CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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TABLE OF CONTENTS

SUMMARY*

The tone of the Redbook this month can be described as "cautiously optimistic." Virtually every District reports that its economic slide has bottomed out and its economy is moving in a positive direction. The recovery process described by Boston and Chicago is still quite weak, while the rebound in Minneapolis and Dallas is somewhat more solid--though not robust. Unemployment rates are still very high, but this month's reports suggest distinct progress in most Districts. However, inflation shows some well-publicized signs of heating up again. An analysis of the national economy by sector produces an equally mixed picture. The manufacturing sector is weak but seems to show distinct signs of improvement. New orders are up and inventory stocks are down. Retailers report sales slightly above last year's levels, and tourism is rather strong. Current crop prospects in the agricultural sector are inconclusive, and farm earnings for the first six months of 1975 are below those of 1974. Construction is still very weak in most regions of the country. Bank lending to consumers is picking up, but commercial loan demand remains soft. Disintermediation is also showing signs of becoming troublesome in a few Districts.

One of the most encouraging developments to surface in the reports this month is a brightening in the job markets across the nation. Many Districts report declining unemployment rates, albeit from very high levels. St. Louis reports that total employment is finally rising again in its region, and one Minneapolis director describes the labor market in a part of that District as "tight." Philadelphia, Richmond, and Dallas note a lengthening of the average workweek in their Districts.

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*Prepared by the Federal Reserve Bank of Philadelphia.

The outlook for inflation is not as encouraging. In varying degrees, most Districts report renewed concern over rising prices. Directors of the Minneapolis Bank see "no widespread resurgence of rapid inflation" for the present, but this confidence is not mirrored in the other reports. Richmond, New York, Chicago and San Francisco all note the anxiety of their respective business communities over the prospect of rekindled inflation. Despite substantial amounts of unused capacity, several basic manufacturing industries are reported to be raising prices. The fear of a reimposition of price controls is mentioned by San Francisco as a reason contributing to the recent price hikes.

In most parts of the country manufacturing is starting an upswing. Richmond, Atlanta and Philadelphia all report higher levels of new manufacturing orders. Petroleum, chemicals and metals are strong in the Dallas District, while mining and pollution control equipment are bright spots for Chicago. The process of cutting inventories appears to be nearly over. The only consistently weak area in manufacturing is the capital goods sector, especially for New York and Chicago.

Retail sales are a bit more encouraging. New York and Dallas both note that department store sales are quite strong in their regions. Auto sales are also showing gradual improvement. Richmond and New York also mention that the tourist business in those regions does not seem to have suffered much from the recession. The agricultural reports vary from region to region. Chicago is optimistic since recent rains have improved the chances for record crops in several states within that District. However, Kansas City reports that rainfall has come too late to help the fall crops in its area. Both Richmond and Kansas City report that cash receipts from farm marketings for the first half of 1975 were below levels posted a year ago in their regions.

The construction industry remains in the doldrums throughout much of the country. Atlanta, St. Louis and Minneapolis report marginal improvements in the health of that sector, but these areas are clearly the exception. The general picture is still one of weak or sluggish markets for single-family housing and very depressed markets for multifamily units. Nonresidential construction is also badly depressed. The dual culprits are reported to be high construction costs and uncertainty about future mortgage rates and financing.

The situation of the country's banking community has changed little in the last few weeks. Loan demand is generally weak, with the exception of consumer loans which are showing some life in Richmond, St. Louis and Kansas City. Boston notes that loan officers in its area are still "occupied with a lot of workouts." The picture on deposit flows is rather mixed with some Districts reporting net inflows while others report mild outflows. Disintermediation is not yet a serious problem, but several Banks mention concern in their regions that it could become serious. Kansas City and St. Louis both indicate that the possibility of future disintermediation may be a drag on recovery of the housing industry.

FIRST DISTRICT - BOSTON

The directors remain convinced that the economy has recovered; they are also convinced that the recovery will be modest, requiring patience. They have not yet become optimistically aggressive in their thinking. Laying a few tempered plans, the directors are responding conservatively and tentatively to improvements in business conditions. The July unemployment rate for New England dropped to 11.1 percent from June's 11.5. Massachusetts' rate is unchanged at 12.3 percent while those of Connecticut and Rhode Island dropped to 9.5 and 14.9 percent, respectively.

The retail trade picture is mixed. In general, volume is not coming back convincingly, despite national trends. One director, engaged in retailing, continues to report strong sales. He admits to outperforming others in his area and reports that sales were well above plan last month. This month, sales are running less ahead of expectations. In view of this experience, he is stocking somewhat more in anticipation of a good fall season. He reports that manufacturers' inventories are well in hand and distress merchandise is dead and gone. Retail bureaus in other cities and states report a much blander state of affairs. Promotions remain a necessary spark to business. The banking reports continue as they have in recent months. All categories of loan demand are weak and there is little evidence of any imminent activity either.

Businessmen seem to be facing a lot of problems and they have no great confidence in an agonizingly slow recovery. Basically, loan officers are occupied with a lot of workouts. In particular, the bankers report that developers are principally trying to get out from under their commitments. Also, savings deposits have begun to show significant weakness at commercial banks and savings banks alike. Interest rates are expected to continue their climb, but only modestly. Construction activity remains depressed in New England. Big projects are sparse, so active firms scramble to pick up small jobs. The future seems to hold little prospect for keeping busy, however.

Directors selling to manufacturers report that business has not changed a lot. Shipments are weak and order backlogs are providing the basis for production. They are encouraged by reports of declining inventories in the economy, but they have yet to see any activity in new orders.

Professors Houthakker, Eckstein, Samuelson, Solow, and Tobin were available for comment this month. Houthakker is confident about the economy and the direction of policy; the others discussed various misgivings. Houthakker sees a relatively slow recovery, and, given the circumstances, he feels this is the appropriate path for the economy. We should not become terribly concerned about price scares; however, should OPEC raise oil prices more than $1.50/barrel, or should crop prices move markedly, monetary policy might be more expansionary. Otherwise, he is content to see M_1 grow near the lower end of the 5-7.5 percent range.

Eckstein, on the other hand, is very worried about prices. He feels the Fed should speak up against instant oil price decontrol, a major factor in the 1976 dilemma of the Board; however, even without decontrol he feels that money growth must exceed 8 percent next year. He believes 7.5 percent money growth is a good long-run number, so it is the task of policy to repress inflationary shocks in every way possible so that money demand is not forced to grow at too rapid a rate.

