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CURRENT ECONOMIC COMMENT BY DISTRICT

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Federal Open Market Committee
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SUMMARY*

Energy shortages are beginning to cause considerable concern, but as yet the pace of economic activity continues to be strong. Retailers in most Districts anticipate good Christmas sales, and agricultural earnings continue to climb. Capital expenditures are another source of strength, and although considerable variation is reported for business investment plans for 1974, the prospects are that capital spending will remain high. Weaknesses are most apparent in residential housing and automobile sales.

The impact of petroleum shortages varies considerably from region to region, and from industry to industry. The prospective gasoline shortages are one cause of reduced demand for regular-size domestic automobiles which has resulted in layoffs in several Districts (Atlanta, Chicago, Kansas City and San Francisco). Sales of compact cars are excellent, and so, interestingly enough, are sales of luxury cars. Diesel fuel, in particular, appears to be in short supply and black markets for this fuel are reported to be developing in some areas. Other industries affected include petrochemical-based plastics, manufacturers of recreational vehicles, and plywood mills. Airlines are laying off employees in several Districts, and tourism-related manufacturers are being hurt according to reports from Minneapolis, Kansas City and San Francisco. Atlanta, in contrast, notes optimism about Florida's tourist business.

Shortages of natural gas are causing problems for the manufacturers who are forced to cut production or shift to high-priced fuels such

*Prepared at the Federal Reserve Bank of San Francisco as propane. Electrical shortages are not prevalent. New England, whose utilities rely relatively heavily on residual oil, appears to face the most serious problems and may have power blackouts this winter. In other areas, conditions have improved. The Pacific Northwest's power shortage has been relieved by heavy rainfall in November.

The view expressed in most Districts is that the uncertainty caused by the energy shortages is disrupting transportation and causing shortages. This is likely to slow economic activity in 1974. However, there is considerable variation in opinions as to the net impact. Some respondents do not think that the shortages will be so severe as to cut into expected capital expenditures or to cause serious layoffs, but others think a serious recession is likely. Directors in the Boston District seem to be most pessimistic in this regard.

As to the proper government response, opinion is divided between those favoring rationing and those wishing to rely upon voluntary reductions. In the St. Louis District, there is less concern about energy shortages and more concern about inflation and the effects of government price controls as a factor causing materials shortages. Similar views are noted by Cleveland.

Chicago, Philadelphia and New York Districts report little change in current investment plans. For example, Chicago describes capital goods manufacturers as being overwhelmed by orders, but St. Louis reports reductions in investment plans. Although there is some reluctance to project trends, there is considerable support for expecting continued heavy investment expenditures. Retail sales in most Districts are equal to or exceed last year's levels but retailers are more uncertain about 1974 and are more cautious about their spring orders. A survey by Richmond indicates 70 percent of its respondents expect a lower rate of economic activity.

High agricultural income is stimulating the heavy expenditures by farmers. Dallas reports harvests and plantings equal to or exceeding last year's schedule for all crops. On the other hand, cattlemen are more uncertain about beef markets. Prices have declined and supplies of beef for slaughter are abundant.

Residential construction is continuing to fall off and it is only being partially offset by commercial construction. Increases in flow of mortgage funds, reported in several Districts, may help but the prospect is for a continued decline.

Dallas reports that oil drilling has responded strongly to the incentives of higher prices and is at the maximum level for the existing availability of crews and rigs. But production from Texas fields is expected to decline because these fields are past their peak in production capacity.

In summary, despite local problems the economy is continuing to expand but uncertainty caused by worry about energy shortages may contribute to a revision of spending plans by businesses and consumers.

FIRST DISTRICT--BOSTON

Our directors fear that in the near term the energy crisis will push the economy into a recession, but they also see the energy situation as stimulating large capital outlays. They feel that both fiscal and monetary policies must be geared to encouraging investment in energy-related areas. For New England as a whole, and Massachusetts in particular, shortages of residual oil (needed to run utilities) and home heating oil will be critical, carrying real threats of rolling blackouts by the electric utilities this winter.

Looking at the supply of oil at the national level, one of our directors,who is an independent oil and gas driller in Louisiana and Texas,states that increasing prices at the wellhead will not substantially increase oil and natural gas production. It is much more important, he said, to increase acreage released by the Federal government for offshore drilling. Other productive measures, according to the director, are stepped-up licensing of nuclear plants and building six oil refineries yearly in the U.S. Our directors pointed out that the proportion of investment in energy-related areas must be raised from the 20 percent of total business investment spending of the last decade to 30 - 40 percent of total capital outlays. They believe that higher energy prices have rendered obsolete much of the current capital stock, which was based on low energy costs, and that appropriate fiscal and monetary policies are needed to help finance the tremendous new investment needs.

On the demand side, one director noted that an internal company study showed it would not be difficult to cut energy use by 20 percent by simply taking energy-saving steps which they should have used all along. Another director from a large conglomerate which manufactures general aviation planes and boats said that material shortages of aluminum and fiberglass would cut his output more than the expected drop in demand. He reported that these companies are "scared to death" over the outlook.

While most New England industries are not energy-intensive, the total dependence of our electric utilities on imported residual oil makes the oil shortage very critical for the economy here. Electric power production is a necessary, if not sufficient, condition for all production. Our utilities are forecasting a 25 - 40 percent shortfall in needed residual oil for 1974.1. There is currently no operating allocation program at the Federal level for residual oil, and, even if there were, there are great doubts that logistically the supplies could be brought to New England. Under these conditions, the Governor of Massachusetts has asked for emergency powers to close schools, put state employees on a four-day workweek, limit retail establishment hours, etc., in order to decrease demands on the electric utilities. The electric utilities in Massachusetts have announced that without these measures, they will have to have rolling blackouts which will cut different users off about 20 percent of the time.

