CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY *

While the reports of the Federal Reserve Banks indicate that the pace of economic activity may have slowed somewhat in recent weeks, the current situation is highlighted by growing demand pressures, material shortages, problems of inadequate capacity, and increased rationing of raw and semi-finished products by the private sector. In the agricultural sector, large crops and increased food supplies are in prospect.

The energy crisis is a topic of prime concern to businessmen throughout the country. Several Reserve Banks report business slowdowns in their Districts resulting from fuel shortages, and respondents in many Districts fear that layoffs of workers will worsen. Dallas reports that oil production in Texas is falling and that present stocks of oil in that state are only sufficient to last through the first severe cold spell. Diesel fuel shortages are being felt in some areas. Atlanta reports that a recent cutback in diesel fuel allotments will reduce coal deliveries to TVA, thus contributing to a power shortage. Cleveland reports that the petrochemical and rubber industries are being adversely affected by lack of oil and that steel production may be curtailed in the months ahead. Chicago reports that industrial users of natural gas and propane may be cut off, but major electric utilities in the Seventh District appear to be in a relatively good position because of the use of coal and nuclear energy.

In addition to the concern about energy, shortages of other materials are widely reported. New York reports shortages in zinc and copper

* Prepared at the Federal Reserve Bank of St. Louis.

which approach "Korean War proportions". Labor, paper, steel products, and various other raw materials are reported to be in short supply in many areas. An increasing number of firms in the St. Louis District report rationing of a wide variety of raw materials by their suppliers, and Cleveland indicates that a three to six-month delivery period is common for many products.

Manufacturing activity continues generally strong, but some Districts report a slowing in the rate of increase. Chicago indicates that lack of supplies and manpower, rather than lack of demand, is responsible for the slowing. Capital goods industries are especially strong, as investment spending continues at a high level. Reports from New York and St. Louis suggest that much of the investment may be for mandatory pollution control equipment rather than for projects which will increase productive capacity. Many investment projects in the Atlanta District are being delayed, largely as a result of shortages. Continued high capital spending in agriculture is projected in the New York District, and Chicago reports that farm equipment firms are "swamped" by orders.

Retail sales generally continue at high levels, although some of the Federal Reserve Banks indicate a slowing in consumer demand. This was noted particularly for automobiles and consumer durables.

Employment generally continues at high levels, with many Districts reporting labor shortages. For example, Dallas reports a sharp rise in employment in recent months, led by increases in construction and government employment; unemployment in the Dallas District remains around 4 percent. By contrast, Boston describes the New England employment picture as "bleak", with September unemployment about 6-1/2 percent in the region and 7-1/2 percent in Massachusetts.

The agricultural situation is good with high crop yields and large farm incomes in prospect. Many Districts report that crop harvesting is progressing rapidly. Livestock production in the Dallas District is slightly higher than last year, and the Florida citrus crop is the second largest on record. Chicago reports that, in the last year, value of farmland has experienced the largest increase in 20 years.

Construction activity is down in many areas, but commercial construction has held up better than residential. A number of the Federal Reserve Banks reported that construction is being retarded by material shortages, late deliveries and uncertainties stemming from rapid price changes.

Interest rates have in some cases declined in recent weeks, reflecting a decrease in bank loan demand, especially for commercial loans. Both San Francisco and St. Louis, for example, reported that the lower business loan demand may reflect the substitution of commercial paper for bank loans. Some Reserve Banks report increased availability of mortgage funds, but the movement in mortgage rates is apparently mixed. Usury laws in some states have tended to limit the supply of mortgage funds. Chicago reports that the 8 percent usury law in Illinois continues to limit new loans. New York reports an increase in the supply of mortgage funds resulting from the raising of the state usury ceiling from 8 to 8-1/2 percent.

FIRST DISTRICT -- BOSTON

Our Directors' businesses continued to experience high levels of activity with no decline in new orders. In fact, one Director notes record-high backlogs both for oil field equipment and super alloys. In contrast, the unemployment picture remained bleak. Despite the decline nationally, the unemployment rate in New England rose from 6.2% in August to 6.5% in September and in Massachusetts the unemployment rate reached 7.5%.

The energy crisis was a major concern of our Directors and seems to be having a mixed impact on their businesses. One Director, President of a large manufacturing conglomerate, mentioned strong demand for helicopters, stimulated in part by the increase in offshore oil exploration and, on the consumer side, strong demand for chain saws, presumably to cut wood for home heating. The head of another major conglomerate found the energy crisis was having offsetting effects. Oil drilling equipment was in great demand, and oil and gas producers were profiting from the higher prices, while, on the other hand, the carbon black business was suffering substantially from the high price of residual oil. Phase III controls prohibit passing the increased energy costs on to the customers. Consequently, carbon black manufacturers were experiencing a profit squeeze. For the longer run, higher gasoline prices and lower speed limits would reduce the demand for tires and, in turn, the demand for carbon black.

Our Director from a large Boston bank reports that the credit situation has eased considerably, primarily due to a contra-seasonal decline in the demand for loans. He attributes this decline to a general hardening of the opinion that we are heading for a recession which will be aggravated by the energy crisis.

While our Directors expect a recession next year in the economy, one Director from a large public utility indicated that the outlook in Connecticut for next year had brightened considerably. A recession next year in Connecticut now appears less likely, and, if it did occur, would be less severe than previously thought. Connecticut has accumulated a $70 million budget surplus which would be available next year either for tax reduction or expanded spending programs. Another Director of a multinational corporation argued that enough softening in the economy has been seen, and that we are definitely due for a recession next year.

