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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 indicate that the current vigorous expansion is increasingly straining capacity. Raw material shortages, lengthening delivery times and difficulties in finding skilled labor are emerging. Inflation is again the major economic concern with recent price increases rekindling inflationary fears.

All districts reported continuing gains in economic activity, with most Banks describing business conditions in terms like "robust" (Atlanta), "expanding at a rapid pace" (Cleveland and Dallas), and "strong" (Minneapolis).

The labor picture, however, varies sharply among districts. Dallas reports the unemployment rate dropping to 3.6 percent, while the First District is still experiencing unemployment rates above 6 percent. Philadelphia reports modest gains in employment, while Chicago, Cleveland, Dallas, Atlanta, and St. Louis have tight labor markets with significant skilled labor shortages.

Growing raw material shortages and lengthening delivery times were also mentioned by most Banks. Shortages of petroleum products, wood products and nonferrous metals were cited by New York, while gasoline rationing was noted in parts of the Atlanta and Dallas districts. The Dallas Bank reports that oil companies believe that rationing is a "definite possibility" and Chicago reports that fuel shortages in the Midwest are the "worst in the world" with oil firms refusing new customers and placing ceilings on

*Prepared at the Federal Reserve Bank of Boston.

sales. The concern expressed by a New York director that "widespread raw material shortages -- rather than plant capacity -- seemed likely to lead to production bottlenecks over the coming months" appeared evident in many Bank reports (Boston, Kansas City, Cleveland, St. Louis, Chicago, and Atlanta).

High levels of construction activity were described by several Banks. Residential construction is described as strong (Atlanta, Chicago, St. Louis, Kansas City, and San Francisco) despite rapid price increases (Kansas City and Atlanta) and recent increases in mortgage rates (Kansas City, Cleveland, and Chicago). Commercial construction is reported as heavy by Atlanta, but "spotty" by St. Louis,and Dallas notes a recent decline in contract awards.

Capital spending by business is a major source of strength. New plant construction and expansions are reported (Atlanta, St. Louis). Boston reports that the machine tool industry is experiencing rapidly rising orders and backlogs double those of a year ago. Chicago and Cleveland report that steel mills are operating at full capacity and that "near-boom conditions" exist in manufacturing in their districts. Chicago reports that one large steel producer has started rationing, because orders exceed capacity.

Most Banks reported mounting concern about inflationary pressures and many district reports noted dissatisfactions with Phase 3 (Boston, New York, San Francisco). The feeling that Phase 3 has triggered "a new wave of inflationary expectations" (New York) and that inflation was again the major economic problem was widespread. Philadelphia reports that two-thirds of surveyed firms are currently encountering rising costs for raw materials and over half are charging higher prices for their goods. Boston notes that skyrocketing price increases for materials appear to be coming from medium-sized firms which are not being carefully scrutinized under Phase 3 rules.

District reports on agriculture do not indicate any immediate alleviation in the supply-demand imbalance. Heavy rains are reported as delaying plantings (Kansas City and St. Louis) and hampering the movement of livestock to market (Kansas City), while transport delays have held up grain shipments (Chicago). Dallas, however, reports favorable conditions in the Southwest and the shifting of acreage into crops in short supply. Cleveland, Chicago, and Kansas City report that farmers responded to the meat boycott by withholding supplies, thus keeping up prices, but that this may lead to heavy marketings in the coming weeks.

Bank loan demand was described as very high (San Francisco, Chicago, Richmond, St. Louis, Kansas City, Boston). Reactions to the proposed dual prime rate were mixed, but those commenting saw administrative complications. San Francisco notes concern that the two-tier system will be "the first step toward a complex system of selective credit controls," while Kansas City and Minneapolis report concern that the community's size or whether it is a national or regional borrower be taken into account in defining large and small businesses.

FIRST DISTRICT -- BOSTON

New orders are reported as very strong in virtually all business lines, with capital goods orders especially heavy. Supplies are very tight and little inventory building is occurring. Concern was expressed about large price increases by suppliers and the lost feeling that we are licking inflationary psychology. Bank directors were worried about heavy loan demand, both in terms of the lowness of the prime rate and banks' inability to attract demand deposits.

The machine tool industry is reported as doing very well. One large manufacturer of capital goods reports that new orders are very, very good, and that backlogs are double those of a year ago. Despite the fact that the unemployment rate in Connecticut is close to 6 percent and over 6 1/2 percent in Massachusetts, capital goods manufacturers in both states are experiencing problems in getting skilled workers or even apprentices. Excellent foreign and commercial orders for helicopters have raised prospects for one aerospace manufacturer, although the defense industry in New England is still suffering from cutbacks in defense spending. According to one director associated with a large conglomerate, everyone is having difficulties in getting supplies. From a situation not too long ago when delivery was almost overnight, there are now delivery waiting times for everything from packaging materials to machinery.

Sky-rocketing price rises by suppliers were noted. These price increases appear to be concentrated among moderate-sized firms (those employing hundreds rather than thousands of employees) which are not being carefully scrutinized for price increases under Phase 3. Our directors feel that the lack of enforcement power for following guidelines is the problem. One director also reports a return to the psychology of hoarding, shortages, and creating artificial shortages. As an example of the latter, he notes that the paper industry is no longer making certain lower grades of paper, forcing buyers to pay for higher grades of paper than they need.

