february

FEDERAL RESERVE BANK OF PHILADELPHIA

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A Bigger Year for Corporate Treasurers In '73?

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Annual Operations and Executive Changes

FEDERAL RESERVE BANK of PHILADELPHIA

business review

1973

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. . . Although trailing the nation in the pace of economic expansion last year, the District posted impressive gains despite hurricane losses in some areas.

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On our cover: Pennsylvania Hospital, the first in the nation, is located at Eighth and Spruce streets in Philadelphia. Founded in 1751 by a group of public-spirited citizens under the leadership of Benjamin Franklin and Dr. Thomas Bond, the hospital opened its doors the following year. Now in its third century of service, Pennsylvania Hospital has become a major teaching and research center, while maintaining its tradition of competent and personal care. Since its founding, more than three million persons have been treated there.

(Photograph by Robert S. Halvery. Courtesy of the Pennsylvania Hospital).

BUSINESS REVIEW is produced in the Department of Research. Ronald B. Williams is Art Director and Manager, Graphic Services. The authors will be glad to receive comments on their articles.

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Relaxed Controls: A Bigger Year for Corporate Treasurers In '73?

by Jerome C. Darnell

Fewer financial worries are in store for the chief money men of major U. S. corporations in 1973. That, in short, is the gist of our annual survey of corporate treasurers. They indicate that wage and price controls under Phase II were biting into profits, but apparently the bite was only a nibble because '73 is expected to be another banner year for corporate profits. With Phase III controls relaxed and shifted to "voluntary cooperation," profits may be even better than first projected, according to a limited recheck of respondents.

Corporate profits after taxes for big companies should spurt 13 percent in '73, if the projections of corporate treasurers representing the nation's largest firms are accurate. A growth rate of this magnitude would mark the third consecutive year for profit gains in excess of 10 percent, a record for sustained growth unmatched since the late 1940s.

Nearly a fifth of the corporate giants canvassed had already bumped against their profit margin ceilings at survey time in November 1972. Consequently, they were expecting to leave their prices essentially unchanged in '73 to avoid piercing the ceiling. The pinch from voluntary guidelines on dividends, however, was not being felt as keenly as the controls aimed at pricing actions and profit figures.

Firms in the poll plan to increase their capital spending by 13 percent, marking a second consecutive year of high investment spending and the best jump since 1966. Corporate cash flow—undistributed profits plus depreciation—should grow by 15 percent, thanks largely to the sizeable boost in retained earnings. The swelling internal cash flow can be counted on for most of the financing needed to put brick, mortar, and machines in operation.

Because of this large bundle of internally

generated money, the pressure on interest rates from the corporate sector, especially in the long-term market, should be minimal. Consequently, interest rates, both short- and long-term, are expected to move slowly but steadily upward in '73, somewhere between 20 and 40 basis points, say the treasurers.

In a nutshell, financial managers are not high-spirited about economic controls. Nevertheless, they do see controls as compatible with sturdy profit performance in '73, serving to expand cash flow and fueling a substantial upswing in capital spending. And, in the view of corporate treasurers, many problems go away when profits roll in.

WHERE CONTROLS WIELDED CLOUT IN '72

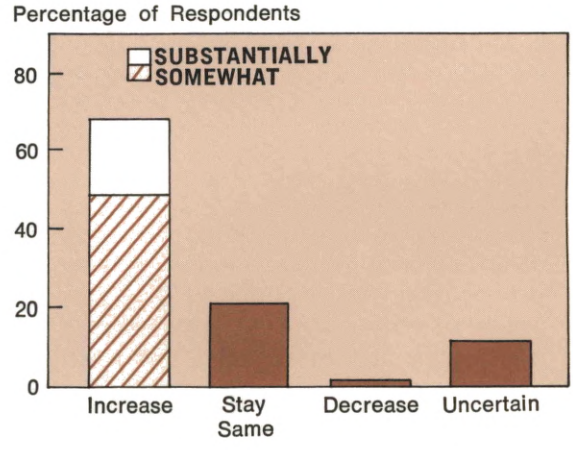
Many observers are wondering if Phase II wage-price controls established under the Economic Stabilization Program exerted any pressure on business firm operations. And with the Administration requesting that controls switch to "voluntary cooperation," a so-called Phase III, the issue takes on future significance as well. The views of corporate treasurers provide some reading on how big companies are living with controls. In short, our survey indicates that controls did wield some clout on prices and profits in 1972, but that they probably had little influence on dividends.

Prices Were Curbed. Eight out of ten manufacturing and retailing respondents report they were subject to a profit margin ceiling under the Price Commission regulations.[1] Thus, roughly two out of ten of the nation's corporate giants had not raised *any* prices and therefore were not subject to a profit margin ceiling. As long as they held the line on prices, these firms could have reaped profits as high as the marketplace would produce.[2]

For those corporations that did raise prices and became subject to a profit margin ceiling, slightly more than a fifth report they would have had to leave prices essentially unchanged in 1973 in order to avoid going through the profit margin ceiling (see Chart 1).[3] Nearly half the firms canvassed still had

CHART 1

UNDER PHASE II, ONE OUT OF FIVE CORPORATE GIANTS EXPECTED TO LEAVE PRICES UNCHANGED IN '73; TWO OUT OF THREE REPORTED ROOM FOR PRICE INCREASES.



[1] Only a fourth of the transportation and utility firms reported being subject to a profit margin ceiling.

[2] Phase II profit margin rules were complex. Essentially a company that raised its prices above its "base price" could not exceed the average profit margin (figured as a percentage of sales) that it had in the best two out of three fiscal years ending before August 15, 1971. The "base price" is whatever price was charged during the 90-day freeze or on May 25, 1970, whichever was higher. When a company exceeded its profit margin ceiling, the Price Commission was authorized to order a price rollback and a refund of the overcharge. When companies were squeezed by the margin ceilings, they could obtain relief by rolling back prices to base levels, making refunds to customers who paid higher prices, and thereby get out from under the profit margin ceiling completely.

[3] Our findings are in substantial agreement with a prediction made by the Price Commission that by the end of 1972 a fifth of the companies subject to profit margin ceilings would have bumped against them. *Wall Street Journal,* November 16, 1972, p. 1.

leeway to raise prices *somewhat* before they reached their ceilings. Another 20 percent believe their prices could have been boosted *substantially* without pushing through the ceiling, with only one firm replying that a price reduction was needed in order to stay under the ceiling.

Phase III Voluntary Guideline. The general Phase III guideline of main concern for corporate giants deals with pricing rules. Basically, it says price increases should only reflect cost increases. And even when costs rise, prices should not be raised to where the firm's resulting profit margin would exceed the base period profit margin.

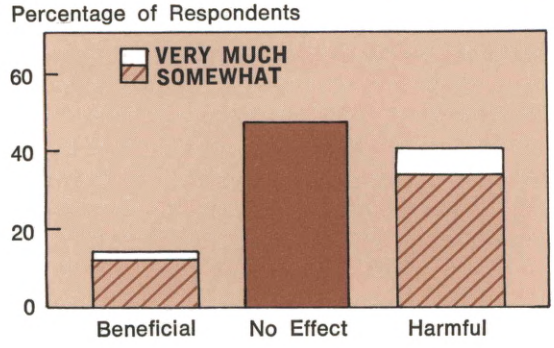
The rules were relaxed in two important dimensions: First, the base period for figuring profit margins has been broadened to include any fiscal year ending since August 15, 1971. This gives four years from which to calculate allowable profit margins instead of three. Second, companies may waive the profit-margin test if their average price increase does not exceed 1.5 percent in a year. Thus, price determination should be a little easier for most big companies with the adoption of the less rigid standard. Firms most likely to reap immediate benefit are those which had already bumped against their profit margin ceilings.

Profits: Higher Under Phase III? Corporate treasurers were already counting on a healthy 13 percent climb in after-tax profits under Phase II codes. A limited recheck of responding firms after Phase III's announcement reveals no clear consensus on the impact of the new rules. On balance, though, corporate treasurers tend to believe that after-tax profits will show an additional moderate boost because of the new guidelines.

About four out of ten financial managers in the original survey reported their '72 profit gains were nipped by controls (see Chart 2), although in the aggregate they say profits were up nearly 14 percent. Approximately half said controls made "no difference" in '72 profits. The "no difference" responses came mainly from manufacturing firms rather than retailers. However, this does not mean the controls were toothless. Rather it suggests that many firms were probably operating substantially below their "normal" profit margin when the controls were initiated. Therefore, they had considerable elbow room in which to increase their profits because of the abnormally low starting base.

CHART 2

HALF OF RESPONDENTS REPORT '72 PROFITS WERE UNAFFECTED BY PHASE II CONTROLS; 40 PERCENT SAY PROFITS WERE PINCHED.



The profit trend remains strongly upward in '73, despite the feeling of many financial chiefs that a continuation of Phase II standards would have dampened profit gains somewhat. A large proportion of firms canvassed feel that Phase II controls would have been harmful to their after-tax profits (see Charts 2 and 3). As a result, profit projections for '73 under an assumed continuation of Phase II fell slightly short of the bullish performances chalked up in '71 and '72. On the average, corporate money men pro-

CHART 3

HALF BELIEVE '73 PROFITS WOULD HAVE BEEN HARMED BY CONTINUATION OF PHASE II CONTROLS; FEW SAW BENEFICIAL INFLUENCE.

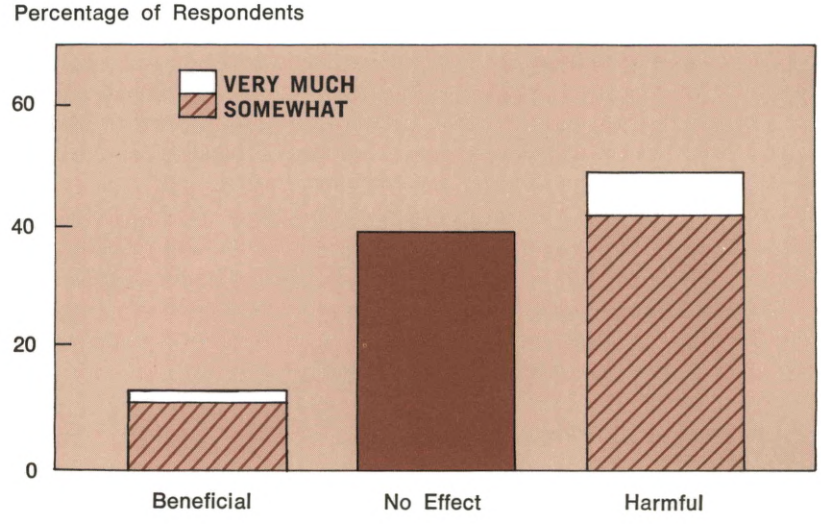
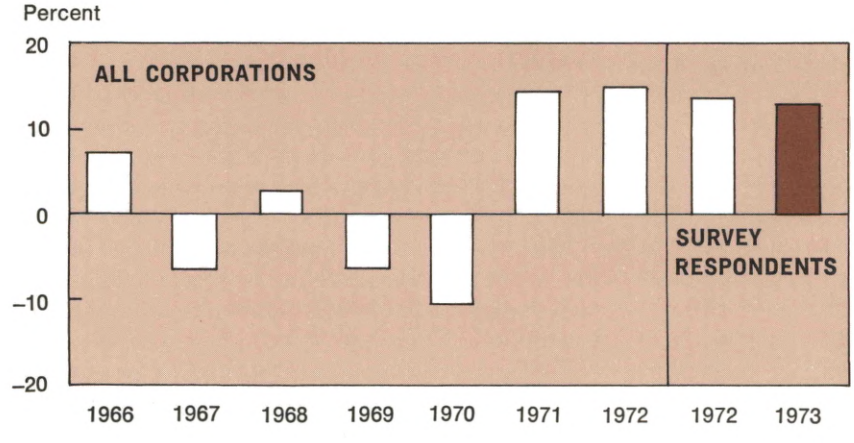