Professors Samuelson, Shapiro, Tobin and Wallich were contacted this month. Most felt the economy has not been cooling as rapidly as many had predicted it would. Several mentioned the large October decline in the unemployment rate and Wallich noted that third quarter real growth was within the statistical limits of long-term potential. Wallich suggested that some of the supply problems may not be "genuine" but due instead to inefficiencies resulting from price controls. Both Samuelson and Shapiro doubted that controls have had a significant limiting effect. Shapiro traced the supply limitations to nearly twenty years of dollar overvaluation which has eroded capacity expansion in U.S. industries (a point Professor Otto Eckstein has also made). Samuelson notes that a slowdown, whether due to demand or supply limitations, still would generate effects of the accelerator principle.

There was broad agreement on a target rate of growth for the money stock near 5 percent. The agreement, however, masked significant underlying differences in implementation. Wallich, for example, would accept a 5 percent target but would not permit short rates to decline in order to achieve it; under present conditions, the more restrictive policy indicator should be followed. Tobin, who does not use an aggregate as a policy target, advocated a gradual decline in the Federal funds rate toward the bill rate; he expressed concern about the stock market and felt that, as a result of the rising costs of capital goods, "equity values have fallen behind the replacement cost of the capital they are claims to". He attributes this shortfall to uncertainties about the Middle East and the Presidential problems. Samuelson preferred a money target "not lower than 4 percent". Shapiro favored a 5 to 6 percent rate of monetary growth. He was puzzled by the recent uptick in the bill rate. Because he could find no objective reason for the rise, he speculated it should be treated as a random event which will be reversed in the future. So long as money growth came in at or above target levels, both Samuelson and Shapiro would allow short rates to be determined in the market.

SECOND DISTRICT -- NEW YORK

Second District directors and other business leaders who were contacted recently reported that demand pressures remain intense, and that materials shortages, capacity limitations, and delivery delays are continuing to hamper production in many industries. The respondents generally felt that current capital spending plans for 1974 would hold up even if the widely forecast slowing in the growth of the economy materializes. A moderate increase in the availability of mortgage funds during coming months was expected, paralleling an anticipated recovery of deposit flows to thrift institutions.

The respondents generally saw no evidence of any easing in the intensity of demand pressures. Indeed, most felt that the materials shortages, capacity pressures, and delivery delays were still "predominant", and in some instances, increasing. A senior official of a large chemical concern reported that demand pressures in his industry have intensified and that shortages have developed to an extent leading to substantial business slowdowns. Another director reported that shortages and delivery delays for fuel and raw materials, including petrochemical products and steel, were expected to slow economic activity in the upstate New York area. The president of a large non-ferrous metals producer reported that shortages in the copper industry are approaching Korean war proportions and that zinc is also in very short supply. Similar observations were made by senior officials of several other major firms in the metals industry. A vice president of a large multinational packaging products firm, moreover, reported that the shortage of paper was hampering his firm's operations.

The only sector where any respondents noted an easing of demand pressures was the consumer sector. One director observed that sales of consumer durables, both automobiles and home goods, appear to be slowing somewhat as a result of heavy purchases over the past year and increasing caution on the part of consumers.

Concerning prospective business capital outlays, all of the respondents who expressed an opinion on the subject felt that current plant and equipment spending plans for 1974 would hold up, even if the generally forecast slowdown in the growth rate of the economy materializes. Most of these respondents felt that owing to the long lead times typically involved in capital spending projects, the funds for most 1974 programs have been committed and many of these projects have already been activated. Some of the business leaders, moreover, pointed to the need for investment in pollution control equipment to meet governmental standards. A number of respondents noted the growing belief on the part of businessmen that current worldwide shortages are likely to persist, inducing businesses to increase operating capacity. A branch director with farming interests predicted a continuation of high capital spending in the agricultural sector as well.

With respect to prospective developments in the mortgage market over the fall and winter, a number of directors felt the availability of funds would meet the demand, but at somewhat higher rates, larger down-payments, and shorter maturities. Thus, an upstate manufacturer felt that while mortgage funds would probably become somewhat more readily available, they still would remain relatively scarce because of the higher rate of return available to financial institutions on alternative investments. The president of an upstate bank, however, reported that the recent declines in market rates and the recent increase in the New

York State usury ceiling to 8-1/2 percent have significantly improved the availability of mortgage funds in his area. A New Jersey banker, however, reported that many New Jersey institutions appear to be delaying making mortgage commitments, awaiting an increase in the State's usury ceiling to 8-1/2 percent, despite the increase in deposits at those institutions resulting from the recent decline in money market rates.

In this connection, the directors in general felt that the worst of the recent wave of disintermediation is past, and that interest rate developments might lead to a reflow of consumer time and savings deposits to banks and thrift institutions in the months ahead. The president of an upstate bank stated he expected a "material" rise in consumer-type deposits, not only because of rate developments, but also because consumers in his area appear to be saving more in anticipation of adverse economic conditions next year. Another director, on the other hand, felt that the lower discretionary income levels, resulting from relatively moderate wage increases at a time when prices are escalating rapidly, is likely to reduce the rate of consumer savings.

