CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

This month's District Red Book reports, on balance, describes the current and prospective pace of business activity as very strong, in some cases reaching boom proportions. Consumer and business investment spending showed impressive strength, and construction remained at a high level. Employment was rising. On the negative side, evidence of increasing strains on productive capacity was emerging, with widespread lengthening delivery schedules and growing shortages of labor as well as materials. Prices were rising and serious doubts were frequently expressed regarding the probable effectiveness of Phase Three in controlling inflation. Countrywide, little concern was expressed over recent international financial developments.

All Banks reported continued advances in economic activity. The assessments ranged from "boom", "near boom", and "most vigorous in many years" (Kansas, Cleveland and Chicago), to a somewhat more restrained expectation of continued expansion at least until mid-1973 (San Francisco and Dallas).

Reports of strength in both consumer spending and in business outlays for plant and equipment were widespread. Atlanta reported that many retailers are expecting a banner year. San Francisco characterized consumer spending as generally "vigorous", especially for automobiles and durables, and a number of major retailers in the Richmond District reported sales to be considerably higher than year ago levels. Similar reports emanated from most other Banks.

Plant and equipment outlays were reported as especially strong (San Francisco), brisk (Atlanta), and continuing at a high level (Philadelphia).

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*Prepared at the Federal Reserve Bank of New York.

A number of Richmond District manufacturers indicated current plant and equipment capacity to be at lower than desired levels. Further evidence of strong capital spending was provided by a number of reports of large order inflows in the capital goods industry, including among others, the Boston, Cleveland, Chicago and St. Louis Districts. A number of Banks also reported a high level of commercial construction, in some instances (Atlanta) reaching boom proportions.

On the darker side, the brisk pace of economic activity has led to mounting strains on productive capacity. Most Banks reported rising backlogs of orders--in some cases to record or near record levels--and lengthening of delivery times. Similarly, there were frequent reports of actual and anticipated shortages of a wide range of basic raw materials, including steel, chemicals and construction materials (notably lumber)--and of semi-finished and finished products as well. The employment picture has tightened further, and shortages of skilled and semi-skilled labor were reported by a number of Districts.

Against this background, concern over the prospects of a heightening of inflationary pressures was widely reported to be on the rise. For example, the Philadelphia report states that inflationary expectations are high and rising, and some respondents in the St. Louis and New York Districts deemed inflation to now be the chief current economic problem. Similar expressions of concern appear in most other reports. Indeed, rising prices are pointed to by well over half of the Banks. In this context, considerable doubt was expressed about the effectiveness of Phase Three in controlling inflation, particularly on the wage side. Dallas reports that the introduction of Phase Three had caused a number of its respondents to alter their expectations regarding prices, which they now foresee rising much faster than previously thought likely.

Turning to the credit scene, most Districts reported a strong demand for bank loans, especially consumer loans. Several Districts reported a slowing down in the rate of deposits, and growing banker concern over disintermediation was mentioned by several Districts, including Philadelphia, Dallas, Kansas and Boston.

In general, little concern was expressed over the domestic impact of the recent international financial disturbances. Respondents in the San Francisco and New York Districts felt that the recent devaluation of the dollar should help stimulate exports.

FIRST DISTRICT--BOSTON

Our business directors report that business continues to be very good in all lines, but a bank director notes growing fears of disintermediation.

Business is reported as so good that firms have been unable to build inventories to desired levels. Machinery lines especially are under pressure. Order backlogs for heavy machinery are reported by one director as the highest in company history, and another director notes that his machinery division is sold out through the end of the year. Concern was voiced about inadequate facilities to handle machinery orders and about complaints from customers over long delivery times. Aircraft orders from the airlines, general aviation, and the military are reported as up for both new designs and replacement engines. One manufacturer of general aviation aircraft notes that order backlogs are at record levels.

In the consumer goods area, a manufacturer of boats and campers notes that the industry is expecting a very good year. Tire sales are strong , and there is less worry now in the industry about a major strike.

One director noted that the devaluation was going to raise metal prices and that the company would have to raise the prices of its nickel-based products and other superalloys. This director mentioned a rumor about Phase Three controls which would prevent a company from passing on devaluation changes by scrutinizing costs in its overall operations, including foreign divisions, rather than continuing the present practice of separating out domestic operations.

Pressures in the financial area were noted by a bank director. Savings deposits slowed dramatically and just covered dividend payments in February, raising fears of disintermediation. The drop in savings flows was especially noticeable in deposits of over $50,000 where rate ceilings continue to prevent banks from effectively competing for funds. This New Hampshire banker noted that business loan demand remains strong and that his bank is fully loaned. A business director mentioned that renewed concern about a credit crunch has led a number of firms to take down big lines of credit at commercial banks just in case they cannot use the commercial paper market. Another director, however, noted that rising interest rates this year will not have the cost impact that they did in the last credit crunch, because the cost of new debt will not be substantially higher than the present imbedded cost of debt. In the last period of monetary restraint, when the cost of new debt was over 7 percent and imbedded debt costs were 3 percent, borrowing substantially raised business costs.

This latter director also expressed the opinion that the current hysteria about inflation, as evidenced in the stock market, is unfounded. While prices will rise more this year than in 1972 and wage contracts will be higher under Phase Three than in Phase Two, he felt that unions would not be seeking exorbitant wage increases for fear of bringing back Phase One-type controls.

