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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

The general impression conveyed by this month's Red Book is that the worst of the economic slowdown appears to be over, and that the economic outlook has improved. Directors throughout the System, along with other businessmen and bankers, are generally more optimistic (or less pessimistic) than a month or two ago. The improvement in attitudes is widely attributed to the lifting of the oil embargo. Moreover, indications are that business in the energy-affected sectors was not as bad as expected, or at least the declines have bottomed out in areas such as auto sales, tourism, and housing. Retail sales are showing signs of a pickup, while capital spending remains very strong. Severe shortages of materials and long delivery times continue to hamper operations in many industries. Residential construction is characterized as having stopped declining, but no solid upswing is yet in progress. Agricultural prospects are viewed as good in most areas, although shortages of certain production inputs are a problem. In addition, producers of meat animals and poultry are incurring severe losses as a result of recent price declines. Business loan demand has surged in recent weeks.

In the consumer sector, there are signs that the most depressed areas, such as new cars, large used cars, and spending for tourism and recreation, are beginning to improve. Districts commenting on the auto market indicate that the decline has ended. Auto dealers are becoming more optimistic as sales of luxury-type and large-sized new and used cars show some pickup. Tourism and recreational spending, which had been dampened by the gasoline situation (and poor weather in some ski areas), is beginning to recover.

*Prepared by the Federal Reserve Bank of Cleveland.

Nonautomotive retail trade is generally described as having been soft during most of the first quarter. Pre-Easter sales, however, appear to be better than expected by retailers in some Districts. Minneapolis attributes good first quarter sales partly to the high level of farm income. On the other hand, Richmond says that consumers are becoming more cautious about discretionary spending, while Cleveland suggests that it is too early to conclude whether a significant pickup in general merchandise trade is underway.

Business fixed investment continues to be an important source of strength. Atlanta notes that the volume of plant announcements is once again on the upswing and emphasizes substantial spending for pollution control. Chicago sees no letup in demand for all types of capital goods, and adds that the farm equipment industry will be hard pressed to increase shipments over last year because output is at capacity and finished goods inventories are down sharply. Cleveland also reports across-the-board strength in capital goods, particularly machine tools. St. Louis, San Francisco, and Philadelphia all see signs of further strength in capital spending.

Shortages and long delivery time continue to be serious economic problems, although of less importance than inflation. Almost every District's report includes some comment on the difficulties in obtaining materials and parts and, in some cases, skilled labor and transportation. Shortages are affecting not only manufacturing, but also mining, construction, and agriculture. There are scattered indications that selective decontrols have helped alleviate tight supply conditions in certain instances. But in some cases the situation has grown worse. Chicago, Cleveland, and Dallas, for example, all emphasize increasingly tight conditions in the steel industry, partly because of rapidly dwindling coal supplies.

Residential construction seems to have bottomed out, but no District reports a solid recovery underway. In fact, there is concern (variously expressed by Boston, Chicago, Cleveland, St. Louis, and San Francisco) that rising interest rates and potential disintermediation may adversely affect the recovery of homebuilding. St. Louis reports that S&Ls already have begun to lose deposits in significant amounts.

In the agricultural sector, prospects for crops are generally good. Dallas, however, notes that the winter wheat crop in Texas has been affected by drought and is expected to be half of last year's harvest. Shortages of agricultural inputs are disrupting production in the Southwest. Chicago and San Francisco also mention problems regarding shortages of inputs such as fertilizer and machinery. Prospects do not appear to be particularly good for cattle, hogs, and poultry. Dallas, Kansas City, Minneapolis, and St. Louis each express concern over the cost-price squeeze currently affecting many producers. Sharp losses due to recent price declines in cattle, hogs, and poultry are reducing the incentive of producers to expand their output.

In the banking sector, business loan demand has risen sharply in recent weeks. Kansas City and New York attribute some of the strength to borrowing in anticipation of higher prices. New York adds that the recent rise in money market rates has caused a shift from the commercial paper market to bank credit.

FIRST DISTRICT - BOSTON

Our directors forecast for 1974 is getting less gloomy as business continues to be very good.

Current business orders are very strong in the capital goods areas and very weak in leisure, auto, and apparel industries, according to our directors. Only one director explained his very good sales in March as largely due to strike hedge buying and to anticipatory buying before an announced price increase for April. In general, business is considered to be quite good, and the continuation of this situation has shaken our directors feelings that 1974 would inevitably be a year of stagflation, with a rapid rise in unemployment. Their current feelings about the outlook are "confused" because they feel that the economic picture is "muddled."

Our bank directors ascribe the recent rise in the prime rate to the rising Federal funds rate and to a sudden surge in business loan demand. The major banks are so heavily dependent on Federal funds, according to a director from a large Boston bank, that a rise in the Federal funds rate assumes major importance in determining the cost of bank funds. This director also reports that business loan demand is booming across the board. Real estate investment trusts in the past 3 to 4 weeks have been pulling down their bank lines because they have not been treated well in the commercial paper market. Major corporations have been coming in for their full lines in the last few weeks, and foreign banks have also been heavy borrowers.

Our academic correspondents, Professors Eckstein, Samuelson, Shapiro and Tobin, were sharply divided in their policy recommendations this month. Eckstein, Samuelson, and Tobin were all prepared to accept significantly higher rates of monetary growth in order to curb the rise in short-term interest rates, while Dr. Shapiro favored continued moderate money growth regardless of the accompanying interest rate pattern.

