

Research Department Federal Reserve Bank of San Francisco

November 30, 1973

For Want of a Gallon

A year which began with a food shortage is now ending with an even worse fuel shortage. Indeed, the President's new six-step plan—the reduction of gasoline refinery runs, the Sunday closing of filling stations, the 50-mile-per-hour speed limit, the further cut in passenger-jet fuel supplies, the ban on outside ornamental lighting, and the reduction in heating-oil supplies for homes, stores and factories—is designed to account for only about 10 percent of the expected 17-percent shortfall in petroleum supplies this winter.

While waiting for the other shoe to drop, economists have been hurriedly revising their 1974 forecasts to take account of the largely unexpected crisis. The exercise hasn't been easy, since the aggregate demand models used by most forecasters assume the continued availability of supplies, of fuels and of everything else. Better answers eventually may emerge from input-output analysis, taking into account the inter-industrial relationships of all sectors of the national economy. (This work was initiated by Wassily Leontief a generation ago, and recently won for him a Nobel Prize.)

Sorting out forecasts

Forecasts for 1974, somewhat iffy to begin with, are now even more tentative in view of the crisis. Still, a rough consensus is beginning to emerge. Some analysts who had

originally predicted a 2 or 3-percent increase in real GNP for 1974 have now reduced their forecasts by at least one percentage point because of expected disruptions in supply. Since energy usage is 75-percent based on oil and gas, and since there is a close correlation between industrial production and energy usage, any reduction in fuel supplies is bound to pull energy usage below its 3.6-percent growth trend and thereby impinge on production and income. Also, instead of projecting a 5 or 6-percent increase in prices for the year, forecasters now expect to see prices rise at least one percentage point more, because of soaring fuel prices and the aggressive bidding throughout the economy for the limited goods and services still available.

The stock market this month has been making its own forecast—a decidedly bearish one. The market has provided a service, however, by indicating which sectors are likely to feel the greatest impact of the crisis. Any forecaster could make up his own list of winners and losers, and it would probably look like the following.

Winners: oil-field equipment manufacturers, Pinto and Vega dealers, coal-mine operators, home-insulation dealers, bus and rail-car manufacturers, urban real-estate salesmen, heating and lighting consultants, and sweater manufacturers.

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Losers: ski-resort operators, Buick dealers, parking-lot operators, color TV manufacturers, hamburger and chicken-dinner franchisers, suburban real-estate salesmen, commercial-aircraft manufacturers, filling-station operators, outdoor advertisers, airline personnel, shopping-center developers—and environmentalists, at least in the short run.

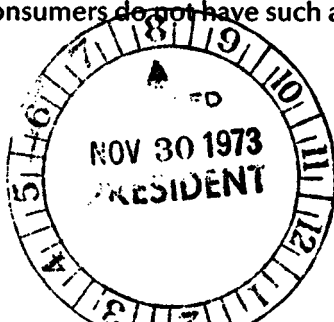
Economic impact

Corporate profits are likely to be a casualty of the fuel-supply pinch. There may be little if any increase in profits next year, in contrast to the very sharp (almost one-third) increase expected for 1973. In auto manufacturing, for example, profits will be hurt by the necessary shift to compacts from larger models, which are high-profit items but also heavy gasoline consumers; profits also will be cut by the cost of high layoff pay (as much as 95 percent of full-time work pay) for the workers who have been manning production lines for the slow-selling larger models. In trucking, moreover, profits will be hurt because of drivers' demands for higher pay scales to offset the cutback in daily cargo ton-miles brought about by reduced speed limits.

Business fixed-investment spending may not be as strong as expected, because of the obvious shortages of fuels and other materials, as well as the more somber outlook for internal financing. But spending in

energy-related industries should continue to increase. According to the Commerce Department's pre-crisis (September) estimates, plant-equipment spending in the current half-year may rise at a 25-percent annual rate for public-utility firms and at a 20-percent rate for petroleum refiners. These high spending rates may well continue, especially in view of the relatively slow pace of the preceding year and a half. (Utility spending grew at an 11-percent rate—and refinery spending actually declined—in 1972 and the first half of 1973.) In addition, the utilities' huge (\$53 billion) carryover of projects already underway, which has doubled in two years' time, provides a strong support for investment spending for some time to come.