Professors Eckstein, Samuelson, and Shapiro were available for comment this month. All felt the major problem for the economy is to get Phase Three "off the ground". Shapiro criticized the strange and contradictory statements about Phase Three which have been made by members of the Administration. He urges greater clarification. He cited the relatively flat yield curve as evidence that "people with money do not have inflationary expectations". Due to a lot of bad luck (weather conditions and blight) and high income elasticity of the demand for meat, Samuelson doubts prices can be held to the stated goals. Specifically, the 5.5 percent wage standard is not possible to achieve, given the recent and likely future path of the cost of living. On the other hand, cost-push inflation is not something that the monetary authorities can or ought to do a lot about, according to Samuelson.

Samuelson also felt it inadvisable to be committed to a dollar parity rate at the cost of tighter interest rates than would be justified on the grounds of domestic policy. While Shapiro would have preferred to have let the dollar float, he urged the United States to stand firm in not supporting the dollar, forcing other countries to take either goods or dollars.

The general monetary policy prescriptions were the same as in previous reports. Samuelson argues there is reason to be tighter now than may be appropriate in eight months; Eckstein continues to advocate steady reserves growth. Given the minimum amount of "creeping inflation" we can expect, Samuelson believes that the long-run target growth rate of nominal gross national product (GNP) must be at least 7 percent and that a 5 percent rate of growth of M1 would squeeze the real system. Eckstein warmly applauded Chairman Burns's recent statement before the Joint Economic Committee. In a memorandum to his subscribers, Eckstein cited approvingly the statement that "the Federal Reserve does not intend to permit severe stringencies to develop in the credit markets, or try to correct for every error in public or private policies". Nevertheless, he expressed some concern that financial stringency will develop and urged the system to monitor carefully the financial system to see "where it breaks" since "it breaks different places every time". Past "crunches" appeared after a period of restraint, when the Fed did not anticipate the degree of stringency which did develop. He has confidence that "we have learned how to apply the monetary brakes gently".

SECOND DISTRICT--NEW YORK

The Second District directors and other business leaders contacted recently remained generally optimistic about the prospect for business activity over the foreseeable future. And, the respondents in general felt that the recent devaluation of the dollar would have a favorable impact on the country's economy. However, concern over the balance-of-payments situation remained very much in evidence. Phase III was not expected to modify the rosy corporate profits outlook, but considerable doubt was expressed regarding its workability with respect to wage controls. Evidence of increasing strains on productive capacity were noted, and widespread concern was voiced over prospects for controlling inflation.

Regarding the recent devaluation of the dollar, several bankers did not anticipate that this move would have an immediate effect on their own business but felt that the economy generally would benefit over the longer run as more United States products are sold, both domestically and abroad. A senior official of a large multinational manufacturing firm headquartered in upstate New York predicted that the devaluation would stimulate foreign sales of multinational companies, with an accompanying reduction in the country's international balance of payment deficit later in the year. The vice chairman of a large non-ferrous metal producer stated that the recent foreign exchange moves had been "helpful" to his firm.

Some respondents, on the other hand, were more restrained and others expressed concern over the uncertainties that they felt continued to surround the current international financial situation. The president of a large multinational petroleum producer stated that the devaluation had no major immediate impact on his firm. Similarly, the president of a lead importing corporation felt the devaluation did not "involve" his firm very much. Further, the owner of a large fruit growing concern--a director--stated he did not expect the devaluation to have any effects on the fruit growing business nor on any agricultural lines oriented to domestic consumption. As noted, a number of respondents expressed general concern over the balance of payments picture, citing the need for reform of the international monetary system. A number were especially concerned over the "Japanese situation", with this view most strongly expressed by one respondent who declared that "the Japanese are the heart of the problem".

Turning to the domestic picture, it was the consensus of the Buffalo branch directors that Phase III had not altered the favorable outlook for corporate profits this year. Also, those directors did not expect Phase III to result in any significant shift in plant and equipment spending. They noted the uncertainties created by the new approach, but felt that the elimination of the "red tape" associated with Phase II more than made up for the unfavorable effect of these uncertainties. On the other hand, some respondents were quite dubious regarding the wage side of the control program. An upstate banker, a director, felt that a "double standard" was being used--one for organized labor and a more stringent one for non-union workers. The lead importer mentioned above stated he expected Phase III to "break down" in the area of wages. The non-ferrous metal producer felt the new program had contributed to a seven week strike in his firm's southern facilities inasmuch as the firm had been close to signing a contract when the "Phase III bombshell hit".

With respect to shortages of raw materials and manufactured goods, most comments on specific products focussed on shortages of lumber products. In part, these shortages were attributed to the export of wood products as a result of the price control program which, according to the respondents, made such exports more profitable than domestic sales. Also, reduction in wood product supply and rises in production costs were attributed to new ecology standards and to the activities of conservationist organizations. Apart from the wood products industries, however, the directors saw no direct indication of shortages and no evidence of inventory stock piling in anticipation of such shortages. But they felt that higher prices and longer delivery schedules pointed to increasing strains on productive capacity.

Against this background, many respondents expressed alarm over the possibility of a return to surging inflation. Most Directors cited this prospect as one of the major problems they foresaw on the economic and financial horizon. The opinions of other business leaders were perhaps best expressed by the chairman of a large financial institution who commented "everything is tending toward inflation".

