CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

The overall impression conveyed by the District Banks' reports is that the economic expansion of 1972 continued undiminished at the turn of the year and was perhaps gathering additional momentum. Retailers generally enjoyed a very good Christmas season, and many were reported to be quite optimistic about sales prospects over the months ahead. Business confidence improved further, as evidenced by increased actual or planned outlays on plant and equipment. Manufacturing activity has quickened, with increases reported in new orders, shipments and backlogs. And while housing construction on balance appears to have peaked out, it remains at very high levels. The unemployment situation improved somewhat further, and there were frequent reports of a growing shortage of skilled and semi-skilled labor. On the dark side, however, concern continued to be voiced over the outlook for further inflation.

One of the brightest spots in the latest District reports was the strength in consumer spending over the Christmas season. Moreover, retail sales were reported as continuing strong during the post-holiday period. To be sure, the phrases used to describe the strength of Christmas sales varied somewhat, from the "continued to expand", "were generally reported good" or "continued strong" (Richmond, Kansas and Dallas, respectively) to "extremely vigorous"; "very strong" and reaching "record levels" (Chicago, Cleveland and San Francisco). It thus appears that nationwide consumer spending was well above that of the 1971 holiday season, frequently surpassing retailers' expectations. An optimistic outlook regarding sales over the months ahead, moreover, was mentioned by a number of districts, including Minneapolis,

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*Prepared at the Federal Reserve Bank of New York.

St. Louis and San Francisco. Boston also reported an unusually high rate of reordering from retail stores for this time of the year.

Another bright spot was the apparent further heightening of businessmen's confidence, as reflected in reports of increases in actual or planned capital outlays. The Chicago Bank thus reports that capital expenditures may be heading for a boom, as additional firms increase appropriations. St. Louis and Boston note that orders for capital goods are rising, and Cleveland reports that machine tool companies in the area are expecting a boom in new orders. Indications of rising plant and equipment outlays were also mentioned by other Banks, including Dallas, Philadelphia and New York.

Against this background, reports from a number of Banks, including Cleveland, St. Louis, Richmond and Chicago, pointed to a further improvement in the industrial production picture, with manufacturers' new orders, shipments, and backlogs on the rise. Cleveland reports strong demand for steel, and that output in certain other durable good industries that had been sluggish since 1970 is beginning to rise. St. Louis notes that all manufacturing industries in that District reported higher levels of output in recent months. The Texas production index reached record levels. A number of Districts, including Cleveland, reported constraints on production stemming either from capacity limitations, difficulties in obtaining supply, fuel shortages (in part due to cold weather), or from a shortage of skilled labor.

Most reports on construction suggest that total activity in that industry, on balance, has stabilized at or near recent high levels. In certain areas, including the Richmond and St. Louis Districts, a rise in nonresidential construction offset declines in residential building activity.

There were indications that the employment picture has continued to improve somewhat. Boston reports tightness in some labor markets in the mist of pockets of high unemployment. Cleveland notes that employment in that District continues to expand at a more rapid rate than in the nation. Richmond reports a severe shortage of textile workers, and Chicago, St. Louis and Dallas all note increases in employment in their areas.

Concern over inflation remains in evidence. Philadelphia reports that over one-half of the respondents in its monthly business outlook survey expect to pay higher prices over the next six months. Atlanta states that the main concern of businessmen is that inflationary pressures will mount. Dallas, St. Louis and Boston respondents voiced expectations of further price increases. Respondents in a number of Districts remarked that the rise in certain farm products would eventually be reflected at the retail level.

FIRST DISTRICT--BOSTON

Our directors reported business continues to be very good in all areas--consumer goods, industrial materials, and capital goods. Tightness in labor markets was noted as well as the continuation of substantial pockets of unemployment. Fears of a cost squeeze in 1973 were voiced as well as the belief that inflation is not completely behind us.

Orders and sales of consumer goods remained very good later into the fourth quarter than is usual, noted a director of a diversified conglomerate. Reordering from retail stores has also been at unusually high rates for this time of year. In the capital goods area, manufacturers of machine tools expressed the belief that the investment cycle is finally on the upturn and that backlogs and orders for substantial pieces of equipment were rising. Even the aerospace industry appears to be improving. An important manufacturer of helicopters reported a substantial new order from Iran.

Despite the universal picture of an improving economic scene, a new director from Connecticut reports that there continue to be pockets of substantial unemployment in his state (areas with rates in excess of 15 percent) due to the depression in the brass and clock industries. Moreover, while the Connecticut economy finally got into an upswing early in 1972, this director sees only a moderate rate of expansion for Connecticut in 1973, to be followed by a mild recession in Connecticut in 1974. Slower growth in Connecticut is connected with a slowing of the influx of new corporate headquarters out of New York City to Connecticut.

Continued price increases or unavailability of industrial raw materials, especially paper and natural gas, were mentioned as putting severe pressure on prices and creating cost squeeze conditions.

