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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Notwithstanding the pervasive concern over the energy situation, District reports on balance point to a sustained high level of industrial activity as strong demand--with the exception of some consumer goods--generally continues in evidence. Weak spots so far by and large have been concentrated in regular or large-sized auto sales, airlines and aircraft manufacturers, residential construction, and, to some extent, recreational business. Largely reflecting developments in these sectors, some softening in the employment picture appears in the offing, though current industrial production and manufacturers' orders and backlogs remain at high levels. However, much concern was expressed over the obstacles to further growth presented by the wide variety of growing shortages of materials in addition to petroleum products. Moreover, many respondents felt that the abatement of inflationary pressures was not in the cards for the immediate future. Increasing doldrums in the residential construction industry were also noted in some Districts, primarily as a result of high mortgage rates and the high cost of new housing. Strong demand and high prices were expected to stimulate increased agricultural production in 1974, though such an increase might be inhibited by fuel and fertilizer shortages.

District respondents generally continued to express serious concern over the potentially adverse effects of the anticipated energy shortage and the rise in oil prices. However, the main thrust of the "energy crisis" in terms of output and employment so far appears to have been concentrated on a relatively few, albeit significant, economic sectors, in particular, according to the District reports, the automobile and

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related industries, airlines and the aircraft industry, and in some areas tourism. The plastics and petrochemical industries have also suffered from shortages of raw materials. However, as noted by Boston, growing shortages of supplies other than petroleum products appear more critical at this time to current production, leading to accumulation at manufacturers of virtually completed products, ranging from aircraft to ovens, for want of a few parts. Indeed, concern over such shortages is mentioned in virtually all District reports. Thus, Chicago succinctly sums up the situation as one where so many different materials and components are in short supply that a list could be constructed almost at random, with shortages of castings, forgings, bearings, steel, nonferrous metals, plastics, all fuels, and paper probably being the most prominent. Cleveland also reports that purchasing agents in the Cleveland area find virtually everything they buy in short supply, with increasingly long delivery time, and that the steel industry continues to operate at full capacity despite some cutback in orders from the auto industry. Dallas reports a dearth of drilling rigs, pipes and other products involved in petroleum output, with little or no relief in sight over the next few years. Against this background, there were frequent reports of business efforts to stockpile, of "double ordering", and in some instances of budding black markets and of sharp price increases.

Despite the uncertainties surrounding fuel and material supplies and the price situation generally, most District reports pointed to a continued strong business plant and equipment picture. Among others, business respondents in the Dallas, St. Louis, and New York Districts indicated they had no intention at this time of changing their current plans for increased capital outlays. Philadelphia reports that many manufacturers in that District expect to increase their capital expenditures in the coming months, and San Francisco notes that capital expenditures remain at a high level, as business continues to modernize or expand capacity to meet expanding demand. Cleveland points to strong new orders for machine tools, and to a high level of backlogs in that industry, while Chicago reports that producers of a wide variety of capital equipment indicate that the very strong demand for such equipment that had prevailed since early 1973 or late 1972 continues unabated.

The consumer spending picture is somewhat more mixed, although with the exception of sales of autos--and, in some instances, of other durables--on balance still appears strong. In part, this strength may reflect anticipatory buying, which was mentioned by Cleveland and New York. A number of Districts, including Minneapolis, Chicago, San Francisco, and Richmond, report that retailers have generally enjoyed a high level of sales over the holiday season, in some cases exceeding expectations. Atlanta, however, notes that increased consumer cautiousness may have kept a "good" Christmas season from being a "great" one, while a mixed consumer spending picture emerges from Cleveland. A slowing down in department store sales of postponable items is mentioned by Philadelphia, while St. Louis also reports a slowdown in consumer purchases, reflecting in part a sharp drop in auto sales, and perhaps the unusually bad weather conditions in that area.

Regarding the employment situation, a number of Districts, including San Francisco, Minneapolis, St. Louis, Chicago, Atlanta, and Richmond report some laying off in industries directly affected by the energy crisis--notably in the auto, airline, and aircraft industry--but otherwise in general see little evidence that this trend is becoming more widespread at this time. Manufacturers in the Kansas City District expect employment to hold up well in 1974, but some manufacturers in the Philadelphia District expect laying off workers by next summer.

FIRST DISTRICT--BOSTON

In general, our directors report that firms at the moment are being only moderately adversely affected by higher petroleum prices. They are more concerned about a recession in 1974 reducing business activity than they are about shortages of oil. Shortages of supplies other than oil appear more critical to current production and are causing rising inventories of almost completed products.

The New England states appear to have enough heating oil to meet the needs of residences and industry. At the moment, residual oil requirements of utilities are being met by the allocation programs. Petrochemicals for the plastics industry and resins are still very short, and shortages here appear to have been created or exacerbated by price controls. The newly announced allocation program on petrochemical feedstocks has made plastics manufacturers more hopeful, although temporary layoffs are continuing.

Our directors did note some adverse impact on their businesses arising from the energy situation. A director of a large conglomerate reports that his firm has closed down its recreational vehicle and large motor boat facilities. Sales of single-engine planes are also down. On the other hand, sailboat sales are up strongly, and twin-engine plane sales are good. An industrial supplier to the auto industry also reported lower sales and orders. Again, however, orders for industrial supplies for utilities, for chain saws, and for helicopters (used for offshore oil exploration) have skyrocketed as a result of the energy situation. Capital goods orders are reported, for the first time, to be tapering off, but order backlogs are so high that shipments in 1974 will continue at high levels.