THIRD DISTRICT -- PHILADELPHIA

The economic expansion continues to move ahead in the Third District but there are some indications that the advance may be slowing. Manufacturing activity increased again this month and employment is up slightly as well. Plant and equipment spending plans are bullish. Loan demand at banks is strong. On the darker side, inventory investment has leveled off and retail sales are lackluster. Finally, inflationary price changes are widespread. Third District manufacturers polled in this month's business outlook survey report their output is increasing less rapidly. The large majority of responding firms report no change in their new orders, shipments, unfilled orders, and delivery times. However, for the minority of firms reporting changes in these categories, there are still more reporting increases than decreases. The six-month outlook is less bullish. Although the majority of firms contacted expect no change in business activity during the six months ahead, the minority expecting change includes more firms expecting decreases than increases.

The continued high level of business activity is reflected in a slight increase in employment. More than twice as many firms report increasing the number of people on their payrolls and the length of the average workweek than are reporting decreases. However, over 85 percent report no change in their current labor usage. During the coming six months, however, the level of employment is expected to remain flat. The number of firms expecting to hire approximately equals the number that foresee layoffs. A slight reduction in the length of the average workweek is also expected by next spring.

The continued high level of current business activity is causing a sizeable number of businessmen to increase their plant and equipment spending. Although half the respondents have no plans to change their capital expenditures, one-third plan increases. Inventory investment is less bullish. The respondents' consensus indicates that current inventories are holding constant, but small inventory reductions are expected during the next six months.

Retail sales are slowing according to executives in Philadelphia department stores. Durable goods purchases of the postponable variety, such as appliances, are off significantly. However, the retailers contacted expect good Christmas sales.

Upward pressure on prices is still strong with over two-thirds of the respondents reporting paying higher prices during the past month. On the other hand, two-thirds of the firms report no change in the prices they charged during the past months. Looking ahead to next summer, however, over 80 percent of the respondents expect higher prices both for the goods they buy and sell.

City and regional bankers report that checking and saving deposits are maintaining the same slow levels of growth as in past months. Dependence of large CDs as a source of funds has weakened as bankers are now returning to the Federal funds market for shorter term funds. Loan demand is strong, especially business, real estate and consumer loans, while loans to non-bank financial intermediaries decreased a little.

FOURTH DISTRICT -- CLEVELAND

Business activity in the District remains strong, although there are some signs of slowing. Apart from the weakening in housing and consumer durables, the slowing is probably more a reflection of capacity limitations and a tight supply situation in raw materials and fuels than the result of a decline in underlying demand. Our Directors and businessmen and economists in the District are gravely concerned over the energy situation and its implications for the economy in 1974.

Output in the District's manufacturing sector continues to rise, but signs of slowing in the upward momentum are accumulating. Our monthly survey of manufacturers shows a significant decline in the proportion of firms reporting gains in new orders and backlogs in recent months. September was the poorest month of the year, and early returns for October suggest further weakening occurred. There has also been some slowdown in the rate of inventory accumulation. Delivery time, however, continues to lengthen, compounding the problem of shortages faced by virtually every firm. (The October report of Cleveland purchasing agents questioned how there could be a recession next year in view of the fact that very little inventory is available and deliveries are taking three to six months or more on practically everything.) There was a surge in price increases during October, as the largest proportion of firms in the ten-year history of our survey reported paying higher prices.

Our industrial Directors, particularly those supplying the capital goods market, generally report strong business conditions, although some softening in the consumer area was noted. The Directors are becoming increasingly concerned over problems of inflation, distortions caused by wage-price controls, public confidence, shortages of raw materials, lead times growing worse and -- of greatest concern -- the energy situation. Some are worried that energy shortages could cause industrial layoffs next year and lead to a recession.

One of the largest refineries in the District is experiencing difficulty in obtaining crude oil supplies. It must purchase 85% of its crude oil, and a significant share of that comes from the Mideast. The company is already allocating supplies to its gasoline stations and oil customers. A financial executive of the company informed us that refinery runs will be cut 20% in December and 30% or more in January if the Arab oil embargo continues.

A major concern of industrial firms in the area is that the energy crisis will precipitate layoffs, especially if natural gas is diverted to home heating. Previously, firms were able to switch to oil when gas supplies were curtailed; now they are uncertain if they can obtain oil.

The rubber industry in Akron reports shortages of raw materials as well as energy problems common to other industries. The petrochemical industry, which supplies the rubber industry with much of its raw materials, has been cut back in its oil allocations, and thus creating problems for the rubber producers.

The steel industry is still operating at peak capacity and is continuing to allocate orders. One major firm just opened its order books for first quarter delivery, and they expect to be filled by December. (As in the past, this procedure of opening and closing order books will cause a distortion in the monthly series on manufacturers' new orders for durable goods.) Fuel shortages are likely to curtail steel output in the months ahead, according to economists from three large steel firms. Cutback in either oil or natural gas will affect their output. In addition, one major steel firm is short on coal and coke. One economist said many of its smaller steel customers have been unable to accumulate inventories and have been forced to operate hand-to-mouth. Thus, any decline in steel output would adversely affect general manufacturing operations.

FIFTH DISTRICT -- RICHMOND

Results of our most recent survey of businessmen and bankers indicates that business activity in the District is still expanding. Further increases were reported in employment, and retail sales remain strong throughout the District. Manufacturers reported further increases in shipments, new orders and backlogs. District manufacturers continued to be plagued by raw material shortages and tight labor markets. The demand for business and consumer loans increased during the past month while the demand for mortgage loans declined. In general, manufacturing and retailing respondents expect that general business activity, both nationally and locally, will decline during the next six months. Business activity in the District is expected to decline less than nationally, however.