CHART 4

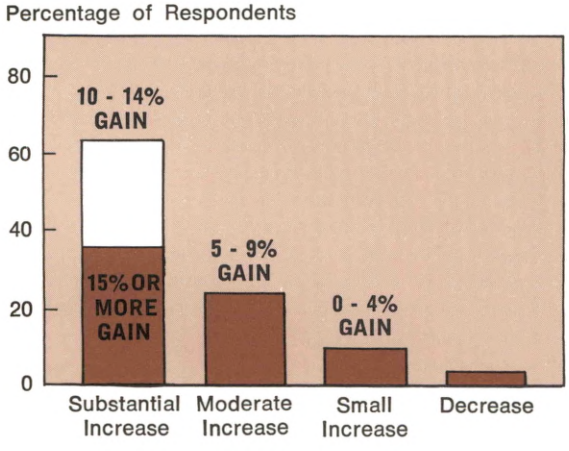
PRIOR TO PHASE III ANNOUNCEMENT, CORPORATE TREASURERS FORECASTED 13 PERCENT SPURT IN AFTER-TAX CORPORATE PROFITS FOR '73.



jected after-tax profits to spurt by 13 percent in '73 under Phase II, still a good year by almost any yardstick (see Chart 4). More than six out of ten treasurers were looking for a jump of 10 percent or more (see Chart 5). Over a third thought they would garner profits of 15 percent or more. Retailers and transportation firms appeared to be more bullish than manufacturers. And virtually none of the treasurers forecasted a profit decrease.

CHART 5

NEARLY ALL RESPONDENTS EXPECT SOME INCREASE IN AFTER-TAX PROFITS FOR '73; ALMOST FOUR OUT OF TEN LOOK FOR 15 PERCENT OR MORE GAIN.



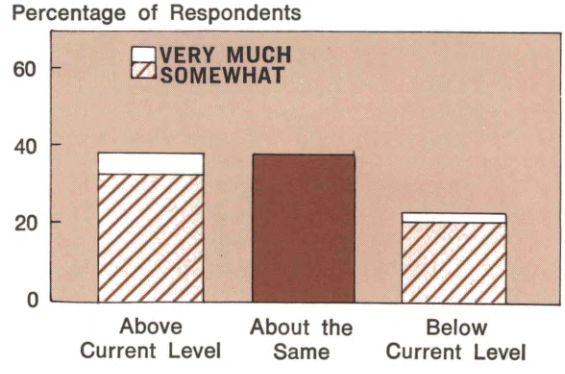
If the profit increase of 13 percent or more materializes, and ample support abounds, 1973 will mark the third consecutive year in which after-tax profits have surged ahead by 10 percent or more. The economy has not experienced such a sustained period of profit growth rates this high since right after World War II.[4]

[4] Since the respondents comprise a broad sample of the major corporations in the country, their profit performance should parallel that of all corporations. Thus, if the profit increase of 13 percent materializes in '73 for the firms polled, a comparable jump for the entire corporate sector is likely.

Because of high profits and of internal cash flow at an all-time high, corporate liquidity does not appear to be a problem for '73. Three years ago liquidity was the biggest headache of all. However, substantial headway was made in '71. Starting in 1972, most firms felt their liquidity was at or above the desired level. About four out of every ten respondents think they will be more liquid by the end of the year, while only one out of four forecast their liquidity to be down by next year (see Chart 6). This decline, however, will likely reflect an intentional effort to correct an overly liquid position that will be inching upward during '73.

CHART 6

FOUR OUT OF TEN FINANCIAL CHIEFS SEE LIQUIDITY ABOVE CURRENT LEVELS BY YEAR-END '73; AN EQUAL NUMBER EXPECT LIQUIDITY TO BE UNCHANGED.

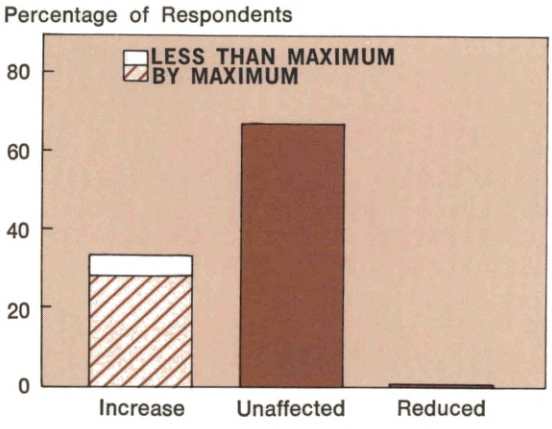


Dividends: Influenced Little by Controls. The Committee on Interest and Dividends established voluntary guidelines limiting dividend increases to 4 percent of the base year. Phase III makes no change in this policy. Top financial officers were asked how a continuation of these guidelines would affect their dividend policies in 1973

(see Chart 7). About one in four say that their dividends will increase by the maximum permitted under the guidelines. Two-thirds say their dividend policies will be largely unaffected by the guidelines, meaning probably that there is no intent to raise dividends by 4 percent. Only one respondent expects to *cut* dividends in order to comply with the rules.

CHART 7

TWO OUT OF THREE FINANCIAL MANAGERS PREDICT DIVIDENDS WILL BE LARGELY UNAFFECTED BY GUIDELINES IN '73.



Why so many big firms seem to be uninfluenced by the dividend guidelines is open to speculation. Perhaps many firms want to keep dividends from rising too rapidly in a time of high profits, fearing that stockholders come to expect high payouts. They may be using the guidelines as a convenient excuse to limit payments. Others may be merely postponing increases in dividends, expecting to catch up later when the guidelines are terminated.

CAPITAL SPENDING: ANOTHER BIG YEAR AHEAD

Spending on new plant and equipment emerged from the doldrums in '72, and this year promises to continue the upward trend. Capital spending had been sluggish in previous years because of rising costs, lackluster sales, excess capacity, and dwindling profits (see Chart 8). These problems have now been overcome and should not be returning soon, according to the treasurers.

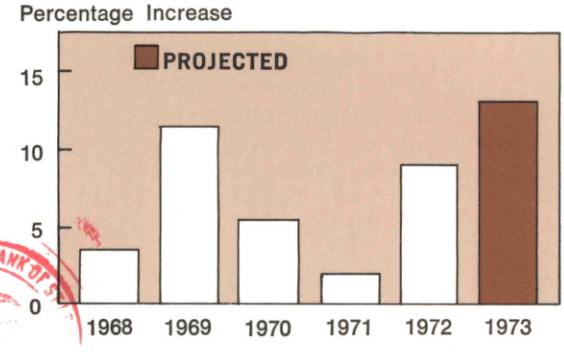
They report plans are on the drawing boards that will push capital spending up by 13 percent in 1973. If these plans hold up and mirror the total corporate sector, the increase will be the largest since 1966. Coming on top of the healthy 10 percent rise in '72, it would mean the best back-to-back investment years since 1965 and 1966.

Last year a substantial part of capital investment went for overhauling and updating physical facilities. More of the spending in '73 will be allocated toward capacity expansion and away from modernization and replacement. Substantial gains in new orders and backlogs, causing output and sales to spurt, have led to higher rates of capacity utilization. This means more firms are finding their working quarters cramped. Also, foreign competition is forcing businesses to adopt the latest cost-reducing innovations in order to hold their markets.

Indications are that manufacturers will be leading the parade of plant and equipment outlays. For example, our responding manu-

CHART 8

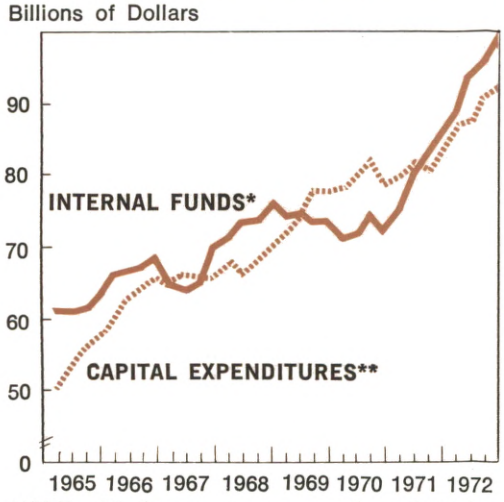
PLANT AND EQUIPMENT EXPENDITURES ARE SLATED FOR 13 PERCENT UPSWING IN '73.



facturing firms say their '73 capital spending will be up 22 percent compared with only 4 percent in '72. Retailers also have budgeted a 20 percent increase, although their spending will not be a substantial part of the total. Conversely, transportation and public utilities made a big splash in '72, but will be cutting their rate of expansion considerably in '73.

CHART 9

GROWTH OF INTERNAL FUNDS PAVES THE WAY FOR CAPITAL EXPENDITURES.



NOTE: All figures are seasonally adjusted annual rates.

* Profits after taxes and dividends plus capital consumption allowances for all corporations.

**Includes total business plant and equipment expenditures except those in agriculture.

Capital spending should not suffer in '73 because of inadequate financing. Internal cash flow, as measured by undistributed profits plus capital consumption allowance, barrels along at record-setting levels. It was up 16 percent in the past year and will likely be moving at a similar pace this year. A rise in internal cash flow tends to signal a speed-up in investment spending (see Chart 9). Moreover, internal cash flow is being buoyed by the ceiling on dividends, serving to increase the pool of retained earnings beyond what would normally be expected.

It appears, therefore, that corporate spending plans should not be dulled by a shortage of internal financing. According to Chart 9, corporations are currently generating internal funds which exceed capital expenditures by as much as $5 to $10 billion.

INTEREST RATES: UPWARD FIRMING BUT NO CRUNCH

Since chief financial officers foresee increases in internally generated funds filling a big portion of their financing needs in '73, they do not expect to be exerting much pressure on interest rates by outside borrowing, at least not in the long-term financial markets.