In Shapiro's view, the current restriction is a desirable measure to make sure excess pressures on capacity will not build up later in the year. Continuation of this policy would lead him to reduce his estimate of housing starts at year-end by about 200,000 units. However, except for the weakness in consumption, the other components of spending remain strong. The job for monetary policy is to hold down inflationary pressures by insuring that the recovery in consumption will be a gradual one. Dr. Shapiro expects output declines over the first half of the year to be offset by increases in the second half. The unemployment rate is predicted to rise to 6 percent by year-end and average to about 5.8 percent in 1975 with real growth of 4.2 percent. He feels a Federal funds rate of about 10 percent would cause a reversal of short-term capital outflows and of the recent tendency for loans which would have been acquired in the Euro-dollar market to come home.

Samuelson feels the tightening of short-term interest rates have been over-done. He notes that the public and business community have come around to the experts' view that we are in a mini-recession which will be near its bottom in the second quarter, but have not accepted the unanimous view that the rate of inflation will be tapering down in the second half. However, "unless money grows at about 8 percent between now and year end, the fourth quarter recovery will not occur as disintermediation will abort the housing recovery," Eckstein said.

Both Samuelson and Eckstein argued that a monetarist approach to policy need not be associated with a 5.5 to 6 percent money growth target in the present context. Noting that monetarist James Meiggs of the Argus Corporation favors a higher growth rate at the present time, they both argued a 5.5 to 6 percent money growth would be appropriate now only if we want a genuine recession, only if the Fed intends "to beat inflation by itself." The current inflation has no particular relationship to excess demand spending and can be brought down only gradually by aggregative policy. Not to accommodate any of this special inflation is an extremely tight policy which will generate a recession of some severity and exceptional duration. "Even if the Fed wished to do this, the political process would not go along with it," according to Eckstein.

Tobin argued that lower interest rates would be necessary to achieve even the administration's hopes for a rather modest recovery this year. With rising rates, this prospect is in jeopardy. The Fed cannot "solve" the problem of inflation without prolonged stagnation and unemployment. The first casualty of rising rates is expected to be housing, where the turnaround was predicted or reintermediation as opposed to the increasing disintermediation associated with higher rates. Tobin stressed the role of the stock market in setting the cost of capital for business fixed investment. While tighter money and higher capital costs now might not preclude this year's investment boom, its consequences would surely be felt in the form of weakened capital spending in 1975. Tobin advocated a Federal funds target of 8 percent.

SECOND DISTRICT - NEW YORK

Second District directors, retailers, and New York City bankers who were contacted recently painted a generally more optimistic picture of the current economic outlook as compared to last month. A number of respondents characterized business conditions as stronger than expected to "very strong" and "booming". The respondents in general felt the end of the Arab oil embargo would provide some, if only moderate, near-term boost to economic activity. The retailers and other respondents on balance reported more strength in consumer spending than had been expected earlier. The sharp rise in recent weeks in business loans was traced primarily to inventory building by business firms as a hedge against expected price increases and scarcities, as well as to a shift from the commercial paper market.

The respondents on balance felt the lifting of the oil embargo would provide some near-term stimulus to economic activity. In particular, the end of the embargo was expected to bring relief to those sectors that have been most adversely affected by the oil shortage and at least removed the threat of the more serious consequences that might have occurred if the embargo had been maintained for a longer period. A number of respondents, however, noted that the severe shortages of productive capacity and of numerous materials remained a serious cause for concern.

Several respondents felt that the lifting of the embargo would have some positive influence on consumer attitudes. And indeed, as noted above, a fairly strong retail sales picture emerged from the observations of the retailers and other respondents. Thus, the Buffalo branch directors reported retail sales in their areas to be at least at, and perhaps somewhat above, earlier forecasts. The president of a Buffalo department store reported sales at his store had been running somewhat above last year, and a senior official of a large multinational firm based in Rochester mentioned a strong demand for firm's products, as did another upstate manufacturer.

Among the retailers who were contacted, the chairman of a New York City area middle-price department store chain stated that, primarily as a result of promotional efforts, sales at his stores in the recent past had exceeded "by a considerable amount" the levels forecast earlier in the year. Moreover, on the basis of conversations with officials of other retail firms, he believed that similar department stores in the New York metropolitan area were having comparable experiences. A senior official of a high-quality New York City department store with branches in the suburbs did characterize the current retail sales picture as "soft," but expected that for 1974 as a whole business at his firm would be somewhat higher than in 1973, in physical volume as well as in dollar terms. An official of a nationwide department store chain reported that his firm's sales had increased somewhat more than expected and noted that, while the rate of increase has been below that of the comparable period last year, his firm had enjoyed an "extremely strong" first quarter in 1973.

Regarding the current large demands for short-term bank credit by business firms, the directors and the New York City bankers who were contacted generally attributed the sharp rise in such credit primarily to inventory building. This accumulation in turn was variously attributed to fears of shortages, to expectations of price increases, and to the higher cost of carrying inventories as a result of the previous increases in prices. Some respondents also felt the rise to be related to some extent to tax-borrowing.

Another major factor cited by the New York City bankers has been a shift from the commercial paper market to commercial bank credit, induced by the rise in money market rates. The effect of this shift, according to one bank economist, may have been largely concentrated in the New York credit market.