Supply problems continue to hamper production. A director of a large manufacturing conglomerate reports that inventories of almost completed products, like airplanes and ovens, are piling up and cannot be shipped for lack of some small parts. This has already led to a 10 percent cut in employment because the conglomerate cannot keep people just standing around waiting for one part.

On balance, our directors see profits in 1974, varying from level with 1973 to down 15 percent.

Our Bank directors report that loan demand is firm. Interestingly, firm loan demand does not indicate good business conditions. A director from a large Boston bank reports that his bank's loan demand is being bolstered by firms building inventories of raw materials, like metals, whose supply they fear could be shut off in a manner similar to oil. Thus a mild form of hoarding is occurring. A New Hampshire bank director states that loan demand is strong because the recreational business is so weak that firms need operating capital.

A Boston bank director also reported that other bankers with whom he has spoken share his surprise that short-term rates have not yet come down. The financial community is beginning to question the Federal Reserve's commitment to an easier policy.

Our Bank directors report that demand for mortgages is very weak and home sales are down sharply. Consumer apprehensiveness is blamed for the rising stock of unsold homes. Mortgage rates have not yet come down but are expected imminently to begin slowly declining.

Although Professors Eckstein, Tobin, and Wallich were contacted this month, Wallich preferred not to give his policy views. Eckstein and

Tobin agreed that the economic slowdown has been at least partly and perhaps primarily demand, rather than supply, determined. Tobin believes the supply situation is not so tight that substitution possibilities cannot be found. He was still distressed by the weak performance of the stock market. Both pointed out that weakness in the demand for housing and automobiles had been expected before the energy scare. Eckstein argued the economy's behavior will generate the feeling of a recession, whether or not a recession is officially declared. The unemployment rate, for example, is certain to be rising rapidly. The role of the monetary authorities, he stated, is to avoid compounding the recession. Eckstein's policy prescription is a 7 percent to 8 percent rate of monetary growth over the next six to nine months. He felt this target would be accompanied by a Federal funds rate in the 8 to 9 percent range in the first quarter and in the 7 to 8 percent range in the second quarter. This policy, according to Eckstein, would not be a very easy one in the current context. Specifically, with the amount of uncontrollable energy-related inflation the economy will experience and with the legacy of a year of modest money growth in a highly inflationary setting, the quantity of money available for output expansion would be quite modest. Tobin's policy prescription is a gradual reduction in the Federal funds rate to 8 percent. He believes the recent uncertainties have produced a shift into more liquid assets and that no harm would be done by creation of additional liquid assets.

SECOND DISTRICT--NEW YORK

Second District directors and other business leaders who were contacted recently in general were somewhat less pessimistic than last month regarding the overall economic impact of the energy crisis. The respondents did not expect a cutback in business plans for plant and equipment outlays, and in their view consumer spending remains strong, at least at this juncture. However, the respondents did see an actual or prospective increase in unemployment in a number of industries resulting from the petroleum shortage. The current weakness in residential construction was attributed primarily to high interest rates and high housing costs rather than to a shortage of mortgage funds.

Regarding the overall impact of the energy crisis, the president of a large petroleum products firm stated his belief that essential industries would get all the oil products required, and that any potential gap in supplies would be met by cutbacks in pleasure driving and in other nonessential oil uses. In his view, the impact on the economy of the oil shortage would turn out to be less severe than had seemed likely initially. He felt that current crude oil prices should provide sufficient returns to oil companies to permit them to launch large-scale research programs to develop alternative sources of energy. He foresaw a sharp increase in gasoline prices, however, and felt that the allocation of gasoline should not be left"in the hands of the man at the gas pump", but that mandatory rationing would probably be necessary.

The respondents generally felt that the energy situation would not lead to substantial cutbacks in business plans for plant and equipment outlays. The Buffalo branch directors thus reported that while investment plans were being restudied in light of the energy situation, they believed that such plans would not be significantly changed given the current high rate of plant capacity utilization, the prospect for continued inflation, and the shortages of a growing number of items. Indeed, the directors felt that while the energy situation would affect certain industries more adversely than others, they expected that the overall effect of recent economic developments would be to stimulate business plant and equipment spending. As examples, they cited specific plans of a number of firms for large-scale capital outlays and reported that agricultural equipment manufacturers were sold out far in advance and required additional manufacturing facilities. Several other respondents also indicated that their firms were "sticking" to their long-term capital investment plans, although some saw the possibility that part of some investment programs might have to be deferred because of shortages of materials. A senior official of a large chemical corporation reported that owing to the uncertainties associated with the energy crisis, capital spending plans were being trimmed in some industrial sectors but that such reductions will have little or no effect on capital outlays over the near term because of the long lead time involved in most capital investment projects.

In the view of a number of respondents, the current consumer spending picture continues strong. The president of a large New York City department store with branches in the suburbs thus reported that his firm had enjoyed a high level of business over the holiday season, both in volume and dollar terms, and that sales had remained strong after Christmas. He noted the possibility of "scare buying", against prospects of rising prices and shortages, but stated that he could not determine if this were the case. The Buffalo branch directors characterized retail sales in Western New York during the Christmas season as good to excellent. Strong post-Christmas sales were also reported in that area, a development which in the view of these directors suggested that there was no "hold back" in consumer spending at this time. The president of a nationwide department store chain, however, felt that the sale of durable goods had become somewhat softer, while an upstate banker reported some reduction in the demand for consumer credit at his bank. The retailers in general did not think the gasoline shortage would have much of an adverse effect on their suburban stores; most of their customers reside nearby, and some expected that women shoppers driving to shopping centers would spend more time at these centers, concentrating their purchases at one time.