Our list of manufacturing survey respondents has been enlarged and this month's report is based on responses from 56 large manufacturing firms in the District. Survey responses indicate that business activity in the manufacturing sector remains strong. More than 30 percent of those surveyed reported an increase in shipments, new orders and backlogs. Increases were especially prevalent among chemical and machinery and equipment producers. Numerous respondents commented about tight labor markets and shortages of raw materials, especially petrochemical based materials. Complaints about the unfavorable impact of price controls were common. On balance, manufacturing respondents indicated that inventory levels were down compared to the previous month, with the decline in finished goods inventories substantially greater than that of materials. In general manufacturers believed that inventory levels were too low.

Survey responses indicated employment in the District increased during the past month. Increases in the number of employees were reported by 24 percent of the manufacturing respondents. While retailers reported no change in the number of employees, one-third of the banking respondents reported that employment in their areas had increased.

Price increases have been widespread in the District during the past month. More than three-fourths of the manufacturing respondents reported increases in prices paid and one-fourth reported increases in prices received. All of the retailers reported increases in prices paid and three-fourths reported increases in prices received.

Retail sales in the District remain strong. More than one-half of the retail respondents reported that sales had increased in recent weeks. In general, banking respondents indicated that retail sales in their areas had increased. Several retailers commented about the negative impact of price controls on profit margins. Comments by retailers suggest some customer resistance to top-of-the-line items and a higher than normal interest in medium priced and sale items.

The demand for business and consumer loans reportedly increased during the past month while mortgage loan demand declined further. More than three-fourth of the banking respondents reported that the demand for mortgage loans either declined or remained the same.

The shortage of funds continues to be reflected in residential construction. More than 90 percent of the banking respondents indicated that residential construction in their areas had declined. Nonresidential construction activity in the District appears to have changed very little since the previous survey.

District farmers continue to benefit from a greatly improved farm income situation, with cash receipts from farm marketings during January-August running 24 percent above a year ago.

In general, manufacturing and retailing respondents expect the level of business activity, both nationally and locally, to decline during the next six months. But both groups expect production and sales in their own firms to increase during the next six months.

SIXTH DISTRICT -- ATLANTA

The District's economy appears to be showing some signs of slowing down from its recent rapid growth pace. Reasons for the slowdown are energy and materials shortages and declines in residential and commercial construction resulting from high interest rates and overbuilding in some areas. Although announcements of new commercial projects and new or expanded plants continue to pour in, there is growing evidence that some of these projects may be delayed or canceled because of energy and materials shortages. Bumper crops are reported in some parts of the District.

According to Directors and businessmen, the energy shortage is beginning to have an impact on the District's economy. TVA announced that coal supplies are running low at several steam plants. The present stockpile is only 19 days rather than the preferred 90-day supply; anything below a 60-day stockpile calls for emergency measures. The shortage of diesel fuel is intensifying TVA's coal shortage. A recent cutback on allotments of diesel fuel means that barges which deliver about one-third of TVA's coal will not be in operation. TVA estimates that the energy loss from the non-delivery of coal is about 300 times that saved by the cutback in diesel fuel. This demonstrates the need for a more rational allocation of fuels. In Louisiana, a gas supplier has implemented cutbacks on natural gas supplies to its electric utilities and industrial customers in several southern states. As a result of this curtailment, 32 of 39 sugar mills in Louisiana will be without natural gas this fall, and a substantial part of this year's sugar cane crop may rot in the fields. The energy and fuels shortages are also causing a scarcity of nitrogen-based fertilizers. According to one Director, this means a shortage of food and high food prices next year. There seems to be a definite choice between suffering some cold this winter or a shortage of food next year. Two major airlines in the District, Eastern and Delta, have announced plans to cut back operations 5 percent and 3 percent, respectively, to save fuel.

The energy shortage, along with the past high level of building activity, has caused delays in the completion of many construction projects. Plastic plumbing, a petrochemical product, is now in short supply. Builders have had to revert to cast-iron plumbing. One Director indicated that plans for a new paint plant were canceled when the manufacturer found that he could not obtain the needed petroleum products. Shortages of cement, steel, and fixtures have also stretched-out completion of a number of projects. In most cases, contractors have been willing to pay whatever the asking price was to obtain materials. According to one Director, these same contractors will be less anxious to start new products because of these shortages.

Reports from around the District indicate that both residential and commercial construction continue to weaken. Although construction on many projects continues, partially because of delays in delivery of materials, a decline in building permits in most areas indicate that further drop-offs in home building are just around the corner. The tightening of credit has also affected the District's large mobile home industry. Reports from northwest Alabama indicate that mobile home plants have been shutting down and laying off workers. In central Florida, Bible World, a proposed $11 million tourist attraction, has been postponed indefinitely because of tight credit conditions. There is evidence of over-building of motels in central Florida. The hotel-motel occupancy rate in the Orlando area is approximately 41 percent, and some of the larger hotels are running only 24 percent of occupancy. However, a shortage of apartments still exists. Disney World, which has a problem in housing its employees, is building a 900-unit apartment complex on its property in Lake Buena Vista.