THIRD DISTRICT - PHILADELPHIA

Economic prospects on the whole have improved during the past month. Production activity is about the same as last month, but respondents foresee increased activity by fall. While employment opportunities are about even with last month, firms expect some increases in the level of employment in the next six months. Inventory spending remains unchanged from last month, although executives see boosts in capital expenditures plans in the months ahead. Construction activity, however, has weakened in the Third District. Easter sales in retail department stores are strong, but soaring prices continue to plague the regional economy. While loan demand and deposit flows leveled off during most of the first quarter, recent weeks show increases in the levels of loans and deposits. Manufacturers in the Third District, responding to this month's business outlook survey, report a divergence between current business activity and their expectations six months in the future. Currently, over two-thirds of the area manufacturers are experiencing no change in their new orders, shipments, and unfilled orders. In contrast, the six-month outlook of the area executives is more optimistic than it has been since last June. Well over a third of the respondents expect new orders, shipments, and unfilled orders to start picking up during the next two quarters. Employment in the Third District remains about where it was last month with almost 90 percent of the firms reporting no changes this month in their number of employees and the length of their average workweek. However, by next fall, almost one-fourth of the firms expect to be increasing the average length of the workweek. Virtually no firm expects a decrease in either employment indicator within the next six months.

Business investment in inventories remains unchanged this month, and over half of the firms surveyed expect this trend to continue six months out. However, manufacturers' plans for boosting expenditures for plant and equipment have increased substantially from several months ago. Almost one-half of the respondents expect to increase spending in this area by October.

Construction activity in the Third District has declined somewhat. Residential housing contracts are off slightly, and nonresidential projects are down considerably from previous levels.

Philadelphia department stores are far more optimistic this month than last. February and early March brought soft sales for retail stores. But the easing of the energy shortage and early Easter have brought shoppers back into area department stores. Accessories, children's clothes, and millinery are all selling well.

Prices continue to travel upward on a broad front. Nearly 80 percent of the Third District's respondents report paying higher prices for raw materials in April than they did in March, and nearly 60 percent report receiving higher prices in April--up from last month. But area manufacturers see no lessening in inflationary pressures during the next six months. Over three-fourths expect to be paying and receiving higher prices by October.

Loan demand has been down in Third District banks most of the first quarter. However, bankers surveyed report increases in loan demand in late March and early April. An increase in business loans appears to be responsible. Deposits seem to be following the same trend as loans have. Deposits were low during most of the first quarter with an increase reported during the last few weeks. Several banks attribute the increase to upward shifts in their time deposits. While most banks report the demand for CD's remaining flat, one bank turned in a significant increase in their volume of CD's.

FOURTH DISTRICT - CLEVELAND

The economic situation in the District is still characterized by a mixture of soft spots coupled with sectors of strength. In the retail area, nonautomotive consumer spending has been soft and signs of a pickup are inconclusive. Steel and capital goods industries continue to operate at peak capacity, but weakening tendencies in automotive and other consumer goods persist. Widespread shortages and long delivery times continue to plague manufacturers, although the lifting of economic controls in certain industries has helped in some instances. The severely depressed housing sector shows a few signs of improvement. S&Ls are becoming increasingly concerned about the possibility of deposit losses.

The president of a major department store in Cleveland reported a pickup in consumer spending since mid-March, following sluggish sales in January and February. He noted across-the-board improvement and states that customers seem to be taking higher prices for apparel in stride. He expressed some concern about a trend toward accounts receivable delinquencies. This executive believes the worst of the retail trade slowdown is over, and he is more optimistic over the near-term sales outlook than he was earlier in the year. On the other hand, an economist with a major retail chain headquartered in the District sees no sign of a pickup in his firm's business. The real volume of their sales in the first quarter was up only 1 percent from a year ago. Further softening in sales of general merchandise, apparel, and furniture (GAF) may be in store as the rate of increase in these retail prices begins to accelerate. The firm's buyers are seeing increasing prices on GAF-line items as a result of higher prices for natural and synthetic fibers at the wholesale level.

Capital goods markets remain strong, but automotive and related industries continued to show signs of weakening through March. There are no indications of a let up in new orders for steel, printing and business equipment machinery, machine tools, and other metalworking machinery.

In recent months, about two-thirds of the purchasing agents in the Cleveland area have been reporting lead times of one year or more for capital equipment. (A year ago, only about one-fifth reported such lead times.)

Representatives from three major steel firms emphasize the tight supply situation for steel; demand continues to exceed productive capacity, and no let-up in demand is in prospect. All three steel firms are hampered by coal shortages. They have been trying, unsuccessfully so far, to build coal inventories to carry them through coal miners' two-week vacation this summer. Steel mill inventories cannot be reduced much further, which may cause steel users to start drawing upon their stocks to maintain output. One steel firm reports that auto companies still have not fully cut back their steel orders in line with current production and inventories.

Complaints of materials shortages and long delivery times continue to be widespread. Some of our industrialist directors, in fact, believe that the most serious economic problem, after inflation, is long delivery time. One director said his firm's lead time in obtaining castings and forging and cutting tools runs one year or more. Another director, in the machine tool business, notes that his firm will not be able to make delivery on any big order until early 1976. He mentioned that machine tool buyers are anxious to get their orders on the books, even without firm price commitments. This director also complained about the difficulty in obtaining castings (64 weeks lead time). A financial officer for a "stripper well" operation in Ohio reports serious problems in obtaining mechanical parts, which is holding down their output of natural gas. An official with a petrochemical firm reports that selected decontrol of products in that industry has tended to alleviate tight supplies for some items, although there are still severe shortages of some products, such as benzene. At least the incentive to export certain products has been lessened as domestic prices were decontrolled. One director also noted that it has been easier to obtain plastics recently.