Samuelson is also worried about prices. In view of depressed levels of capacity utilization, he expects no endogenous price pressures until 1977. However, exogenous pressures on prices may weaken the outlook. The recovery is weak, and those who paint a rosy picture depend on an inventory cycle to carry the economy. Only luck would make 7.5 percent money growth optimal from 1975:II to 1976:II. If things begin to boom, policy may reduce money growth below 6 percent.

Solow shares the opinions of Eckstein and Samuelson. He feels that the economy is in a critical phase and that overly restrictive policy may retard economic activity. Current policy is too restrictive; a more aggressive money target is needed until vigorous growth is firmly in hand.

Tobin remains of the opinion that the economy is so low and has so far to go that there will be plenty of time later to worry about fine tuning once the economy begins respectable growth. He does not feel comfortable forecasting big increases in velocity to permit current money targets to finance the recovery. The preconditions of previous recoveries were much more encouraging than the current situation; weak fiscal stimulus, disheveled balance sheets, and an insecure future temper his forecast of velocity increases. He too would like to see a substantial upward revision of money targets.

SECOND DISTRICT - NEW YORK

The gradual improvement in business conditions indicated in recent months by observations of Second District directors and other business leaders remains in evidence. According to our respondents, the retail sales picture continued to improve in August and early September, and some retailers reported they were now understocked in some lines. Business capital spending, however, remains weak. The weakening of business loan demand in the District appears to have abated, and most loan officers contacted recently looked for a pickup in demand in the near future. The strengthening of the dollar on the foreign exchange market in general was believed to be likely to have little impact on U. S. trade.

Perhaps the brightest spot in the current economic situation has been continued improvement in the retail sales picture. The president of a nationwide chain of department stores reported that his firm had cashed many Federal income tax rebate checks. While this suggested that a large part of the rebates was spent rather than saved, the retailer anticipated consumer demand for general merchandise to continue to rise well into 1976. He reported that his company, which had experienced a large inventory overhang a few months ago, was now understocked in apparel lines. Retail sales in upstate New York, which already had been picking up in recent months, improved further in August, and resort areas were reported to have had a very good tourist season. Although retail sales in New York City continued to lag behind the nationwide performance, reflecting in part the high rate of unemployment in the city, sales at large department stores showed the best improvement since September 1974. This improvement, moreover, appears to have continued in early September. Merchants were generally optimistic and reported very good business over the Labor Day holiday, when many large department stores remained open. An even better performance was shown over the past month at stores in the suburbs.

On the darker side, business spending on plant and equipment apparently remains weak. For example, the president of the department store mentioned above saw no evidence of a reactivation of capital spending plans in his industry, noting that the current emphasis was on increasing the productivity of existing facilities rather than on expansion. The chairman of a multinational oil company stated that business capital spending in general appeared to be lower than had been expected last spring. He reported that his own firm had cut its investment plans for 1975 by $100 million before the year began and by another $300 million in January because of deteriorating profits. The Buffalo Branch Directors also saw no evidence of a reactivation of capital spending plans that had previously been shelved, with one director citing continued excess capacity, escalating building costs, and relatively high interest rates as factors inhibiting capital spending. An upstate banker in a resort area, however, reported on plans for expansion of tourist facilities.

A number of respondents expressed concern over a possible resurgence of inflation. Among others, the president of a large nonferrous metal firm stated he was "fearful" about inflation. He pointed to the currently low price/cost ratio in his industry and to the large proportion of capital spending for environmental protection adding nothing to productive capacity. These factors, he felt, would put upward pressure on materials prices. The chairman of the oil company felt that the current spending pattern, with consumers' outlays rising while business capital spending was not, could well have inflationary implications. And the Buffalo Branch Directors believed that fear of a resurgence of inflation was a major factor behind businessmen's currently cautious mood.

Regarding the demand for business loans, the Buffalo Branch Directors reported no further weakening in such demand, as did the majority of the loan officers at commercial banks in and outside New York City who were contacted recently. Moreover, nearly two-thirds of these loan officers expected loan demand to be stronger over the coming months, with virtually all others anticipating no change.

We recently asked our directors and other respondents about their opinions regarding the possible impact on United States foreign trade stemming from the strengthening of the dollar on the exchange markets. Most respondents felt that this impact would be negligible. They agreed that this strengthening had not significantly eroded the competitiveness of U. S. exports to date, and was not likely to do so in the future, and that imports would not be spurred significantly. In their opinion, U. S. prices of goods continue to be attractive vis-à-vis those of foreign goods because of the greater rates of inflation experienced by many other countries. A senior economist at a large New York City bank stated that the strength of the dollar in recent months was only a rebound from an undervalued position. The present rate in his view is nearer the equilibrium rate and is more desirable over the longer run. The chairman of the oil company thought that the strengthening of the dollar should make OPEC countries less aggressive in raising oil prices this fall. The president of the nonferrous metal concern, however, believed the stronger dollar to have been a factor in the increase in aluminum and stainless steel imports.

THIRD DISTRICT - PHILADELPHIA

Business conditions in the Third District continue to improve. Area manufacturers report that new orders and shipments are higher this month than last while inventories are lower. Employment is also marginally higher, and the average workweek has been extended. However, prices paid for supplies and received for finished products are both up over last month. At the same time, these businessmen look for further improvement over the next six months. Manufacturers expect new orders and inventories to be higher, and they anticipate adding employees and lengthening the workweek. Prices are expected to climb, however, and capital spending plans are cautious six months out. The market for existing housing is active, but there's little vigor in new housing starts. Retailers report that sales are flat or up slightly, and they look for some improvement through year-end. Area bankers report level demand deposits while savings accounts are steady or off slightly. In addition, bankers indicate that loan demand is flat.

Third District manufacturers, responding to this month's Business Outlook Survey, report economic expansion for the second consecutive month. Almost 40 percent of the respondents report an improvement in overall business conditions this month. The level of new orders is generally higher and fewer than 10 percent of the respondents indicate a drop in new orders this month. Last January, by comparison, almost half were reporting a decline in new orders. Shipments of manufactured goods are up as well. Overall, inventories are down, but there are some signs that they are stabilizing. Half of the manufacturers surveyed report no change in their stocks on hand. Employment is also a "plus." Manufacturing work forces are up slightly this month, and for the first time in a year the average workweek is longer.