Bank directors report heavy loan demand. One large Boston bank director expressed the opinion that some business firms are drawing down loan commitments at the bargain prime rate to buy CD's in New York. Another bank director noted that he has had to use the discount window quite heavily to meet the legitimate loan needs of his business customers because he cannot attract demand deposits with current interest rate ceilings. Savings deposit inflows in March, however, were reported as strong, reversing February's performance.

The monetary policy recommendations of our academic correspondents, Professors Eckstein, Samuelson, and Wallich, fell into three distinct categories. Samuelson, citing Alan Greenspan's projection of a $20 billion boom in inventory investment in 1973, urged a more active policy of "lean against the wind." He suggested a monetary growth rate of under 3 percent for the next two months. Wallich, who felt that the expansion is still reasonably well balanced, urged that policy tighten "a notch," specifically that monetary growth be in the 3 to 5 percent range. He argued that recent price developments could be viewed as a bulge, due to the transition from past decontrol or to anticipated future recontrol. Eckstein, concerned with the lagged impact of policy, advised a 5 to 6 percent money growth target. Sensitive prices, he reminded, are an indicator which has moved early in a cycle and, if history is any guide, will soon begin to decline. He felt the greatest risk at present would be that the Federal Reserve will overreact to this development which, he estimated, will have only a modest impact on final list prices. More importantly, the wage round settlements have not as yet deteriorated, despite other price behavior. Eckstein warned that bank loan demand over the next few weeks (and again in June) will be unseasonably large due to tax payments. He believed that obligations are exceptionally large and have been underestimated by the Treasury.

SECOND DISTRICT -- NEW YORK

The second district directors that were recently contacted continued to point to a strong business outlook. Consumer spending and business plant and equipment outlays were said to have remained at a high level, and the devaluation of the dollar in general was expected to lead to an improved international trade balance. However, there were continued reports of further tightening in labor markets, of growing shortages of fuel and raw materials, and of imbalances between the demand and supply of food which current consumer resistance to high food prices would do little to correct. As a result, concern over mounting inflationary pressures, and skepticism over the capability of Phase 3 to cope with such pressures, continued to be expressed.

Retail sales were reported as generally strong, and it was noted that the income tax refunds now being paid would provide added stimulus in the months ahead. One director felt that the currently high level of auto sales -- which he characterized as of boom proportions -- in part reflected some "buying ahead" in anticipation of higher prices resulting from the additional antipollution and safety equipment scheduled for the 1974 and 1975 models. As in previous months, a number of directors reported that retail sales were stronger in the suburban shopping areas than in innercity outlets. One director noted the recent softening of consumer confidence, probably reflecting concern over inflation, indicated in some recent surveys; however, this director felt that consumer spending would nonetheless be strong.

The trend of business plant and equipment spending was also characterized as strong by a number of directors. A similar assessment was implicit in reports of the Buffalo branch directors, who observed that while there seemed to be a pervasive gloominess among businessmen in their area, these same businessmen were forecasting continued strength in their own companies' performances. The chairman of the board of a large oil company noted the adverse effect of environmental controls on capital outlays in the petroleum industry, which were severely hampering the construction of deep ports to accommodate super tankers, new drilling operations, and the construction of the Alaska pipe line.

A number of directors reported that employment has continued at a high level in their area, with the availability of certain types of workers falling short of demand. A senior official of a large upstate manufacturer felt that the job market in general was gradually tightening, with skilled workers in short supply. Two upstate bankers characterized employment as at a very high level, with continued tight market conditions expected for the balance of the year. Another respondent noted that unemployment in the Buffalo area still remained relatively high, but looked for this situation to improve as steel and auto plants increased hiring. However, most directors commenting on the employment outlook for students this summer took a gloomy view of prospects in that area, partly because of cutbacks in federally funded student summer employment programs. Some of the directors observed that substantial youth unemployment over the summer was one of the most serious problems facing cities in their areas. The senior official of the large upstate manufacturing firm, however, felt that the outlook for student employment this summer was probably the best since 1969.

There were also further reports of growing raw material shortages, including petroleum products, wood products, and nonferrous metals. In the latter context, the president of a multinational nonferrous metals producing corporation reported there were indications that "hot money" had moved into the future markets for such metals. The same director also stated that widespread raw material shortages -- rather than plant capacity -- seemed likely to lead to production bottlenecks over the coming months, and that the energy crisis was the single most important problem on the economic horizon.

Concerning the impact of the recent dollar devaluation, a New York City banker reported that this move would tend to produce a "one shot" increase in his institution's earnings by virtue of its effect on income from its overseas investments. He expressed concern, however, over the extent to which this development might give rise over the long run to more widespread use of controls on the international flow of funds. The official of the oil company reported that the recent international monetary steps should eventually help improve the country's trade balance, although he felt labor costs and productivity remained the crucial factors in any lasting improvement. According to this director, one immediate effect of the devaluation has been to exert significant upward pressures on oil import prices. Similarly, the president of a multinational nonferrous metal producing firm stated the devaluation had heightened the pressure on raw material prices, particularly those of nonferrous metals.

Against this background, concern over the prospects of mounting inflationary pressures in general continued unabated. The New York banker felt that Phase 3 appears to have triggered a new wave of inflationary expectations, and stated that inflation was currently the major economic and financial problem facing the Nation. Another director felt that the elimination under Phase 3 of the day-to-day administrative delays in granting price increases was contributing to the rapid rise in prices (and would also contribute to a sharp increase in profits). According to most of the Buffalo branch directors, growing consumer resistance to high food prices by itself would not have a lasting effect. However, the directors felt that recent moves by the Administration to increase the supply of feed grains and imported beef should tend to bring about a levelling of prices by the last quarter of the year.

