CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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TABLE OF CONTENTS

SUMMARY*

District reports describe a generally weakening economy, punctuated by booming conditions in agriculture and the capital goods industries. Shortages of materials are hampering production and leading to some hoarding of supplies. The impact of the truckers' strike in most Districts appears to have been mainly limited to a temporary disruption of livestock marketing and food processing operations.

Economic conditions varied both among and within Districts. Only Richmond concluded that business activity remains "strong." Dallas noted a decline in industrial production led by falling refinery runs, while New York, Philadelphia and Atlanta reported their economies as weakening. Chicago described communities dependent on manufacturing of full-sized cars and recreational vehicles as "economic disaster areas," and Atlanta called the motels around Disney World "ghost towns." Yet, Atlanta reported brisk announcements of new plants, and Chicago noted that equipment manufacturers are experiencing an "unparalleled boom" and that the steel industry was operating at capacity. The general feeling, as noted by the San Francisco District, was that some sectors and regions continue to exhibit considerable strength, but the overall outlook was cautious.

Retail sales in January were described as good and better than anticipated (Philadelpha, Dallas, Richmond and St. Louis), but retailers were reported as still maintaining their conservative sales forecasts for 1974. Only Atlanta reported some weakening in January sales.

*Prepared by the Federal Reserve Bank of Boston.

slower unit sales of the more expensive food items, notably meat, at retail food stores. Similarly, Kansas City attributes the recent sharp decline in livestock prices partly to sluggish consumer demand for meat. Several Districts, including Boston, Richmond, and Atlanta, report weaknesses in tourism and recreation related businesses, while Kansas City refers to generally poor power boat sales.

In the building sector, residential construction is termed weak by Atlanta, severely depressed by Cleveland, and falling by San Francisco, while Chicago reports that commercial and public construction has been weaker than expected. House-builders in the Dallas District, however, anticipate a strong turnaround in residential construction by midyear, while several Districts, including Cleveland, Chicago, and San Francisco, characterize industrial construction as strong, reflecting businesses' efforts to expand capacity.

Indeed, most Districts paint a strong capital investment picture. Among others, Boston notes that capital goods orders are very strong and backlogs high; 40 percent of the respondents to the Philadelphia survey of manufacturers expect to boost their capital outlays over the next six months. Chicago terms the demand for machinery as intense, while capital goods producers in the Cleveland area are more optimistic over the outlook for 1974 than they were a month ago.

Good prospects for agriculture were also generally reported by most Districts in agricultural areas, dimmed somewhat, however, by potential shortages of fertilizers, farm equipment, and fuel. Minneapolis, however, notes that fertilizers may have been stockpiled, that many farmers have tended to overfertilize and if available fertilizer is used more efficiently, crop yields may not be affected.

As in previous months, growing shortages of industrial items were also reported by most Districts. Among others, St. Louis mentions that many firms report "frantic" searches for raw material. Steel economists in the Cleveland District state that the demand for steel continues to exceed capacity. Chicago and Richmond report the shortage situation to be a major problem. In this context, respondents in the Minneapolis District felt that price and wage controls have contributed to bringing about existing shortages, and should be eliminated. Similar sentiments were expressed by New York respondents.

Regarding bank credit developments, Kansas City and Richmond report a strong loan demand, but Philadelphia and St. Louis report a softening of demand while a mixed picture appears to characterize the situation in the Atlanta and San Francisco Districts.

FIRST DISTRICT--BOSTON

Our directors report continued strength in capital goods areas and a mixed orders picture in other areas. There are also mixed reports on materials shortages, with some directors saying shortages are much worse while others report that supplies are more readily available but at substantially higher prices. Our directors express extreme pessimism about the business outlook, with most of them expecting a significant recession and continued inflation.

Capital goods orders are still very strong and backlogs very high, but an industrial supplier to the automotive industry reports that in the past month he has received tremendous cutbacks in orders which even affect such items as fasteners and die casting. Another director who is a supplier to the tire industry notes that the tire output is very strong, but he expects a drop-off soon, as present production must be going into inventory. One element which he feels is keeping up production is the belief that it will only be more expensive to produce later. Defense industries in Connecticut are reported as being very strong.

Consumer product lines were reported as slack for a variety of reasons. Apparel sales are down, possibly, according to a zipper manufacturer, because all discretionary spending is being cut. Another director reports high demand for consumer products but an inability to produce because of shortages of supplies. Recreational industries in New England have had a disastrous year primarily because of the lack of snow but also because of gasoline scarcities.

While one director reports that shortages of materials are worse than ever, some of our other directors feel that it is getting easier to get what is needed, albeit at much higher prices. A director from a large conglomerate remarked that the cost of everything is skyrocketing and called the price of metals "ridiculous".

Our directors are generally pessimistic on the outlook for both the pace of economic activity and inflation. They believe that the economy is likely to experience more than a mild recession, with one director citing that he expects the unemployment rate for Connecticut in 1974 to average 7 1/4 percent, up from 5 1/2 percent just a few months ago.

All three of the academic correspondents contacted this month, Professors Eckstein, Samuelson, and Tobin, agreed the Federal funds rate should be lowered to about 7 percent. The main concern was how to keep the reversible bulge in commodities prices due to shortages from being built into wage inflation. Samuelson and Tobin felt that the political trade of some sort of expansionary policy, such as the tax cut suggested by Walter Heller, for moderation in wage bargaining would be desirable though neither was optimistic about the possibility of such a trade. Tobin favored some effort to make peace with labor in order to get some guidepost type of consensus, but he was skeptical that it would be possible for this Administration to do that.

