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Monthly Review

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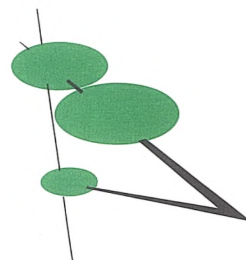

May 1972

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Spring Upsurge?

. . . The business scene was mixed this spring, as some problems lingered on in the midst of a strongly developing upturn.

Western Spring

. . . Construction and agribusiness led the early '72 upturn in the Western economy, but most other sectors contributed also.

Loan Upsurge?

. . . Bank credit grew at a 15-percent annual rate, as monetary policy accommodated a strengthening regional economy.

Editor: William Burke

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Spring Upsurge?

Solid signs of the long-expected business upsurge began to appear as the winter turned into spring, although the first quarter as a whole recorded some rather mixed statistics. GNP rose $30 billion to an $1,103-billion annual rate—a strong increase, although the gain in real terms, at 5.3 percent annually, was somewhat below the preceding quarter's gain. More than half of the dollar increase, however, was eaten up by the post-freeze bulge in prices. At the same time, unemployment remained a problem even in the face of an employment expansion worthy of the boom of the late 1960s.

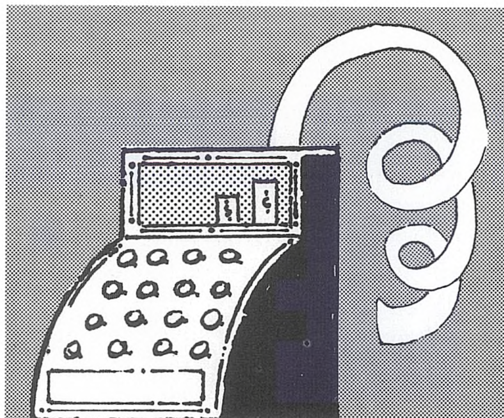
Consumers spent selectively during the first quarter, participating in the phenomenal housing boom and the related furniture-appliance boom, but also saving a very substantial share of their expanded income. Business firms spent heavily for new plant and equipment, and government agencies also increased their expenditures, largely on the strength of military and civilian pay raises. But the long-expected inventory expansion still failed to materialize, and the GNP figures were actually reduced by the substantial import balance which showed up in the nation's foreign-trade figures.

Industrial production rose briskly during the quarter; output of construction materials, carpeting, and furniture rose sharply (reflecting the housing boom), and business-equipment output increased rapidly in late winter to signal the end of a two-year-long downtrend in this key sector. The overall production index in March was 7 percent above its 1970 recession trough—although still 2 percent below the 1969 peak—and the upturn in the index was helped along by the steel industry's recovery from the sharp inventory reductions of last summer and fall.

Housing phenomenal

The housing boom dominated the headlines in early 1972, as spending for residential construction clearly exceeded the estimates of the most optimistic forecasters. Spending rose almost $5 billion to a $49-billion annual rate during the first quarter, and at that level was about three-fourths higher than it was just a year and a half ago. Private housing starts in this period jumped to a 2.5 million rate—well above the average generally expected for the year as a whole—largely on the basis of a strong acceleration in apartment building. (In February, multi-family starts exceeded single-family starts for the first time on record.)

The vigorous pace of housing activity since mid-1970 has been associated with an ample supply of mortgage money, which in turn has reflected the large volume of consumer savings channeled into thrift institutions.



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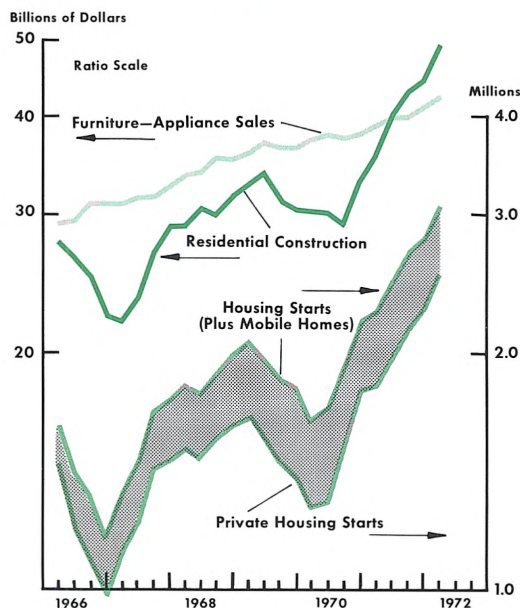
Funds poured into savings-and-loan and other depository institutions over this interval, as a favorable differential developed between deposit interest rates and rapidly falling money-market rates, and the inflow continued even as the direction of market-rate movements reversed in early spring '72. The boom in housing starts also has been paralleled by a boom in mobile-home shipments, spurred along by easy (auto-style) financing as well as favorable demographic and cost factors. In the first quarter of 1972, such shipments were at an annual rate of about 550,000 units.

At this stage, most observers wonder if the housing boom can continue at anywhere near its recent phenomenal pace, even if relatively favorable financing terms are maintained. Admittedly, the industry is benefitting from the strength of basic demand implicit in a high level of household formations, as well as from backlog demand of perhaps as many as 800,000 units that developed initially in 1966. However, some areas now report overproduction of certain types of housing, and building costs have continued to rise, led by a 25-percent jump in lumber prices over the past year.

Business, government up

The housing boom was reinforced in early 1972 by a strong improvement in the business fixed-investment sector, which advanced more than $5 billion to a $118-billion rate. According to the latest Commerce Department survey, 1972 as a whole could record a 10.5-percent increase in plant-equipment spending, in contrast to 1971's less-than-expected 1.9-percent gain. (Because of sharp price increases, the latter represented an actual decline in real terms.) The Commerce findings could even turn out to be on the conservative side, in view of the fact that actual increases outran the anticipated figures during the expansionary period of the late 1960s.

Boom in housing — and household durables — dominates the headlines



A strong uptrend is expected throughout 1972, continuing the recovery from the low-point of late 1970, with the sharpest gains occurring during the current half-year. Durable-goods manufacturers expect a 14-percent gain in expenditures for the year, in contrast to a cutback of almost the same magnitude in 1971. Public utilities, in the midst of a long-continued boom, also plan to boost spending by 14 percent, to a level about double that of a half-decade ago. The airlines plan to spend very heavily this year, in a reversal of their 1971 performance — and if they ever had any doubts about the wisdom of their capital-spending plans, the recent upsurge in airline travel would help dispel them.

The projected strength in business plant-equipment spending might appear surprising, since this is the first time that such a large spending boost has been projected in the face of serious underutilization of already installed manufacturing facilities. (One-fourth of total capacity again remained unutilized in the

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first quarter of this year.) But much of the excess equipment, although technologically adequate, is becoming rapidly obsolete in the fast-changing world competitive situation. Moreover, capital spending plans for labor-saving equipment have been encouraged by the sharply rising unit-labor costs of the past decade, and also by the Administration's fiscal program, which has helped to boost corporate cash flow while lowering equipment prices through the investment tax credit.