Professors Samuelson, Shapiro, and Wallich were contacted this month. Dr. Shapiro now sees 1974 as a year of no output growth, with the unemployment rate above 6 percent by year-end. Due to lower incomes, the budget may not show the surplus which had been hoped for. Shapiro's main concern is that the Fed doesn't loosen too much, and feels this is an opportunity to try to wipe out excessive demands and price expectations. He proposes an even keel policy for the aggregates -- 4 to 5 percent growth in money, 7 percent in the monetary base -- even if short-term interest rates were to rise.

Noting the rise in new orders for durables, Wallich believes there is no evidence of a serious downturn. He stated that supply difficulties always lead to expansion -- large cars, houses and some business equipment have become obsolescent and now need to be replaced. He doubts there will be a cutback from the 14 percent increase in business investment reported in the McGraw-Hill survey. Wallich grants there may be a downturn in the first quarter but expects the expansion to begin again, if the embargo is ended by mid-year. With prices rising faster than the money stock, he pointed out "the situation is tightening itself." He advocated a continued, moderately tight policy until the downturn is seen.

Samuelson argued that "when an exogenous microeconomic event (i.e., the energy shortage) raises the price level, that inflation is limited by the event itself and is not recurring." Accordingly, it is not the duty of the Fed to roll back those prices but instead its duty is to provide for the limited structural increase in prices. He favored a "supportive" monetary policy, focusing on interest rates, between now and next Easter. The policy target should be to bring short rates down slowly, tolerating shifts in the demand for money such as the upward shift which recently occurred.

SECOND DISTRICT--NEW YORK

Second District directors and other business leaders contacted recently expressed considerable concern over the energy crisis. Shortages of petroleum were viewed as affecting a wide range of industries and as likely to lead to a marked reduction in the growth of economic activity next year and, perhaps, to a recession. For the most part, however, business capital spending plans were expected to hold up in spite of the energy situation. The business inventory picture was mixed but on balance pointed to attempts to increase inventories that may well not succeed because of shortages. The respondents expected retailers to enjoy a relatively good holiday season, but anticipated a leveling off in sales over the coming months.

The respondents continued to feel that the shortages and rising costs of petroleum products, both as fuel and as raw material, were going to have a pronounced adverse effect on virtually all segments of the economy. Typical of their assessments of the situation was the expectation that supply constraints on output will eventually result in a drop-off in demand owing to growing unemployment and reduced corporate and individual earnings. Several respondents forecast zero or negative growth in real GNP in 1974. A New York City banker, a head office director, saw possibilities that the shortages might lead to a significant decline in GNP. In his view, efforts to curtail industrial and consumer energy consumption might ease the problem but not solve it. Similar sentiments regarding the overall impact of the energy crisis were expressed by a number of other respondents, and senior officials of a wide range of manufacturing as well as retail firms complained of specific problems the petroleum shortage was having on their respective firms. Several respondents noted that the energy crisis had been building up for some time, and would have emerged in the not too distant future even without the Arab embargo, in good part as a result of insufficient investment by the oil industry in past years in the face of rising worldwide demand.

Against this background, the Buffalo directors generally felt that the Government's allocation program did not go far enough and that a system of rationing was needed. Other respondents variously called for tougher and more clearcut allocation measures that would give priority to the maintenance of industrial and agricultural output, and for severe cutbacks in non-essential use. Efforts to increase domestic fuel supplies were urged, but as several respondents noted, a fairly long lead time and very large capital investment would be necessary before a significant increase could be expected.

Regarding business investments, those respondents commenting on business capital outlays reported that either their firm or the firms of most of their business contacts intended to implement current plans with no cutbacks. One respondent, however, qualified his remarks by stating that "all bets are off" because of the energy crisis. With respect to inventory policy, the retailers stated that they intended to keep their stocks on hand under close scrutiny in view of the expected leveling off in consumer demand. Other respondents, however, felt that businessmen were actively attempting to strengthen inventory positions,reflecting fears of increasing shortages and higher prices, as well as lower than normal inventory positions. Some felt that existing shortages of both raw materials and finished goods might well frustrate these efforts, with only a slight or no increase in inventories. Several Buffalo branch directors, however, believed many businessmen would find substitute products to meet their requirements and that such shifts in demand might mitigate somewhat the unemployment situation. Some respondents mentioned the possibility of a rise in inventory-to-sales ratios -- even of involuntary inventory accumulation -- if the expected decline in business activity materializes.

Concerning consumer spending, senior officials of retail firms who were contacted looked for a fairly good holiday season, comparable or somewhat better than last year's. These expectations were shared by a number of other respondents. However, the respondents in general were markedly less ebullient than at this time last year. Moreover, most realized that there were "clouds ahead" for the retail sales industry. Shortages of goods were expected to become more acute as stocks on hand for the holiday season were drawn down. On the demand side, tapering off in consumer outlays was expected to accompany the anticipated economic slowdown. In addition to the rise in unemployment, worries over the economic outlook, resistance to high prices and curtailment of automobile use to reach shopping centers were also cited as factors likely to affect sales adversely.

THIRD DISTRICT--PHILADELPHIA

Business activity in the Third District is tapering off in some areas and the six-month outlook is not very bright. One in five of the firms contacted report a decrease in their current level of business activity and over 60 percent expect decreases by late spring of next year. Employment opportunities are stable at last month's level.

