

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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SUMMARY *

Reports by the Reserve Banks indicate that the economy has continued to expand vigorously in recent weeks. However, the rate of expansion has apparently slowed in the residential construction industry, and a number of Banks reported expectations of a more moderate rate of expansion in the overall economy in the second half of the year.

Retail sales have generally continued strongly upward. The most common report was that sales continue to rise at about the same rate as in recent months. However, some softening in retail trade was detected in the Fourth District, especially in appliance sales, and a Minneapolis Director associated with the retail industry reported that a slowdown in consumer spending may be occurring.

There is no letup in manufacturing expansion. Most Banks which reported on this topic found the uptrend noticeable. Cleveland and St. Louis indicate that factories are operating at or near capacity; the former, however, found a modest decline in the proportion of firms reporting new orders in May. Dallas, Minneapolis, Philadelphia, and Richmond reported further gains in manufacturing activity. Atlanta reported that employees were working overtime in lumber, machinery, and metal products. Chicago reported that the uptrend of manufacturers' orders may be slowing because of reluctance to take new orders many months ahead at stated prices.

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

Shortages and rationing continue to be major complaints in many product lines. Seven of the Reserve Banks reported either raw materials or manufactured products of some type in short supply. Items reported in short supply include: labor, gasoline, natural gas, paper, paperboard, transportation facilities, cement, fertilizer and other agricultural supplies, and electric power.

The shortages are apparently leading to a capital spending "boom." The impending plant expansions in the Sixth District include a wide range of the major industries of the nation. Cleveland respondents representing steel and other industries reported that capital spending to expand capacity is underway and that no plans exist for cutting back in 1974 as long as new orders and profits warrant the expenditures. A high level of capital investment in plant and equipment was indicated by Dallas and San Francisco, and plant capacity is reported to be inadequate to meet expected future sales in a number of other Districts.

The reports indicate that inflation is still a major concern of businessmen, and there is little optimism that it will come to an early end. Chicago reported an acceleration in the number of announced price increases in June. Dallas Directors expect wage rates in their companies to rise at a 7 percent rate in the second half of the year. Philadelphia respondents report higher prices for raw materials, and over half of the area's executives expect a worsening of the situation. New York Directors expect further price increases over the coming months, but at a more moderate rate. New York expressed the view that the increased food prices may have a strong impact on union wage demands.

Residential construction has apparently turned down in most of the Districts. Chicago reported that a decline in residential construction is clearly underway. Other Districts reporting either a slowdown or weakness in such activity include: Atlanta, Cleveland, Dallas and San Francisco. Only Richmond reported further increases in home building. The trend in commercial construction is mixed.

Employment has leveled off in most of the Districts and unemployment has inched up, but most of the Banks still report a "tight" labor market and labor shortages, especially of skilled labor.

The nation's agricultural situation has vastly improved in recent weeks. After an extremely difficult planting season because of wet weather and floods, prospects are now good for a large production of critical food and feed crops. Some shortages in seed and fertilizer still exist in limited areas and some land along the Mississippi River may not dry in time to plant cotton, the intended crop, which will be critical to individual cotton farmers. Farm production costs are high and rising, but overall prospects are for high farm incomes. If average growing conditions are realized, record levels of production are likely for a number of major crops and record prices may be received for them. In the meantime, however, as reported by Chicago and Kansas City, prices of meat animals may be pressing against the ceilings, and rising feed costs are reducing profit levels from feeding. The ceilings could thus result in lower levels of production.

Most Districts reported a strong loan demand, slower deposit growth, and generally higher interest rates than heretofore. Regular

business customers are apparently having no trouble obtaining credit at the higher rates, but Chicago reports that country elevators are having increased financing difficulties as a result of transportation problems and sizable margin calls on hedged grain.

In response to the Board's request for information on the impact of the Treasury's tax proposals for eliminating real estate tax shelters, the replies varied from little or no impact on construction activity to a definite dampening effect. Boston, after a study in some depth, concluded that subsidized housing would be severely hurt, and that while profits in the private market would be reduced, most "worthwhile" projects would be built. A decline in construction would be anticipated in the Kansas City and Minneapolis Districts. Kansas City reported that the healthy business situation in the Tenth District would be dealt a severe blow if investment funds flowing into cattle and construction were suddenly cut back by tax reform. The respondents indicate that the tax would not have a significant impact on construction in the Chicago, New York, Richmond, and St. Louis Districts.

FIRST DISTRICT -- BOSTON

Discussions with three large Boston real estate developers about the Treasury proposals to limit artificial accounting losses indicated that only subsidized housing built by limited dividend corporations would be severely hurt. Developers of apartments for the private market and of commercial construction felt that while profits would be reduced, worthwhile investment projects would still be built and only marginal projects would be affected.

The Massachusetts Housing Finance Agency channels funds into the subsidized housing market to limited dividend corporations. Between 95-100 percent of the equity capital put up in these corporations is attracted by the tax shelter feature. The Director of the agency said, "We're in the business of selling tax shelter." Without the tax shelter provision, the limited dividend corporation would not attract private capital and the low income housing market would disappear. Developers are only interested in this kind of construction if they can sell off their losses at the front end and end up with no investment or even a negative investment of their own capital.

In the private market for apartments, developers felt that the tax shelters were one of the factors increasing profits, but that its removal would not really hurt large firms. As one developer put it, "The Treasury proposals are like higher lumber prices; they're another factor affecting a firm's income stream, but they only affect the marginal situation." The Treasury proposals may, therefore, partially slow down some construction activity, but it's not going to kill the apartment market.

In some cases, this developer felt that removal of the tax shelter provision will help the housing market because it has been an added ingredient distorting the economic picture and has led to overbuilding. He cited overbuilding in Southern California, Florida and Texas where there are wealthy tax-conscious populations which have put their money into projects which were not economically viable investments just because they provided tax shelters. These projects are built for sale, not investment.