Government purchases, like business capital spending, showed considerable strength during the January-March period. Federal spending jumped $5 billion to a $105-billion rate, mostly on the basis of military and civilian pay increases, while state-and-local spending rose at more than a $4-billion pace to a $145-billion rate.

The new Federal budget authorizes a $6-billion increase in defense spending for fiscal 1973. Two-thirds of this would go for pay raises, and most of the rest for increased procurement and research-and-development spending. The budget envisages the acceleration of many military programs, including an undersea long-range missile system and a fourth nuclear aircraft carrier, yet it also looks forward to the end of large troop reductions. But some budgetary increases, amounting to perhaps $1-2 billion, might be required to finance the re-escalation of the Vietnam war, which has caused naval and air strength in that theater to double within the past several months.

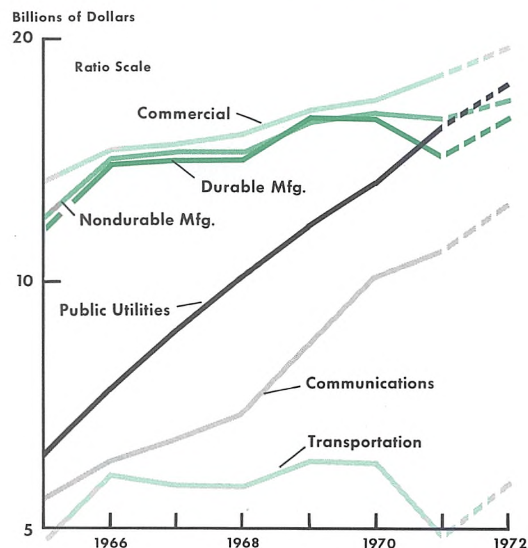
Inventories — and caution

Inventory spending increased at less than a $1 billion annual rate during the first quarter, on a GNP basis. The official explanation was that businessmen were still being cautious in restocking their shelves, but there also may have been some cases of involuntary depletion of stocks because of the recent upsurge in demand.

Purchasing agents, according to several recent surveys, are beginning to increase their inventories of raw materials and component parts, and are also ordering further in advance than they had been doing during the early winter months. Moreover, stock-sales ratios this spring have been quite low by most historical standards, suggesting an upsurge in inventory demand if final sales should continue to expand.

The evident signs of caution in the inventory situation could be attributed in part to the remaining signs of caution in consumer buying attitudes. Those signs have begun to diminish, however, since consumer spending jumped $13 billion in the first quarter to a $690-billion annual rate—the sharpest gain of the past several years, except for the immediate aftermath of the 1970 auto strike. One bullish sign was the high level of spending for household goods, autos, and other big-ticket items — items which no longer seemed postponable to many consumers — and another bullish sign was the improvement in consumer buying plans.

Utilities' capital spending continues to boom . . . manufacturers plan upturn



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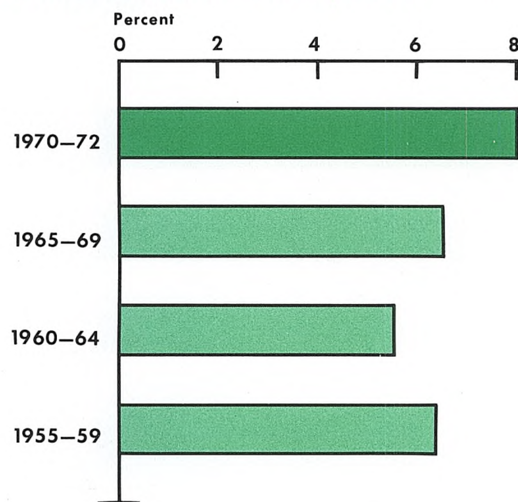
On the other hand, nondurable goods spending increased hardly at all in real terms, and services spending rose at a good but not spectacular pace during the quarter. Another sign of caution was the still relatively high level of consumer savings, at 7.4 percent of disposable income. This rate contrasted with the previous quarter's 7.8-percent figure, partly because of much higher tax-withholding schedules, which sharply reduced the rise in personal disposable income.

New auto sales stabilized at a fairly high level after the slump which followed last fall's record buying splurge. (The freeze period, during which new 1972 models sold at '71 prices, may have borrowed as many as 400,-000 units from future sales.) In the January-March period, total new car sales exceeded a 10-million annual pace, on the basis of a strong performance by Detroit's models, as expected, plus a strong performance by the imports, which bounced back to regain their 15-percent share of the U.S. market.

Incomes and taxes

Personal income during the first quarter rose by a whopping $23 billion—the largest gain of the last three years. The total was boosted by a number of factors—increases in military and Federal civilian pay, retroactive wage increases by the Pay Board, and the clustering of wage boosts in the period following the end of the freeze. Yet despite the substantial increase in total income, the relatively modest gain in disposable income led many consumers to wonder about the whereabouts of the income-tax reductions voted last December. In many cases, the effects of that tax cut were swamped by a host of other factors—the substantial over-withholding resulting from new Federal tax withholding schedules, the mid-April extra payments for underwithheld 1971 taxes, the combination of 1971 state tax bills with newly instituted withholding deductions (California), and the raising of the wage base for social-security tax payments.

Consumers save much higher share of income than in earlier periods



All of these developments created some taxpayer misunderstanding, particularly the Treasury overwithholding. During the early months of the year, Federal income taxes were overwithheld at about an $8-billion rate from roughly 40 million paychecks, as the Internal Revenue Service corrected for the underwithholding which affected about 2 million taxpayers last year. But only 15 percent of the taxpayers then followed the Treasury's advice on adjusting for overwithholding, and this failure largely frustrated the stimulative effect of the January 1 tax reduction.

The surge in total income owed a great deal to the rapid rise of employment, which since last summer has matched the expansionary growth of the booming '60s. (March recorded the largest monthly increase in total employment of the past five years.) Even manufacturing employment turned upward, on the heels of several years of stagnation or even decline.

Even so, the unemployment rate improved only marginally during the January-April pe-

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riod, holding at 5.9 percent of the civilian labor force throughout most of that timespan. During this generally strong period, the labor force expanded as rapidly as employment, partly (as expected) because of the continuing rapid rise in the number of young workers, but also because of a continuing upsurge in the total number of jobseekers entering the labor force.

Problems: Pay Board

The Pay Board made several important decisions during early 1972, but at the cost of the breakup of the original labor-management-public tripartite arrangement. One problem case involved an aerospace contract which called for a 12-percent first-year pay increase; on this, the Board reduced the allowable increase to 8 percent. The next and even more decisive case involved a West Coast longshoremen's contract which called for a 21-percent first-year increase; on this, the Board called for a 15-percent increase. This decision led to the walkout of four of the five labor members of the Board, whereupon it was reconstituted as a seven-man all-public agency similar to the Price Commission. Still, the Board could claim an overall measure of success, since the average first-year wage increase in major collective-bargaining agreements negotiated during the January-March period amounted to 8.4 percent, considerably below the 1971 average of 11.7 percent.

