplies are reasonably adequate in most areas, but scattered shortages remain. We are told most oil firms are not following the government guidelines for allocating supplies to favored users. Rigid price controls on gasoline, diesel fuel, and home heating oils may reduce availability. For example, prices for industrial fuels are above prices of the higher grades, thereby encouraging diversions. A cold winter may bring critical heating oil shortages, especially for the Midwest and the plains, which are not allowed to bid supplies away from other areas. Moreover, present rules provide no incentive to import oil products from abroad.

Net outflows of funds from the S&Ls remained large in August, at least in downtown Chicago. The volume of existing mortgage commitments remains very large, but new commitments on home mortgages in the Chicago area are being made on 30-40 percent down payments (at the 8 percent usury ceiling), and are commonly restricted to established customers. The home-building picture for next year is growing darker.

Power shortages in this area partly have reflected restrictions on nuclear power plant operations. The August heat wave caused interruptions for industrial users and some voltage reductions.

The prospect is for record crops of corn and soybeans. Beef supplies appear adequate to prevent a sharp rise in prices. Closed slaughterhouses have been reopened. Elevators have paid premiums to obtain covered hopper cars, still in short supply, to move grain.

EIGHTH DISTRICT--ST. LOUIS

Business activity generally continues up in the Eighth Federal Reserve District. Retail sales at major outlets continue to increase on a seasonally adjusted basis. Most manufacturing firms report that operations remain at or near capacity levels. Raw materials are still scarce in many lines of production with no major increases of supply in sight. Construction activity is mixed; residential building is down but commercial construction is increasing. The agricultural situation generally points to large crops and high farm incomes. Credit demand remains high, and no major decline in interest rates is foreseen by officials of those financial institutions interviewed.

Apparel and clothing items led the upward movement of sales at large District retail stores in recent weeks. There was a slackening in the sales of some appliance items which are installed by home builders, but the slowdown was more than offset by increased sales of clothing, household equipment and fixtures, and other items.

Manufacturing establishments in the District continue to report capacity operations, backlogs of orders, shortages of raw materials and skilled labor, and pricing problems. The backlogs of orders are holding stable for most industries. A representative of the paper and paperboard industry reported that capacity construction underway is only sufficient to take care of projected population increases, and that the profits of the firms, at current product prices, are not sufficient to provide incentive for the amount of construction necessary to relieve the shortage. He also reported that there is an insufficient number of pulpwood harvesting workers to meet the demand for pulpwood at current prices. A natural gas company representative reported that gas consumption in the Nation had exceeded the amount discovered in each of the past six year. As a result, the supply of gas is diminishing and only about nine to twelve years of reserves remain at current consumption levels.

Residential construction has slowed considerably over most of the District in the past three months. In some areas home building is reported to be at a standstill. Commercial construction, however, continues at a relatively high level and is reported to be gaining momentum in the St. Louis metropolitan area.

Large crops, relatively high farm prices and record farm incomes are in prospect for farmers in the Eighth District. Although most crops were planted later than average, the weather has been generally favorable. Rainfall has been timely and crop conditions are good to excellent. Prices of farm products remain relatively high despite recent declines in some feed grain and livestock prices, and with the large marketings in prospect net farm income should be well above the previous record level.

Credit conditions in the District remain very "tight." Loan demand continues to rise faster than the supply of loanable funds, and upward pressure on interest rates continues. Total deposits at the large District banks have declined in recent weeks. Time and savings accounts have increased somewhat, but not enough to offset the decline in demand deposits. Savings inflows into savings and loan associations have been at a slower rate in recent weeks than heretofore, and there has been some complaint among the savings and loan associations that the current margin of one-fourth of a percentage point between bank and savings and loan rates is too small. A few savings and loan associations, however, continue to search for loans, and most prospective home purchasers can obtain mortgage credit. The rate on conventional mortgages in the St. Louis area is 8 percent plus one to three points. The maximum legal rate in several of the Eighth District states is 8 percent; hence a higher point charge will be used to reflect further increases in market rates on home purchase loans.

NINTH DISTRICT--MINNEAPOLIS

Although second quarter District manufacturing sales were up substantially from a year earlier, respondents to our latest Industrial Expectations Survey foresee some slowing in sales growth. Recent price increases and uncertainties about the economy have not dampened District consumers' enthusiasm to spend, and District retailers expect business to remain good. Despite high interest rates and Phase IV regulations, Bank directors report that District businessmen have not altered their investment plans. However, high interest rates and a lack of mortgage funds are expected to curb District residential construction.

