Research Department
Federal Reserve
Bank of
San Francisco

June 6, 1975

Clear Skies for Aerospace?

The aerospace industry is in somewhat better shape than most other manufacturing industries. It has been forced to schedule production cutbacks and layoffs because of weakening orders from domestic airlines as well as inventory problems in the civilian-electronics end of the business, but its overall sales trend has remained strong because of a heavy inflow of orders from the Pentagon and from foreign buyers. Thus, aerospace sales are likely to expand further in 1975 on top of last year's 10-percent gain (to $26.8 billion), and profits are likely to remain high for most firms because of the industry's thick orderbooks and vigorous cost-reduction efforts.

Commercial-aircraft orders (both domestic and foreign) could decline this year as a result of the airlines' sluggish traffic growth and soaring fuel costs, but their heavy backlog of unfilled orders should help maintain a fairly high level of deliveries. Moreover, the strength of the military market, both here and abroad, should more than compensate for any loss of commercial business. But as backlogs dwindle, shipments of commercial airliners eventually will turn downward, and the weakness could spread if foreign competition and Congressional restraints reduce military exports.

Guns or butter?

The aerospace industry benefited in 1974 from a 6-percent increase in purchases by the Pentagon—its largest customer—to some $15.3 billion. This rise was part of a 5-percent gain in total defense spending in fiscal 1974 and (probably) a further 8½-percent gain in fiscal 1975, which reversed the downward trend in defense spending of the 1969-73 period. The turnaround reflected the need to replenish inventories and to overcome deficiencies in weaponry revealed during the 1973 Arab-Israeli conflict—but more importantly, the need to offset inflationary cost increases.

The Administration has presented Congress with a $94.0-billion defense budget for fiscal 1976, for a further 10-percent increase. (Beyond 1976, budget planners provided for an increase in real purchasing power of about 2 percent annually, in an attempt to reverse the steady decline in real resources going into the defense program.) Fiscal 1976 outlays for procurement and research-and-development activities—the crucial portion of the budget for the aerospace industry—were budgeted to increase 12 percent to $26.1 billion. The emphasis was on force modernization, with increased funds requested for a sophisticated new generation of aircraft and tactical missiles. Congressional budget debates so far this year have indicated little pressure to cut back on such programs, especially in view of Congressional fears about unemployment and worldwide political tensions.

(continued on page 2)

Research Department
Federal Reserve
Bank of
San Francisco

The nation's space budget also is on a rising trend after several years of stability, although much of the growth is in one program—the space shuttle. For fiscal 1976, the National Aeronautics and Space Administration has requested $3.5 billion—up 9 percent from the current fiscal year.

Jet lag

Domestic airlines reduced their orders for jet transports sharply in 1974 as a result of rising fuel costs and a slowdown in passenger traffic. But foreign airlines continued to increase their purchases, reacting in part to the devaluation of the dollar and an increase in their share of total traffic. As a result, U.S. commercial-transport sales rose 12 percent to almost $4.2 billion, as export sales soared to comprise almost two-thirds of the total market for commercial airliners. Boeing accounted for the entire gain; McDonnell-Douglas and Lockheed both suffered sales declines because of the weak domestic market for their jets.

Domestic and foreign orders for jet transports both could decline this year, because of the continued worldwide slowdown of passenger traffic as well as the market glut caused by the used-aircraft sales of hard-pressed airlines. Worldwide growth of passenger traffic slowed from a 13-percent annual rate during the 1960's and a 10-percent rate during the early 1970's to only 4 percent in 1974—the smallest gain on record. This year, with the recession, it may not increase at all. Order backlogs still remain fairly high, but the reduced order flow for commercial transports is likely to affect deliveries this year and even more sharply in 1976-77.

Nonetheless, manufacturers are quite optimistic about long-run prospects for the commercial market. Over the next decade, Boeing expects worldwide passenger traffic to resume growth at a 7-9 percent annual rate and cargo traffic to grow even faster. It also expects the world's airlines to retire a substantial number of older-generation aircraft, such as the 707 and the DC-8, and to replace them with newer planes offering lower costs per mile. The growth in traffic, along with replacement needs, thus could mean a worldwide commercial market of $50 billion (constant dollars) in the 1975-85 period. Manufacturers are not planning to introduce any completely new models until after 1980, but modified versions of existing planes, such as the Boeing 727-300 and a revised McDonnell Douglas DC-10, are likely to enter production as soon as airline traffic improves.