The employment picture was more somber. A number of respondents cited actual or prospective lay-offs, not only in the airline and automobile industries, but also in the tourist and related industries, as well as in several other key industries, particularly those using petrochemicals.

None of the respondents expressing an opinion on the residential construction situation believed the decline in activity in that industry to be traceable to a lack of available mortgage funds at this time. Rather, major deterrents to homebuilding were seen as high interest rates, the high and rising cost of land and of new housing, shortages of building materials, overbuilding in some regions, and the termination of certain Government-sponsored housing programs. The Buffalo branch directors also felt that energy uncertainties--both as to heating fuels and as to possible gasoline rationing--could have a potentially serious impact on building in the suburbs.

THIRD DISTRICT -- PHILADELPHIA

General business conditions in the Third District have begun to soften and are expected to deteriorate in the months ahead. Production activity continues to move ahead slowly, but respondents to this month's business outlook survey foresee reduced activity in the months ahead. Employment opportunities still exist, and layoffs are not a significant problem at the present. Inventory spending is about level, but plant and equipment spending plans are still strong. Retail sales have slowed a bit more than usual at Philadelphia department stores. Bankers are experiencing continued deposit inflows, but certain categories of loan demand show signs of weakening. However, prices are still climbing and are expected to continue to do so in the next six months.

There is a divergence between current business activity and what the respondents expect six months in the future. At the present time, the majority of area manufacturers are experiencing no change in their new orders, shipments, and unfilled orders. Of those experiencing changes, a few more are reporting increases than decreases. In contrast, the six-month outlook reported by the same respondents is less optimistic. Only a minority expect increases in their new orders, shipments, and unfilled orders.

The employment market in the Third District is stable with over 85 percent of the respondents reporting no change this month in their number of employees and the length of their average workweek. By summertime, however, one in five expects to be laying off workers. Most of the remaining firms expect to hold their labor forces constant through the first half of the year.

Inventory investment is increasing at a few more plants than it is decreasing, and the six-month outlook is for no change in overall inventories.

But capital equipment spending should be a source of strength in the coming months, as 45 percent of the firms report plans to increase their capital expenditures.

Philadelphia department store executives report that energy-conserving goods, such as fireplace equipment and blankets, are selling very well, but sales on postponable items, such as appliances, and credit sales are off a bit more than usual for this season.

Prices continue upward on a broad front, as nearly 80 percent of the area respondents report paying higher prices for the goods they buy and half report charging higher prices. The inflation is expected to accelerate, as over 75 percent anticipate paying and receiving higher prices as summer nears.

Area bankers report that total deposit inflows are outplacing loan extensions. Changes in time deposits are insignificant at the banks contacted, but demand deposits are rising. At the same time, consumer loans are off a bit and business loan demand shows signs of slackening. Only mortgage loan demand is maintaining strong growth.

FOURTH DISTRICT -- CLEVELAND

There are some signs of weakening in retail sales and a softening in the manufacturing sector. Capital goods industries are still doing well, but automotive-related business has been hit hard. Large firms appear to be weathering the effects of the energy situation better than smaller firms. Prospects for the steel industry remain good, despite the downturn in autos and housing.

Department store sales in the District seem to have been a mixed situation during the holiday season. One of our directors, with a national retailing firm, reported that sales were poor in the District relative to the nation. There was strong demand for luxury items, which was attributed largely to anticipatory buying, as a hedge against inflation or, possibly, as an investment. The same director also indicated that he expects additional upward pressures on retail prices in the months ahead as a result of higher priced goods in the early stages of the retail pipeline. Finally, the senior management of the firm is less optimistic about the economic outlook than they were last fall, and they are reexamining their capital expenditure plans for 1974.

In contrast, the president of a large department store in Cleveland reported that holiday sales were good, although he noted some decline in luxury goods. Credit sales were stronger than expected because of a highly publicized deferred billing plan promoted by the firm. The post-Christmas season, however, has been marked by a larger volume of merchandise returns than last year. A vigorous promotion to interest customers will be necessary in the coming months, according to the executive, because of the rising number of layoffs taking place in firms caused by the energy situation.

Our monthly (December) survey of District manufacturers indicates further slowing in the pace of manufacturing activity and continued upward pressures on prices. There was a significant reduction in the proportion of firms reporting gains in new orders, and a continued slowdown in the rate of inventory accumulation, employment, and hours. In addition, business expectations for January are not particularly encouraging. The diffusion index for prices paid reached a record high for the third consecutive month.

Automotive-related business has dropped sharply in many firms, and in recent weeks there have been widespread reports of layoffs among auto producers and suppliers in the District. According to an economist with a firm heavily dependent on the motor vehicle industry, cyclical forces are expected to account for the bulk of the decline in new car sales this year. As early as last August, this economist had forecast an 8 percent decline in new car sales for 1974. He expects that the petroleum situation will reduce sales by another 3 percent.