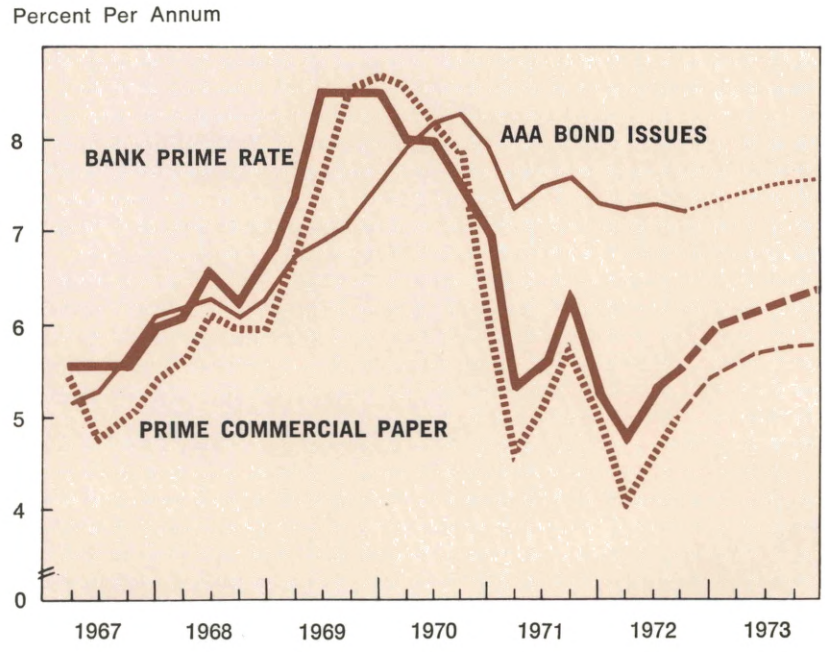
For those companies needing outside funds, roughly three out of ten intend to get them by increasing their short-term bank loans. Commercial paper and intermediate-term bank loans will be used more heavily this year by approximately a fourth of the firms. Bond sales will rise for one out of five companies, while equity sales will be used more by 12 percent.

Interest rates, of course, are not determined solely by supply and demand pressures of the top corporations. For example, government financing, international credit conditions, the home mortgage market, and Federal Reserve actions make important contributions in the final determination of interest rates.

Estimates by financial watchers suggest that total demand for long-term funds in '73 by the dominant borrowers—corporations, state and local governments, and home buyers—will be little changed from last year. And '72 failed to measure up to the peak demand registered in '71. In contrast, indications are that short- and intermediate-

CHART 10

INTEREST RATES WILL CLIMB SLOWLY THROUGHOUT '73, SAY CORPORATE TREASURERS.



term credit demands will be up in '73, perhaps as much as 20 percent. Most of the push will come from borrowing needs of the Federal Government and from bank loans to business firms for working capital.

Meshing the noncorporate financing needs with those of the major corporations gives a picture of firming interest rates and some narrowing of the spread between the short and long ends of the rate spectrum, say corporate treasurers. They are projecting short rates to climb by 40 basis points (100 basis points = 1.00 percent) and long ones by around 20 (see Chart 10). The prime rate for commercial bank loans, a closely watched rate by the public, is predicted to reach 6 percent by the first quarter of '73, but is not expected to be higher than 6¼ percent by the end of the year.[5]

Would a spread reduction between short- and long-term rates cause shifts in outside financing plans? Financial managers were almost unanimous in their belief that a spread reduction by as much as 50 points would be insufficient to cause a shift from short- to long-term types of credit. Nor would they rearrange their short-term borrowing priorities.

SUMMING UP

Apparently economic controls under Phase II were causing some headaches for

[5] Corporate Treasurers have misjudged the timing on the prime rate increase since the rate inched up to 6 percent during the final days of 1972.

corporate treasurers. According to survey responses, a number of industry leaders had no more room for price hikes this year lest they pierce their profit margin ceilings. With the controls relaxed, these firms may now have some room for price maneuverability. The views of several respondents, contacted after Phase III's announcement, indicate that '73 profits may be better than originally envisioned.

Internal cash flow will be speeding along at record levels, thus minimizing liquidity problems for most firms. Plant and equipment outlays will be soaking up most of the high cash flow, marking the biggest gain in capital spending since 1966. Moreover, the huge cash flow will probably keep some pressure off interest rates, especially from the corporate sector.

In short, it looks like corporate treasurers should be headed for another good year in '73. ■

ABOUT THE SURVEY

In early November questionnaires were sent to treasurers of corporations included in *Fortune's* compilation of the largest 500 manufacturing and 150 nonmanufacturing firms. The overall response rate was 56 percent.

Although surveys for business outlays on plant and equipment are well known, this survey is the only large-scale attempt to determine the financial feasibility of total corporate spending plans. Since firms responding to our survey account for a large share of the corporate sector, a reading of their financial expectations can give us a clue to the general firmness of overall spending plans for next year.

Two caveats should be entered, however. First, the survey is limited to the largest firms in the country, and no attempt was made to ascertain if expectations of smaller firms might differ. Second, probing expectations of the corporate financial mind on a comprehensive basis is relatively new and must be regarded as experimental. The survey is too new, for example, to attempt to remove systematic biases on the respondents' answers.

Despite Damage By Agnes . . . District Economy Forges Ahead in '72

by Curtis R. Smith

Most Third District residents had reason to cheer in 1972. Businessmen saw the economy post some solid gains—banking and retailing led the field while manufacturing emerged from its recessionary doldrums. Area consumers also achieved meaningful progress over the year. They were in a better position to buy goods and services or, perhaps, to salt away part of their growing paychecks.

In some sections of the District, however, 1972 was a disastrous year. Hurricane Agnes caused substantial personal suffering and property damage. The swirling waters also washed out many jobs, making it more difficult to lower already uncomfortably high levels of unemployment in some areas.

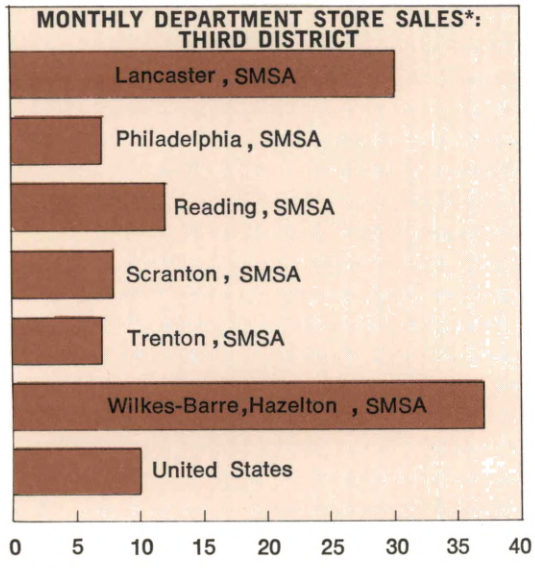
AREA ECONOMY ADVANCES STEADILY

Nineteen seventy-two was a banner year for the national economy, with real growth reaching 6½ percent. While the Third District had its bright spots, business activity in the region still grew less rapidly than in the U. S. as a whole.

Retailing in the area surged as families converted higher incomes into consumer goods. Department store sales in the first 10 months in major District cities not only surpassed those of '71, but they rose at a faster rate. Leading cities were Lancaster and the Wilkes-Barre-Hazelton area. Lancaster's 30 percent increase typifies this area's rapid growth. Wilkes-Barre's 37 percent gain probably reflects replacement of property destroyed by Agnes. Although sales in other cities in the District grew somewhat more slowly, unofficial reports indicate that Yuletide business boomed.

One area in which the District didn't garner its full share of the expansion was construction. The boom in housing at the national level continued in 1972—the value of private residential and nonresidential

INCREASED RETAIL ACTIVITY SPURRED THE REGIONAL ECONOMY IN '72 . . .



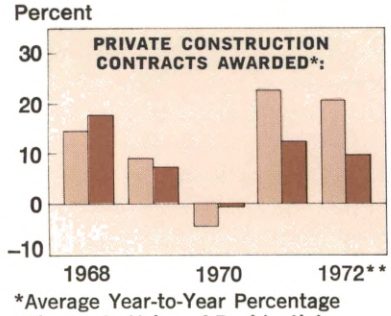
*Percentage change based on first 11 months
Source: Department of Commerce, SMSA Basis

construction contracts soared at a better than 20 percent clip for the second year in a row. While the Third District failed to match this spectacular increase, it did post close to a 10 percent gain in private residential and nonresidential building in the first 11 months of '72.

When contract awards covering public works and utilities construction are included, however, the regional picture becomes gloomier. The awarding of public contracts is quite volatile at the District level. During 1970 and 1971, the area had a disproportionally high share of public projects. This year, however, the District suffered a 44 percent drop in public construction. Consequently, the value of total area construction awards nosedived in 1972, after a close to 20 percent surge in 1971.

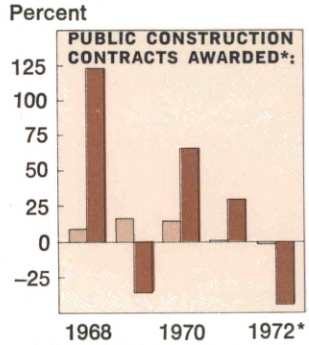
Another measure of economic progress is the amount of electric power consumed in manufacturing. Power consumption is an imperfect measure of industrial output, but it does tend to mirror ups and downs in the

AND, ALTHOUGH PRIVATE CONSTRUCTION ROSE,



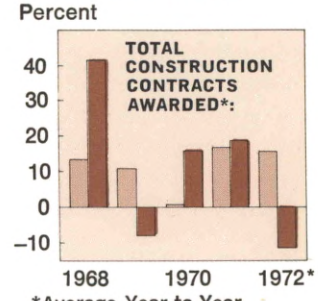
*Average Year-to-Year Percentage Change In Value of Residential and Nonresidential Building Contracts Awarded
**Based on first 11 months
Source: F. W. Dodge Corp.

PUBLIC WORKS AWARDS DROPPED TREMENDOUSLY,



*Average Year-to-Year Percentage Change in Value of Public Works Contracts Awarded
**Based on first 11 months
Source: F. W. Dodge Corp.

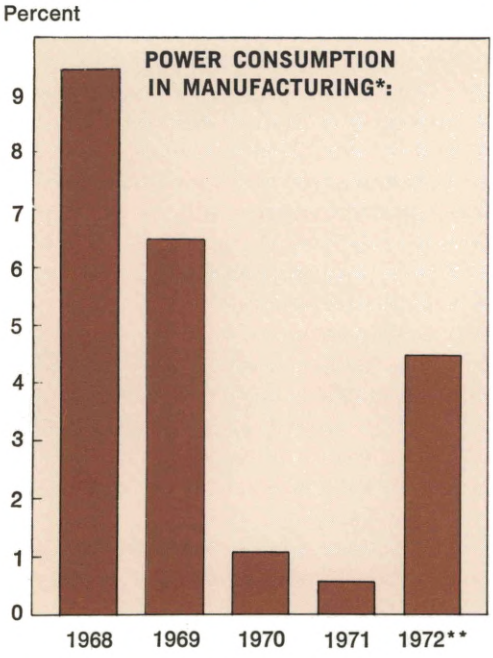
CAUSING THE VALUE OF TOTAL CONSTRUCTION TO PLUMMET . . .



*Average Year-to-Year Percentage Change in Value of Total Construction Contracts Awarded
**Based on first 11 months
Source: F. W. Dodge Corp.

UNITED STATES
THIRD DISTRICT

YET, ON THE WHOLE, THE DISTRICT POSTED MODERATE GAINS IN OUTPUT.



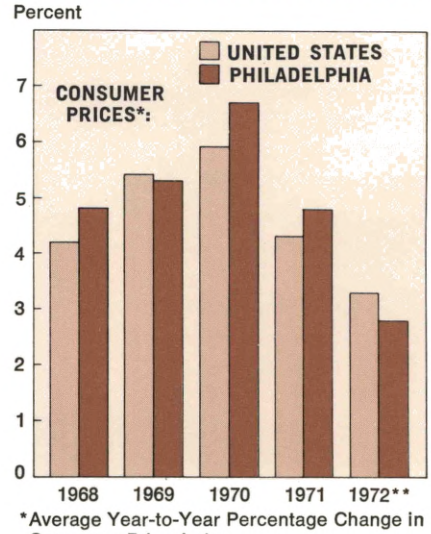
*Average Year-to-Year Percentage Change in Electric Power Consumed by Third District Manufacturers
**Based on first 11 months

industrial economy. Electric power consumed by industrial firms rose 4½ percent in '72, well above the recession-plagued gains of '70 and '71. Although showing signs of cyclical recovery, area manufacturing was not in the vanguard of the upswing.