THIRD DISTRICT -- PHILADELPHIA

Third district business conditions are favorable and are expected to continue improving. Inventory investment is increasing and local businessmen expect it to continue upward for at least six months. Capital expenditures are holding steady. The employment picture is improving. Production is strong and construction is continuing at a high level. Area bankers have or can get funds to lend, but most are not aggressively seeking loan applicants because of the unfavorable prime rate. On the darker side, inflation still plagues district businessmen.

Manufacturing activity remains brisk. Forty-seven percent of the respondents to this month's business outlook survey report increases in new orders and sales, while 52 percent report increased shipments. However, the percentage of local firms experiencing decreases in production has increased somewhat from last month. The outlook is even brighter on the six month planning horizon; nearly 60 percent of the executives foresee increases in new orders and shipments.

The third district is experiencing continued modest gains in employment. While the majority of businesses contacted see no change in the labor situation, a large and increasing minority report taking on additional employees. Over 80 percent report that the length of their average workweek is unchanged, and 75 percent foresee no change in the length of their workweek six months hence. Looking further into the future, small improvements on the employment front are expected to continue into fourth quarter 1973. One-quarter of the responding firms plan to increase hiring by then.

Inventory investment is still increasing. Forty-three percent of the manufacturers surveyed report increased inventories over last month. These respondents foresee continued gains in the next six months too. Most firms anticipate increased capital expenditures six months from now. But the number of firms predicting an increase in their plant and equipment expenditures is down slightly from a month ago.

Area bankers contacted say that their demand deposits are up slightly above what they normally experience during this season. Savings deposits are about flat. Two banks said disintermediation was holding back growth in their savings deposits. All the bankers contacted indicated that they could get funds by selling CDs -- but they also noted that they were not anxious to do so because of the unfavorable downward pressure on the prime rate. Business and consumer loans are up slightly. Mortgage loans are flat at the same high levels as past months.

Inflationary pressure is still heavy. Two-thirds of the surveyed firms are currently encountering rising costs for raw materials, and over half are charging higher prices for their goods. Long range inflationary expectations are even higher. Over 80 percent of the firms expect to be paying higher prices, and 64 percent expect to receive higher prices, in the next six months.

FOURTH DISTRICT -- CLEVELAND

Economic activity in the district is continuing to expand at a rapid pace, but prices are under increasing upward pressure, and reports of shortages of skilled labor and materials are more numerous. Conditions in the manufacturing sector remain particularly strong, with lengthening lead times and shortages becoming more of a problem. The steel industry is operating at full capacity, and will continue to do so throughout the remainder of the year. Reports from business and financial executives reflect growing concern about the duration of the current rapid pace of economic expansion, particularly in view of the inflationary situation and the view that monetary and fiscal policies are becoming more restrictive. Cleveland banks recently raised interest rates on time and savings deposits. Finally, farmers in northern Ohio are conducting their own meat boycott.

The near-boom conditions in the district's manufacturing sector (mentioned in last month's report) continued in March, according to early returns from our monthly survey of district manufacturers. Purchasing agents in the greater Cleveland area complained that Phase 3 controls are not tight enough, and that price increases are widespread. March was the third consecutive month in which the overwhelming majority of firms paid higher prices; such price increases have not been reported for three successive months since the early 1950s. In addition, buyers reported that lead times are lengthening markedly and that shortages of materials are multiplying. Skilled labor is difficult to find, and firms are forced increasingly to expand overtime and some are going to a six-day workweek.

At a recent meeting in the bank, a number of chief executive officers, representing securities firms, manufacturers, and retailers in the Cleveland area expressed concern over inflation and economic prospects for next year. The security firm executives indicated that the weakness in stock prices is reflecting the inflationary climate and tightening monetary policy. They were apprehensive that there could be another credit crunch and, perhaps, a recession.

Economists from three major steel companies in the district report that their mills are operating at peak capacity. One noted that orders are coming in at a rate 30 percent higher than shipping capabilities, which is pushing lead times out. Some customers have been trying to place orders for fourth quarter delivery, but the company will not accept orders that far ahead at this time. Another steel firm reports that pollution controls are partly responsible for restraining production; some of the firm's steel furnaces are inoperative because they cannot meet the clean air standards. A third steel company reported that shipments are on a controlled distribution basis and order acceptance is being limited to prevent serious overbooking.

The three economists expect steel imports to decline during the second half of 1973. Steel customers report that foreign producers are reluctant to make commitments for the second half because of strong world demand. Some foreign steel items -- particularly those in heavy demand -- are now more expensive than domestically produced items. In addition, the recent no-strike bargaining agreement between the United Steel Workers and ten major steel companies (which assures an uninterrupted flow of steel) is expected to curb imports, and to eliminate the need for inventory stockpiling as a strike hedge.

During the past two weeks, Cleveland banks increased interest rates on consumer-type savings accounts by one-half percent to the regulation Q limits (banks had lowered their rate on savings in April 1971). Mortgage rates have generally moved up one-quarter percent (in some instances before the deposit rate adjustment, and in other cases afterwards). One bank contact suggested that increases in mortgage rates were in anticipation of a freeze on interest rates.

