CONFIDENTIAL

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

September 15, 1976

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SUMMARY*

Continued moderation in the pace of economic activity highlights reports from most Districts. Several Districts report spurts in retail sales in August, but few report signs of strengthening in manufacturing and housing. The recovery in capital goods continues at a gradual and uneven pace, and the outlook does not suggest substantial acceleration in the short-term. Concern over possible shortages and bottlenecks appears to have diminished with the slower rate of recovery. Business loan demand remains weak, and there is little indication of much revival for the next several months. Drought, especially in the corn belt, has reduced harvest prospects for corn, soybeans and cotton, suggesting possible upward price pressures for those crops and for cattle.

Most Districts report a spurt in consumer sales in August. The pickup reported in most areas was mixed, but New York was especially encouraged by "substantial momentum in recent weeks" across all product lines. New car sales were strong across the nation, but other big-ticket items and the tourist trade moved well only in some Districts. The outlook for consumer spending for the rest of the year ranged from continued steady improvement in Philadelphia, Cleveland, Chicago, and San Francisco to little change in Richmond.

Manufacturing activity continues to improve gradually and unevenly. Further strengthening is noted in Philadelphia, Atlanta, St. Louis, and Minneapolis; but Cleveland reports declines in steel, Atlanta and St. Louis declines in paper, and Dallas reports slower growth in chemicals. Philadelphia's most recent survey of manufacturers showed that two-thirds of the respondents expect continued gains in manufacturing over the next 6 months, and Minneapolis reports its latest survey showed manufacturers expect substantial gains in sales for the next three quarters.

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*Prepared by the Federal Reserve Bank of Cleveland.

Reports on residential construction suggest fairly strong demand for single-family housing. St. Louis notes that low vacancy rates for apartments in St. Louis and Little Rock spurred plans for new apartment projects. A special sales incentive program doubled condominium sales in Memphis. San Francisco reports a rise in home building in Southern California and Utah has stimulated lumber sales production.

Despite the moderated pace of recovery, businessmen are still optimistic over prospects. Cleveland, Philadelphia, St. Louis, and Kansas City all indicate little fear exists that the recovery will prematurely peak. Nevertheless, inventory and capital spending plans of business appear to be cautious. Richmond reports that some manufacturers still view their inventories as higher than desired. Philadelphia's survey shows manufacturers plan little addition to inventories for the next 6 months. There is still some liquidation of stocks, including copper, linerboard and corrugated paper, electrical machinery, and sheet steel.

There is still little indication of a surge in capital spending. Ample capacity and projections of only moderate growth in demand over the next year or so are among factors that are dampening spending. For capital goods producers, recovery is spotty. Perhaps most encouraging reports are those from Chicago and Cleveland, where sizable increases in machine tool business occurred in the last few months. Recent increases were also noted for heavy-duty trucks and drilling rigs. However, both Chicago and Cleveland comment that demand for machinery, such as cranes, construction machinery, and mine shovels, is still weak.

Concern over shortages appears to have diminished. Tightness in steel products virtually disappeared with the sharp drop in demand for flat-rolled products, which some producers were informally allocating a few months ago. Spot shortages may appear for a limited number of products, such as special castings, snow tires, and some chemical products, but District reports suggest no widespread bottlenecks or shortages are now apparent or in prospect.

Business loan demand remains weak and the outlook suggests little to moderate recovery over the next several months. Boston and San Francisco cite the lack of inventory building, the inability to recover return on investment, and the availability of funds from other sources among reasons for the continued sluggishnesss.

Drought in several parts of the country has reduced yield estimates for corn, soybeans, and cotton, according to reports from St. Louis, Kansas City, and Minneapolis. However, Kansas City reports the corn harvest is still expected to slightly exceed the record 1975 harvest. Sharp declines in supplies of soybeans from 1975 will likely cause upward price pressures, but the outlook for corn prices remains uncertain. Minneapolis, San Francisco, and Richmond report wheat, fruit crops, and flue-cured tobacco harvests are expected to range from good to excellent.

FIRST DISTRICT - Boston

Most New England directors report that little has changed from last month. However, some retailers have become increasingly anxious about their disappointing sales volumes. Some machine tool manufacturers and parts suppliers, on the other hand, are pleased to see the first signs of a recovery in new orders. Except for lumber suppliers, the directors have noticed no indications of inadequate capacity in the industries with which they are familiar.

According to the banking directors, loan demand remains very weak throughout most of the region. Not only are businesses avoiding building inventory stocks and the attendant short-term debt, but commerce has not justified a notable expansion of fixed assets on the part of regional industries. Consequently, the banks are not under pressure, and one director comments that, "The Board of Governors will be pleased: it looks like they can get through the elections without making any waves." In fact, one large bank in Connecticut is forecasting only a 10 percent increase of commercial loans over the next 16 months.