The longer-term outlook in manufacturing is optimistic. None of the executives surveyed expects a decline in general business activity within the next six months while almost 90 percent anticipate improvement. In fact, none of the respondents expects new orders to be lower through March and most expect them to be higher. Moreover, almost one-third of the executives polled plan to increase their inventories over the period. Prospects for employment are bright as well. None of the respondents anticipates a reduced work force or shorter workweek, while 43 percent plan to hire additional employees and 40 percent foresee a longer average workweek. Plans for capital spending are still conservative, however, with almost 60 percent of the respondents expecting to hold the line through late winter.

Retailers in the area report that sales are even with or slightly above the levels of the last few months. Soft goods and some heavily-advertised appliances are reported to be selling well. One retail executive looks for sales to stay flat in real terms through the rest of this year while another expects sales to improve by the end of the year and looks for a strong spring. All of the merchants contacted report that inventories have been reduced below their 1974 levels and that inventory/sales ratios are where they want them.

On the price front, manufacturers report higher prices this month compared to last for their supplies as well as for their finished products. One-half of those surveyed report paying higher prices compared with one-fourth last month. In addition, prices received for finished manufactured goods are up slightly this month. This is the first time since February that the number of respondents receiving higher prices exceeds those receiving lower prices. For the longer term, manufacturers expect prices to rise further. More than three-fourths of the businessmen polled expect to be paying higher prices six months out, while almost 70 percent anticipate receiving higher prices for the products they sell. Retailers in the area report paying slightly higher prices for their supplies while trying to keep the prices they charge "competitive." One merchant notes that his store is finding it somewhat easier to pass along small cost increases.

The resale housing market in the area is reported to be brisk, but new starts are minimal. One MSB official notes that demand is strong and there's heavy mortgage lending for used housing. But he sees the anticipation of higher interest rates hampering new housing starts. Though mortgage rates at this contact's bank are currently 25 basis points below Pennsylvania's legal ceiling, he feels that if the recent net outflow of savings continues into next year, mortgage rates will go to the ceiling and mortgage lending will be impeded.

Bankers in the District report that, in general, loan demand is flat. The outlook is for lending to increase modestly with the recovery, but no big pickup is foreseen during the next year. Area financial executives expect the economy to recover gradually with annual real growth in the 4-6 percent range through most of 1976. In addition, they see only slow improvement in unemployment. All of the bankers contacted feel that inflation is still a major concern and one expects double-digit inflation within 18 months. Another banker in the District is concerned about how the recovery will be financed, noting that improvements in bank liquidity have not been substantial, and that it will be difficult for banks to raise capital. Area bankers look for short-term interest rates to trend upward, and all express concern over the projected Federal deficit. They feel that borrowers will be "crowded out" to some degree, and that this will put a damper on recovery.

FOURTH DISTRICT - CLEVELAND

Economic recovery in the Fourth District appears to be spreading beyond consumer goods to include some types of capital goods. Consumer goods industries have improved gradually in response to further improvement in spending and an end to reductions in inventories. The coal strike is not expected to hamper recovery. Employment in the District has shown little improvement in recent months. Upward price pressures remain intense but less widespread than reported last month.

Financial officers and economists in the appliance, automotive, glass, and machinery industries reported production and orders have risen from winter and early spring lows. A producer of electrical and gas ranges reported significant increases in sales since June had led to a 16 percent increase in output in September and had boosted their operating rate to 70 percent of capacity. Another appliance producer noted production of small appliances had picked up sharply in July and August, because of relatively short supplies at the retail level; but sales and orders of major appliances were still weak. He expects only a 10 percent increase in sales of major appliances in 1976 because of continued weakness in housing. A director with a machine tool firm reported incoming orders were very strong in August. A major glass producer that is a chief supplier of the auto industry reported that orders have picked up strongly since the trough in January-February 1975, but that future gains will slow unless automotive output rises more than is projected. An economist with a machine tool firm stated its recovery appeared to be V-shaped. Its net orders rose 11 units in August while net orders declined 25-35 units a month at the trough last winter. He expects orders for small cutting tools to increase about 25 percent over the next 12 months, or typical for the first year of recovery. An executive with a machinery firm reported printing press orders began to pick up late in the second quarter after a fourth-quarter low. A financial officer for a truck and construction and agricultural machinery producer stated orders for heavy duty trucks have picked up rapidly each month since spring, but orders for earthmoving machinery and mining machinery softened in August. An economist for a major producer of electrical machinery reported orders this quarter will be above depressed second-quarter levels because of special export orders this quarter.

Conditions in steel have changed abruptly in the past month as a result of customer efforts to beat the October 1 price increase. Economists with three major steel firms in the District report that September order books are full, especially for the flat rolled products. One producer expects hedge buying will boost September shipments 20-25 percent from the July low. October shipments are now expected to fall back to or slightly above the July level. No real recovery is expected until the first quarter of 1976.

The wildcat coal strike caused coal production to slip 7-8 million tons. An economist with a major coal producer reported that many miners have returned to work. He expects a moderate rise in coal output in 1976 (up about 5 percent from 1975) and a small price hike in coal around year-end. In his view, the industry has ample capacity to accommodate a stronger rise in demand. EPA regulations that restrict use of high sulphur coal represent the main short-run problem for management.

As reported last month, most of our contacts do not expect capacity or material shortages to hinder the early stages of recovery, except those industries (especially steel and chemicals) heavily dependent on natural gas. The wildcat coal strike will not hinder utility or steel operations where ample stocks of coal are reported. Contacts in machine tools, electrical machinery, heavy duty trucks and steel expect no capacity constraint for their products at least until early 1977 because of current low utilization. A steel firm and a capital goods producer are concerned that they will not generate enough cash flow to support long-run capital expenditure plans.

Our Monthly Survey of District Manufacturers shows that most respondents experienced increases in new orders and shipments in August and are still liquidating inventories. For September, continued improvement in orders and shipments, and a slower rate of inventory liquidation than in recent months are anticipated. The proportion expecting expansion in employment and hours worked also rose.