In the agricultural sector, farmers in northeastern Ohio conducted their own boycott last week by withholding their steers, hogs, and lambs from the market. Sales declined by 50 percent at the regular weekly stockyard auction in Cleveland, and cattle prices were bid up \$3 a hundredweight.

FIFTH DISTRICT -- RICHMOND

Results of our most recent survey of businessmen and bankers indicate that business conditions in the district continued to improve in the past month. More than 50 percent of the manufacturing respondents reported increases in shipments, backlogs and new orders. Retail sales were reported to have increased substantially. Banking respondents reported a high level of demand for loans, especially consumer and business loans. Construction activity remains at a high level throughout the district. In general, businessmen and bankers are highly optimistic about the economic outlook for the district although the degree of optimism among bankers is somewhat lower than last month.

District manufacturers continue to report rising business activity. More than 50 percent of the manufacturing respondents reported gains in shipments, new orders and backlogs. While gains were fairly widespread, producers of steel and synthetic fibers appear to be experiencing especially robust gains. One large synthetic fiber producer commented on a recent unexpected increase in the world demand for synthetic fibers, which increased the output of his firm. Reports from furniture manufacturers are mixed, although labor shortages continue to plague the producers. All manufacturing concerns producing materials directly related to construction activity are experiencing high levels of demand for their products.

While nearly 60 percent of the manufacturing respondents reported a decline in inventories, most believed that inventories were at appropriate levels. On balance, retail respondents reported increases in inventory levels during the last month. Forty percent of the manufacturing respondents indicated that plant and equipment capacity was lower than they would like it to be given current business conditions.

Manufacturers continue to experience little change in employment and slight increases in hours worked per week. More than one-third of the banking respondents reported increases in employment in their area. The tight labor supply situation was mentioned by several banking respondents located in the Carolinas. Wage and price increases were widespread with more than one-third of manufacturing and trade and service respondents reporting increases.

Retail sales are reported to be strong in the district. Two-thirds of the banking respondents reported that retail sales in their area had improved during the past month. All of the retailers responding to this month's survey indicated gains in sales over the previous month. In general, retailers appear to be very optimistic about the outlook for continued increases in sales.

Reports from bankers indicate that loan demand continues strong throughout the district. In particular, the demand for consumer and business loans appears to have gained momentum in recent weeks. Increases in consumer loans were reported by 75 percent of the banking respondents, while 60 percent reported increases in the demand for business loans. Construction continues at a very high level throughout most of the district.

Because of sharply higher farm prices and weather-delayed harvest of many 1972 late season crops, January cash receipts from farm marketings were up 28 percent over a year earlier.

Businessmen and bankers continue to be optimistic about the general economic outlook. While the degree of optimism among banking respondents is down from last month, more than one-half of the banking respondents expect improvement in business activity in their areas in the next two or three months.

SIXTH DISTRICT -- ATLANTA

Economic activity remains robust. The outlook for commercial construction appears particularly strong, and several new major plants have been announced. There is a growing consensus among businessmen that labor shortages are increasing and that resource and material shortages are worsening, causing delayed deliveries and increased costs. Businessmen foresee little relief from labor and resource shortages.

The outlook for commercial construction continues strong. Two office buildings and a warehouse are planned in Atlanta suburbs, and a five-story bank building is to be built in Savannah. Several hospital expansion projects have been announced, and a large number of highway construction projects are planned. The State of Louisiana has announced plans to build an $18 million school of veterinary medicine. A $2 1/2 million shopping center is to be built in Tennessee, and an Atlanta area shopping center will be substantially expanded. More motels have been announced, including a 12-story motel near the Atlanta Airport, a multi-million dollar beach front facility at Pensacola, a 170-room budget motel in Nashville, and 7 Ramada Inns in various district locations. A $600,000 ice skating rink will be built in the Atlanta area.

Residential construction is reportedly strong in New Orleans, Atlanta, and Jacksonville. Four 22-story condominiums will eventually rise in north Atlanta. Costs of homes are inflating so fast in the New Orleans area that builders are unwilling to quote prices even four or five months in advance. Some builders expect residential construction to slow as the year goes on. The rate of growth of residential construction is reportedly slowing in the Orlando area.

Several major new plant announcements have been made recently, including a $30 million plus paperboard plant in Alabama, a $30 million improvement and expansion of a Louisiana chemical plant, a $20 million plant in Alabama to produce air-cooled gas engines and electric-generating sets, and a plant to manufacture electrical goods in east Tennessee. A Japanese firm that manufactures zippers is planning to locate a plant in central Georgia with eventual employment of 2,500. New clothes manufacturing plants are scheduled for Tennessee and Louisiana. A box fabricator is building four miniplants in Atlanta. A $4 million plant to build shipping containers will be built in Jackson. Two large businesses in the Pensacola area are issuing $125 million in industrial revenue bonds for pollution control equipment.

Shortages of skilled labor have been reported by firms in Louisiana, Georgia, and Florida. One Florida banker reports an increase in the number of labor disputes, with wage increases being the main issue. A telephone company executive says that his firm plans to hire 500 workers in the New Orleans area in the coming months. They expect to find it difficult to hire skilled workers and therefore, are hoping to find semiskilled workers who can be trained for higher-skilled slots. A Georgia insurance executive pointed out that the labor turnover rate in his business rose sharply last year. Textile and cement industries in central Georgia are having difficulty finding workers and are increasing purchases of productivity-increasing equipment.