In the District's housing sector, residential construction contracts have edged up moderately in the past few months, following a precipitous decline in 1973. Sources close to the industry are hesitant to conclude that a solid turnaround has occurred, in view of the high level of interest rates, the relatively mild winter, and seasonal adjustment problems. Banks and S&Ls seem to be cautious in making loan commitments because of uncertain prospects for deposit flows. One of the District's largest banks has raised the minimum down payment on home loans from one-fifth to one-third and has shortened the maximum maturity from 25 to 20 years. An economist with a Federal Home Loan Bank said S&Ls experienced some deposit losses as a result of the recent 8 percent Treasury note offering. He reports that S&Ls are very concerned over possible disintermediation because of present money market rates. The S&Ls have made substantial withdrawals from their overnight accounts with the FHLB, and they are placing the funds in short-term money instruments.

FIFTH DISTRICT - RICHMOND

Results of our most recent survey of businessmen indicate that business activity in the District remains strong. Little change was reported in the manufacturing sector. However, business sentiments in this sector improved considerably in the past month. Employment in the manufacturing sector registered a further slight decline. Price increases continue to be widespread in both manufacturing and retailing. Retail sales increased in recent weeks, although consumers are reported to be more discriminating in their purchases.

Manufacturing activity remains strong in the Fifth District. Shipments and backlogs increased slightly during March, while new orders were essentially unchanged. Textiles, chemicals, primary metals, and machinery and equipment industries are among those reporting increased activity. Many manufacturers, particularly those in textiles, are concerned that some consumer resistance to sharply higher fall prices may be encountered, while material shortages remain a problem, some easing in the shortage of electronic components was reported. Shortages of synthetic fibers continue to be a problem in the textile industry.

The level of employment in the District has apparently declined somewhat in recent weeks. The diffusion of survey responses suggests that in manufacturing both the number of employees and the hours worked per week declined. Retailers reported no change in the number of employees. Reports of price increases are pervasive. More than 90 percent of the manufacturers reported higher prices paid and 55 percent reported higher prices received.

All respondents in retail trade reported an increase in prices paid and three-fourths reported an increase in prices received.

Survey results suggest that retail sales remain strong in the District. Nearly two-thirds of the respondents indicated increased volume during the past month. Reports are common, however, that higher prices for food and fuel are causing consumers to be more discriminating in purchasing discretionary goods. Reports of adverse effects of the gasoline shortage on tourism continue to be received. Colonial Williamsburg, one of the largest tourist attractions in Virginia, reported that attendance for February was 50 percent below year-ago levels. Lodging and restaurant business in the Myrtle Beach, South Carolina area are said to be off 30 percent compared to a year ago.

Large commercial banks in the District indicate that demand for business, consumer, and real estate loans remains strong. Loans in all three categories rose substantially during the month of March and are apparently continuing strong so far in April.

Farm income continues to show significant improvement over year-earlier levels. The District's 35 percent increase in January, however, was below the 48 percent gain nationally.

District farmers' planting plans for this year have changed little since January. Overall, the planned acreage increase as of March 1 adds up to about 6 percent over 1973. Corn accounts for better than half of the planned expansion, while wheat, with acreage stepped up sharply, comprises around one-third. Most of the remaining intended acreage increase will go into tobacco and soybeans.

The diffusion of responses suggests a substantial improvement in business psychology since the last survey, with much of this improvement apparently due to the lifting of the oil embargo. Among manufacturing respondents, nearly three-fourths expect national business activity to remain the same or improve, whereas only 46 percent were this optimistic last month. Nearly one-half of the manufacturers expect the level of production in their own firms to increase. Only 27 percent were this optimistic a month ago. Responses from retailers suggest that they also expect business conditions to improve both nationally and locally.

SIXTH DISTRICT - ATLANTA

The District economy appears to be improving despite some reports of job layoffs. Both new and used auto sales have apparently bottomed out, and announcements of new and expanded plants and commercial projects are strong. But several job layoffs and strikes continue to depress certain economic areas.

Surveys of Louisiana auto dealers indicate a more optimistic attitude than in previous months. The lifting of the oil embargo seems to add encouragement to their outlook. Used car sales are apparently also starting to move in these areas. Florida directors report a pickup in sales of both new and used big cars. However, retail sales in general remain soft. Most local retailers in the New Orleans area are complaining about sluggish business. Sales tax receipts, particularly gas tax revenues, are down in the early months of 1974 from year-ago levels. However, one bank director from Louisiana notes that business seems to have picked up over the past several weeks. Tourist activity also seems to be reviving, particularly in Florida. Officials of Disney World, Cypress Gardens, and Circus World report their business is up over the past few weeks. Yet, tourist travel in Tennessee's Great Smoky Mountains National Park remains depressed.

Job layoffs continue to plague the region's economy. Most notable were an extension of previously announced layoffs of Atlanta area auto assembly plants and the temporary deferral of 1,300 workers at a Ford glass plant in the Nashville area. Because of the auto industry slump, an Alabama textile manufacturer will shut down next month. A Louisiana army ammunition plant is idling 1,200 workers through April. In central Mississippi, 1,500 workers will be temporarily unemployed, resulting from the slaughter of several million chickens contaminated by pesticide tainted feed. This is a severe blow to that local economy and particularly to poultry producers who will suffer several million dollars in losses. Several large strikes in Alabama, Mississippi, and Tennessee have also temporarily idled several thousand workers. On the brighter side, regionally based airlines are beginning to hire back previously furloughed employees.

The volume of plant announcements appears to once again be on the upswing. A $25 million electric steel mill, which will use recycled autos and other steel scrap, is planned for Jacksonville. Ashland Oil has announced plans to build a town of approximately 45,000 people, a refinery, and an offshore oil port near Florida's Atlantic Coast. The refinery should generate 1,000 jobs. Related businesses are expected to create between 8,000 and 10,000 jobs, in Jackson, Mississippi, the expansion of two plants will add 200 new jobs. Alabama appears to be in the race along with Mississippi and Louisiana as the location of a $600 million refinery on the coast after the refinery was voted out of New Hampshire. Several chemical plants may soon be announced in this area. While new and expanded plants were being announced, some other plans to build plants have apparently been shelved. The Florida Department of Commerce reported that 14 companies suspended plans to build plants there because of the energy crunch.