A large number of commercial and industrial projects continue to be announced. Several national corporations have announced plans to locate regional offices in the Atlanta area; four new hotels have been announced for its outlying areas. Some businessmen believe the present fuel shortages and the possible reduction in traveling may force cancellation of some of these projects. As last month's report indicated, the shortages of energy and materials are stimulating some new announcements of industrial projects. The energy shortage has forced a $28.4 million expenditure by Copolymer Rubber and Chemical Corporation in Baton Rouge in order to modify their equipment for a reduction in natural gas usage. In west central Alabama, Citadel Cement Corporation plans a $50 million Portland cement plant with an annual capacity of 750,000 tons. Pass Christian, Mississippi, seems certain to be the location of a $100 million Dupont chemical plant which will eventually employ 1,200 workers.

A new twist may be in the offing for foreign investment in the District. One Georgia official speculates that Japanese banks will soon be opening branches in Atlanta, and a British bank is currently in the process of establishing a branch here. A Japanese textile firm plans to build a $15 million plant in Augusta, Georgia. This will be the tenth Japanese firm in Georgia.

In agricultural news, the soybean harvest is going well; nearly 50 percent of the crop is harvested. Bad weather has reduced the cotton crop in middle Louisiana to 20 to 30 percent below last year's production. This year's Florida citrus crop is the second largest on record.

SEVENTH DISTRICT -- CHICAGO

The fuel situation was potentially critical in the Seventh District before the curtailments in oil supplies resulting from the Mid-East war. The President's conservation speech of November 7 was greeted as long overdue. Attempts to assess the overall impact of fuel shortages are still inconclusive. Demands for workers are very strong, and total consumer spending apparently continues at a very high level, despite reports of "consumer pessimism." The availability of residential mortgage funds has eased somewhat in the past month, but no significant reversal of the decline in residential construction is foreseen before mid-1974. Demand for capital goods (in fact, for all manufactured goods) is intense with widespread shortages of materials, components, and manpower impeding attempts to increase output, especially of buildings and equipment. Crop harvests have progressed rapidly. Farmland values have jumped sharply in the past year.

Business firms, governmental units, and many individuals are taking steps to cut consumption of fuel and electricity along the lines suggested by the President. Major electrical utilities in the District appear to be in a relatively good position to handle demand this winter because of relatively heavy use of nuclear power and coal. Many industrial users of natural gas and propane have been notified that their fuel would be curtailed or shut off. Some plants could shift to oil, but they have no current basis for an allocation. There is great uneasiness that layoffs will occur as a result of fuel shortages, not only in the industries using fuel and petrochemical feedstocks, but also in plants that require plastic parts and other components.

A "shakeout" of weaker competitors in the motor home and other recreational fields is said to be near-at-hand. Such a shakeout has been in progress for the past year in modular home building, and plant shutdowns are still reported.

The mortgage market has eased with rates in the Detroit area reduced from 9 to 8.5 percent in the past few weeks. The 8 percent usury ceiling in Illinois continues to limit new loans. Home sales in the Chicago area were off about 50 percent from last year in recent weeks. Nevertheless, a recent survey shows prices of existing homes in the Chicago area to average 10 percent above a year earlier, compared to an 8 percent rise in the previous 12 months.

This Bank's survey of farmland values shows an average increase of 17 percent from a year ago as of October 1, and a rise of 8 percent in the third quarter. These are the largest increases in the 20 years of the survey. The soybean and corn harvests are coming along very well. Most areas report lower grain moisture content (and better quality) than last year, so less fuel will be needed for drying.

When polled concerning their views of the U. S. economic outlook for 1974, business and financial executives in the District report expectations of slower growth (but no recession), continued rapid price inflation, weaker consumer markets, large capital spending, strong exports, and some rise in unemployment. This should be no surprise because they all see the same national publications and subscribe to the same services. When asked about their own prospects, most all executives report continued problems in meeting demand.

District experts are very concerned about reduced availability of diesel truck fuel, which could cut production in many factories dependent on trucks for shipments in and out. Postponements or reversals of environmental regulations relating to types of fuel used are deemed essential. Moreover, price controls are interfering with the most efficient distribution of available supplies. Gasoline prices in the Chicago area have jumped to 45-47 cents for regular, and a further boost to 55 or 60 cents is anticipated for next spring.

Factory output is being limited in most major industries by availability of supplies and manpower, not by lack of demand. Auto sales in October were somewhat below expectations, but sales still reflect production shortfalls resulting from lack of components and strikes. Consumer purchases of small cars, appliances, furniture, TV sets, audio products, and most soft goods are at a very high level. Demand for capital goods is so vigorous that some firms are having trouble untangling their order books. Farm equipment firms are "swamped" and will maintain output in the off season. Steel output is expected to be as large in 1974 as in 1973, despite a cutback in motor vehicles. Steel shipments earlier in 1973 were helped by liquidation of mill inventories and, therefore, steel shipments are expected to be lower in 1974. No net growth in steel capacity is expected in 1974, but a large expansion program has been announced for northern Indiana -- the first such announcement in recent years. Foreign demand for capital goods and for steel is excellent in virtually all markets, but not all orders can be accepted because of U. S. needs.

EIGHTH DISTRICT — ST. LOUIS

Business activity in the Eighth Federal Reserve District generally remains strong. Retail sales have continued to increase in recent weeks, but at a somewhat slower pace than earlier. Manufacturing firms generally remain operating at full capacity. There has been no letup in the problem of raw material "shortages" and backlogs of unfilled orders. However, businesses are reluctant to expand plant capacity even though current demands apparently call for further plant expansion. Credit demands at commercial banks have slackened off in recent weeks, but mortgage funds generally remain in short supply. In the agricultural sector, crop harvesting is generally on schedule for this date.

