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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Economic activity remains strong across the nation. Consumer spending is consistently described as continuing to grow in each District. A high level of activity is also reported in most manufacturing areas, as order backlogs keep production at full capacity in most industries. In spite of some signs of weakness, construction is maintaining current volume and in some Districts, it is expanding. The principal economic problem concerns stabilization policy, and in particular, the price freeze. The price freeze is causing major dislocations in agricultural processing. At the moment, the effects in other sectors such as manufacturing and retailing are limited, yet some inequities are appearing which would become serious if the freeze should continue beyond 60 days. Credit conditions remain tight as banks face very strong loan demand.

Consumer spending is showing no sign of slowing. In part this is attributed to expectations of higher prices. Heavy purchases of durables are reported by retailers in the Minneapolis and San Francisco Districts. Automobile dealers are also experiencing excellent sales, particularly in the Dallas and Atlanta Districts. In Minneapolis, Richmond and Cleveland, a shift is noted toward smaller cars, and this is thought to be a reaction to prospective gasoline shortages.

Manufacturing activity is pressing against capacity in most Districts, and order backlogs show no sign of shortening. Shortages of many materials are developing, and according to the Cleveland and St. Louis Banks, they are beginning to affect production adversely. Chicago reports

*Prepared at the Federal Reserve Bank of San Francisco.

shortages in steel, castings, chemicals, and many other products; furthermore, delivery dependability and product quality have deteriorated. Farm equipment and parts are also in short supply in several Districts.

Construction, despite some expectations of slowing later this year, is at high levels in most Districts. Residential construction contracts increased in the Dallas and Richmond Districts, but Atlanta and San Francisco report forecasts of a construction slowdown later this year. Gasoline shortages are affecting tourism in such Districts as Kansas City and Minneapolis. In other Districts, shortages are not as severe, but the problem is causing some uncertainty and it is reducing demand for such products as recreational vehicles. Dallas reports its District refineries are turning out record amounts of gasoline; both Dallas and Chicago indicate, although there may be localized distribution problems, the shortage is not as severe as expected.

Despite a high level of activity, more concern is reported about prospective economic conditions in Philadelphia, Cleveland, and Atlanta. In contrast, the Chicago Bank describes local businessmen and bankers as seeing no sign of any downward trend. In other areas, the evidence is mixed; industrial equipment lines are at capacity in the Boston District, but orders for consumer goods are slackening. Inventories are variously reported unchanged in New York, lower in Richmond, and up in Philadelphia. In the St. Louis District, many industries are expanding production facilities, but in the Philadelphia area more firms are now expecting to decrease their capital expenditures.

Directors in several Districts are expressing concern over the direction of economic policy. Most feel that more emphasis should be given to fiscal policy. Reports for all Districts indicate various degrees of hostility to the present price freeze, ranging from belief that it is ill conceived to the opinion that it is disastrous. The common conclusion is that the freeze cannot be continued beyond the planned 60 days without serious problems developing.

The most serious consequences are now felt in agriculture and associated food-processing industries. The price freeze is cutting into livestock and poultry production. Feedlot operators and poultry producers are being squeezed by higher feed grain prices and fixed wholesale prices which do not cover costs. Food and grain processors in the Chicago, Richmond, Kansas City and San Francisco Districts have cut back or closed operations. Egg and milk production is expected to fall. Both St. Louis and Dallas forecast reduced beef supplies this fall as a result of the freeze.

In nonagricultural industry, the price freeze is beginning to cause dislocations. New York, Dallas and Chicago describe shortages caused by imports being hampered by low domestic prices. Some suppliers, according to the New York Bank, are exporting to obtain higher external prices and thus not filling domestic orders. Chicago lists a large number of devices that are beginning to be used by suppliers to evade price ceilings.

Banks in all Districts report strong loan demand. Real estate loans, in particular, are being restricted or tied to higher down payments. Kansas City banks report that the recent increases in prime rate are not discouraging business borrowing.

FIRST DISTRICT -- BOSTON

Our directors report that industrial equipment lines are operating at capacity, but that new orders for consumer goods are slackening. Outside of food processing lines, our directors can report no specific cases of hardship created by the freeze. However, disappointment was expressed that recent fiscal and monetary policy actions were based on political rather than economic criteria.

Industrial equipment lines for machine tools, fasteners, bearings, etc. are running at capacity. In some cases, lack of skilled labor is an additional supply constraint. Manufacturers, however, do not want to add to capacity at this time because they see this as a cyclical phenomenon and they don't think the boom is going to last much longer. For the first time, inventories are reported as substantially higher. This is accounted for by a rise in work in process and by hedge buying of supplies because of fears of future shortages.

New orders for consumer goods are reported as spotty. While most lines are doing well, some deterioration in new orders is noticeable. Manufacturers of recreational vehicles, which had been a booming area, sense a slackening of demand for next year. In most consumer goods lines, manufacturers reported they had no capacity strains. Retail sales in Connecticut were reported as disappointing but resort areas, like Martha's Vineyard, report higher retail sales and bookings than last year.

One director commented that the "price freeze has more inequities than we've ever seen" and another reported that the general opinion of businessmen in Connecticut is that "the damn thing won't work." While our non-food-processing directors could not report any specific cases of hardship, they could cite examples of inequities. For example, although a machine tool may have been ordered a year ago, if it was shipped during the first week in June, then that sale in June set the price for new orders for that kind of machine tool for the rest of the freeze, despite cost increases over the past year.