REAL GAINS FOR REGIONAL RESIDENTS

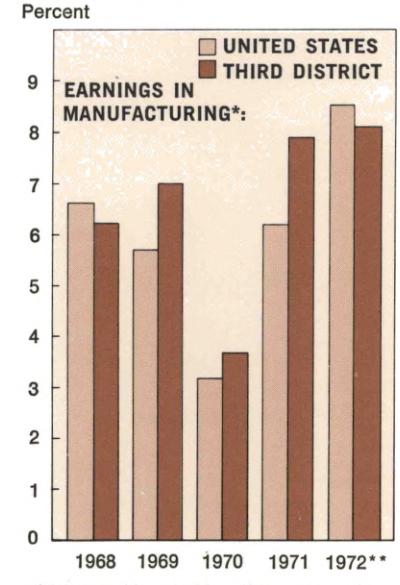
Paralleling the increases in business activity, Third District residents saw their earnings go farther in 1972. Prices of goods and services continued to rise, but the rate of increase in both Philadelphia and the nation also continued to moderate. In the first 11 months of 1972, the average Philadelphia Consumer Price Index (CPI) moved up just under 3 percent while the national index advanced almost 3½ percent. Any

EVEN THOUGH PRICES ROSE, THEIR RATE OF INCREASE TRENDED DOWNWARD . . .



*Average Year-to-Year Percentage Change in Consumer Price Index
**Based on first 11 months
Source: U. S. Department of Labor

WHILE WORKERS PULLED DOWN BIGGER CHECKS



*Average Year-to-Year Percentage Change in Average Weekly Earnings in Manufacturing
**Based on first 11 months
Source: U. S. Data, Department of Labor

relief on the price front is welcome since this is only the second year out of the last five that Philadelphia consumer prices have increased more slowly than the United States average—and in 1969 the difference was a minuscule tenth of a percentage point.

As consumer prices in the region were rising at a slower rate, District earnings, as measured by average weekly earnings in manufacturing, reached new highs. These gains reflected both increased wages and longer work weeks. Thus, even with a full year of wage-price controls, the average pay envelope of District manufacturing employees was fattened by over 8 percent—topping '71's record increase.

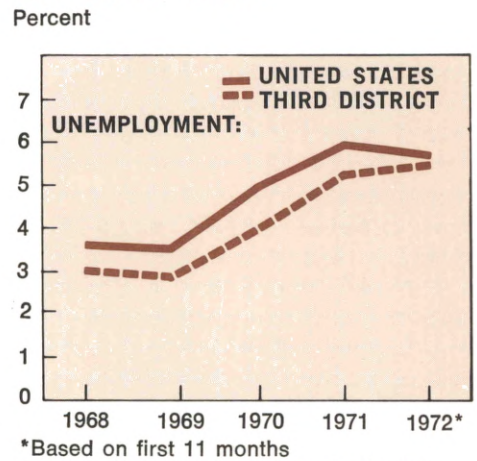
Consequently, the combined wage-price picture boded well for the average wage earner in the Third District. Real purchasing power rose by more than 5 percent in 1972, following a 3 percent gain in 1971. Therefore, after barely staying ahead of inflation in recent years, District consumers chalked up some real gains last year.

LABOR MARKETS STILL LAG

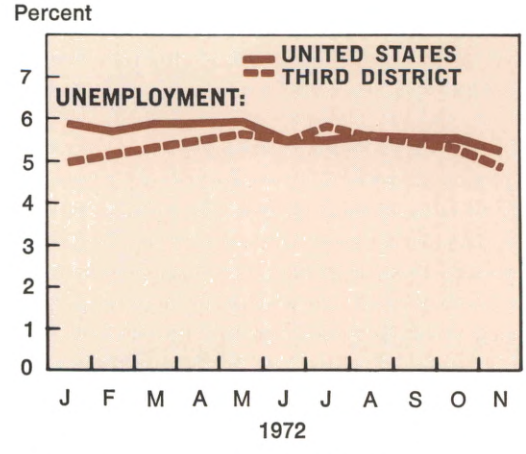
Despite the Third District's modest recovery, the local unemployment rate continued to rise in 1972. The jobless figure edged up to 5.4 percent for 1972 as a whole, making it the third straight year of increase and the highest District rate since the early '60s. However, conditions looked better as moderate declines finally showed up in the month-to-month figures toward the end of the year. Hurricane Agnes, it seems, had something to do with holding the unemployment rate up in mid-year. In May, the jobless rate peaked and noticeable improvement was seen in June. Then Agnes hit, and the region did not regain June's level until September. Happily, the latest reports do show further amelioration.

There are other signs that progress is at hand in the labor market. Average weekly hours of production workers in manufacturing finally recovered in 1972, after two years at depressed levels. This reflects the general pickup in business activity and is typically a harbinger of continuing economic growth. In the early stages of a recovery, the initial response of businessmen usually is to increase the hours of workers already on their payrolls. Then, as the expansion builds up a head of steam, laid-off workers are rehired and new ones recruited. While other parts of the country have already reached this

UNEMPLOYMENT REMAINED HIGH, ALTHOUGH DECLINING NEAR THE END OF '72 . . .



*Based on first 11 months
Source: U. S. Data, Department of Labor



REBUILDING IN THE WAKE OF AGNES

One of the worst storms in Pennsylvania's history dampened the already modest pace of recovery in the Third District in 1972. Sweeping up the East Coast in late June, Agness dumped heavy rains on West Virginia, Maryland, Virginia, and New York. Then she looped back into central Pennsylvania and stalled, causing the worst natural disaster in the Keystone State's history. The final figures will probably never be known with great precision, but the estimates are grim—44 Pennsylvanians dead; thousands homeless; $1.5 billion damage to homes, businesses, highways, bridges, and crops.

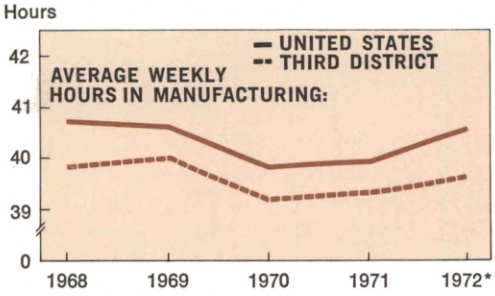
Unemployment figures from Harrisburg and Wilkes-Barre give some idea of the extent of the disaster. In June, a week before the flood, Harrisburg had a jobless rate of 3 percent. In July, three weeks after the storm, the rate doubled. Even though three weeks of intensive relief efforts had restored some jobs and created others, 2,400 positions vanished in the swirling waters. The situation was worse in Wilkes-Barre. Already an area with nearly 8 percent of the work force unemployed, the flood swept more than 10,000 workers off their jobs and sent unemployment soaring to close to 20 percent.

Other indicators of economic distress reflect Agnes's visit also. Jobless benefits paid to Pennsylvania storm victims have already topped $20 million and the state Bureau of Employment Security estimates that unemployed workers will eventually receive between $25 million and $50 million as compensation for Agnes's rampage. Personal income in Pennsylvania dropped a percentage point in the second quarter thanks to Agnes instead of registering an expected increase of over 2 percent. In dollar terms, the personal income loss attributable to the storm was $1.6 billion. Business firms in the state not only were hit with losses caused by the interruption of production, but also saw $585 million worth of inventory, machinery, and buildings damaged by water and muck.

But Pennsylvania has bounced back, spurred by a determination to rebuild and $1.2 billion in Federal assistance. Close to $410 million in 1 percent loans from the Small Business Administration have already been granted or are being processed. This help in getting employers back on their feet is reflected in the jobless rates. The figure for all of Pennsylvania went from 5.3 percent just before the flood, up to 6 in July, down to 5½ in August, and finally regained its preflood level in September. Wilkes-Barre took longer to regain a semblance of order since the area accounted for more than half the jobs lost in Pennsylvania because of Agnes. Finally, in November, Wilkes-Barre's rate dipped below its preflood level, but the area still remains one of substantial unemployment.

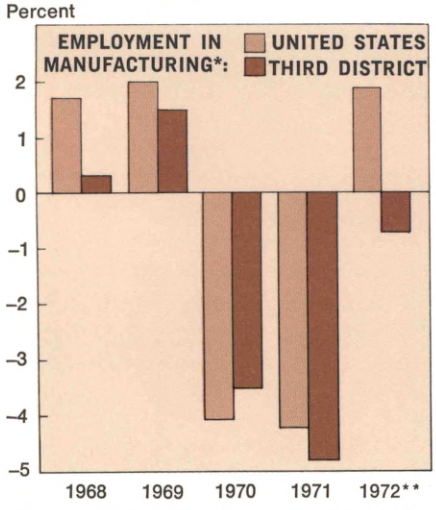
Hurricane Agnes dented the economy and walloped many Pennsylvanians. Despite her, however, the economy has recovered and the outlook is optimistic for '73. But the people, though they will rebound, will never forget the Great Flood of '72.

HOURS WORKED RETURNED TO PRERECESSION LEVELS . . .



*Based on first 11 months
Source: U. S. Data, Department of Labor

AND MANUFACTURING EMPLOYMENT LOOKED MORE PROMISING.



*Average Year-to-Year Percentage Change in Total Employment in Manufacturing
**Based on first 11 months
Source: U. S. Data, Department of Labor

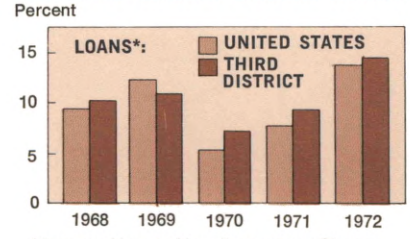
stage, the Third District still lags (in part, because of Agnes). Total employment in manufacturing in the nation went from substantial declines in 1970 and 1971 to a modest, but accelerating, increase this past year. In our areas, however, employment in manufacturing didn't quite break even after hefty declines in the previous two years.

BANKING BURGEONS

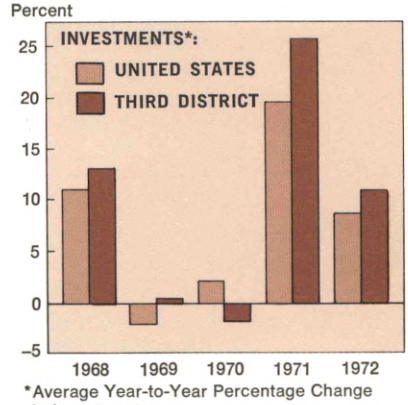
Economic recovery and an accommodating monetary policy in 1972 added up to a good year for banking in the Third District. For the third straight year, loans increased in both the District and the nation. The rate of increase for area bank loans was slightly over 14 percent—representing the third year in a row that local increases topped those of the nation.