Oil and gas exploration is intensifying in the southeast. Florida Power and Light Company and Amoco Production Company have announced a $10.5 million joint oil exploration venture in 26 south Florida counties. At the same time, Florida Gas Company has made a gas discovery in south central Mississippi.

Spending for pollution control is becoming an important ingredient of the region's capital spending plans. According to the Alabama Water Improvement Commission, in 1973, 27 industries constructed water pollution control facilities in Alabama valued at $19.5 million. In 1974, announced plans are for 40 different industries in the State putting nearly $28 million in new pollution control facilities into operation. In Tennessee, $10 million in bonds to finance additions to the environmental protection facilities of a large paper manufacturer have been approved. A Meridian, Mississippi, manufacturer has announced that it is investing $600,000 in new equipment and facilities for pollution abatement and increased efficiency.

Numerous commercial projects were announced. A team of Houston, Texas, and Sidney, Australia, developers will start construction this May on a 114-acre planned residential and commercial city near Atlanta costing $50 million. Another $75 million multipurpose commercial project has also been announced for Atlanta's south side. Several smaller commercial projects were announced in the Baton Rouge, Louisiana, area.

Atlanta bankers have indicated a strong interest in the new issue of $1.5 billion of U. S. Treasury notes paying 8 percent. They expressed fears of losing funds from checking and savings accounts as small investors draw down these accounts to purchase these Treasury bills. One other bit of news, the refinancing of New Orleans' Superdome in the approximate amount of $138,930,000 came to market and found no bidders. The primary reasons noted were (1) the 6-percent legal limitation on interest rates for public entities in the State and (2) the high inventory of municipal bonds on the shelves of banks and investment houses in a very depressed bond market.

SEVENTH DISTRICT - CHICAGO

The capital goods producers in the Seventh District see absolutely no letup in demand. Industries worst hit by slower sales and the oil shortage--large cars, plastics, and recreation-related activities--appear to have bottomed out with some improvement noted. The feared "secondary" impacts of the energy crisis have not been clearly significant. General shortages of skilled labor, materials, and components continue. Prices of components and finished goods are moving up even more rapidly as controls are relaxed. Forecasts for the general economy by regional experts were being revised upward recently, but the renewed upsurge in interest rates has raised new doubts, particularly for on-site housing. Prospects for large farm crops are good, but there is concern over shortages of machinery, transportation, and fertilizer.

Large firms will be raising prices in the next few months as circumstances permit, but even industries that have been "freed" of controls realize that caution is necessary. Chicago daily newspapers were raised from 10 to 15 cents on April 1, apparently without repercussions, which may reflect the public's acceptance of inflation as a continuing trend.

Declines in demand for such products as autos, some appliances, and TV sets have not eased supplies, except for components used in consumer electronics. Shortages mentioned most frequently include steel, nonferrous metals, petroleum-based products, and paper. Inventories are rising, but they are badly unbalanced. "You take what you can get and wait for the rest." Purchasers complain of vendors disregarding terms of contracts and that "business ethics are on the block to the highest bidders." Strikes, e.g., in transportation, coal mines, truck wheels, and outboard motor components, have contributed to problems. Firm shipping dates and firm prices are becoming the exception rather than the rule.

Freight car availability is the "worst in all railroad history." Frieght car builders are booked through the first quarter of 1975, but production has been hampered by a strike at the major factory producing wheels. Shippers in Michigan are worried about proposed abandonment of railroad trackage, which is now heavily used. Pressure on capacity of truckers has been increased by reduced speeds and by problems of independent truckers (who handle over one-third of highway freight) in getting adequate fuel at prices they can afford.

Gasoline has become generally available in the past several weeks in the Chicago area, which had much the worst problem in the District. Many smaller cities were never seriously inconvenienced. Local experts believe the world price for crude oil will "settle" at about $10 per barrel, which might be compatible with a U. S. retail gasoline price of 63-65 cents.

Some users of steel have been told that their allocations will be reduced in the next few months because of the coal strike of early March and other problems holding back steel output--availability of scrap, ore pellets, and fuel. A shipbuilder has been unable to bid on contracts because he cannot get commitments on steel.

Because lead times continue to lengthen on new capital goods, some firms that normally buy only new equipment are purchasing used equipment. Demand for capital goods is very strong "for all products, and in all foreign countries, including the U. K." Down payments are now required on some products, on which such payments were not required before, with no effect on demand. A large construction equipment producer, who recently shifted pricing to time of delivery instead of time of order, would be "happy if our order backlog were half as large." There is "no way" the farm equipment industry can increase sales over last year because output is at capacity and finished goods inventories are down sharply.

Shortages of skilled labor, including machinists, welders, mining technicians, and electronics engineers, etc., are said to be "the worst ever." In contrast, the market for teachers is weak and will weaken further as school enrollments continue to decline. A Chicago teacher is being aided by the ACLU in a suit against compulsory retirement at 65, the outcome of which may have a widespread impact on employment practices. Michigan observers believe many laid-off auto workers will never be rehired. In the past, the industry has used such layoff periods to revamp operations so fewer workers are employed.