Tobin disagreed with the William Wolman-Milton Friedman argument that the Fed is responsible for virtually all of the recent inflation. The underlying problem in the present inflation is that the country has experienced real income losses--due to exchange depreciation and the need to export more real goods to obtain imported oil--and substantial redistribution of income and wealth--in favor of farmers and domestic mineral resource owners--which will be hard to overcome. All parties must realize this has been a real-income loss that cannot be restored in aggregate. This situation differs from most past inflations when higher prices for some meant higher incomes to others. Price increases for farmers and oil drillers may not increase the demand for labor as much as a more general price inflation would have.

Samuelson cautioned against talk of "double-digit" inflation when forecasts ranged from about 4.5 percent to slightly over 7 percent for the GNP deflator by the year-end. On the basis of conversations with businessmen in the building materials and paper industries, he believed many industrialists are preparing to raise prices substantially if economic controls end. Samuelson noted that the strength in the steel, paper, and basic materials industries was not typical of a virulent recession. He also pointed out that the effects of the energy shortage on propensities to spend are reversible, should the embargo end.

Due to the behavior of Government deposits, Samuelson said, the two-month money growth figure contains more information than the February figure alone. Samuelson advocated an easier policy, with money growth in the 6 to 7 percent range between now and midyear and the Federal funds rate moving to 7 percent. Tobin had the same Federal funds rate recommendation to stimulate housing and the stock market.

Eckstein wants an orderly fall in short-term rates. He would be content with the "shadow FOMC" money growth target of 5 to 5.5 percent over this period of economic adjustment. However, as the economy picks up in the second half, the increased demand for money should be accommodated in order to sustain the upswing.

SECOND DISTRICT--NEW YORK

Second District directors and other business leaders who were recently contacted generally welcomed the phasing out of wage and price controls. The respondents continued to see strength in business capital spending. Apart from automobiles and some other consumer durables, retail sales seem to be stronger than expected, but some retailers appear to be rather cautious in their sales expectations. The recent rise in business inventories does not appear to have resulted from weak sales--excepting large-size automobiles--but rather was attributed primarily to precautionary purchases by businesses against expectations of further price increases and shortages.

The respondents generally indicated that the time had come to eliminate wage and price controls. Some directors did expect the phasing out of controls to bring about a short-term spurt in inflation, but felt that such a move on balance would have a positive psychological effect on businessmen's decision-making, and that over the longer term market forces would correct supply-demand imbalances. The sentiment that controls were contributing to these imbalances was expressed by several other respondents. Among these, the chairman of a large multinational oil corporation noted that while controls had been in effect for over two and one half years, they had failed to bring inflation under control, but had created uncertainties and contributed to shortages of various products. He felt that their removal would improve the business climate and probably help avoid a serious contraction in business activity.

The respondents in general expected the sizable planned increase for 1974 in business plant and equipment outlays to be largely implemented.

A New York City banker thus noted that many industries will continue to operate close to capacity even during a mild recession, and will require additional capacity to meet demand in the next period of expansion. The view that capacity shortages would stimulate capital investments was also expressed by the chairman of a large oil corporation, who noted that petroleum industry capital spending was expected to rise sharply to help meet the country's energy need. An upstate banker similarly looked for increased demand for energy-related capital equipment, while another upstate banker felt that the current shift toward smaller cars in the automobile industry would require major plant and equipment expenditures. The president of a large nationwide retail chain felt that recent economic developments should have no significant impact on business spending plans. He noted that in the retail industry (and presumably many other industries) capital spending decisions are made far in advance of actual outlays, leaving little flexibility to respond to changes in the short-term economic outlook. Some respondents, however, while in general expecting continued strength in capital outlays, did express some reservations regarding businessmen's ability to implement fully their plans because of materials shortages.

Concerning consumer spending, the president of the retail chain mentioned above reported that his firm's sales in February had slightly exceeded expectations, in both store and catalog operations, but that the firm was maintaining a cautious attitude over the sales outlook because of the potential problems facing the economy over the next several months. A New York City banker, while characterizing retail sales as "fairly good", pointed to the decline in auto sales and to signs of slippage in appliance and lower-priced furniture sales. One observer noted, however, that appliance sales have been exceeding some manufacturers' expectations. The chairman of a drug manufacturing firm, moreover, felt the retail sales picture remained strong, while another respondent reported that his contacts at a large New York City department store characterized business as "booming".

A number of respondents reported some changes in consumers' buying habits. The Buffalo branch directors felt that on the one hand inflation was promoting anticipatory buying, but that at the same time, consumers were constrained by the fact that prices were rising faster than incomes. One director pointed to increased emphasis on utilitarian purchases and decreased emphasis on "frill" items. On the other hand, the chairman of a major nationwide food processing firm reported a surprising upgrading of quality in consumers' purchases. A retailer reported that owing to the gasoline shortage, consumers seem to be concentrating their grocery, clothes, dry cleaning, and most other shopping at one time--mainly on Saturdays.