According to results of our third quarter Industrial Expectations Survey, District manufacturing sales continue to expand at a brisk pace. Following an extremely large first quarter advance of 21.8 percent, District manufacturing sales in the second quarter were up 15.7 percent from a year earlier. These large gains undoubtedly reflect substantial price increases and are not considered by survey respondents to be sustainable. Looking ahead to the third and fourth quarters, District manufacturing sales are expected to surpass year-earlier levels by 12.9 and 9.8 percent, respectively. By the first quarter of 1974 sales growth is expected to slow to a 6.9 percent rate. In recent surveys, however, actual sales gains have generally exceeded manufacturers' earlier expectations.

Bank directors report that District consumers are continuing to spend at a brisk pace, and District retailers are optimistic about their sales prospects. A Twin Cities area director associated with the retail trade industry indicates that his firm's sales were good in August and that he expects business to continue strong for some time. Another director reveals that his area's merchants foresee good sales gains, providing merchandise is available. Industrial construction activity is stimulating retail spending in Michigan's Upper Peninsula, and directors from District agricultural regions, where farm income is up markedly, report sizable advances in retail spending. Another director, however, foresees some slowing in the Minneapolis/St. Paul metropolitan area's economy and looks for future retail sales gains to be smaller than they have been recently. One director believes that recent gains in consumer spending stem from consumers' desires to avoid future price increases.

According to directors' responses, record high interest rates and Phase IV regulations have not caused District businessmen to alter their plant and equipment expenditure plans. One director, for example, says that high interest rates have not affected his firm's plans. Another director indicates that high interest rates have deterred some of his area's businessmen, but most are going ahead with their plans. No slowdown in northeastern Minnesota's economy was foreseen, and businessmen there have not changed their spending plans. One director, however, thinks that capital spending in real terms in the Minneapolis/St. Paul metropolitan area will not change much between 1973 and 1974.

A lack of mortgage funds and high interest rates are expected to dampen District home building, but several directors foresee no letup in nonresidential construction. In the Minneapolis/St. Paul area, where Minnesota's 8 percent usury law has significantly contributed to a drying up of mortgage funds, a decline in housing starts is foreseen. Many directors report that mortgage funds remain available in their areas but interest rates have risen, which has discouraged many potential home buyers. A South Dakota director indicates that the decline in farm loan demand in his area is providing mortgage funds.

TENTH DISTRICT--KANSAS CITY

Purchasing managers at Tenth District manufacturing firms reported that nearly all materials are in short supply, with no easing of the situation in sight. Lead times are considerably longer than normal, and are lengthening. Prices are rising sharply and are expected to continue to rise. Although larger inventories are desired, firms are unable to increase them for several reasons. Business loan activity at District commercial banks has decreased, for both demand and supply reasons. In the agricultural sector, higher farm prices will maintain pressure on food prices although greater stability should occur in the months ahead.

Purchasing officers and managers at a number of manufacturing firms in the Tenth District were interviewed with regard to their materials supply situation, including availability, lead times, prices, and inventory plans. The composite picture resulting from this survey was one of uncertainty and disarray. The following quotation from one respondent captures much of the feeling of disorder: "The whole raw material situation is very unstable. You cannot be sure that you will get the quantity you ordered, you cannot be sure you will get it when you want it, and you cannot be sure of the price you will have to pay." Nearly all materials were reported to be in tight supply, with some simply not available. Many firms find themselves facing materials allocations and allotments from their suppliers, which in some cases are less than the desired amounts. Furthermore, the purchasing managers do not anticipate an imminent easing of the situation. The following materials were specifically mentioned as being in short supply: textile products, especially burlap; paper and paper products, including containers; aluminum; plastics; petroleum products for manufacturing purposes, including solvents; metal castings; and steel, especially so-called "low profit" items--with specific mention of reinforcing bars.

Purchasing managers almost unanimously report that lead times are now considerably longer than normal on virtually all materials ordered, and nearly all report that lead times are continuing to lengthen. Among the products and materials showing lengthening lead times are plastics, metal castings, steel products, electronic components, and electric motors. One firm estimated that lead times now are generally about four times their normal length, very close to the average increase in lead times for those items specifically reported.