Investment in inventories is down slightly, but plant and equipment spending plans are strong. In the retail sector, sales are currently running slightly below expected levels. Construction activity has leveled off in most areas -- especially residential construction. Area bankers report that credit is tight because deposits are only trickling in. Finally, price increases are widespread and expected to continue over the next six months. Manufacturers in the Third District responding to this month's business outlook survey report slight decreases in their output. Though roughly two-thirds of the firms report no change in their new orders, shipments, and unfilled orders, most of the remainder experienced declines. Six months from now the responding executives expect more significant decreases. Approximately half the executives contacted foresee drops in new orders, shipments, and unfilled orders by May.

Current employment opportunities are not significantly different from last month. The few firms reporting layoffs are about equal to the number that are hiring. However, the length of the average work-week has been trimmed at a few factories. By next summer, however, over one-fourth of the responding firms expect to be laying off workers and cutting down the length of their workweek.

Business investment in inventories is unchanged at most firms contacted this month. But, over 40 percent expect to cut their inventories in the first half of next year. In contrast, investment in plant and equipment is expected to be up strongly. Retail sales are not as high as might be expected for the Christmas season according to area department store executives. Most stores' dollar volume for the year-to-date is up because of inflation, but their physical volume is down slightly. Accessories, like handbags, jewelry, and sportswear, are selling well. Blankets and electric blankets are in strong demand too. Shoppers are showing preference for lower priced models when given a choice of prices.

Construction activity in the Third District has leveled off somewhat. Residential housing starts are about flat. But public works projects are up significantly. Price increases are prevalent as over 60 percent of the firms report paying higher prices, and almost 90 percent expect to be paying higher prices in the next half year.

Bank credit is tight in Philadelphia as the loan-to-deposit ratio for all of the local reserve city banks hovers around 99 percent. Demand for mortgage and commercial and consumer loans remains strong according to the bankers surveyed. But, loans are not growing faster because deposits are coming in slowly at the banks contacted, and loan applications are not being encouraged. Demand deposits are about flat. Time deposits rose slightly in the last two weeks at some of the city banks, but high short-term market rates are keeping deposit funds scarce. Most banks aren't increasing their outstanding CD's. On balance total deposits remain unchanged at most banks.

FOURTH DISTRICT--CLEVELAND

Activity in the District's manufacturing sector remains strong, although shortages of fuels and raw materials seem to have become more severe in the past month. Two major tire companies may reduce their capital spending plans for next year as a result of the energy situation. Retail trade is showing signs of weakness. Housing continues to decline sharply. S&L's are experiencing a recovery in net savings inflows, but remain cautious about making mortgage commitments.

In recent weeks, there have been scattered reports of industrial layoffs as a result of fuel shortages. Total employment in the District is still rising, however, and conditions in the manufacturing sector generally remain strong. Early returns from our monthly survey of manufacturers and the latest report from purchasing agents in the Cleveland area indicate a pickup in new orders and production during November. Shortages of fuels, raw materials, and parts have worsened in the past month. Firms are experiencing difficulty accumulating inventories. Our survey shows a continued lengthening in delivery time for orders placed, and purchasing agents report further extension of buying lead times for both production materials and capital equipment. Manufacturers of capital goods are reported to be having difficulty in shipping completed equipment because of parts shortages.

An economist from a major rubber and chemicals firm reports that output of chemicals has been seriously affected by supply shortages.

One of our directors, whose firm manufactures rubber and plastic goods, reported that the company is on an allocation basis with several suppliers of petroleum-based raw materials. He indicated that there is evidence that increasing quantities of feed stocks (benzene and styrene) for the plastics industry are being sold abroad in response to higher prices. The firm is also out of titianaux -- a basic raw material for white rubber products -- and they are unsure when supplies of this material will be available again.

According to this source, the chemicals industry is not able to secure enough of its raw material requirements. Most shortages are attributed to price controls, which are thought to have led to the disappearance of certain items from domestic markets. Firms in the rubber and chemical industries are re-evaluating capital spending plans for next year, and a substantial cutback from previous projections may be in store.

Steel industry economists report that demand remains strong. Orders continue to be controlled to reduce the carryover of shipments past due. Auto manufacturers are beginning to reduce orders; but steel released can be reallocated easily to other industries. The economists expect about a 25 percent increase in the steel industry's capital spending next year. A considerable amount will be spent on pollution controls, and a major portion of the rest will go toward eliminating bottlenecks in existing equipment. Reduction of bottlenecks is expected to add about 10 million tons of capacity at less cost and in much faster time than attempting to increase capacity by starting from scratch. The steel economists are reasonably confident that demand for steel will remain at a high level throughout 1974, if energy supplies are adequate. One steel producer is concerned over the increased use of oil as a substitute for coke, which has been in short supply. Another steel producer foresees production curtailments if the steel industry is not exempt from proposed plans to limit industries to 90 percent of 1972 oil consumption.

Our contacts in the auto industry are expecting a decline in total new car sales to about 10 million units in 1974; sales of recreation vehicles are also expected to drop sharply. An auto industry economist reported that the industry has already shifted as much production as possible from large to small cars for 1974 models.

A major retailing firm headquartered in the District reports a flattening in sales of general merchandise, apparel, and furniture since September. Sales and bargains are more widespread this Christmas season than last. The firm is expecting a mild recession in the first half of 1974 with virtually no growth in GAF sales.