Among our academic correspondents, Professors Eckstein, Samuelson, and Wallich, there was a universal call for monetary restraint. Samuelson stressed that most economic forecasts of 1973 have been revised upward by \$5 billion to \$10 billion since Thanksgiving. He felt the economy is excessively strong from the standpoint of the expansion lasting. Wallich favored tightening wage and price standards. He reasoned that the current standards when combined with increased demand pressures will produce the expectation that a 3.5 percent rate of inflation is the minimum to be expected. He favored a 6 percent monetary growth target, even at the expense of rising interest rates. To postpone the rise in interest rates, Wallich stated, would mean only that the rise will be greater at a later date. The only exception would be if the economy were forecast to soften, and we cannot count on that happening.

At the same time, considerable caution was expressed about the degree of tightening until there has been a careful postmortem of the year-end bulge in the aggregates. Samuelson urged flexibility, rejecting any money growth, interest structure, or path of interest rate increase shibboleth. Eckstein warned against basing actions on the extremely high December retail sales performance, suggesting that fine tuning has not proved successful. Eckstein recommended a study of "what failed in the system that produced the result of grossly excessive growth" in the monetary aggregates. His prescription was, "having sinned, do not flagellate; just stop sinning slowly".

SECOND DISTRICT--NEW YORK

An optimistic tone regarding the economic outlook characterized the views expressed by Second District directors and other leading businessmen contacted recently. Retailers enjoyed a very good Christmas season. Business confidence was reported to have strengthened further, but no signs of an emerging "boom" psychology were detected. Apart from isolated instances, industrial product markets have not tightened any further of late, and in general industrial prices have risen only in response to production cost increases. The unemployment picture has improved on balance, and growing shortages of skilled and semi-skilled workers were reported.

Most respondents reported that holiday sales in their area had been exceptionally good--well above year-ago levels and also generally well above earlier expectations. The president of a large retail concern with nationwide outlets said his firm's sales during this period had exceeded expectations which were already "very high to begin with". One director observed that sales during the week after Christmas were also unusually good, presumably indicating that consumers were still in a bargain-hunting mood.

The Buffalo branch directors felt the current well-balanced expansion has given businessmen an optimistic outlook, with expectations now widespread that growth would continue throughout 1973. A senior official of a large upstate manufacturer, who felt that business confidence had improved greatly of late, said this development was now being translated into increased orders, inventories and plant and equipment outlays. The president of a large retail firm also felt that strength in the overall business situation was likely to continue over the months ahead. Generally similar sentiments were expressed by other directors and business leaders. Concern, however, continued to be voiced by some of the respondents over the uncertainties surrounding wage-price controls and Government spending.

Regarding the raw materials and industrial products markets, a majority of the directors detected no widespread tightening in these markets at this time, although there were reports of scattered tight spots. However, the senior official of the large upstate industrial firm did state that while the most outstanding example of tightness so far was in the lumber industry, conditions in other industries might become tighter if price controls prevent normal market forces from expanding supplies. Several other directors also reported that building materials were in short supply, and an upstate owner-operator of a large agricultural enterprise commented that paperboard and some textile products seemed harder to obtain. It was also reported that delivery of raw materials in the automotive parts business has stretched out from the normal three to four weeks to seven to eight weeks. The New Jersey banker reported that several firms in his area were adding second and third shifts to keep output in line with incoming orders.

On the price front, respondents expressing an opinion stated that they were not aware of any increases in industrial prices which did not appear to be directly related to cost increases. With respect to agricultural prices, however, an upstate director engaged in agriculture noted that short supply and high demand had resulted in "drastically" increased prices for apples and for livestock and poultry feeds, the latter being reflected in higher milk and egg prices.

According to most respondents, there is no general shortage of labor in the Second District, but conditions are tight in scattered localities and widespread shortages of skilled workers exist. The labor market in the Rochester area was said to be quite tight, with a large number of vacancies open for skilled labor. Labor conditions in Albany also were described as tight, reflecting in part the continued growth in government-related employment. A New Jersey banker not only reported a shortage of skilled blue-collar workers in his area, but noted that there was some difficulty in obtaining employees in the banking field as well. Most other directors also mentioned shortages of skilled workers.

THIRD DISTRICT--PHILADELPHIA

Most Third District businesses which were contacted report continued healthy expansion. Production activity has leveled off a bit but is still moving upward. Employment opportunities are currently static but are expected to be better in the months ahead. Retail sales are high. Inventory investment is increasing a bit and is expected to accelerate, and many firms are increasing their plant and equipment outlays. Construction activity is progressing at a moderate rate with residential building ahead of other types of construction. Area bankers report rising deposits. Loan demand is good, with consumer and mortgage loans being the strongest. On the darker side, inflationary expectations continue high.