The ability of consumers to adjust to a chilly and somewhat immobile winter period may be gauged by their ability to respond to the earlier food crisis. Despite a 19-percent rise in food prices between the third quarter of 1972 and the comparable period of 1973, total food spending increased only about 12 percent over that period, indicating a conscious decision by consumers to substitute cheaper foods for fast-rising commodities such as beef. With gas and oil, of course, consumers do not have such a wide



range of available substitutes, but the price elasticities of those fuels apparently are large enough to induce some reduction in usage as prices rise.

Government role

Much will depend upon what next steps will be taken, if necessary, to curb consumer demand. On this point, a political as well as an economic argument rages. Some Administration leaders are reluctant to impose consumer rationing, partly because of the market distortions that would be introduced, and partly because of the large (and expensive) bureaucracy that would be needed to administer a system for 118 million vehicles, four times as many as existed during the World War II rationing period. (The Office of Price Administration, which handled rationing of food, gasoline and other commodities during World War II, required a staff of 35,000 paid workers and almost 200,000 volunteer clerks.) Some Congressional leaders, on the other hand, prefer rationing to a market or fiscal solution, reasoning that any price (or tax) increase sufficient to deter consumption would be so prohibitively high as to price lower-income families out of the market.

The Federal budget is likely to be affected by the fuel shortage,

completely apart from the question of whether or not a gasoline surtax is imposed. The ceiling on economic activity imposed by the fuel shortage will have a depressing effect on revenues, while any subsidies to affected workers or industries will boost Federal spending, adding to a list of increases which already includes higher Pentagon spending, higher social-security benefits, and higher interest payments. Thus, there is increasing doubt that the budget for fiscal 1974 will balance out at about \$270 billion, as had been expected just a month ago.

The worldwide nature of the fuel crisis will strongly affect the nation's foreign-trade sector. Since Europe and Japan are more heavily dependent than the U.S. on Mideast oil, their economies are even more likely than ours to suffer from forthcoming shortages. (Japan had expected a 10-percent rise in real GNP during its current fiscal year, but now may be lucky to post a 5-percent gain.) A slowdown in those economies should lead to a slowdown in U.S. exports, not necessarily for farm products, but certainly for those industrial products which have provided the backbone of the boom in recent months. The U.S. may continue to record a trade surplus, since imports should weaken in the face of a slowdown here, but this surplus may occur at a somewhat reduced level of overall activity.

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

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 11/14/73	Change from 11/7/73	Change from year ago	
			Dollar	Percent
Loans adjusted and investments*	75,639	— 142	+ 8,944	+ 13.41
Loans adjusted—total*	57,893	+ 170	+ 8,257	+ 16.64
Securities loans	1,364	+ 66	— 1,028	— 42.98
Commercial and industrial	19,911	+ 169	+ 2,649	+ 15.35
Real estate	17,917	+ 80	+ 3,172	+ 21.51
Consumer instalment	8,878	+ 33	+ 1,366	+ 18.18
U.S. Treasury securities	5,656	+ 8	— 328	— 5.48
Other securities	12,090	— 320	+ 1,015	+ 9.16
Deposits (less cash items)—total*	72,403	— 1,108	+ 6,815	+ 10.39
Demand deposits adjusted	22,281	— 427	+ 1,052	+ 4.96
U.S. Government deposits	364	— 91	— 567	— 60.90
Time deposits—total*	48,576	— 474	+ 6,582	+ 15.67
Savings	17,485	— 9	— 793	— 4.34
Other time I.P.C.	22,283	— 270	+ 5,451	+ 32.38
State and political subdivisions	5,675	— 73	+ 983	+ 20.95
(Large negotiable CD's)	10,756	— 412	+ 4,343	+ 67.72
Weekly Averages of Daily Figures	Week ended 11/14/73	Week ended 11/7/73	Comparable year-ago period	
Member Bank Reserve Position				
Excess reserves	— 23	51	16	
Borrowings	140	11	2	
Net free (+) / Net borrowed (—)	— 163	40	+ 14	
Federal Funds—Seven Large Banks				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (—)	+ 66	— 199	— 736	
Transactions: U.S. securities dealers				
Net loans (+) / Net borrowings (—)	+ 76	+ 106	+ 262	

*Includes items not shown separately.