The retailers are not of one mind this month. Many report that sales were "good" in August, while others were disappointed by low volumes. The optimists are anticipating rewarding fall and Christmas seasons, while the pessimists are considering more aggressive promotional strategies in the fourth quarter. Retailers believe they are failing to maintain their share of discretionary personal income.

Machine tool manufacturers are also receiving divergent signals. Some report that August's level of new orders is very encouraging. Others are worried. Of course, firms supplying the motor transport industries are well appointed with orders, but machine tool manufacturers who supply other industries tend to be less excited. In one recent development, new orders for drilling rigs have increased significantly after the nationwide gas price announcement.

All of our academic correspondents--Professors Eckstein, Houthakker, Samuelson, Solow, and Tobin--were available for comment this month. All had similar assessments of the state of the economy--the economy is muddling along at only about the same rate as in the second quarter, although no prospect of a downturn is in sight. Houthakker and Tobin each regard the slowdown as vindication of the views they had previously expressed--that moderate monetary growth targets go along with a moderate recovery. These academicians differed in their preferred policy response. In view of the progress so far against inflation and the lack of progress in reducing unemployment, Houthakker feels that there is room for a slightly higher rate of monetary growth. To insure continuing progress in reducing inflation, Houthakker favors a long-term monetary target of about 5 percent. Eckstein, Solow, and Tobin did not welcome the pause in activity. The prospect of continuing growth at approximately the trend rate certainly rules out the desirability of tightening. Due to the vagaries of money demand, each favored a policy of stabilizing short-term rates at their present levels. Samuelson was also concerned by real growth far short of socially desirable target rates for this stage in the expansion. He feared the combination of relatively loose fiscal and tight monetary policy would stifle the capital formation needed in the basic industries. If money demand has been weak due to the pause in the recovery, stable rates actually starve the economic system. Samuelson preferred downward pressure on rates now; he would be fully prepared to reverse course subsequently, if the economic data start to come in strong.

SECOND DISTRICT - New York

Scattered signs of pickup in the pace of business activity in the Second District were reported by directors and businessmen who were contacted recently. In early September, there appears to have been a substantial rebound in New York City's retail sales. The strength of this improvement was so pronounced that merchants expected its momentum to carry through the remainder of the month. Other sectors of the region's economy appear much less buoyant and continue to lag behind the nation's recovery. In the view of respondents, inventory investment appears unlikely to be stepped up significantly; and while capital spending is increasing, it has gathered little momentum in this District. The financial scene reflects these developments, with loan demand showing few signs of reviving.

Retail sales in and around New York City appear to have gained substantial momentum in recent weeks. Executives of several leading department stores reported a surge in consumer buying activity that began with the Labor Day weekend. One department store official characterized sales as "tremendous," and other respondents felt that sales gains were substantial and well above typical holiday and back-to-school buying. The pickup was large enough that a vice president of a national retailer observed that New York sales, which had been lagging the rest of the nation, had now caught up to the nation. The pickup in buying cut across all product lines, but smaller kitchen and personal care appliances were pointed to as leading the advance in one department store.

In the view of at least some merchants, Sunday openings have been an important factor in adding further impetus to the recovery in consumer buying. Major department stores in New York City and the metroplitan area last month began to open their doors on Sundays, and Sunday openings appear to be gaining acceptance among retailers. Most retailers were convinced that Sunday hours have added substantially to total sales rather than merely redistributing daily sales within the week. In addition to providing a shopping day to those who work on Saturday, merchants noted that heads of households were more likely to shop on Sunday, thus increasing the likelihood of big-ticket or credit buying. Whatever the cause of the acceleration in consumer activity, most retailers expected the momentum to carry through the month.

Directors of the Buffalo Branch were less sure of the upturn in consumer spending and were generally gloomy over prospects of the fall selling season. The reluctance of consumers to spend was attributed to a lack of sufficient confidence as well as continued concern about job security. The president of a Buffalo department store chain reported August sales were below a year ago; however, at the same time, the chief executive of a major Rochester retail firm stated that conditions had improved.

With respect to the outlook for business fixed investment spending, Second District directors reported little evidence of a step-up in capital spending plans. The chairman of a multinational oil company observed that the percentage increase in petroleum industry spending would exceed the rate of price increases. One executive in the electrical construction business reported a shift from governmental to private spending as limited evidence of a revival of capital spending plans in Western New York.