The Pay Board's task has been eased by the fact that 1972 is a very light year for collective bargaining. Only about 2.8 million workers are involved in major contract reopenings this year, as against roughly 4.8 million in both of the two previous years, and no major sector of the economy is affected by large-scale wage negotiations. About 6.7 million workers are due for deferred wage increases, probably averaging in excess of 7 percent—partly because about one-half of the contracts involve escalator clauses—but this figure will still fall short of last year's average increase of close to 8 percent.

This general situation, plus the existence of the Pay Board's 5.5-percent standard for wage increases, suggests a deceleration in the growth of labor costs, although Chairman Boldt recently warned that a large number of cases in the Board's backlog involve proposed raises substantially exceeding the 5.5-percent guideline. But farther in the future, 1973 may turn out to be the biggest year for large-scale collective-bargaining contracts since World War II.

Problems: Price Commission

The Price Commission, if anything, came under even more fire than the Pay Board during recent months, because of the expected yet still disappointing post-freeze bulge in food and industrial prices. The private GNP price deflator advanced at a 5.3-percent annual rate during the January-March period, in contrast to the 1.2-percent rise of the preceding quarter and the 4.4-percent rise of the pre-freeze period of 1971. Since the end of the freeze, wholesale prices of industrial commodities have risen at a 4.2-percent annual rate, while consumer food prices have advanced at a 7.2-percent rate.

The food-price situation led to a great deal of finger pointing, with blame being liberally allocated among farmers, processors and retailers. (Federal import-restriction and price-support programs also received their share of criticism.) Treasury Secretary Connally called in a number of major food retailers for a jawboning session, and Price Commission Chairman Grayson held Commission hearings for a number of interested parties. (He noted that the hearings gave the Commission a better idea of the "emotionality" of the food-price issue, even though they did not elicit "much new data" from the farmers, retailers, and consumers who participated.)

Actually, cyclical imbalances in supply and demand seemed to account for the bulk

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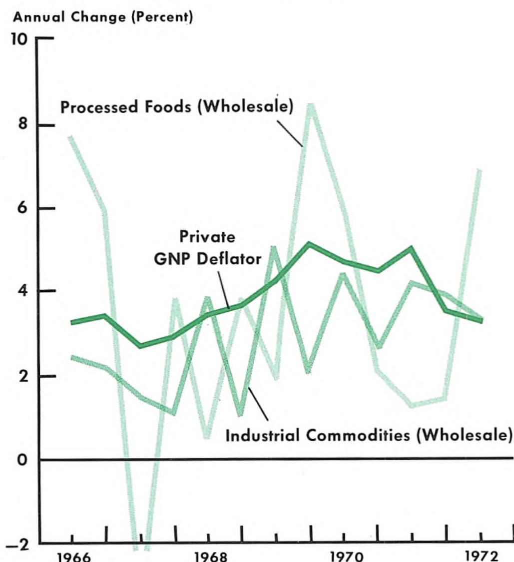
Price increases continue, despite freeze and Phase II controls



of the price upsurge. Beef was the most widely-cited case, although the problem was concentrated just as heavily in pork, with its short corn-hog cycle. Rising demand for meat helped push up prices because of the recent increases in income and employment, along with the growing population of heavy-eating teen-agers and young adults, but supply considerations probably played an even greater role.

Cattle prices this past winter rose to the highest levels of the past 20 years, reflecting the delayed effects of the 1970 corn blight and the 1971 Texas drought, and in addition, rising feed-grain costs for cattle feeders, higher transport costs for packers and retailers, and higher labor costs all along the line, all helped pyramid the original increase into a 14-percent jump in the retail price within just a year's time. Some relief (though perhaps temporary) should come soon from the growing supply of heavier cattle due to reach the market, but the Price Commision meanwhile may consider limiting cost increases to a straight dollars-and-cents pass-through in approving requests for price increases from processors and retailers.

On the industrial front, the Price Commission acted in March to curb excessive price increases occurring in that sector. It lowered, from 2.0 to 1.8 percent annually, the weighted-average price increase allowable to firms under its term-limit pricing policy. (This still gives each firm the flexibility to lift the prices of individual products as much as 8 percent, as long as the overall price increase remains within the average.) Also, for the purpose of computing cost increases included in price-increase applications, it ordered every firm to use the industry-wide average of output per manhour, and not its estimate of its own individual productivity.

In late April, Chairman Grayson reported that companies exceeding their allowable profit margins will soon be forced to make price reductions amounting to "hundreds of millions of dollars." Under Commission rules, companies boosting prices cannot increase their profit margins above the average achieved in the best two of the three fiscal years preceding the freeze.

Meanwhile, the parent Cost-of-Living Council reduced the scope of the control program by exempting nearly all businesses and local governments with 60 or fewer employees. (These account for over one-fourth of the nation's total sales and employment.) However, it kept under controls the small units operating in two inflation-prone sectors, construction and medical care.

Stimulus: fiscal

While the Board and the Commission did their part in attempting to keep cost-push inflationary tendencies under control, the Administration's fiscal policy played its assigned role in stimulating the economy. The amount of the stimulus could not be calculated exactly, however, because of the discrepancy between the budget figures released

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in January and the figures now actually developing.

The original budget document had projected very sharp increases in spending during the current half-year, not only for purchases of goods and services, but also for grant-in-aid programs such as general revenue sharing and public-assistance grants. In contrast, it anticipated hardly any increase for personal income-tax receipts. In April, however, the Treasury announced that the final figures for fiscal 1972 will not look anything like the dramatic $39-billion deficit originally projected (unified budget basis), because of better than expected revenues and slower than expected expenditure outflows. (Some outside experts expect a final figure below $30 billion.) Present Treasury estimates include an unexpected $6 billion boost in fiscal 1972 revenues, due not only to the over-withholding phenomenon but also to the impact of the business expansion on corporate and personal income tax receipts.

The Administration has proposed a 5-percent increase in socal security benefits, effective in June, but Chairman Mills of the House Ways and Means Committee has countered with a proposal for a 20-percent boost in benefits and a companion tax boost. Adoption of the latter plan would mean a 50-percent increase in benefits within a 2½ year period. Even excluding the Mills proposal, transfer payments of this type have now supplanted defense expenditures as the largest single budget item—doubling in size between fiscal 1968 and fiscal 1973 — because of the large expansion and extension of existing programs and the introduction of major new programs such as Medicare.