Purchasing agents in the Cleveland area report that virtually everything they buy is in short supply and that delivery time continues to grow longer. The lead times on orders now being placed go well into 1974 and 1975. More than half of the buyers say that three to six months are needed for delivery of production materials and a year or more for capital equipment.

Machine tool builders in the area report that incoming new orders are still strong and that a heavy volume of inquiries indicated strength in future orders. Although a few firms report some cancellations as a result of the energy situation, the cancellation rate is viewed as normal with the current length of lead times. The high level of backlogs assures capacity operations in the industry well into 1974, even if new orders should decline in the months ahead. One of our directors in the machine tool business corroborates the strength in the industry and, he adds, the coal companies are buying everything they can get their hands on.

A leading producer of casting equipment in Cleveland says the foundry business is so strong these days that the firm has a year's backlog on the books--three times the normal level.

Economists from three major steel firms in the District all report some order cancellations from the automotive industry. Two companies, however, say the decline in steel orders is less than the cutback in auto production. According to the steel industry economists, the auto firms usually draw down their steel inventories when output is reduced, which reinforces the decline in steel orders. The auto companies do not appear to be following their normal steel-inventory policy, thus far, however.

The slack created by the auto firms is being absorbed by other steel-using industries. Demand for steel products other than sheets remains greater than the steel firms' ability to produce. The steel companies are continuing to operate at peak capacity with full order books. Some of their concern over possible fuel shortages has been alleviated since last month. It now appears that the steel companies will receive enough fuel in 1974 to enable them to produce as much steel as last year. The 5.5 million to 6 million tons of steel shipped from mill inventories last year, but not available this year, will just about be offset by reduced steel demand for autos, furniture, and appliances. Moreover, imports are expected to be hit before domestic steel by any decline in demand, because the price differential is so large.

FIFTH DISTRICT -- RICHMOND

Results of our most recent survey of businessmen suggest that business activity in the District has experienced some moderation in recent weeks, although it remains at a high level. In the manufacturing sector both employment and hours worked per week have declined, and recent increases in retail sales have not been up to those registered earlier in the year. Survey respondents, in general, remain pessimistic about the outlook for business activity during the next six months.

Manufacturing activity in the District continues at a high level, although a number of survey respondents report some slowing in recent weeks. Our latest survey shows little or no change in shipments and new orders and a decline in backlogs. Raw material shortages and uncertainty over the energy situation continue as major problems facing manufacturers. The diffusion of manufacturers' responses indicate that materials inventories increased slightly in recent weeks, while finished goods inventories declined slightly. More than one third of the respondents reported that inventories were below desired levels.

Judging from the results of our survey, employment in the District apparently declined slightly during the past month. Manufacturing respondents indicated a small decline, while retailers reported employment unchanged. Hours worked per week were down appreciably in manufacturing, however, with nearly one third of the respondents reporting a decline. Scattered layoffs related to the energy crisis continue to be reported.

Further increases in prices were reported by the majority of both manufacturing and retail respondents. More than 80 percent of the manufacturers reported higher prices paid, and one third reported higher prices received.

Increases in prices paid were reported by 100 percent of the retailers, and 60 percent indicated increases in prices received.

Reports from major District retailers suggest that retail sales remain strong. Most retailers report increases in sales during the past month, although the increases were generally less than those registered earlier in the year. Reports from directors and other sources indicate that motel occupancy along Interstate 95, running through Virginia and the Carolinas, is down substantially. Motels and other tourist-related businesses are expected to be hurt by the gasoline situation.

The experience of large commercial banks in the District suggest that the demand for all types of loans has increased in recent weeks.

The 1973 farm income situation continued to show improvement as the marketing season progressed, with January-October cash receipts registering gains over a year ago of 27 percent in the District and 37 percent nationally.

Most survey respondents continue to express pessimism about the economic outlook. More than three fourths believe that the level of business activity nationally will worsen during the next six months, and more than 40 percent believe that local business activity will decline.

SIXTH DISTRICT -- ATLANTA

The District's economy continues to hold up well, but distortions related to energy and materials shortages in some industries have been reported. Christmas holiday sales were good, if not outstanding, in most areas. New car sales especially in the larger models are sluggish, and the used car market has fallen completely apart. Announcements of new and expanded plants as well as new commercial projects were strong, but energy problems are causing some curtailment in previous plans. For the most part, workers laid off in some industries are finding jobs in other areas; however, some rise in unemployment insurance claims has occurred.

Consumer cautiousness and apprehension over merchandise shortages may have kept a "good" Christmas buying season from being a "great" one. The largest department store in the Southeast has only a modest gain in Christmas sales over 1972. Tennessee retailers report that many people shopped earlier than usual because of expected merchandise shortages that never materialized. Many retailers were pessimistic about the outlook for 1974 sales.

Auto sales continue to be blah but small car sales remain strong. A Nashville-area car dealer reports that pickup truck sales have been excellent. Small foreign cars even with price increases are in great demand. In the Montgomery, Alabama area, sales of larger cars are down by 20 percent or more. The area most adversely affected is the used car market as reports from around the District indicate very sluggish sales. One dealer indicated that a 1971 Cadillac, with a wholesale book value of $3,500 a month ago, now wholesales at about $1,500. Dealers are very reluctant to take cars in on trade.