THIRD DISTRICT--PHILADELPHIA

General business conditions are very favorable and improving in the Third District. Production activity is surging ahead strongly and is expected to continue to do so for at least the next six months. Labor markets are bullish, as many firms hire more workers and extend the length of their average workweek. The employment outlook for the next six months is up significantly too. Investment in inventory and plant and equipment is boosting the area economy, with plant and equipment increases mentioned more frequently than increases in inventory investment. Retail sales are recovering nicely from a lull after Christmas. On the darker side, however, inflationary expectations are high and rising. And, bankers are complaining about the Regulation Q interest rate ceilings.

Production activity is moving up strongly: 71 percent of the respondents to this month's business outlook survey report increases in their new orders, and 67 percent report increased shipments. Virtually none of the local manufacturers are currently experiencing decreases in production. On the six-month horizon, the production outlook is even brighter; almost 80 percent of the firms contacted expect increased shipments.

Employment in the Third District has improved significantly since last month. One quarter of the firms are increasing their number of employees, and one quarter are increasing the number of hours in their average workweek. Over 70 percent report no change in their number of employees or the length of their average workweek. The situations should improve further; half the firms report plans to hire more workers in the next six months.

Plant and equipment spending plans continue high at the level reported last month. Slightly over half the firms report plans to increase their investment in plant and equipment in the next six months.

Investment in inventory is increasing, at over a third of the firms responding to the survey; most of the rest report no change in inventories. This increased inventory investment is expected to be short-lived, however. Six months in the future almost as many firms report plans to decrease as to increase their inventories.

Local retailers report that consumers are spending liberally again after a lull following Christmas. Autos are selling very well. Inflationary expectations are high and rising. Over a third of the firms participating in the survey report increases in the prices they charge and the prices they pay. During the next six months over three fourths of the respondents expect to pay and to receive higher prices; this is a significant increase in inflationary expectations over last month. Virtually no firms report decreases in current prices or the prices they expect six months hence.

Area bankers report that demand deposits, time deposits, and savings deposits are all growing slowly. They complain that Regulation Q interest rate ceilings are hindering their ability to get deposits. Demand for mortgage loans is good, and these loans can be made if they are sought, but the bankers report that mortgage loans are increasingly unattractive as interest rates in other areas rise above the mortgage ceilings. Consumer loans and business loans are up nicely. However, one banker pointed out that his bank was suffering a loss of 60 basis points on all loans made at the prime rate when it is compared with the bank's weighted average cost of the capital.

FOURTH DISTRICT -- CLEVELAND

Economic activity in the District seems to be approaching near-boom proportions, according to the recent performance of key economic indicators and comments from businessmen, directors, and economists. The international currency situation does not appear to have affected business sentiment. Expansion in the manufacturing sector continues at a robust pace; the major sources of strength are the steel, automotive, and machinery industries. Residential construction is at a record high, while nonresidential construction contracts rose in January to the highest level in four years. Recent gains in payroll employment continue to be somewhat stronger in the District than in the nation, and there are widespread reports of shortages of skilled labor. Some of our directors are concerned about the likelihood of further acceleration of inflationary pressures and about the possibility of a slowdown in economic activity during 1974.

Our monthly survey of manufacturers indicated that economic activity in the District's manufacturing sector was increasing in January at the fastest rate in the nine-year history of the survey. Returns received so far this month show that new orders, shipments, backlogs, and inventories all posted substantial additional gains in February. Also, the proportion of firms experiencing increases in delivery time, employment, the workweek, and prices paid reached record highs. (The pervasiveness of recent price increases is substantiated by the latest report of purchasing agents in the Cleveland area--92 percent reported paying higher prices in February than in January, the highest figure since August 1956.)

Comments of our industrial directors emphasized the strength of new orders and backlogs in their firms. Those associated with capital goods and consumer goods areas mentioned that business has been extremely good, both they and their customers are having difficulty in building inventories. Several of the directors reported that they plan to keep a tight rein on their inventory situation, however. Some of the directors were of the opinion that part of the strength in new orders was the result of numerous capital goods customers placing advance orders because they fear shortages later this year. Concern was also expressed about the effect of recent price behavior on the large number of major labor negotiations scheduled through 1973. Some of the directors are also becoming concerned about the prospects for a reduced pace of business activity in 1974. One director whose diversified firm has record orders in all areas of its business, mentioned specifically that he expects a drop off in business next year and is therefore avoiding an overextension of plant capacity.

Economists from major firms in the area are also reporting ebullient business conditions, and they are projecting a sustained high level of operations--at or near capacity--through 1973. One economist with a large machine tool firm in Cleveland said that orders have risen more sharply since September than for any comparable period in the twenty-five years he has been with the firm. Lead times have lengthened significantly. Last September, this firm was quoting six-month deliveries; now they are on a fifteen-to eighteen-month basis. Thus, the management of this firm is extremely optimistic over the prospects for production well into 1974.

Economists in the steel industry report that the recent volume of orders has been close to a record high, and orders are expected to strengthen in the months ahead. Production is likely to continue at the practical limits of capacity through the balance of this year. Steel consumers will have difficulty in stockpiling later this year (anticipating next year's labor negotiations) because of capacity limitations. Industry sources also report that a substantial portion of the planned capital spending for 1973 will represent pollution control equipment, while spending for modernization and additions to capacity is still well below recent years.