Prices of materials are reported to be rising by nearly all respondents--"enough that it hurts," said one. In a few instances, firms reported that they had been able to protect themselves by contracts for the rest of this year for materials such as aluminum, textiles, and plastics. Further significant price increases are almost universally expected. The majority of respondents suggest that it is still too early for the influence of Phase IV rules to be ascertained. Several commented on the importance for future price movements of decisions that will be made on pending requests for increases, with the steel industry request singled out for particular attention.

Increasing voluntary accumulation of materials inventories is very exceptional among the Tenth District firms surveyed. Several reasons were given by purchasing managers: high interest rates are a deterrent ("money is too expensive for building inventories"); materials are not available or in such short supply that inventories cannot be greatly expanded; allocation of materials by suppliers prevents further stock building. Some respondents stated that they could not keep production at desired levels with available materials, and thus could not add to inventories although they wanted to. The only reported instances of stock building as strictly a price hedge were from one heavy user of copper and another of polyethylene, both of whom expect significant price increases.

A rise of 20 percent in the month ended August 15 pushed farm prices more than 60 percent above a year earlier and intensified the pressures on food prices, pressures that will continue to be felt for several weeks. However, there are indications that the upward spiral in food prices may soon start to level out. Consumer resistance to high retail prices has induced a lowering of live animal prices, especially hogs which have dropped significantly from their August high. Grain prices have also weakened during this period, reflecting new crop prospects and slightly dampened foreign demand. Furthermore, with the lifting of the freeze on retail beef prices, cattle prices may dip somewhat if a bulge in marketings develops over the next few weeks. However, any decline is likely to be temporary. On balance, food prices should tend to stabilize in coming months, but hoped-for declines of a significant magnitude are still sometime off.

A decline in business loans over the last few weeks at Tenth District banks has been due to both tighter supply conditions and decreased demand. Banks in Denver and Kansas City tended to stress the supply side, saying they were only making loans to old customers, and then very selectively. Potential new customers who had exhausted credit lines at competing banks and were shopping around for additional credit sources were being turned down. In other District cities a distinct slackening in loan demand from businesses has been noted in recent weeks. Resistance to higher interest rates was one reason cited for this decline. Demand in some other loan categories (e.g., consumer loans and loans for carrying grain inventories) continues to be strong.

Aggressive marketing of consumer and large CD's has offset demand deposit declines at District banks. Large CD maturities are being kept short at most banks as a decline in short rates is expected soon. The public's enthusiastic response to the 4-year consumer CD's was something of a surprise to many bankers who soon realized that most of this money was coming from passbook savings in their own banks.

ELEVENTH DISTRICT--DALLAS

A number of indicators of economic activity for the Eleventh District continue to show strength, although others demonstrate some weakness. Employment in the five southwestern states rose to record levels in July, department store sales continued strong, and crop prospects remain good to excellent. Yet, in July, industrial production in Texas moved down and registrations of new passenger automobiles in the largest cities of the state declined. Moreover, total loans at District weekly reporting banks fell slightly during the month of August.

Seasonally adjusted total employment in the five southwestern states rose to a new high level in July, following an upward revision in the number of people employed in June. Total employment was higher than a year before, and even with a slight increase in the labor force, the unemployment rate dropped to 3.8 percent in July.

Manufacturing employment was essentially unchanged, as gains in the employment at durable goods producers were offset by declines at nondurables plants. The advance in nonmanufacturing employment was paced by new hirings for construction and government jobs. All categories of industry were well above their employment levels of a year earlier.

The seasonally adjusted Texas industrial production index fell in July but remained 6.0 percent higher than a year earlier. The decline was the largest since August of last year. All major components of the index except utilities contributed to the reduction.

Department store sales in the Eleventh District were 13 percent higher in the four weeks ended August 25 than in the comparable period last year. Cumulative year-to-date sales were also 13 percent above the corresponding period in 1972. Registrations of new passenger automobiles in Dallas, Fort Worth, Houston, and San Antonio declined in July but still remained higher than in July of last year. Cumulative registrations for the first seven months of 1973 were 8 percent above the same period in 1972.

Agricultural activities in the Eleventh District continue slightly behind normal schedule, but general crop prospects remain good to excellent. Harvest activity for corn, sorghum, and cotton is gaining momentum; soybean crops are showing excellent progress; and seedbed preparation is under way for wheat and winter vegetables. The rice harvest is sharply behind last year though yields have been very good. Texas and Louisiana could suffer some losses to rice and cotton as a result of tropical storm Delia.