In the view of most respondents, large-size automobiles were about the only sector where weak sales seem to have accounted for the recent build-up in inventories. Most felt that inflation and fear of scarcities were important factors in the recent increase. An upstate banker reported that inventory financing at his bank was at an all time high, and saw evidence that some businesses were buying whatever they could now, in anticipation of more serious future shortages. A New York banker also mentioned evidence of growing speculative inventory building because of fears of further price increases or of continued shortages. He and several other respondents, however, reported that businessmen in general felt their inventory positions to be in reasonable balance with sales, except for shortages of a number of materials. In this context, it was noted that in some instances, shortages of certain items prevented some firms from converting a substantial part of their present inventories into marketable products.

THIRD DISTRICT -- PHILADELPHIA

Business activity in the Third District continues to cool, and the six-month outlook reflects a continuation of the slowdown. Seven out of ten executives surveyed report no change in business activity in March, and one in three expects decreases by September. Employment levels are continuing to hold up in the region, and area manufacturers see little change in employment or in the average length of the workweek by fall. Inventory investment will remain stable into fall, but by September two in five firms expect to increase spending on plant and equipment goods. February was disappointing for area retailers, but March looks more favorable. Prices continue to escalate, and no relief is expected during the next six months. Area bankers report decreasing loan demand and weak deposit flows.

According to this month's business outlook survey of manufacturers in the Third District, industrial activity in the area is continuing to slow down. More than half the firms report no change in new orders, shipments, unfilled orders, and delivery times in March. And area manufacturers expect business activity to continue to level off in the next six months. Those executives expecting increases in new orders by early fall just about equal those expecting decreases, with two in five respondents reporting no change expected.

At the present time, the slowing in business activity is having very slight effects on employment in the District. Over three quarters of the respondents report no change in their number of employees and the length of their average workweek. And, the employment picture is not expected to alter much in the next six months. Seven out of ten executives expect to maintain stable employment levels into early fall, and eight out of ten expect to keep the length of the average workweek the same.

Half the manufacturers report no change in inventory levels this month, and four out of five expect no change or decreases in inventory stocks by September. While half of the respondents report no change in plans for capital expenditures in the next six months, 40 percent expect to boost spending on plant and equipment, an increase of 12 percent from last month.

Retailers here experienced declines in sales in February, after a pretty good month in January. Heavy snows and a gas station strike combined to pull down the level of sales in February. Although still cautious in their spending plans, area retailers are forecasting a better month in March.

Not a single firm surveyed reported a decrease in the prices it pays or the prices it receives, and nine out of ten reported paying higher prices in February. Six months from now, over 80 percent of the firms expect to pay higher prices for raw materials and to receive higher prices for finished goods.

In general, financial conditions in the Third District remain tight. Loan demand is off more in our area than in the nation as a whole. Bankers report the demand for short-term business loans is soft. Demand deposit flows are also weak and are not expected to increase in March. Most banks surveyed are stepping up plans to attract new deposits. Buyers are decreasing their demand for short-term certificates of deposit and increasing their demands for longer term ones. As expectations of lower rates continue to mount, banks are unwilling to commit themselves to the longer term CDs.

FOURTH DISTRICT -- CLEVELAND

The District's economy is mixed with signs of softening and areas of continued strength. Employment has leveled off, while unemployment has risen significantly, primarily in response to cutbacks in manufacturing. Weakness in manufacturing stems largely from reduced operations by motor vehicle producers and suppliers, and to some extent it also reflects the distortions caused by the recent trucking strike. Capital goods producers report good business conditions for their industry and are now somewhat more optimistic regarding the near-term economic outlook. The demand situation in the steel industry also remains good, but the availability of coal has recently become a major problem. Housing is severely depressed, although nonresidential building continues to show strength.

Early returns from our monthly survey of manufacturers suggest some further softening in key series during February. New orders declined slightly, following a leveling in January. Gains in shipments, backlogs, and inventories all slowed sharply last month. Manufacturing employment also started to decline. (Since November, total nonfarm employment has stopped growing, while the District's seasonally adjusted unemployment rate has risen 0.8 percent.) Long delivery times continue to trouble the majority of firms, although there are scattered signs that the situation is beginning to improve. Recent price increases have been pervasive. In February, higher prices paid were reported by the largest proportion of firms in the ten-year history of our survey.

Representatives from four capital goods industries headquartered in Cleveland expressed somewhat more optimism over the outlook for 1974 than they did a month ago. Reasons for this change include less uncertainty over fuel and a lack of signs indicating a cumulative decline in economic activity. An official with a major petro-chemical firm believes that the energy problem is not so bad as it was expected to be by his management as recently as a month ago and that consumers have probably adjusted to higher prices and shortages of fuel. A steel representative feels more confident because of the ease with which his firm and the industry have been able to absorb cancellations by the auto industry. Sustained strength in capital goods and the absence of a downward spiral in key sectors of the economy are among other reasons for increased optimism.

Economists from steel firms report underlying demand remains greater than the industry's capacity to produce. The steel firms have changed their output mix this year -- producing more structural shapes, plates, and tubular steel and less sheet steel. Major problems confronting the steel industry are the inability to accumulate coal inventories and a tight supply situation in steel scrap. One major steel company has been forced to reduce operations because of coal shortages worsened by the West Virginia coal miners' strike. In addition, there are complaints by steel companies that Government regulations allow utilities to pay $20 a ton more than other industries. Removal of price controls on coal will help the matter according to steel industry sources. Shortages of steel scrap are hurting the mini-mills (with their electric furnaces) more than the big mills, which rely mainly on basic oxygen furnaces.