The price freeze and recent increases in the discount rate prompted one director to voice his concern over the politicization of economic decisions. He was skeptical that the recent rise in the discount rate was stabilizing, given economic forecasts. He noted that when boards of directors had tried to raise the discount rate earlier this year, when the signs were clear of a continuing boom, they were cautioned against doing so because it might anger Congress and lead to a freeze. This director found it disillusioning that the much-vaunted independence of the Fed was illusory.

Professors Eckstein and Samuelson both based their remarks on the preliminary indications, reported to the Board by Eckstein and Alan Greenspan, that real economic growth in the second quarter was about 3 percent. Samuelson welcomed this slowdown insofar as it reflects slowing of demand but warned that, to the extent it represents supply limitations (primarily in food and staples), it indicates "we are not yet out of the woods." Noting that the slowdown came primarily in the components where it had been expected -- retail sales, auto sales, and residential construction -- Eckstein attributed most of the slowing to the demand side. He also felt that recent wage behavior suggests that labor supply has not been the constraining factor; he acknowledged that the insufficiency of basic manufacturing industrial capacity can become a problem later this year.

Both men agreed that Phase IV must be limited in scope, focusing on the large companies with high profit margins. With regard to food and gasoline prices, "the public can't get what it wants" Samuelson said. Eckstein said the political situation, staffing problems, and waning public support would all force Phase IV to be limited. While he urged that phase-out characteristics be built into the program, he insisted that the guidelines in the program be vigorously enforced.

Both professors urged policy be geared to preventing a credit crunch rather than to short-term changes in the money stock. Samuelson would aim for a 5 percent rate of money growth but would be perfectly willing to raise that target if interest rates were to rise rapidly. New macroeconomic tightness, according to Samuelson, is getting to be risky. Eckstein criticized the monetary policy by the month-to-month changes in money. He felt the Federal funds rate is a critical indicator which must be held below 8.5 percent to avoid a credit crunch before the end of August.

SECOND DISTRICT -- NEW YORK

Second District directors and other business leaders who were contacted recently were unanimously critical of the price freeze and called for its early termination. Some had already encountered distortions in their operations owing to the freeze, while others had not yet felt any direct impact on their business. All, however, foresaw serious dislocations if the freeze were to continue much longer. The sustained buoyancy of retail sales in general continued to be linked to expectations of further price increases. No evidence of business inventory buildup was reported.

All of the business leaders surveyed in the Second District shared the view that the price freeze was likely to lead to serious market distortions. The feeling was generally expressed that the temporary freeze should be terminated quickly and that Phase IV of the Administration's program should be formulated and implemented as rapidly as possible. In this connection, most of those contacted felt that an early announcement of "strong" controls was an absolute necessity, while some of the directors expressed disappointment that Federal fiscal policy had not "faced up to its responsibility in the current situation." The president of a tire and rubber manufacturing concern expressed the hope that the country is headed for "controlled inflation rather than what we are presently experiencing" and suggested that the Government should provide some indication of its plans if it is going "to change the rules of the game."

As far as specific problems were concerned, discussions with the Second District business leaders revealed that serious distortions had already arisen in the agricultural, chemical, petroleum, and some metals industries. With domestic prices of a number of items frozen below world market prices, the freeze was said to be causing shortages by hampering imports of essential materials and by encouraging sales abroad. For example, an upstate manufacturer pointed to the difficulties resulting from the continued rise in the cost of imported raw materials, which could not be reflected in the prices charged by his company. Similar experiences were reported by a number of other respondents. An upstate banker cited a serious shortage of specialty steel and reported that a number of small machine tool manufacturers in his area were being forced out of business as a direct result of the freeze. Special concern was expressed over the situation in agriculture, where poultry and hog production was being seriously disrupted. It was predicted that critical shortages of feedstuffs and fertilizers, resulting in part from the freeze, might cause food shortages later on.

Regarding consumer spending, the directors felt it was still too early to assess the impact of the freeze on consumer attitudes. However, they saw consumers as willing to pay whatever prices were necessary to purchase goods they currently wanted. As in previous months, the current high level of retail sales was attributed to expectations of further price increases. A Buffalo banker, however, reported that "considerable apprehension" regarding the future demand for automobiles had been expressed at an economic briefing he had recently attended in Detroit. To some extent, the forecasted decline in demand was attributed to the pollution-control devices mandated for future model years.

Regarding business inventory positions, the respondents reported seeing no evidence of a buildup at this time, partly because of the high cost of financing inventories. The upstate manufacturer, however, reported that while his firm was concerned about low inventories, it was having difficulty in strengthening its inventory position because of increased sales.

THIRD DISTRICT -- PHILADELPHIA

The overall assessment of business activity in the Third District is essentially one of "no changes" from last month. Signs are beginning to appear suggesting that current business expansion is losing some of its vigor, but the outlook is still basically positive. Manufacturing activity is continuing undiminished. Employment is still gaining slightly. Inventory investment continues upward, but capital outlay expectations have leveled off. Bankers report tightening credit conditions. Prices are currently frozen but are expected to rise in the future.

Manufacturing activity in the Third District maintained last month's high level according to this Bank's July Business Outlook Survey. Most firms report no change in their new orders, shipments, unfilled orders, and delivery times this month; and they expect little change in the future. For the six-month outlook, manufacturers are slightly optimistic with predictions of advance in orders and sales outnumbering predictions of declines by a 6 to 5 ratio.