Material shortages are evidently becoming more widespread. Bus companies in Atlanta, Columbus, and Macon, Georgia are having difficulty in obtaining diesel fuel. A retailing firm is limiting gasoline purchases at its south Florida stores to 10 gallons per customer because of difficulties in obtaining supplies. A heavy construction equipment manufacturer notes that many of his purchase orders to suppliers have been put on allocation and that continued expansion of the economy will, in his view, make the problem worse. A paper industry executive claims that his suppliers are trimming out marginal products in order to cut costs. A Georgia real estate developer says that materials can be obtained but only at exorbitant prices. There has been widespread flooding in the district, and a recent tornado in north Georgia did $113 million in property damage.

SEVENTH DISTRICT -- CHICAGO

The business upsurge continues in the seventh district. Virtually all industries and areas are participating. Reports of shortages -- raw materials, supplies, components, and skilled and trainable labor -- are spreading. The rise in employment has accelerated and is expected to continue. Upward pressures are building on wages and salaries. Except for products and services of large firms, prices appear to be rising at a faster pace. It is generally expected that monetary policy will not be so severe as to cut off the expansion of 1973.

The tightening of the labor market in this region since the turn of the year has been striking. Labor turnover has increased rapidly, causing some managers to "double up" on requisitions. Job hopping has increased especially for those who had been held back for two years by lack of alternatives. Night shifts are often undermanned, especially in large cities. Steel firms in the Gary area are sending recruiting teams to other areas for the first time in many years. Firms with reactivated apprenticeship programs complain that it is hard to get men to stick. Informed observers expect the typical labor settlement this year to increase compensation 7.5 percent on average. Cost-of-living adjustments and dental benefits will be sought in several negotiations. The UAW is pushing "voluntary overtime," a change which motor vehicle, farm and construction equipment producers maintain would drastically increase their costs. Insistence on voluntary overtime could lead to a "collision course."

The capital expenditure boom appears to be in its early stages. Order lead times for some equipment have stretched out to four or more times last year's quotations. (For example, certain machine tools that had been available in six months now require a two-year wait.) Some manufacturers of hydraulic excavators, materials handling equipment, and moveable cranes have stopped taking orders (presumably because of the need to quote firm prices). Some equipment assembly operations have been slowed to await missing parts.

Some firms, large and small, are weighing decisions on expansion projects that require new buildings. One large firm has extended its planning horizon on capital outlays beyond 1974, even though a business slowdown is assumed likely for early 1974.

The steel market is running away with new orders far in excess of capacity. (Doubtless, some panic buying is occurring.) Estimates of shipments for 1973 have been raised to 103 million tons or more. One large midwest steel producer has stated that it has started a program of "controlled order acceptance," a polite term for "rationing." Steel importers are seeking U.S. sources. The price differential on imports has narrowed or vanished, and availability has been curtailed.

Oil companies insist that price controls are hampering their operations and are intensifying shortages, especially in attracting supplies to areas of stringency. Fuel shortages in the Midwest are said to be the "worst in the world" because refining capacity is not sufficient here to satisfy demand, and because direct access to imports is limited. No new refineries are under construction, and prices of imports equal or exceed U.S. prices. Most major oil firms are restricting sales of gasoline by refusing new customers and by placing a ceiling on sales to customers.

Some large oil firms that do not have refineries in the Midwest are shrinking their dealer organizations here.

Agricultural loans of large Chicago banks are double year-ago levels, mainly because of larger loans to cattle feeders and for grain storage. (Transport bottlenecks have delayed grain shipments.) Supplies of fertilizer are limited. Reports tell of shortages of farm tractors with order times on the popular larger tractors out to six months.

The meat boycott apparently reduced meat sales substantially last week, but there has been little effect on prices. Several district packing plants have sharply reduced operations. Farmer's withholdings of animals could cause heavy marketings in the next few weeks.

Permits for new housing units in the Chicago area were far above last year's high level in January and February. Apartments were especially strong, but home permits were also up. Some builders are said to be cutting back on plans because of shortages of materials, especially lumber. Premium prices are being paid for lumber, well above announced increases. Conventional mortgage rates have gone from 7 to 7 1/2 percent in the Chicago area in the past six weeks. Savings inflows to S&Ls have slowed from last year's record volume.

Business loan demand at banks remains very strong, beyond expectations at the start of the year. Large banks would like to cut off the shift from the commercial paper markets, but are not always able to tell which loan applications are involved. Starting in February, life insurance companies experienced a sharp rise in net disbursements on policy loans.

EIGHTH DISTRICT -- ST. LOUIS

A group of businessmen in the eighth district are optimistic that the business uptrend of recent months will continue through 1973. Retail sales at major department stores rose throughout the district in March. Manufacturing activity continued up, and more firms reported operations at capacity levels than a month ago. Also an increasing number have made plans for plant expansion. Construction remains at a relatively high level. Employment continues to rise. Loan demand at banks and savings and loan associations continues to grow faster than savings. Following a lull in January, seasonally adjusted retail sales by major firms in the eighth district turned up in February and continued upward through March. The rise was more widespread in March than heretofore.

Manufacturing activity continued to expand in March, and output is now approaching reported capacity levels in most industries. Typical comments were: industry is operating at full capacity, the supply situation is very tight, we need additional capacity for many items, and employment is at a peak with present mill capacity.