Another economist said that output in both basic chemical and plastic products has been at capacity, and will remain so for the foreseeable future. The only problem on the near-term horizon in this area is expected to come from the energy shortage, particularly electric power during the peak power-consuming months in the summer.

Reports from bankers reveal a tightening in loan terms, especially for real estate (higher downpayments and shorter maturities). In addition, finance companies are moving out of commercial paper and back to the banks. The largest banks in Pittsburgh and Cleveland report that their large accounts headquartered in these two cities, and for whom they are the principal bankers, have not yet come in to borrow significant amounts for investment purposes. The bankers still expect such a surge in credit demand and attribute the softness in this area to date to strong corporate cash flows.

FIFTH DISTRICT--RICHMOND

According to businessmen and bankers responding to our most recent survey, the Fifth District economy continued its upward momentum during the past month. Retail sales were reported to be considerably above year-ago levels. Manufacturers' shipments, new orders, and backlogs continued to expand. Demand for credit continued to grow, with the demand for consumer loans being especially strong. Construction activity was reported to be at high levels despite substantial increases in building costs in recent weeks. Generally, businessmen and bankers are confident that the economic outlook for the District is favorable.

Reports of continued strength in the manufacturing sector were almost universal in this month's survey. Shipments, new orders, and backlogs were reported to have increased substantially. Except in hosiery lines, textile production and sales remained strong; a short supply of synthetic fibers is causing some problems for the industry. Foreign investment appears to be increasing significantly in the District, most notably in the Carolinas. Several foreign firms have recently started manufacturing operations in the Carolinas or announced their intention to do so.

While inventories reportedly declined further in the past month, most respondents believe that inventories are at appropriate levels. Some retailers reported recent upward adjustments in inventory levels to bring them in line with increased sales expectations. A number of manufacturing firms indicate that current plant and equipment capacity is at lower than desired levels.

Manufacturers reported that employment was unchanged from recent high levels and that hours worked per week had increased slightly since the last survey. A sizable number of banking respondents reported increases in employment in their areas. As in the past several surveys, a shortage of labor was the most common problem mentioned by respondents. Insured unemployment rates are reported to be less than 1 percent in some areas, and numerous firms are said to be advertising heavily in an attempt to attract workers. Numerous firms reported increases in both wages and prices received since our last survey. Several respondents cited sharp increases in building costs in recent weeks.

The retail sales picture in the District remains very favorable. Several major retailers reported that sales are considerably higher than year-ago levels, with sales of women's apparel being especially strong. Generally, retailers appear to be optimistic about the outlook for the spring season.

Demand for all types of loans remains strong in the District. Demand for consumer loans is apparently stronger than the demand for business and mortgage loans. One large bank reported that February was the best month that his bank had ever had for consumer loans. This was attributable, in part, to favorable weather conditions. Both residential and nonresidential construction activity increased in the last month.

In the District farm sector, realized gross and net income per farm reached record levels in 1972. Average net income in the District amounted to $4,069 per farm, 19 percent above a year earlier.

District businessmen and bankers remain confident about the general economic outlook. Nearly two thirds of the banking respondents expect improvement in business activity in their areas in the next two or three months.

SIXTH DISTRICT--ATLANTA

Businessmen and bankers expect a robust expansion of economic activity to continue. A boom appears to be developing in commercial construction. There is upward price pressure on autos and furniture and construction materials. Scattered shortages of construction and manufacturing workers are reported.

In the past month, plans for a large number of hotels and motels have been announced. Among the largest projects are a 31-story hotel for Atlanta, a 33-story hotel for Nashville, and a 19-story hotel for Jacksonville. Two new budget motel firms have sprung up in Atlanta with plans to build six motels in various locations in the District. A luxury motel chain has also been founded in Atlanta; its first project will be a motel near Orlando, and additional projects are planned in three other District locations. In addition, there have been several announcements of smaller motels.

There is much other prospective commercial construction. Announcements include: a twelve-story bank building in Jacksonville, an $18 million airline company facility in Atlanta, twin ten-story towers in Tallahassee, a $12 million civic center in Huntsville, a $100 million commercial-residential project in Jacksonville, a $4 million office building in Atlanta, a $3.5 million office building near Clearwater, and four shopping malls.

Announcements of residential construction projects continue to be relatively few. Accommodations for up to 22,000 residents will be built within Disney World. A $6 million condominium is planned for Jacksonville. However, residential construction contractors are worried about labor shortages and rising prices of materials and land. Because of a gas shortage, a brick producer in Tennessee had to cut production, and normal delivery delay has now extended to sixteen to twenty weeks. A scarcity of concrete blocks and lumber is reported. One Florida real estate dealer fears a "condominium crash" because of overbuilding.

Announcements of new plants and plant expansions continue brisk. A Tennessee banker reports that businessmen are being less conservative about capital expenditure projects, and new-plant inquiries are at the highest level in three years in Tennessee. A $24 million newspaper plant will be built in Tampa. A tire company is expanding its plant in Huntsville, and three new industries are planning to locate there. There have been several announcements of relatively small plants that will manufacture building materials and shoes.

Retail sales are reported to be strong, and many retailers are expecting a banner year. One auto dealer in Tennessee said that inventories are scarce. He reports that popular models are selling at sticker prices or even above and that dealer profit margins should double this year. In order to get cars, one dealer offered to buy thirty luxury cars from another dealer at $750 per unit above dealer cost. A furniture dealer reports strong consumer demands have pushed up prices and strung out deliveries. Newspaper and radio advertising revenues in the Nashville area are described as "remarkable". Some tourist areas are looking for a robust 1973. Some national chain stores are reportedly reluctant to increase prices and are willing to shave markups.