Energy-related shortages are continuing to plague District manufacturers causing only inconvenience to some in actual production and employment declines to others, and some smaller plant shutdowns. The plastics industry is experiencing severe problems in obtaining raw materials. One Tennessee manufacturer is cutting back on his labor force by 55 percent because of these shortages. He cited suppliers exporting plastic materials overseas in order to make better profits as the reason. These materials,which previously sold for 30 cents per pound,were finally purchased in the foreign market for 90 cents per pound. Plastic pipe manufacturers report they cannot find enough resin, and an Atlanta-area wire manufacturer indicates no shutdowns or layoffs as yet but difficulty in finding plastic for plastic-covered wiring.

A Mobile, Alabama area manufacturer of engines for small private aircraft has recently laid off 300 workers, with the energy crisis cited for the softening in demand. Mobile home and recreation vehicle manufacturers are being severely affected by the energy shortage. Motor home and mobile home manufacturers in Florida and Georgia have reported layoffs and shorter workweeks. Many motor home manufacturers have switched to producing smaller vehicles such as campers and trucks. Georgia mobile home manufacturers report production declines because of high interest rates and fuel shortages. A furniture manufacturer who supplies the mobile home industry has also reduced its payrolls and workweek. In another energy-related development, a south Florida citrus processor says it will delay the opening of its new $5 million plant until the United States Government can assure adequate fuel supplies. Textile manufacturers, on the other hand, are expecting a good year and are not yet seriously affected by energy shortages. They may absorb some workers released from other industries.

Tourist-related activity continues to soften, with the gasoline shortage most often cited as the primary reason. Motel occupancy along

Georgia's major highways is down considerably, and operators are offering enticements such as "free breakfasts" and a "guaranteed tank of gas" to attract the dwindling number of travelers. Disney World has laid off 700 employees because of declining attendance related to the fuel shortage. Cypress Gardens has announced a layoff of 10 percent of its work force.

Announcements of new commercial and industrial projects continue strong. Eastman Kodak plans to double capital expenditures from 1973 levels. General Motors has announced plans to build a $50 million facility in Huntsville, Alabama, to manufacture power-steering components. Florida Power and Light has signed a $65 million contract with Westinghouse for the construction of a new electric generating plant. The Baton Rouge, Louisiana area has reported several plant expansion plans. At least $200 million will be spent by area plants for pollution control. One oil refinery has announced a capacity expansion of 150,000 barrels which will double capacity. However, one area businessman estimated that only about 50 percent of these planned expenditures will actually take place because of the present energy shortage. There have also been isolated reports of other postponements in capital spending plans in the District. These have been limited largely to Southern Bell Telephone and the plastics industry.

SEVENTH DISTRICT--CHICAGO

The picture in the Seventh District continues to show marked contrasts among sectors to an extent seldom witnessed in the past. On the one hand, sales and construction of housing, standard-sized cars, the airlines, and certain other less important sectors have been hard hit. On the other hand, demand for capital goods, almost all basic materials, and many consumer goods remains intense and exceeds capacity. Except for autos and the airlines, there is very little evidence of output and employment being affected adversely by the primary or secondary effects of the fuel crisis. In part, this may reflect the fact that so many other goods and services are in short supply. Inventories are generally low, but badly unbalanced. Prospects for abatement of inflation appear dimmer than before. Nonautomotive retail sales in December apparently were very strong. Prominent forecasters of the general economy in this region are modest concerning the accuracy of their current projections because of the unprecedented nature of recent developments. Some point out that a gross national product (GNP) forecast has less meaning than usual for the individual business.

Our contacts with producers of a wide variety of capital equipment (e.g., for farms, construction, mining, industry, materials handling, railroads, and trucklines) indicate that the great strength of demand shown since early 1973 or late 1972 did not diminish in December or January. Exceptions are firms dependent on petrochemicals. In typical cases, new orders were up 50 percent from last year in December and backlogs were double. Moreover, most of these firms have controlled acceptance of new orders for at least several months; some have a large volume of firm but "unbooked orders"; some have surveyed order backlogs and have canceled orders believed to be soft; some have refused to sell to dealers for their inventory; and some have demanded renegotiation of orders booked at an earlier stage of the inflation. Altogether, these factors suggest problems in evaluating the Commerce orders data.

Steel companies continue to ship at capacity levels. There is little evidence of auto companies reducing orders, but such a trend is regarded as inevitable. However, at present, domestic markets (foreign markets remain unexploited) can absorb steel released by auto firms, and many users would like to build inventories. The bottleneck in the industry is not metal but finishing capacity, so that there is flexibility in adjusting the product mix. The industry insists that an allocation of residual fuel oil equal to 100 percent of 1973 usage would require production cutbacks. Oil use was increasing during 1973 because of natural gas cutoffs, pollution controls, closing of obsolete facilities, and shortages of coke.

The primary or direct impact of the energy crisis in this District thus far has been largely confined to the airlines, the petrochemical and related plastics industries, and wholesale and retail oil distributors. The major secondary impact has been on sales and output of standard-sized cars and recreational vehicles and on recreational areas. Almost all firms have taken steps such as reducing thermostats, doubling delivery runs, re-capturing, and recirculating heat, etc. Many have been surprised at their success. These actions need not be "patriotic"; they are highly profitable and would have been induced in large degree merely by higher fuel costs.

Most areas of this region have ample supplies of natural gas for existing noninterruptible customers, but utilities are concerned that their favorable position based on sound planning may be eroded by Government orders to divert supplies to the East Coast. Large electric utilities also are in a relatively good position, in part because they have been leaders in developing nuclear power. There appears to be a marked shift to electric heat for residences, especially in Michigan where new gas customers have not been accepted since March of 1973.