While large real estate developers will be able to continue operating, it was felt that many small builders are not dependent on outside capital attracted by the tax shelter provisions. For large builders, the tax shelter has been a windfall, but for many small builders it is crucial. Developers also felt that the Treasury proposals would accelerate condominium construction.

A large developer of commercial construction reported that the Treasury proposals should not have a dramatic effect on that market because there is more capital available for investment in good industrial and commercial leases than there are good projects. Since there aren't small developers in the commercial market, the effects will again be less than on apartment construction. This developer summarized his company's position by saying, "We'll survive, but it won't be as much fun."

Both of the academic correspondents available this month, Professor Eckstein and Dr. Shapiro, felt the prospects are good that economic growth will taper off without becoming negative. Neither was pessimistic about the long-run outlook for inflation.

Shapiro felt that internal sources of funds would be sufficient to finance the most likely prospective levels of nonfinancial corporate investment. Thus, he felt short rates, and later long-term rates, will come down. This would preclude a significant squeeze on housing and consumer credit. Shapiro recommended a 7 to 8 percent rate of growth in RPDs for the current policy period.

Eckstein again expressed concern about a credit crunch. Past crunches, he suggested, have been "stumbled into, not planned." He noted that the indicators of a crunch -- short rates close to long rates, and no growth in unborrowed reserves -- are present in the current situation. In order to prevent the Federal funds rate from stabilizing as high as 8.5 percent, additional reserves must be made available over the next two months. Unless borrowings are to rise to unprecedented heights, therefore, nonborrowed reserves must be expanded. Eckstein grants that current policy must tread "the narrow path between not worsening the prospects for a decline in 1974 and not contributing to the current commodity price explosion."

SECOND DISTRICT -- NEW YORK

The Second District Directors who were contacted recently generally felt that prices will continue to rise rapidly in the months ahead, albeit at a more moderate pace than has been experienced recently. A good deal of concern was expressed over the possibility that continued price increases might lead to inflationary wage settlements. Despite the stability of the overall rate of unemployment, the Directors have seen increasing evidence of tightness in the labor market, especially shortages of skilled labor. None of the Directors expressed apprehension over the large buildup in consumer credit during the past several months. A number of respondents expected the rise to taper off in coming months, along with a moderation of the demand for consumer durables. The real estate specialists who were contacted expressed mixed opinions on the implications of the proposed changes in the tax treatment of some income from real estate investments, but most foresaw little impact on overall construction activity.

Regarding the price picture, the Directors expected further increases over the coming months, but at a more moderate rate. The feeling was widely expressed that the sharpness of the recent increases was largely traceable to temporary factors. These factors were summed up by the Buffalo branch Directors as including a broad-based "catch up" increase in price following the termination of Phase II, the recent devaluation of the dollar, earlier pressures on industrial production, and bad weather conditions for agriculture here and abroad last year.

The continuation of poor weather conditions this year was expected to increase further the cost of foodstuffs to the consumer -- a development felt likely to have a strong impact on union wage demands. The chairman of a large New York City bank thus stated that "The upsurge in prices will be a significant factor in wage negotiations and could lead to large wage demands. This is a major area of uncertainty, but if the upsurge in prices is allowed to be translated into large wage settlements next year, then the stabilization program will be rendered ineffective. This is perhaps the strongest argument for modifying the program and seeking broad-based support." Similar expectations regarding the possible effects of price increases on wage negotiations were expressed by most other respondents.

Upward pressures on wages, moreover, were considered likely to be intensified by conditions in the labor market, which, as in previous months, were generally reported to be tightening. Special note was taken of shortages of skilled workers, including managerial and technical personnel.

Concerning consumer credit, the chairman of the New York bank argued that the nonmortgage debt of households was not out of line, historically, with consumer incomes. Similarly, none of the Buffalo branch Directors reported any indication that consumers in their area have been over-extending themselves in this regard. The president of a Buffalo bank mentioned that his assessment was based, among other things, on an examination of ratios of delinquencies and refinancing to the total amount of consumer credit at his bank.

The New York banker attributed the rapid run up in consumer credit to the strong demand for cars, appliances, and other consumer durables. The president of a nationwide chain of retail stores mentioned that the recent sharp rise in this type of credit in good part reflected anticipatory buying related to expected tax refunds and to expected higher prices. Indeed, the desire to avoid higher prices was widely mentioned as a major factor in the high level of consumer spending and the accompanying growth in consumer credit.

The president of the retail firm reported that there were now some indications of a slowing in the rate of growth of such credit, and the New York banker expected the rate of growth in the sale of consumer durables to slacken significantly over the next year, with a concomitant slowdown in the rise of consumer credit. While the Buffalo branch Directors have observed no signs of any weakening of consumer willingness to incur additional debt, some noted a growing concern by the public regarding economic conditions that could lead to a slackening in the use of credit later in the year.

Several construction industry specialists at New York banks, insurance companies, and mortgage firms were queried regarding the possible adverse effects on construction activity of the proposed change in tax legislation, mentioned in the St. Louis Bank telegram, that would curb the use of some real estate tax shelters. One observer forecast a drastic decline in the number of individual investors in the real estate business. Most respondents, however, felt that the impact on construction activity of the proposed change was likely to be very limited.

THIRD DISTRICT -- PHILADELPHIA

Business conditions in the Third District are generally favorable. Production activity is still brisk and expected to improve further. Labor markets are holding steady with small increases in payroll and work week possible by year end. A considerable number of firms are increasing their inventories in anticipation of further sales advances; retailers are experiencing good demand for their summer sportswear lines. Construction activity has slowed somewhat. Bankers are feeling the beginnings of loan demand pressure, and inflation continues to plague the District.