A few aerospace and defense-related layoffs have been announced, but labor shortages continue. Construction and manufacturing laborers are in short supply in several areas, and hotel jobs in Atlanta are going unfilled. The job market for college graduates has picked up appreciably at the University of Tennessee and at the University of Jacksonville.

SEVENTH DISTRICT -- CHICAGO

The general economic picture in the Seventh District is the most vigorous in many years, certainly since early 1968. Prices of industrial goods are rising at a faster pace. Reports of shortages of skilled or trainable workers are increasingly common. Lead times are stretching out, very sharply in some cases, and there are indications of a cumulative impact on orders as firms attempt to assure their lines of supply. Inventories are low, and attempts to rebuild inventories relative to sales are unsuccessful in many cases bacause of rising shipments. Considerable confusion exists on the part of those who attempt to reconcile various official statements on Phase Three. The tendency here is to discount reports emanating from eastern centers that a significant slowdown, even a recession, is probable by the fourth quarter--assuming, some add, no critical "money crunch".

Except for higher prices of imports, the dollar devaluation and the continuing international monetary crisis have been taken calmly by Mid-west businessmen, so far as we can determine, and have not influenced domestic plans or expectations. Those selling abroad often have plants abroad or use licensees. Despite increasing foreign demand and more competitive United States prices, there is little interest in pushing foreign sales. Businessmen point out that a large share of foreign trade, both in imports and exports, is in "noncompetitive" items.

Each month additional firms report that they have joined the main-stream of the vigorous business uptrend. This has been most significant re-cently in the case of capital goods associated with expansion rather than renovation, such as overhead cranes. Mining equipment, which had been in a slump, has revived again.

Despite nagging concerns of various sorts, business sentiment is ebullient. Nothing is so conducive to "confidence" as rising sales and orders accompanied by rising profit margins. A typical report shows sales up 15 percent and profits up 25 percent last year, with similar gains expected for 1973.

For fear of "rocking the boat" there will be great reluctance to "get tough" in upcoming union negotiations. The 5.5 percent (or 6.2 percent?) wage guideline is looked upon as a dead letter for union negotiations. Earlier hopes that some unions would be satisfied with cost-of-living adjustments plus some fringes, such as dental care or voluntary overtime, appear to be fading. Aside from current needs, firms facing possible strikes later this year will try to build inventories to strengthen their bargaining position.

In addition to rising output, sales, orders, and employment, purchasing agents report longer lead times and increasing quality problems. Higher prices are being paid for a long list of items, both hard and soft goods from both foreign and domestic sources. Lumber prices are described as "shocking". The Chicago report for February shows 87 percent paying higher prices, up from 60 percent a year ago and above the 83 percent peak month for 1969. In the Milwaukee group, 81 percent paid higher prices in February, equal to the proportion in the peak month of 1969.

The steel market is booming. Some mills are booked through the second quarter for cold-rolled sheet. Some quote August delivery. Steel importers who are unable to get assurance of adequate supplies from foreign sources are having difficulty getting booked on United States schedules. Some importers and some United States mills have stopped taking on new customers. It appears that United States steel mills could not supply all United States needs in 1973. Perhaps 10 million tons of imports will be required, even if the United States industry operates at capacity in 1973 with shipments of 100 million tons.

Availability of trained, or readily trainable, workers is said to be limiting output increases in some industries. A typical list of shortage occupations includes "electricians, auto mechanics, appliance repairmen, welders, machinists, tool and die workers, pipe fitters, and plumbers". A composite list could be extended to include almost any recognized skill.

Additional firms complain about lack of availability of components, especially metal fasteners, castings, forgings, bearings, but also more elaborate parts such as drives, couplings, and electric motors. Spokesmen say that business is the strongest since "1968" or "1966", "in ten years", even "since World War II". Part of the problem has been the closing of smaller plants and a rather sudden reduction in availability of foreign supplies, especially from Japan.

Construction may show weakness later in the year. New project developments have been slowed by environmental factors, overbuilding in some areas, financial problems, and fuel shortages. But currently, demand for all building materials is very strong, and many items are on allocation or critically short.

EIGHTH DISTRICT -- ST. LOUIS

Economic activity in the Eighth Federal Reserve District continued strongly upward and fears of accelerating inflation intensified in February and early March, according to a selected group of businessmen. Retail sales rose throughout the District with the exception of the St. Louis metropolitan area. Manufacturing activity expanded further. Construction continued at a high level throughout most of the District. Employment was up, and the unemployment rate generally declined. Banks reported further upward pressure on interest rates.

Retail sales at department stores in the Eighth District were generally well above year-ago levels in February and early March. The uptrend of the past year apparently continued throughout the District except in the St. Louis area where department stores reported little change in sales from a year ago. This is consistent with other economic trends for the St. Louis area. For example, even though the unemployment rate has fallen, employment in St. Louis declined about 2 percent in the past twelve months and at an annual rate of about 2 percent for the past three years.

