MONTHLY REVIEW

Contents:

FEDERAL RESERVE BANK OF MINNEAPOLIS

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Construction industry reacts to restrictive monetary policy

Within the last few months the effects of a restrictive monetary policy appear to have been distinctly felt in the construction industry — both throughout the nation and in the Ninth district. Private housing starts in the months of July and August were at the lowest level ever observed in the current business expansion. A major reason for this sharp decline in housing was the tightness of the mortgage market — both in terms of interest rates and credit availability. During the first eight months of 1966 interest rates on conventional mortgages rose by more than 40 basis points, and the amount of mortgage loans made by savings and loan associations throughout the nation during July were more than 40 per cent below the previous year's level. Testimony concerning the tightness of the mortgage market appears almost daily in the newspapers and financial press.

In chart form, the leading construction industry statistical data of the nation and the Ninth district tend to corroborate the story of decline. The charts also present no clear evidence that the impact of recent monetary policy in the district has been significantly different than the impact on the entire nation.

Construction contracts

One of the broadest measures available to measure the construction industry is the valuation of construction contracts awarded. Chart 1 indicates a substantial decline in the level of construction contracts from the first few months of the year. A more dramatic picture of the state of the construction industry is presented by Chart 2 showing only the valuation of residential building

Chart 1 — Total valuation of construction contracts awarded
(seasonally adjusted)

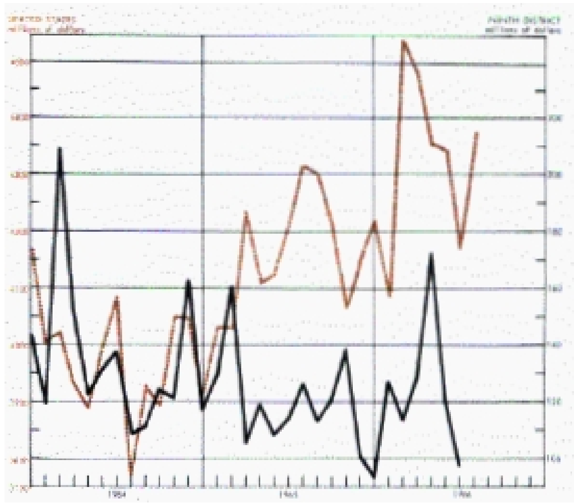
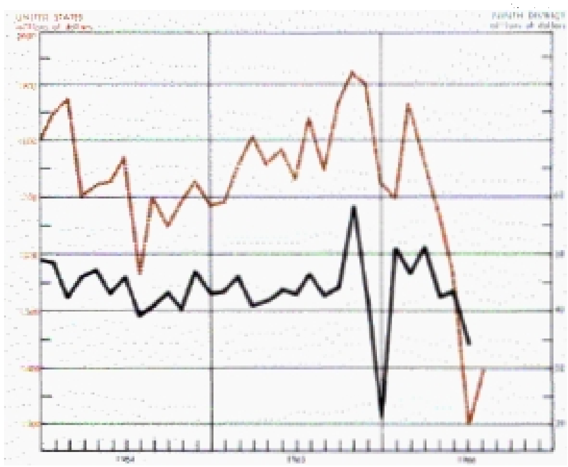
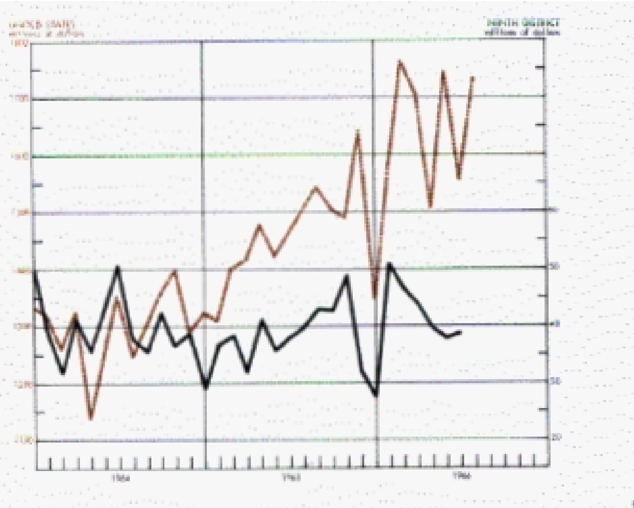


Chart 2 — Residential building contracts awarded
(seasonally adjusted)



contracts awarded. During July the value of residential contracts declined in both the district and the nation by more than 30 per cent from the peak achieved earlier in the year. In contrast, value of non residential building awards has held up reasonably well during this period of credit restraint (Chart 3), more so in the nation than in the district. In recent months the level of district nonresidential contracts awarded has declined, but the decline has not been as severe as in residential building.