Production activity is maintaining last month's brisk pace. Over half of the respondents to this month's business outlook survey report sales and shipments unchanged, and a substantial 35 percent reported sales advances. While a small minority of the local manufacturers are experiencing a drop in sales, the six month outlook is bright. The majority of respondents anticipate increased sales and shipments.

The employment situation in the Third District remains basically unchanged despite small pluses and minuses in some areas. Twenty percent of the firms report increasing the number of people they employ and 14 percent are increasing the number of hours in their average work week. But the overwhelming majority report no change in either their work week or the number of people on their payroll. However, some improvement is anticipated; almost a third of the firms plan to hire more workers by year end. Investment in inventory is generally holding steady, although over a quarter of the firms surveyed are increasing stocks this month.

On the six month planning horizon, over 80 percent expect to either increase inventories or, at least, maintain them at their current levels. A considerable minority of respondents plan to increase capital outlays within six months, but their number does not represent a gain over last month. Local retailers note that recent rainy weather has slowed sales. Nevertheless, demand for goods such as summer sportswear has been good.

Overall, construction activity in the Third District is down slightly, particularly in the nonresidential and public works sectors. Bright spots are the Atlantic City metropolitan area, where increases in resort homes are boosting the local economy, and the Wilkes Barre area, which is still hard at work rebuilding from the disastrous hurricane floods of last year.

Over half of the survey respondents report paying higher prices for raw materials, and nearly 60 percent report that they are keeping their own prices steady. No relief is expected, with well over half of area executives queried anticipating a worsening of the situation.

Third District bankers report that loan demand is up slightly, deposits are flat, and loan demand pressures are building. Several said that they were discouraging many loan applicants; but, none reported denying worthy requests for funds. Two banks report witnessing disintermediation as savers request conversion of their deposits to U.S. Government bonds.

FOURTH DISTRICT -- CLEVELAND

Business activity in the District is still strong, although there are a few scattered signs of slowing in the pace of the expansion. Some softening is detected in retail trade, residential construction is declining, gains in employment have slowed, and manufacturers are experiencing some difficulties in increasing output.

The chief executive officer of a major department store in Cleveland informed us that retail sales were not as strong in May as in previous months of the year. Sales of home furnishings and soft goods remain at a high level, but the appliance business has slowed. There is no evidence of consumer resistance to higher prices by way of a downgrading in purchases; that is, the sales volume of color TV sets remains at a high level and there has been no unusual pickup in budget department sales. There is no sign of an increase in payment delinquencies; in fact, collections were up in May, probably because of tax refunds. With respect to prospects in the period ahead, the department store official expects that each succeeding quarter will probably show reduced rates of growth, and the fourth quarter may be a difficult one for retail sales.

An economist from one of the nation's largest department store chains also expects consumer spending to slow sharply by late this year or early next year -- mainly because of the extraordinary pace of debt accumulation and the effects of the recent surge in consumer prices. Both consumer expenditures and borrowings have been growing faster than recent historical averages. The economist reports no evidence of consumer downgrading or rising delinquencies.

Residential construction contracts in the District seem to have peaked in January of this year; since then, the decline has been more pronounced in the District than in the nation. Nonresidential construction, on the other hand, is on a strong upward trend.

Overall business conditions in the District's manufacturing sector remain strong, although there have been a growing number of reports in recent months indicating problems of physical capacity limitations, material shortages, lengthening delivery times, and widespread price increases. Early returns from our monthly survey of manufacturers reveal a moderate decline in the proportion of firms reporting gains in new orders during May. The proportion of firms reporting higher shipments has also slowed recently. Some manufacturers are finding it more difficult to increase output because of material shortages; delivery time continues to lengthen for the majority of firms. The diffusion index for prices paid by District manufacturers, which had hovered around the 60 percent level during most of Phase II, moved to the 80 percent level between February and April, and jumped to 85 percent in May -- the highest figure in the nine-year history of our survey. In recent months, gains in manufacturing employment have slowed markedly compared with the increases that occurred late last year and early this year.

Remarks from some of our industrial Directors tend to support the general conclusions of the manufacturers' survey. Three of our industrial Directors (industries: consumer goods, producers durable goods and office equipment) noted that new orders had levelled off in the last month in contrast to the continuous monthly increases recorded

earlier in 1973. All three also reported some problems in increasing output because of capacity limitations. The Director of the office equipment industry said that they had experienced a sharp backup in shipment schedules because of the high level of orders and the need to hire and train additional employees; this situation has been complicated by the introduction of a new line of their basic equipment, however. The Director in the producers durables industry reported continued problems in finding high-quality skilled and semi-skilled labor.

Steel firms mentioned that new orders were down in May, reflecting order limitations imposed by the mills rather than any decline in underlying demand. Steel demand is said to be at peak and is expected to stay high for the rest of the year. One steel firm notes that further increases in output are impossible due to capacity constraints. Comments from our Directors in other industries indicate they, too, are operating at capacity. Capital spending to expand capacity in their firms is underway, with no plans for cutting back in 1974 as long as new orders and profits warrant such expenditures.

FIFTH DISTRICT -- RICHMOND

Results of our most recent survey of businessmen and bankers indicate that the Fifth District economy remains in a strong advance, with the manufacturing sector continuing to gain momentum. Further increases in manufacturers' shipments, new orders and backlogs are reported, while manufacturers' inventories have apparently declined further in recent weeks. It now appears that for a significant number of manufacturers, inventory levels are lower than desired. Increases in retail sales evident in recent months are continuing while construction outlays apparently remain on the rise. According to a special survey, the mortgage markets have tightened significantly in recent weeks.