EIGHTH DISTRICT - ST. LOUIS

In summary, economic activity in the Eighth Federal Reserve District has apparently turned up following a minor slowdown near the end of last year. Retail sales continue to increase, and construction activity has turned up on a seasonally adjusted basis. Manufacturing activity generally has remained at capacity levels, with the exception of those industries affected by the petroleum shortage, and most businessmen believe that the decline in output in these industries has bottomed out. Loan demand has risen sharply in recent weeks. On the agricultural scene, large crops are in prospect, but some producers are taking losses on meat animals. Inflation remains a major concern of businessmen, and little optimism was expressed that the problem will be satisfactorily handled.

Retail sales generally continue their uptrend of the past year. Representatives of department stores reported further sales gains in recent weeks on a seasonally adjusted basis. The decline in automobile sales apparently has bottomed out after a sharp decline late last year. Dealers expressed greater optimism as a result of the improved gasoline supply situation.

Businessmen report that both residential and commercial construction is picking up throughout the District. Materials shortages are still a problem in the industry, but fewer complaints of shortages were heard this month than a month ago.

Manufacturing activity continues at a high rate, and backlogs of orders are still reported for many industries. Such backlogs, however, do not appear to be as critical as in recent months. Profit margins in manufacturing have improved with the lifting of price controls, and larger supplies of most products are being made available. As a result of the greater incentive for producers, plant expansion is on the upswing in those industries where shortages were a problem. Furthermore, with the higher prices, consumers demand a smaller quantity of products than at the lower controlled prices.

Loan demand has increased sharply in recent weeks, and interest rates have risen. Commercial loans have increased for all purposes, and rising construction has boosted the volume of real estate loans. The prime rate on commercial loans is somewhat higher than a month ago, and the points charged on real estate loans are also up.

The recent rise in market interest rates coupled with the restrictions on rates paid on savings is again causing disintermediation among the savings and loan associations. Savings and loan officials reported that the 7-1/2 percent maximum rate payable by their firms is not competitive with the 8 to 8-1/4 percent rates on Government and Government Agency securities with similar maturities. They have reported sizable outflows of savings in recent weeks. Usury laws are also a problem in most of the Eighth District states as market rates have risen above the maximum permissible rates on loans.

Farmers in the Eighth District are planning sizable increases in crop plantings for 1974. Cotton planting is expected to be up 20 percent in eastern Arkansas and 33 percent in west Tennessee. Corn, soybean, and hay plantings are also expected to increase. The earlier-than-expected decline in fat cattle and hog prices, however, has reduced the incentive for expansion of livestock feeding at current feed/livestock price ratios.

Businessmen continue to view inflation as the nation's most serious economic problem. An Arkansas businessman asserted, "worldwide inflation is a serious threat to our society and the current situation is frightening."

A representative from Louisville said, "There is an inflation psychology that is the worst in history, and people are resigned to it." A leading corporate representative in St. Louis stated, "Continued high inflation is the major problem with business and consumers."

NINTH DISTRICT - MINNEAPOLIS

Directors' reports indicate that District farmers generally look for a good year in 1974, even though the livestock feeding industry is experiencing difficulties and the outlook for grain prices is uncertain. Gains in District retail sales probably exceeded national increases in the first quarter, and District retailers expect business to remain good in the second quarter. With the lifting of the Arab oil embargo and the prospect of increased gasoline supplies, the outlook for this summer's tourist business has improved. Many directors report that both residential and nonresidential construction are expected to be quite strong in their areas this year.

Despite problems in the cattle feeding industry and concern about grain prices, most District farmers still hope for a good year. Many District cattle feeders are losing money, however, as high feed costs combine with declining prices for fat cattle. A Minnesota director indicates that these developments will force marginal cattle feeders out of business. A Montana director does not expect the situation to improve in the near future since cattle marketings in March fell considerably short of expectations and sizable inventories remain to be marketed. Not only are fat cattle prices down, but prices for feeder cattle have also declined recently, and a western South Dakota director indicates some uneasiness among ranchers in his area about the outlook for feeder cattle prices this year. A southern Minnesota director also points out that poultry producers are also facing a cost-price squeeze, and his area's two largest turkey producers are losing money on their current flocks due to high feed costs. Furthermore, dairy farmers fear reduced demand because of consumer resistence to higher milk prices.

The outlook for crops is not so discouraging. The general impression conveyed by the directors is that some decline in grain prices is expected this year because of a softening in export markets and increased domestic supplies.

Although District farm incomes in 1974 may not match the record set in 1973, several directors indicate that farm income gains this year will probably compare quite favorably to those of recent years. Even if farm prices decline this year, one director feels that increased production will prevent a loss of gross income. In addition, many farmers carried crops over from 1973, postponing income until early 1974 for tax purposes. This too should enhance farm income in 1974.

Due primarily to 1973's high farm income, directors report that District retailers enjoyed a good first quarter and are quite optimistic about the second quarter. A Minneapolis-St. Paul area banker, for example, estimates that relative gains in District retail sales in the first quarter were probably double the comparable national increase and expects this region to exceed national increases in the second quarter. Another director, however, indicates that District retail sales may have been off somewhat in the first quarter, but he looks for improvement in the second quarter. A different view comes from a southern Minnesota director who believes that concern about future income may discourage farm spending and therefore his area's retail sales in the second quarter. Although District automobile sales have been down from a year ago, sales in the Midwest have been much better than in the nation. Furthermore, District car dealers in early March reported a pickup in full-sized car sales. Pickup trucks and particularly medium-sized grain trucks have been selling at a rapid rate.

Reduced snowfall and fears of gasoline shortages dampened the District's winter recreational business, but the prospects for the summer tourist season have brightened recently. Several directors from areas where the tourist industry is important indicate that the outlook for tourism has improved with the prospect of increased gasoline supplies later this spring.