In the construction sector, housing remains severely depressed. Since early 1973, the decline in residential construction contracts has been more pronounced in the District than in the nation. Nonresidential construction contracts, on the other hand, have been registering strong improvement. Major banks are not actively soliciting real estate loans, as has been the case for many months. Savings and loan associations appear to be more active lenders since the year-end.

FIFTH DISTRICT -- RICHMOND

Results of our most recent survey of businessmen indicate that business activity in the District remains at a high plateau. Manufacturing activity continues at a high level, although employment and hours worked per week are reported to have declined some in recent weeks. A coal miners' strike growing out of protests over gasoline allocation has idled some 20,000 miners in southern West Virginia. Retail sales in the District apparently remain strong.

Manufacturing activity in the District generally continues at a high level. The diffusion of responses of manufacturers in our survey indicates that shipments, new orders, and backlogs declined slightly in February. Shortages of materials remain a major problem and appear to be especially acute for producers of synthetic fibers. Shortages and stretched-out delivery time for electronic component parts are also adversely affecting production in the electrical equipment and supplies industry. Manufacturing inventories apparently increased slightly during the past month.

In protest to alleged hardships caused by West Virginia's gasoline-rationing plan, an estimated 20,000 to 25,000 coal miners are off the job in the southern part of the state. Even though the original plan, under which no one with more than a quarter tank of gasoline could buy fuel, has been amended to allow those who drive more than 250 work-connected miles per week to make more frequent purchases, the miners remain off the job. At this point, the miners are not expected to return to work this weekend. It is rumored that the strike may spread to northern West Virginia. Scattered incidents of violence on the picket lines have been reported. Reserve supplies of metallurgical coal have been hard hit, and steel production is already being affected adversely.

Employment in the District apparently has changed little since our last survey, with both manufacturing and retail respondents reporting no change. Manufacturing respondents, however, report a substantial decline in hours worked per week. Reports of price increases continue to be widespread. More than 85 percent of the manufacturers reported higher prices paid, and 49 percent reported higher prices received. All of the retailers reported an increase in prices paid, and two thirds reported an increase in prices received.

While retail sales are reported as strong in most parts of the District, some retailers indicate that sales in suburban outlets are being adversely affected by the gasoline situation. Gasoline shortages are also having considerable impact on tourist-related business and on sales of recreational property. Long distance traffic on Interstate 95 is down sharply and, as a result, motel registrations are running far below the year-ago level. Sales of recreational property in the Myrtle Beach area are reported to have slowed considerably, as buyers await further developments in the fuel situation.

Realized gross and net income from farming, in the aggregate and on a per farm basis, hit record levels in 1973 in both the District and the nation. The District's realized gross income per farm jumped 33 percent over a year earlier, but average farm production expenses rocketed upward by an unprecedented 42 percent. Realized net income per farm thus rose only 15 percent as against a 34 percent gain nationally.

Reports from large commercial banks in the District indicate that demand for business, consumer, and real estate loans remains strong. All three loan categories have risen substantially in the last few weeks.

Most survey respondents continue to express pessimism about the economic outlook. More than 50 percent believe that the level of business activity nationally will worsen, while nearly 30 percent believe that local business activity will decline.

SIXTH DISTRICT -- ATLANTA

The general economic picture appears to be very mixed. While the current situation is one of shortages, layoffs, sluggish residential construction, and a sharp dip in tourism, the longer run view is one of optimism, as reflected by many announced commercial and industrial projects. Some bankers report a softening in commercial bank loan demand and a growing inflow of funds, partially brought about by consumers' growing conservatism in spending patterns. Reported shortages of fertilizer throughout the Southeast and flooding conditions in Louisiana may reduce agricultural output. South Florida appears hardest hit by gasoline shortages, and a proposed stricter building moratorium may add to the decline in construction activity in this area.

Job layoffs continue in several key industries, as the effects of petroleum and gasoline shortages rippled through the economy. Atlanta area auto assembly plants continue to report layoffs, both temporary and permanent, because of the decline in large-car auto sales. The second shift at one GM assembly plant has been shut down, leaving 1,150 workers without jobs. The slowdown in car sales is also affecting auto parts manufacturers. An Alabama knitting mill will shut down because of the cutback in the auto industry's demand for fabrics. A manufacturer in Meridian, Mississippi, was forced to lay off 500 workers because of a shortage of plastic materials.

Steel shortages remain a problem. Two Alabama manufacturers plus an electrical supply company reported, when surveyed, that steel shortages are affecting production and profits. One of these manufacturers, a large coat hanger manufacturer, reports a definite shortage of steel wire.

Residential construction and tourism remain weak. South Florida's construction sector received some shocking news when proposed amendments to the building moratorium were announced by Florida's Pollution Control Board. Endangered by these more restrictive amendments are several large condominium projects in the Palm Beach area. South Florida's decline in tourist activity may have bottomed out at least temporarily. Tourism has dropped 5 to 15 percent in some areas because of the gasoline shortage. Tourist activity may dip further this summer when tourists traditionally arrive by automobile. It is estimated that only 20 percent of the area's tourists arrive by automobile in the winter and 80 percent arrive by mass transit, but the situation completely reverses in the summer months. Rainbow Springs, a 50-year old tourist attraction in North Central Florida, has closed because of the fuel shortage. Tennessee's tourist industry also is beginning to feel the fuel shortage. The number of travelers coming into Tennessee has dropped approximately 20 percent so far this year, according to state officials. The Chattanooga area is the hardest hit.