Increases in shipments, new orders and backlogs were reported by more than 50 percent of the manufacturing respondents in the latest survey. Among the manufacturers reporting gains were producers of synthetic fibers, chemicals, and steel. Nearly one-half of the manufacturing respondents reported declines in inventories, while one-fifth indicated that inventory levels are too low relative to sales prospects. Nearly one-third of the manufacturing respondents reported that current plant and equipment capacity is inadequate.

The number of manufacturing firms reporting increases in employment rose sharply and manufacturers on balance also reported an increase in hours worked per week. Trade and services respondents indicated little change in employment and hours worked per week. Widespread wage and price increases were reported by both manufacturing and trade and services respondents.

Retail sales in the District remain strong. All retail respondents reported sales increases and more than one-half of the banking respondents indicated that retail sales in their areas had risen further in recent weeks.

Banking respondents report that the demand for all types of loans continues strong. Increases in the demand for business, consumer and mortgage loans were reported by more than 60 percent of all banking respondents. Bankers also indicate that both residential and nonresidential construction activity increased in their areas during the past month. Some overbuilding of residential apartments is reported in parts of the Carolinas. Contacts with several major builders in the District suggest that the proposed changes in real estate tax shelters have not had any noticeable impact on construction activity.

A recent survey of residential mortgage lenders in the Fifth District indicates that mortgage markets have tightened in recent weeks. This tightening is associated with a slowdown of deposit inflows at savings and loan associations and savings banks which, in turn, is attributed to increased consumer spending and rising market rates of interest. Also contributing to the tighter conditions is the large volume of loans to which these institutions have committed themselves in recent months. Very few funds are available for new loans, while rates to preferred customers are in the 8 percent range. The Washington, D.C. area appears to be experiencing the tightest conditions, while Baltimore has some institutions (savings banks) that are still making new loans. Other major Fifth District cities seem to fall between these two extremes.

The significantly improved farm income situation continued throughout the first quarter of 1973, with cash receipts from farm marketing recording a 26 percent increase over a year ago. While spring plantings in the District are about on schedule, recent sharp increases in the price of feed are of major concern to livestock producers and may be having adverse effects on poultry and hog production.

On balance, businessmen and bankers in the Fifth District continue to be optimistic about the general economic outlook. All of the banking respondents expect business activity in their areas to stabilize at present levels or to advance further during the next three months.

SIXTH DISTRICT -- ATLANTA

The District's economy remains robust with no letup in sight. There continue to be numerous announcements of new plants and plant expansions. Plans have been announced for several large real estate projects, but there are some reports of impending weakness in residential construction and some doubts that all of the planned major projects for Atlanta will actually be built. Tight labor market conditions are common, especially in Florida.

A large flow of new plant and plant expansion announcements continues throughout the District. Firms in the chemical industry have announced plans for a \$90 million phosphate processing plant in North Florida, a \$50 million polyvinyl chloride plant in Lake Charles, a \$50 million plant expansion in Nashville, and a \$21 million synthetic resin plant near Mobile. Chrysler Corporation is planning to locate an assembly plant employing 1,000 in South Georgia. A multimillion-dollar tire fabric plant, which will eventually employ 300, is to be built in North Alabama. Firms in the electrical products industry have announced plans to expand an air-conditioner plant and to build a thermostat plant and a new air-conditioner plant, all in Tennessee. A dictation equipment plant is slated for Central Georgia and an electrical tool plant for Jackson, Mississippi. There is also a possibility that a major investment will be made at an engineering center in Tennessee. Lumber products companies intend to build two new plants in Georgia and three others in Alabama, Mississippi, and Louisiana. Three apparel plants in Mississippi and Alabama are being expanded, generating from 300 to 400 new jobs.

The outlook for residential construction is mixed. There have been some noteworthy announcements, including two planned unit developments covering a total of 2,600 acres near Orlando, a \$28 million residential development in Jacksonville, and a 1,000-acre residential development north of Atlanta. An Atlanta firm has bought 5,500 acres north of Daytona for eventual development of a "recreational-oriented residential community." There has been a multimillion-dollar land deal in the Florida Panhandle involving thousands of acres, but no definite plans have yet been announced. There are some reports of weakness in residential construction, however. In some areas such as East Tennessee, this is the result of labor or material shortages or weather conditions. Five-month delays in brick delivery are reported in East Tennessee. One Tennessee banker notes that the "increasing cost and the diminishing supplies make it difficult for contractors to bid on projects." A low supply of labor and a shortage of concrete and plywood are reportedly slowing construction in the Jacksonville area. Construction activity in the Miami area is expected to slow after a rush to beat a permit moratorium ordered by a pollution control board.

Plans for another 30-story office building and parking facility have been announced for downtown Atlanta. However, because of the large number and the ambitiousness of many of the planned Atlanta projects, real estate people have begun to express skepticism that all the projected developments will actually be built. They note that, in the past, projected developments have sometimes been scrapped because of a lack of sufficient financing. On the other hand, the occupancy rate in metropolitan Atlanta area office buildings has reportedly risen to 87 percent and the rate is even higher in moderately priced space in downtown Atlanta.

Plans have been announced for a \$200 million shopping center and office complex in a planned community southwest of Atlanta and for a \$50 million office park north of Miami. On a smaller scale, plans have been announced for a \$7 million hotel complex in Augusta, Georgia, a \$4.5 million addition to a motel in downtown Atlanta, a \$3 million shopping center in Northeast Florida, and a \$2.1 million retail office building in South Atlanta.

Taut labor market conditions are reported in some areas of the District. The unemployment rate is less than 2 percent in some areas of Florida. One businessman claims that a shortage of labor is an impediment to attracting new firms to the Tampa area. The citrus and vegetable industries in Central Florida report difficulty in attracting sufficient harvesting labor. In Tennessee, overtime in the lumber, machinery, and metal products industries has kept unemployment so low that a Knoxville businessman complains that "It is still virtually impossible to find anybody to work." An exception to these conditions exists in areas of Louisiana where layoffs in manufacturing, reportedly due in part to a lack of raw materials, have pushed up unemployment.