Although building permit data do not yet point toward a resurgence in District homebuilding, many directors look for a good year for both residential and nonresidential construction in their areas. Housing construction is down in the Minneapolis-St. Paul metropolitan area, but two directors located on the periphery of the Twin Cities report considerable residential construction in their areas. Other directors throughout the District also expect considerable residential and nonresidential construction. However, a Minneapolis-St. Paul area banker feels that Minnesota's 8 percent usury law will depress homebuilding in Minnesota this year, and he does not expect commercial construction to be strong in the Twin Cities metropolitan area. With regard to highway and heavy construction, a director associated with that industry says that lettings for new projects so far this year are down and that many blacktop contractors are looking for work.

TENTH DISTRICT - KANSAS CITY

Manufacturing firms in the Tenth District continue to be plagued with supply shortages and rising prices of materials. Yet most of those surveyed report their own business to be good and their view of the economy to be fairly optimistic. The worst of the decline in auto sales may be past. Declining farm prices will slow the growth of farm income, but may result in more stable food prices at retail. Business loan demand at District commercial banks is strong for nearly all types of customers.

Rising prices, inadequate supplies, and lengthening lead times for delivery continue to face manufacturing firms in the Tenth District, with variations on these themes appearing from industry to industry. In some instances, shutdowns have been averted by slight modifications in product that permit substitutions among inputs, or by finding alternative sources of input supply. Further price increases are expected by nearly all respondents, and several have already been put on notice of future increases. The majority of purchasing agents queried seem to expect more ample supplies and improved availability of materials in the short run and expressed a willingness to pay the higher prices if supplies could thereby be assured.

Some materials, such as steel, rubber, and plastics, come in for special mention in discussions of short supplies. A maker of rubber goods reports either feast or famine: after going months without a delivery, he may receive a six-month supply thus creating unwanted inventory. Delivery times for plastics are reported to be very long (and lengthening), and prices are rising sharply. One plastic goods fabricator put it this way: "A year ago suppliers were giving us green stamps to buy their polyethylene; now, we have to beg them for it, and take something less in the way of specifications than we want. When you buy what you can get, you don't get what you want." Steel castings and rebars continue to get special mention among steel goods in tight supply, along with some fabricated steel items. A manufacturer of small appliances summed up his supply situation in this way: "...it's give and take; it's search and find--or search some more; it's accept higher-priced items than you need, or get nothing at all; it's pay higher prices, period." There were few respondents echoing this relatively optimistic view from a metals firm: "I see signs of people coming up with items that have been hard to get, and I think this is the beginning of new supplies responding to demands."

In spite of these problems, nearly all respondents felt that their own businesses were doing pretty well, and several believed that only inadequate supplies of materials were preventing them from expanding output further. Views on the condition of the economy ranged from "...I think the economy is a good bit weaker than we read about...", to "...I think that the economy is a lot stronger than some people are saying." In general, the responses tended to support the latter view somewhat more than the former.

Responses from automobile dealers in major cities of the Tenth District suggest that the new auto sales situation is no longer worsening. As elsewhere, smaller cars continue to sell better than full-sized cars, but several dealers believe they are seeing a turnaround in large-car sales. Sales of small imported automobiles appears to be rather weak. Farm prices fell four percent during the month ended March 15, led by an 8 percent decline in the price of meat animals and a 10 percent drop in the price of wheat. Further declines since mid-March have brought hog prices to their lowest level in 14 months. Expectations of large marketings during the next few weeks have limited buying and may portend even lower prices for hogs. Fed cattle prices have also declined since mid-March, and a number of heavy cattle continue to hang over the market. Wheat prices have dropped precipitously since late February due to strong progress of the winter wheat crop and increased competition to sell wheat in foreign markets. Farmers are also putting pressure on the market by selling wheat to make room for the record 2.1 billion bushels expected to be harvested this year. These factors will have a negative influence on farm income, but will be welcomed by consumers if these lower prices are passed along to the supermarket.

A survey of District bankers revealed that business loan demand in the first quarter of 1974 generally far exceeded what was expected. Most interviewees attributed the heavy loan demand to the underlying economic strength of the local and regional economies. In addition, higher prices were frequently cited as a prime source of the increase in business borrowing. In many instances, bankers also felt some borrowing appeared to be in anticipation of higher prices and, perhaps, higher interest rates in the future. Related to this, one banker in Denver reported that suppliers were now demanding immediate payment for goods, thereby forcing many of the bank's customers to increase their borrowings. In reflection of economic strength, increased borrowing was reported to be fairly uniformly distributed across bank customers and not confined to any single industry. Increased borrowing to finance inventories was noted by several bankers, but this was generally felt to reflect higher prices rather than declining sales.

ELEVENTH DISTRICT - DALLAS

Texas steel producers are faced with rising demand which has outstripped supplies of many steel products. Because of the strong demand, some steel producers report they are allocating supplies to customers on a nonprice basis, and they expect to continue to limit shipments throughout 1974. A shortage of drilling pipe has already hampered efforts to increase oil production, especially by wildcatters. Shortages of structural and reinforcing steel are also causing disruptions in construction activity. In addition, an executive of one steel company claims their entire output could be sold to customers in Japan at substantially higher prices. However, exporting all the firm's production would force its domestic customers to severely curtail operations.

The relative scarcity of steel in Texas has not been due to inadequate supplies of energy. However, the ability to keep pace with expanding demand is being hindered by a shortage of high quality scrap metal and the requirement that increased capital expenditures comply with Environmental Protection Agency guidelines on pollution control. Record exports of scrap last year have forced the State's steelmakers to rely on poor quality scrap, which in the case of one plant resulted in production being cut from six days to five days a week. Also, a steel industry spokesman pointed out that exporting scrap was equivalent to exporting energy since it takes four times as much energy to produce steel from ore as it does from scrap. Even with the scrap shortage, the manager of one plant maintains an additional gas oven would have been installed this year if the cost of complying with the EPA guidelines had not been so high.