Production activity has leveled off somewhat at most of the firms responding to this Bank's monthly business outlook survey. The majority of firms report no current change in new orders and shipments; most of the remaining firms are experiencing increases, however. Over half the firms have rising production schedules for the next six months. This represents slightly less production growth than was reported last month.

Current employment demand is holding steady with over three fourths of the surveyed firms reporting no changes in their number of employees or their average workweek. However, almost one third of the business outlook survey respondents do expect to hire more workers within the next six months. Retail sales are high. Area department stores and auto dealers both report strong consumer demand.

Business inventories are currently being increased at about one third of the firms surveyed, while over half of them report no change in inventories.

During the next six months the picture is better, with 50 percent of the firms reporting plans to increase their inventories.

Almost half the firms contacted in this District are increasing their plant and equipment during the next six months, and nearly all the rest of the firms are maintaining their present plant and equipment facilities.

Home construction activity in the Third District is expanding, particularly in the suburbs and at the beach-resort areas. Nonresidential construction remains flat at a high level. Public works projects are hardly moving at all. In the Third District, total construction outlays are expanding but at a slower rate than the national average.

Inflationary expectations remain high. Almost one third of the responding firms report paying higher prices, while only 10 percent of them are charging higher prices. Looking ahead six months, over one half expect to pay higher prices and almost one third plan on increasing the prices they charge.

Local banks report that deposits are increasing a bit more rapidly now. Some demand deposits are coming in. The local bankers report that time deposits can be easily increased if the bank is willing to pay a high enough savings rate. Loan demand is good. Most banks report strong demand for consumer and mortgage loans. But, one large bank reported that its rate of consumer loan delinquencies is at an all-time high. The senior officer reporting this fact attributed it to easier consumer loan criteria and a change in public morality. Business loans are increasing at most of the banks contacted.

FOURTH DISTRICT--CLEVELAND

Economic activity in the District ended the year on a strong upward trend. Retail sales surpassed expectations. Manufacturers have been experiencing increased inventory building on the part of customers. Payroll employment continues to expand at a more rapid rate in the District than in the nation, and residential building remains at a high level. There are, however, some indications of constraints on production stemming from physical capacity limitations, fuel and labor shortages, and difficulty in obtaining supplies. Bankers report strong deposit flows at the year-end.

Retail sales over the holiday period are reported to have been very strong. The improvement in the Cleveland area was much better than anticipated by retail merchants. They were particularly surprised by the surge in shopping between Christmas and New Year's Day, and by the continued boom in sales during the first week of January. The Pittsburgh area also had an excellent volume of retail trade over the holidays. According to one bank economist, Pittsburgh's economy came back from the recession only in the fourth quarter of 1972. The area's steel industry is finally showing year-to-year gains in employment, while other durable goods industries that had been sluggish since 1970 are beginning to demonstrate signs of increased activity.

Steel industry economists report strong order demand, with recovery in those product lines that had been relatively weak. Steel users are beginning to accumulate inventories more aggressively. One steel company is becoming concerned about their ability to ship all of the orders currently scheduled for March delivery. They are approaching capacity limits on some products in certain plants. One of our directors reported that another large steel company in his area is operating at full capacity. A third steel company mentioned a surge of inventory accumulation by their customers, stemming partly from attempts to beat price increases, partly from a greater willingness of users to hold larger inventories to ensure continuity of production, and partly because the cash positions of their customers has improved.

Several of our industrial directors mentioned that the fourth quarter was outstanding for their businesses, particularly in the areas of office equipment and motor vehicle equipment. Delivery times are stretching out, and there are reports of difficulty in hiring skilled employees and in one instance high quality unskilled workers. One of our directors, a university president, commented that for the first time in years the employment situation is much better for their graduates, based on the increased number of recruiters and job offers.

Machine tool companies in the area are expecting a boom in new orders. Some are having difficulty in getting supplies that could have been purchased off the shelf a few months ago. Others are having difficulty in obtaining skilled labor. An economist from a large machine tool firm in Cleveland said they are deliberately stretching out backlogs rather than attempting to increase output by hiring more workers (which they are not sure of finding even if they tried). The firm is running down its inventory of cutting tools built during the previous slack period, and their customers have begun to accumulate inventories in earnest.

Economists from several major oil companies headquartered in the District report bottlenecks in physical plant, with operations running over 100 percent capacity. Even though fuel oil is in short supply, oil refineries are tending to concentrate on producing gasoline, which (because of price ceilings) is more profitable than fuel oil. One economist expects a shortage of transportation fuels by spring. The oil companies are having difficulty in satisfying the demands of their regular customers, and they are reluctant to take on new customers. In some instances, fuel shortages have constrained manufacturing output in the District. In recent weeks, some plants have had to shut down and others have had to reduce operations because their supplies of natural gas were curtailed and they could not obtain alternative fuel sources such as crude oil.