An economist from a large retail food chain reports a recent drop in meat prices as a result of West Coast transportation strikes, which left a big supply in the Midwest, and a slight decrease in demand from institutional buyers. If prices remain depressed and feed costs continue at present levels, there will be a severe cut in beef production by mid-1974.

Residential construction contracts in the District continue to decline sharply, while nonresidential building remains strong. S&L's report a rebound in savings flows during November and early December. However, an FHLB economist in the District is concerned over prospects for savings flows early in 1974 when a large volume of CD's is scheduled to mature. He felt if rates were 8 percent or higher on Treasury bills, funds would again shift from the S&L's into the money market.

FIFTH DISTRICT--RICHMOND

Results of our most recent survey of businessmen suggest that business activity in the District continues to expand. The energy shortage has resulted in a high level of uncertainty, however, and respondents are pessimistic about the outlook for business activity. Reports of raw material and labor shortages continue to be widespread. Retail sales showed further increases during the month of November. Employment increased further, despite a number of scattered lay-offs related to the energy shortage.

Survey responses suggest that the pace of activity in the District manufacturing sector moderated during the month of November. Although reports were mixed, a consensus of the responses indicates that shipments, backlogs and new orders were essentially unchanged. Declines in shipments,new orders and backlogs were reported by textiles and furniture producers while chemical, primary metal and machinery producers reported increases. As in recent surveys, numerous respondents commented on the disruptive impact of raw material and labor shortages, and uncertainty over the potential impact of the energy shortage is widespread. In general, manufacturing respondents reported that inventories had declined in recent weeks, and more than one-third believed that inventory levels were too low in view of sales prospects.

Employment in the District apparently increased further since the last survey. Both manufacturing and retail respondents reported additions to their work forces, and hours worked per week in manufacturing were unchanged. Scattered reports indicate some lay-offs related to the energy shortage. A number of automobile dealerships have released workers, and a sizable number have reduced their hours of operation. At least one parts manufacturer has cut back its work force.

Additional price increases were reported by the majority of manufacturing and retail respondents. Nearly 80 percent of the manufacturing respondents indicated an increase in prices paid, and one-fourth reported an increase in prices received. Increases in prices paid were reported by 100 percent of the retailers, and 70 percent reported increases in prices received.

Reports from major retailers in the District suggest that retail sales remain strong. Sixty percent of the retail respondents reported increased sales during November, with many of these noting that consumers are more price conscious because of the uncertain economic outlook. The energy crisis is apparently causing some retailers to go slow on spring orders.

Judging from the experience of large commercial banks in the District, the demand for consumer and commercial and industrial loans declined in November while the demand for real estate loans increased slightly.

Record high prices for most grades of flue-cured tobacco highlighted the 1973 marketing season. Quality of the tobacco was generally better than last year, and the general average price soared to a new all-time high of $88.13 per hundred. Volume was up 17 percent and value of gross sales hit a record $905 million, topping the value of the 1972 crop by 20 percent.

The sharply improved farm income situation has continued through the first three quarters of 1973. The District gain of 23 percent, however, is considerably less than the 34 percent recorded nationally.

In general, survey respondents are pessimistic about the economic outlook. More than 70 percent believe that the level of business activity nationally will worsen during the next six months, and more than 50 percent believe that local business activity will decline.

SIXTH DISTRICT--ATLANTA

Reports from area businessmen indicate that energy shortages are beginning to affect the District's economy. A wide range of industries has already or is expected to be affected by direct shortages of energy or petrochemical by-products. Labor shortages and order backlogs also remain acute in most industries. Some stockpiling of materials which are in short supply was noted. The effect of currency realignments has improved demand for many products while causing shortages of some materials. In general, area businessmen expect a marked slowing of the District's economy next year.

Manufacturers of automobiles, boats, chemicals, textile and apparel goods, along with poultry producers, advertising firms, telephone companies, airlines, residential builders specializing in second homes, and the tourist industry have all been affected or will be affected by the energy shortage. The two large Atlanta area General Motors auto assembly plants have announced that more than 6,000 workers will be temporarily laid off beginning December 17 to permit retooling for smaller cars. Further reductions in schedules and employment have been announced by airlines headquartered in the District. Miami-based Eastern Airlines has announced that nearly 5,000 employees will be laid off, partially because of fuel shortages.

Several boat manufacturers in Florida and Tennessee have closed temporarily because of a shortage of petroleum derivatives needed in making fiberglass. Telephone companies are having trouble getting commitments for gasoline deliveries this year and next. This will curtail the large repair fleets of cars and trucks operated by these companies. Advertising has also been hit by the energy shortage. One Florida broadcasting company reports that weeks ago major oil companies cancelled all long-term advertising contracts; airlines and most national auto producers soon followed. An Atlanta area advertising firm indicates that while most national advertisers have reduced their budgets, local advertising has taken up the slack.

There is also much speculation about the effects of the energy shortage on other industries. Man-made fibers, a petrochemical by-product, are in short supply and limiting the output of the textile industry. Besides fuel shortages, one textile manufacturer noted that wool is in short supply and that he cannot supply customers with sweaters this winter. Fuel shortages may also cause serious cutbacks in Georgia's $800 million poultry industry, affecting transportation, production of feed, and heating of broiler houses. The fuel shortage is apparently hurting the resort and second-home markets and, in general, changing home-buying patterns, favoring inner city locations over more suburban neighborhoods.