Stimulus: monetary

The monetary scene during the first quarter was characterized by a sharp upturn in the monetary aggregates following the late '71 slowdown, but also by a reversal in the direction of interest rates as the economy began to strengthen towards the end of the period. The general tone of policy, however, was set by Federal Reserve Chairman Burns in his February testimony to the Joint Economic Committee. On that occasion, he said that the Federal Reserve "does not intend to let the present recovery falter for want of money or credit," but he added that it "will not release the forces of a renewed inflationary spiral."

The Federal Open Market Committee, concerned over the persistent sluggishness of the monetary aggregates during the early winter months, decided at its January meeting that it "should be guided more by the course of total reserves than had been customary in the past." The subsequent injection of a substantial amount of reserves into the commercial banking system was followed by an acceleration in monetary growth and (for a while) by a continuation of the earlier downtrend in rates. For the quarter as a whole, the money supply (M_1) increased at about a 9-percent annual rate—in line with the strong growth of first-half '71 but in sharp contrast to the second-half slowdown. In another sign of ease, banks shifted to a $140-million net free-reserve position, after several years of operating generally with net borrowed reserves.

But with the quickening of the national economy, most rates began to rise sharply during the latter part of the quarter. The 90-day Treasury bill, for instance, was bid at 3.05 percent in mid-February, but at 3.90 percent in mid-March and close to that level a month later. The advance in yields since the early-1972 lowpoint has offset about a third of the short-term declines and more than half of the long-term declines achieved since last summer's shift in economic policy. The strengthening economy has had much to do with this, but there has also been some rekindling of inflationary fears, with many investors showing reluctance to commit funds at long term.

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Commercial banks reacted to the firming of money-market rates and the strengthening of loan demand by raising the prime business-loan rate for the first time since last summer. From a low of 4½ percent this winter, the prime moved upward, until in April it ranged between 5 and 5¼ percent. Commercial-bank credit rose at a very rapid pace during the first quarter, with strong increases in both loans and investments. By April, heavy credit demands were evident in practically every segment of the market.

The Treasury sold $1.8 billion of 3-year notes in early spring, but it may not need any of the $6.0 billion in additional new cash it originally expected to borrow this quarter, simply because it is receiving more and spending less than it had intended. Indeed, it plans to use $700 million of its available cash to repay part of a $2.4 billion issue of maturing notes on May 15. But Treasury new cash needs promise to be heavy in the second half of calendar 1972, perhaps in line with the $16 billion cash needs of second-half 1970 although considerably below the $21 billion figure of second-half 1971.

The financing task was eased last year by foreign purchases (mostly central-bank purchases) of about $14 billion in U.S. Treasury securities—a feat which is unlikely to be repeated this year. Some improvement may result, however, if others follow the recent German lead and fund some of their holdings of U.S. Government debt. West Germany exchanged $1.9 billion of Treasury bills and $0.6 billion of maturing nonmarketable securities for $2.5 billion of new nonmarketable securities, at about a 6¼-percent rate.

World problems

In this connection, the winter months passed without any of the expected large return of dollars from abroad. Liquid liabilities to foreign official entities approached $50 billion at the end of the first quarter, with a small net outflow during the post-devaluation period being added to the very heavy outflow of 1971. This situation reflected the rate differential in favor of foreign money markets, the strong liquidity position of American corporations (and their difficulty in sending funds abroad again once they brought them home), and the tendency for foreign holders of dollars to wait and see which way currency values would move within their wider permissible margins.

For a while last winter, the Smithsonian agreement of new exchange rates looked in danger of becoming unstuck, as a speculative attack developed against the newly-devalued dollar. The uncertainty was soon dispelled, however, with the help of energetic central-bank intervention, Congressional action on the dollar-devaluation bill, the narrowing of interest-rate disparities, and the imposition of capital controls by major foreign countries to discourage the further inflow of dollars. Between mid-March and mid-April, the spot exchange rates in dollars for the currencies of the Group of Ten (excluding Canada) fell by an average of 0.7 percent.

The President signed the dollar-devaluation bill into law in early April, thereby authorizing a change in the par value of the dollar from 1/35 to 1/38 ounce of gold — a shift of 7.89 percent. (The Secretary of the Treasury formally notified the International Monetary Fund of the change in early May.) The shift in values of the major currencies actually took place in world marketplaces last December, but the recent actions of the Congress and the President still played an important role in stabilizing the monetary situation.

Common Market central bankers meanwhile agreed to narrow the margins within which they will allow their own exchange rates to fluctuate, thus activating a first step toward monetary union for the Six—and later for the four prospective members (Great Britain, Ireland, Denmark, and Norway). Henceforth, EEC currencies will be

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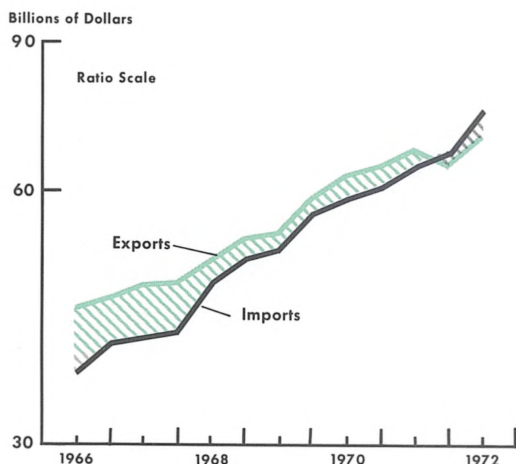
Imports exceed exports, for first time in this century



permitted to fluctuate no more than 2¼ percent in relation to each other, while continuing to move within a 4½-percent band against the dollar, as agreed upon at the Smithsonian in December.

EEC countries also moved to stimulate their domestic economies—and to bring their short-term rate structures more into line with the U.S.—by reducing central-bank lending rates. West Germany moved first (late February) by lowering its discount rate from 4 to 3 percent, and the Low Countries soon after followed suit with reductions from 4½ to 4 percent. In April, France cut its discount rate from 6 to 5¾ percent, and Italy moved from 4½ to 4 percent. In the U.K., the Chancellor's budget message unveiled major corporate and consumer tax cuts designed to spur the lagging economy. Moreover, in preparation for entering the EEC, he proposed a 10-percent value-added tax effective next year, with the levy applying to all goods except export commodities, food, and new construction.

In the U.S., meanwhile, most attention seemed to be centered on the lagging competitive position of the nation's foreign-trade sector. Imports continued to top exports by a considerable margin during the first quarter, as the net import surplus hovered around a $5-billion annual rate for the second successive quarter (GNP basis). Altogether, that represented a $10-billion swing over the past year, and a consequent drag on the nation's GNP.

This country's competitive position eventually should be improved by last December's devaluation, but the first-quarter figures reflected the typical initial effect—sluggish export receipts and higher import outlays. Other factors were an upsurge in imports resulting from the expanding pace of the American economy, and a weakening demand by sluggish foreign economies for capital goods, an American export specialty. On the other hand, the first-quarter export figures were probably enhanced by the return of striking dock workers, and also by the relatively higher rates of inflation now affecting the major trading nations abroad.

