Federal Reserve Bank of San Francisco

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Business & Financial Letter

Old Fashioned Boom

The Commerce Department's latest plant-equipment survey provides further evidence (as though any were needed) that the nation is in the midst of an old-fashioned capital-goods boom. The survey indicates a 13-percent increase in spending in 1973, to $100 billion, for the sharpest gain since 1966.

The boom has been fairly slow in getting underway—not too surprisingly, in view of the fact that investment spending is generally considered a lagging cyclical indicator. Even at that, the overall expansion between the 1970 cyclical trough and late 1972 was relatively moderate, in comparison with the two earlier capital-goods expansions which began in 1963 and 1967. Spending increased very slowly in 1971, then rose at a 12-percent annual rate in first-half 1972 and at an 8-percent rate in the second half of that year. In the current half-year, however, spending should jump at a 17-percent annual rate, before decelerating to an 11-percent rate of increase in the July-December period.

Running fast

The largest gain in expenditures for 1973 is scheduled by durable-goods manufacturers. They increased their spending at a healthy 10½-percent clip in 1972, and now plan for a 22-percent increase this year, with substantial gains promised for almost every industry. Nondurable-goods manufacturers actually reduced their spending by a small amount last year, but now plan a 15½-percent expansion, largely because of substantial outlays by rubber, paper, and chemical manufacturers.

Manufacturers may simply be making up for lost time, since their plant-equipment outlays grew at less than 2 percent annually over the entire 1966-1972 period. With the utilities, however, the situation is different, since their expenditures have risen at more than a 16-percent annual rate throughout the last decade—and this year again are scheduled to rise by 16 percent. Much of the recent spending in this sector is due to an upsurge in purchases of new generating facilities by electric utilities.

The capital-goods boom is attributable in part to the easy cash-flow position of most corporations. Spending has been encouraged by the liberalized depreciation rules adopted in mid-1971 and by the investment tax-credit enacted near the end of that year; with the help of these fiscal stimuli, cash flow has jumped about 20 percent over the past year. Some special factors have also been involved; nonferrous-metals and paper firms have incurred substantial expenditures to meet pollution-control requirements, while rubber manufacturers have built new facilities to supply the expanded market for radial-ply tires.

Running short

The major cause of the spending upsurge, however, is the boom-

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caused jump in capacity utilization. In 1972 alone, the proportion of firms with inadequate facilities rose from 30 to 40 percent of all firms (weighted by size) and the proportion evidently has risen higher since then. (At the 1966 peak, 50 percent of the total reported inadequate facilities.) In April, according to the monthly Purchasing Management survey, three-fourths of the survey group reported that they were operating at more than 90 percent of capacity, and more than one-fifth said that they were operating "beyond normal capacity."

In some respects, 1973 is unfolding in a different fashion from 1972. Last year, the emphasis seemed to be on replacing outmoded facilities in order to reduce costs; accordingly, most purchases were for new equipment, which is associated most closely with modernization projects. This year, equipment purchases remain heavy, but purchases of new plant have also increased to meet looming capacity shortages. Some make-up work is involved here, since spending for new factories actually declined every year of the 1970-72 period.

Overcoming capacity shortages may be somewhat difficult because of the limited capacity of the machine-tool industry itself. Consequently, at least a portion of the planned 1973 increase in capital spending will probably be deferred into 1974. Capacity shortages thus could persist for some time, partly because of this deferral of spending, and partly because of the long lead time between the recognition of the need for more capacity and the actual delivery of the desired facilities. The capital-goods boom now in progress thus should be a favorable factor for 1974, since it takes at least several quarters to complete projects now underway.