The uptrend in retail sales is continuing in the District, although at a somewhat reduced rate on a seasonally adjusted basis. Some outlets reported difficulties in making a profit at some of their stores, particularly in the central city areas. One remedy contemplated by these firms is to reduce inventories and offer somewhat different types of goods.

"Shortages" and production "bottlenecks" are problems of increasing intensity for business managers in the District. Shortages of basic raw materials were reported in numerous instances, and in the case of some products such as paper, boxboard, fabricated steel, brass, forestry products and gasoline, the shortages may have grown more intense in recent weeks. An increasing number of firms report rationing of a wide variety of raw materials by their suppliers. In the construction industry it is reported that a number of subcontractors are refusing to make bids because of uncertainties stemming from rapid price changes and availability of materials. In a number of instances shortages of raw or semi-finished products have led to production stoppages and the laying-off of workers.

Although most manufacturing firms are operating at or near peak capacity levels, some firms stated a reluctance to enter into long-term projects to increase capacity. These firms expressed a desire to be quite certain of the profitability of such projects before undertaking them. This reluctance apparently reflects many uncertainties including the near-term outlook for the economy and the possibility of profit restricting Government price control policies. Also, a number of firms reported that most of their recent investments were made to meet environmental requirements rather than provide for new capacity. Scheduled capacity increases for 1974 in many cases will not occur because of shortages.

Employment at major businesses in this District continues to inch up, according to the firms interviewed. "Shortages" of skilled labor continue throughout the District, and in recent weeks the problem was apparently more serious in the smaller communities than heretofore. The unemployment rate has remained stable at a relatively low level for several months.

Some large commercial banks in the area report a recent slowing of demand for business loans. The prime rate is generally 9-3/4 percent, although bankers felt that this rate will soon be reduced to 9-1/2 percent. One factor leading to the slackening demand for bank loans is the substitution of commercial paper for bank loans by large business firms. This reflects the more attractive commercial paper rate in recent weeks relative to the prime bank loan rate. Net savings at commercial banks and savings and loan institutions were generally reported to have increased recently, although at substantially reduced rates compared with the early months of 1973. Saving and loan associations, however, reported great difficulty in attracting funds in recent months. This apparently reflects the strong competition from commercial banks and higher yielding market instruments such as Treasury bills, government agency securities, and commercial paper.

Favorable harvesting weather has permitted farmers to get "on schedule" with crop harvesting operations despite the later than normal planting of crops. Crops are generally good and record breaking farm incomes are in prospect.

NINTH DISTRICT -- MINNEAPOLIS

Despite evidence in national surveys of declining consumer confidence, District retail spending continues to expand, but there are signs of slowing. Many District businessmen plan to increase their plant and equipment spending; there was less certainty, though, about increasing inventory outlays. In response to the President's request, District businessmen and Governmental officials are adopting energy conservation programs and are very concerned about the adequacy of fuel supplies this winter. District farmers are making good progress in harvesting this year's crops and look for record yields.

Although Bank Directors reported that consumer spending continues quite strong and District retailers in general look for a good Christmas season, some softening in sales growth has recently emerged. A Director associated with the retail trade industry revealed that a recent decline in consumer sentiment has not yet affected his firm's sales. He did, however, express some concern about how the recent deterioration in consumer confidence would affect Christmas spending. Furthermore, he stated that substantial year-to-year sales gains this Christmas season are going to be hard to achieve, since sales gains were so large last Christmas. A Twin Cities area banker disclosed that his commercial customers report some recent slowing in retail sales gains but are quite optimistic about Christmas spending. Another Minnesota director noted that retailers in his area are optimistic about Christmas spending but are experiencing delays in receiving needed inventories. Given the favorable agricultural situation, a North Dakota director termed the outlook for retail spending in his state as very good. A Duluth Director indicated that a definite softening in his area's retail spending has occurred in the last three weeks, and many retailers expect that Christmas spending will probably remain at last year's level.

District businessmen, according to Directors' responses, plan to increase their plant and equipment spending, but the outlook for inventories was mixed. One Director said that customers surveyed by his bank plan to substantially increase their plant and equipment spending and that many firms want to expand their inventories but are encountering supply constraints. Another Director disclosed his firm is having difficulty obtaining steel supplies as a result of recent increases in business spending. In the Upper Peninsula of Michigan, the construction of a large mining installation has stimulated a great deal of plant and equipment spending. In the Duluth area, several major capital investments are under way, but businessmen are being very cautious with regard to inventory spending.

In response to the President's request to curb energy usage, District businessmen and Governmental officials have instituted fuel conservation programs. Many Minneapolis/St. Paul businesses have announced plans to forego their annual Christmas lighting, and temperatures have been lowered in many of the area's major office buildings and plants. In addition, the airlines headquartered in the District have cut flights. Furthermore, many firms are encouraging their employees to form car pools and are imposing 50 m.p.h. speed limits on company vehicles.

Fuel shortages have not yet seriously hampered District business activity, but businessmen are concerned about shortages this winter. A Twin Cities area retailer thought it possible that his firm may have to shorten hours this winter. Although a lack of fuel has not yet restricted operations, major district manufacturers reported difficulties obtaining needed supplies. If shortages develop, two firms indicated they may shift to a four-day week, while another may close its smaller plants. Twin Cities area motor carriers are very concerned about inadequate fuel supplies, and one railroad headquartered in the District looks for a really difficult winter. Major fuel oil distributors are not accepting any new business but are hopeful they will be able to meet their old customers' fuel needs this winter.