In summary, the national economy this spring provided a somewhat mixed picture, but one dominated by signs of increasing expansion at home and increasing stability in the marketplaces of the world. The problems of inflation and unemployment still affect the domestic scene, and a number of problems still remain on the agenda for international discussion, including the fundamental question of reform of the international monetary system—and the perennial question of Vietnam. Even so, economic growth may be a useful prescription for many of the nation's ills, and the signs of such growth were increasingly evident as the spring progressed.

William Burke

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Western Spring

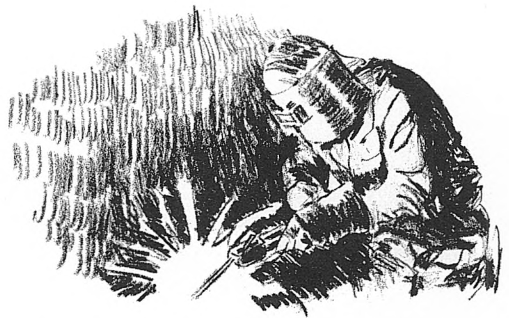
The Western economy expanded strongly during the early months of 1972, sparked by the construction and agribusiness sectors, but with significant support from most other sectors as well. Indeed, even the depressed aerospace industry exhibited scattered signs of recovery. Consequently, job opportunities increased while unemployment rates continued to decline from last spring's peak levels.

Nonfarm employment in this District, which comprises the nine Westernmost states, has expanded at a 4-percent annual rate since the recovery began to take hold around mid-1971. (In contrast, nonfarm jobs increased at a 3-percent rate elsewhere in the nation.) At 10.7 million, the number of Western jobholders finally exceeded the previous (early 1970) peak in the first quarter of this year. The expansion of employment has been distributed evenly throughout most sectors of the economy, although construction has outdistanced other industries with a 10-percent rate of growth since last fall. Similarly, the expansion has spread evenly throughout most states of the region.

Joblessness has dropped sharply in the West since mid-1971, thanks in part to the relatively strong business expansion and in part to a relatively slow-growing labor force. (Elsewhere in the nation, the rapid growth of the labor force has offset the force of the employment upsurge, leaving the jobless rate relatively unchanged.) In the first quarter, unemployment in Pacific Coast states amounted to 6.4 percent of the civilian labor force—a full 1½ percentage points below the peak figure reached last spring. Washington's situation remained difficult, with a jobless rate exceeding 10 percent for the sixth consecutive quarter, but even there the improvement since last spring has been quite noticeable.

Construction continues to boom

The construction industry provided the major support for the regional business expansion during the early months of 1972. Residential contract awards exceeded even the phenomenal late-1971 pace, at an $8.0-billion annual rate, spurred on by the availability of record amounts of mortgage money at relatively low rates.



Actual housing starts jumped 25 percent over the quarter to a 615,000-unit annual rate, far outdistancing any earlier period in Western history. A few areas reported a slowdown from the torrid pace of late 1971, but homebuilding in the West as a whole still ran ahead of the strong pace reported elsewhere in the nation.

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Meanwhile, nonresidential building and heavy-engineering awards spurted ahead of the previous quarter's pace, to just under an $8.0-billion annual rate. This reflected a higher volume of contracts of commercial and office buildings, factories, and streets and highways.

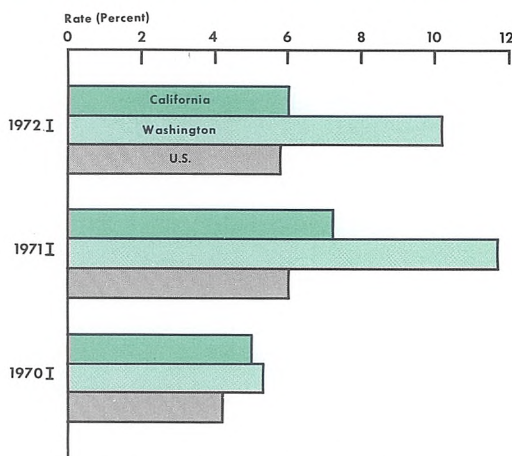
Aerospace remains sluggish

The region's key aerospace industry failed to provide much support to the recent strengthening of business activity, as employment and order inflows remained relatively depressed. Payrolls increased slightly to 518,000 during the first quarter, but the figures showed no increase at all after adjustment for a strike settlement at a Southern California plant. Altogether, the employment decline since the Vietnam war peak amounts to about a quarter-million jobs.

Commercial-aircraft manufacturers reported little interest by customers, except for the medium-range 727-200 jet; orders for 33 of these planes (plus options for 8 more) were booked during the January-March period. However, Defense Department suppliers reported some improvement in business, on the basis of a near-record inflow of contract awards in the last half of calendar 1971. (But the upturn in awards was reversed in the first quarter, with a very sharp drop in new contracts for California firms.) Space-agency awards remained depressed during the same period, but NASA suppliers now envisage a strong upturn in business as work begins on the proposed space shuttle with a $5.2-billion research-and-development effort.

The shuttle is planned as a reusable two-stage rocket capable of carrying about a dozen passengers and a payload of 65,000 pounds into earth orbit. To date, NASA has chosen Cape Kennedy in Florida and Vandenberg Air Force Base in California to be the launching sites for the proposed rocket; roughly $500 million in construction work will be required at the latter site, beginning

Jobless rates fall steeply in major Western states, but still remain high



around 1975. Selection of the prime contractor for the airframe will be made in July, and in view of the depressed nature of the industry, the bidding may be quite lively.

Lumber responds to housing boom

Production and prices generally advanced in the region's extractive industries—especially the lumber industry—as a reflection of the stronger tone of the national economy. Lumber and plywood prices, which had declined slightly during the 90-day freeze, rose steadily in early 1972 because of rising stumpage prices, seasonal production problems, and the nationwide boom in home-building.

Between November and March, softwood-lumber prices increased 8 percent at wholesale, while the index for softwood plywood was up by 18 percent. Prices were somewhat mixed during April, but in certain cases of heavy demand and tight supply (such as ponderosa-pine boards), prices far exceeded the ceiling levels established in the freeze period and even approached the record highs reached during early 1969.

The ability of prices to rise sharply above the so-called ceiling levels reflected the impact of the Price Commission's term-limit-

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pricing (TLP) agreements with large forest-products companies, as well as the lack of price ceilings on many smaller producers. The TLP agreements (before recent amendments) limited the average price increase on a company's entire product line to 2 percent over the succeeding 12-month period, but permitted the company to boost prices on individual items as much as 15 percent. Smaller producers were able to justify price increases on the basis of the fast-rising cost of timber, which remained exempt from price controls during both the freeze and the Phase II period.