Capital goods production in the District continues to lag, however. Most producers report some pickup in new orders, but business remains below their earlier expectations. The corporate treasurer of an industrial machinery producer termed the overall recovery of new orders "spotty." One machinery equipment manufacturer felt that part of the flatness of his order book was due to buyers holding back orders until after the September machinery show in Chicago. New orders at a tractor and crane manufacturer had edged up slightly since early summer, but the backlog at this firm has been almost completely eroded. A major steel maker located in Western New York reported that demand for structural steel continued to languish. He explained that the operating rate of his firm's upstate plant had held near the company's average due to the strong demand for flat-rolled products. While some of the sluggishness in capital goods production in the region is due to the sluggish recovery in national business spending, a bank economist emphasized the maturity of the region in this connection. As a result, this analyst felt that the region's capital goods industries could be expected to lag behind the national recovery in investment goods demand.

Business inventories by and large appeared to be in relatively good balance with sales. Most of our directors viewed the early summer increases in inventories largely as the result of weaker than expected sales, but none felt that the increases were excessive. Buffalo directors observed that overall inventory levels were somewhat low in relation to sales and expected moderate stock building over the balance of the year. Retail respondents appeared to be relatively satisfied with their sales-inventory balance but reiterated that tight controls were being held on inventories. One electrical machinery manufacturer, however, reported that inventories were high and that his firm was in the process of working them down.

Second District bankers saw little evidence of a recovery in business loan demand as yet in New York City, although some recovery was observed in some outlying areas. For example, one director noted signs of a sustained recovery in business loan demand in the Binghamton area. Most of the Second District bankers contacted outside of New York City expected loan demand to strengthen during the next several months, but a majority of the New York City bankers foresaw flat loan demand for some time to come.

THIRD DISTRICT - Philadelphia

Economic activity in the Third District is expanding, but at an uneven clip. While performance in the retail sector is mixed, conditions in manufacturing continue to improve gradually. Gains are reported in new orders and shipments, while work forces and inventories in manufacturing are unchanged. The longer-term outlook both in retailing and manufacturing remains optimistic. Bankers report that business borrowing is still weak and expect this to continue in the near term. Businessmen indicate that prices are still rising, but no substantial change in inflationary pressures is evident. Major manufacturers in the District report that production capacity is adequate to meet current requirements and expect to be able to meet customers' demands in the foreseeable future.

Manufacturers responding to this month's business outlook survey report that business is better than in August. Four out of ten executives surveyed indicate improvement in overall business conditions compared to three out of ten last month. New orders and shipments are higher; and inventories, which declined last month, are reported to be unchanged from a month ago. In terms of employment, the factory workweek is fractionally longer this month, while work forces are at the same level as in August. This is the first time since March that no growth has been recorded in the number of employees in manufacturing.

Despite the current pause in the national economy, the outlook in area manufacturing for the next 6 months is optimistic. Of the businessmen surveyed, two out of three project a higher level of economic activity by next March. Increases are anticipated in new orders, shipments and employment. At the same time, higher levels of spending for plant and equipment are projected by 40 percent of those surveyed--roughly the same proportion of respondents as last month. No additional investment is planned in inventories, which are expected to be virtually unchanged from present levels.

Retailers in the area paint a mixed picture with sales ranging from 16 percent above, to a level slightly below, the same period last year. No specific merchandise lines are cited as particularly strong or weak. The majority of retailers feel that "things are looking up" compared to the lull of a few months ago, but they view this improvement as gradual and below the forecasts they made earlier in the year. The outlook for the near term is for an improved sales picture, although no big surge in buying is expected until late in the year. One merchant anticipates a boost in sales after the election, and another looks for a loosening of purse strings for big-ticket items around the holidays. If this occurs on top of normal gift buying, this retailer feels that the fourth quarter will be fairly strong. However, he's doubtful that it will show any substantial improvement over the last quarter of 1975.

On the inflation front, manufacturers report paying and receiving higher prices this month. One-half of the executives in the current survey report paying more for their inputs, and one-third indicate charging higher prices for outputs. Over the next half year, 84 percent expect to be paying more for their supplies and 75 percent anticipate higher prices for their finished products. At the same time, retailers report that the hesitancy in consumer demand is helping to moderate the upward movements in the prices they pay for supplies.

Bankers in the region report that loan volume remains basically flat. Consumer loans are level or up somewhat, but there are no signs yet of any recovery in business borrowing. At the same time, retail savings deposits are rising, although most bankers feel that the increase has been disappointing in the face of the softness in short-term interest rates available elsewhere in the market.

Down the road, bankers are looking for the lull in business loan demand to continue. According to one executive, "We don't expect volume to improve before yearend, at the earliest." Another sees the possibility of the weakness continuing through the first quarter of 1977. The outlook for interest rates is for little change over the rest of 1976; and for 1977, forecasts of the prime rate call for an average of about 7 1/2 percent. This is down from a few months ago when a prime of 8 percent was considered possible by yearend 1976.