Another steel producer said plant improvements, planned to be operational in late 1973, were delayed until this year in order to implement a pollution control program.

Texas building contractors agree that the shortage of reinforcing steel has delayed both the beginning of new jobs and the completion of many projects already under way. But as of now, the shortage has not caused a significant number of construction plans to be abandoned. To acquire a sufficient supply of construction steel, the largest commercial builder in the State has relied on higher priced foreign supplies. In addition to paying approximately 40 percent more for steel bars purchased abroad, foreign producers often insist on large orders, which resulted in an additional inventory cost to this builder.

The cattle feeding industry in the Southwest is under a severe cost-price squeeze. Because of the drop in price for fed cattle and the relatively high cost of grain, many cattle feeders have experienced major losses in earnings in recent months. Net losses have ranged from $100 to $150 per head recently, with one feeder reporting to have lost $1 million since the break in prices for slaughter cattle last fall. The president of the Texas Cattle Feeders Association estimates these losses will result in 10-15 percent fewer cattle placed on feed in the State this year as compared to 1973. However, one windfall to feeders has been the shortage of fertilizer. Brisk demand for manure has boosted prices to $2 per ton, four times the price a year ago.

Drought in West Texas has diminished prospects for the dryland winter wheat crop in Texas. This year's crop is expected to be about half of the nearly 100 million bushels of wheat harvested in 1973. According to a Lubbock banker, a considerable amount of wheat acreage in the southern high plains has already been plowed under in hopes that enough rainfall will occur to plant grain sorghum later this spring.

The lack of rain plus shortages of chemical fertilizer, herbicides, pesticides, and baling wire is disrupting agricultural production in the Southwest. In addition, many farmers and farm lenders are concerned about a possible drop in agricultural prices. With the recent decline in spot and future prices of farm commodities and with substantial investments in the 1974 crop, farmers are alarmed that a big world harvest could cause a sharp setback in farm incomes this year.

TWELFTH DISTRICT - SAN FRANCISCO

A distinct shift has occured in the sentiments of our directors compared to recent months. Although there remains some uncertainty, more directors feel that business conditions will be stronger in the coming quarter than they had thought they would be. Continued weakness exists in residential construction and automobile sales, but business spending is very strong and consumer spending is holding up.

Most directors had expected a slowdown in economic activity in the first half of the year. The energy crisis was a major cause of concern; but now that the worst of the gasoline shortage appears to be over and business remains good overall, there is much more optimism. Several directors stated that 1974 will be much better than previously expected despite some shortages and dislocations. One director, after a recent trip around the country, reported most of his contacts have better business than they had anticipated. Other directors were "very optimistic;" they noted "strong growth" patterns and reported "there has been a significant improvement" in the last month.

The energy problem is turning out to be less severe than expected. The Pacific Northwest and Utah have surplus electric power, and gasoline is in greater supply although at higher prices. The greater availability of gasoline has been one element in the improved attitudes of consumers and businessmen. Automobile sales remain slow, but according to the reports by several directors, signs of a recovery are present. Sales of standard and luxury cars are reported to be improving, and used car prices have risen. In addition, the conversion of production to smaller-sized cars is having benefits for suppliers of automobile parts whose orders are heavier. A manufacturer of large power boats reports that sales are brisk. Fuel shortages had caused a noticeable decline in sales of smaller boats, but the market has rebounded.

Consumer retail spending is holding up, buoyed by heavy Federal income tax refunds and, in California, a one-time refund of taxes. Consumer borrowing has not declined significantly. Industrial activity also continues at a strong pace. Wood products, electronics, and industrial machinery manufacturers are at near-capacity levels of production. Lumber demand is much higher than expected. Shortages of metals and petrochemicals, however, are causing some problems for manufacturers. In both cases, the shortages reflect worldwide demand, and the situation is likely to persist for some time.

Capital spending by business has helped keep up activity in the construction industry. In most areas of the district, the decline in residential housing has been partially offset by heavy commercial activity. The building trades are not experiencing significant unemployment as a result of this shift in demand. Residential housing has stopped declining, but no major recovery is expected this year. In California, for example, the number of starts in early 1974 was running on a seasonally adjusted rate at about half of the 1973 levels. The sharpest declines both in California and in other District states has been in apartments. Some recovery in residential activity is expected later in the year, but it will still be below 1973 levels. There are some localities where residential construction is increasing. In the Seattle area where construction has had low rates for several years, excess stocks have been worked off, and demand for new housing is stronger. Some weakness is reported in office and professional building construction. Builders are concerned that the recent jump in mortgage rates and higher costs will cut down housing demand. Costs are expected to jump with the end of price controls and with new wage contracts.

The agricultural situation remains unchanged--excellent crops and high prices. Farmers are having some problems from shortages of equipment and fertilizer. While prices may be good, costs will be rising also, but generally farmers are optimistic about this year's income.

In banking, loan demand by both business and consumers is strong. A few banks have also experienced increased real estate loan demand, and savings institutions appear to have more funds available. Several banks think that the recent increases in interest rates will soon be reversed, although others are worried that longer-term rates such as mortgage rates will rise steadily to the point where demand for housing is reduced. Views are mixed about future interest rates. Some bankers think that rates will fall slowly over the rest of the year, but others think that an upturn in rates will come in the second half.