Employment and unemployment have not improved much since the trough in April despite improvements in several key District industries. Recalls have been confined largely to automotive and household goods. A glass producer has recalled the bulk of workers laid off during the recession. Scattered recalls in steel are largely attributable to the bulge in September order books rather than any fundamental improvement in market conditions. Generally, rubber, chemical, and capital goods have had few recalls despite reported rising trends in orders and output in recent months.

Consumer spending continues to climb, although real gains are apparently relatively small. A director in the consumer recreation business commented that their revenues are 11 percent above last year. A financial officer for a large department store stated sales in August were better than in previous months as well as a year earlier although big-ticket items remained rather weak. He noted no deterioration in collections.

Auto sales in the District have been climbing gradually for the last several months, but two large dealers reported inventories higher than a year ago. Both reported customers are buying fully-equipped cars, although customers show more interest in the top-of-the-line smaller cars rather than standard size cars. A director reported his bank lengthened maturity on car loans to 48 months because of the high price of cars.

Several directors and chief executive officers again expressed apprehension that current renewed cost-price pressures would inhibit overall economic recovery. However, our Monthly Survey of Manufacturers shows that the percent of respondents who expect no change in prices for September exceed the percent who expect further increases in prices. The only concrete comments on price increases came from an official in the rubber industry who reported higher costs of synthetic fibers and certain raw materials, and a container and glassware producer who reported that glassware prices were increased 5 percent in August. On the other hand, weak market conditions have inhibited price increases for machine tools and certain other types of machinery.

Some bankers noted continued weakness in commercial and industrial loans, and one expects no sizable pickup until early 1976. Another banker reported higher demand for credit from a paper and container company that plans a sizable buildup of stocks in the fourth quarter of 1975. A small banker commented that raising the usury rate ceiling in Ohio resulted in additional mortgage loans by his bank. Mortgage loan demand is generally reported to be strong, and a financial officer with one of the largest savings and loans in the District remarked that mortgage rates were increased again to discourage demand.

FIFTH DISTRICT - RICHMOND

The September Survey of Fifth District Business Conditions reveals continued improvement across a broad range of economic activity. Responses indicate sizable increases in manufacturing shipments and new orders along with greater backlogs of orders and further reductions of inventories, particularly of raw materials. Inventories of finished goods apparently declined only slightly during August. Over 40 percent of manufacturing respondents still view current inventory levels as excessive. Employment seems to have increased slightly in the manufacturing sector while hours worked per week increased for the fourth consecutive month. Among retailers participating in our Survey, sales were generally up for the month, and sales of big ticket items relative to total sales remained unchanged. Prices apparently rose across a wide range as substantial numbers of manufacturers and retailers reported paying and receiving higher prices. In the banking sector, commercial and industrial loans outstanding at Weekly Reporting Banks have declined over the past several weeks while consumer loans continued to post modest but steady gains. Both demand and time deposits have shown weakness during August.

Among manufacturers responding to the September Survey, one-half reported increases in shipments and in the volume of new orders during August. In addition, those reporting increases in backlogs of orders outnumbered those reporting decreases by two to one. In each of these areas, the improvement was more broadly based than at any time in recent months. These improvements in the level of business activity seem to be most pronounced in the basic industries and in consumer related areas. Textile mills, apparel and related products, and furniture and fixtures accounted for a sizable portion of the improvement along with primary metals and chemicals. Judging from the Survey, those industries which seem to be lagging are in the machinery and equipment, and electrical equipment areas, although the food industry also reports little change. Inventories of materials held by manufacturers declined further during August while stocks of finished goods showed little change. As in August, over 40 percent of the manufacturers feel current inventory levels are excessive. But almost all of those surveyed are satisfied with current expansion plans.

Prices seem to have taken a turn for the worse during August, as over half of the manufacturers responding to our Survey report paying, and over one-third report receiving, higher prices. The Survey of Retailers yielded much the same results concerning prices. The indicated price movement may have contributed to the minor deterioration of the outlook for the next six months. While our Survey respondents remain basically optimistic, that feeling seems to have weakened slightly in the past month, despite the fact that recent optimistic expectations have been largely borne out by business developments. One manufacturer surveyed specifically noted his expectation that the level of business activity will improve during September and October and then fall off for the remainder of the year.

Other results from our Survey of District Retailers also support the view that business activity is continuing to improve. Over one-half of the retailers surveyed reported increased sales during August. During that period, sales of big ticket items relative to total sales remained unchanged. In view of the improved level of total sales, the situation in big ticket items may be significant. Judging from our monthly surveys, sales of big ticket items have been declining, in both absolute and relative terms, for the past year. If the relative decline has abated and total sales are, in fact, beginning to increase, the general recovery may be due for a substantial new impetus from the durable goods sector.

Inventories at the retail level declined slightly during the month and most Survey respondents view current levels as about right. There is also general satisfaction, among the retailers surveyed, with the number and size of outlets presently operating. Retailers also remain basically optimistic with regard to the outlook over the next six months, expecting improvement nationally, locally, and within their own firms.

There is a widespread expectation among Fifth District bankers that business loan demand will increase, at least moderately, by the end of the year. Nevertheless, commercial and industrial loans outstanding at Weekly Reporting Banks over the past several weeks have declined from the level reached after a surge in demand during July. There has been no easing in the firm credit standards that have become common at District banks. Consumer loans continue to post modest but steady gains, and it appears that some banks are becoming more interested in these types of loans. In fact, District banks seem more receptive to making most types of loans, with the exception of multifamily mortgage loans.

Both demand and time deposits have shown some weakness during August, and savings deposits at Weekly Reporting Banks declined for the first time this year. CD holdings have remained rather steady, while average net Federal funds purchases and discount window borrowings have increased to offset liability declines in other areas.

The District's cash receipts from farm marketings during the first half of the year were 2 percent under the same period last year. The District decline is much less than that for the nation, however.

Better quality marketings and improved grade prices have combined to bring about an upward trend in the general average price for flue-cured tobacco over the past several weeks. Flue-cured prices for the season through September 5 averaged 7 percent below a year earlier, however. With gross sales also down (probably because many farmers are holding their tobacco off the market in hopes of further improvement in prices), value of sales is 14 percent under a year ago.