In the eighth district a strong upward movement in capital spending on plant and equipment is apparently underway. Plans for increasing capital investment in 1973 over 1972 levels were reported by electrical equipment, paperboard and chemical manufacturing companies. Demand for paperboard containers, however, is still expected to rise faster than the productive capacity for another two years. Industrial expansion is most pronounced in Arkansas, Kentucky, Mississippi, and Tennessee. There has been very little industrial expansion in St. Louis during the past three years.

Eighth district construction continues at the relatively high level reached more than a year ago. Residential building is at a high level throughout the district, but commercial and industrial building is quite spotty, varying from generally high in the southern portion of the district to sluggish in St. Louis. Building materials are reported to be in very tight supply over most of the district, with deliveries six months or more behind schedule in some locations. Part of the problem reflects the sharp increase in demand for freight cars which became noticeable with the step-up in grain deliveries to seaports for export. In part, however, it reflects a sharp increase in demand for raw materials such as pulpwood and sawtimber.

Employment has continued up in recent weeks, but the lack of more manpower is reported to be limiting real output in an increasing number of communities. Some of the businessmen interviewed reported that all people wanting and willing to hold a job are now working.

Bankers reported that loan demand was very high and deposit growth was slowing. Upward pressure on interest rates continues. However, those interviewed reported that quoted rates had not been increased on consumer installment and real estate loans.

Many farmers are pessimistic about planting 1973 crops as a result of the excessive rainfall and flooding in recent weeks. Some have estimated that it will require 10 days or more of sunshine after rainfall ceases and the water recedes from the flooded areas before machinery can be used in the fields. On the optimistic side, however, are the high prices for farm products and the expected high farm incomes this year.

Inflation continues to be a major topic of concern among businessmen as well as among consumers. Most businessmen foresee little abatement in the rate of inflation from the trend rate of recent years.

NINTH DISTRICT -- MINNEAPOLIS

Economic activity so far this year has matched expectations, and bank directors look for business to remain strong for the rest of 1973. District retailers report sizable first quarter sales gains and expect business to remain good. District labor markets have tightened considerably in recent months and some manpower shortages are beginning to emerge. One director looks for only a modest expansion in livestock production in his area this year, while another anticipates a noticeable increase. Most directors foresee some further advances in interest rates and view the two-tier prime rate proposal favorably.

According to our directors, no noticeable erosion of consumers' confidence has occurred. Businessmen generally look for business to remain strong throughout 1973, but they are uncertain about the economic outlook for 1974. Inflation is generally considered this year's major threat to the district's economy. A primary concern in the district's agriculture areas, however, is that the Administration's efforts to curb food price increases could reduce farm income.

A telephone survey of large district department/discount stores and automobile sales managers indicates that district retail sales remained strong in the first quarter of 1973. Large retailers with outlets located primarily in the Minneapolis/St. Paul metropolitan area reported first quarter sales gains ranging from 8 to 12 percent over the first quarter of 1972. Year-over-year increases in the number of autos and trucks sold during the January-February period ranged from 9 percent to 28 percent among the regional automobile sales managers surveyed. District retailers and automobile sales managers expect brisk sales growth in the months ahead. Retailers state that a late Easter this year should boost second quarter sales gains, and both retailers and automobile sales managers are counting on the Federal income tax refunds to have a noticeable impact on sales.

The district's unemployment rate has declined approximately one percentage point since last fall and some labor shortages are starting to emerge. Minnesota job vacancies in manufacturing, for example, in early 1973 were three times as great as they were a year ago. Two directors find that skilled labor is becoming difficult to hire, but unskilled workers are plentiful. Another director states that fewer workers are applying for jobs at his firm's plants. A South Dakota director reports shortages of both skilled and unskilled workers and states that a lack of farm laborers could hurt agricultural production in his state.

Directors' views concerning livestock production in 1973 vary. A South Dakota director looks for only a modest expansion in livestock production for several reasons. Older farmers in his area would rather remain liquid than tie up funds in livestock production, while younger farmers have difficulty obtaining necessary capital. Uncertainties surrounding pollution control requirements in South Dakota also mean that farmers are unclear about the costs involved in expanding livestock production. Furthermore, current market conditions have dampened farmers' enthusiasm to expand their production, and memories of hog overproduction in 1970 and 1971 tend to make farmers cautious. On the other hand, a Montana director looks for a sizable increase in his area's livestock production.

Although directors' responses vary, most agree that commercial bank interest rates will climb further. Commercial bankers in one director's area believe that interest rates could advance another one-quarter to one-half of a percentage point. One director thinks that interest rates won't peak until late summer or early fall, and another that the Committee on Interest and Dividends will largely determine future interest rate movements. One director expects interest rates to remain at their present levels.

Some directors endorse a two-tier prime rate, while others express reservations. One twin cities area director indicates that his bank has already implemented a two-tier prime rate and is charging 6 3/4 percent on loans over $500,000 and 6 1/2 percent on loans under that amount. Another director feels that the two-tier prime rate is a "great thing" because it provides a break for the small businessmen. In implementing a two-tier prime rate, two directors are concerned about defining "large" and "small" businesses and believe the community's size should be a factor in determining whether a business is considered large or small. One director also wonders how loans already tied to the prime rate will be handled under a two-tier scheme.