Businessmen indicated widespread strength in the manufacturing sector. Representatives of all manufacturing firms interviewed reported rising output and sales. Sales by major chemical firms in the District continued to exceed year-ago levels by 10 to 15 percent. A representative of the aircraft manufacturing industry reported that orders for passenger planes are moving sharply up and that production is being geared to higher levels as a result of the larger incoming orders. The paper and paperboard-container industries are still operating at capacity, and representatives report that there will be little expansion in the near future as little construction of additional productive capacity is currently underway. The clothing industry likewise reported that plants were operating at capacity levels and that few plans were being made for plant expansion. Employment is increasing, however, at some of the clothing plants.

Construction continues at a very high level throughout most of the District. Contractors in northeast Mississippi are four to seven months behind their schedules and must wait six months to get delivery of bricks. Some builders in eastern Arkansas are postponing projects because of excessive demands for construction resources. Building is beginning to increase in St. Louis, where it has been at a relatively low level since 1970.

Employment continued to "inch up" throughout the District, and the unemployment rate continued to decline. Most firms reported some additions to their work force, and some manufacturing establishments reported that a second shift of production workers was being used. In general, labor markets continued to tighten for both skilled and unskilled workers. The January unemployment rate was down in most of the District, and it declined sharply in St. Louis where the rate was relatively high throughout last year.

Representatives of financial firms reported further upward pressure on most interest rates in recent weeks. Bank deposits have continued to rise, and savings at savings and loan associations continued up but at a somewhat slower rate than last fall. Loan demand has continued sharply upward. Savings and loan associations in St. Louis were lenders of funds outside the area last year, but they now report that local demand is picking up and fewer loans will be made elsewhere. Mortgage rates remain stable but are expected to rise later in 1973.

Agricultural conditions are generally favorable to farmers, with the exception of those operators who lost a large percentage of their 1972 crops because of unfavorable harvesting conditions. With the recent sharp increases in prices of farm commodities, there is sufficient incentive for expansion of output and larger crops are in prospect for the current year. Financing, however, may be somewhat more difficult for those farmers with low equities as a result of higher production costs and "tighter credit markets".

Inflation continues to be a major topic of discussion among businessmen. Such expressions as "now inflation is the chief economic problem" and "how do I hedge against the declining value of the dollar" were frequent during the recent survey. Most of those interviewed expressed concern about rising food costs.

NINTH DISTRICT -- MINNEAPOLIS

Bank directors are concerned whether Phase Three will be able to restrain price increases. One director feels that meat prices are at or near their peak but sees no large decline until 1974. Some directors report inventory overbuilding, while others reveal that excess inventories are not a problem. Farm production will be up this year which will place some strain on District farm suppliers. District manufacturers anticipate sizable sales gains in 1973.

Given the recent announcements concerning food price increases and the dispute between the Administration and organized labor over the 5.5 percent wage guideline, bank directors generally express concern about the Administration's ability to control inflation during Phase Three. Two directors indicate that people expect the rate of inflation to increase without question. One feels that Phase Three has lost its grip on the economy, unless the Administration takes some firm action to restrain wage and price increases. Another director states that uncertainty over Phase Three will not be dispelled until "flexibility" with respect to the 5.5 percent wage guideline is clearly defined. A Montana director reveals that prices of products purchased by his area's businessmen have been rising quite rapidly, and an upper Michigan director expresses concern over increasing food costs. One director, however, feels that it is too early to assess the impact of Phase Three, and another discloses that several businessmen in his area are not concerned about price increases.

With regard to food prices, one director believes that the peak for meat prices has been reached or is near. Many farmers, he believes, are currently refraining from marketing cattle in order to take advantage of expected price increases, and as these cattle come to market in the near future some decline in prices will occur. However, he does not expect a pronounced drop in beef prices until next year, since many farmers will hold heifers off the market later this year in order to be able to produce more cattle in 1974. Nor does he anticipate any large drop in hog prices this spring but believes hog production should expand noticeably by next fall which will dampen pork prices.

Directors' opinions regarding inventories are mixed. A Twin Cities area banker indicates that firms surveyed by his bank have not reported any inventory buildup and have generally not experienced a lengthening in delivery times, and a major Twin Cities area retailer indicates that his firm is not experiencing inventory problems. While a Twin Cities area manufacturer reports no speculative inventory buildup, he reveals that certain materials are becoming scarce and that delivery times are lengthening. Some danger exists, he believes, that demand may not be adequate to absorb rising inventories in the future. In the construction industry, according to another director, speculative inventory building is occurring. A South Dakota director discloses that slow delivery times are encouraging his area's businessmen to build up their inventories, while another director states that salesmen encourage businessmen in his area to increase their purchases in order to avoid future shortages. Several other directors report that their areas' businessmen have not experienced inventory problems or difficulty in procuring goods.

District farmers are planning to increase production this year which could place some strain on suppliers of fuel, fertilizer, and other crop-raising inputs. A recent newspaper survey of farm cooperatives discloses that Midwest farmers face a tight supply of fertilizer and fuel. Also, a major railroad may be unable to meet 40 percent of the demand for boxcars to haul fertilizer. According to a bank director, a critical shortage of farm machinery parts is anticipated in South Dakota, and reports reveal that farm machinery is becoming difficult to obtain in Montana and South Dakota. For example, the delivery time on a new tractor is now between six to eight months in South Dakota.