The District is experiencing modest but continuing gains in employment. Less than 5 percent of the manufacturers surveyed report cutbacks in their payrolls and work hours, while 10 percent are taking on additional employees. By early 1974, 16 percent of those surveyed plan hiring increases, but another 16 percent foresee layoffs. So, the longer-run employment outlook seems to have leveled off.

Inventory investment is still headed upward. Thirty-one percent of the responding firms indicate increased stocks over last month. Looking six months into the future, however, further inventory increases were not revealed by the survey. The majority of firms report unchanged or increased capital expenditures within six months but the minority predicting decreases has doubled from last month.

Area bankers report tightening credit markets. Loan applications from new business customers and some old customers who deserve loans are being denied. Demand for mortgage credit exceeds most banks' willingness to make mortgage loans at the current low ceilings. Demand for consumer loans continues to grow. However deposits are not growing at most banks. Several banks report that the velocity of their demand deposits is skyrocketing while demand deposits grow very slowly. Disintermediation is a problem at all the banks contacted except one which just started giving free checking account service if more than $200 is kept in savings. The bankers report that interest rates on CD's are very high but they can still be sold fairly easily; no credit crunch atmosphere exists. The area bankers contacted report that the effect of the higher interest rate ceilings cannot be determined yet.

Prices are reported frozen stable at June levels by every firm contacted. But, inflation continues to loom as a problem for the beginning months of 1974 although manufacturers unanimously indicated that they are presently holding the line on price increases. Well over half of the respondents fear that both their costs and the prices they charge will be higher by January.

FOURTH DISTRICT -- CLEVELAND

Business activity in the District is generally strong, although rates of increase in key indicators have begun to slow somewhat from the pace registered earlier this year. Shortages of materials and lags in delivery time, which appear to have grown worse during the past month, continue to hamper production in many firms.

In recent months, our survey of manufacturers has reflected a gradual tapering in the proportion of firms reporting increases in new orders, shipments, employment, and the workweek. Gains in backlogs and inventories, on the other hand, have been stronger recently than earlier in the year. Delivery time on orders placed has continued to lengthen for the majority of firms. Purchasing agents in the area report that widespread shortages of materials are adversely affecting production and, in some instances, are causing a reduction in overtime. Lead times on orders placed for all types of materials, supplies, and capital equipment have extended unbelievably. Early returns from our latest survey indicate little slowing in the proportion of companies paying higher prices from May to June. In fact, an economist with a major building materials company in the District candidly remarked, the price freeze is being widely ignored by suppliers.

An economist with one of the area's major machine tool producers indicated that his firm is still experiencing very strong demand, but the rate of increase in new orders has started to taper off. He expects new orders to start declining in about six months. Material shortages have been a problem to his firm in selective areas of production.

Reports from the steel industry indicate no letup in the strength of underlying demand. Although steel companies continue to allocate new orders, the bookings are still running ahead of shipments and productive capacity. Lead times continue to lengthen, and some orders are now being booked for the first quarter of next year. One major steel firm reports a slowdown in output may occur during the near term because of maintenance work that has been postponed due to the recent strong demand for steel. Economists expect steel inventory building by customers to level off during the second half.

An economist with a major auto producer attributed part of the recent strength in new car sales to anticipatory buying. He is concerned over the repercussions in the auto industry and the feedback on the economy if demand for the 1974 models weakens significantly and if unemployment begins to rise. In his opinion, the high sales volume of imported new cars is definitely related to the publicity given to the gasoline shortage and to projections of sharply higher gasoline prices. In addition, the recent sales performance of imported cars partially reflects the fact that domestic subcompact capacity is not great enough to meet the demand. The 1973 model carry-over is expected to be concentrated largely in the standard sized cars, and a strong sales incentive program will be necessary to move them.

An economist with one of the Federal Home Loan Banks in the District reports that savings flows at S&L's in recent months have averaged only about half of the volume of a comparable period in 1972. Although deposit growth has slowed, there is little evidence of disintermediation so far. But the thrift institutions are concerned, recalling the experiences of 1966 and 1969. Mortgage commitments have started to slow in recent months, both because of reduced savings flows and some decline in multi-family units. Mortgage terms (rates and downpayments) are gradually tightening.

FIFTH DISTRICT -- RICHMOND

Results of our most recent survey of businessmen and bankers suggest that the District economy remains robust. Some abatement in the rapid rate of expansion reported in recent months is evident, however. Most manufacturers reported no change in shipments, new orders and backlogs, although manufacturing employment increased further. Reports from bankers suggest some tapering off in residential construction activity, while non-residential construction activity continues at recent high levels. Further advances in retail sales were reported, with automobile sales being especially vigorous. On balance, businessmen and bankers expect economic activity in the District to stabilize at present levels.

Survey responses indicate that economic activity in the manufacturing sector of the District economy may be leveling off at recent high levels. The range of responses from manufacturers shows little change in shipments, new orders, and backlogs. This is in sharp contrast to recent surveys in which numerous firms have reported increases in these items. Manufacturing inventory levels declined further and one-third of the respondents reported that inventory levels were low relative to sales prospects. Tight labor markets continue to hamper production in some manufacturing lines, especially furniture.

Employment in the District apparently increased during the past month. Approximately one-fifth of the manufacturing firms reported an increase in employment, and nearly one-third of the banking respondents indicated that employment in their area had risen. Manufacturing respondents reported further increases in wages paid with little change in prices received.

Retail sales in the District remain strong. Forty percent of the banking respondents reported further increases in retail sales in their areas. Information from major District retailers and other sources also indicate gains in retail sales during the past month. Automobile sales were reportedly strong with the demand for smaller cars, both domestic and foreign, being especially brisk. One major retailer reported plans to reduce inventory levels substantially because of the recent sharp increases in business loan rates.