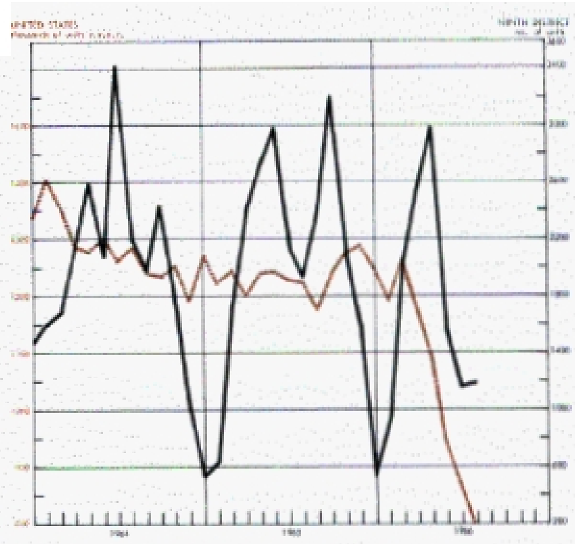
Chart 3 – Nonresidential building contracts awarded
(seasonally adjusted)



Building permits

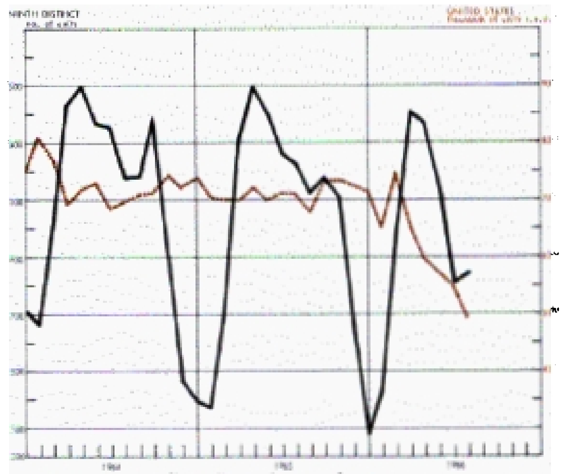
The number of housing units authorized by building permits for both all residential structures and single-family housing units are portrayed in Charts 4 and 5. Chart 4 shows the extreme decline in building permits experienced in the nation — the July and August figures are the lowest experienced since at least 1959. Since the district data are not seasonally adjusted, interpretation is somewhat more difficult. However, a careful examination of Chart 4 comparing 1966 levels with 1965 levels shows that the decline in the number of permits issued between May and August was more substantial than normally experienced. The July and August figures in the district were lower than any July or August figures for the past several years. Looking at Charts 4 and 5 together it

Chart 4 – Number of housing units authorized by building permits



s.a.a.r. = seasonally adjusted annual rate

Chart 5 – Number of single family housing units authorized by building permits

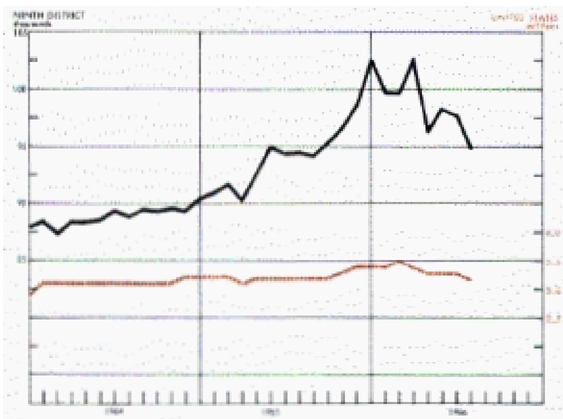


s.a.a.r. = seasonally adjusted annual rate is seen that the decline in housing starts was not confined to single-family units, it was spread rather evenly between single-family and multi-family dwellings.