Our first-quarter industrial expectations survey discloses that District manufacturers look for sizable sales gains in 1973 with durable goods sales rising faster than nondurable goods sales. First-quarter sales are expected to be up 12.2 percent from a year earlier, followed by gains of 10.9 percent and 9.5 percent in the second and third quarters, respectively. In the fourth quarter of 1972, District manufacturing sales increased 16.7 percent, which surpassed the 12.8 percent advance anticipated three months earlier.

TENTH DISTRICT -- KANSAS CITY

Boom conditions prevail in the Tenth District. Growth continues in all major sectors, with the possible exception of residential construction. The agricultural sector is especially strong with a large volume of output being marketed at record high prices. Recent sales gains, reinforced by heavy orders, are encouraging manufacturers to build up inventories of materials. Shortages are thwarting their efforts somewhat, driving up prices and lengthening lead times. Transportation difficulties are slowing grain deliveries, causing country elevators to borrow heavily at a time when banks are experiencing very strong loan demand from other sources. Bankers are concerned about disintermediation; businessmen criticize the uncertainty, and doubt the effectiveness, of Phase Three.

Purchasing agents throughout the District continue to add to their inventories. Many buyers complain of lengthening lead times and late deliveries. They grumble about especially short supplies of sheet steel, textiles and paper, castings, petroleum derivatives, copper materials, and certain plastics and chemicals. Machine tools also are more and more difficult to come by, as are electric motors, glass bottles, refrigeration controls, pressure gauges, and radio-TV components. One agricultural supplier cannot get enough 1,000 gallon fuel storage tanks as farmers buy up those available, apparently planning to hoard gasoline so as not to be caught short again.

Prices of some materials have increased sharply in recent weeks. The cost of goods bought abroad jumped up following the devaluation. Most other big price increases appear to reflect market forces; they are confined largely to products of those industries operating at capacity. Virtually all prices, however, are increasing. Purchasing agents are optimistic about business this year, but they doubt that Phase Three will effectively curb inflation. Some worry about 1974, because "recession follows inflation".

Boxcar shortages have severely restricted grain movements from country positions to terminal ports for exporting. Many elevators are unable to deliver grain in accordance with contractual agreements that were negotiated several months ago. Some penalties have been assessed for failure to make delivery, but by and large the exporters and processors are taking a lenient stance because of the transportation bottlenecks. Nonetheless, the inability to deliver grain has created huge credit requirements to refinance inventories and to meet higher margin requirements on short hedges in the future market because of high grain prices.

Commercial banks and banks for cooperatives (BCs) have reported sharp increases in loan demands from country elevators. Two of the BCs headquartered in the District indicated that outstanding loans are roughly double those of a year ago, with about 40 percent of the increase coming in the last two months. Even if the marketing channels should open soon, which appears doubtful, any reduction in the amount of credit outstanding for grain will be largely offset by normal seasonal increases in loans to finance farm supplies. On balance, most country elevators are expected to come out of the current situation intact due to the availability of credit when it was needed.

Besides the extraordinary loan demands of grain elevators, District commercial bankers report very strong loan demand from other sectors. Commercial and industrial, consumer instalment, and agricultural loans have all been expanding at greater than normal seasonal rates in the past month. Respondents cited the vigorous pace of economic activity as a major source of loan demand, but a number mentioned specifically the impact of higher prices on the nominal financial needs of borrowers. In particular, sharply higher prices paid have greatly increased loan requirements for livestock feeding and other agricultural activity. Several banks reported that, because of relative interest costs, larger national firms had borrowed from banks instead of selling commercial paper. A month ago this was an insignificant factor in the lending activity of Tenth District banks, which have relatively few large national accounts and are called upon for such financing to a greater extent during periods of tight credit and misaligned rates.

Total deposits at large District banks rose moderately in February, roughly in line with the normal seasonal pattern. However, this came about through a somewhat unusual combination of sizable demand deposit outflow (primarily from state and local government accounts), a miniscule inflow of consumer savings deposits, and a large increase in certificates of deposit (CDs). Despite their apparent success in selling large CDs, more bankers seem concerned about disintermediation than was true a month ago. A few asserted that rising market rates had already affected their deposits. A greater number felt that the maintenance of present Regulation Q ceilings, along with restraints on lending rates, would put them in a difficult position in the near future.

ELEVENTH DISTRICT -- DALLAS

The economy of the Eleventh District continues to advance as 1973 unfolds. Industrial production in Texas rose to a record level in January, and total employment in the five District states continued to expand. Construction activity in the District states also increased in January, and District department stores sales showed monthly as well as year-to-year increases in February. New automobile registrations fell in January but were still well ahead of their year-earlier pace. The results of a recent survey of our directors who are bankers indicate that business in the Eleventh District is likely to improve still further over the next six months but that inflationary pressures are also likely to mount.

Most responding bank directors feel that business conditions in their communities have improved over the past three months and are likely to continue improving over the next six months. While the majority foresee little change in the rate of increase in consumer prices during the first half of 1973, most believe that the rise in consumer prices will accelerate in the second half of the year. The majority also indicated that the introduction of Phase Three caused them to alter their expectations with respect to future price movements, and they now believe that prices will rise much faster than previously anticipated. About half the directors improved their expectations of future business conditions because of the recent devaluation of the dollar. The remaining half indicated no change in their outlook.

Most respondents expect short-term market rates of interest to increase over the next six months, but only a few expect substantially higher short-term rates. The majority anticipate little change in long-term rates, although some expect a moderate increase in these rates. None expect either category of rates to be lower. Almost none of the respondents anticipate that the prime lending rate will rise above 7 percent at either midyear or the year-end.