A strong demand for all types of loans continues to be evident throughout the District. Increases in the demand for business, consumer and mortgage loans were reported by more than 50 percent of all banking respondents. Several District banks moved quickly to raise interest rates paid on savings deposits following the change in Regulation Q ceilings. Bankers in all parts of the District also report general tightening of loan terms and a much closer screening of loan applications.

Construction activity in the District remains strong. Banking respondents report that residential construction in their areas increased again during the past month, although the number reporting increases was considerably lower than in recent months. Increases in non-residential construction activity were reported by more than 50 percent of the banking respondents. New plant locations and plant expansion account for much of this activity. Weyerhaeuser recently announced a $100 million expansion program in North Carolina.

Dislocations resulting from the price freeze have created almost chaotic conditions in certain segments of the agricultural industry. Numerous broiler, egg, and hog producers have been forced to curtail production. Tabacco farmers in North Carolina could lose more than $27 million worth of this season's crop because of a shortage of fuel for curing, according to an estimate by North Carolina agricultural extension service. District farmers' January-April cash receipts increased 29 percent above a year ago. Farmland values recorded one of the sharpest increases on record during the year ended March 1, 1973. Gains in all District states, except South Carolina, were well above the national increase of 13 percent.

On balance, business men and bankers expect little change in District economic activity in the immediate future. More than 60 percent of the banking respondents expect economic activity in their areas to stabilize at present levels.

SIXTH DISTRICT -- ATLANTA

A feeling of pessimism has been detected among some businessmen and bankers who feel economic problems are worsening and that little is being done about them. Other businessmen, however, continue to assess economic conditions and prospects optimistically. The pace of construction project announcements has slowed, but many new plants and plant expansions are planned. Several recent wage settlements call for increases of between 5.5 and 6 percent.

Zoning has been approved for a major planned unit development north of Atlanta. The project will contain homes in the $70,000 to $150,000 range, as well as condominiums and apartments, and will cost $350 million to develop as planned. Except for this project, there have been few other major projects announced. Condominum developments in the $3 million to $7 million range have been announced for Atlanta, a north Georgia resort area, Birmingham, and Fort Lauderdale. An economic research firm located in south Florida has warned that that area may be entering a period of overbuilding similar to that of 1969-70. Tight credit conditions are blamed for holding down single-family housing starts in the Atlanta area. Savings and loan associations in Atlanta have reportedly tightened credit standards, and a local newspaper has carried a story predicting an increase in mortgage rates.

There have also been relatively few announcements of major nonresidential construction projects. A new hotel is scheduled for New Orleans, and there is a possibility that a new complex of hotels and office buildings will be built in that city. A $50 million, 100 acre office park is planned near Miami. A $7 million shopping center will be built at Huntsville, Alabama. A textile firm will build a $5 million office and distribution center in the Atlanta area. Near Tampa, a glass producer has purchased a tract of land for a distribution center. Two 100-unit motels will be built in east Alabama.

A chemical company is undertaking a $43 million expansion of fertilizer plants in Mississippi. Wood product firms will build three plants in Alabama and two in Georgia at a total cost of $35 million. An oil company has announced a $13.5 million expansion at a south Alabama refinery. A $12 million heavy machinery plant is planned for the Birmingham area. A tire company is tripling the size of its Alabama plant. Rubber and plastic products will be manufactured at a new plant in north Alabama. An underground coal mine employing 200 will also be opening in Alabama. Apparel manufacturers will locate two plants in southwest Louisiana, each eventually employing 300. A number of smaller plants are planned throughout the District. In recent months, there has been a sharp increase in the number of companies investigating the Lake Charles, Louisiana area as a possible plant location.

Several Atlanta construction trade unions have recently accepted two-year wage contracts calling for increases near the 5.5 percent guideline. Hourly workers in the nuclear industry at Oak Ridge, Tennessee have accepted a wage increase considerably above the 5.5 percent level. Workers in Florida's sugar cane industry are pressing for a $1 an hour increase, but producers are offering a 10-cent-an-hour raise. An auto assembly plant in Atlanta has been struck in dispute over production schedules and health and safety standards. Despite an unemployment rate near

5 percent, a Mobile businessman reports that an extreme shortage of skilled labor has forced many companies to increase training efforts.

A special survey of retailers in east Alabama found that sales are up strongly and that merchants were particularly pleased with sales in the July 4th week. However, retailers in Tennessee report that shoppers are becoming more price and quality conscious and that they are waiting for sales. Auto sales are reportedly booming in the Tennessee portion of the District and used cars are particularly scarce. Two auto dealers in east Alabama expect their inventories to be depleted by the time 1974 models arrive.

In spite of late plantings and other difficulties, the Louisiana rice crop is in good condition.

SEVENTH DISTRICT -- CHICAGO

No signs have yet developed in the Seventh District that the uptrend in overall activity is losing momentum. Businessmen and bankers, almost universally, believe the 60-day price freeze was ill conceived, but the immediate impact on slowing activity seems to be confined to food processing and petroleum refining. Any slowing of growth in other sectors appears to reflect shortages of manpower, materials and components, and summer vacations. The freeze and a tough Phase IV may have an adverse affect on long-range planning, however. Inventories are generally low relative to activity, critically so in some cases. Retail sales of both hard and soft goods appear to be very strong.