Although some knowledgable observers still express optimism about Florida's tourist industry, economists for the state reportedly forecasted a rise in Florida's unemployment rate, from the present 2.5 percent to the 6.5 percent range. Motel occupancy along Georgia's interstate highways, where customers are mainly out-of-state tourists, is down, and they are expected to be severely hurt by the gasoline situation.

Shortages of other materials are plaguing many District manufacturers, and there are attempts to stockpile. One large chemical manufacturer has reduced deliveries of polyesters by 10 percent because of a shortage of raw materials made from petrochemical feed stocks. Shortages of steel and boxes are also delaying delivery time, and his customers have attempted to stockpile some of these materials in short supply. The owner of a truck leasing firm felt that tires (again produced from petrochemical by-products) would soon be in short supply and indicated that he was now trying to stockpile a 60-day supply.

Area businessmen indicate that the currency realignments have had a beneficial effect on demand for their products. One textile manufacturer indicated that he could sell his products at higher prices overseas and make greater profits in the short run. The representative of a hosiery mill reports requests for such products as ski and sweat suits that were formerly bought in Hong Kong. A bicycle manufacturer also noted that foreign bicycles are now more expensive than U.S. bicycles and that his company's sales were increasing. The currency realignments may be heightening the shortage of materials, however. One textile manufacturer indicated that textile material shortages have been aggravated because foreign countries have stopped selling to the U.S. now that the foreign price is higher. Currency realignments also have intensified the steel shortage. One commercial contractor notes that wire mesh and bar steel are in short supply and that foreign countries will not sell to the U.S. now. Many U.S. scrap dealers are now selling in foreign rather than domestic markets because of the currency realignments, thus intensifying the steel shortage.

Most businessmen contacted were concerned over acute labor shortages. Without exception, they were unable to find labor, particularly skilled labor. However, they expected labor shortages to ease somewhat next year, since the general consensus was a marked slowing of the District economy, with shortages of energy and energy-related by-products largely responsible.

SEVENTH DISTRICT--CHICAGO

In recent weeks, discussions of business developments in the Seventh District have been dominated by problems, current or potential, associated with the cutback in petroleum supplies. On balance, it is clear that reduced fuel availability is strongly negative, but many business sectors will benefit -- not only in the near future, but for years to come. The passenger car industry (more specifically standard-size cars) and the airlines must now be added to residential construction and recreational vehicles as sectors where activity is declining with no early reversal in sight. In most areas, however, employment is holding up well. Sales of general merchandise appear to be strong. The farm community is extremely prosperous, although beset by rising costs and limited availability of supplies and equipment. Demands for capital equipment and components for nonresidential buildings remain extremely strong.

The fuel shortage has now adversely affected District employment in the auto, airline, recreational vehicle, petroleum distribution, and plastics fabricating industries. More layoffs are certain in January. There are expectations that fuel shortages will require cutbacks in output of hardboard, gypsum board, and, perhaps, steel.

The auto industry is striving to rapidly increase production of small cars which are in short supply and which are in strong demand by fleet buyers as well as individuals. (Interestingly, sales of the three major luxury autos have been excellent.) There appears to have been a moderate dip in demand for lighter trucks. Sales of heavy-duty trucks and diesel engines have not weakened, however, and deliveries are stretched out to the third quarter of 1974.

A leading manufacturer of diesels sharply criticizes a nationally-syndicated columnist who wrote that trucks are most efficient at 50 miles per hours. Actually, this company's studies indicate that the most efficient speed depends on the engineering of particular trucks and the type of driving. Optimum speeds can range from 45 to over 60.

There is great concern over the impact of employment reduction in Southeastern Michigan, especially on minority groups. Unemployment rates have remained high in the Detroit area, even at the peak of the auto boom.

Some businesses emphasize that shortages of parts, materials (including fuel), and skilled manpower were so extensive prior to the Arab oil embargo that it will be difficult to sort out the effects of fuel availability as such. Resources of steel, plastics, and nonferrous metals made available by cutbacks in standard-size autos and recreational vehicles will readily be absorbed elsewhere -- unless, of course, reductions in income and reduced confidence lead to a cumulating decline in general activity. The most common view in this region is that a snowballing recession will not occur in 1974.

The capital goods industries are still overwhelmed by orders. A typical comment is, "I have never seen our economy stretched so tight." There are many reports of used equipment, e.g., farm equipment and machine tools, selling for more than identical new equipment. Suppliers of materials and equipment for nonresidential equipment also are hard pressed to meet demand. Capital expenditures by utilities, auto firms, railroads, coal mines, and oil companies are likely to be even stronger in 1974 because of the energy crisis than would otherwise be the case.

Our contacts with major firms with diversified operations indicate they had been preparing for fuel shortages for the past year by laying in additional stocks and by arranging for future supplies. They have been more concerned about their suppliers and their customers. (Some major firms are purchasing fuel and materials for use by their suppliers.) But the situation is still far from clear. An oil expert says, "there is no such thing as a firm contract in this industry." Attempts are being made to allocate available supplies of oil as equitably as possible. But there have been increasingly frequent reports of black market prices, particularly by stations selling gasoline and diesel fuel.

Sharp declines in farm and wholesale beef prices since last August have not been fully reflected at retail as marketing margins have widened. In recent weeks, beef supplies have about equaled year-ago levels. Capital spending by farmers is exceptionally strong, partly reflecting tax strategies related to record levels of income. Field preparations are ahead of normal seasonal patterns as farmers gear up for another rise in spring plantings. This should moderate the usual spring surge in demand for fuel and fertilizer.

