Research Department
Federal Reserve
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Ides of March

The nation successfully survived the Ides of March, and indeed, some Sunday drivers became positively euphoric after hearing about the suspension of the Arab oil embargo. Still, the lifting of the embargo may yet turn out to be the non-event of the year. Energy supplies remain scarce and quite expensive, and the same is true of most other major commodities, while a few sectors remain beset by weakening demand and job losses—and no one yet knows for sure how these conflicting developments will sort themselves out in coming months.

On the production front, recession fears subsided slightly with the release of statistics showing two successive monthly increases in housing starts and durable goods' orders, as well as the first modest signs of an end to the massive slump in auto sales. On the financial front, the markets tightened significantly, partly because of larger-than-expected corporate financial demands over the March tax date, but perhaps more because of fears of rampant inflation. The same fears affected international financial markets; the dollar weakened significantly, and the price of gold again reached a new high.

Falling output

Industrial production fell in February—the third consecutive month—for a 2-percent overall decline from the November peak. However, this drop was no more than half as steep as the declines recorded at the outset of the 1969 recession and during the 1970 auto strike. Total production recently has been relatively flat, except for and decided weakness in the auto and energy industries.

Auto assemblies continued dropping last month to a 6.6-million-unit annual rate—roughly one-third below the year-ago level. By reducing its production rate during the past several months, the industry apparently is beginning to get its topheavy inventories under control. Auto analysts now expect new-car sales (including imports) of about 10 million units for the year, compared with the 1973 record of 11.4 million units. But compact-car enthusiasts claim that the year-to-year decline would be only half that large if the industry were better able to meet the demand for the smaller models.

Energy production also continued to weaken in February, and is now off about 16 percent (annual rate) from last summer's peak. This decline isn't all bad; it can be attributed not only to the weakening of industrial and household demand but also to a significant improvement in efficiency on the part of a suddenly energy-conscious populace. During the final quarter of 1973, for instance, Federal agencies cut electricity consumption by 21½ percent, while reducing gasoline usage in the Government's 67,000-car fleet by 7½ percent.

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Sluggish earnings

Personal-income growth resumed its normal uptrend in February after a modest decline in January. (That decline was only half as large as originally reported.) Wages in manufacturing and other commodity-producing industries improved in February and thus made up for part of the decline of the preceding month. Another development which cut into the January total—a sharp increase in the social security tax take—was not a factor last month.

Real spendable earnings per worker meanwhile fell to 4½ percent below the year-ago level, thus increasing the pressure on labor contract negotiators to gain substantial catch-up increases this year. At the same time, with Congress on the verge of raising the minimum wage from $1.60 to $2.00 an hour, upward pressures on wage rates and earnings may soon develop throughout the salary structure.

Employment statistics were somewhat mixed in February. The unemployment rate stabilized at 5.2 percent, but it would have risen significantly if the labor force had continued to grow at the same rate as in the preceding several months. The rate is widely expected to rise to 6 percent or more as the year goes on, and may remain high even as the economy returns to its historical growth trend over the next several years, because of a heavy inflow of jobseekers into the market. (Labor Department projections indicate a 17-million expansion of the labor force during the 1970's as a whole, compared with a gain of less than 14 million workers during the previous decade.) With the maturing of the former bumper crop of teenagers, unemployment in this decade may be concentrated increasingly among prime-age workers—many of them family breadwinners.

Lower taxes?

With the economy still sluggish, Congress has been debating the feasibility of a fiscal stimulus to keep the downturn from getting out of hand. One major proposal calls for a $5-6 billion cut in income taxes, probably through a rise in the personal exemption from $750 to $900. (This proposal would give a sudden boost to workers' spendable earnings, and could thus relieve some of the pressure for catch-up wage increases.) Another alternative, suggested by Treasury Secretary Shultz, would simply involve a shift in tax-withholding schedules, providing some relief to workers' paychecks today but at no future cost to the Treasury, since this move would be offset by reduced tax refunds in 1975.