Bankers report a strong flow of deposits at the year-end, reflecting the rapid pace of business activity. Mortgage loan demand continues to be strong, while the volume of residential construction contracts in the District (as of November) was only a shade below the record high reached last May. Business loan demand has shown signs of further strength in recent weeks.

FIFTH DISTRICT--RICHMOND

According to our latest survey of businessmen and bankers, most Fifth District economic indicators either have recorded further gains or have shown no significant change. Manufacturers' shipments, backlogs, and new orders increased again in the past month, while retail sales, including sales of automobiles, continued to expand. Following increases in the last several months, manufacturing employment and residential construction have apparently stabilized at high levels. Severe labor shortages, reported in several areas of the District, have restricted the output of textiles and furniture. Optimism concerning the economic outlook remains high among District businessmen and bankers.

Manufacturing activity in the District continues in a strong advance, with further gains in shipments, new orders and backlogs reported. While strength appears to be widespread, textile producers in particular seem to be benefiting from the economic expansion under way. Further declines in inventory levels were reported, but on balance manufacturing respondents believe that inventory levels relative to desired levels are now about right. A sizable number of manufacturing firms continue to report that current plant and equipment capacity is at lower than desired levels.

Our latest survey shows a strong employment picture in the District. Manufacturing respondents indicated no change in employment but sizable increases in hours worked per week. Trade and service respondents reported increases in both employment and hours worked per week, and most banking respondents believe that employment has increased in their areas. A severe shortage of labor, reported in several areas of the District, is particularly troublesome to textile and furniture producers and has apparently restricted output increases. Both manufacturers and retailers continue to report increases in wages and prices received.

Survey responses indicate further increases in retail sales throughout the District. More than 85 percent of the banking respondents reported that retail sales rose on a seasonally adjusted basis during the last month. One half of the trade and service respondents reported gains in general retail sales, while increases in automobile sales were reported by three fourths of the banking respondents.

Loan demand at reporting banks appeared to be of greater than seasonal strength, with increases reported in business, mortgage, and consumer loans. More than 85 percent of the banking respondents indicated further increases in consumer loans. One large banking respondent reported business loan demand at an all-time high for his institution. For the first time in several months, banking respondents reported a slight decline in residential construction in their areas. Increases in nonresidential construction continue to be reported, however. Nonresidential construction has benefited from new industries locating in the District and from sizable plant expansions by several manufacturing firms.

District farmers' cash receipts from farm marketings during January-October 1972 were 8 percent above those a year earlier, compared with a 10 percent gain nationally.

Most businessmen and bankers in the District remain optimistic about the general economic outlook. More than 60 percent of the banking respondents expect an improvement in business activity in their areas in the immediate future. Optimism about the business outlook among textile producers seems especially high.

SIXTH DISTRICT--ATLANTA

Economic activity is brisk in the District, and the outlook is optimistic. Numerous year-end newspaper articles and editorials highlighted the strong economic gains of 1972 and predictions of prosperity in 1973. A special survey of Tennessee businessmen shows an optimistic outlook for 1973. With wage and other cost pressures and labor shortages being major concerns, higher grain prices are increasing the cost of some food items. Many state and local governments in the District ran surpluses in 1972 and are flush with funds. Some feel that these funds will be expended in relatively short order, adding to demand and inflationary pressures.

The following is a sample of optimistic headlines appearing in local newspapers around the turn of the year: "Atlanta businessmen see strong 1973 economy", "Florida's economic picture is bright", "Dade County (Miami) economy still rising", "Mississippi economy is on the move with big gains indicated in 1973", "Major economic boom forecast", "Drop in unemployment and rise in income mirror state (Mississippi) gains", "Tampa jobless rate tumbles", "Unemployment is low in Meridian", and "Textile industry optimistic". These headlines both reflect and reinforce the optimistic mood of businessmen, bankers, and the general public.

The main concern of businessmen is that inflationary pressures will mount. There is a shortage of labor in Tennessee, and 70 percent of Tennessee businessmen participating in a recent survey think that wage demands in 1973 will exceed those of 1972. Corporate leaders expect many costs to rise, including costs of utilities and fuel, pollution abatement, taxes, and raw materials. For this reason, there is sentiment for the continuation of controls. Increases in the price of milk and bread in New Orleans are blamed on higher grain prices. A Louisiana egg and poultry producer says that his feed costs have risen by

180 percent in the past year. Three telephone companies and three other utilities have been granted rate increases in the past month. The foundry and coke industries in the Birmingham area are taxed to capacity. The demand for coal is also strong. Controls, however, are constraining the development of needed capacity in the coal industry.

Three New Orleans-area savings and loan associations report strong demand for mortgage funds and dwindling excess lending capacity. A similar sampling of New Orleans consumer finance companies indicates especially good business in November and December.

Retail and tourist activity is generally reported good, but the New Orleans hotel business is an exception. During November, occupancy in downtown hotels was as low as 50 percent. Occupancy at a recently opened hotel has been averaging a disappointing 83 percent.