EIGHTH DISTRICT--ST. LOUIS

Business activity in the Eighth Federal Reserve District generally continues at a high level, although a slower rate of activity in recent weeks was reported by a number of District businessmen. Slowing was particularly noted in retail trade and in the construction industry. Manufacturing activity continues strong, but shortages caused by government continue to hamper the production process. In the agricultural sector, crop harvesting has been largely completed with good crop yields being reported.

Businessmen seem to be more uncertain than usual about the future course of economic activity. "Shortages" of many materials, inflation, and the course of government actions are all contributing to this uncertainty. Our contacts with business indicate that at the present time the shortages and distortions caused by the controls are of greater concern than the energy problem. One result of the uncertainty is that capital spending plans for 1974 are being pared down. Some firms are stretching out their capital investment projects much longer than anticipated earlier.

Several major retail stores reported that sales have slowed in recent weeks. Retailers are generally optimistic about Christmas-oriented sales. However, the current slower rate of sales is having an impact on 1974 plans and a number of retailers are re-evaluating planned orders for the spring season. They report that such orders will likely be reduced somewhat from earlier plans. Rumors of circumvention of price and wage controls were also reported.

Construction activity has declined throughout the District. Residential construction has been the most affected, although commercial construction is also beginning to slow.

Manufacturing activity continues at a high level. Current demand for manufactured goods remains strong, but several firms anticipate some slowing in the spring. Many firms still report a backlog of orders and smaller inventories than desired. Shortages of many items continue to be reported and are expected by some firms to contribute to the slowdown in business activity in 1974.

Net inflows of savings at saving and loan institutions and commercial banks have improved further recently following small increases in July and August. Mortgage interest rates are generally holding steady, despite the reports that mortgage demand is weak.

The farm situation in the District is generally good. Harvesting has almost been completed except in some isolated areas. Large crops have been harvested, which coupled with relatively high farm commodity prices, have led to record high farm incomes. At the retail level, food prices are tending to level off, representing one of the brighter spots in the inflation picture.

NINTH DISTRICT--MINNEAPOLIS

The lack of fuel has not yet seriously disrupted District business activity, but businessmen are worried about the future. All District industrial sectors are likely to feel the impact of fuel shortages to some extent, but at this point, the District's travel and winter recreational industries appear to be especially vulnerable. District residents are cooperating with the Administration's efforts to conserve energy, and bank directors hope that gasoline rationing can be avoided. Several directors expressed the view that it is too early to see if the Administration's fuel allocation plans are workable. Public concern over fuel shortages is not expected to dampen Christmas spending in general, but businessmen are concerned about their 1974 sales prospects. District manufacturers look for sizable fourth quarter sales gains and expect further increases during the first half of 1974.

Fuel shortages have not yet curbed District business activity, but businessmen are concerned about the future. A Northeastern Minnesota banker indicated that his area's cement and wood products plants may have to reduce operations and his area's important winter recreational industry is seriously threatened. Furthermore, he believed his area's businessmen have reduced hiring and business spending plans. A South Dakota director disclosed that fuel shortages will adversely affect his state's travel industry. Area motels, for example, are canceling expansion plans and reducing their work forces. Also, transportation problems are being encountered in shipping agricultural products. A Minnesota director whose firm manufactures products for the construction industry was very concerned about fuel shortages, but was even more concerned about obtaining adequate steel and cement supplies.

Major twin cities manufacturers surveyed by this Bank are worried but hopeful that they will have adequate fuel supplies to get through the winter. A Wisconsin director revealed that his community's industries presently have adequate fuel supplies, but their operations could be jeopardized if fuel shortages persist. Montana directors indicated that their state's recreational and tourist industries could be seriously affected by fuel shortages.

According to director responses, District businessmen and consumers are complying with the Administration's request to conserve energy, but is is too early to judge the effectiveness of the Administration's fuel allocation plans. Most directors indicated that their area's residents are driving slower, turning down their thermostats, and eliminating unneeded lighting. Two major utilities serving the District, for example, disclosed that their sales in November were less than normally would have been expected, given temperature conditions. With regard to fuel allocation plans, a major twin cities area retailer indicated that a 25 percent reduction of fuel from a year ago could cause his firm to reduce operations after January 1. Several Minneapolis/St. Paul area manufacturers, on the other hand, stated that the fuel allocation plans should provide them adequate fuel through the winter. Directors expressed general dislike for gasoline rationing and are hopeful that existing measures to curb gasoline usage will suffice.

In general, public concern over fuel shortages is not expected to adversely affect Christmas spending, but District retailers are concerned about 1974 business prospects. A newspaper survey of Minneapolis/St.Paul retailers revealed that they are still hopeful for a good Christmas season. With regard to the first six months of 1974, however, they foresee their sales increasing 5 to 8 percent from a year ago as compared to 13 to 15 percent gains realised in 1973.

A large Twin Cities area retailer disclosed that his firm has not yet noticed that fuel shortages have had an impact on his firm's sales. In the District's agricultural regions, retailers feel this year's high farm income points to a good Christmas season. Two directors indicated, however, that retailers in their area are having difficulty obtaining inventories and could sell more merchandise if it was available. A director from the upper peninsula of Michigan indicated that fuel shortages and the weather may have already dampened his area's consumer spending. Minneapolis/St. Paul automobile sales data disclosed that District consumers are turning to small- and intermediate-sized cars, shunning purchases of full-sized automobiles.