In reply to questions relating to their particular banks, our directors indicated that business, consumer, and mortgage loan demand strengthened moderately during the last three months. Only agricultural loan demand remained essentially unchanged. Most respondents did not essentially change their willingness to make mortgage and agricultural loans during the last three months. A few were even more moderately willing to make consumer and business loans.

Taking into account their expectations for loan demand, our directors generally rated funds either very available or moderately available at their banks. Slightly more than half are aggressively seeking large certificates of deposit (CDs). While the majority were paying less than 6 percent for 30- to 89-day large CDs, most were paying between 6 and 7 percent for CDs with maturities beyond 89 days. The Directors split half and half as to whether they expect disintermediation of savings and time deposits in the coming six months.

The seasonally adjusted Texas industrial production index rose to a new high in January after easing slightly the month before. Both the manufacturing and mining components increased, while the utilities components fell slightly. In manufacturing, both durable and nondurable goods industries shared in the monthly rise.

Oil allowables for the District states were left unchanged in February, permitting maximum production of crude oil except for a few fields in Texas that are partially restricted for conservation reasons. With the prospect of gasoline shortages in the near future and the difficulty of getting enough low sulfur crude from abroad, refiners in the District are finding themselves in a production bind.

Seasonally adjusted total employment in the five southwestern states rose substantially in January. Nevertheless, the unemployment rate remained at 4.1 percent slightly higher than a year ago.

The value of construction contracts awarded in the five southwestern states continued to rise in January. Both residential and nonresidential building in the five-state area rose from December levels, while nonbuilding construction fell moderately.

Sales of department stores in the District continued to rise above year-ago levels in February. Cumulative sales for the first two months of the year were significantly above the level for the corresponding period last year in all five metropolitan areas for which data are regularly published. The total number of new automobile registrations for the four largest metropolitan areas of Texas -- Dallas, Fort Worth, Houston, and San Antonio -- fell in January from the December level, although the San Antonio area reported a slight increase. Nevertheless, the level in January is still more than 30 percent higher than in January a year ago.

Agricultural activities in the District have been hindered by cold and wet weather conditions. However, the winter wheat crop is making good to excellent growth as moisture is adequate. Farmers of the five District states sold nearly $7.3 billion of farm products in 1972. This is 15 percent above 1971 and established a new record for cash receipts from farm marketings. This higher cash flow level has been reflected in increased expenditures for land and capital items.

TWELFTH DISTRICT -- SAN FRANCISCO

In the opinion of our directors, the present expansion in the national economy will continue at least through mid-1973. Consumer spending and business investment expenditures are seen as being particularly strong. Construction activity remains on a high plateau, with commercial building showing considerable strength, but a significant decline in home building is expected by midyear. Combined with the overall optimism, there is concern on the part of some directors about inflation and the effectiveness of Phase Three in restraining wage increases.

Most directors believe that a vigorous economic expansion will continue throughout the first half of 1973. Others think that a slowing will occur in the second half of the year, and some believe that the turning point will be delayed until 1974. Estimates of the growth in GNP range from 9 to 10 percent annually, with the real increase being from 5 to 7 percent.

Consumer spending, especially for automobiles and durables, is described as vigorous in most areas of the District. Retail sales in California, for example, are thought to be running 10 percent above last year's level. Plant and equipment expenditures are rising in most areas. Spending is increasing for pollution-control equipment as well as for expansion of productive capacity.

Overall construction activity shows no signs of slowdown, although a decline is expected in the second half of the year. One director attributes this strength largely to commercial construction. He estimates that this type of construction accounts for 25 percent of the increase in completions in the San Francisco Bay area and for 15 percent in southern California, compared with 8 percent nationally. Part of the recent jump in California building permits is ascribed to attempts to start projects before new environmental controls take effect. Whether commercial building activity will be sustained is not certain; one large bank expects a substantial decline in commercial construction in the San Francisco area because of aerospace and government cutbacks. Several directors also expect a significant slowdown in residential construction by midyear. Contrary to most observers, some directors think that the building mix will shift more to apartments, and away from single-family residences.

Inflation is viewed as a serious problem by many directors. There is some doubt about the effectiveness of Phase III, especially in restraining large wage increases in upcoming major union-contract negotiations. Some directors urge a more restrictive fiscal policy as a means of reducing the burdens on monetary policy.

A few directors feel that international conditions are causing considerable uncertainty and disrupting trade patterns. Most directors expressed little, if any, concern over the recent devaluation of the dollar and believe that it should help stimulate exports.

Agricultural prospects are viewed as favorable for most crops, and reportedly have contributed to higher farm investment expenditures and a strong demand for land. Feeder cattle prices are at record highs. High prices have encouraged heavier plantings of wheat, potatoes, and feed grains, but lower prices are expected by some directors later this year if export demand should fall.

Bankers generally report strong loan demand, both by businesses and consumers. Although a few report deposit runoffs and rising loan-deposit ratios, most bankers think they can meet their customers' loan demands without experiencing major liquidity problems. One bank estimates a 13 percent increase in its business loans for the year, but also expects a late-year slowdown in real estate and consumer loans. Interest rates are expected to be higher, with short-term rates rising the most. The higher rates paid on time and savings accounts may not be matched by higher lending rates, and therefore several bankers expect a profit squeeze.