Investment portfolios of District banks also increased substantially for the second straight year. Last year's jump fell well below the 26 percent rise experienced in '71, but this slowing of the rate of increase

REGIONAL ECONOMIC RECOVERY GENERATED GREATER BANKING ACTIVITY



*Average Year-to-Year Percentage Change in Loans
Note: Loans include both loans and discounts and apply for member banks only. Data is for last Wednesday of each month.



*Average Year-to-Year Percentage Change in Investments
Note: Investments include U. S. Government obligations and other securities and apply for member banks only. Data is for last Wednesday of each month.
Source: U. S. Data, Board of Governors, Federal Reserve System

probably reflects rising loan demand. As the economy expands, better loan opportunities appear and bankers shift available funds from securities to more profitable loans. However, the continued rise in investments held indicates that banks are not fully loaned up and that additional loans can still be accommodated.

WHAT'S NEXT

The past year, then, was a period of solid recovery in the Third District. While still trailing the nation in the speed of economic pickup, business activity in the region registered positive gains. Manufacturing output and private building construction posted good increases, and retail sales and banking action accelerated rapidly. Consumers enjoyed welcome relief from inflation, seeing their real purchasing power rise. And, although the unemployment rate for the area averaged slightly higher, it was heading downward by year's end. This upturn in economic activity is consistent as well with expectations of area executives, who are bullish about business prospects in the coming months (see Box). ■

THIRD DISTRICT BUSINESSMEN GAZE INTO '73

The Federal Reserve Bank of Philadelphia conducts a monthly business outlook survey. This survey is designed to gain insight into prospective economic conditions in the Third Federal Reserve District, an area that includes the eastern two-thirds of Pennsylvania, the southern half of New Jersey, and Delaware. Executives of manufacturing firms with 500 or more employees are polled with regard to their readings of local business activity.

Since its inception at the request of the regional business community almost five years ago, the Business Outlook Survey has become a useful source of economic intelligence both for business and public policymakers. Copies of the monthly summary of the Outlook Survey may be obtained by writing to Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

OUTLOOK FOR 1973

Area executives are optimistic about the regional outlook for 1973. Three out of four businessmen polled look for an increased level of business activity six months down the pike. Over two-thirds of the respondents feel that their own firms will boost sales and new orders in the coming months. These favorable prospects are causing regional managers to increase plans for capital expenditures. More than half the firms queried intend to up capital spending in the first half of '73. In fact, the capital expenditure index is now at its highest level since the Survey began. The only cloud on the horizon is the expectation or rising prices, as almost two-thirds of the large manufacturers expect to be paying higher prices six months from now.

In short, Third District businessmen forsee continuing expansion in the regional economy with some upward pressure on prices.

Has the Inventory Cycle Lost Its Oomph?

by Jack Clark Francis

May 1971—"The Inventory Outlook: A Turn to The Plus Side," *Fortune*.

November 18, 1971—"Price Freeze Failed to Convince Companies to Enlarge Inventories," *Wall Street Journal*.

August 1972—"The Puzzling Performance of Inventories," *Business In Brief* by Chase-Manhattan Bank.

For over a year now, business inventories have been like the proverbial Chinese puzzle—hard to figure out. Bamboozled forecasters and perplexed economists have had a hard time fathoming, much less explaining, the crazy performance of inventories, as the headlines above suggest.

The major falls and rises in inventory spending used to be one of the most reliable ingredients in economic recessions and recoveries. And because of the relatively large dollar amounts invested in inventory spending, it usually plays a big part in business ups and downs, providing a downward shove to recessions and then a boost to recoveries. However, during the last recession and the current upturn the inventory cycle just isn't behaving like it has for the past two decades—it seems to have lost its oomph.

The relatively small rate of current inventory change could spell the beginning of a new relationship between inventory spending and the rest of the economy. In the coming decades better inventory management techniques, applied by profit-minded businessmen, may cut the size of inventories relative to sales and operate to dampen the cyclical effects of inventory spending. Furthermore, better monetary and fiscal policy may continue to reduce the severity of economic expansions and contractions which go hand in hand with the inventory cycle. As a result of these changes, the inventory cycle of the future may not be the snarling beast it used to be.

WHY HOLD INVENTORIES?

Necessary Evil. An important step in coming to grips with the inventory cycle is to understand what prompts businessmen to hold inventories in the first place. After all, maintaining inventory has its heartaches: it is costly to store; it is frequently subject to local taxes; it may become worthless because of mice, fashion changes, or leaky roofing; and it is expensive to insure against losses caused by fire, theft, and acts of God. Yet one simple motivation causes a businessman to hold an inventory: he can make more money by carrying an inventory than he can without one. In this sense inventories are a necessary evil.

With the exception of made-to-order enterprises, such as portrait painting and custom tailoring, operating without an inventory will cost a business some sales. Customers often won't wait for a product to be ordered, made up, and delivered; they'll go to a competitor. Since the businessman has no way of knowing for sure what tomorrow will bring, in terms of sales, he must have a buffer stock on hand or risk losing customers and profits. Thus, the profit-seeking businessman must strike a delicate balance between (a) minimizing his inventory costs by carrying a small inventory and (b) maximizing his sales by carrying a large enough inventory so that customers can find what they want and then buy it without waiting. Managing inventories so as to strike a happy and profitable median between sales and the stock of goods held can be especially tricky in those firms whose managers like to gamble.

Speculative Goal. Sometimes a businessman's profit motive can cause him to alter the size of his inventory for speculative reasons. For example, if a businessman expects a labor strike or rationing (associated with wartime) to stop his deliveries, rising raw material prices, low-cost inventory financing, or some similar event, then increasing inventories may be a good way to increase profit. Essentially, this is speculating with inventories.

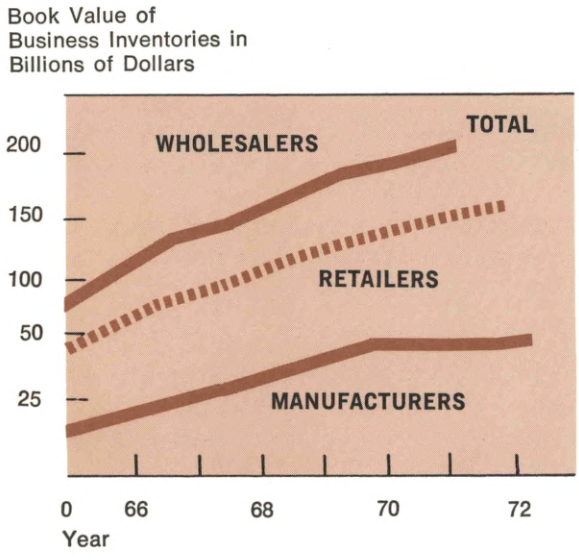
A Firm's Inventory-Sales Relationship. Although speculative motives can have an important effect on a businessman's decisions to increase or decrease his inventory at a particular moment, sales expectations are the main factor behind the inventory plans of most businesses. For example, a firm's sales may be particularly heavy for a month and its inventory depleted. Should the profit-minded owner of the firm build up the depleted inventory? The answer depends on whether he thinks sales the following month will remain up or drop back below their old level. If he boosts inventory and sales drop below what is expected, he ends up with "too big" an inventory which is costly to maintain. Of course, if the owner leaves inventory in a depleted condition and sales continue at a high level, he may miss out on some sales and hence profits. Thus, businessmen strive to adjust their inventories to changes in demand for their products so as to maintain a profitable balance or ratio between inventory and sales.

AGGREGATE INVENTORIES

Understanding the motives which cause an individual businessman to increase or decrease his inventories gives some clues about the inventory cycle which makes recessions worse and recoveries racier. The next step is to look beyond individual firms to the total inventory held by all businesses in the U. S. With respect to the whole economy, *inventories* refers to the total value of finished goods plus work in process plus raw materials which all businesses are holding at a certain time.

Chart 1 shows total inventories aggregated over all manufacturers, wholesalers, and retailers in the U. S.

CHART 1—HOW THE STOCK OF INVENTORIES HAS INCREASED IN RECENT YEARS

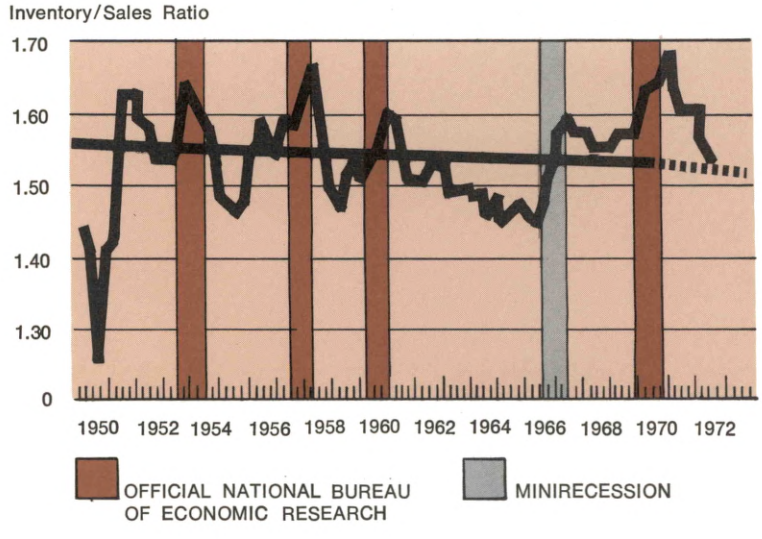


The graph of inventories in Chart 1 is rising smoothly. This trendline of aggregate inventory is smoother than a graph of some individual company's inventory because the numerous fluctuations up and down in each company's inventories are averaged out and only the general trend shows when they are all added together. By dividing the aggregate inventory numbers graphed in Chart 1 by total monthly sales, we can get some facts about the inventory-sales ratios—called I/S ratio.

Chart 2 shows the average I/S ratio for all American businessmen fluctuating around 1.5 times during the past two decades. This seems to indicate that businessmen think that it is most profitable for their firms to try to maintain inventories that are about 1.5 times larger than their sales in an average month. Of course, different industries and firms will have different I/S ratios which depend on the product they sell and how they operate (see Box). But overall, 1.5 seems to be the target.

CHART 2

FOR THE PAST TWO DECADES BUSINESS AS WHOLE HAS MAINTAINED AN INVENTORY SALES OF ROUGHLY 1.5 TIMES



The average I/S ratio of about 1.5 times used by many economists glosses over details about the I/S ratios which can be useful for economic analysis and forecasting. First, there are different categories of firms which carry inventory. The main distinction between firms centers around whether they are primarily manufacturers of goods or sellers of goods—namely, wholesalers or retailers. The second way to break down inventory holdings is by the stage of fabrication—essentially three stages are analyzed.

1) Raw Materials. Nearly all manufacturers have parts, or glue,or paint, or packages, or other things in their warehouses to use in making their products. For example, a furniture manufacturer or a toymaker must inventory such raw materials and supplies.
2) Goods in Process. Manufacturing firms usually have partially finished products on their production lines. These are called goods-in-process inventories and can be quite large for some firms—like a distiller of eight-year-old whiskey.
3) Finished Goods. In order to keep their customers from going elsewhere most companies—especially retailers—keep an inventory of finished goods ready for immediate sale and prompt delivery. For example, department stores keep large inventories of finished goods.