Many people in this region (not necessarily the uneducated) believe that the fuel crisis is a fake, perpetrated to increase oil company profits and to divert attention from Government scandals and inflation. These views are encouraged by various prominent citizens and by newspaper columns and cartoons. The oil industry has a problem stating its case, partly because of many uncertainties in the supply-demand picture. Very little is known of demand elasticities, but it is feared that completely decontrolled prices could rise "explosively". Almost nothing is known of the size of inventories in the hands of distributors and retailers, to say nothing of oil users.

So many different materials and components are in short supply that a list could be constructed almost at random. Castings, forgings, bearings, steel, nonferrous metals, plastics, fuel (any fuel), and paper probably are cited most prominently. These conditions have led to widespread black markets (usually with no questions asked), innovative pricing practices, imbalancing of inventories by purchases of "what is available", a resort to barter or "swaps", "embargoes" on shipments awaiting favorable CLC actions, and steps by purchasers to aid suppliers. Some minor effects include elimination of "double-bagging" at supermarkets and long delays in production of records by popular rock groups.

EIGHTH DISTRICT -- ST. LOUIS

Business activity in the Eighth Federal Reserve District generally remains strong. Substantial weakness, however, was reported in a number of activities, including the automobile and construction industries. In general manufacturing activity continues at a high level, with shortages and inflation remaining as difficult problems. Higher farm incomes and expected increased acreages have bolstered the business situation in rural areas.

Retail sales have slowed in recent weeks, although unusually bad winter weather in the region makes the sales data difficult to assess. Some items such as electric heaters and warm winter clothing have been selling strongly, but automobile sales have dropped off sharply. Dealers report very few sales and precipitous price declines of the larger car models. On the other hand, small cars were reported as difficult to find and were selling at premium prices.

Most manufacturing firms still report operations at full capacity; however, some temporary plant closings and layoffs have occurred in the automobile industry. No change was reported in capital investment plans for plant expansion, which generally call for greater investment this year than last.

Inflation, shortages of raw materials, and the energy situation in particular, remain major problems on the minds of businessmen. In view of the many shortages of materials, some "double" ordering by businessmen was reported, thus adding to the confusion relative to the shortage problem.

Construction activity is generally down in the District. In 1973, construction of single-family dwelling units in the St. Louis area was about the same as in 1971 and 1972. However, construction of multifamily dwellings dipped to about one-half the 1971-72 levels. Expectations are that construction of single-family dwellings in the St. Louis area will decline by as much as 30 percent in 1974.

Banks report that commercial loan demand continues strong. Savings and loan associations in the St. Louis area report increases in savings in the first part of January, after small negative net inflows in December. Mortgage demand was reported as weak, but mortgage rates remain steady, despite the somewhat greater inflows of funds.

The farm outlook is optimistic based on both last year's high farm income and the relatively high current prices of farm commodities. Many farmers are reported to be selling contracts on the futures market to avoid the risk of a price decline prior to harvesting. With higher farm incomes, business activity continues strong in rural areas and banks have experienced increased deposits. This strength is associated with a high demand for agricultural supplies in anticipation of a larger crop acreage than last year.

NINTH DISTRICT--MINNEAPOLIS

The energy crisis has not yet forced substantial cutbacks in District economic activity, but businessmen are concerned about the future. In addition, other materials besides fuel are in short supply and delivery times are being stretched out. District retailers enjoyed a good Christmas season, with sales generally up to expectations. Several bank directors expect a decline in home building in their areas in 1974.

Although a number of District layoffs have been attributed to the energy crisis, fuel shortages have not yet seriously disrupted District economic activity, and mild fourth-quarter weather has lessened the threat of heating-fuel shortages. District businessmen, however, remain concerned about how the energy crisis will affect their operations. A director associated with retail trade said that his firm has had enough fuel for its regular operations, but he felt it was too early to assess the impact of gasoline shortages on consumer shopping habits. Another director reported some concern in his community about employees having adequate gasoline to commute to work. Also, in his community a firm producing plastic parts for cars was concerned about automobile sales declining in 1974. According to another director, the fuel crisis has not yet directly affected sewer and highway building, but uncertainty over prices is making contractors hesitant to bid on projects. A Montana director indicated that there was no lack of gasoline in his area; he believed that a considerable amount of gasoline is being stored by consumers and businessmen.

A survey of nine ski resorts located away from the District's major population centers indicated that the energy crisis did not hurt their holiday business. Only one ski area reported poor business during the

Christmas-New Year period and, in general, ski-area operators look for business to remain good for the remainder of the season. No shortage of gasoline existed in any of the areas surveyed. Several operators indicated, however, that business from local customers was up, while customers who had to travel any distance were staying away. The concern in the resort and travel industry appears to be shifting from the fuel shortage's impact on winter recreational activities to the summer tourist business. A lack of gasoline this summer as well as the possibility of rationing could seriously hamper the District's tourist industry.

Directors indicated that other materials besides fuel are becoming difficult to obtain. A plastic resins shortage has forced one director's firm to curb some operations. Other directors reported no shortages in their areas but stated that delivery times are being stretched out. A Montana director has had to wait over a year to obtain farm machinery and remains uncertain as to when this machinery will be shipped.