The question of production capacity was examined with executives in the food, apparel, chemical, petroleum, steel, nonelectrical machinery, and electrical machinery industries. For all of these industries, except chemicals, business is reported to be the same as, or better than, in June. Nevertheless, no major supply bottlenecks are reported, and any increased pressure on production capacity seems to be minimal.

Compared to a few months ago, operating rates in food, apparel, and petroleum are unchanged (90-95 percent). In chemicals, an executive of one large company notes that utilization in some fiber operations is down to 70 percent from 90 percent in early spring. At the same time, a major steel producer notes that one plant manufacturing rails is running near capacity, but another producing structural shapes still has plenty of slack. Conditions at both of these plants are about the same as in June. Two industries that report declining excess capacity are electrical and nonelectrical machinery. But in both of these industries, such reductions in unused resources appear to be slight. Operating rates are put around 85 percent--at most, only a few percentage points above June levels. Delivery times are lengthening in these industries, but not "significantly" according to the executives contacted.

For the longer term, manufacturers expect capacity utilization to rise somewhat, but none of the officials contacted foresees substantial problems in meeting customers' demands over the next 6 months.

FOURTH DISTRICT - Cleveland

Recovery in the Fourth District, as in the nation, continues at the moderated pace of the past few months. Directors, financial officers and economists, although somewhat more skeptical than they were a few months ago, are still generally optimistic that recovery will be sustained into 1977. Skepticism in part reflects erratic behavior in consumer spending, modest revival in capital goods and some scaling down in steel orders and output.

Directors and financial officers appear somewhat apprehensive over prospects for the economy, but economists expect recovery in real GNP to continue at a rate of 4 1/2 to 5 1/2 percent during 1977. Directors view the recovery as from "very healthy" to moderate. They expect errors in projections to be on the downside. Economists appear less concerned that recovery will slow further from the pace of recent months. Except for an economist associated with a retail chain, there is little fear that the recovery will peak in 1977. Economists view recent weaknesses in retail sales and steel as transitory and the slower pace of output in recent months as typical for the second year of the recovery.

Erratic behavior of consumer spending is one of the key uncertainties expressed by some of the directors and economists in the District. Shifting in consumer spending from autos and apparel to services, travel and food was cited by some respondents to explain recent consumer behavior. Sales of food, meat, laundry and persoanl care items did not slump in recent months, according to directors and economists associated with food processing and consumer goods manufacturers. Home remodeling continues very strong, according to a director with a major producer of those products. Another director and manufacturer of consumer housewares expected retail sales to remain stable in the months ahead. Most of the concern and uncertainty comes from retailers of department store goods. An economist with a national department store chain noted that apparel sales did not pickup in August and expressed concern that the slump in real GAF sales has been caused by a continued squeeze on consumer purchasing power. A director with a national retail chain noted that the slowdown in retail sales has been widespread and has caused an unanticipated buildup in inventories.

Recovery in capital goods continues to be gradual and spotty, and comments from directors and economists with these producers tend to reflect different patterns in timing and magnitude of recovery in their respective industries. Orders for machine-cutting tools rose about 70 percent so far this year compared with the same period last year, but backlogs are still not rising, according to one major tool producer. Orders for another large tool builder were up sharply in July and August, to a level nearly double their average for the first half of 1976; but this volume is still about 75 percent of their desired operating rate. A major supplier to heavy-duty truck producers notes its orders have gains strength since the trough early this year. Orders rose 10 percent in recent months, largely because inventory liquidation of heavy-duty trucks is finally over and inventories are back to a normal level. A major bearing producer and supplier to capital goods firms notes its orders from railroad and construction machinery firms bottomed out in recent months, but there is yet no evidence of an upturn. The decline in orders for some type of construction machinery, such as wheel loaders and bulldozers bottomed out last spring, and demand is "just limping along," according to one economist. Demand is expected to improve gradually during the balance of this year but is not expected to recover to previous peaks during this business expansion. Another official with a capital goods firm that produces hydraulic excavators and cranes also sees little prospect for any significant improvement over the next year because of high inventories held by distributors, lack of funds for sanitation, waterworks and other public construction, and squeezed profit margins that prevent contractors from purchasing new construction machinery. Bids for heavy construction work are still running below a year-ago, and contractors are frequently bidding below engineer costs in order to get business.