Employment in the construction industry

The effect of the construction slowdown has been felt by both employers and employees of the industry. Chart 6 depicts the impact of the recent slowdown on total construction employment. By August construction employment in the district had declined by about 7 per cent from its April peak. A similar decline was experienced at the national level. In addition, the construction employment data correspond quite closely to the picture presented by the construction contract data: most of the decline in construction employment was attributable to declines in building construction since gains were experienced in highway and heavy construction as well as special trades construction. For example, in Minnesota, building construction employment during August was about 3 per cent below the corresponding period of 1965 while employment in highway and heavy construction advanced by about 17 per cent and employment in special trades construction advanced by about 9 per cent. Some evidence indicates that the building construction workers who are losing

Chart 6 — Construction employment
(seasonally adjusted)



their jobs are not all going on the unemployment rolls. Many appear to be finding employment in other areas of construction as well as in other

Chart 7 — Construction firm business failures

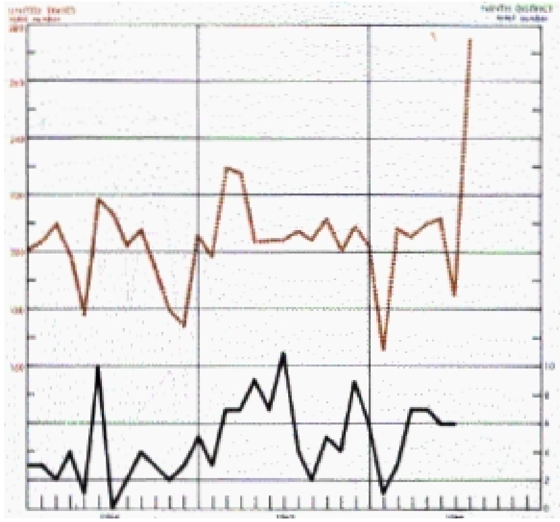
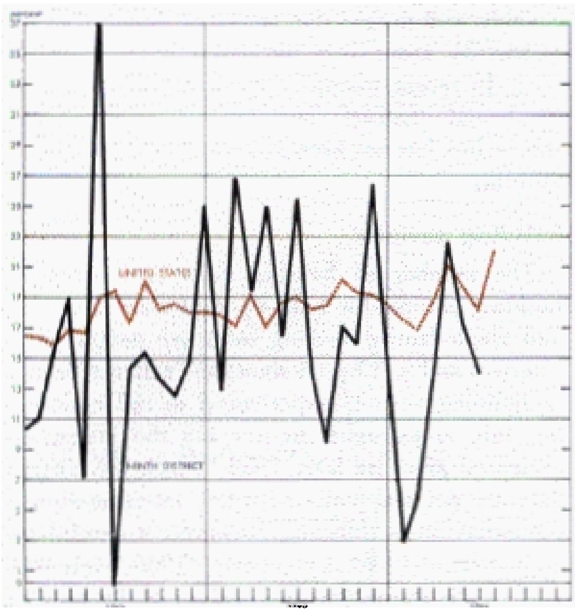


Chart 8 — Construction firm failures as a percent of total failures



industries, and these shifts have helped to ease the situation of excess demand for workers by these industries which appeared earlier in the year.

Construction firm business failures

A partial picture of the impact of the construction slowdown on construction employers may be observed from Charts 7 and 8 which show business failures of construction firms. In the nation the number of construction firms which failed during August 1966 reached the highest level ever observed in the post-World War II period, but no evidence of an unusually large number of construction firm failures within the Ninth district is indicated. Although the number of failures in the construction industry was quite high in the nation during August, one might be tempted to argue that the tight money situation has affected all business severely. However, Chart 8, showing the percentage of total business failures attributable to the construction industry, refutes this argument. Not only was the number of failures large in August, but the percentage of total failures was historically large as well.

One of the major weaknesses in interpreting the failure statistics in a period of tight money is that these data give no indication of the number of firms leaving the industry. For example, within the Minneapolis area one building executive has estimated that there are perhaps 40 to 50 "borderline" cases which would leave the industry by the end of the year. None of these firms, in this executive's opinion, would be classified as business failures — they would not leave the industry because of bankruptcy or other liability reasons.

Source credits for charts

Charts 1, 2, and 3: Dodge Construction Statistics. Seasonal adjustment by the Federal Reserve Bank of Minneapolis.

Charts 4 and 5: Bureau of the Census and Federal Reserve Bank of Minneapolis.

Chart 6: Various state departments of employment security, Bureau of Labor Statistics, and the Federal Reserve Bank of Minneapolis.

Charts 7 and 8: Dun & Bradstreet, Inc. Business failures include those businesses that ceased operations following assignment or bankruptcy; ceased with loss to creditors after such actions as execution, foreclosure, or attachment; voluntarily withdrew leaving unpaid obligations; were involved in court actions such as receivership, reorganization, or arrangement; or voluntarily compromised with creditors out of court.