The table below shows how I/S ratios differ from firm to firm and from one stage

AVERAGE END-OF-MONTH BOOK-VALUE INVENTORIES AND AVERAGE MONTHLY SALES IN U.S. MANUFACTURING, WHOLESALING, AND RETAILING, 12 MONTH PERIOD OCT. 1971 TO SEPT. 1972*

Distribution level and fabrication stage	*Sellers of nondurable goods*			*Sellers of durable goods*			*Total (nondurable and durable)*		
	Inventories†	Sales†	I/S	Inventories†	Sales†	I/S	Inventories†	Sales†	I/S
Manufacturing	36.0	27.5	1.31	66.9	32.7	2.05	102.9	60.2	1.71
Fabrication stages:									
Materials and supplies	(13.6)			(19.1)			(32.7)		
Work in process	(5.4)			(30.3)			(35.7)		
Finished goods	(17.0)			(17.4)			(34.4)		
Wholesale merchant	11.8	12.8	.92	17.5	11.1	1.58	29.4	23.9	1.23
Retail	29.1	24.3	1.20	23.7	12.0	1.97	52.8	36.3	1.45
Total	76.9	64.6	1.19	108.1	55.8	1.94	185.0	120.4	1.54

* Details do not necessarily add to totals because of rounding.
† In billions of dollars
Source: U.S. Department of Commerce

of fabrication to the next. Figures like those in the table are published monthly by the Department of Commerce. These data convey a fairly accurate picture of the country's inventory structure.

The data in the table indicate that manufacturers tend to hold over half of America's total inventories. Manufacturers' inventories are larger than the inventories of merchants because supplies, raw materials, and work in process, as well as finished goods, are included in manufacturers' inventories. There is a high I/S ratio for manufacturers because they turn these big inventories over slowly as goods in process are completed. Moreover, the data in the table show that the manufacturers of durable goods carry the largest inventories and turn them over more slowly than other manufacturers. Inventory adjustments of durable goods manufacturers also lag behind sales more than the inventory adjustments of, say, a retail store because of the time required to cut back production. For example, a manufacturer of ocean liners carries a huge work-in-process inventory which lags sales demand for the product by many months. As a result of their large size and the delays involved, inventories of durable goods of manufacturers are the most likely to get out of hand and accentuate the economic impact of a business recession or recovery. Economic forecasters, therefore, frequently focus on the inventories of durables' manufacturers.

Although 1.5 seems to be the average I/S ratio which is sought by most inventory managers, shifting demand for their products frequently causes them to under- or overshoot the mark. For example, another glance at Chart 2 shows that during business slowdowns (marked by the darkened bars running up and down in the chart) the I/S ratio rises to a peak. The I/S ratio peaks during busines contractions because businessmen's sales decrease faster than they can cut back their inventory. This leads to what is called negative "inventory investment," the "inventory cycle," and business fluctuations.

Inventory Investment. "Inventory investment" means something different than "inventory" in the lingo of economists. *Inventory investment* means the change in aggregate inventories over a period of time—it may be a positive or negative number, depending on whether inventory grew or shrank.[1] Thus, "inventories" refers to a *stock* of goods while inventory investment refers to the *flow* of goods into or out of inventories.

Inventory investment fluctuated more than any other major component of gross national

[1] The phrase *inventory investment* is a synonym for *change in inventories* or *inventory adjustments*. Inventory investment can also be defined as the excess of production output over sales (where the sales can be made to consumers or other firms). Inventory investment is thus an addition to GNP if it is positive, or a reduction in GNP if it's negative.

There are two main sources of data about inventories. Both are published by the Department of Commerce in the *Survey of Current Business*. One is an end-of-month inventory level series. The other is the inventory component of GNP which measures the inventory investment and is published quarterly. Unfortunately, it is not possible to take the difference in the level of manufacturing and trade inventories between two periods and arrive at a figure comparable to the inventory investment figure in the GNP accounts. There are two reasons for the divergence in these two figures. First, the scope of the data is not the same. Second, the monthly data on inventory levels is at book value but the inventory change component of GNP is valued at current prices. For a readable discussion of these matters, see J. P. Lewis and R. C. Turner, *Business Conditions Analysis* (New York: McGraw-Hill Book Company, 1967), pp. 56-58.

product (GNP) during the business fluctuations which have occurred since the end of World War II. As a result, economic downturns are often called *inventory recessions*. In fact, economic researchers have suggested that if fluctuations in inventory had somehow been held constant since World War II, the actual values of the other components of GNP fluctuated so little that the U. S. would not have had a single recession in recent decades.[2]

The Inventory Cycle. A glance at Chart 3 shows that inventory investment starts to shrink before or at the start of recessions and minirecessions.[3] Then, after the recessions, inventory investment usually rises sharply. This is the typical inventory cycle. After the cycle finishes its spurt upward during the business recovery, wiggles and kinks reappear until the next recession and another inventory cycle. But, the damage has already been done: the recovery cycle magnifies the plunge of the recession and the following recovery.

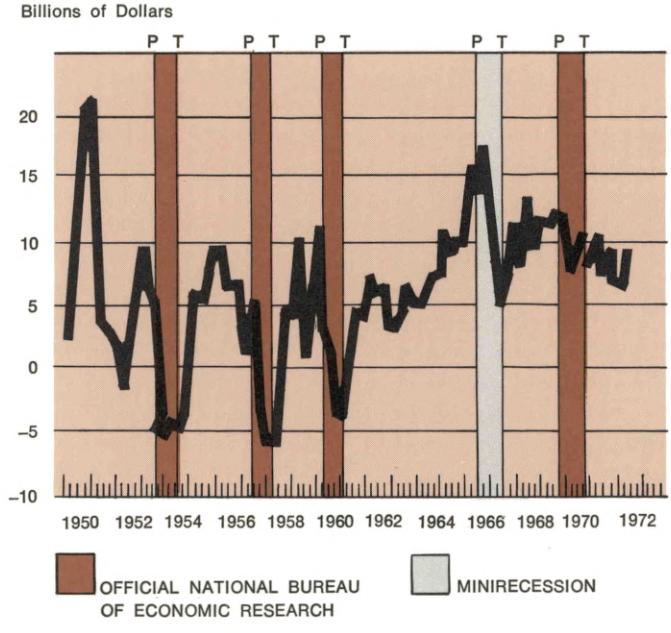
The reason for an inventory cycle is not hard to understand. Many businessmen's production *lags* behind their sales, and then they *overreact* in getting inventories back in line with their sales. Thus, in a business slowdown, decreases in companies' sales cause their inventories to become too large in proportion to their sales. To avoid the cost of excess inventory, firms slow or stop production and procurement. Inventories are sometimes slashed as businessmen overreact, and the slowdown may snowball into a recession. The opposite occurs when the

[2] M. K. Evans, *Macroeconomic Activity* (New York: Harper and Row, 1969), p. 201.

[3] Here a recession is defined as a period when real GNP falls for at least two quarters. A minirecession is a little recession lasting only a quarter. These are not official NBER definitions.

CHART 3

UNTIL THE MOST RECENT RECESSION LARGE CHANGES IN BUSINESS INVENTORIES MARKED THE ECONOMY'S UPS AND DOWNS



recession is over and a business recovery is starting. Sales accelerate faster than inventories can be increased at most firms. As a result, many firms seeking to attain the profitable balance between inventory and sales hurriedly increase their raw material orders and production in order to get their inventory back in line with their new higher sales. So, the economy experiences a spurt in orders, business activity, and inventory accumulation.

Timing and Volatility of the Cycle. Unfortunately, the inventory cycle usually occurs at the same time the rest of the economy is falling or rising. As explained above, large cuts in inventory during a business slowdown reduces business purchasing; this causes production cutbacks and layoffs — all of which deepen a recession. Likewise, after sales turn up and temporarily deplete inventories, increased purchases of raw materials to rebuild inventories boost the business upturn higher and can even push total demand to inflationary levels.

Not only does the timing of most inventory cycles cause problems, but the size of the changes in inventory is destabilizing as well. In recent business cycles, the decline in inventory investment was never less than 40 percent of the total decline in real GNP (see Chart 4). This documents the large role inventories have played during economic slowdowns.

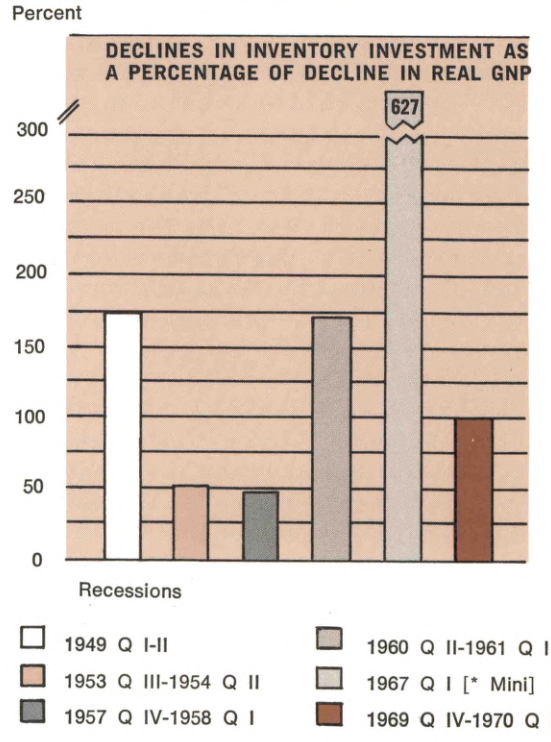
Inventory increases have also contributed to the beginning of most major business recoveries—until the present one, that is. For some reason the inventory cycle isn't performing as usual during this recovery. If it were, then inventory investment would have spurted upward over a year ago.[4]

BREAKING THE INVENTORY CYCLE?

The current slowness in inventory recovery may represent the beginning of a new trend.

[4] Evans, op. cit., p. 207.

CHART 4
INVENTORY INVESTMENT HAS PLAYED AN IMPORTANT ROLE IN U. S. RECESSIONS



Future inventory adjustment may not be such a destabilizing influence in the economy. Essentially, there are two forces working to take the cycle out of inventory investment. First, some businessmen are improving their inventory management techniques. As a result, inventories may fluctuate less in the future than they did in the past. Second, better monetary and fiscal policymaking may be reducing the size of business fluctuations and associated inventory fluctuations.

Better Inventory Management. Many companies are trying new ways to minimize

their losses on obsolete inventory, losses from theft, the financing costs of carrying inventories, the cost of storing an inventory, and similar inventory expenses. Most firms can't hope to reduce the total size of their inventories; they are just trying to keep their inventories from getting much bigger. Several new techniques of inventory management are being employed by these firms.

Some businesses use *computers* to control their inventory. These firms can operate smoothly without large inventory increases because their computers continually check and realign inventories to correspond with sales. As a result of improved techniques of inventory control, our economy's total investment in inventory is not as large as it might be. And, smaller inventories probably are not as destabilizing as larger inventories. For example, if a small inventory is slashed in half, the dollar size of the associated inventory investment is less than if a larger inventory is halved. Smaller fluctuations in inventory investment mean smaller fluctuations in GNP. Thus, using computers to control inventories may help diminish fluctuations in inventory spending which magnify our economic oscillations.