Florida's economy appears to be weaker than at any time in the recent past. On top of sluggishness in tourism and residential construction, the Cape Kennedy area is again in the doldrums as a result of the end of the Skylab project. Layoffs will involve 1,816 workers, and by midyear the work force at the Cape will be down to slightly over 9,000 workers. While a definite slowdown is in progress in other areas of Florida, the Jacksonville area is booming with a wide range of commercial and industrial projects under way. New commercial and industrial projects were also announced in other areas of the District. The latest commercial project in Atlanta is a 24-story Federal office building to be jointly developed by Government and private interests.

District bankers give a mixed view on strength in loan demand. A report from the Nashville area indicates continued strength. Areas of Louisiana, however, report a sharp decline in loan demand. One banker notes that for the first time in eight months his bank is not in the Federal funds market. Deposit inflows are picking up at both commercial banks and savings and loan associations. One Tennessee banker believes that the increase in deposits is a result of a more conservative stance by consumers, who are now saving more out of their incomes.

Flooding and fertilizer shortages may well affect agricultural output this year. In Louisiana, nearly two million acres have been flooded at a loss of between \$2 million and \$3 million, part of which represents damage to the sugarcane crop. No one as yet seems to know how serious the fertilizer shortage is. One Tennessee director believes that because of the shortage of fertilizer, ammonium nitrate, and phosphates the soybean crop, which requires little or no nitrogen, will increase and the corn crop will decrease.

SEVENTH DISTRICT -- CHICAGO

The economy of the Seventh District continues to be characterized by sharp contrasts, with demand for various consumer products substantially reduced while demand for machinery and equipment remains intense. Orders backlogs for equipment continue to mount. Shortages of materials and components remain severe, despite reduced requirements for motor vehicles. While prices of agricultural commodities have declined, prices of most industrial goods continue to rise, with substantial additional increases likely for most finished goods as controls are relaxed. Labor markets have eased in most areas, but many employers find it difficult to recruit quality workers. Lines at gas stations in the Chicago area have largely disappeared since late February. Overall, morale appears to be holding up fairly well, and businessmen in less vigorous industries frequently report that volume has been "better than expected". The availability of mortgage credit has improved significantly, and most real estate people believe the low point for their industry has been passed.

Increasingly, the public has been acclimated to more rapid price inflation, and any price declines will be a welcome surprise. Many businessmen think that a broad sector of basic commodity prices is vulnerable to declines, partly because materials are being hoarded by some users. Nevertheless, rising costs for labor and practically everything else, coupled with controls, have build up a backwater of pressure for higher prices for virtually all components and finished goods. There are widespread complaints of gray or black markets, with items offered by speculators at prices two, three, or more times higher than original manufacturers' prices. Under controls, prices for steel and petroleum products are called a "crazy quilt" with widely different prices quoted by various "legitimate" corporations.

Despite cutbacks by manufacturers of motor vehicles and other products, and the reduced level of residential construction, shortages of materials and components remain as bad as before. Steel sheet is more available, but shortages of other steel products, nonferrous metals, castings, forging, motors, valves, etc., are impeding production. Capital goods producers find that it is difficult to schedule work efficiently. Problems of supply are intensified by slower truck speeds, requirements that trucks wait for full loads, and longer freight trains.

The strength of demand for capital goods has not let up. The energy problem is directly responsible for strength in major areas. Often new equipment is related to development of energy resources, and many types of equipment can do more work per unit of fuel. Shipbuilding (especially in Wisconsin) and barge construction have now joined the boom industries. Heavy trucks and equipment for railroads, agriculture, construction, mining, and oil and gas well drilling and transmission are all booked out far in advance, and many firms have large unbooked or "memo" orders. Some suspect that there is "water" in the backlogs, but that this is not likely to be apparent for months to come.

Steel firms in the Chicago area have been complaining about shortages of iron ore, scrap, and coking coal for several months, now. The main problem is the West Virginia coal strike of the past two weeks, which is adversely affecting production at several of the most important mills. Steel released by the auto firms has been absorbed by other users, either as sheet or in other forms. One large-area steel firm will not accept orders for the third quarter until April 1. It is expected that the order books will soon fill up after that date.

Auto firms are making desperate efforts to convert to smaller cars. There is no sure knowledge of the time schedule for "conversion". The bottleneck is mainly small engines, for which new production lines composed of specialized machines are on order. Announcements of projections of the increase in the percentage of capacity to be in small cars later this year, or in 1975, have limited meaning because large-car capacity is being reduced as small-car capacity is increased. Layoffs at the auto firms have hit white-collar workers as well as blue-collar workers -- sometimes by forcing retirement of men as young as fifty-five. Laid-off auto workers typically get 95 percent of their base pay, and are not anxious to seek other jobs. Also, other employers are reluctant to hire workers who will return to their former jobs when called.