The recent slide in steel output has reduced utilization of capacity to nearly 85 percent of capacity, compared with the second quarter average of close to 90 percent. Steel producers have lowered their estimates of output for the balance of this year to an 80-85 percent of capacity range. Demand for hot-rolled steel products, which some producers were informally allocating last quarter, has softened; one economist commented that the psychology of steel buyers shifted rapidly from fear of shortage to fear of excess inventories. Rescinding of a schedule of price increases on October 1, price hedging that ballooned orders for hot-rolled products last quarter, and lagging revival in captial goods are among reasons cited for scaling down of projections for steel production next quarter. On the other hand, steel economists were not apprehensive that the overall recovery would soon peak, and still expect real growth in 1977 at about 4 1/2 to 5 1/2 percent. One economist expects the industry to operate at 90 to 95 percent of capacity during the first half of 1977 but commented that shortages of steel are unlikely.

Production in the rubber industry is expected to reach about 75 percent of capacity in the first month of resumption in work, 90 percent in the second month and 100 percent in the third month, according to an economist with a major tire producer. Therefore, spot shortages may appear, especially for snow tires.

Manufacturers generally seem to express less concern over shortages than they did a few months ago when the pace of recovery was more rapid. Capacity for a variety of capital goods appears more than ample at least through 1977, although some spot shortages, such as castings, can develop as machinery production approaches higher utilization rates. Some chemical products, including polyvinyl chloride, polyproplene, and chlorine, now in tight supply, could be in short supply by yearend if demand continues to strengthen as much as it has in recent months.

A small sample of savings and loan associations in the District shows savings inflows during August slowed, and mortgage lending and mortgage terms were relatively unchanged from July. Liquidity of associations was somewhat lower than in July, as some S&Ls stepped up borrowing from FHLBB, partly because deposit flows during the summer months were less than needed to meet commitments.

FIFTH DISTRICT - Richmond

Judging from our latest survey of Fifth District business conditions, the level of activity among manufacturers showed little change in the past month. The level of shipments, in fact, has remained essentially unchanged since June, while the volume of new orders has registered minimal declines in each of the past 3 months. Backlogs of orders and finished goods inventories are down somewhat from July, and stocks of materials are reported to have risen slightly since then. Manufacturing inventories remain somewhat above desired levels as does current plant and equipment capacity. Retailers apparently experienced some improvement in sales during August, but at least one respondent attributes this to heavy price markdowns. Sales of big-ticket items continue to lag relative to total sales. Demand for bank loans remains soft. In the agricultural sector, dry weather for the past several weeks has damaged pastures and most major crops in wide areas of the District.

Survey responses of District manufacturers exhibit much the same pattern as in the past 2 months, suggesting a stable level of shipments, some weakness in the volume of new orders, and a small decline in order backlogs. Some accumulation of materials inventories in August is indicated, but over one-third of the respondents report reduced stocks of finished goods. Thirty-seven percent of the manufacturers still feel current inventory levels are higher than desired. Current plant and equipment capacity remains somewhat above desired levels, but there seems to be little sentiment for altering current expansion plans.

Manufacturing employment continues to rise, although more slowly than in the second quarter. Hours worked per week also increased slightly in August. Prices, including employee compensation, remain under some upward pressure as nearly one-half of the manufacturers report increases. Respondents remain essentially optimistic as most expect further improvement in the level of business activity nationally, locally, and within their respective firms over the next 6 months.

Most of the retailers surveyed report increased sales during the latest month, but sales of big-ticket items failed, once again, to keep pace. Despite this apparent improvement in sales, comments of respondents retain a somewhat negative tone. One respondent attributed sales increases solely to heavy discounts. Another cites a lack of consumer confidence, unemployment, and rising prices as adverse factors.

Inventories at retail apparently grew over the past month and remain above desired levels. Nearly one-third of our respondents, however, view their current number and size of outlets as inadequate. Prices generally continue to rise as three-fourths of the retailers reported paying and nearly as many reported receiving higher prices this month. Most of the retailers responding to the survey expect little or no change in the level of activity, nationally or locally, over the next 6 months, although over one-third expect sales in their own firms to improve over that time period.

There continues to be no indication of any serious problems arising from supply or capacity constraints. In most industries surveyed, there are no problems at all while others are experiencing no worse than minor lengthening of lead times. There are some isolated cases, principally in the area of building materials, where the performance of key suppliers is hampering the operation of individual firms. Such cases are rare; and if there has been any recent change in the outlook of District manufacturers regarding supplies and capacity, it has been toward optimism.

Commercial and industrial loans have shown no signs of recovery in recent weeks, except for the expected seasonal strength from local agriculture related companies. There has been some increase in loans made to durable goods manufacturers, but loans to retailers have been flat and those to wholesalers have declined. More than half the respondents to our August survey of changes in bank lending practices have indicated that they expect moderate recovery in business loan volume in coming months. Consumer loans continue to follow their recent pattern of advance, showing steady if unspectacular increases. Growth in real estate loans has been negligible. Agricultural loans remain strong.