Banks in New Orleans and Mobile report decided increases in demand deposits around the year-end.

SEVENTH DISTRICT--CHICAGO

The Seventh District economy retains a strong upward momentum. Employment is increasing, retail sales have been extremely vigorous, order backlogs are building, and lead times are stretching out. Inflationary pressures are increasing as indicated by the recent rise in farm prices, higher prices charged by small firms exempt from controls, and requests of utilities and regulated public transport lines for substantial increases in rates and fares. Increases in production are impeded by lack of availability of fuel, skilled labor, parts, and components. The most serious supply problems relate to availability of fuel, both natural gas and heating oil.

Fuel shortages have been reported in all five states of the Seventh District in the past month. Much colder weather this year has increased fuel usage for home heating by 20 percent to 25 percent over last year. Shortages of propane gas are widespread. Utilities have shut off "interruptible" natural gas customers in a number of cases. There have been reports of temporary shutdowns of manufacturing facilities and of apparatus for drying corn and soybeans. Suppliers of heating oil and diesel fuel have stopped taking new customers, and have reduced allotments to established customers. On January 8, the largest supplier of these products in the Midwest announced it was cutting deliveries to established customers to 75 percent of last year's January level. Price controls are blamed, in part, for fuel oil shortages because of an artifically low price for home heating oil and lack of flexibility in prices in wholesale markets. The Midwest is a deficit refining area, and the price mechanism normally allows area oil firms to bid additional supplies away from the Gulf region.

Employment apparently would be increasing faster and output would be rising faster if sufficient numbers of qualified workers were available. Many firms are having difficulty rebuilding work forces reduced during the recession. Affected industries include steel, machine tools, capital goods components, and furniture. Apprenticeship programs are being expanded, but results will take time.

District businessmen do not appear to worry about a second-half slowdown. For example, Milwaukee purchasing managers are said to "show concern, not for the future, but rather for the deterioration of deliveries and quality, and the growing list of shortages of materials and skilled labor".

Steel firms expect a record year in 1973. One large area firm is operating at effective capacity and order books are filling for future months. Recent months have seen a revival of orders for fabricated structural steel, including orders for manufacturing buildings.

Capital expenditures may be heading for a boom as additional firms increase appropriations. Foreign demand also has increased substantially in the past several months. The improvement is broadly based and includes Communist countries.

Among the supplies and components requiring longer lead times currently are electric motors, fluid drives, axles, diesel engines, bearings, castings, forgings, cutting tools, dies, and molds. In several cases the delivery situation deteriorated very rapidly in the final months of 1972. Of course, shortages and delays tend to cumulate as precautionary measures are taken. There are reports of growing imbalance in inventories of supplies.

A number of reports indicate that manufacturers are planning production at levels that will permit them to weather strikes in 1973. Examples are construction machinery, farm machinery, and motor vehicles. Steel firms expect that their orders will reflect these plans.

Housing experts are gradually raising their forecasts for 1973, although most still see a significant decline from 1972 to 2.0-2.1 million units. Demand for used homes is strong, and a large Chicago area real estate firm projects an average rise in prices of existing homes of at least 6 percent this year. Supplies of many building materials are tight. Gypsum board is being substituted for high-priced plywood and fiberboard.

Farm prices continue to strengthen, suggesting a continuance of relatively high farm income, and also higher prices at retail, especially for meat. Both cattle and hog prices rose even more sharply than expected in December, reflecting reduced production and weather-delayed marketings. Wholesale meat prices are now above the peak reached near mid-1972. About 10 percent of the corn and soybean crops remain in the fields, but current reports indicate that losses will be small and much less than had been feared.

EIGHTH DISTRICT--ST. LOUIS

Businessmen in the Eighth Federal Reserve District continue to be optimistic as to business prospects in the year ahead. Christmas sales were generally ahead of expectations despite some unfavorable shopping weather, and retailers expect sales in the coming months to be up on a seasonally adjusted basis. Most manufacturing firms report that operations are at or near capacity levels; thus, plant expansion is expected to pick up in the current year. Residential construction may have peaked, but any decline in home building is expected to be offset by gains in industrial construction. Employment continues to rise moderately in the District and the unemployment rate to decline. Growth in loan demand continues to outpace the growth in supply of loan funds, and interest rates continue their persistent uptrend. A large portion of the cotton and soybean crops remained in the field at the year-end, which will result in deterioration of quality and reduced harvests. An increasing number of businessmen indicate that a higher rate of inflation is in prospect for 1973.

Christmas sales by major department stores in the Eighth District generally exceeded expectations and in some instances exceeded year-earlier sales by 10 percent. As a result, fewer after-Christmas bargains are to be found. This higher level of sales occurred despite unfavorable shopping weather. Thus, retailers are generally optimistic as to the outlook for the months ahead.