Metals firms fight discounting

Western steel production lagged 8 percent behind its year-earlier pace in mid-April. This disappointing performance followed on the heels of a six-week strike at a large Fontana (California) mill, which erased almost a quarter-million tons from production schedules. Then, on the price front, the nation's steel producers raised prices in January on most sheet and strip products by an average of almost 8 percent, but shortly thereafter they erased part of those posted increases in an attempt to deal with the heavy discounting prevalent throughout the industry. In April, in an effort to introduce some stability into price and production planning, and to improve their competitive position relative to foreign steelmakers, they announced that they would not post any price increases for the remainder of the year.

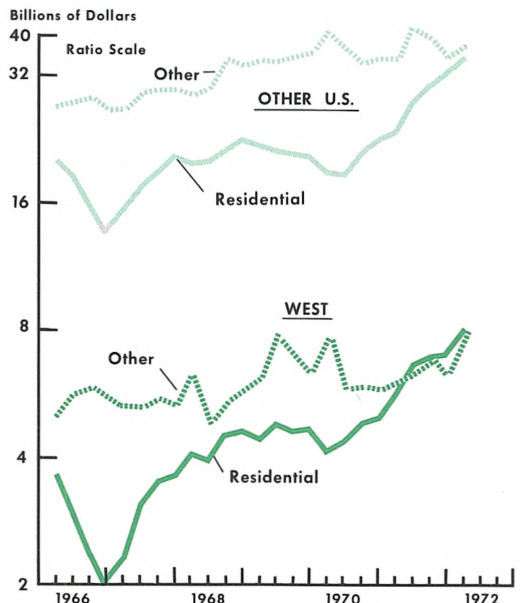
Rising domestic demand for copper, and rising prices for the metal in world markets, encouraged producers to boost refined-copper prices by about 4 percent in late February. But even at the new level of 52½ cents a pound, the producer price still was about 12 percent below the 1970 peak.

The demand for Pacific Northwest aluminum picked up markedly during the quarter, and several leading producers took steps to reduce the widespread price discounting that had been evident in earlier months. The first move in this direction came in early March, when a major producer announced a 3-percent increase in actual selling prices on a wide range of high-volume sheet and plate products. The success of this tactic will depend, however, on how fast overall demand improves and on how well the industry deals with its worldwide problem of overcapacity.

The quickening business pace brought about a 5-percent year-to-year increase in oil-refining activity, but crude-petroleum output from Western fields declined 4 percent in the same period. To make up for the difference, crude imports from Canadian and other foreign sources jumped 45 percent over year-ago levels, to 648,000 barrels/day. At that level, imports account for over one-third of the District's total supplies of crude.

Petroleum resources on Alaska's North Slope remained untouched in early 1972, although some progress was made to facilitate access to these supplies. Congress passed

Construction—especially housing—provides main support of upturn



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legislation to satisfy Alaska native land claims, and the Administration announced that it would grant right-of-way permits for the proposed pipeline. Several environmental organizations are fighting the decision in the courts, however, and even if all legal deterrents were to be removed soon, construction on the pipeline probably would not start until next year.

Farming continues to boom

Cash receipts of Western farmers advanced sharply in early 1972, despite falling prices for some major products, particularly eggs. Soaring meat prices contributed to the overall increase in receipts for Western farmers, and led to even larger income gains for farmers elsewhere in the nation.

Field-crop output this year may vary considerably from last year's results, largely because of modifications in Federal crop programs. Substantial increases are projected for winter-wheat and cotton acreage, while a decline is expected for feed-crop acreage. Moreover, recent spells of unseasonably cold weather have severely damaged fruit and nut crops; a sizeable share of California's raisin-grape crop may be lost, and damage appears extensive to Utah's deciduous-fruit crops. Problems also may result from the almost-complete lack of moisture in the Southwest so far this year, which contrasts with the situation of abnormally heavy snowpack and ample water supplies in the Northwest and Mountain states. In drought areas, heavy pumping of ground-water supplies may be necessary, and reservoir storage may be unusually low by the end of the irrigation season.

Western feedlots received record numbers of cattle in recent months, at least partly because of the unusually dry weather and consequent lack of pasture in Southwest range lands. Between early 1971 and early 1972, the number of cattle placed on feed increased about one-third in California and almost one-fifth in Arizona, while remaining stable elsewhere in the nation. This pattern of feeding activity could lead to a bunching of locally-fed beef slaughter later this year followed by a sharp drop-off in supplies later on, and thus could help create sharp swings in beef prices.

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Loan Upsurge?

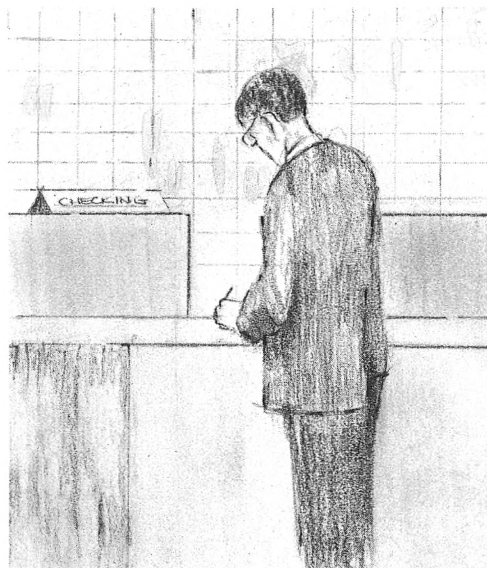
In the first quarter of 1972, Twelfth District commercial banks recorded a $2.6-billion rise in total credit, reflecting the strengthening of the regional economy and an accommodative monetary policy designed to permit a more rapid growth in monetary aggregates. The credit expansion at Western banks—at a 15-percent annual rate of growth — was slightly greater than in the preceding quarter although well below the rapid early-1971 pace. This first-quarter performance was roughly in line with the national experience.

Loans accounted for roughly 90 percent of the District-bank expansion in total credit, because of much stronger loan demand from the business sector as well as accelerated mortgage financing. This was in sharp contrast to the last quarter of 1971, when loans showed no increase after seasonal adjustment. District banks meanwhile increased their holdings of securities at a moderate pace. They shifted out of Treasury bills into municipal warrants and short-term notes, although their total holdings of liquid, short-term issues changed little from the fourth quarter.

Deposit experience varies

District member banks reported a $1.4-billion increase in total net deposits (daily average) in the January-March period. This 9-percent gain was well below the preceding quarter's rate of inflow and even farther behind the year-ago pace, largely because of a slowdown in the time-deposit category. The demand-deposit component, however, expanded at a 14-percent annual rate with gains in each month of the quarter. Private demand deposits accounted for the entire increase, as U.S. Government deposits remained at a relatively low level throughout the quarter.