Very poor pasture conditions in Virginia are forcing farmers to step up the sale of livestock and increase early feeding. With a continued upswing in quality and grade prices in recent weeks, the general average price for flue-cured tobacco is now running 14 percent above a year ago. Sales volume has been heavy, and the value of gross sales is up 36 percent. District farm income during the first half of 1976 recorded a 3 percent increase over a year earlier compared with a 14 percent gain nationally.

SIXTH DISTRICT - Atlanta

Uneven gains continue in the Southeast; the geographic areas of greatest relative strength and weakness remain unchanged. Retail sales strengthened in late summer, following earlier weakness. The improved financial position of consumers is evident in reports of lower delinquency rates. Tourist activity has been disappointing, except in Tennessee. Production increases are noted in the carpet, furniture, and apparel industries, but paper, consumer durables, and construction-related manufacturing are experiencing cutbacks. Several mining operations have been plagued by layoffs and strikes, but new construction and mining projects create a more promising outlook.

In South Florida, the economy is described as generally healthy but not robust. Pockets of recession remain in real estate. However, a general sideward movement is viewed for the most part as a seasonal slowdown. In Central Florida, a slowing of the expansion is attributed to weak tourist activity; again, a lateral movement is perceived. In contrast, Louisiana directors note continuing slow but steady progress. Ongoing improvement is also noted in Alabama. A steady rate of expansion continues in Tennessee.

Mixed feelings are expressed concerning this summer's retail sales in South Florida. Disagreement exists as to whether sales have exceeded or simply equaled those of a year ago. Only slight gains have occurred in Central Florida, but larger advances are anticipated in the fall. Auto sales are a key area of strength. In Louisiana, soft goods sales have been weak, and retailers are entering the fall season with caution. However, reports from Mississippi indicate sizable gains in merchandising. Again, automobiles are a bright spot. Alabama retailers report that weakness during most of the summer was followed by sales gains from late July through early September. Inventory levels are reportedly healthy. Tennessee retailers cite a similar sales pattern; with early weakness followed by acceleration in late summer, they remain cautious but optimistic. Auto sales continue to set records.

Strength is apparent in the do-it-yourself home improvement market. A building materials supplier reports strong sales, and lenders cite gains in home improvement loans. Loans are also being made for car repairs as an alternative to new car purchases. Delinquency rates have declined sharply.

Much of Florida's weakness in retail sales is attributed to a slowdown in tourist traffic. Occupancy rates in South Florida have declined. This slowing is attributed to the attractiveness of bicentennial observations in other tourist centers. A good winter season is expected, now that this unique seasonal influence has dissipated. Tourist trade has also been disappointing in Central Florida. One attraction notes an 11-percent decline in traffic during July. As a result, services employment in the restaurant and lodging industries has declined. Reports from Tennessee suggest that the tourist industry remains a bright spot. The opening in early September of the Georgia World Congress Center for a major apparel trade show boosted hotel occupancy and tourist-related business in Atlanta.

Industrial developments include an increase to four shifts at a Georgia carpet factory. Several Southeastern producers of linerboard and corrugated paper are reducing production because customers are cutting their inventories. A major supplier of metal products notes unusually large stockpiles of copper goods. Manufacturers of furniture and apparel are increasing their output. Lumber demand continues to be strong, with most grades selling at record high prices. An aluminum manufacturer reports operations at maximum capacity. Two comments reminiscent of 1975 find a Tennessee manufacturer of appliance timers cutting production and an industrial lighting manufacturer experiencing a slowdown in orders.

Layoffs in Florida's phosphate industry continue to boost that State's unemployment rate. Over the past 3 months, more than 1,000 workers have been dismissed. A Tennessee director reports layoffs resulting from Federal environmental regulations which caused several strip mines to be closed. Most Alabama coal mining operations were shut down by wildcat strikes which began in mid-July; over 2,000 workers have been idled. An economy move by a major electric utility in Florida has laid off 615 construction workers and 250 office personnel. Employment in Tennessee will receive a major impetus over the next 4 years. Thirty thousand new jobs are expected to result from large Federal construction projects in the energy, defense, and metals industries. A major zinc mining project has also begun in Tennessee. Additional mines and ore processing facilities to be opened at the site will employ between 600 and 700 persons. Other companies are also expanding existing zinc operations in this area. A Louisiana shipyard has received a Navy contract to construct two ships; 520 men will be employed for 46 months.