All manufacturing industries report higher levels of output in recent months. An increasing number of industries report operations at or near capacity levels and plans for plant expansion. These reports are consistent with the fact that orders for capital goods are rising sharply. Steel representatives report that heavy construction has finally turned upward, that railroad demand for steel is coming back, and that farm equipment and appliance demands for steel are strong. Capital goods industries are thus very optimistic as to the prospects for business in the months ahead.

Construction remains at a high level, and the outlook is optimistic for 1973. Reports on the residential sector are diverse, however, with some areas reporting gains and others sluggishness. The sluggishness is generally confined to St. Louis, where some slowdown has occurred in recent months, and to those rural areas where crops remain in the field. Residential construction generally remains at a relatively higher level in other parts of the District, and industrial construction is believed to be gaining momentum.

Most firms in the Eighth District report further moderate gains in employment. Higher wage rates, however, have raised the marginal returns to labor-saving devices and cost-reducing practices. In retailing, for example, one firm reported that all full-time employees who resign are replaced with part-time help, thereby avoiding many fringe benefit costs. The unemployment rate continues downward, and the labor market is reported to be tighter in most parts of the District.

Interest rates continue their persistent uptrend of recent months. Commercial banks report that all commercial loan rates have generally moved up with the rise in the prime rate. Instalment and real estate loan rates have likewise increased somewhat.

Crop harvesting problems are a major economic factor over much of the District. Twenty percent of more of the cotton and soybean crops were estimated to remain unharvested at the year-end in the Mississippi Valley area. The quality of the cotton has deteriorated substantially and much of the unharvested beans are lying on the ground and cannot be harvested with combines. Major losses are thus in prospect for many farmers despite the higher prices for farm products.

NINTH DISTRICT--MINNEAPOLIS

Although warmer weather in late December temporarily alleviated District fuel shortages, the problem reappeared with the return of colder weather in early January and currently threatens District economic activity. District grain shippers are now experiencing difficulty in obtaining boxcars, and this problem will probably persist until spring. District retailers enjoyed a very good Christmas season and are very optimistic about their sales prospects for the first six months of 1973.

Although economic activity was not seriously hampered, unseasonably cold weather in December revealed severe fuel shortages in the District, especially in the Minneapolis-St. Paul metropolitan area. No major District manufacturing facility was shut down due to fuel shortages, but several large manufacturers' fuel supplies were strained and a number of smaller manufacturing plants actually did shut down or reduce operations. A steel plant in St. Paul, for example, lost forty-eight production hours in December due to lack of fuel, and two metal-treating plants in Minneapolis curtailed operations. A South Dakota director reports that fuel shortages interrupted crop-drying operations in his area and, as a consequence, many farmers will be forced to sell their crops at a considerable discount.

Warmer weather in late December temporarily alleviated District fuel shortages, but they reemerged as colder weather returned in early January. Minnesota's state civil defense director indicated that some fuel oil users currently are having difficulty obtaining needed supplies. Also, in order to meet residential heating requirements, a major fuel supplier in Minnesota reduced January's fuel allotments of airlines, railroads, and trucking firms by 20 percent to 25 percent, which could result in District transportation services being curtailed. In addition, in North Dakota, the Governor has instituted emergency measures in order to avoid closing some public facilities because of a lack of heating fuel.

Several directors report the District is currently experiencing a boxcar shortage. A major grain merchant in the Twin Cities reports difficulty obtaining cars and currently could use an additional 1,000 hopper cars. This firm has resorted to using coal and refrigeration cars and does not expect the problem to improve until the Great Lakes shipping season starts this spring. Although rail transportation was available to fill all ships before shipping on the Great Lakes ceased, a Duluth banker reports that sufficient boxcars are not available to ship grain currently stored in Duluth, especially sunflower seeds destined for Gulf ports, and his area's shippers have had to use coal cars. In South Dakota no boxcar shortage had yet occurred, but the potential exists. A large amount of grain in South Dakota is currently stored under the Government loan programs from the 1968, 1969, and 1970 growing seasons, and the United States Department of Agriculture recently announced these storage contracts will not be renewed. Much of this grain will be shipped out of South Dakota when these contracts expire in 1973, and a South Dakota director anticipates problems in obtaining needed boxcars. A North Dakota director reports that grain elevators in his area are full and are refusing to buy grain because boxcars are not available for shipping it. No grain is piled outdoors, however, and as long as the grain prices remain high no one is losing money because of the lack of boxcars. In contrast to the rest of the District, directors from Montana indicated that their state, for the first time in several years, is not experiencing a boxcar shortage.