According to the results of our fourth quarter industrial expectations survey, taken in early November, District industrial activity continued to expand. Third quarter District manufacturing sales are up 20.1 percent from a year ago and are expected to advance 14.1 percent in the fourth quarter and about 10.5 percent during the first half of 1974. These gains are larger than respondents anticipated three months ago, and recent price increases are probably one factor which caused respondents to revise their sales expectations upward. A breakdown of manufacturing sales into durable and nondurable goods sales shows that durables increased 23.7 percent in the third quarter and are anticipated to rise 19.5 percent in the current quarter. A 14 percent year-to-year sales increase is expected during the first half of 1974. Nondurable goods sales rose 16.3 percent from a year earlier in the third quarter and an 8.2 percent fourth quarter advance is anticipated; sales gains of 7.0 percent are expected in the first and second quarters of 1974.

TENTH DISTRICT--KANSAS CITY

The Tenth District economy appears to be slowing down. Loan demand has flattened or is declining; real retail sales are off vis-a-vis a year ago; and, the dislocations and depressing effects of the energy shortage are now clearly beginning to be felt. Retailers are pessimistic about the year ahead. Among District livestock feeders and bankers the prolonged period of lower meat animal prices is a source of increasing concern. In addition, a strike involving TWA has seriously affected the Kansas City economy.

A six-week strike by TWA cabin attendants has resulted in a cut-off of much of the $12.8 million monthly payroll to the metropolitan area and reduced convention and tourist business by about 15 percent, according to estimates of the City Development Department. In addition, the energy shortage has resulted in pilot layoffs to accommodate reduced flight scheduling. The decreased demand for standard-sized automobiles has led to layoffs for 6,600 workers at the local GM assembly plants as of December 17, and there are increased reports from small local manufacturers of shortages of petrochemical-based plastics which have caused them to curtail operations and reduce employment. Several rural school districts using natural gas on an interruptible basis have received notice of curtailment of supplies and have switched to alternate, but more expensive propane systems.

Department stores are ringing up Christmas sales at about last year's pace in dollar volume. Selling especially well are apparel items, and stay-at-home durables, such as stereos, and T.V.'s, do-ityourself merchandise, and gardening equipment. While most store executives expect to finish the year strongly, many doubt that 1974 will be very good. Their pessimism in many cases stems from the energy crisis, which they think may require closing earlier, may discourage the driving shopper, and may interfere with shipments of merchandise to the stores.

Reports from auto dealers show car buying behavior here to be similar to that for the nation as a whole. New and used intermediates are selling poorly; luxuries and compacts are moving well. Judging from the sample of those contacted, about half of the dealers would prefer rationing to an increase in the price of gasoline. Few would say how they felt about the year ahead, although one Buick dealer thought sales could be off as much as 50 percent.

Retail sales and other business in the Kansas City metropolitan area cannot help but suffer from a continuation of the TWA strike. Not many months ago, the reports coming out of Wichita were especially rosy, thanks in part to a booming light aircraft industry. Now, however, the energy pinch on general aviation is having severe repercussions. In the District's western states of Colorado, New Mexico, and Wyoming, the skiing season is getting underway. If there is compliance with the voluntary controls, ski areas will surely be hurt, although it is too soon to tell by how much. As one of our Bank's skiers observed, "It now will take three or four hours longer for the bus to reach Colorado from Kansas City, so I end up with less skiing and more riding fatigue at the same price." Looking further into the future, regional analysts are observing that the probable loss in tourism in the western part of the District will be largely offset by the accelerated development of major deposits of oil shale, uranium, and coal in those states, although such help will be some time in coming.

Continuing a recent trend, farm prices declined another 1 1/2 percent during the month ended November 15. Lower prices for cattle, calves, broilers, and soybeans contributed most to the decrease. This prolonged period of lower meat animal prices has caused much concern among livestock feeders and bankers in the District, since profits have fallen sharply. Several weeks ago, it was expected that beef slaughter rates would accelerate to year-earlier levels reflecting the buildup in numbers during the freeze period. Once this backlog was worked off, prices were expected to strengthen. Instead, slaughter rates have generally continued to run below year-ago levels, and the market is still receiving fleshy animals which has kept prices down longer than expected.

Also contributing to this phenomenon has been a widening of the farm-retail price spread on beef. Very little of the sharp decline in the farm price has been reflected at retail, which has resulted in a lackluster consumer demand for beef. Although some of this price stickiness can be justified by higher costs for labor, transportation, packaging, and electricity, the recent surge in beef margins seems unusually large under the Phase IV guidelines. Therefore, for a large part of the District's cattle industry, these developments, when combined with the uncertainty over the energy shortage, have greatly dimmed the outlook for the period ahead.

Tenth District bankers contacted report that total demand is either stable or declining. The only exception is one bank in the Kansas City area which says its loan demand is exceptionally strong. Our weekly reporting bank figures suggest an even weaker loan demand picture for the District than is indicated by our telephone survey.

Rates charged on loans by most banks appear to be uniform and unchanged from last month except for one bank whose rate was lowered and then raised to the previous level.

The picture for deposits appears to be somewhat mixed throughout the Tenth District, with no pattern emerging between loan demand and total deposits. Most bankers also report CD rates below those of New York, some were experiencing small runoffs, and most expected CD rates to rise in the future.

ELEVENTH DISTRICT--DALLAS

Refining operations in the District slowed in November in response to the Arab oil embargo. For the month ending November 23, capacity utilization declined from near 100 percent to 94 percent. Part of the oil refined in November was of Arab origin shipped before the embargo was imposed, and as this source is fast drying up, refining operations are expected to be even more severely curtailed.