Many District retailers enjoyed a good Christmas season, as sales exceeded earlier expectations. Major Minneapolis-St. Paul retailers responding to a newspaper survey indicated that December sales were up from a year ago, and most stores equaled or surpassed their sales expectations. Furthermore, a director who heads a major retailing organization reported that, after some softening in sales growth last fall, his firm's relative year-to-year sales gain in December came close to matching the larger increases achieved earlier in the year. A North Dakota director termed his area's Christmas spending "great" due to high farm incomes. A Wisconsin director reported "excellent" Christmas business in his community, and a Montana director termed Christmas spending "good" in his area. On the other hand, an Upper Peninsula director said Christmas sales in his area only equaled year-earlier levels, while a Minnesota director from outside the Twin Cities indicated his area's Christmas sales were not up to expectations. Major Minneapolis-St. Paul retailers are uncertain about the future, and most look for modest sales gains in 1974.

The number of new District housing units authorized during the first eleven months of 1973 was down 22 percent from a year earlier, and several directors look for declines in their areas' residential building in 1974. A director from the upper peninsula of Michigan indicated that a scarcity of fuel for heating homes was expected to curb his area's residential construction, while two other directors indicated the availability and cost of mortgage money would hurt their areas' home building. A North Dakota director, on the other hand, stated that the outlook for home building in his area was good. In addition, the apartment vacancy rate in the Minneapolis-St. Paul area in November was 5.6 percent, compared with 8.9 percent last February, which indicates District apartment construction may improve later this year.

TENTH DISTRICT--KANSAS CITY

Judging from responses of buyers of materials for major manufacturers in the Tenth District, no recession in this region is likely in 1974. Although many raw materials, such as petrochemicals, and many advanced-product inputs, such as electric motors, are in extremely short supply, most manufacturers are cautiously optimistic that sales this year will surpass those in 1973. Bank deposits remain at high levels, and the energy crisis appears to have stimulated business loan demand. Consumer instalment lending continues strong, and feedlot operations are boosting agricultural loans. In fact, bankers report no recent developments suggestive of a slowing economy, save weaknesses in construction loans and auto loans. All bankers contacted are keeping their CD maturities short, anticipating a decline in interest rates. In the agricultural sector, farmers have planted more wheat again, and an insulating snow cover is improving crop prospects.

The materials supply situation continues to deteriorate. Purchasing agents for major manufacturers in the Tenth District say that most items are harder to get now than they were a few months ago, when they reported extremely short supplies. Prices and lead times have doubled or tripled on certain items, such as zinc; some materials are not available at all, even on an allocation basis. In many instances, the energy crisis is blamed for making matters worse.

Despite the severe difficulties in obtaining supplies, almost all the manufacturers expect to produce and sell at last year's level or higher. True, some have revised downward their earlier, more optimistic sales forecasts for 1974. For example, because of the energy crisis, one major manufacturer of private aircraft now expects to sell 5 percent fewer airplanes, instead of 35 percent more, in 1974 over 1973. Another company, tied to the auto industry, expects a "down" year. All of the others, however, say that 1974 will be better than 1973, although several hedged their forecasts with phrases like "if we don't panic", "if raw materials are available", and "if we don't have to shut down because of fuel cutoffs". Consistent with their ordering plans and their firms' sales expectations, most purchasing agents expect employment to hold up well at their factories during 1974.

Seeding of winter wheat last fall totaled 51 million acres, up 18 percent from the previous year and the largest since the 1967 crop. Currently, United States production is projected at 1.51 billion bushels which would be 19 percent above the record crop in 1973. In the District, where roughly one half of the nation's winter wheat is produced, fall seedings of wheat were 10 percent larger than a year earlier. However, current projections point to a slightly smaller crop than in 1973--715 million bushels versus 734 million--due to much late seeding which increases the likelihood of winter kill from cold winds. Fortunately, a heavy blanket of snow now covers a large portion of the wheat in the District, reducing the threat of this hazard.

Interviews with larger Tenth District banks revealed deposit and loan activity over the last few weeks to be at or above seasonal norms. Business demand deposits increased about as expected in the latter part of December, but some bankers are pleasantly surprised at the continuation of high levels of deposits through the first week in January. Large CD positions have not changed appreciably. Of those interviewed, only one banker feels that the lower reserve requirements have encouraged them to be more aggressive in selling large CDs. All banks anticipate a decline in interest rates and are setting their offering rates to keep their CD maturities very short. Loan demand at District banks shows no sign of slackening. To date, the petroleum shortage seems to have added to business loan demand. Some firms need to finance larger stockpiles of petroleum products they feel may become in short supply. This was especially evident to Kansas City banks serving customers in the plastics industry. Banks in Tulsa and Denver were feeling the effects of increased oil and coal production, respectively. Consumer instalment loan volume is also holding up as reductions in auto loans were being compensated for by increases in other areas, including home-improvement and credit-card loans. Agricultural loans are sharply higher in some parts of the District because larger numbers of cattle are moving onto feedlots. The only loan category demonstrating consistent weakness throughout the District is construction loans.

ELEVENTH DISTRICT--DALLAS

Scarcity of pipe, rigs, and work crews continues to constrain petroleum drilling in the Southwest, according to an association of drillers, since many do not have permanent workers or established lines of supply. The association reports that the shortage of drilling rigs could be a problem for as long as three years because capacity constraints are limiting the ability of manufacturers to fill a growing backlog of orders.