Improved techniques for making long-range forecasts of sales are also helping to iron out the inventory fluctuations of some companies. These firms are trying to minimize their operating costs by running their production lines and purchasing departments at a fairly constant rate through booms and recessions. This minimizes costly layoffs and startups. In order to achieve this constant rate of production, they forecast their sales and then produce what they estimate the long-run average sales to be. This causes inventory to fluctuate countercyclically; that is, firms' inventories expand during recessions as production continues at about the same levels while sales drop. This more stable production schedule tends to minimize production cutbacks and any accompanying economic contractions or expansions.

If enough firms improve their techniques for inventory management, the old gyrations of the inventory cycle may be substantially compressed during future economic fluctuations. Thus, businessmen's desires to strike the most profitable balance between minimizing their inventory costs while trying to maximize sales by carrying larger inventories results in inventory management practices which tend to stabilize the economy.

Improvement in Economic Policymaking. The Federal Government may be exerting a more steadying influence on inventories too. Today's policymakers know more about managing the economy than their predecessors. While modern policymakers still have plenty of problems, they have learned to do a better job at ironing out the boom-bust cycles of past decades. For example, the most recent economic downturn had the smallest percentage drop in real GNP of any post-World War II recession.

With the fluctuation in the economy as a whole reduced, inventory managers have a more stable and certain environment in which to forecast sales and adjust their stocks of goods. Hence, inventory managers are not as likely to miss the mark (that is, the I/S ratio) they are shooting at. This means fewer sharp buildups or cutbacks in inventories with their snowballing effect on business fluctuations. This scenario seems to fit the 1970-71 break in the inventory cycle.

JUST ANOTHER COG

If the inventory cycle has been tamed a little, it's probably because businessmen thought that their profits might be better that way. Better inventory management techniques may be smoothing inventories, or, better economic policies may be making it easier to keep inventories in line, or maybe some of both are at work. If so, this means

that some economics textbooks about business cycles will have to have their chapters on inventories rewritten. But, on the brighter side, it also means that wide swings in economic activity, which in the past have been aided and abetted by the inventory cycle, won't be such a problem in the future. Inventory investment will have much less impact on the economy's ups and downs, neither snowballing recessions nor recoveries. Thus, the inventory cycle, rather than being a magnifying force, will be just another cog in the intricate machinery of the modern economy.

Of course, just as one inning doesn't make a ball game, one break in the inventory cycle does not break a trend. The possibility exists that the 1971-72 inventory behavior is one of those strange happenings that will never reoccur. If so, the conventional inventory cycle will reappear unscathed to flaunt itself in the face of better inventory management and improved economic policy just as it has in the past. ■

Annual Operations and Executive Changes

DIRECTORS AND OFFICERS

At the election held in the fall of 1972, John H. Hassler, President, The City National Bank and Trust Company of Salem, Salem, New Jersey, was elected by member banks in Electoral Group 2 as a Class A Director for a three-year term beginning January 1, 1973. He succeeds William R. Cosby, Chairman of the Board, Princeton Bank and Trust Company, Princeton, New Jersey. James H. Dawson, President and Chairman of the Board, Bank of Delaware, Wilmington, Delaware, resigned on November 22, 1972, as a Class A Director. The election in Electoral Group 1 for a Class A Director is being held. Bernard D. Broeker, Executive Vice President, Bethlehem Steel Corporation, Bethlehem, Pennsylvania, was elected by member banks in Electoral Group 3 as a Class B Director for a three-year term beginning January 1, 1973. He succeeds Edward J. Dwyer, Chairman of the Board, ESB Incorporated, Philadelphia, Pennsylvania. Philip H. Glatfelter, III, Chairman of the Board and President, P. H. Glatfelter Co., Spring Grove, Pennsylvania, resigned as a Class B Director August 22, 1972. An election in Electoral Group 1 is being held to replace him.

The Board of Governors of the Federal Reserve System designated John R. Coleman, President, Haverford College, Haverford, Pennsylvania, as Chairman of the Board of Directors of this Bank and Federal Reserve Agent for 1973. Edward J. Dwyer, formerly a Class B Director, was appointed a Class C Director by the Board of Governors for a three-year term, beginning January 1, 1973 and Deputy Chairman of the Board for the year 1973.

The Board of Directors selected G. Morris Dorrance, Jr., Chairman of the Board, President and Chief Executive Officer, The Philadelphia National Bank, Philadelphia, Pennsylvania, to serve again during 1973 as the member of the Federal Advisory Council from the Third Federal Reserve District.

Jack H. James, Examining Officer, passed away on January 12, 1972.

Effective January 24, 1972, G. William Metz, Vice President, became officer in charge of Fiscal-Safekeeping Operations, replacing Norman G. Dash, Vice President.

David H. Scott, Examining Officer, became Regulations Officer in the Department of Supervision and Regulation.

On February 15, Alexander A. Kudelich, Vice President, became officer in charge of Cash Operations, and retained responsibility for the Collections and Check Processing Operation.

Effective March 1, 1972, five new officers were appointed in the Bank: Lyle P. Bickley was appointed Computer Systems Coordinator; Judith H. Helmuth, Computer Applications Officer; Joseph J. Ponczka, Examining Officer—Commercial; Victor H. Shumaker, Examining Officer—Trust; and Robert A. Wallgren, Examining Officer—Trust.

On May 31, Norman G. Dash, Vice President; Ralph E. Haas, Vice President; and Eugene W. Lowe, Assistant Vice President; retired from the Bank.

Effective June 26, Robert R. Swander joined the Bank as Vice President and General Auditor.

James V. Vergari, Senior Vice President and General Counsel, retired from the Bank on June 30, 1972.

Effective July 1, 1972, Hiliary H. Holloway, Assistant Counsel and Assistant Secretary, became Counsel and Assistant Secretary, replacing James V. Vergari as Chief Legal Officer. Joseph R. Joyce, Assistant Vice President, became Vice President—Staff and Assistant Secretary. Peter M. DiPlacido, Special Assistant, Fiscal-Safekeeping Operations, became Fiscal Operations Officer. Paul E. Kirn, Jr., Special Assistant, Cash Operations, became Cash Operations Officer.

Joseph R. Campbell, Senior Vice President, and James A. Agnew, Assistant Vice President, retired from the Bank on July 31, 1972.

Effective August 1, 1972, Thomas K. Desch, Assistant Vice President, became Vice President.

On September 5, 1972, two new members were added to the official staff. William E. Roman became Vice President and Budget Officer and Elizabeth A. Schenk joined the Bank as Assistant Counsel.

Effective January 1, 1973, Hugh Barrie, Vice President, became Senior Vice President, with responsibility for Computer Applications, Data Processing, and Emergency Operations; Edward G. Boehne, Vice President and Director of Research, became Senior Vice President, with responsibility for the Research Department; and Alexander A. Kudelich, Vice President, became Senior Vice President, with responsibility for Cash and Collections and Check Processing Operations. Hiliary H. Holloway, Counsel and Assistant Secretary, was appointed Vice President and General Counsel. D. Russell Connor, Assistant Vice President, was appointed Vice President. Donald J. McAneny, Chief Examining Officer, was appointed Assistant Vice President. Edwin C. Lodge was appointed Research Officer and Lawrence C. Santana, Jr., was appointed Security Officer.

On March 1, Edward G. Boehne, Senior Vice President, with responsibility for the Research Department, also became officer in charge of Credit Discount and Bank Services. Edward A. Aff, Vice President, retired. Hugh A. Chairnoff, Assistant Vice President, became Vice President and Lending Officer, replacing Mr. Aff. Richard W. Epps, Research Officer and Economist, became Vice President and Assistant Secretary. He will direct the new Operations Research function. W. Lee Hoskins, Research Officer and Economist, became Vice President in the Research Department. Ira P. Kaminow, Research Officer and Economist, became Economic Adviser in the Research Department. Lawrence C. Murdoch, Jr., Vice President and Secretary, became responsible for the Public Services function, in addition to having assumed overall direction of the Building Department and Internal Services on January 1. William E. Roman, Vice President and Budget Officer, assumed responsibility for the Statistical Information Section formerly located in the Department of Research. Edwin C. Lodge, Research Officer, became Statistical Officer. Kathleen C. Holmes was appointed Research Officer.

DIRECTORS AS OF JANUARY 1, 1973

JOHN R. COLEMAN, Chairman of the Board
and Federal Reserve Agent

EDWARD J. DWYER, Deputy Chairman

GROUP		Term expires December 31
	CLASS A	
3	RICHARD A. HERBSTER President, Lewistown Trust Company Lewistown, Pennsylvania	1973
2	JOHN H. HASSLER President, The City National Bank and Trust Company of Salem Salem, New Jersey	1975
1	Temporarily vacant	
	CLASS B	
2	C. GRAHAM BERWIND, Jr. President and Chief Executive Officer Berwind Corporation Philadelphia, Pennsylvania	1974
3	BERNARD D. BROEKER Executive Vice President Bethlehem Steel Corporation Bethlehem, Pennsylvania	1975
1	Temporarily vacant	
	CLASS C	
	JOHN R. COLEMAN President, Haverford College Haverford, Pennsylvania	1973
	EDWARD W. ROBINSON, JR. President and Chief Executive Officer Provident Home Industrial Mutual Life Insurance Company Philadelphia, Pennsylvania	1974
	EDWARD J. DWYER Chairman of the Board ESB Incorporated Philadelphia, Pennsylvania	1975
	Member of the Federal Advisory Council	
	G. MORRIS DORRANCE, JR., Chairman of the Board and President, The Philadelphia National Bank, Philadelphia, Pennsylvania	1973

OFFICERS AS OF MARCH 1, 1973

DAVID P. EASTBURN, President

MARK H. WILLES, First Vice President

HUGH BARRIE, *Senior Vice President*
EDWARD G. BOEHNE, *Senior Vice President*
WILLIAM A. JAMES, *Senior Vice President*
ALEXANDER A. KUDELICH, *Senior Vice President*
LYLE P. BICKLEY, *Computer Systems Coordinator*
JOSEPH M. CASE, *Vice President*
HUGH A. CHAIRNOFF, *Vice President and Lending Officer*
D. RUSSELL CONNOR, *Vice President*
THOMAS K. DESCH, *Vice President*
RICHARD W. EPPS, *Vice President and Assistant Secretary*
HILIARY H. HOLLOWAY, *Vice President and General Counsel*
W. LEE HOSKINS, *Vice President*
JOSEPH R. JOYCE, *Vice President—Staff and Assistant Secretary*
IRA P. KAMINOW, *Economic Adviser*
G. WILLIAM METZ, *Vice President*
LAWRENCE C. MURDOCH, JR., *Vice President and Secretary*
WILLIAM E. ROMAN, *Vice President and Budget Officer*
KENNETH M. SNADER, *Vice President*
ROBERT R. SWANDER, *Vice President and General Auditor*
JACK P. BESSE, *Assistant Vice President*
DONALD J. McANENY, *Assistant Vice President*
WARREN R. MOLL, *Assistant Vice President*
ELIZABETH A. SCHENK, *Assistant Counsel*
J. DAVID STONER, *Assistant Counsel*
RUSSELL P. SUDDERS, *Assistant Vice President*
EVELYN G. BATTISTA, *Personnel Officer*
SAMUEL J. CULBERT, JR., *Bank Services Officer*
PETER M. DiPLACIDO, *Fiscal Operations Officer*
GEORGE C. HAAG, *Public Services Officer*
JUDITH H. HELMUTH, *Computer Applications Officer*
KATHLEEN C. HOLMES, *Research Officer*
PAUL E. KIRN, JR., *Cash Operations Officer*
EDWIN C. LODGE, *Statistical Officer*
A. LAMONT MAGEE, *Assistant General Auditor*
DOMINIC L. MATTEO, *Check Processing Officer*
JAMES H. MUNTZ, *Accounting Officer*
STEPHEN M. ONDECK, *Examining Officer—Commercial*
JOSEPH J. PONCZKA, *Examining Officer—Commercial*
LAWRENCE C. SANTANA, JR., *Security Officer*
DAVID H. SCOTT, *Regulations Officer*
VICTOR H. SHUMAKER, *Examining Officer—Trust*
ROBERT A. WALLGREN, *Examining Officer—Trust*