Outlook

The outlook for the construction industry appears to depend quite critically upon future monetary and fiscal policy as well as the impact of recent policy changes. In the residential area recent national legislation authorized the Federal National Mortgage Association (FNMA) to borrow $4.8 billion to buy existing mortgages and for direct investment in mortgages. To avoid adding to money market pressures, most of FNMA's borrowing would be done through government trust accounts rather than in the open market.

In order to improve sales under present conditions, it appears that the home building industry is likely to increase its advertising outlays. This has occurred, for example, in the Twin Cities area. Although it may seem paradoxical that home builders have increased their advertising outlays in the face of restricted credit availability, their reasoning seems to be that they simply have to get more people interested in houses in order to find one customer who is able to obtain credit. One banker has expressed this attitude by saying that in effect the builder has got to sell his house three times rather than once: of three potential buyers presented for credit, all of whom would have been accepted about six to eight months ago, only one is accepted.

In the nonresidential building area the outlook appears to depend in large part upon the reaction by businessmen to the pending national legislation eliminating the accelerated depreciation allowances on building and structures. It is, of course, too early to evaluate this policy decision, but from the testimony provided by the financial press, there does not appear to be an overly restrictive attitude within the business community. Nonresidential building has been the backbone of construction building throughout the year and a small survey of structural engineers and architects within the Minneapolis-St. Paul area indicates continued strength in this area. This survey indicated that a large part of the work in construction over the next six months will be at educational and public institutions. As much of this type of construction is probably insensitive to depreciation allowances, the outlook must remain optimistic within the nonresidential construction area.

In summary, there is ample data to support the testimony of the popular press concerning the slowdown in the construction industry. Housing in particular has suffered. There is, however, no particular evidence that this situation has had a significant impact on the over-all economy — other industries have picked up the slack created by construction so that total income is continuing its rapid rate of growth and unemployment remains at reasonably low levels.

— Thomas M. Supel

Current conditions . . .

At the approach of fall the economy of the Ninth Federal Reserve district continued to register its summertime ascension. Except for a slack created by a slowdown in construction, most district economic sectors registered moderate increases. The construction decline was more than made up by exhibits of growth in the manufacturing and government sectors and by signals pointing to favorable farm income.

Impetus for growth in manufacturing, according to indices of production worker man hours, came rather uniformly from most major industries. In particular, the machinery industry chronicled rapid gains within the district just as it did in the nation. In Minnesota 10,000 machinery industry workers were added during the year ending in August. The district's unemployment rate during August was estimated at 3.7 per cent (seasonally adjusted), about the same rate experienced in June and July.

Industrial production, as measured by consumption of electrical power by industrial users, which expanded rapidly during July, slowed somewhat in August. Slight increases occurred in such industries as fabricated metals, electrical machinery, and nonelectrical machinery.

In construction, a decline in housing starts has been rather uniformly spread throughout the Ninth district's geographical regions — declines were registered in all states except in Upper Michigan and northwestern Wisconsin.

Crop output and prices appear favorable for farm income. The September crop report showed a marked improvement in district crop production estimates as compared to the August report. The estimated production of all wheat is now set at 305 million bushels, up 3 million bushels from the August estimate. Soybean estimates also moved upward 4 million bushels, pushing the district total to 92 million bushels. The sharpest increase in estimates occurred in corn — 435 million bushels, up 35 million bushels. Crop prices continue to run well ahead of last year's.

Total deposits during September flowed into district banks at a pace which fell short of the normal inflow by 20 per cent. This slower-than-usual growth was due in large part to deposit behavior at city banks. These banks recorded a sizeable contraction in time deposits (primarily in negotiable time certificates of deposit) which was not entirely offset by growth in private demand deposits. Thus, instead of a healthy advance which might have been expected during September based on the experience of recent years, city bank deposits declined slightly. Country banks reported an unusually vigorous upsurge in deposits during September. Demand deposits inflow was slightly stronger than usual while time deposit growth was twice as large as the average inflow for comparable periods in recent years.

The reserve and liquidity positions of city banks remained relatively tight during September: a decline in credit was generally offset by the contraction in deposits. The loan-to-deposit ratio at the end of September (67 per cent) was slightly above that of the end of August. City banks, in order to meet reserve requirements, borrowed more heavily during September than in August in the federal funds market. Borrowing at the Federal Reserve's discount window during the month was virtually nonexistent.

Quite the contrary was reserve and liquidity experience of country banks. The loan-to-deposit ratio fell to 56 per cent at the end of September.