SEVENTH DISTRICT - Chicago

The gradual improvement in general economic activity continues in the Seventh District. However, final sales of some items--e.g., apparel, household appliances, and medium and heavy trucks--have not matched expectations. Inventories are generally "in good shape," although on the low side in some cases. Fears that shortages would develop late this year or early next year have diminished. Attitudes of business executives and most consumers remain cautious, with an eye either to possible shortfalls from forecasts, or possible adverse political developments. Capital expenditures appear to be gaining strength, overall, but very gradually. Credit is in good supply in all sectors. There are some signs of revival in nonresidential construction. Forecasts of interest rate increases are more moderate as loan demand from both the business and consumer sectors has been less than expected.

Many business executives, who report demand for their products to be far less robust than in 1973 and early 1974, emphasize that they look back upon the chaotic multiple-ordering and gray markets of that period with horror. Distortions, partly caused by price controls, made accurate readings of the underlying strength of their markets impossible. Businesses are attempting to keep tight control on costs relating to capital expenditures, purchase commitments, and use of labor. Some say that "the financial people are in control today," rather than the sales people who made the big decisions in the last boom.

Lead times have lengthened further on average, despite margins of unused capacity. Cancellation of the scheduled October 1 steel price boost reflects buyer resistance and their reluctance to build inventories. Except for a few items such as special castings, there are no reports of current shortages. The 130-day tire strike, apparently, did not affect vehicle output at all, but supplies of snow tires may be tight this winter. Relatively easy supply situations do not necessarily mean stable or declining prices. Producers have raised prices of rubber products substantially, although "quietly." In another example, paper prices are expected to average 5 to 7 percent higher this year, followed by another 6 percent rise in 1977, despite ample capacity.

Large retailers indicate that sales were stronger in most departments in August. Apparel and fashion goods sales continue below forecasts, however. Retailers' inventories are judged to be fairly well-balanced because of cautious ordering policies. Sales are expected to rise further in the months ahead.

Sales of major appliances are below expectations with freezers far below last year. Sales of "built-ins" going to individual remodeling projects as well as to new construction are quite strong.

Retailers and other suppliers of consumer wants comment that luxury products are in strongest demand, a phenomenon noted throughout the recession. Airline travel measured by passenger miles has been about 10 percent above last year in recent months with all of the gain in pleasure travel. Flights to Hawaii are virtually filled.

Sales of autos and other vehicles to consumers have continued at an excellent pace. As many dealers exhausted their supplies of large cars, sales of small cars, including imports, were stimulated. Some small cars have been sold at cut-rate prices, especially certain 1975 models still on hand after two years. Inventories of new models are less ample than a year ago and production is being pushed hard with Saturday work typical. General Motors is anxious to "get a reading" on public acceptance of its new lines of lighter, shorter "big cars." Chicago area sales will be watched as a bellwether for the nation.

Light truck sales have been at record levels for some months with a large share going to consumers. Sales of medium (10,000 to 26,000 pounds), have remained slow. Sales of heavy trucks have increased, but not as much as expected, and advanced production schedules may have to be pared back. A producer of diesel engines is operating at all-time high levels, and wonders if orders for truck engines will be maintained. Meanwhile, sales of diesels for construction equipment and industrial uses have not increased significantly.

Most producers of equipment report that demand has improved, but very gradually and the picture is "spotty." In general, it is the "early movers"--smaller equipment and components such as controls and smaller electric motors--that have showed the largest gains with the "laggers," including most types of heavy equipment, still slow. A producer of heavy industrial cranes and large mining shovels reports that order backlogs are eroding rapidly and production may be reduced from current record levels in the months ahead. Machine tool builders have been pleased with recent increases in orders and expect substantial additional orders to be placed during or after the 10-day biennial machine tool show now being held in Chicago (September 10-17).

Stocks of all types of petroleum products are ample. One forecast of the rise in total sales this year has been reduced from 6 to 4.5 percent, mostly because vacation driving has been less than anticipated. A "normal" winter or worse could mean some problems with availability of fuel oil, and, also, further curtailments of natural gas. OPEC nations are now expected to increase crude oil prices by 15 percent at yearend, double the rise expected earlier, mainly because of stronger than expected demand outside the U. S.

Lead times on cold-rolled steel and galvanized sheets have been cut by half since late spring. One forecast of steel shipments for 1976 has been reduced from 98 to 96 million tons because user inventories are not being increased as expected, not because consumption is less than expected. Local analysts point to a change in steel order patterns with "reservation planning" by large users over a longer horizon.

EIGHTH DISTRICT - St. Louis

Economic recovery in the Eighth District continues, but at a slower pace than in the first half of the year. Despite the moderation in growth, businessmen generally continue to be optimistic about future business prospects. Gains in retail sales have been unevenly distributed, reflecting both the nature of the recovery and unusual weather conditions. Manufacturing activity continues to move up moderately for a number of major products, such as chemicals, paper, and home furnishings. Capital goods equipment orders are beginning to increase. Home-building activity is mixed, with single-family home construction generally quite strong, whereas multi-family activity remains at a low level. On the agricultural side, lack of rain over recent weeks has reduced substantially expected crop yields in many parts of the District.