District retailers enjoyed a very good Christmas season and have a very optimistic sales outlook for the first six months of 1973. A major Minneapolis-St. Paul area retailer revealed that his firm enjoyed excellent business in 1972 and achieved its largest year-to-year relative sales gains in December. His firm estimates that department-discount store sales in the Minneapolis-St. Paul metropolitan area will be up 12 percent from a year earlier in 1973. Other reports from the Twin Cities are that retailers indicated that they also enjoyed a very good fourth quarter and expect business to remain strong during the first six months of 1973. In addition, directors from outside the Twin Cities metropolitan area disclosed that their area's merchants had an excellent Christmas season and are very encouraged about their business prospects in 1973. A South Dakota director, however, stated that many farmers' incomes will be curtailed because they were unable to dry their crops in December, and this could curb his area's retail spending. Although retailers are optimistic about business in 1973, the consensus was that inventory re-building will be in line with year-earlier levels.

TENTH DISTRICT--KANSAS CITY

December sales at leading retail outlets in Tenth District metropolitan areas were, in most instances, well above those of a year earlier. Although the picture varies from firm to firm and place to place, it appears that District retail sales increases may not have kept pace with those of the nation. However, District sales activity was strong enough to support large demand deposit inflows at District commercial banks, and strong increases in consumer instalment and credit card loans as well. Adverse weather conditions, which had some restraining influence on District retail sales growth, are contributing (along with other factors) to a farm products-and-food price situation that is not favorable to stability in consumer prices.

Adverse weather conditions in several metropolitan areas appear to have held down December retail sales growth in the District, at least by comparison with the record increases experienced by national retail chains. However, most District retailers interviewed reported very solid gains in sales over December 1971. Descriptive adjectives ranged from "favorable" to "very nice" to "anywhere from tremendous to fantastic". Although sales increases generally ranged across the board, some retailers noted particularly strong gains in furniture, home improvement items, and sportswear.

Tenth District bankers described recent demand deposit inflows in terms ranging from "above average" to "spectacular" and "greatly beyond expectations". These rapid increases in demand deposits were attributed to very strong retail sales activity during the holiday season. Large increases were reported in consumer instalment and credit card loans, probably due also to Christmas purchases. Increases in time and savings deposits were much more modest, with CDs appearing to decline despite inflows by governments investing tax revenues.

Bankers made few changes in CD rates during December; some banks in large District cities reported that they are paying maximum interest rates on most classes of deposits. Most, however, did not appear to be concerned about possible disintermediation, at least in the near term. Few banks changed in the prime lending rate in December since most were already charging 6 percent or more to prime customers.

A few bankers expressed concern that the recent rise in short-term interest rates would bring on some form of controls. Most, however, did not anticipate controls unless interest rates rose substantially further. Virtually all the bankers interviewed thought that controls, whether in the form of limitations on bank profits or interest rate ceilings, would not be effective, particularly in the long run. One banker expressed the view that, if effective, controls would discriminate against the banking industry, since he anticipated that interest rates on bank assets would be controlled, while those on bank liabilities would not.

Continued adverse weather conditions, sharp boosts in farm commodity prices, reports about smaller increases in prospective pork supplies than earlier anticipated, and unusually brisk consumer demand have all combined to place food prices in the national headlines once more. The above developments greatly dim the chances that food prices will prove less troublesome as a source of inflation in 1973. Farm prices, led by upturns for wheat, cattle and hogs, jumped 5 percent for the month ended December 15, thus pushing the level 18 percent above a year ago. Despite higher prices, profit margins in livestock feeding have narrowed owing to the sharp increase in feed costs. As a result, red meat supplies will probably be smaller this year than earlier expected, since producers likely will reduce the weights at which the animals are marketed and at the same time curb or revise downward their plans for expansion. The most recent hog report--showing a smaller than expected increase in pork supplies for 1973--attests to the likelihood of this development.

Several retail food chains reported that, while their prices on average have been fairly stable, the recent spurts in wholesale food prices will likely result in upward adjustments at retail. Egg prices have already moved up sharply, and further increases in milk prices are contemplated. Rather than raising meat prices, the merchants have elected to let their margins suffer but, unless wholesale prices fall off soon, retail meat prices can be expected to rise, perhaps sharply. On balance, then, the prospects of holding food price increases within tolerable limits are not particularly bright under the present form of wage-price controls.

ELEVENTH DISTRICT--DALLAS

Most recent indicators of economic activity in the Eleventh District continue to show growing strength. Both the Texas industrial production index and total employment in the five-state area reached record levels in November. New car registrations were also up, and department store sales continued strong in December. Construction activity, however, was lower in November. A recent survey of the directors of this bank representing the nonbanking sector revealed that most of them expect 1973 to be another good year but with some reservations. The directors generally agreed that 1973 would be a good year for sales and plant and equipment investment, but they expected increasing upward pressures on prices and wages.

Our responding directors were generally optimistic about the prospects of their own firms in 1973. Sales, for example, were expected to increase an average of about 10 percent, and most firms expected to increase their investment in plant and equipment--in one case, possibly by as much as 100 percent.