The seasonally adjusted index of industrial production in Texas fell in November for the first time since July 1973. The decline was centered in mining of crude oil, petroleum refining, and production of petroleum-related chemicals. Despite intensified drilling, mining of crude oil has decreased because of the reduction of domestic reserves of crude. At the same time, shortages of crude oil have contributed to the reduction in refining activity, although in recent weeks imports have been greater than they were earlier anticipated to be. Unscheduled shutdowns for repairs and maintenance have also hampered refining.

A survey of manufacturers based in Texas indicates that many firms are taking action to stockpile petroleum or petroleum-related products. While many businesses complained about more limited supplies and rising prices, there is no evidence that petroleum or related products are unobtainable. Shortages were reported in plastics, solvents, and diesel fuel, but many manufacturers seemed just as concerned about the scarcity of nonpetroleum materials such as steel, copper, and aluminum.

At present, these manufacturers are not planning to cancel or even delay previously made plans to expand plant and equipment expenditures because of the energy situation. Of those contacted who had plans for significant investment in 1974, most are drawing up contingency plans in the event that the energy shortage becomes critically disruptive, but all seemed optimistic that the economy will remain sufficiently strong to warrant continuation of their capital spending programs in 1974.

New car registrations in the four largest metropolitan counties in Texas declined in November. The fall came in the wake of a substantial increase in October registrations--which has the result of filling large fleet orders placed earlier in the year. The November decline indicates the continuation of a cyclical downturn in Texas automobile sales which began last March.

Agriculture in the five District states had a record year in 1973 for crop production, income, and investment. Encouraged by strong demand and higher prices, farmers and ranchers are planning even greater production in 1974. However, they are seriously concerned that the necessary stocks of fuel and fertilizer may not be available to achieve this goal. Farmers in several major cotton-and grain-producing areas have reported difficulties in obtaining diesel fuel and complain that distributors are reluctant or unable to assure them of adequate fuel supplies for the approaching planting season. Local shortages of fertilizer have also been reported, and many cases have been noted where the price of fertilizer has doubled in the past year.

TWELFTH DISTRICT--SAN FRANCISCO

Despite the problems associated with the energy crisis, the majority of our directors expect only a slowing of the economy this year but no serious recession. Consumer spending for nondurables and business capital expenditures are strong, and District agriculture is also likely to experience another prosperous year. The major weaknesses are in housing and consumer expenditures for durables and automobiles.

The energy crisis has had little impact on this District's employment and output as yet. Some directors report shortages of some classes of raw materials, and manufactured goods are just as important, as energy shortages in restraining output. For example, lack of resins are slowing plywood production, and petrochemicals and some metals are in short supply. The energy problems in the District are largely limited to sectors dependent upon gasoline supplies. Therefore, automobile sales are lower, and layoffs have occurred both in assembly plants and at the dealer level. Manufacturers of recreational vehicles are particularly hard hit, a "disaster area" according to one director. Airlines are another industry which has been reducing employment. Nonetheless, these sectors represent a minor fraction of total employment and the overall level of employment has not changed much.

In states such as Oregon and Washington, recent rains have eliminated previous power shortages, and these states have surplus power. Industries such as aluminum smelting, which had been on part-shifts, have been able to increase output and employment.

Forest products in the Pacific Northwest are experiencing strong external and domestic demand. The reduction in housing starts has been partially offset by higher demand in orders for various paper products as a substitute for plastics which are in short supply.

Utah and Idaho similarly expect no power shortage. Ninety percent of the region's power is generated from plentiful low-sulphur coal, and utilities are able to export their surplus to other states. The principal shortage of energy in this District appears to be in gasoline, but this is limited to a few areas, such as Arizona and Oregon. A major factor in the Oregon situation has been the decision of two oil companies, Gulf and Amoco, to close their stations in the state. In contrast, independent dealers in Idaho are in an "oversupply position". Although California appears to have sufficient gasoline supplies, there would be more economic dislocations if the proposed 35 gallon monthly ration is imposed in areas dependent upon the automobile for transportation. Los Angeles would be especially hard hit by rationing. The Los Angeles area also appears to face a more serious power shortage than the rest of the state. Mandatory cutbacks have been ordered.

Our directors described various efforts of business to save power. Forest products firms are burning previously discarded waste products; Georgia Pacific expects to save in 1974 energy equal to 200 million gallons of fuel oil by its program of utilizing wastes. The general response of business has been to reduce lighting, especially for display purposes, and to lower heat in buildings. Christmas retail sales were higher in most areas. Business capital expenditures remain strong because of continued efforts to modernize and to expand capacity to meet expanding demand. Commercial construction is maintaining a high level of activity, but there is no sign of any recovery in residential housing. Spending on consumer durables is expected by several directors to be lower this year, and automobile sales are also likely to fall more.

Agricultural prospects for 1974 remain good. High prices are expected--record highs were reported for Idaho potatoes--and farmers are increasing planted acreage of most crops. Net income of farmers, however, may be reduced somewhat by rising costs of such items as fertilizer and machinery which remain in short supply.

Bankers are experiencing continued growth in deposits, and they face strong loan demand particularly by business. Short-run interest rates are expected to decline slightly, but little change is seen for long-term rates.

In summary, although some directors are uncertain about the effect stemming from possible energy shortages, the majority expect only a slight slowing in economic activity. For the moment, shortages of energy have not had a significant effect on the District economy.