Information obtained from a drilling contractors' association in Texas indicates that oil drilling in the District has responded strongly to the incentive of higher prices. Drilling is currently at the maximum level allowed by the availability of drilling rigs, crews, pipe, and other materials. Last month's concern that provisions of the fuel allocation program would prevent rigs from obtaining the needed diesel fuel for operation has abated due to changes in Administration policy. Nevertheless, production from Texas fields by late 1974 is expected to decline from rates reached in the third quarter of this year by as much as 200,000 barrels per day. This anticipated decline reflects the fact that most oil fields in Texas are past their peak in production capacity.

Seasonally adjusted registrations of new passenger automobiles in the four largest metropolitan counties of Texas rose 12 percent in October. Several dealers in the District attribute the increase largely to the filling of fleet orders placed earlier in the year. Most likely the increase does not signal a reversal in the decline of new car sales which began last March. Dealers feel that sales are down due to tight credit conditions and a changing preference for smaller cars which are in limited supply. The controller of a large assembly plant in the Dallas area, which produces intermediate and compact cars, expects a good winter for car sales. However, he is concerned that labor contract awards will require higher car prices and that fuel shortages may force a cutback in production.

The seasonally-adjusted value of total construction contracts in the five southwestern states increased by 22 percent in October, reflecting a more than doubling in the value of nonbuilding contracts. Residential contracts have declined since May but experienced a 7 percent increase in October. However, this probably does not represent a turning point in the southwest housing decline. The marketing research director of the largest residential builder in Dallas revealed that sales for most builders are now down 50 to 60 percent from last year's level. He feels that high interest rates and spiraling home prices have forced many people out of the market. But he is optimistic about a recovery in 1974 if interest rates decline.

At the same time, representatives of two large savings and loan associations in Dallas are less optimistic with regard to increased residential construction in 1974 and they anticipate further declines in home building through the remainder of 1973. Deposits in their institutions have begun to grow recently -- after falling since the middle of the year -- and more mortgage credit is expected to be available. However, they anticipate that mortgage interest rates will be "sticky" in the downward direction and that increases in home prices will further hamper home sales.

District farmers made excellent progress during November, and for the first time this year, they are either attaining or surpassing last year's schedule for harvesting or planting all crops. However, there are problems in beef production stemming from price controls imposed earlier. During the period of controls, the amount of beef marketed declined, and fewer additional cattle were placed on feed. Therefore, supplies might be reduced somewhat in the first half of 1974, although there is currently an abundant supply of beef ready for slaughter.

TWELFTH DISTRICT--SAN FRANCISCO

The mood of our directors has become much more uncertain about the future course of the economy because of the energy crisis that may, in the view of some directors, cause a recession in 1974. At present, consumer demand, with some exceptions, and private capital expenditures are still high. Residential construction continues to fall off and layoffs are occurring in some industries. Banks report little change in financial conditions.

The energy crisis is a major concern of our directors. Because of uncertainty about its seriousness, most are not able to forecast the impact on general economic activity, but continued expansion is expected. The pessimistic view is that a serious recession is possible along with more inflation. On the other hand, continuing strong consumer demand and private capital expenditures are thought by many to insure a lower, though still acceptable, rate of expansion next year. Export activity is another important source of demand, but there is some sign of a reduction in Japanese purchases, and the fuel crisis may also have an adverse effect on foreign demand.

Consumer spending for most nondurables and services is still high in most District states, but there are reports that purchases of durables are lower. Reports from merchants indicate excellent Christmas sales are likely. Sales of automobiles, especially the larger models, are much lower. Dealers are cutting their sales forces and several automobile assembly plants have been closed in California.

Energy shortages are causing problems particularly for the lumber industry and plastic manufacturers. Plywood mills in the Pacific Northwest have, or are likely, to cut production because of a shortage of natural gas for drying and glues for bonding wood. Diesel fuel appears to be in short supply in most areas. In southern California, one director reported that a black market is developing for this fuel. The gasoline shortage, although not severe as yet, is causing problems for tourism throughout the District and for products such as recreational vehicles and pleasure boat manufacturers.

On the other hand, heavy rains in November have relieved much of the hydroelectric power shortage in the Pacific Northwest, and public utilities now expect to meet existing levels of demand this winter. The only area in this District where an electricity shortage appears likely is in southern California.

Agricultural prospects remain good, farm receipts are forecast to be up to 40 percent higher in Oregon, and similar optimism prevails in other District states. The energy crisis may affect agriculture primarily through shortages of diesel fuel and nitrogen fertilizers. Some food processors may also experience difficulties where they are dependent upon interruptible supplies of power.

Residential construction continues to decline, especially multiple units. However, this decline is offset in many areas of California and the Pacific Northwest by strength in commercial activity. A large manufacturer of building hardware thinks that the energy shortage on top of the high cost of money and material shortages will hurt construction more than recent industry forecasts indicate.

Investment prospects, according to our directors, remain strong. Backlogs of orders encourage efforts to expand and capital appropriations remain high, while inventory holdings are judged to be below desired levels. One large bank optimistically forecasts that the need to expand capacity and restock inventories will dominate problems arising from energy shortages.

Bankers report little change in monetary conditions. Deposits continue to grow and there is now little disintermediation. Business loan demand has weakened at some banks, but in general it remains strong. Demand for term loans to be used for capital investment has increased at some California banks, demand for residential mortgages has increased despite the fall in construction, and some banks are increasing their mortgage lending to build up their portfolio at current high rates. Consumer borrowing has slowed from the pace achieved earlier this year.