The construction picture is mixed. Commercial construction is weaker than expected. Public construction is also less than expected, partly because of shortfalls in gas tax receipts and tolls. Residential mortgage funds have become more available, and some Chicago area savings and loan associations are offering 10 percent downpayment loans. A gradual improvement in residential construction is anticipated, with some shift away from scattered sites and closer to public transportation. Industrial construction is going full blast.

EIGHTH DISTRICT--ST. LOUIS

Economic activity in the Eighth Federal Reserve District continues at a high level, except for a slowdown in the automobile and related industries. The majority of manufacturers continue to report material "shortages", order backlogs, and low inventories. In general, retail sales have been strong so far this year. Loan demand is down somewhat and most interest rates have declined.

Manufacturing activity continues generally strong in the Eighth District, although it is still plagued with materials shortages. Chemicals, capital goods, and paper industries are among those reporting strong demand. Many firms report "frantic" searches to locate raw materials. Items reported in short supply include aluminum, copper, castings, wire, zinc, forgings, electric motors, lumber, bearings, paper, textiles, chemicals, valves, and pipes. Apparently, "black" markets are developing in a number of these items, with transactions taking place at prices considerably higher than the controlled levels.

Members of the Purchasing Management Association of St. Louis, meeting in late February, reported virtually no declines in business since the first of this year despite the slowdown in automobile production. Furthermore, more than half of the members reported their firms were operating at full capacity and were unable to fill orders on time. The widespread reports that factory inventories are getting too high, given the sales outlook, was amusing to many of the buyers because of local "shortages". On the whole, retail sales in the District generally have been strong this year, although the dollar volume of sales has been boosted by higher prices. Some St. Louis retailers reported sales were off in the first part of March; however, this was not expected to be the start of a new trend. Automobile sales continued down, although some dealers felt that the declines have bottomed out. Farm equipment sales are reported down in some parts of the District, largely reflecting lack of supply.

Loan demand has slackened somewhat in recent weeks. Loans at commercial banks in the District have declined, and interest rates are somewhat lower than a month ago. Mortgage rates at savings and loan associations have been steady to somewhat lower. Savings institutions have experienced moderate increases in savings inflows. Generally, those institutions offering 7 1/2 percent on longer maturity CDs report sizable inflows while those offering less than maximum rates have been less successful in attracting deposits. In some parts of the District, usury laws constrain residential mortgage rates. Those savings and loan associations committed to servicing markets, where these laws exist, find 7 1/2 percent money unprofitable.

Loan demand appears to be stronger in rural areas than urban areas, probably reflecting a sharp upsurge in demand for farm credit. Prices for most farm inputs have increased substantially this year. Nitrogen fertilizer and fuel prices have about doubled since last year. Planting intentions are also up, reflecting the high demand for farm products. These higher costs have in turn contributed to rising credit demand.

NINTH DISTRICT--MINNEAPOLIS

Most bank directors believe that the Administration's efforts to control wages and prices directly should be terminated on April 30, and that the Congress should not extend the Economic Stabilization Act. Concern about job security is not expected to temper union demands for wage increases this year. District fertilizer supplies will be very tight this spring, which could reduce District crop yields. District manufacturers look for continued sales gains during the first nine months of 1974.

The general opinion expressed by bank directors was that the Economic Stabilization Act should be allowed to expire completely on April 30 instead of being extended along the lines recommended by the Administration. One set of views was that wage-price controls are not workable in a market-oriented economy and have resulted in distortions and shortages. A Montana director indicated, for example, that the cattle market has not yet recovered from last year's freeze on beef prices and, in the view of a Twin Cities-area banker, efforts to control interest rates have been disruptive to capital markets and have contributed to higher interest rates. These directors believe that a complete lifting of wage-price controls would alleviate shortage problems. Another view was that the uncertainties surrounding the Administration's current efforts to decontrol the economy have made it very difficult for businessmen to determine costs and prices; this director believed that completely decontrolling the economy would allow costs to stabilize. Furthermore, two directors indicated that further efforts to control health care costs could result in distortions and shortages in that industry. Given the current easing in demand pressures and rising unemployment, one director thinks the timing is as nearly perfect as could be desired for an immediate and complete end of controls.

In contrast to these views, two directors indicated that the Government should continue to have some direct influence on wage and price decisions and believed the Administration's proposals should be implemented. However, one of these directors favored eventually dropping the control program. Another opinion was that the Federal Government should do something to control wages and prices, but this director thought the Administration's recommendations are unworkable.

The directors believe rising unemployment and concerns over job security are not likely to lessen wage demands this year. At one director's firm, collective bargaining agreements so far this year have led to minimum wage increases of 10 percent; the unions still negotiating are demanding substantially more. Several directors indicated that their area's teachers are going to be asking for very large wage increases this spring. Besides the recent increases in the cost of living, shorter working hours this year and higher social security taxes are going to make workers more adamant in demanding wage increases. In the upper peninsula of Michigan, steelworkers are expected to demand a full cost-of-living increase as well as job security provisions. In certain industries where business is softening, workers may lessen their wage demands in return for job security provisions.

Directors expect fertilizer supplies to be very tight this spring. Several directors cited shortages of nitrogen and phosphate fertilizers in their areas, ranging from 10 to 30 percent of anticipated demand. Not only are fertilizer shortages foreseen, but the price of fertilizer has risen tremendously. However, several factors were cited that could minimize the impact of prospective fertilizer shortages on agricultural production. First, the stockpiling of fertilizer may have occurred, so that shortages may not be as great as currently expected. Second, many farmers have tended to over-fertilize, so that, if available fertilizer is used more efficiently, crop yields may not be affected. Third, nitrogen shortages can be offset or minimized if the weather is favorable--if the District receives adequate rainfall.