There are reports of increased real estate speculation. In Tennessee, where land prices are "booming," people are acquiring land which was considered "wasteland two or three years ago." A Tennessee banker claims that older people compare the current situation to the speculation of the late 1920s. In the Cape Kennedy area, house prices have reportedly fully recouped from the depressed levels of 1970. The average cost of used homes in the Atlanta area has risen sharply.

Paid attendance at the tourist attractions in Florida, particularly Disney World, has increased. Attendance during the first seven months of Disney World's second year has been running 8 percent ahead of the comparable period last year. However, people in the tourist industry are worried that the gas shortage will diminish the current volume of tourism.

Farm costs are reportedly rising sharply because of the high price of seeds and feed and shortages of fuel and fertilizer.

SEVENTH DISTRICT -- CHICAGO

The strong uptrend in employment, output, factory orders, retail sales, personal income, and profits continues in the Seventh District. Demand for apartments has slowed, however, and the expected decline in residential construction is clearly underway. The well-publicized decision of a major producer of recreational motor homes to cut output sharply because of excessive inventories stands out as an isolated example. Most manufacturers are concentrating on maintenance of high level production schedules, with due concern for quality, in the face of shortages of materials and manpower. Prospects for large crops are now excellent, following earlier fears that wet fields would cut yields.

Higher short-term interest rates and reduced availability of mortgage credit have caused some apprehension that credit conditions will tighten generally in the remainder of the year. The adverse psychological factors -- Watergate, inflation, international pressures on the dollar, and the failure of the stock market to rebound -- are widely commented upon, but there is no solid evidence that either planned consumer purchases or planned business investments have been curtailed as a result. Newspapers have publicized views of Chicago forecasters that a general recession, or a marked slowdown in growth may occur late in 1973 or early in 1974, but, again, there is no clear evidence that these reports have affected planning.

Possible anti-inflation moves by the Administration, of course, are a subject of general interest. In June, there has been an acceleration in the number of announcements of price increases for a variety of products and services, including petroleum products, chemicals, motor vehicles, tires, nonferrous metals, and utility rates. This may reflect, in part, fears of either a price freeze or tougher Phase IV controls. Some union contracts have been negotiated at the 5.5-6.0 percent guideline level, but others, including the building trades, are valued at 8 percent or more.

The uptrend in manufacturers' orders may be slowing because of a reluctance to take on new orders for delivery many months ahead at firm prices. This factor is present in steel, capital goods, nonferrous metals, textiles, paper, petroleum, and chemicals.

The heat wave of the past several days (with heavy demands for air conditioning) caused major utilities in Michigan and Illinois to lower voltages, reduce sales to industrial customers, and call upon other companies for help. Margins of power capacity are lower than desired at peak loads. Utility executives insist that the situation would be extremely critical if Nader is successful in shutting down nuclear power stations.

Gasoline shortages are continually in the news. Most major companies have strict allocation on sales to dealers, and independent distributors are cutting operations. More stations are limiting purchases and are reducing hours of operation to the point that motorists are warned against long journeys at night. Municipalities that usually obtain supplies on contracts covering a year or more have trouble getting bids.

Despite all efforts at publicity by major oil companies, there is a widespread view that the fuel shortage is artificial and is based on a conspiracy. The gasoline situation is especially severe in the Midwest where refineries are largely dependent on domestic crude oil production which has been declining in volume for the past year.

The flurry of interest in the Treasury's proposed tax shelter reforms that relate to construction has largely disappeared. Many builders and real estate financiers never heard of these proposals. For those who were concerned, Representative Mills' statement in early June was taken to mean that no impact would be felt this year. It is doubtful that tax reform proposals would influence real estate activity before the reform became law. Even if the Treasury's proposals were enacted, many limited partnerships to finance speculative building would still be arranged because of the apparent profitability of such arrangements. Many investors with \$5,000 to \$100,000 to invest have become disillusioned with the stock market and find real estate attractive, especially with prospects for further inflation of land values and construction costs. Of greater concern to real estate people than tax reform are (1) overbuilding of apartments in some areas, (2) the possibility of significantly tighter credit, and (3) the difficulty of getting new projects approved in the face of environmentalist pressures.

Sharp advances in farm prices and in wholesale prices of processed foods, together with the current structure of future prices, portend further increases in retail food prices. Recent prices paid for livestock at the farm level in some cases have exceeded implied ceilings.

A growing number of experts in this region believe the rise in food prices for 1973 as a whole will exceed the revised government estimate of 10 percent.

Country elevators are encountering increased difficulties in obtaining adequate financing. Sizable margin calls on hedged grain and transportation shortages further sharply raised operating capital requirements. The situation is likely to worsen as harvest seasons begin.

EIGHTH DISTRICT -- ST. LOUIS

Economic activity continued sharply up in May and early June according to a group of businessmen in the Eighth District. Retail sales continue up, plants are operating at full capacity and in some cases rationing output. The labor market remains "tight," demand for loans is high, and interest rates are rising. Excessive rainfall and floods retarded farming operations and may cause a reduction in the acreage of some crops from intended plantings.

Rising demand and inflation is of increasing concern. Representatives of manufacturers report that selling is no more a problem; now their chief problem is obtaining raw materials and allocating output at current prices. The price outlook is so uncertain that some manufacturers refuse to quote prices for future delivery.

Manufacturing plants are apparently operating at full capacity in all industries, and in some instances arbitrary rationing of products to wholesalers and retailers was reported. Supply relative to demand is apparently shortest in the oil refining, paper and paperboard industries which are rationing output.