Another favorable market factor is Lockheed's recently negotiated agreement for easing the financial burden connected with its L-1011 project. The plan will extend to the end of 1977 both the Federal government's $250-million loan

guarantee and the private $650-million loan agreement, and it will also reduce the interest charge on the nonguaranteed portion of that debt. Later on, in early 1977, Lockheed's lending banks are scheduled to obtain an equity share in the company in exchange for writing off a portion of its outstanding debt.

Sales of general-aviation aircraft, used for both business and pleasure, rose 10 percent in 1974 to a new record of $920 million on the strength of both the export and domestic markets. But the present decline in corporate profits and discretionary consumer spending could reduce 1975 sales and leave this segment of the industry with excess inventory on its hands.

Export boom

Exports represent the brightest element in the aerospace outlook. Exports of U.S. military and commercial aerospace equipment jumped 82 percent during the 1972-74 period to a record $6.9 billion. This year they are expected to reach $7.8 billion—30 percent of total industry shipments. The Middle East oil-producing nations have emerged as the major growth market for both military and commercial equipment.

Military sales are expected to show the largest increase in this sector. Because of the several devaluations of the dollar, the rise in Middle East purchasing power and growing political tensions throughout the world, U.S. exports of aircraft, missiles and other weapons could exceed $3.5 billion in fiscal 1975—20 percent above the 1974 figure and almost triple the year-earlier figure. New foreign orders for all types of military equipment have doubled during the past year and are now running well over $8 billion annually, making the United States the world's largest arms supplier.

Although the U.S. now supplies over two-thirds of all worldwide aerospace exports, its share is likely to decline in the future as France, Britain and other producing nations seek to improve their trade balance by aggressively marketing new products. The Common Market countries have formed multinational aerospace firms which stress a policy of "buy and sell European." Also, Congressional limitations on arms exports may limit industry sales. The Senate Appropriations Committee last August directed the Defense Department to give it prior notification of all sales in excess of $25 million, and declared its concern "that the long-term security interests of the U.S. might be jeopardized by large cash sales of sophisticated weapons systems in areas of potential conflict." Still, despite the likelihood of increased foreign competition and possible limitations on military sales, the export sector may well provide the basic support of the U.S. aerospace industry for the rest of this decade.

Yvonne Levy

Research Department
Federal Reserve
Bank of
San Francisco

Alaska • Arizona • California • Hawaii
Idaho • Nevada • Oregon • Utah • Washington

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 5/21/75	Change from 5/14/75	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	85,033	+ 280	+ 2,313	+ 2.80
Loans (gross, adjusted)—total	64,590	+ 152	+ 206	+ 0.32
Security loans	1,339	+ 382	+ 108	+ 8.77
Commercial and industrial	23,769	– 149	+ 624	+ 2.70
Real estate	19,531	+ 2	+ 353	+ 1.84
Consumer instalment	9,801	– 16	+ 516	+ 5.56
U.S. Treasury securities	7,954	+ 69	+ 2,728	+ 52.20
Other securities	12,489	+ 59	– 621	– 4.74
Deposits (less cash items)—total*	84,331	– 461	+ 6,189	+ 7.92
Demand deposits (adjusted)	22,538	– 455	+ 1,162	+ 5.44
U.S. Government deposits	381	+ 77	– 88	– 18.76
Time deposits—total*	60,159	– 31	+ 5,065	+ 9.19
States and political subdivisions	7,619	+ 34	+ 255	+ 3.46
Savings deposits	19,777	+ 162	+ 1,857	+ 10.36
Other time deposits‡	29,195	– 239	+ 2,052	+ 7.56
Large negotiable CD's	15,794	– 292	+ 1,652	+ 11.68

Weekly Averages of Daily Figures	Week ended 5/21/75	Week ended 5/14/75	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	29.1	33.4	34.0
Borrowings	0.0	0.0	258.1
Net free (+) / Net borrowed (–)	+ 29.1	+ 33.4	– 224.1
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+) / Net sales (–)	+1,501.3	+1,164.3	+1,213.0
Transactions of U.S. security dealers			
Net loans (+) / Net borrowings (–)	+ 562.5	+ 462.6	+ 403.3

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 397-1137.