Respondents to our first-quarter industrial expectations survey look for continued sales growth during the first nine months of 1974. First-quarter District manufacturing sales are anticipated to be up 12.7 percent from a year ago and then advance 9.5 percent during the next six months. Durable goods sales gains during this period are expected to surpass advances in nondurable goods sales. As these sales expectations are quite close to those made last November, concern over materials shortages and the impending slowdown in economic activity have not caused respondents to alter their sales outlook.

TENTH DISTRICT -- KANSAS CITY

Retail sales at department stores in the Tenth District continue to hold up, although managers are still more unsure than usual about the months ahead. Disaffection with the big car is reemphasized by the extension of the closedown of Kansas City's Buick-Oldsmobile-Pontiac assembly plant. Power boat dealers, too, are feeling the energy crunch. Farm income is suffering a setback with the recent decline in farm prices, especially the prices of livestock. The consumer is beginning to benefit as meat prices come down, but a reduced supply of feed cattle in the months ahead may soon reverse this downturn. Business loan demand has been unseasonally strong, and deposits have increased apace. Oil companies are among those businesses largely responsible for the rising demand for loans, while deposit growth is largely in consumer time deposits and large certificates of deposit.

Department store executives in metropolitan areas throughout the District report that, while business is not booming, sales do show strength. In most stores contacted, sales are up more than prices over last year. Several managers emphasized that it is still too early to gauge sales trends. They are looking to Easter sales as the first solid indicator of the consumers' buying mood. For those who would make one, the current best guess as to the outlook for department stores is for rising volume in the upcoming months, assuming gasoline supplies remain adequate to support shopping. Contrary to fears some months ago, inventory levels have been relatively easy to maintain, and currently are considered adequate for spring. Most managers note no significant change in the departmental mix of their sales, although sales of television sets and stereos are "outstanding" at one store, and a luxury retailer is enjoying extremely strong demand for silver and fine jewelry. Some declining interest in department store lines of outdoor recreation and leisure goods is observable, although the season still is young.

Boat dealers already are convinced that they will suffer in 1974. One describes sales so far as "terrible". With the exception of big luxury cruisers, power boats are not selling well at all. A major distributor of boats in the District says that bank refusals to finance the inventories of boat retailers last fall has further depressed sales by limiting stocks. Consumer concern about the gasoline shortage is substantiated by the increasing popularity of canoes and sailboats. Another facet of spending patterns is indicated by rising sales of alcoholic beverages reported by two major retail chains in the Kansas City area.

Following a 1 1/2 percent gain during the month ended February 15, farm prices have since experienced a sharp reversal, especially for livestock. Beef prices are down almost 20 percent from their February level, and hog prices have also fallen somewhat. Although meat supplies have risen, reflecting the settlement of the truckers' strike and the shipment of heavier animals, prices at the farm level have slipped more than anticipated. One reason rests with consumer demand, which has remained quite sluggish as food merchants have widened their profit margins rather than pass on savings to consumers. Moreover, given the current plight of the cattle industry, producers have been sending more cows and bulls to slaughter, which tends to depress prices because the meat is of lower quality. Very recently, however, retail meat prices have begun to reflect developments at the farm level. Several Kansas City merchants reported that they have lowered beef prices and are now beginning to feature sales and engage in more advertising. Generally, most of them expect some further price moderation over the next few weeks. However, if feed cattle marketings decline in the second quarter as expected, any downturn in retail beef prices is likely to be short-lived.

Interviews with larger Tenth District member banks indicate that business loan demand has been unseasonally strong in recent weeks. Most banks report heavy borrowings by both national and local firms, although a few banks have experienced some softening in borrowing by national firms, which are felt to be switching to the commercial paper market. Even though shortages of pipe are reported to have limited operations of oil and oil-related businesses, banks in Tulsa and Oklahoma City continue to experience especially strong loan demand by these firms. Deposit inflows have generally been sufficient to satisfy loan demand. In some cases, several banks have found themselves with a surplus of loanable funds and have begun to increase their holdings of state and local securities, after having permitted them to run down for a period of time. One source of the deposit strength has been in consumer-type time deposits, inflows of which have been attributed to the drop in Treasury bill rates that occurred in late January and February. Certificates of deposit have also increased in recent weeks, as several banks are continuing to rely on this instrument to augment their supply of loanable funds.

ELEVENTH DISTRICT--DALLAS

Consumer expenditures on nondurable goods continue to be strong in the Eleventh District, according to a survey of major retailers in the area. And, while purchases of durable goods are still relatively weak, they appear to be recovering somewhat. There also seems to have been a shift in consumer buying attitudes, with impulse buying giving way to cost-conscious "smart shopping". Many big-ticket purchases are currently being made simply to beat anticipated price increases in the future.

Sales of automobiles are beginning to return to a more normal mix of standard- and small-size cars, following the sharp jump in sales of economy models in the past few months. For example, one dealer says he is now selling four times as many large cars as compact models. This shift, along with recent deliveries of back orders of small cars, is restoring dealers inventories to a more normal mix than in recent months. However, inventory costs have increased, and dealers maintain they have not been able to pass these higher costs on to consumers. To ease the profit squeeze, one auto manufacturer is granting dealers a $200 across-the-board rebate on each car delivered from the factory.