Total time-and-savings deposits expanded at only a 6½ percent annual rate—barely half the national rate—mainly because of a very large run-off in public deposits, a situation peculiar to the District. This phenomenon stemmed from the extremely large build-up of such deposits last December; in fact, if the data are adjusted for this factor, the resulting withdrawal pattern falls within the normal seasonal movement. But a reduced issuance of large negotiable CD's also tended to limit the time-deposit increase, as large District banks accounted for four-fifths of the total national decline in this category.



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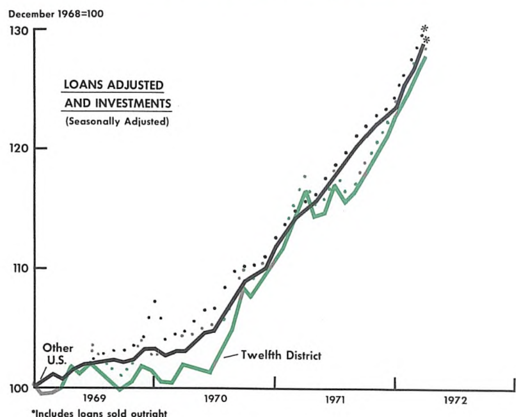
Loan demand, with monetary ease, sparks Western credit expansion



*Includes loans sold outright

Western banks meanwhile experienced an accelerated inflow of passbook savings and consumer-type time deposits, although the gain did not match the massive increase of a year ago. The rate of increase in passbook savings slackened somewhat in February, probably as an initial reaction to the reduction (to 4 percent) in the rate paid by many District banks. March data, however, indicate that this was only a temporary slowdown in the rate of savings inflow.

Profit margins narrow

District banks started the new year with a narrow margin between their rate of return on earning assets and their cost of funds. This margin narrowed further in January and early February, as banks reduced the rates charged on prime commercial loans, on mortgages, and on consumer loans. Security yields also declined until about mid-March. Finally, on February 1, many banks cut the rate paid on passbook savings to 4 percent. Since this ½-percent reduction applied to a large proportion of District banks' total interest-bearing deposits, it served to alleviate the cost squeeze.

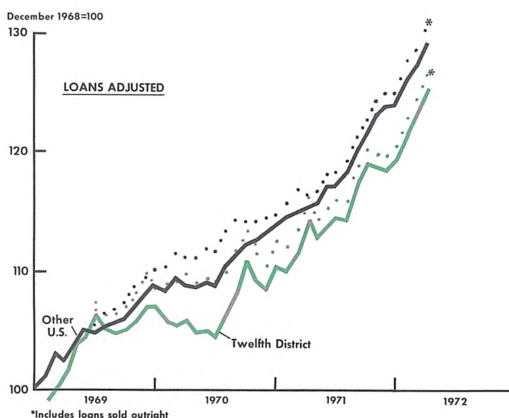
Despite the relatively large increase in earning assets, narrow profit margins resulted generally in a year-to-year decline in first-quarter income, both before and after securities gains (losses). (However, many smaller banks, and some large banks as well, reported higher 1972 income.) For some banks, the earnings decline reflected their failure to match the gains from security sales and trading accounts recorded in the year-ago period.

Reserve pressure eased

District member banks experienced a substantial increase in total required reserves during the January-March period. Their deposits rose further from the high level reached in late 1971 (daily average basis), and the increment was heavily weighted by demand deposits, which carry higher reserve requirements than time deposits. However, borrowings from the Federal Reserve Bank fell below $2 million, reflecting reduced reserve pressure. District banks had average *free* reserves of $12 million (excess reserves less borrowings) compared with net *borrowed* reserves of $8 million in the preceding quarter. (Data not seasonally adjusted.)

Reduced pressure on bank reserves also was evident in the decline in net interbank purchases of Federal funds, that is, short-term borrowings of unused member-bank

Loans increase sharply, reflecting broadly based credit demands



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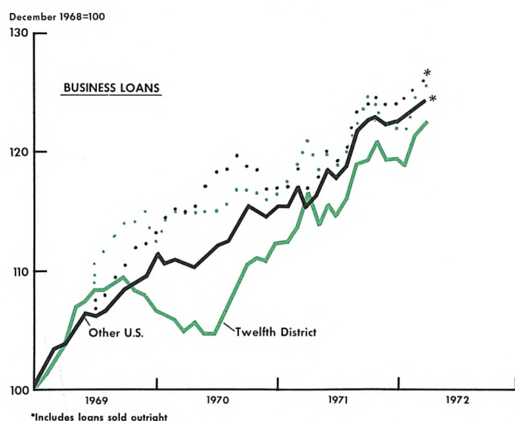
Business loans in West rise at double national pace



reserves. Purchases dropped from $905 million in the fourth quarter to $343 million in the January-March period (daily average). Moreover, District banks continued to be net sellers of funds to U.S. Government security dealers, so their net purchase position on *total* Fed-funds transactions also declined. On the other hand, they borrowed more than $1.5 billion (daily average) under corporate and other repurchase agreements, an amount only slightly below the very high level of the preceding quarter.

District banks also augmented their sources of funds in early 1972 by adding substantial amounts to their capital accounts, mainly in the form of notes and debentures. The decline in money-market rates made it advantageous for banks to obtain funds from this source.

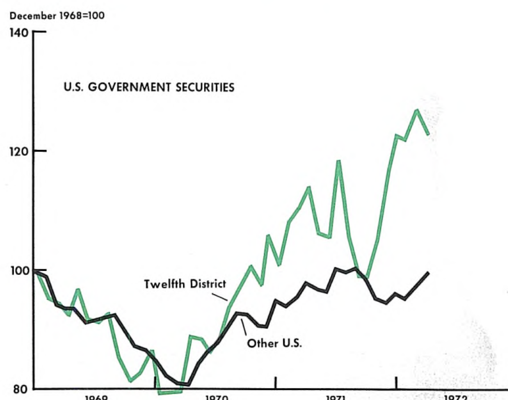
Stronger business-loan demand

Loans at Western commercial banks increased in each month of the quarter, for a total gain of $2.3 billion. Altogether, this represented a 19-percent annual rate of gain, as most major categories of loans showed increases.

Business loans rose somewhat faster than nationally for an 11-percent annual growth rate. A small decline in January was followed by a very large increase in February and a further gain in March. The strength in business-loan demand tended to be concentrated in a few sectors, such as machinery and other durable goods manufacturing—but particularly in services, where a few large firms borrowed heavily during February. In addition, seasonal credit repayments were less than usual for many business-loan categories, while commodity dealers borrowed contra-seasonally. In the public-utility sector, however, large repayments showed up in early March when a major company repaid bank debt with the proceeds of a capital offering.

The step-up in business borrowing was accompanied by a decline in borrowing costs, as most Western banks reduced their prime rate twice in January, first to 5 percent and then to 4¾ percent. This was the lowest level reached by the prime rate since 1965. Between November and February, average rates declined 82 basis points on short-term loans and 75 basis points on revolving-credit loans, according to the quarterly survey of business borrowers in major District metropolitan cities. Rate reductions were substantial for all loan-size categories, indicating a pervasive realignment of rates to the lower prime rate.