Retail sales at major department stores in the District are maintaining their uptrend established more than a year ago. Sales in the mid-city stores are not as strong as elsewhere relative to a year ago but such sales have turned up and the outlook is reported to be generally good.

Payroll employment in the Eighth District has apparently leveled off in recent weeks after rising sharply in late 1972 and early this year.

The unemployment rate in most District states and major cities remained relatively low in April averaging below 4 percent and not exceeding 5 percent of the labor force in any state or major city.

Financial firms report that the credit market is very "tight" with upward pressure on interest rates for all types of loans. Savings and loan associations in St. Louis reported that net savings are noticeably down and that residential mortgage rates are rising. Loans at major Eighth District banks have leveled off in recent weeks after rising sharply since mid-1972. Total deposits have been generally unchanged since early April. A small decline in demand deposits was offset by a slight increase in time deposits.

The delay in farming operations became quite critical in late May as a result of excessive rainfall and floods. Corn yields and production generally decline substantially if planting is delayed beyond early June. It is generally believed that most of the intended corn acreage was planted by the end of May except in some flooded and extremely wet areas. A sizable portion of the intended cotton acreage in the Central Mississippi Valley Area was not planted. Most of the shortage is in Southeastern Missouri; Mississippi County, Arkansas; Lake and Dyer Counties, Tennessee and the lower delta counties of Mississippi. In some of these areas less than 50 percent of the intended acreage is believed to be planted and it is now too late for further planting. It is believed that much of the land that was not planted in cotton will be planted to soybeans. However, soybean seed is scarce and high priced which will tend to limit the acreage planted.

Although some of the major buildings in downtown St. Louis apparently were built as a result of tax shelters, we have no evidence of great concern over the proposed change in the tax laws.

NINTH DISTRICT -- MINNEAPOLIS

Ninth District manufacturing activity has expanded vigorously in recent months, and District retailers have enjoyed sizable sales gains. However, reports disclose that some slowing may occur in both areas during the last half of 1973. Transportation problems continue to plague the District and several materials are in short supply. Interest rates have generally not risen at rural, agriculturally oriented banks but have moved up at large urban banks. Business loan demand is characterized as strong throughout the District. If real estate tax shelters are eliminated, District construction activity will be curbed.

According to our latest industrial expectations survey, first quarter District manufacturing sales exceeded year-earlier levels by 21.8 percent, and a 17.2 percent second quarter sales increase is anticipated. These record-breaking sales gains noticeably exceed both durable and non-durable goods respondents' last February's sales expectations. During the last half of 1973, however, District manufacturers look for a marked slowdown in their sales growth. District manufacturing sales are expected to be up 12.5 percent in the third quarter and increase 8.1 percent in the fourth quarter.

Further evidence of the recent acceleration in District manufacturing activity is manifested in survey respondents' attitudes about their inventories and plant and equipment. In the current survey, 33 percent of the respondents indicated that their inventories are low in relation to their sales outlook. This compares with 20 percent a year ago and 13 percent two years earlier. Furthermore, 24 percent of the respondents

consider their current plant and equipment inadequate to meet their expected sales while 15 percent voiced this opinion twelve months ago, and 10 percent in May 1971.

Bank Directors disclose that District retailers generally have been recording quite strong sales gains and attribute these increases to favorable economic conditions rather than to consumers' desires to avoid future price increases. However, one Director associated with the retail trade industry indicates that the anticipated slowdown in consumer spending may be occurring already: his firm's May sales growth was down markedly from the prior four months. Several other Twin Cities area retailers reveal that they expect their sales growth to soften this fall and some anticipate relative sales gains in the last half of 1973 to be below comparable 1972 sales advances. Outside the Minneapolis/St. Paul metropolitan area, Directors report that retailers generally look for continued strong sales growth and that much of this optimism stems from the favorable outlook for District farm income this year.

Due to the heavy demand placed on transportation facilities by grain shipments, transportation bottlenecks have emerged in the District. Several Twin Cities users of rail cars and barges are operating on a day-to-day basis and others have found that the flooding on the lower Mississippi has hampered their barge shipments to the Gulf. A Director from the Upper Peninsula of Michigan reports a shortage of gondola cars; a shortage of railroad cars is also a problem in Northeastern Minnesota. A South Dakota Director voices concern that part of the 1972 crop is still awaiting shipment in his state and fears that facilities will not be available to handle the 1973 crop.

With the District's fuel supply situation remaining tight, other material shortages have emerged as well. Cement shortages were reported in the Minneapolis/St. Paul metropolitan area as a result of transportation problems among other difficulties. Although the transportation situation has improved, cement is expected to remain in tight supply throughout the summer. Reinforcing steel used in construction is also becoming very difficult to obtain. Printers and paper distributors in the Sioux Falls SMSA are experiencing the tightest squeeze on paper supplies since World War II. Fertilizer is in very short supply in the District, and a South Dakota Director reports that since the 15th of April only a third of the demand for fertilizer has been met in his state. A Montana Director, however, indicated that the fertilizer situation has started to improve in his state. Also, Directors from South Dakota and Montana indicate that farmers and ranchers are having difficulty obtaining agricultural supplies and in South Dakota, major seed corn companies are completely sold out of seed.

Directors' reports generally indicate that commercial bank interest rates have risen at larger urban banks but have changed very little in rural areas. One Director from a rural area, however, revealed that interest rates have risen 0.5 percent in his area. Loan demand was characterized as vigorous throughout the District. One large urban bank, for example, termed loan demand "strong" in spite of a marked rise in interest rates.