Blessed with favorable weather in recent weeks, farmers in the grain-producing areas of the District have made good progress in harvesting this year's crop. Favorable harvest conditions have all but eliminated the threat of propane shortage for drying the District's 1973 corn crop. As of November 4, the harvest of soybeans in Minnesota was 98 percent completed. The corn harvest was 74 percent completed, compared with less than 50 percent a year ago. Record yields are now being forecast for both crops.

TENTH DISTRICT — KANSAS CITY

Directors of the Federal Reserve Bank of Kansas City and its Branches report that economic activity remains generally strong in their areas, with the exception of residential construction. Concern was expressed about the energy supply situation, and most respondents called for an end to wage-price controls. Farm prospects continue strong, except among some cattle feeders. Total loan demand at District banks was weak in October, with business loans the weakest component.

General economic activity remains strong in most parts of the Tenth District, although some slowing in the rate of increase has occurred. Retail sales as a whole continue to be fairly strong, but automobile sales seem to be weaker than anticipated earlier. Residential construction is reported to be generally slower across the District. Homebuilding is off in Omaha and Oklahoma City as well as in out-state Nebraska and Oklahoma. Earlier overbuilding of apartments in Oklahoma City has led to extremely high vacancy rates as well as to a halt in new construction. Only Denver reports continued strength in homebuilding, with construction labor in tight supply. Commercial construction activity is holding up better than homebuilding in most areas.

Two matters of concern were mentioned specifically by several Directors: the energy situation, and wage-price controls. Reactions to the energy situation were mixed. (These reports preceded the President's speech on the subject.) Several Directors blamed the situation on "going overboard on ecology." "Much concern over the energy crisis" is reported from Albuquerque, while little concern was reported from smaller cities and agricultural areas of Colorado and Oklahoma. While one respondent felt that the situation was not as critical in Denver as elsewhere, another reported that "people here in Denver are scared...of what the energy crisis will bring." One Director believes that current economic forecasts are giving too little weight to the energy supply situation.

Only one Director spoke in favor of keeping wage-price controls in place. All others commenting on them believed that controls should be abandoned soon, as being "ineffective" and "an unnecessary nuisance." A Director in the steel business remarked that controls have really "goofed up" that industry, specifically by keeping prices of some items so low that they become unprofitable to produce and hence difficult to get.

Generally, farm prospects continue strong in most areas, although the downturn in cattle prices has put several producers in serious trouble. This stems from their buying feeder animals at unrealistically high levels and then holding them too long, thinking that prices were bound to go up shortly after the freeze was lifted. However, it was the Directors' view that, while a few smaller operators would suffer big losses, most producers are in good enough financial shape to weather the storm, assuming that cattle prices strengthen in the not too distant future. Most of the other sectors seem to be in excellent shape. The harvest is progressing rapidly, the crops are good, and prices are such that crop income will show a sharp jump over last year. Furthermore, producers of feeder and stocker cattle are still making good profits, although not as good as was experienced earlier in the year.

Locally severe flooding occurred this fall in parts of Kansas, Nebraska, and Oklahoma. The effects in Nebraska have not been as harmful as first expected, and high prices and good crops there are contributing to a healthy economic situation for the state as a whole. In Oklahoma, the floods affected some of the best wheat land in the state. The major impact there is likely to be the lessened availability of winter pasture on much of that land.

Tenth District bankers indicate that total loan demand was weak in October, although this was not uniformly true for all banks contacted. In general, the component of loan demand reported weakest was business loans, while agricultural and real estate loans were generally steady. On the other hand, consumer installment loan demand was reported as being strong. Most respondents reporting weak loan demand also reported that the interest rates they were charging were declining or would decline in the near future. The decline in interest rates was attributed to the need to keep rates in line with money market conditions in New York. One respondent reported that it lowered its rates to compete on a national level with large money center banks as its national business was off somewhat. No respondent reported any effects on rates charged from the newly imposed ceiling on wild-card CDs.

Total deposits at weekly reporting banks continued to increase in October. In conformity with the trend for this year, but in contrast to September, most of the increase in deposits was in time and savings deposits rather than in demand deposits. Large CDs at weekly reporting banks also increased substantially in October. Several of the banks surveyed, however, especially those reporting weak loan demand, reported a runoff in CDs and a reduction in their CD rates. This gives rise to the possibility that the runoff may have been intentional on their part.

ELEVENTH DISTRICT -- DALLAS

Recent changes in economic indicators suggest that the Eleventh District economy is continuing to grow, although the present expansion may have begun to slow. Texas industrial production and District employment advanced strongly in September, and District agricultural conditions are good to excellent. But new construction contracts and demands for credit dropped sharply, and department store sales have leveled off. In addition, an informal survey in early November of Texas buyers of crude oil, petroleum industry associations, and Texas railroad commission staff revealed broad concern over the adequacy of present and future availability of crude oil and refined petroleum products to meet the state's energy requirements.

Several respondents felt that present stocks of crude and refined products are not as adequate as statistics indicate because figures include pipeline fill. As a result, fuel stocks may only be sufficient this winter to see the state through its first severe cold spell. Moreover, the crude oil buyers indicated that they are already having difficulty finding the supplies to meet their company needs and the full impact of restrictions already placed on petroleum exports from the Middle East has not been felt.

The outlook for oil availability is further dimmed since production in Texas oil fields is currently falling at a rate around 3 percent per annum, while demand has been rising about 6 percent or more a year. Some of the Texas railroad commission's staff indicated a belief that the commission would be reluctant to waive conservation restrictions to allow greater production and that it may not have the legal authority to do so in any event.