Most businessmen and bankers are aware of forecasts of a recession to begin late this year or early next year. Even those who accept such projections, however, indicate that they see no signs of slippage in their own areas. In fact, most manufacturers are most concerned about their ability to maintain production schedules and product quality in the face of bottlenecks.

The 60-day freeze was very generally opposed in this District, even by most of those who viewed favorably the 1971 freeze. One factor, of course, is the fact that wages are excluded. But a widespread belief exists that tight price controls under conditions of tight supplies will do more harm than good. Businessmen are particularly adamant that a pass-through of increased costs of raw materials and imported commodities must be permitted to prevent further shortages.

Many District feeders of swine and cattle say they will lose money because of the squeeze between operating costs and the price of meat packers can afford to pay under ceilings. A number of medium-sized pork packers have ceased operations. An ominous note for future months, the current swine slaughter includes a highly abnormal proportion of pregnant sows. The number of cattle moving into feed lots is below last year, partly because cattle are being kept longer on grass. Beef processors are aided by high prices for by-products. Except where supplies have been reduced by adverse weather, canning of fruits and vegetables appears to be proceeding normally. But there are reports that part of the pack will be held back awaiting the end of the freeze. A bright spot in the meat situation is the drop in spot prices for soybean meal, partly because of the embargo. Corn prices remain near recent highs, however. Current developments in agriculture probably will have their major adverse impact on livestock and meat supplies in the fourth quarter.

A number of District firms had to cancel price increases because of the freeze, e.g., steel, appliances, and machinery. They maintain they must have price flexibility to justify the risk of new investments.

Oil industry experts say that the price freeze has sharply curtailed imports of refined products, and, in some cases, imports of crude oil. The sharp increase in prices of imported petroleum means that imports can only be resold at an out-of-pocket loss. The gasoline crisis appears to have eased except for scattered situations. But oil firms are not building up stocks of heating oil as planned.

A steel producer now estimates shipments of U.S. mills at 108 million tons for 1973, with all categories much stronger than had been projected earlier. There is "absolutely no sign of demand weakening." Steel warehouse stocks are very short.

The Milwaukee Purchasing Managers report (July 8) that "lead times on a vast number of products are extremely long." Items in short supply include steel, castings, aluminum, paper, lumber, plywood, fuels, rubber, cork, electronic components, wire, small motors, glass, fasteners, bearings, zinc, many chemicals including petrochemicals, hydraulic components and large tires. Delivery dependability has deteriorated badly and almost one-third complain of poor quality.

A Chicago producer of a variety of products stated recently: "every component we purchase is in short supply. Paper, wood, steel -- everything. The worst in my 30-years in business." This moderate-size firm, like many others, has appointed a "procurement expediter."

Steps taken to side-step price controls include: low profit lines dropped; products "redesigned"; fictitious upgrading; inclusion of rejects; dropping discount practices; insistence on larger orders than customers require; "tie-in" sales; elimination of "free" services; new charges for "extras"; curtailment of sales to nonaffiliated customers; and curtailment of sales to customers whose business is less profitable.

EIGHTH DISTRICT -- ST. LOUIS

Business activity in the Eighth Federal Reserve District continues strongly upward. Retail sales have expanded further in recent weeks, manufacturing orders are up, and demand for output continues to exceed the amount that can be supplied at current prices. The labor market is reported to be "tight" over most of the District, but there has been little change in the unemployment rate in most of the metropolitan areas during the past two months.

Excessive demand, inflation, and supply shortages are the major problems of businessmen. Interruptions to output caused by the price "freeze" and raw material shortages have become more general throughout the District. Shortages of forest products, paperboard, gasoline and livestock feed are apparently causing the greatest concern. However, delayed deliveries were mentioned for numerous items. Some increase in the delivery of raw forest products to mills has occurred with the improved weather conditions in recent weeks but paperboard container manufacturers report that there has been no reduction in the lag between orders and deliveries of such products. An engineering equipment manufacturer reported that merely trying to meet demand was now a problem. Also pricing for future delivery is reported to be hazardous because of the uncertainty about future price controls on raw materials and output. An increasing number of firms are refusing to quote prices on such orders.

Most manufacturing firms report that operations are at full capacity. Numerous reports of capacity expansion programs indicate that major increases in capacity are underway. In some cases, however, such plans are being delayed because of the uncertainty caused by public policies with respect to wages and prices.

Retail sales at major department stores in the District have continued upward in recent weeks at about the same rate as during the last twelve months on a seasonally adjusted basis. Representatives of the stores report that their suppliers are not shipping as much as ordered and that for more than a year there have been long delays on delivery of furniture ordered from manufacturers.

The labor situation remains tight throughout the District. Employment continues to rise slowly but the unemployment rate has leveled off after declining for about two years. Representatives of the larger firms report that they can still get help but the smaller firms report that all the good workers they can find are currently employed. A major complaint in the lumber and pulpwood industries is that they can no longer get workers to do timber cutting operations.

Financial markets have tightened throughout the District in recent weeks. Rates on all types of credit instruments have been increased and larger down payments are being required by most lenders, especially on real estate mortgages. One savings and loan association reported that it is no longer interested in residential loans with less than a 20 percent down payment.