Falling behind plans

Some such deferral of demand must be behind the paradoxical failure of actual spending to come up to announced spending plans over the past year or so. Normally, in a boom period, it's the other way around, with actual spending outstripping spending plans by a wide margin. In early 1972, the Commerce survey indicated a 10½-percent increase in spending for the year, but each successive quarterly survey showed a smaller gain, and the actual increase for the year turned out to be less than 9 percent. (The first quarter of 1973 showed a similar tendency.) Commerce analysts ran a special survey last fall and found that these shortfalls were not due to actual cutbacks in projects, but rather to such factors as over-optimism in regard to the speed with which work could be completed. In addition, unexpected delays of one type or another occurred in various projects—in progress of construction, in equipment deliveries and in payments for work done.

With developments such as these, it is understandable that a sharp increase has occurred in recent quarters in carryover, that is, in the amounts still to be spent on projects already underway. For manufacturing firms, carryover was relatively stable through most of 1971 and 1972, but between last September and the end of March, project backlogs rose from $10.3 billion to $11.6 billion for durable goods, and from $10.4 billion to $12.4 billion for nondurable-goods manufacturing. For public utilities, with their necessarily long lead times, carryover jumped from $25.9 billion in March 1971 to $47.0 billion in March 1973.

Durable boom?

This expansion of carryover expenditures points to the durability of the boom, and the same is true of several other measures which all happen to be leading cyclical indicators. Capital appropriations by manufacturing firms have increased almost by half between early 1972 and early 1973, while two other indicators—new orders for capital goods and construction contracts for new stores and factories have jumped 25 percent or more over the past year.

Order backlogs for durable goods rose substantially in the second half of 1972, and then accelerated in first-quarter 1973 to one of the largest gains of the past two decades. Nearly all of the entire increase since mid-1972 has come from business capital-equipment backlogs; such backlogs increased 20 percent over this period, mostly in the nonelectrical-machinery category.

To keep capital spending going at a high yet sustainable pace, some dampening of the boom through deferral of marginal projects would seem to be called for. This might well occur if monetary policy continues restrictive and interest rates remain at their present high levels. An obvious fiscal tool—the variable investment tax-credit—could also be made available to curb runaway spending in the investment sector.

Federal Reserve Chairman Burns has proposed the adoption of this tool on several occasions, in its latest version in a Paris speech just last week. Basically, the credit would vary over time in accordance with business conditions—instead of remaining at 7 percent as at present—with the President setting the rate subject to Congressional approval. Our experience since 1966 suggests that variation in the credit would significantly affect the behavior of business investment over the course of the business cycle. This fiscal tool therefore would reduce the burden on monetary policy, and thus make possible some improvement in the management of the national economy.

William Burke

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 5/30/73	Change from 5/23/73	Change from year ago Dollar	Percent
Loans adjusted and investments*	72,833	+ 687	+ 9,872	+ 15.68
Loans adjusted—total*	55,692	+ 518	+ 10,428	+ 23.04
Commercial and industrial	19,998	− 102	+ 3,426	+ 20.67
Real estate	16,109	+ 78	+ 2,685	+ 20.00
Consumer instalment	8,236	+ 29	+ 1,381	+ 20.15
U.S. Treasury securities	5,676	− 67	− 902	− 13.71
Other securities	11,465	+ 236	+ 346	+ 3.11
Deposits (less cash items)—total*	70,193	− 160	+ 7,915	+ 12.71
Demand deposits adjusted	20,376	+ 62	+ 1,429	+ 7.54
U.S. Government deposits	640	− 237	− 410	− 39.05
Time deposits—total*	47,894	− 133	+ 6,821	+ 16.61
Savings	18,020	− 34	− 67	− 0.37
Other time I.P.C.	19,870	− 104	+ 4,813	+ 31.97
State and political subdivisions	7,435	− 2	+ 1,240	+ 20.02
(Large negotiable CD's)	9,388	− 98	+ 4,310	+ 84.88

Weekly Averages of Daily Figures	Week ended 5/30/73	Week ended 5/23/73	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	16	19	− 32
Borrowings	439	71	+ 48
Net free (+) / Net borrowed (−)	423	− 52	− 80
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions			
Net purchases (+) / Net sales (−)	+ 755	+ 320	− 697
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (−)	+ 294	− 255	− 107

* Includes items not shown separately.

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