SIXTH DISTRICT - ATLANTA

Depressed sectors of the regional economy show signs of reviving. Some purchasing managers enjoy a buyer's market; others question how long it can last. Poultry and livestock producers in the Sixth District are already feeling the pinch of higher feed prices, partly as a result of export sales of grain. Impending shortages of natural gas pose relatively mild problems for commercial and residential customers, although for certain industrial customers the outlook is less bright.

Recently announced changes in production suggest recovery in various sectors which were previously depressed. A Tennessee manufacturer has announced a 16 percent increase in the production of gas and electric ranges beginning in early September. The increase is attributed to increased orders over the past two months and will result in additional employment and restoration of operations to 70 percent of capacity. Production is resuming after a one-year lapse at a large sawmill in Georgia. Also, a Florida plant, which manufactures corrugated shipping containers, is resuming production as of October 15, following an expansion program. A Tennessee furniture manufacturer expects to begin by late September the manufacture of a new line of furniture. Production will begin with the rehiring of employees laid off since last spring and over the next six months should result in an expansion of employment.

Tourist activity appears to be strong in many areas, according to reports from directors and other sources. Hotel occupancy and associated tax revenues show increases. Some brightening has appeared in the housing market, as new permits have increased and inventories in South Florida and other areas are declining. A large life insurance company reports a decline since February in its policy lapse ratio, followed by a leveling off of the ratio of policy loans to policy reserves. These developments are regarded as signs of economic strengthening.

Members of a Georgia Purchasing Managers' Organization, surveyed from June through August, indicate that delivery times are stabilizing. The proportion reporting faster deliveries has declined markedly as of August, with most respondents indicating little further change in that month. A marked shift has also occurred in the movement of prices. The percentage reporting higher prices has risen from 25 to 40 percent; the proportion responding that prices are the same as in the previous month has risen from 43 to 60 percent; and the proportion reporting declining prices has fallen from one-third in June to zero in August. Survey results indicate that order backlogs are increasing on the whole. Throughout the period, declining inventories are reported by a substantially greater number of respondents for raw materials than for finished goods. Conversely, a larger proportion of respondents report increases in finished goods stocks than those indicating growth in raw materials inventories. Conversations with individual purchasing agents convey an impression of shorter delivery times and sporadic price negotiability. Use of escalator clauses in contracts for items as diverse as heavy equipment and food services is reported. Reemergence of delays in delivery for items such as fabricated metal products, plant, and certain printing supplies is attributed by some to overly zealous inventory reductions by suppliers rather than to shortages of goods at the point of manufacture.

This District's important poultry and livestock industry is feeling effects from grain sales to Russia. The increased cost of feed has narrowed the profit margin for eggs. Further feed cost increases or a decline in retail prices may result in additional bankruptcies among producers and a further curtailment in the size of the nation's egg flock, now at its lowest point in 30 years. In the broiler industry, placements have increased in response to an improved feed-price ratio. Although hog production has again become profitable because of reduced output, producers' decisions to increase the number of hogs await indications concerning the size of the corn harvest and its effect on the price of feed. Cattle producers had hoped for increased prices of lightweight feeder calves as a result of lower feed grain prices, but instead witnessed further declines in cattle prices as Russian purchases increased the cost of grain. A substantial number of producers may be unable to survive another year of depressed cattle prices.

Recent press reports indicate that, with the possible exception of Tennessee, shortages of natural gas will be felt primarily by industrial users served on an interruptible basis. Reports of adequate supplies for residential and commercial customers come from the state energy office in Atlanta as well as a large utility company which maintains underground storage facilities for natural gas and a variety of supplementary sources of supply. The principal pipeline supplier of gas also confirms the adequacy of supplies, except for large industrial customers such as electric utilities using gas as a fuel for boilers.

Executives of two major regional electric utilities discount the threat posed by a gas shortage to their companies' operations. One relies primarily upon coal as a fuel; the other, which in the past has depended primarily upon natural gas, is in the final stage of an extensive conversion program to permit alternate use of fuel oil. Provisions include facilities for the supply and storage of liquid fuels. A series of nuclear-powered generating facilities is being constructed by a major regional utility holding company, and additional coal-powered units are also under construction. Utility spokesmen voice the opinion that users of natural gas have been tardy in developing alternate fuel sources, in part because of reluctance to confront the problem and also because of the impediments to additional investment posed by shortages of capital.

A leading electric power supplier in this region anticipates a normal cyclical increase in industrial demand for power because there is no expectation of natural gas shortages severe enough to seriously curtail the operations of its customers. The technical difficulty was also noted of conversion from gas to coal as a boiler fuel. Use of coal involves substantial materials handling problems and requires storage facilities and much more complicated equipment with reduced reliability.

SEVENTH DISTRICT - CHICAGO

Signs of improvement in business activity in the Seventh District are becoming more evident. Consumer confidence is strengthening and most merchants are less gloomy. Demand for workers has increased slightly. Steel orders have increased, only partly because of the price rise scheduled for October 1. Most firms are completing inventory liquidation programs, notably for steel, but also for other items. Overall, the producer goods industries are still slipping, but mining equipment and pollution control equipment remain very strong and order cancellations in other lines are much less frequent. Increases in industrial prices are becoming more significant again. Single-family home building activity has improved significantly, especially in the Chicago area, but remains far below earlier peaks. Recent rains have stabilized the deteriorating crop picture in Iowa and crops in District states east of the Mississippi look excellent, even better than reported earlier.

A survey of consumer confidence for the Chicago area showed a clear improvement in the third quarter from the low ebb reached early in the year. Most retailers have noted some improvement in sales since July, with a good volume of sales of back-to-school items. Sales of big ticket items involving use of credit are still sluggish. Auto sales may have been aided by a desire to avoid price increases on 1976 models.

Various evidence, including help-wanted ad volume, suggests a modest increase in demand for workers in the past month or so. Steel companies have recalled some workers. About 12 percent of the auto workers are still on indefinite layoff. While this is down from 39 percent last February, no further improvement is likely in the short run.

Unemployment was estimated at 9.6 percent in August in the Chicago area, 11.6 percent in the city, and 40 percent among Black youths. While estimates of local unemployment should be regarded skeptically, there is little question that the Chicago area's job market is weaker than the nation's, in contrast to historical experience. The city continues to lose employment opportunities as such important industries as printing firms shift operations to other areas, especially the South. An expert estimates that 19 percent of the population of the city of Chicago are on welfare, compared to 9 percent five years ago.