The food and agricultural situation has suddenly changed from favorable to disastrous as a result of the recent price freeze. The crop outlook is generally good but timely rainfall throughout the summer months will be necessary for high yields since most crops were planted later than average. Most livestock producers are losing money from feeding at the current feed cost-livestock price ratios. The unexpected sharp increase in feed costs has taken most if not all of the profit out of livestock feeding. Some hog feeders may still be covering their costs, but all cattle, laying hens, and broilers are probably being fed at a loss. Profits are insufficient in all livestock feeding to provide incentive for increased production. Unless relief is quickly forthcoming, the outlook for lower food prices early next year must be revised markedly upward. Some meat shortages are already beginning to develop in grocery stores. Feed dealers and other farm specialists report that farmers are simply not making plans for increased production. Instead of holding back breeding animals for larger output, they are selling them off at lower than normal market weights to reduce losses. Given this condition the supply of meat animals and animal products for market early next year will be reduced regardless of the size of crop harvested this fall.

NINTH DISTRICT -- MINNEAPOLIS

Bank directors had mixed views on how Phase IV should be structured, but generally supported tighter fiscal policies to accompany the new wage-price control program. District labor markets were characterized as tight, and skilled workers were in many cases scarce. District businessmen continued to be confronted with shortages; in some instances a lack of materials has actually slowed District business activity. Further advances in District consumer spending were reported and District retailers anticipated no immediate letup in their sales growth.

Bank directors' opinions varied on how Phase IV ought to be structured. Two directors believed Phase IV should concentrate on those industries that are significantly contributing to our current inflationary situation -- industries where price increases are the most visible. Another view was that big companies and unions should be required to inform the government of proposed wage and price increases. One director wanted Phase IV controls to be as flexible as possible, and another director voiced opposition to mandatory wage-price controls. One director expressed a personal dislike of wage-price controls, but believed that such controls would be necessary for some time in the future.

Although their views varied, bank directors generally favored tighter fiscal policies to accompany Phase IV. A cutback in the investment tax credit was favored by one director and another felt several measures to tighten fiscal policy would be necessary to deal with our current inflationary situation. Rather than raising taxes, one director advocated cutting expenditures. Another director voiced his opposition to increasing personal taxes because, in his opinion, tax increases would only result in higher wage demands since inflation has already eroded a considerable amount of workers' purchasing power.

According to the bank directors' responses, District labor markets were characterized as tight. Employment conditions have improved recently in the upper peninsula of Michigan, and a Wisconsin director indicated that unemployment was not a problem in his community because local industries were expanding. A South Dakota director reported gains in his state's manufacturing activity and disclosed that workers were in short supply. A Minnesota director reported an abundance of summer and college educated workers but a lack of workers for permanent year-round blue collar jobs. A director from southeast Montana revealed employment gains in his area and stated that labor shortages existed for workers in the service industries and farm workers. A director from Bozeman, Montana indicated a shortage of construction workers in his area. A North Dakota director, on the other hand, disclosed no lack of employable workers in his state.

Various material shortages continued to confront Ninth District businessmen and in some instances shortages have curbed District business activity. A South Dakota director indicated that spare parts for agricultural machinery were in very short supply and that new farm machinery was almost impossible to obtain. A small manufacturer in his area has been unable to expand operations because of a lack of steel. A director associated with the construction industry revealed that cement and reinforcing steel continued to be in tight supply and indicated that a lack of spare parts was also a construction industry problem. Two large Minneapolis/St. Paul manufacturers reported difficulties in obtaining electronic components and one firm disclosed these shortages have slowed down production. Also, a lack of kraft paper has restrained the output of another Twin Cities firm.

Several directors indicated that their areas' businessmen were continuing to express concern over the gasoline situation, and gasoline shortages have affected the District's tourist industry. In the upper peninsula of Michigan a 10 percent decline in tourist business from a year ago was attributed to the gasoline supply situation. In North Dakota slow business at that state's major tourist attraction was also attributed to the gas supply problem. In South Dakota no expansion in tourist activity was foreseen. In Montana, on the other hand, tourist business has been good so far this year. One Montana director voiced the opinion that the concern over gas shortages has caused individuals to take their vacations earlier and his area experienced a good June tourist business.

District consumer expenditures have continued to expand and further increases in consumer spending are anticipated throughout the summer and into early fall. Large Ninth District retail stores reported recent sales running 8 to 10 percent above a year earlier, with particularly strong sales outside the Minneapolis/St. Paul metropolitan area. Most survey respondents attributed their sales increases to improved farm income and to strong sales of durables accompanying new home purchases. Survey respondents expected sales increases in the 8 to 10 percent range to continue through the summer, with possibly some tapering off this fall. Retail sales in rural areas were expected to remain strong through 1974.

Area automobile dealers reported phenomenal rises in new car sales this spring: trucks and smaller cars were selling particularly well. Several dealers noted that sales of smaller cars were well in excess of their manufacturers' capacity to produce these models. Most dealers stated that gasoline mileage has become of great importance to new car buyers and cited this as a major reason for the sharp rise in sales of smaller automobiles. Truck sales this spring have been 20 percent to two-thirds higher than a year ago, with most of the increase again attributed to higher rural incomes. Auto dealers, however, were concerned that current high sales may be displacing potential sales for the 1974 model year.

TENTH DISTRICT -- KANSAS CITY

Difficulties in obtaining fuel because of station closings apparently are scaring some motoring tourists away from the Tenth District this summer. But while the energy crisis may be depressing tourism, it is generating activity in the extractive industries in Wyoming and elsewhere. A survey of many light manufacturers throughout the District turned up none pessimistic about sales outlooks. Good news of a bumper crop of wheat in Kansas is largely offset by the bad news of the adverse effects of the price freeze on food supplies. Bankers feel that recent increases in administered interest rates (discount, prime) will have little dampening influence on economic activity.