TENTH DISTRICT -- KANSAS CITY

Residential construction activity is going on at a rapid pace in most tenth district cities, especially for single-family structures. The rising cost and short supply of some construction materials are being felt by some builders and customers, but funds remain available -- though more expensive. Savings inflows to savings and loan institutions continue to be strong, as does mortgage loan demand. District commercial banks are also experiencing strong loan demands. Better weather conditions will probably bring increased livestock shipments, and the likelihood of a temporary dip in meat animal prices.

Executives of home builders associations in a number of district cities, representatives of several savings and loan associations, and some home builders, were surveyed to acquire additional information about the residential construction sector, and its financing. Aside from being slowed somewhat by bad weather, residential construction activity is generally strong in major urban centers of the tenth district -- with the exception of Albuquerque. Activity is stronger in single-family unit building than in multi-family structures, and there is still apparently no overbuilding of the former. There is a great deal of speculative building, and some tendency for a shift from custom toward speculative building, as contractors find little trouble in selling the latter. In Kansas City, for example, speculative builders generally have no inventory, with many units sold before completion.

The impact of the withdrawal of Federal subsidies has varied among district cities. The slowdown in construction activity reported for Albuquerque is attributed largely to the end of Federal subsidies for low income housing, and a lesser anticipated effect is reported from Omaha and Tulsa. All respondents stressed the rising cost of construction materials, especially lumber, and its influence on the price of houses. Furthermore, some materials are in short supply. Lumber is not only expensive but hard to get in many places, particularly in the types and grades desired. Bricks are also reported as hard to get in Omaha, Albuquerque, and Tulsa. Increases in the price of concrete and the possibility of a cement shortage were also mentioned. On the other hand, both builders and builders association executives described funds as readily available, although getting more costly.

Spokesmen for various savings and loan associations corroborated the rapid pace of home building activity and most of those surveyed believe that it will continue to be strong for a while. Mortgage loan demand and commitments were reported as "up," "way up," "out of sight" by most respondents, with Denver being the major geographical exception. Mortgage rates have already been increased in recent weeks by at least one-eighth to one-fourth of one percent by institutions in several district cities. A further "inching up" is anticipated if mortgage loan demand remains high. Savings inflows were very good in the first quarter, although some concern was expressed for the future. No serious disintermediation has been experienced yet by the institutions surveyed. However, one respondent called disintermediation "a definite threat in the rest of 1973," and another is worried about a large amount of deposits he considers "vulnerable."

Loan demand at tenth district commercial banks continues to be strong in almost all categories. Exceptionally strong demand has caused some banks to concentrate more heavily in commercial loans. The prime rate has risen to 6 1/2 percent at all survey banks, but there were few reports of credit rationing or tightening of nonprice loan terms. Nevertheless, several banks have become more diligent in enforcing compensating balances requirements, while others felt that rationing was imminent. Most banks have relied heavily upon purchases of Federal funds, CDs, and maturing securities to provide funds to accommodate loan demand. Outflows of demand deposits, savings deposits, and consumer-type time deposits have been larger than is typical for this time of the year.

Reactions by tenth district bankers to the proposed dual prime rate were mixed. Some bankers felt it would be wise to differentiate between national and regional borrowers, as credit demands are often quite different for the two groups. Others expressed the view that credit-worthiness -- not the size of the borrower -- should be the criterion for establishing loan rates, with a single prime rate serving as a benchmark. Virtually all bankers interviewed agreed that the dual prime system might be difficult to administer. The consensus seemed to be that, under the system, funds would still be available to meet the needs of small borrowers even when higher rates existed on loans to large borrowers.

Unusually heavy rains during March proved to be a mixed blessing for farmers and ranchers throughout the district. While valuable moisture was added to the soil for the new wheat crop, many of the low spots in the fields were flooded and heavily damaged. However, most, if not all, of this loss will probably be offset by higher yields in the undamaged portions of the fields. As a result of the wet weather, very few farmers have been able to start the field work that must be completed before the spring crops can be planted. Further delays will likely reduce corn yields and perhaps induce some substitution of soybeans.

The weather has also greatly impaired the movement of livestock to market, partly explaining the strong prices for cattle and hogs prior to the boycott. The boycott apparently has had an effect on the market, and producers have responded to reduced sales by shipping significantly fewer animals to market. On the whole, prices have not weakened substantially. An end to the boycott and better weather conditions will probably bring fairly heavy shipments of livestock, causing meat animal prices to dip rather sharply until this backlog is marketed.

ELEVENTH DISTRICT -- DALLAS

The economy of the eleventh district is continuing to expand at a rapid pace. Industrial production in Texas again rose to a record level in February, and total employment in the five district states continued to expand. Construction activity eased slightly in February, but remained substantially above its year-earlier level. District department store sales increased further in March, while new automobile registrations declined slightly in February.

The biggest concern of economists employed by business and financial institutions in the district appears to be the threat of renewed inflation. They do not attribute much of this concern to the introduction of Phase 3, however. The economists working for industrial firms indicated that the cost of goods used in their firms' production processes might increase somewhat as a result of Phase 3, but that prices of goods sold by their companies would not increase any faster because of the adoption of Phase 3.

Reflecting the growing tightness of labor markets in some areas of the district, several respondents indicated that their companies are experiencing some difficulty in obtaining skilled employees. None of the respondents indicated any problems in obtaining bank credit, although interest rates were expected to continue rising.