The relevant fiscal-policy guide has been suggested by William Fellner, of the Council of Economic Advisers. In his view, stimulus would be called for if the public happens to be reducing its overall level of demand, but it would only add fuel to inflation if the public is simply shifting its demand from

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one sector to another, such as from large cars to the small-car market. In the view of Federal Reserve Chairman Arthur Burns, "It is not clear that a strong dose of fiscal stimulus is needed now, and we surely need to proceed cautiously at a time when the price level is still soaring."

In other words, policymakers' fears recently have centered around the continued price upsurge—for energy, for food, and for practically everything else. (One exception: used-car prices have been falling for the past several months.) Roughly two-thirds of the recent upsurge has been concentrated in food and fuels, but the rise in other categories has been almost as worrisome. Industrial commodity prices have risen at a 28-percent annual rate over the past three months, and much of that increase is bound to show up later at the retail counter, especially in view of the price bulge that is now appearing with the dismantling of the price-control mechanism.

Tighter markets

Continued bad news on the inflation front, scattered hints of a strengthening economy, and a tighter Federal Reserve posture than had been expected by market participants—all led to a tightening of financial markets in recent weeks. Short-term rates rose sharply, offsetting much of the irregular decline that had occurred since last summer. The Treasury 90-day bill rate exceeded 8 percent last week, after dropping almost to 7 percent in mid-February. Banks' prime business-loan rate rose generally to 9 percent last week, compared with the 8½-percent figure posted by some banks only several weeks earlier. This increase reflected not just the general economic picture, but also such specific factors as the rising cost of funds to banks and the unexpected strength of business-loan demand. If the latter represents anything more than seasonal tax financing, the general expectation of a further decline in the prime rate may well be forgotten.

In long-term markets, rates in most areas except the mortgage market remain close to 1973 peaks, partly because of inflation fears but also because of the market's difficulty in digesting extremely large inventories of Treasury, municipal and corporate securities. The sharp increase in corporate long-term capital needs projected for 1974 also is helping to push rates upward. Many firms, in the energy field and elsewhere, plan to spend a great deal to end shortages of plant capacity, as the Commerce Dept. survey shows, with a 14½-percent annual rate of increase in capital spending in the second half of the year. To finance that type of spending, however, corporations must look to external as well as internal sources of funds. The profits boom flattened out in the spring of last year, and the flush liquidity position of that period is now only a fond memory in the hearts of corporate treasurers.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 3/13/74	Change from 3/6/74	Change from year ago Dollar	Change from year ago Percent
Loan gross adjusted and investments*	79,396	+ 482	+8,285	+ 11.65
Loans gross adjusted—	60,210	+ 163	+6,983	+ 13.12
Securities loans	1,128	− 54	− 259	− 18.67
Commercial and industrial	21,268	+ 170	+1,969	+ 10.20
Real estate	18,613	+ 32	+3,115	+ 20.10
Consumer instalment	9,117	+ 4	+1,044	+ 12.93
U.S. Treasury securities	6,140	+ 131	− 104	− 1.67
Other Securities	13,046	+ 188	+1,406	+ 12.08
Deposits (less cash items)—total*	74,524	+ 396	+5,216	+ 7.53
Demand deposits adjusted	21,903	+ 265	+1,070	+ 5.14
U.S. Government deposits	344	− 78	− 764	− 68.95
Time deposits—total*	51,124	+ 245	+4,950	+ 10.72
Savings	17,856	+ 73	− 362	− 1.99
Other time I.P.C.	24,438	+ 463	+5,368	+ 28.15
State and political subdivisions	6,412	− 172	− 29	− 0.45
(Large negotiable CD's)	11,305	+ 204	+3,226	+ 39.93

Weekly Averages of Daily Figures	Week ended 3/13/74	Week ended 3/6/74	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	4	51	24
Borrowings	243	84	76
Net free (+) / Net borrowed (−)	− 239	− 33	− 52
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions Net purchases (+) / Net sales (−)	+1,582	+1,583	−180
Transactions: U.S. securities dealers Net loans (+) / Net borrowings (−)	− 21	+ 78	−115

*Includes items not shown separately.

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