In most cases, popular historical sites and outdoor recreation areas throughout the District are attracting fewer tourists. Attendance at Eisenhower Center in Abilene, Kansas, for example, is running 20 percent below last year. Colorado apparently has been hit hardest. Park and museum visitations there are down "tremendously." Even campground use has declined for the first time, while motel receipts are off as much as 30 percent in some Colorado areas, and perhaps 10 percent statewide. Businessmen blame problems in obtaining gasoline. New Mexico also is suffering a decline in tourist business, with national park and monument visitation down 7 percent and state park visitation down 4 percent through May. Tourist inquiries received by the New Mexico Department of Development during June of this year were 25 percent fewer than those received during June of 1972.

Wyoming tourism so far this year appears about as good as last year, and perhaps somewhat better. But respondents fear that the early visitors are trying to beat the gasoline shortage, and that the season will finish slow. Advanced sales of nonresident hunting and fishing licenses are down 30 percent, no doubt partly due to their increased prices, but probably also due to fears of short gasoline supplies.

Thanks largely to fuel shortages, mining activity has increased greatly in the Tenth District western states. The shift toward atomic energy is stimulating the pace of extraction and processing of uranium in the Rocky Mountain States, where much of the nation's known reserves of uranium ore are located. On top of this, the renewed importance of coal has given a boost to the Wyoming economy, where major reserves of low sulphur coal are found in thick seams near the surface. In most of the District states, petroleum and natural gas production is of continuing economic importance. Stepped up efforts of discovering new fields and producing zones, and the possible economic feasibility of extracting oil from vast shale deposits, further brighten the economic outlook in the District.

Sales managers of many light manufacturing firms in the District see little indication of an end to the boom. They expect continued sales growth into 1974. Most firms are producing at or near capacity. Several are adding, or planning to add, to capacity. Only minor inconviences are being experienced because of the price freeze. However, one Wyoming manufacturer came near closing recently because of inability to get diesel fuel.

For the month ended June 15, farm prices posted another gain, rising 6 percent above May on the strength of higher grain prices. The spurt in grain prices was precipitated in large measure by a wave of buy orders from abroad in anticipation of export control. Despite record high prices, the freeze has locked much of the livestock industry into an unprofitable position, and with controls on exports, crop producers may curb their plans to expand output in the future. Food processors have also been hard hit by the new program as several have either cut back or closed down operations. On the whole, the stiff actions taken to ease food prices likely will prove counter productive and result in more restrictive production.

Harvest of the 1973 winter wheat crop is progressing rapidly. Earlier fears about possible shortages of combines, fuel, and elevator storage have been largely unfounded. Isolated shortages occur nearly every year, but usually are not so well publicized. If anything, the Kansas harvest has been less troublesome than usual. Some wheat is being stored on the ground, but none has been lost due to an inability to get it out of the field. At this point, the 1973 crop could quite possibly exceed the June 1 estimates.

Following the lead of the nation's largest banks, all but one of the major District banks increased their large borrower prime rates to 8 percent in the past week. The only exception, a large Tulsa bank, raised its prime rate to 8 1/4 percent. Surveyed banks generally felt that further increases in the prime rate would be required to slow business loan demand. With regard to the prime rate charged to small borrowers, only two banks reported increases since the guidelines went into effect. However, the level of this rate varied greatly among banks, ranging from 6 1/2 to 8 1/2 percent. Recent increases in the discount rate were not viewed as being much of a deterrent to further borrowing from the Federal Reserve. Several banks implied that unless otherwise restricted they would continue to use the discount window as long as it remained their cheapest source of funds. Two banks also said that the recent increases in required reserve ratios would be far more effective in restraining their lending activities.

ELEVENTH DISTRICT -- DALLAS

The economy of the Eleventh District continues to expand with almost all major economic indicators showing greater strength. The only notable exception is the unemployment rate, which edged up slightly in May. Industrial production in Texas reached another record level in May, and the pace of construction activity picked up substantially. Sales of District department stores also rose further in May and June, and automobile registrations rebounded sharply from April's decline. A survey of major District retailers indicates that the price freeze has had little effect on their business operations.

The vast majority of the retailers surveyed felt that their sales, adjusted for seasonal factors, would be at least as strong in the second half of 1973 as in the first half. Moreover, the price freeze has so far had no effect on their sales. None of the retailers reported their current inventory-to-sales ratio as being abnormally low, and none reported any effort to take advantage of the price freeze to accelerate inventory buying.

The majority of the retailers also indicated that the current price freeze has had no discernable effect on their company's profit margin. Most of the remaining respondents reporting any effect felt that their profit margins are moderately smaller than they would have been without the freeze. The retailers, on the average, reported no change in the extent to which their customers are using credit in their purchases, and they noticed no change in the quality mix of goods their customers buy. The recent increase in commercial bank lending rates have not influenced retailers to use less bank credit. Almost all report no change in their bank borrowings as a result of the interest rate increases.

The seasonally adjusted Texas Industrial Production Index rose further in May, as gains were posted in all three major sectors. In manufacturing, the largest production increases occurred in petroleum refining, food and food products, primary metals, and stone, clay and glass products. Mining rose mainly as a result of increases in output of crude oil, and metal, stone and earth minerals. Utilities edged up only slightly.

With imports of foreign crude helping to ease the supply shortage, District refineries are turning out record amounts of gasoline. The gasoline shortage has not proven to be as severe as originally feared, although some companies warn that there may still be some local shortages due to distribution problems. A few municipalities, particularly Austin, continue to face energy shortages, as natural gas supplies have been curtailed.