The survey respondents were also concerned that new mandatory allocation programs based on historical use patterns would make fuel oils more scarce in the Gulf states. In Texas, for example, many utilities and industrial concerns have recently switched from expensive and hard-to-get natural gas to fuel oil, and consequently, they may not qualify for allocations on the basis of past use patterns. Many farmers could be denied diesel fuel because last year's weather conditions prevented planting and reduced their demand for fuel. Similarly, some drilling and transportation firms face problems obtaining diesel fuel because they have recently switched from another type of fuel or because the mobility of their operations has not allowed them to establish a use pattern in a given region.

Seasonally adjusted total employment in the five District states rose 0.6 percent in September. Gains were made in all sectors except nondurable manufacturing, but the increase largely reflects a sharp rise in construction and governmental employment. The 4.0 percent unemployment rate for September is 0.4 percentage points lower than the figure a year earlier, but it has remained in a narrow band around 4.0 percent since November 1972.

The seasonally adjusted Texas industrial production index advanced 1.0 percent in September to a level 7.4 percent higher than a year ago. All major components contributed to the increase, but the advance in utilities was particularly sharp.

Department store sales in the District were 7.8 percent higher in the four weeks ended October 27 than in the comparable period of 1972. But at the same time, the sales pace has subsided from the peak reached last August when sales were 5.2 percent above last month.

Construction activity in the five southwestern states, as measured by the value of new contracts, fell 25 percent in September. Contracts declined in all categories, but most of the fall resulted from reductions in awards for residential and nonbuilding construction. While the value of nonbuilding contracts has vacillated each month this year, residential contracts have generally declined since June. Agricultural conditions in the five District states remain good to excellent as the harvest of a bumper crop gathers momentum. If current conditions prevail, crop production for 1973 is anticipated to reach a level 22 percent higher than in 1972, and livestock production is expected to be slightly greater than last year. As production increased, average farm prices have also risen. Through the first eight months of this year, cash receipts from farm marketing rose to $6.0 billion, 35 percent greater than in the same period of 1972.

TWELFTH DISTRICT -- SAN FRANCISCO

Our Directors have mixed views on the prospects for a recession in 1974. Some expect a slower, though still not satisfactory, rate of growth, but others expect a mild recession. Inflation is expected to be less severe in 1974. A new source of uncertainty is the impact of fuel shortages on employment and production. Bankers report less demand for some classes of loans and interest rates are somewhat lower.

Although the general level of economic activity remains high in this District, and many of our Directors expect a continuation of growth at a somewhat lower rate, other Directors think there will be a mild recession in 1974. Weakness is now apparent in consumer durable expenditures, and residential housing construction remains weak. A further complication is the energy shortage which is beginning to create significant problems in some states such as Oregon and Washington. Layoffs, caused by fuel shortages, are likely to be more common later this winter. In contrast, outlook is for continued strength in business investment expenditures and exports.

The labor market in most District states is nearly fully employed, with the exception of Washington where the unemployment rate is still above 7 percent. In most states, unemployment is highest among unskilled workers. Banks report no shortage of applicants, including college graduates, for entry and training positions. In particular, there is a surplus of applicants with graduate training. Despite reports of shortages of skilled workers, there is no indication that lack of labor is holding up production; the principal bottlenecks in industry are caused by lack of capacity and materials. There are, however, some industries where layoffs have occurred because of lack of demand. Lockheed has recently laid off production workers in its southern California plants. Generally, the unemployment picture in this District has not changed very much in the past six months.

Agricultural prospects remain excellent. Farmers are maintaining heavy expenditures for new equipment and for consumer durables. In most areas the demand for farm land has jumped substantially, and in California new irrigated farm land is being brought into production in response to high agricultural prices. Farm income in the District is expected to climb in 1974.

In construction, non-residential building remains very strong, but residential construction continues to fall. The decline in housing activity had caused lower lumber and plywood prices, and producers had expected to cut back production this winter. However, fears of shortage of fuel and glues for plywood has caused a resurgence of demand by buyers who are attempting to build up inventories.

Except in agricultural areas, consumer spending on durables and automobiles has fallen off. Spending on nondurables is still growing and many, but not all, retailers expect excellent Christmas sales. Demand for automobiles has weakened with large domestic automobiles experiencing the greatest declines.

Demand for compact cars, both foreign and domestic, is still satisfactory. Many Directors are worried about a possible energy crisis this winter. The energy shortage is likely to be most severe in the Pacific Northwest where a hydro-electric power shortage exists. If serious oil and gasoline shortages develop, then production cutbacks would occur. Reductions in oil imports might also create further shortages of chemical fertilizers.

Many banks report less demand for loans but there is considerable variation among banks as to the specific categories affected. A large Oregon bank reports a decline in consumer credit to finance durable but an increase in general consumer credit, especially through its credit-card lending. Agricultural lending is high at some banks, but at others, increased farm income has resulted in less borrowing. In Utah, a softening in demand for mortgages is noted, but a large California bank reports an increased demand for real estate loans. Business loan demand is lower at several California and Oregon banks. One bank explains the decline as reflecting a shift to financing through other sources such as commercial paper. Other banks expect a recovery in business loan demand in the next few months. In contrast, loan demand at other banks in California is still strong, with the funds being used to finance inventories.

Interest rates have eased off, but they are expected to be firmer in the months ahead.