STATEMENT OF CONDITION
Federal Reserve Bank of Philadelphia

(000's omitted in dollar figures)	End of Year 1972	1971
ASSETS		
Gold certificate account	$ 632,518	$ 471,490
Special Drawing Rights Certificate	23,000	23,000
Federal Reserve notes of other Federal Reserve Banks	54,487	81,867
Other cash	10,240	10,321
Loans and securities:		
Discounts and advances	92,950	400
United States Government securities	3,912,588	3,849,646
Total loans and securities	$4,005,538	$3,850,046
Uncollected cash items	446,809	803,108
Bank premises	4,515	3,281
All other assets	54,918	39,739
Total assets	$5,232,025	$5,282,852
LIABILITIES		
Federal Reserve notes	$3,646,351	$3,237,391
Deposits:		
Member bank reserve accounts	1,010,598	1,164,006
United States Government	121,026	155,230
Foreign	15,080	14,280
Other deposits	23,916	22,030
Total deposits	$1,170,620	$1,355,546
Deferred availability cash items	307,206	581,435
All other liabilities	30,054	31,662
Total liabilities	$5,154,231	$5,206,034
CAPITAL ACCOUNTS		
Capital paid in	38,897	38,409
Surplus	38,897	38,409
Total liabilities and capital accounts	$5,232,025	$5,282,852
Ratio of gold certificate reserve to Federal Reserve note liability	17.3%	14.6%

EARNINGS AND EXPENSES
Federal Reserve Bank of Philadelphia

(000's omitted)	1972	1971
Earnings from:		
United States Government securities	$199,460	$192,792
Other sources	587	754
Total current earnings	$200,047	$193,546
Net expenses:		
Operating expenses*	16,888	14,241
Cost of Federal Reserve currency	1,985	1,508
Assessment for expenses of Board of Governors	1,816	1,680
Total net expenses	$ 20,689	$ 17,429
Current net earnings	$179,358	$176,116
Additions to current net earnings:		
Profit on sales of U.S. Government securities (net)	181	5,218
All other	63	2
Total additions	$ 244	$ 5,220
Deductions from current net earnings:		
Miscellaneous non-operating expenses	2,698	420
Total deductions	$ 2,698	$ 420
Net additions	$ (2,454)	$ 4,800
Net earnings before payments to U.S. Treasury	$176,905	$180,916
Dividends paid	$ 2,344	$ 2,238
Paid to U.S. Treasury (interest on Federal Reserve notes)	$174,073	$176,241
Transferred to or deducted from (—) Surplus	$ 488	$ 2,437

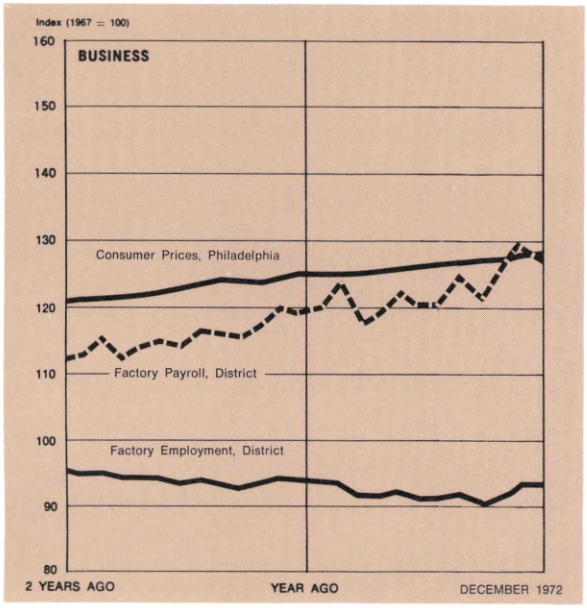
* After deducting reimbursable or recoverable expenses

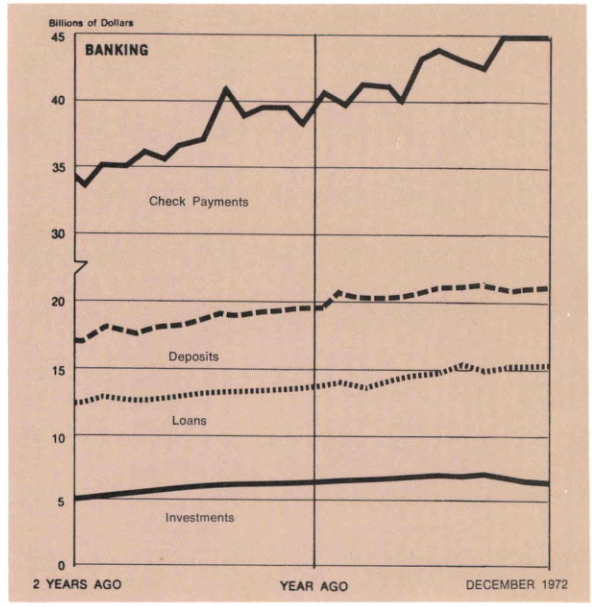
VOLUME OF OPERATIONS
Federal Reserve Bank of Philadelphia

Number of pieces (000's omitted)	1972	1971	1970
Collections:			
Ordinary checks*	$438,534	$412,949	$386,878
Government checks (paper and card)	36,560	39,689	38,050
Postal money orders (card)	12,016	12,917	13,022
Non-cash items	948	993	876
Food stamps redeemed	19,369	73,807	51,492
Clearing operations in connection with direct sendings & wire & group clearing plans**	608	606	606
Transfers of funds	382	349	325
Currency counted	372,511	368,459	349,173
Coins counted	901,993	801,081	752,489
Discounts and advances to member banks	(a)	(a)	1
Depositary receipts for withheld taxes	1,664	1,691	1,296
Fiscal agency activities:			
Marketable securities delivered or redeemed	292	355	557
Computerized marketable securities (Book entry transactions)	12	15	7
Savings bonds and notes (F.R. Bank and agents)			
Issues (including reissues)	10,665	11,511	10,932
Redemptions	7,497	7,557	9,098
Coupons redeemed (Government and agencies)	726	856	867
Dollar amounts (000,000's omitted)			
Collections:			
Ordinary checks	$139,115	$126,693	$120,156
Government checks (paper and card)	11,795	10,506	9,553
Postal money orders (card)	219	236	240
Non-cash items	2,707	2,243	1,775
Food stamps redeemed	152	124	76
Clearing operations in connection with direct sendings & wire & group clearing plans**	87,787	76,689	69,340
Transfers of funds	569,433	515,117	404,927
Currency counted	2,853	2,837	2,650
Coins counted	120	106	102
Discounts and advances to member banks	2,725	2,260	4,607
Depositary receipts for withheld taxes	8,275	7,294	6,344
Fiscal agency activities:			
Marketable securities delivered or redeemed	8,950	11,297	11,155
Computerized marketable securities (Book entry transactions)	29,657	30,902	7,286
Savings bonds and notes (F.R. Bank and agents)			
Issues (including reissues)	623	586	491
Redemptions	355	360	497
Coupons redeemed (Government and agencies)	158	159	146

* Checks handled in sealed packages counted as units
** Debits and credit items
(a) Less than 1,000 rounded

FOR THE RECORD...





SUMMARY	Third Federal Reserve District			United States		
	Percent change			Percent change		
	Dec. 1972 from		12 mos. 1972 from	Dec. 1972 from		12 mos. 1972 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
MANUFACTURING						
Production	....	....	....	− 3	+11	+8
Electric power consumed	N/A	N/A	N/A	....	....	....
Man-hours, total*	+ 1	0	− 1	....	....	....
Employment, total	0	− 1	− 2	....	....	....
Wage income*	+ 1	+ 7	+ 6	....	....	....
CONSTRUCTION**	−51	−34	−13	−11	+ 3	+14
COAL PRODUCTION	N/A	N/A	N/A	− 7	−14	+ 4
BANKING (All member banks)						
Deposits	+ 3	+11	+13	+ 5	+12	+10
Loans	+ 3	+17	+14	+ 4	+18	+14
Investments	− 2	+ 4	+11	+ 1	+ 6	+ 9
U.S. Govt. securities	− 2	− 5	0	+ 2	0	+ 1
Other	− 2	+ 9	+17	+ 1	+10	+13
Check payments***	+ 3†	+20†	+15†	− 2	+19	+15
PRICES						
Wholesale	....	....	....	+ 2	+ 6	+ 5
Consumer	0‡	+ 3‡	+ 3‡	0	+ 3	+ 3

*Production workers only
**Value of contracts
***Adjusted for seasonal variation
†15 SMSA's
‡Philadelphia

LOCAL CHANGES Standard Metropolitan Statistical Areas*	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Percent change Dec. 1972 from		Percent change Dec. 1972 from		Percent change Dec. 1972 from		Percent change Dec. 1972 from	
	month ago	year ago	month ago	year ago	month ago	year ago	month ago	year ago
Wilmington	− 1	+ 2	+ 8	+11	− 6	+ 2	N/A	N/A
Atlantic City	− 2	+ 1	+ 3	+12	− 5	+15	+ 2	+17
Bridgeton	− 1	+ 6	N/A	N/A	N/A	N/A	+ 3	N/A
Trenton	− 2	0	+ 2	+17	+ 9	+24	0	+ 7
Altoona	+ 1	+ 1	0	+ 8	+ 4	+16	+ 3	+15
Harrisburg	0	+ 2	− 3	+10	− 1	+18	+ 4	+20
Johnstown	− 2	+ 3	−12	− 1	− 1	+10	+ 5	+ 9
Lancaster	0	+ 6	+ 2	+17	+ 6	+159	+ 5	+15
Lehigh Valley	0	+ 3	− 3	+ 9	+ 5	+17	+ 4	+15
Philadelphia	0	0	+ 1	+ 7	+ 4	+24	+ 6	+12
Reading	+ 1	+ 2	0	+ 9	+ 2	+ 5	+ 3	+18
Scranton	− 2	− 1	− 2	+ 6	− 2	+ 2	+ 4	+13
Wilkes-Barre	+ 1	0	− 1	+20	+ 4	+34	+ 4	+34
Williamsport	N/A	N/A	N/A	N/A	− 4	+25	+ 3	N/A
York	− 2	+ 1	− 2	+10	+ 1	−39	+ 2	+13

*Not restricted to corporate limits of cities but covers areas of one or more counties.
**All commercial banks. Adjusted for seasonal variation.
***Member banks only. Last Wednesday of the month.

FEDERAL RESERVE BANK of PHILADELPHIA
PHILADELPHIA, PENNSYLVANIA 19101

business review

FEDERAL RESERVE BANK
OF PHILADELPHIA
PHILADELPHIA, PA. 19101

ADDRESS CORRECTION REQUESTED