Orders have strengthened for lighter steel products. July appears to have marked the low point, seasonally adjusted. Some orders have been moved up because of the price increases announced for October 1, but inventories of vehicle and appliance producers and various other users are believed to be quite lean. One large Chicago area steel company with a strong competitive postition is operating at near capacity level. This firm's output was threatened by the coal strike in West Virginia, which appears to have ended this week, just in time to prevent cutbacks in operations.

The drive to reduce inventories has lost momentum, although many firms still view their holdings as excessive. Some firms have slowed inventory reduction programs because of increased demand for their products, but announced or expected price increases and possible interruptions of supplies also are factors.

Certain District producers of mining equipment and heavy construction equipment related to mining or resource development have maintained output at capacity levels and are pushing plans to expand capacity. Backlogs for large electric mining shovels and heavy overhead cranes stretch out a year or more. A leading producer of diesel engines has recalled workers because of increased demand for heavy highway trucks, but this may reflect desires of dealers to restock in anticipation of stronger final sales. Sales of tractors and other farm equipment, especially combines, have improved from reduced levels earlier in the year, bolstered by prospects for improved farm income resulting from higher prices for crops and livestock. Generally, however, capital goods producers have been cutting output as backlogs have eroded.

Construction activity continues at depressed levels. Permits for single-family homes in the Chicago area have been above last year in recent months, but well below earlier years. There is little hope for apartments or commercial construction. A builder recently canceled a 600-unit condominium project in an urban renewal area near the Chicago Loop as "too risky." Sales of pre-owned homes have increased, but prices averaged 9 percent higher than a year ago, only slightly less than increases reported for the two previous years. Prices of homes are expected to rise almost as much in the year ahead. Aside from higher costs of labor, materials and financing, rising home prices are also blamed on restrictive building codes and stiffer zoning restrictions.

Much needed rains in recent weeks arrested deteriorating crop conditions in Iowa and solidified prospects for record harvests in Illinois. Growing conditions in Indiana, Michigan, and Wisconsin also have been excellent. The current state of crop development much reduces the possiblity of damage from an early frost such as occurred in 1974.

EIGHTH DISTRICT - ST. LOUIS

The uptrend in business activity continues in the District, according to reports from area businessmen. The rate of increase, however, appears to be rather modest, and recent employment data indicates that the District economy may be lagging the nation as a whole. Nevertheless, sales at both the retail and manufacturing level, as well as construction activity, have continued to improve in recent weeks. Savings flows into thrift institutions have slowed recently from the rapid pace earlier in the year.

Retail sales have made further gains in recent weeks. One retail executive reported that sales have improved through August and that he was fairly optimistic about continued increase as the recovery gains momentum. Automobile sales are still substantially off from the year-ago level, but improvement has been noted from earlier months of this year. Some foreign car dealers have complained that they could not obtain enough cars to satisfy their customers' demands, and a waiting period of two to three weeks is required for many deliveries.

Reports from several manufacturers indicate improvement has continued in the manufacturing sector of the economy. A representative of the paint coatings business reported a gradual improvement month by month. A major durable goods manufacturer reported that sales improved since late last year. He noted that during the first four to five months of the year real production trailed last year by 30 percent on a monthly basis, but in the last two months it has trailed by only 20 percent. A representative of a cutting tools firm stated that the consumer-related part of his business, especially do-it-yourself tools, had held up well over the recession. This firm's sales in the first six months were up two percent over a year ago. In addition, manufacturers of appliances, paper and products, welding equipment, and metal connector plates used in construction, all reported some improvement in recent months.

Latest data for total employment show an increase for the District. Reports of the rehires and callback of workers have been made for several months, but only recently has total employment begun to increase in most parts of the District. In contrast, U. S. total employment has risen since April, indicating that the economic recovery in the District may have lagged behind that of the nation as a whole.

The home building industry continues to show some slight improvement, despite the higher interest rates in recent months. The St. Louis area, where the inventory of homes was relatively low at the beginning of the recession, showed a substantial improvement in building activity in the first seven months of the year over that of the previous year. Much of the improvement came in June and July. According to a housing representative, housing permits are expected to show improvement in August. Considerable amounts of funds are reportedly available in thrift institutions for loans to the home building market. However, expectations of higher interest rates in the future are evidently causing these institutions to be cautious of lending at current rates. Representatives of savings and loan institutions indicated that the rate of growth in net savings slowed noticeably last month. Higher short-term rates on government and other securities were believed to be a chief cause of this development. Both banks and savings and loan institutions experienced large withdrawals from passbook savings accounts following a steady increase in this type of account for several months. Total time deposits at large District banks remained approximately unchanged from July to August.

Demand for most types of loans at District banks continues to be rather sluggish. Commercial and industrial loans, as well as real estate loans, continued to decline at large commercial banks in recent weeks; however, some upturn was noted for consumer instalment loans.

NINTH DISTRICT - MINNEAPOLIS

Bank directors' comments indicate that District business activity has begun to recover. The demand for District workers has recently picked up, and regional labor market conditions have improved. District construction activity also appears to be reviving, and several directors reported considerable building activity in their areas. No widespread resurgence of rapid inflation was seen, but several directors look for prices to continue rising due to the increased cost of doing business. According to our latest Quarterly Industrial Expectations Survey, District manufacturers expect their sales to improve in the fourth quarter and early 1976, but experienced no sales growth this spring and summer.

A feeling that District economic activity generally has improved was conveyed by many directors' reports that labor market conditions are stable or improving in their areas. A North Dakota director actually termed conditions "tight," and three directors said workers were being recalled in their areas.

District labor force data back up these reports of a leveling off in joblessness. The District's unemployment rate, seasonally adjusted, inched up 0.2 percent from April to July after a 1.1 percent jump during the previous three months. And the District's Help Wanted Advertising Index increased 21 percent between May and July, another encouraging development. District initial claims, however, are still running well ahead of a year ago, so some layoffs are continuing.

Construction activity has also improved in the District. Housing unit authorizations in late spring and early summer were up 13 percent from a year ago, and directors' comments indicate that homebuilding has probably continued to revive. Nonresidential construction has also begun to pick up.

Concern was expressed, though, that high building costs and mortgage interest rates could restrain future building activity.