The following topic describes a particular aspect of the district's current economic scene:

Maximum time deposit rate rolled back

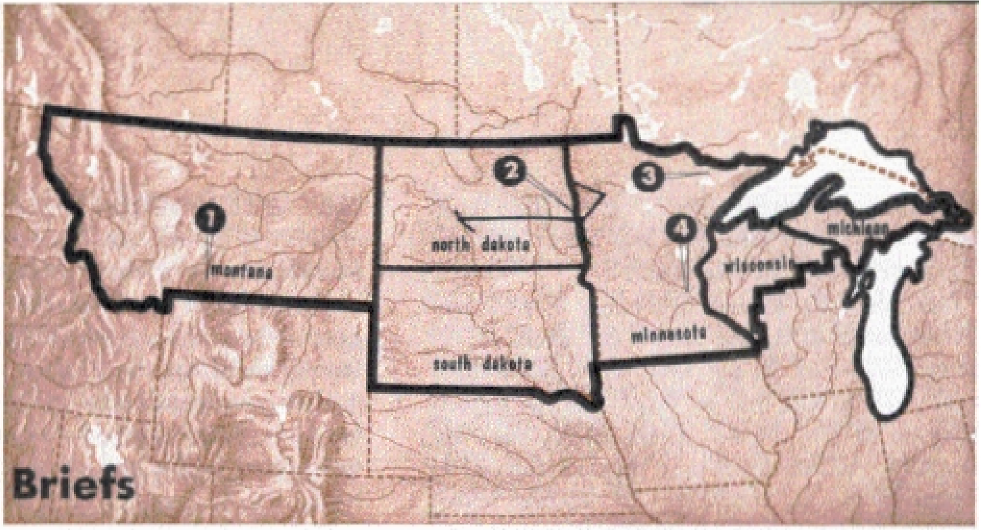
The Federal Reserve Board in September moved to limit escalation of interest rates paid by commercial banks in competition for consumer savings. In action effective September 26 the Board reduced to 5 per cent from 5½ per cent the maximum interest rates that banks can pay to attract savings. Authority for the action was granted in a law signed by President Johnson a few hours before the Board's decision. The law provides increased flexibility for establishing ceiling rates on time deposits and savings accounts at commercial banks and other depository institutions.

The reduction in maximum rates applies to time deposits of less than $100,000. It does not by itself require any change in interest paid on certificates of deposit and other time deposits outstanding on the effective date. If a member bank has agreed to pay a specified rate of interest on such a deposit, without any right to modify its obligation, it may continue to pay the contract rate to maturity. If the deposit is then renewed, the rate of interest may not exceed the new ceiling.

The Board's action does not change the maximum rate payable by member banks on savings accounts, which remains at 4 per cent. The maximum rates payable on multiple-maturity time deposits, which are 4 per cent or 5 per cent, depending on maturity, are also unchanged. The ceiling rate on single-maturity time deposits of over $100,000 remains at the present level of 5½ per cent.

The September action is one of a series of measures taken by the Federal Reserve System in recent months to temper the aggressive competition for funds among commercial banks and other financial institutions, and at the same time to assure an orderly and moderate rate of growth in bank credit in order to restrain inflationary pressures. Earlier actions included a lowering of interest rate ceilings on time deposits with multiple maturities, two increases in the reserves that member banks must maintain against some of their time deposits and, more recently, a statement to member banks concerning the need to adopt lending policies that will result in slowing the growth of business loans.

Economic Briefs



1. Lime plant to expand

A $1 million expansion is planned at Big Horn Calcium Company, Warren, Montana. A kiln and hydrator will be installed to produce 250 tons per day of quicklime, pebble lime, and hydrated lime. The new expansion is the second since the firm began operations in Warren seven years ago.

2. REA grant approved

The Rural Electrification administration, Washington, D.C., has approved a $55.7 million loan to the Minnkota Power Cooperative, Grand Forks, North Dakota, for the construction of a 212,000-kilowatt generating plant, 430 miles of heavy-duty transmission lines, and 25 new substations. The generating plant will be built at Center, North Dakota; the transmission lines in North Dakota and northwestern Minnesota.

3. Nickel leases granted

International Nickel Company has been granted mining leases over about 5,000 acres in northeastern Minnesota from the U.S. government. The properties covered by the leases are about eight miles southeast of Ely, Minnesota, in Lake and St. Louis counties. The company is now conducting evaluation studies to determine the over-all feasibility of establishing a nickel mining operation in the area.

4. City to receive beautification funds

Minneapolis, Minnesota, will receive a $502,625 federal grant under the Urban Beautification Program to landscape and improve a main downtown shopping street and to aid in other citywide beautification projects. Nicollet avenue, the downtown street, is being reconstructed into a shopping mall and transit roadway.