Texas house-builders anticipate a strong turnaround in residential construction by midyear. Inventories of new houses completed but not sold are down, and more starts are planned. Sales are already beginning to exceed the levels recorded in late 1973, and some builders expect that the dollar volume will be up 33 to 60 percent by the year-end. However, builders predict home prices will increase as much as 10 to 15 percent, and land costs are described only as "going out of sight".

Strong sales are reported by the largest department store chains in the Southwest, with no evidence of a letup in the near term. However, some sales have been lost due to scattered shortages of selected items. Recently, catalog sales and purchases at rural outlets have risen sharply, as consumers reduce the number of shopping trips to metropolitan centers in order to save gasoline. Some Texas department stores specializing in more expensive product lines report sales slowed markedly in February, as consumers have become increasingly price conscious.

Higher dollar volumes but sharply slower unit sales of some items--especially meat--are reported by retail food stores. Consumers have significantly altered buying patterns as they attempt to stretch their food budgets, as evidenced by higher unit sales of macaroni and other flour products. Retailers also say that, while beef is a slow-moving item, meat extenders are selling very well. In anticipation of shortages and higher wholesale prices, some major grocery chains are stockpiling any available goods and report inventories at record levels.

The gasoline shortage has reduced or eliminated price differentials between major and minor brand stations, according to a spokesman for the Texas Service Station Operators Association. Consumers no longer are seeking out the minor brand stations as they did when these stations offered lower prices on gasoline. Therefore, the minor brand stations are in a better position with regard to their allocation of gasoline--relative to demands on them by customers--than are major brand stations. The response by some of the minor brand companies to the favorable allotment position has been to truck gasoline out of the state to higher priced markets.

Expenditures for travel continue to grow in Texas, although the composition of such spending is changing. One local travel agency is booking AMTRAK reservations for the first time, and much of the increase in air travel in Texas, particularly commuter flights, is in response to the higher cost of auto travel. Business at metropolitan motels and hotels continues to grow with increased business and convention traffic, while occupancy rates at motels located along interstate highways are off substantially.

TWELFTH DISTRICT--SAN FRANCISCO

The economic situation in the Twelfth District has changed little from the previous month. Unemployment has increased somewhat, but the overall level of output is still rising. Business capital expenditures remain an important source of demand, and agricultural prospects for the coming crop year are excellent. The greatest weaknesses are in consumer durables, automobiles, and residential housing. Gasoline shortages are causing problems and creating uncertainty, but the economic effects so far are limited.

Consumer retail spending is steady, although there are some indications of slowing in February. Sales of durables are lower, and this reduction in spending is matched by increased savings flows to banks. Sales of standard-sized automobiles continue to be weak. Because of gasoline shortages, the tourist centers, such as Disneyland, have had significant drops in business in February.

The strongest sectors are business capital spending and agriculture. Aerospace activity is strong in the Pacific Northwest, where Boeing continues to attract new orders, but weaker in southern California. Industrial output is being hampered by shortages in steel products and petrochemicals. The petroleum shortage has had a minor effect except for those industries closely tied to automobile usage and the availability of gasoline supplies. Recreational-vehicle and mobile-home producers have had to cut production.

Agricultural prospects are good throughout the District. In western Washington, the weather has been excellent and farmers are increasing planted acreage by bringing marginal land into cultivation. A similar situation exists in California, Idaho, and Utah where farmers are optimistic and attempting to increase production. The demand for new agricultural equipment is very strong, and dealers are having difficulties in getting deliveries. Fuel shortages may also cause problems. Generally, farmers expect continued high prices, and wheat producers are hoping to receive $4 to $5 per bushel for this year's crop.

Residential construction activity is still falling and, although one director notes a slight improvement in housing sales, there seems little expectation of an immediate change in this situation. Nonresidential construction, reflecting the efforts of business to expand capacity, is still strong.

The consensus of our directors is that there will be a slight downturn in economic activity in the first half of this year followed by a recovery. Only a few think there will be a serious recession, even though there is uncertainty over the effects of the fuel shortage. Inflation is regarded as the major problem, and little moderation in price rises is expected.

In banking, credit demands by business remain strong, although shifts in relative yields have caused some shift of borrowing into commercial paper. Real estate loan demand is weak in all regions of the District, but some recovery is expected by some bankers in the second half of the year.

Consumer borrowing has declined with the largest drop occurring in automobile loans. Several bankers report an increase in delinquencies in consumer credit. Others think that losses on problem automobile loans will begin to increase, because of unemployment and the lower resale value of standard-sized cars. On the other hand, the unwillingness of consumers to increase their indebtedness is matched by their greater savings. Both banks and savings and loan associations are experiencing heavy inflows of savings. For other classes of deposits there has been little change.

Bankers expect a continued decline in short-term rates at least until midyear. The lower limit for short-term rates would be in the 5 to 5 1/2 percent range. The most common forecast of the level of the prime rate is that it will fall to 7 1/2 percent, and a few bankers think that the prime rate might even go down to 7 percent. Real estate loans will probably fall to 8 percent. The continued inflation expected for this year will, in the view of most bankers, prevent any substantial fall in the long-term rates.