Bank directors reported no widespread resurgence of rapid inflation. Several directors said price increases so far have been restricted to food and fuel; they were not aware of excessive increases in other areas. Two directors said their firms have not experienced any renewed inflationary pressures. One director associated with the food industry felt that the impact of the Russian grain sales on food prices may not be as great as many anticipate and that the market overreacted.

Even though directors did not see a sharp return of inflationary pressures, many are worried about inflation and expect prices to continue climbing. Several indicated that increased business costs, especially for labor, would force firms to keep boosting prices in order to maintain profit margins. One director reported considerable resistance to price decreases even in the face of falling demand because businesspeople want to recover their costs and protect profit margins. The possibility of wage-price controls adds to price pressures. A Montana director, for example, indicated that the list prices of farm machinery in his area have been raised largely in response to this fear.

Essentially no growth in the District's manufacturing sales occurred this summer, but manufacturers look for sales to pick up late this year and in early 1976. According to our Third-Quarter Industrial Expectations Survey, second-quarter District manufacturing sales were unchanged from a year ago and no growth is anticipated this quarter. In real terms, sales were undoubtedly down from a year ago since prices increased over the last twelve months. Respondents foresee sales increasing 4.8 percent in the fourth quarter, however, then advancing 10.2 percent in the first quarter of 1976.

Given price increases, these expected gains do not point to any significant pickup in District manufacturing activity. If realized, though, they may be large enough to help check the decline in District manufacturing employment (it's now about 6 percent below a year ago). Also, manufacturers did not revise down their sales expectations as they did last May, so Distict manufacturing activity may be stabilizing.

TENTH DISTRICT - KANSAS CITY

Two important barometers of construction activity in the Tenth District continue to depict a weak and struggling construction sector. Interviews with home builders revealed a dichotomy in the market, with higher priced houses selling well while the lower priced sector remains depressed. However, almost all respondents paint a very bleak housing picture for the future. In District agriculture, the recent rains have generally arrived too late to benefit the fall crops. On the income side, first-half cash receipts from farm marketings are well below last year, but earlier 1975 farm income estimates will probably still have to be revised upward. Loan demand at Tenth District banks remains weak with the exception of consumer loans, while demand deposit growth is reported to be strong.

Data for the Tenth District on the value of construction contracts awarded and on the number of housing permits issued continue to depict a weak and struggling construction sector. While the current dollar value of all construction contracts awarded in the District rose from June to July, the increase was much less than in the same period in 1974. As a result, the value of Tenth District construction awards in July was more than 22 percent below the year-earlier level. On a month-to-month basis, nonresidential awards and awards for public works and utilities rose from June to July, while residential awards fell slightly. In comparison with July 1974, however, only nonresidential contracts increased slightly, as residential contracts declined and public works and utilities awards fell by more than one-half.

On the Tenth District housing front, a leading indicator of future housing activity, the seasonally adjusted number of privately-owned housing permits issued, continued its decline in June after reaching a yearly peak in April 1975. Similarly, the number of permits issued for single-family units, a component of the total figure, also continued to decline from its April high. Despite these declines, however, both of these statistics were well above last June's level, when the number of permits issued fell precipitously.

Interviews with Tenth District home builders provided significant insight into the interpretation of these data. Without exception, respondents who build houses costing above $45,000 reported a very strong year. One builder stated: "As far as I'm concerned, everyone must be busy now. We're as busy as we've ever been." Another reported starts 15-26 percent ahead of last year, while a third reported the best year in 3 years. For low priced home builders, however, the situation was quite different. Starts, in this case, were about the same as last year, very depressed. As one Home Builder Association spokesman noted: "We're building just for rich people."

Expectations, on the other hand, were almost universally bleak. While virtually no respondent reported an inventory problem, a great fear was expressed of disintermediation from savings and loan associations, with the consequent high cost and unavailability of mortgage money, the price of which has already risen above 9 percent for conventional loans. This fear of disintermediation,due largely to competition from rising Treasury issue yields, was the principal factor mentioned as restricting the recovery of the housing industry.

Little change has occurred in the District's agriculture over the last month. Several droughty areas have received rain in recent weeks, but for the most part, the fall crops will not benefit appreciably from this moisture due to its tardiness. However, the rains have improved pasture conditions and have provided good moisture for the fall seeding of the winter wheat crop, which will soon be underway.

For the first half of 1975, cash receipts from farm marketings in the District were 10.2 percent below the same period in 1974. This compares with an 8.1 percent fall nationally. However, given the developments in farm prices over the last five months, earlier estimates of net farm income for 1975 will almost certainly be revised upward. Interestingly, the sharp run-up in grain prices during July was partly responsible for a 13 percent drop in the placement of cattle in feedlots in seven major feeding states, the first such year-to-year decline since February. Should this trend continue, the supply of grain-fed animals will remain tight longer than previously expected.

Tenth District bankers contacted in a recent telephone survey indicated that except for consumer loans there were few signs of strengthened loan demand. Weekly Reporting Banks data for August showed a similar pattern in that the total volume of loans (other than Federal funds sold) fell more than seasonally during the month while consumer instalment loans rose sharply. Surveyed bankers also indicated that they had stepped up their investments in securities in recent weeks to compensate for the continued weak loan demand. Deposit growth was reported to be stronger than seasonal in recent weeks, with a large increase in demand deposits partly offsetting a decline in time and savings deposits.

Bankers contacted in the survey were generally uncertain about the behavior of the prime rate and other interest rates between now and the end of the year. Some bankers thought interest rates were on a plateau and would remain so in the months ahead, while others thought interest rates would continue to rise.

ELEVENTH DISTRICT - DALLAS

On balance, economic barometers of the Eleventh District indicate recovery is under way. The unemployment rate in the District states peaked at 7.4 percent in May and by July was down to 7.0 percent. Additional strength in the labor market is evident. In Texas, which accounts for roughly 60 percent of total employment in the District states, initial claims for unemployment insurance have fallen to about half the peak level last February. Moreover, the average workweek in manufacturing in the state stands at 40.6 hours, up from the low of 39.7 hours.

In addition, industrial production in Texas--over two-thirds of all industrial output of the District states--has trended upward since March with increased petroleum refining and output of chemicals and primary metals. The rise in production levels has boosted the Index of Manufacturing Capacity Utilization at an annual rate of 3 percent.