The proposed changes in real estate tax shelters, if enacted, would undoubtedly curb District construction activity. Following the announcement of the proposed tax changes, a major Minneapolis/St. Paul

area bank revealed that four planned apartment projects which would have involved this bank were dropped. A representative of a firm selling tax shelters indicated that immediately following the release of the proposed tax changes considerable confusion existed, but he expects the tax shelter business in 1973 to be good, especially after the announcement that tax shelters would not be eliminated in 1973. A trade association spokesman for Twin Cities area builders states that the proposed changes would not curb building activity in 1973. Builders, however, are aware of the proposed tax shelters, and he feels that the elimination of tax shelters would dampen future Twin Cities construction activity.

TENTH DISTRICT -- KANSAS CITY

The Tenth District economy looks very good, although our respondents had a few complaints. The ability of bankers to loan is being squeezed as deposit inflows weaken while business loan demand does not. Auto dealers are disappointed that big cars have stopped selling well, but they allow that customers are buying up small cars fast. Farmers are having to pay much higher prices for their supplies, but stand to make a net gain because of the favorable price situation for agricultural products. The overall strength of the regional economy is summarized by retail sales totals, which continue to rise. This healthy business situation would be dealt a severe blow, according to our special respondents on tax shelters, if investment funds now flowing heavily into cattle and construction were suddenly cut back by tax reform.

Deposit flows at several large District banks have been somewhat weaker than expected. Most bankers feel that high short-term interest rates are inducing intensified efforts to economize on money holdings. Only a little disintermediation out of consumer-type time deposits has been noted. Many of the banks contacted indicated that they need to roll over up to 50 percent of their large CDs in June. About half are continuing efforts to reissue shorter dated CDs, while the rest are trying to stretch their maturities to prevent a bunching three months hence. The latter group is offering higher rates out to six months, and level or declining rates from six months to a year. No takers are being found beyond six months.

Business loan demand remains very strong. Several banks noted that their volume of business loans has not been growing quite as rapidly of late, but attribute this to their reluctance to loan, rather than to a lack of demand. The cost of rolling over June CDs and expectations of an even tighter squeeze over the next few months have caused banks to raise credit standards and limit new loan commitments. Prime rates to large borrowers have followed the lead of the New York banks. The small borrowers' prime ranges from 6-1/4 percent to 7-1/4 percent at District banks. Attitudes about changing it vary considerably. Several banks feel they are locked into whatever the rate was when the dual system was instituted, while others are increasing their small borrower prime with a lag behind that to large borrowers.

Retail sales continue to boom in the Tenth District. Most department store executives said sales were up in May over April, and running considerably ahead of last year. The increase seems to be fairly widespread among all types of products. Some of the executives singled out women's apparel as a strong seller. Most stores reported a continued high volume of durable goods sales. Furniture and appliances are still selling especially well. What was earlier described as an "excellent" year for auto sales is now being characterized as "good" by dealers throughout the Tenth District. Respondents almost universally cite the gas shortage, or the threat of a shortage, as being responsible for a shift in demand from luxury cars to economy cars. As the current model year draws to a close, compact cars and pick-up trucks are in short supply.

According to several builders, realtors, and investment counselors, private capital that is financing the construction of office buildings and housing units, especially multi-family dwellings, would be greatly reduced should the tax shelter reform proposal be enacted. Estimates of the amount of new construction that would be dried up ranged from 20 to 60 percent. The individuals contacted foresee a severe shock to the economy should the proposal become law without a transitional phase.

Owners and operators of cattle feedlots, as well as investment counselors knowledgeable in cowboy economics, also were asked about the probable effects of removing the tax shelter. The feedlot managers acknowledge that prepayment of expenses is the rule, and that many of the owners live as far away as Connecticut. Investment counselors estimate that a third of the cattle on feed in the country, and 60 percent of those in major feedlots, are owned by individuals attracted by the tax shelter aspects. Removing the tax shelter, therefore, would drive down the price of feeder cattle, reducing the supply and increasing the price of beef over time.

Due to a sharp drop in shipments, meat animal prices have recently approached levels that are squeezing slaughtering margins under current meat price ceilings. The low slaughter has been somewhat surprising since, on the basis of the animal inventory figures, larger supplies normally would be expected. If numbers have been overestimated and high feed costs continue to erode profit margins, prices may be pressing against the ceilings most of the year, causing economic hardships for feeders and processors alike. In fact, one large packer has announced an immediate cutback in production and employment at all plants because of an inability to operate profitably under the price ceilings.

After a temporary dip in April, farm prices advanced 4 percent in May, to an all-time high. Although farm prices are currently averaging one-third above a year ago, the prices farmers pay for inputs are up sharply also. Over the past 12 months, these prices - including those for feeder livestock and feed - have risen 14 percent, offsetting some of the farmers' gains from rising output prices. Despite continued uncertainty over the weather and new crop prospects, all indications - particularly recent quotations in the future's market - point to another outstanding year for farm income. On a more somber note, however, these projections raise serious doubts that a turnaround in food prices can be achieved by year-end.

ELEVENTH DISTRICT -- DALLAS

The economy of the Eleventh District is continuing to expand, although the expansion appears less widespread than in earlier recent months. Industrial production in Texas continued to increase in April, but employment in the five District states declined slightly. The pace of construction activity also slowed in April. And although sales of District department stores rose substantially in May, automobile registrations in April were sharply below their previous month's levels.

In response to a survey of the nonbanking Directors of the Bank, only a third of the respondents indicated that their companies have altered their 1973 plans for plant and equipment expenditures since the first of the year. Those indicating that their companies' capital spending plans have been altered stated that these plans have been scaled up only moderately. The majority of the Directors also felt that the current inventory-sales ratios for their companies were not below their desired long-run levels. However, most of those with companies having abnormally low inventory-sales ratios indicated that they were unable to build their stocks because of rising sales.