The respondents were not so optimistic about prices. Inflation was expected to accelerate moderately despite the consensus that wage and price controls would remain through 1973. Judging from our responses, the pace of inflation might rise even more if controls were to be lifted. Two of our directors, for example, indicated that their firms would raise prices if the controls were lifted. The majority, however, indicated that competition would prevent such increases. Wage increases, too, were expected to accelerate slightly next year. And like prices, some directors saw wages rising more rapidly for their firms if the controls were eliminated.

Looking at their current positions, two thirds of our respondents expressed satisfaction with their profit margins. Inventory levels were also judged to be about normal. But interest rates had risen 1/4 percent to 1/2 percent for some of them over the last month.

The seasonally adjusted Texas industrial production index rose in November to a record level. All major industry sectors shared in the rise. Output of utilities, paced by a substantial rise in the distribution of electricity, rebounded strongly in November after declining sharply in October. Within manufacturing, production of durable goods recorded the larger gain as all durable goods industries posted gains over October. Mining also increased slightly, as small increases in the production of crude oil and natural gas liquids more than offset declines in output of natural gas and metal, stone, and earth minerals. The regulatory commissions of District states are continuing to permit maximum production of crude oil except for a few fields in Texas that are partially restricted for conservation reasons. Several manufacturing plants in Texas, relying on natural gas for fuel, suffered supply cutbacks in early December and were forced to suspend operations briefly. However, the weather improvement toward the end of the month helped to ease the situation.

The weather has also forced suspension of cotton harvesting on the high plains. Harvesting had already been delayed by early-December storms and had just begun to pick up around Christmas week when another severe storm stopped all field activities. It is now feared that additional losses of both quantity and quality will occur in this area. Despite this, cash receipts from farm marketings through October continued sharply ahead of last year, and farm income in 1972 for the District should be a record, given the continuing higher prices for cattle and grains. As of December 1, Texas and Arizona had nearly 2.9 million head of cattle to feed, unchanged from the month earlier but 27 percent above December 1971.

Seasonally adjusted total employment in the five southwestern states rose in November for the fifth consecutive month. This increase, coupled with a decline in the labor force, caused the employment rate to drop from 4.4 percent to 4.0 percent. Gains in manufacturing employment were responsible for most of the rise in employment, as substantial increases were reported in both the durable and nondurable goods sectors.

Recent indicators of consumer spending also continued to advance. Department store sales rose again in December and were especially strong in Dallas and Houston. Automobile registrations were also higher in November, particularly in Dallas.

Construction activity, as measured by the value of contracts awarded, decreased in November for the third consecutive month. Both residential and nonresidential construction fell in November, but nonbuilding construction did increase slightly. The cumulative value of contracts for the District states through November, nevertheless, was still almost 25 percent ahead of the corresponding period last year.

TWELFTH DISTRICT--SAN FRANCISCO

Business activity in the Twelfth District continues to be strong, and our directors are optimistic about continued strength in 1973. Retail sales reached record levels in the District during December, and consumers are expected to maintain a steady demand for goods and services during the coming year. Banks report year-end gains in deposits and steady loan demand.

December retail sales were reported to be 10 percent to 12 percent higher than in previous years in most areas. This demand was broadly based, but sales of furniture and other durables were noted as being particularly good. One director in California reported that jewelry stores in his locality had sales increases of up to 20 percent. A similar situation exists for automobile sales. New car dealers had excellent sales during December, and at the same time dealers' inventories are at more satisfactory levels. As a result, dealers are expecting an excellent year for automobile sales. In general, consumers are regarded as being in a more confident mood and likely to be a major stimulus for the economy in 1973.

At present, construction activity is being maintained at recently established levels. In a few areas, such as Utah, there has been a seasonal decline, but in other areas, such as Phoenix and San Diego, there has been greater activity. In California, there remains some uncertainty about the impact of required environmental studies, but this problem should be reduced as experience is gained in preparing the necessary studies. As has been the case in recent months, higher vacancy rates in apartments are exerting a restraining influence on multi-unit construction in many areas.

The overall level of construction activity is sufficiently high that our directors single it out as the principal industry where there exists a shortage of labor. The demand is highest in the skilled trades, such as plumbers and electricians. The timber industry is another industry operating at near capacity and experiencing difficulties in finding some classes of workers.

In most other industries, the supply of labor both skilled and unskilled is sufficient for expected needs in 1973, even though shortages of specific skills do exist. In a few cases, layoffs are adding to unemployment. For example, Lockheed is laying off 1,000 people at its Sunnyvale, California, plant and many of these workers are in skilled trades. The consensus of our directors is, despite their optimistic view of the economy, the rate of expansion in 1973 will not result in a substantially lower unemployment rate.

Most banks in the District appear to have had substantial gains in deposits. Both savings and demand deposits are higher, and the banks expect to be able to meet most demands for credit without difficulty. Some interest rates, such as those on commercial loans, are moderately higher, but mortgage rates are described by one banker as being softer.