The seasonally adjusted Texas industrial production index rose sharply in February as the manufacturing sector continued to surge. Nonetheless, mining decreased for the fifth consecutive month and utilities increased only slightly. In manufacturing, only two industry groups --

petroleum refining and primary metal products -- failed to show an increase in February. The strongest production gains were reported in transportation equipment, textile mill products, and stone, clay, and glass products. All industries are producing over year-ago levels. In mining, the only reported increase in output was that of metal, stone, and earth minerals, as crude petroleum, natural gas, and natural gas liquids production all dropped in February. Utilities increased only slightly, as the drop in natural gas distribution almost entirely offset the increase in the distribution of electricity.

Although the Texas Railroad Commission permitted the Texas fields to produce at maximum levels again in April for the thirteenth consecutive month, the State's oil production has been declining since its peak in October last year. Part of the decline in January was attributed to weather, which will also be a factor in the expected drop for February. Moreover, although exploration has increased recently, the efforts have not been great enough to replace withdrawn reserves resulting from the heavy production over the past year. In spite of some government assurance that there will be no widespread rationing of gasoline this summer, rationing has become a reality in some areas and the oil companies feel that widespread rationing is a definite possibility.

Seasonally adjusted total employment in the five southwestern states continued to rise in February while the area's labor force fell slightly. The unemployment rate dropped sharply to 3.6 percent in February from a revised 3.9 percent in January. Both manufacturing and nonmanufacturing industries shared in the monthly employment rise. Major gains were reported in durable manufacturing, construction, and government employment. All industry groups reported year-to-year gains in employment.

The value of construction contracts awarded in the five district states fell in February from the month-earlier level. A sharp decline in nonresidential building was the cause of the overall drop, as both residential building and nonbuilding construction posted slight increases. Despite the monthly fall, the cumulative value of contracts awarded this year remained substantially higher than last year. Texas followed the district trend, although registering a small year-to-year increase.

Sales of department stores in the district continued to rise above year-ago levels in February. Cumulative sales for the first three 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. San Antonio, Houston, and Austin reported the largest increases. The total number of new automobile registrations for the four largest metropolitan areas of Texas -- Dallas, Fort Worth, Houston, and San Antonio -- fell in February from the January level. Although Dallas and Fort Worth reported increases, these were not great enough to compensate for the declines in Houston and San Antonio. Nevertheless, the cumulative sales of new automobiles this year were still almost 20 percent above last year.

Agricultural conditions in the Southwest remain favorable, and district farmers are planning to shift more acreage away from the production of upland cotton and into crops of short supply such as feed grains, rice, and soybeans. Winter wheat is progressing quite well and prospects are good for an excellent crop.

TWELFTH DISTRICT -- SAN FRANCISCO

Our directors report that the present economic expansion remains strong in the twelfth reserve district, with major growth indicators in most district states running ahead of the national average. Inflation remains the major economic concern: Some directors advocate more restrictive fiscal policy and stronger Phase 3 price controls; others believe that price pressures will ease, especially for agricultural and timber products, in the second half of the year. Bankers expect further increases in short-term interest rates, but they foresee no serious liquidity problems. A number of bankers commented on distortions introduced into financial markets by the CID's efforts to control the prime rate. General expectations are for continued strong growth with rising prices.

Consumer and business investment expenditures are reported to be high in all district states, and to be providing the main impetus for high overall growth rates in the West. Growth is especially strong in California and in the Pacific Northwest. In Oregon, the usual seasonal increase in unemployment did not develop this year, and the unemployment rate is below that for the Nation as a whole. Prospects for the Puget Sound area of Washington are excellent. Boeing Aircraft is increasing production, and payrolls are growing at Washington's defense facilities. Local agriculture, timber production and port activity also are experiencing an excellent year. Consumer spending is reported to be setting new records with department store sales in some localities 10 to 15 percent above last year's levels. Automobile sales also are high and would be still higher if dealer inventories were larger.

Construction activity in the district still shows no signs of decline. Recent high levels of residential and nonresidential building are being maintained, with apartment construction being the only area of weakness reported. A manufacturer of builders' equipment reports difficulty in meeting current demand. However, another director thinks that recent cutbacks in government spending and subsidies will slow down construction, especially construction of low-income housing, dams, and flood control projects.

Bankers report that loan demand by both businesses and consumers is very strong. No serious liquidity problems are expected, though many banks have been forced to sell short-term securities and bid up short-term CD rates to avoid a liquidity squeeze. Some bankers are concerned about the prospect of interest rate controls, and about the possible instigation of a two-tier prime rate system. The latter is seen as the first step toward a complex system of selective credit controls. Higher interest rates paid on time deposits are expected to squeeze earnings, because loan rates are not expected to rise enough to offset these costs.

The major short-run policy concern of our directors is the control of inflation, although a majority of them believe that price increases will moderate in the second half of the year, with increased agricultural production being an important element in the adjustment. Two directors reported that increased acreage will lower grain prices, and other directors think that meat prices also will fall as the result of increased supplies. Similarly, a director in Oregon forecasts that timber prices will begin to fall in mid-year, and by the end of 1973 market prices will be significantly lower.

A minority of directors see no slowing of price inflation, and are especially worried about coming wage settlements. One described Phase 3 as "a failure" and feels Phase 2 was ended too soon. These directors advocate the imposition of stronger controls, and feel that a tax increase also is needed.

Only two directors singled out international conditions as a major source of concern.