A sizable number of the respondents reported shortages in the goods or production supplies their companies purchased, and about two-thirds indicated that their companies were having at least some difficulty in employing or retaining skilled workers. On average, the Directors expected wage rates for employees in their companies to increase at an annual rate of about 7 percent in the second half of the year.

Without exception, the Directors stated that the recent increases in the commercial bank prime rate have not caused their companies to decrease their use of bank lines of credit. Furthermore, the overwhelming majority of companies have not altered their borrowing policies at all in recent months.

The seasonally adjusted Texas industrial production index rose sharply in April as every industry category reported an increase over the month before. The manufacturing sector was again primarily responsible for the rise, although both mining and utilities also showed monthly increases. In manufacturing, substantial monthly increases were reported in leather and leather products, petroleum refining, printing and publishing, primary metals, and apparel products. In mining, crude petroleum and metal, stone, and earth minerals reported the largest monthly increases as natural gas and natural gas liquids rose only slightly. Utilities also reported a small gain over the revised level in March.

The energy shortage is becoming increasingly evident in the District. Several municipalities have experienced trouble in receiving bids for future energy supplies, and farmers are being threatened with fuel shortages which could hamper harvesting operations. There has also been some rationing by service stations to motorists, as monthly gasoline quotas for the stations have fallen behind demand. Although drilling was predicted to increase this year, first quarter drilling was off 4.1 percent from the corresponding period last year, probably due to unfavorable weather conditions.

Seasonally adjusted total employment in the five District states fell slightly in April, the first drop since June of last year. Although the labor force also contracted slightly in April, the unemployment rate edged up to 3.8 percent from 3.7 percent in March. The employment drop was attributed to the manufacturing sector, where both durable and non-durable industries reported declines in the number of jobs. Nonmanufacturing continued to report employment increases, in spite of reported declines in the mining and construction industries. All industries reported year-to-year increases.

The value of construction contracts awarded in the five District states fell slightly in April as both residential and nonresidential building slipped from their March levels. Spurred by large volume contracts in Louisiana and Texas, nonbuilding construction was the only category to show an increase. The cumulative value of contracts awarded through April of this year fell to a level only 6.2 percent above the corresponding period last year.

Sales of department stores in the District continued to show substantial increases over year-ago levels in May. Cumulative sales for the first five months of the year were 13 percent above the levels for the corresponding period last year. However, the number of new automobile registrations for the four largest metropolitan areas of Texas -- Dallas, Fort Worth, Houston, and San Antonio -- suffered a sharp fall in April from the previous month's high level. Nevertheless, cumulative car registrations through April were over a fifth higher than in 1972.

Agricultural activities in the five states of the Eleventh District gained momentum in May after a slow start due to excessive moisture in the early spring. Flooding in Louisiana continued to hamper planting, but in Texas and Oklahoma, planting was nearing average completion levels. Wheat and oat crops in the District states were reaching maturity, and early yields were above average. The outlook for farm income this year in the District states remained good as cash receipts from farm marketing continued at record levels through the first quarter.

TWELFTH DISTRICT -- SAN FRANCISCO

Our Directors report continued strong expansion in the Twelfth District, but are divided on whether the expansion will continue unabated into 1974, or will slow in the second half of 1973. Principal strength centers in consumer spending and business outlays for plant and equipment. Agricultural prospects appear good, except in areas suffering from drought. Banks report strong loan demand, principally for consumer credit and business loans.

Economic activity is at a high level in all regions of the District. Most Directors think that this expansion will continue for the rest of the year, although some anticipate a slowing in the second half of the year in response to a slower pace of consumer expenditures for durable goods, a decline in exports, and fewer housing starts. Consumer expenditures currently are at a very high level, particularly for autos and durables. Among other industries exhibiting high rates of expansion are electronics, recreational vehicles and aerospace. Homebuilding has slackened, but there is considerable strength in nonresidential construction. The impetus of recent construction demand also is supporting a high level of orders for builders' hardware. Problems may develop later this summer according to some Directors, who think consumers' purchases of durables will decline. Another concern is the possible impact of gasoline rationing. Unemployment may increase in areas dependent upon tourism, if a serious gasoline shortage develops.

Reports from District agricultural areas generally indicate excellent crop prospects, the exception being the wheat-growing areas of Eastern Washington and Oregon, which have experienced drought. Generally,

farmers are optimistic that above-average prices will hold and are continuing to invest in new equipment. Orchard crops, such as pears, are expected to be at near record levels. Cattle prices and feed-crop prices are high.

The forest products industry is maintaining output to meet continuing domestic and export demands. Mill prices for plywood and lumber have fallen from 15 to 26 percent in the last month. Despite this decline in prices, however, current employment and production are expected to be maintained for the next few months.

Inflation continues to be a major concern of our Directors. Some Directors believe the ability of the Federal Government to provide firm leadership has been weakened by the Watergate affair. Others are concerned about the impact of restrictive monetary policy and credit market conditions on the economy, and still others are concerned over the impact of possible gasoline rationing. Several Directors feel that, despite the current strength of the economy, businessmen are becoming less confident, and that this attitude will cause a slowdown later this year.

Banks report that loan demand by consumers and business is very strong. Consumers apparently are borrowing heavily to finance purchases of autos and other durables.

Business borrowing appears to be aimed at building up working capital and financing inventories, but bank loans also are being sought to finance plant equipment outlays. In California and Oregon, bankers report that cut-backs in mortgage lending by other financial institutions have resulted in a jump in mortgage loan applications. At the moment, regular business customers appear to have no problem in obtaining credit, which is available but at higher interest rates. In some cases, banks are stressing

the need for appropriate compensatory balances. Banks are tightening standards and some marginal borrowers are being screened. In addition, some classes of loans, especially those for speculative purposes, are being restricted.