Seasonally adjusted total employment in the five District states rebounded in May, regaining most of the loss of the month before. The labor force grew at a slightly faster pace than employment, however, causing the unemployment rate to edge up to 3.9 percent from April's 3.8 percent. Manufacturing employment remained unchanged, while nonmanufacturing employment rose slightly, as substantial gains were recorded in finance and services.

The value of construction contracts awarded in the five District states increased in May as residential building contracts rose to their highest level since August 1972. Nonresidential building rose only slightly, while nonbuilding construction fell from April. The cumulative value of contracts awarded through May was only 1.3 percent above the corresponding period last year, primarily due to the sharp year-to-year decline in nonbuilding construction.

Sales of department stores in the District continued to show substantial increases over the year-ago level in June. Cumulative sales for the first half of the year were 12 percent above the level for the corresponding period last year. The number of new automobile registrations for the four largest metropolitan areas of Texas--Dallas, Forth Worth, Houston, and San Antonio -- rebounded sharply in May with particularly strong year-to-year increases in Dallas and Forth Worth. Cumulative car registrations through May were over a fifth higher than in 1972.

The agricultural outlook in the Eleventh District is favorable. Increased field activity has closed the lag in planting and harvesting created by the earlier bad weather. The wheat harvest in Texas is nearing completion with yields good to excellent. Oklahoma is also making rapid advances in its wheat harvest -- although average moisture content continues somewhat higher than usual and protein content is down somewhat. Livestock conditions are generally good. However, the screwworm regulations governing interstate shipments of livestock were recently extended to include Arizona and New Mexico. This action was necessary because of serious fly spillover from Mexico into Arizona and to some extent into New Mexico.

The price freeze has caused serious distortions in both the livestock and poultry industries. Placements of cattle on feed have dropped significantly because of the squeeze between the cost of feeding cattle and the price received for slaughter cattle. As a result, spokesmen for the cattle industry expect a shortage of beef this fall. In addition, the latest production figures for Texas poultry are bleak, with Texas broiler egg sets down 15 percent in the last half of June from a year earlier. Dairymen, also faced with high feed costs, are reported to be culling their herds to eliminate marginal producers.

TWELFTH DISTRICT -- SAN FRANCISCO

The Twelfth District economy led by consumer spending continues to maintain a strong rate of expansion. Many of our Directors now feel that this expansion will not continue through the rest of the year and a slowing may occur in the fourth quarter. The price freeze is viewed as a temporary measure in terms of restraining inflation but recent Federal Reserve actions are expected to restrain the economy. In addition, the price freeze may cause serious shortages, especially of processed agricultural products, if it is maintained beyond 60 days.

Consumer spending is reported to be strong in all parts of the District, particularly for consumer durables and for automobiles. Industrial production similarly is maintaining output, and wood products is the only industry where some signs of weakness are present. In Washington and Idaho, mills are still operating at full capacity, but in Oregon some mills are now operating at 25 to 50 percent below capacity. Aerospace activity continues to be a major source of strength in Washington and southern California.

Construction activity, except for residences, is still vigorous, and shortages of skilled tradesmen continued to be reported. Residential construction is weaker in some areas -- for example, Washington. Directors in California and Utah report construction of new housing has not turned down, but a decline is expected later this year, as construction may soon be affected by reduced credit availibility. Savings and loan associations have less funds, and some banks report that they are rationing real estate loans because the demand cannot otherwise be met at the rates set under the price freeze.

The gasoline shortage is continuing to cause some concern in tourism-oriented areas. In Idaho, an oil distributor describes the marketing situation as confused. Increased numbers of visitors are reported in some areas but others have experienced less activity. Oregon manufacturers of recreational vehicles blame reduced orders on uncertainty about gasoline availability. Despite the local problems, the gasoline shortages have not caused serious difficulties in this District.

In general, our directors feel that the current strength of the economy will not be maintained into 1974, and a slowdown is expected before the end of the year or earlier. Recent actions by the Federal Reserve System are expected to have a major restrictive influence according to some directors. The directors think consumer expenditures on durables will be lower. Other factors tending to cause uncertainty and to slow down the economy are the international situation, the Watergate hearings and prospective energy shortages. Several directors advocate more restrictive fiscal policy to reduce some of the burdens on monetary policy.

Local businessmen and farmers are unhappy with the price freeze. It is seen as having only transitory effects in restraining inflation, but it is also beginning to cause dislocations and shortages which would become serious if the freeze is kept beyond 60 days. The major problems are centered in the processing of agricultural products. Feed lot operators and poultry processors are being squeezed by the higher cost of grain, and at the same time mill operators are reported to be cutting production of many types of feed. In reaction to the freeze, millers in Oregon have canceled contracts to furnish flour under government contracts. At present prices, they cannot affort to mill flour. Similar pressures stemming from high feed prices are tending to cut milk and egg production. Livestock producers in Washington have begun to sell hogs and cows ordinarily kept for breeding purposes. A shortage of hay in Oregon and Washington is compounding the difficulties of local cattle producers. Food processors report difficulties in obtaining semi-processed foods, which are being exported at higher prices than domestic buyers are willing to pay.

In nonagricultural industries, some manufacturers report difficulties in obtaining supplies. Suppliers appear to be postponing commitments to fill orders at present prices, in expectation of higher prices at the end of the present price freeze. Retailers do not appear to be experiencing major difficulties as yet. A few chains were caught during a sale period when the freeze was imposed and they are locked into below-normal prices.