Consumer spending in the District is also strengthening. Department store sales, seasonally adjusted, have risen 11 percent since April. Executives of the District's leading retail stores report a solid recovery is under way. Increased sales are broad-based across all consumer product lines, inventories are generally at low levels, and credit card delinquencies are well within acceptable limits.

New car sales are booming. Seasonally adjusted registrations of new cars in the four largest metropolitan counties of Texas rose 16 percent and 11 percent in June and July, respectively. A survey of new car dealers indicates August sales are keeping apace with July's sales rate. A consensus of those polled suggests that, unlike last year, price hikes for the 1976 models are having only modest impact on sales because the announced increases are much smaller than the markups were on the 1975 cars.

In addition, on Detroit's recommendation, dealers are down-playing the price differential. Dealers expect 1976 to be a reasonably good model year, particularly since there appears to be a strong rebound in company car sales and fleet leasing, a market that dried up a year ago.

Homebuilding in the District remains badly depressed. While single-family construction is down only slightly from a year ago, apartment building has fallen sharply. In Texas, for example, the number of building permits for multifamily units is running nearly two-thirds behind the pace of a year ago. Lenders report that the costs of building and operating multifamily complexes--particularly utility costs--are rising so rapidly that apartment construction cannot be profitably undertaken. Even in Houston, where homebuilding has held up better than in any District city, multifamily construction is down more than a third from last year's level. And in San Antonio, the inability of apartment owners to recover costs has resulted in 41 notices of foreclosure this year, representing $45 million in property value.

A survey of the largest savings and loan associations in the District indicates mortgage markets are tightening. In July, the rate of saving inflows at District thrift institutions slowed and withdrawals increased sharply. In August, disintermediation accelerated. Thrift institutions in Houston appear to have been the hardest hit. The largest savings and loan association in that city had a net savings inflow of only $500,000 in August, as compared to $7 million in July. Four other associations in Houston reported net outflows in August. In Dallas, the leading S & L's stated net deposit inflows in August were down to roughly half of July's pace. As a result of deposit losses, several mortgage lenders warned that their institutions are rapidly approaching a liquidity crunch, particularly since liquidity requirements were raised September 1.

Faced with tighter liquidity positions, most thrift institutions in the District have raised mortgage rates a quarter of a percentage point since midsummer. Moreover, the consensus of the savings and loan officials contacted is that rates will continue to climb. The president of a large S & L in Houston admits that in anticipation of higher yields by year-end, he has raised loan rates above the prevailing rate to discourage borrowing at the present time. Instead, he plans to wait and aggressively seek loans after rates have climbed another half point.

Rising costs of savings are also exerting upward pressure on loan rates. All the thrift institutions contacted reported portfolio costs are continuing to climb. The president of an S & L in Dallas, for example, said the cost of his savings portfolio had risen from 5.96 percent to 6.53 percent in the past year, or nearly 5 basis points a month. A primary reason for increased portfolio costs, according to these lenders, is a shift of savings out of passbook accounts into 7 1/4 percent and 7 1/2 percent certificates of deposit.

Disintermediation is expected to worsen. Moreover, the expectation that the country is entering another period of tight money is already curtailing homebuilding. Virtually all the S & L's surveyed reported that contractors have cut back sharply on the number of units they are planning to build to avoid being left with sizable inventories of homes when mortgage money dries up.

TWELFTH DISTRICT - SAN FRANCISCO

Our directors report a growing concern over price increases. Inflationary expectations appear to have increased as a result of rises in fuel and food costs. Interest rates are also on the rise in spite of lagging demand for loans. Consumer spending is picking up slowly but construction activity remains depressed.

Consumer spending is currently being affected strongly by the prospect of higher food and fuel costs. For example, it has speeded up conversion to small cars which signals awareness of the need to conserve, and a willingness to adapt to lower cost substitutes. The high current rate of consumer loan delinquencies as well as high interest rates will deter maintaining expenditures through borrowing, but credit demand will increase somewhat, in part because of higher prices. Growth in retail sales, therefore, is expected to be slow over the next six months.

Many of our large manufacturers on the West Coast expect shortages of fuel oil and natural gas this winter and contingency planning is in effect. No inventory build-up is being observed and operation rates continue to be closely geared to the pace of incoming orders. A sudden cutback in fuel availability would translate into a decline in final sales almost immediately. Research into substitute sources of energy is being emphasized. One large lumber manufacturer reports that his firm is already converting its firing systems from natural gas to wood fuel.

In very few cases is the existence of unused capacity dampening the passthrough of increased costs. When questioned about price increases, a leading manufacturer of aluminum responded that current low profit margins could not justify further capital spending as long as costs continued to escalate without offsetting productivity increases. He anticipates a return to double-digit inflation in the "not-too-distant" future. Directors are worried about higher interest rates and the reimposition of price controls. Most believe, however, that the inflationary momentum will not be sufficient to stop the recovery currently underway although there appears to be less confidence today than was apparent two months ago.

Bank of America expects that the following specific forces are likely to place upward pressure on wholesale and consumer prices over the next six to nine months:

a. higher than orginally anticipated growth in aggregate demand over the period;

b. lower than historical post-recession productivity increases, at least initially;

c. an increase in the price per barrel of oil due to a combination of a price increase by OPEC and partial or complete decontrol of domestic old oil prices;

d. a continuation of food price increases for the remainder of this year;

e. a continuation of relatively high wage and fringe benefit settlements;

f. increased importation of high priced raw materials; and

g. increased cost pressures directly related to purchases of pollution control equipment in a large number of industries.

The construction industry continues to show little sign of a strong recovery. Some nonresidential projects have been cancelled or stretched out and state governments have placed tight lids on expansion projects. Residential building too is almost at a standstill according to our directors, with little hope of a major turnaround in sight over the near future.

The expected increase in food prices stems partly from the fact that agriculture uses a large amount of fuel and that many fertilizers are derived from natural gases and other petroleum base products. The increased return to farmers from higher prices is expected to be wiped out by higher costs. In the District's dairy farming operations, higher grain feed costs and energy prices will further aggravate the adverse price relationships which have held dairy farming in a depressed condition for more than a year. Low plantings of potatoes elsewhere in the United States has resulted in a shortage with high prices which should benefit growers in Washington where output is normal.

Large commercial loan activity continues very quiet and demand deposits related to usage of money are down compared with a year ago.