Texas and Arizona reported a total of over 2.8 million head of cattle and calves on feed as of August 1. The 2.3 million head in Texas was 9 percent above a year earlier but slightly below July 1. Arizona had a small gain on a year-to-year basis but showed a 15 percent decline from the preceding month. July marketings in both states were above year-ago levels. But placements continued sharply below both those in the previous month and in July of last year, apparently as animals are being held on pasture. Texas cattle slaughter in July also was down from both June and year-ago levels. However, the total for the first seven months continued 1 percent above 1972, in contrast to the 5 percent decline nationally.

Total credit at weekly reporting banks in the Eleventh District decreased slightly during the month of August. The decline which was represented in a fall in both loans and investments, was accompanied by a sizable outflow of deposits. Total loans edged downward during the month, primarily reflecting a substantial fall in business loan demand. The drop in business loans, however, resulted mainly from reductions in bankers' acceptances at one large bank.

Construction activity in the District was brisk and demand for real estate loans remained high. Growth in consumer loans at District banks was still strong, as borrowers apparently continue to use bank credit to finance purchases of automobiles and other durable goods.

Despite the decline in the overall demand for loans, District reporting banks on balance reduced their security holdings. They did add a substantial volume of Government issues, mainly Treasury bills, to their investment portfolios; but decreases in other security holdings, primarily municipal issues, more than offset the rise in bills.

TWELFTH DISTRICT--SAN FRANCISCO

Economic activity continues to maintain a high level, led by consumer and business spending. The agricultural sector is another source of strength, but residential construction is at a lower level. With certain exoeptions, inventories appear to be low relative to demand, primarily because of delays of manufacturers in filling orders. Commercial banks report strong loan demand in most categories.

Consumer and business spending are maintaining the rates established in recent months. Purchases of consumer durables, especially freezers and refrigerators, are very strong, and automobile sales are good. The demand for compact cars is particularly strong, and this is attributed partly to concern about gasoline shortages. Demand for large domestic automobiles is somewhat weaker. Business spending for commercial buildings and new equipment shows no sign of slowing. Although some directors expect that the demand for consumer durables will ease later this year, there is no sign of any slowing in overall economic activity.

Agricultural prospects in the District are excellent according to our directors in farming areas. Drought is causing some crop losses for wheat in eastern Oregon and Washington, but otherwise yields are expected to be above average for this crop year. Farm prices are at a record high for most crops, and the resulting high farm income is encouraging heavy purchases of consumer goods and farm equipment.

The only major sector exhibiting weakness is residential construction which is falling off in most parts of the District. In some areas the decline affects apartment construction, as well as single- to four-family residences. A factor in this decline is the high level of interest rates and lack of available mortgage finance at savings and loan associations.

The decline in housing demand is affecting the lumber and plywood industry which is experiencing lower prices. Currently a rail strike in Canada is cutting imports of green lumber and supporting the demand for domestic timber, but when this strike is over, prices are expected to resume their downward trend. The pulp and paper sectors of the forest products industry are facing strong demand, in part caused by the Canadian strike. Domestic mills are running at full capacity. According to one director, supplies should be tight for several years, because new capacity is being added at half the normal growth rate.

Our directors were asked to comment on prospective changes in inventories. Their reports indicate that inventories are low for most manufacturers and many retailers. Only inventories of large model cars are more than adequate. Shortages are most severe in raw materials and semi-finished goods. Copper and steel are in particularly short supply and the order backlog is so great that some steel companies have taken their salesmen off the road. Paper inventories are on the low side but not lumber. Retail inventories except for those products facing strong demand are satisfactory. Although inventory levels are somewhat low, the consensus seems to be that there will be no major buildup of inventories this year. High interest costs discourage large stocks and there is uncertainty, especially by retailers, about long-term business prospects.

District banks report continuing strong demand for loans over most categories. The decline in housing construction has not resulted in a decline in mortgage demand at banks. The run-off of funds at many S & L's has caused a shift in demand to the banks. The recent increases in time deposit interest rates have allowed most banks to hold their deposits or to limit outflows. Although more individuals are putting funds directly into such market instruments as Treasury bills, the major losses are being experienced by S & L's, not banks. Some bankers now feel that short-term rates are at their peak and the only question concerns the timing of the downturn.