District banks reduce Treasury securities, unlike banks elsewhere



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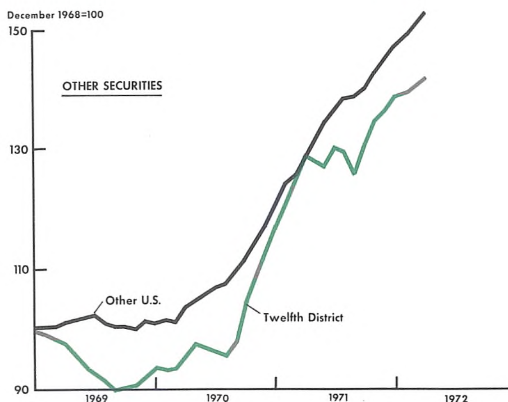
Heavy mortgage demand

Mortgage-financing activities remained very strong in the first quarter, as District banks added about $400 million, and savings-and-loan associations about $1.1 billion, to their mortgage portfolios. (Data not seasonally adjusted.) This heavy volume was financed with easier non-price terms of lending and at lower interest rates—for example, with a 30-basis-point drop (to 7.55 percent) in the average rate on conventional new-home loans. Still, for the S&L's at least, this represented a substantial deceleration from their 1971 lending pace. At the same time, S&L loan commitments rose by about $560 million to a record $1.7 billion, thus assuring a continuing high volume of lending in the months ahead.

The high level of mortgage financing in early '72 reflected an accelerated flow of savings into both banks and S&L's. In the West as in the nation, households continued to save a large proportion of their disposable incomes, and continued to channel these

District banks lag behind others in municipal-security purchases



SELECTED ASSET AND LIABILITY ITEMS OF WEEKLY REPORTING LARGE BANKS
Data Not Seasonally Adjusted
(Dollar amounts in millions)

	TWELFTH DISTRICT				OTHER U.S.
	Outstandings	Net Change			Net Change
	March 29, 1972	Dec. 29, 1971 to March 29, 1972		Dec. 30, 1970 to Mar. 31, 1971	Dec. 29, 1971 to Mar. 29, 1972
		Dollars	Percent	Percent	Percent
Loans Gross Adjusted[1] and Investments	62,041	+ 112	+ 0.18	+ 1.71	+ 0.99
Loans Gross Adjusted[1]	43,848	+ 538	+ 1.24	− 0.29	+ 0.95
Federal Funds Sold[2]	2,857	+ 129	+ 4.73	−30.02	+15.21
To Commercial Banks	2,618	+ 386	+17.29	−29.28	+14.17
To Brokers and Dealers	239	− 189	−44.16	−30.78	+48.79
Other Loans—Total	43,850	+ 920	+ 2.14	+ 0.68	+ 0.92
Commercial and Industrial Loans	16,049	− 104	− 0.64	+ 0.27	+ 0.20
Real Estate Loans	12,986	+ 349	+ 2.76	+ 0.57	+ 3.29
Consumer Installment Loans	6,498	+ 45	+ 0.70	+ 0.68	− 0.31
Agricultural Loans	1,513	+ 64	+ 4.42	+ 1.73	+ 5.62
Loans to Nonbank Financial Institutions	2,485	+ 176	+ 7.62	+11.91	+ 0.04
All Other Loans	4,319	+ 390	+ 9.93	− 4.62	+ 1.55
Total Investments	18,193	− 426	− 2.29	+ 6.83	+ 1.09
U.S. Government Securities	6,594	− 724	− 9.89	− 1.31	− 2.48
Obligations of States and Political Subdivisions	9,591	+ 311	+ 3.35	+12.27	+ 2.68
Other Securities	2,008	− 13	− 0.64	+12.67	+ 5.00
Total Deposits (Less Cash Items)	60,687	− 413	− 0.68	+ 2.81	+ 0.22
Demand Deposits Adjusted	19,453	+ 220	+ 1.14	− 0.82	− 1.54
U.S. Government Demand Deposits	946	− 344	−26.67	−27.71	−26.30
Total Time and Savings Deposits	39,351	− 124	− 0.31	+ 5.78	+ 3.66
Savings Deposits	18,264	+ 905	+ 5.21	+10.89	+ 5.28
Other Time Deposits IPC	14,534	+ 147	+ 1.02	+ 5.44	+ 0.84
Deposits of States and Political Subdivisions	4,793	−1,241	−20.57	− 8.82	+ 9.97
(Negotiable CD's—$100,000 and over)	4,874	− 426	− 8.04	+ 0.94	− 0.33
Capital Accounts	5,017	+ 336	+ 7.18	+ 3.59	+ 2.62
Total Assets/Liabilities, Reserves and Capital Accounts	79,027	− 16	− 0.02	+ 2.97	− 0.35

[1]Total loans minus loans to domestic commercial banks
[2]Including securities purchased under resale agreements

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savings into thrift-institution deposits rather than into lower-paying market instruments.

Consumer demand for bank installment credit remained modest, although it accelerated during March. Partial quarterly data indicate that extensions increased over the early-1971 period, particularly for mobile homes and personal loans made under check-credit plans. Some of the sluggishness in consumer borrowing may have been due to hesitancy by California consumers to incur added liabilities when faced for the first time with state income-tax withholding.

Rosier outlook

The decline in bank lending rates appeared to bottom out as the second quarter began. Following a turnaround in short-term money rates, banks raised their prime business-loan rate to 5 percent in early April, and a few major Eastern banks later went to 5¼ percent. (This increase, however, has not yet spread to the West, and indeed, some of the Eastern banks have recently backed away from the 5¼ percent figure.) The upward adjustment in the prime rate was not followed by any change in the passbook-savings rate, but some Western banks that had discontinued offering certain types of consumer time-deposit instruments began to offer them again and, in some instances, reinstituted higher rates on longer maturities. Banks expect higher loan rates and higher short-term security yields to ease their profit position, particularly if upward pressure does not necessitate a change in the current 4-percent passbook-savings rate.

As the second quarter began, District banks encountered stronger business demand for credit, leading to a very rapid expansion in business loans in the first half of April. Meanwhile, real-estate loans continued to increase at the fast March pace. Consumers also increased their borrowing in early April, but some of this reflected their need to meet income-tax and property-tax payments. District banks expanded not only their loans but also their security portfolios, particularly in short-term Treasury bills and municipal warrants.

Deposit flows at District banks followed the usual early-April seasonal pattern, with a build-up of demand deposits prior to the income-tax date and a sharp decline in passbook savings. However, the mid-April increase in public time deposits was far larger than customary, possibly because of investment of funds obtained through California income-tax withholding as well as from payments of 1971 state-income taxes.

Ruth Wilson and Verle Johnston

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