Retail sales have remained on a relatively high plateau over the summer months. Retailers report new fall software items are currently selling fairly well. Sales of certain big-ticket items, such as air conditioners and lawn mowers, were reported to have been sluggish over the summer months as a result of unusually dry and relatively cool weather. Automobile sales, on the other hand, continue strong, particularly among the full-size models.

Manufacturing activity continues to make gains, but at a slower pace in the past few months than earlier in the year. A large paper manufacturer noted that orders slowed in the summer months, but in the last 2 weeks some increased strength in orders has occurred. Appliance manufacturing has also been at a reduced pace in recent months which was largely attributed to a drop off in inventory demand. A representative of the chemical industry reports that most chemicals and plastic products are registering increases in orders, although demand for certain fiber products is weak. On the bullish side, advanced sales for new automobiles are reported to be quite strong, and two large automobile plants in the St. Louis area are planning to add additional shifts in October. One representative of the capital equipment industry reported that demand is currently picking up strength.

Single-family home building continues at a fairly strong pace in most of the District. However, apartment construction is still at a very low level. Reports from St. Louis and Little Rock indicate apartment vacancy rates are quite low, and some new apartment projects are being planned. In Memphis, no new apartment or condominium projects have been under way for a couple of years, but some of the previously started projects are now being completed. Some condominium owners in the Memphis area are offering special sales incentives, and some are offering to buy the condominiums back at the original price after 2 years. Recent figures from Memphis indicate that condominium sales doubled from June to July and in July were about 90 percent above a year earlier.

Nonresidential construction continues at a relatively slow pace. One contractor reported that new commercial projects of any size are hard to find. However, several institutional projects, such as hospitals and government buildings, are under way.

Savings and loan associations report increases in savings deposits in recent weeks at about the same rate as in June and July. Mortgage loan demand continues upward reflecting the increased housing activity. Mortgage interest rates are generally at 8 3/4 percent for an 80 percent loan, up from 8 1/2 percent a couple of months ago. All types of savings deposits at commercial banks, except for large negotiable CD's, have increased in recent weeks. Business loan demand continues sluggish, although increases in consumer and other types of loans have been observed.

The continuing lack of rain in many parts of the District over the past month has dimmed the yield prospects for corn, soybeans and cotton. Parts of

Missouri have been severely hit by drought conditions and reports from Arkansas and Mississippi, indicate that crops in these areas also are being damaged by lack of moisture. Reports indicate that the Arkansas rice crop is generally in good shape, although the current prices for rice threaten to make production unprofitable this year. Soybean production is expected to be down from earlier estimates, and prices are relatively high. Some reporters believe that soybean prices will rise further as knowledge of drought damage becomes more widespread. Reports from Arkansas indicate a sizable increase in poultry production is under way.

NINTH DISTRICT - Minneapolis

The drought continued to plague the Ninth District's farm economy this month, but other sectors seemed to be reviving. Bank directors expected smaller corn and soybean harvests and described the livestock industry as "in a state of confusion." The dryness dampened retail sales in many rural areas, they said, but consumer spending elsewhere was encouraging. Furthermore, recent manufacturing activity dramatically surpassed expectations, and manufacturers were very optimistic. Bank directors unanimously said material shortages were not a problem.

In early September, several bank directors expressed general concern and uncertainty about how the sustained dry weather would affect District agriculture. The already poor prospects for the corn and soybean harvests have been further reduced, but the wheat harvest was quite good. Directors believed the corn and soybean prices would rise in the coming months as wheat prices remain stable or decline.

The confused cattle industry was expected to continue to feel the effects of the drought too. Dryness and high feed prices helped to increase livestock marketings and further depress fed cattle prices to their current low levels. Directors expected higher corn and soybean prices to make profitable livestock feeding still more difficult. However, as the number of cattle declines, livestock prices should improve.

The drought's full impact on the District's farm economy was considered hard to assess. The big crunch should not come until after the 1976 harvest, but the drought's effects could linger for several years.

Drought conditions were already curtailing consumer spending in dry rural areas. A director from Central Minnesota, for example, felt dry weather had noticeably affected his area's spending in recent weeks, and a North Dakota director said uncertainty about the agricultural situation had cut sales of big-ticket items there. Also, farm implement sales were reportedly off quite sharply in the dry areas of Minnesota and South Dakota.

In areas without drought conditions, however, consumer spending was said to be quite good. One large Minneapolis-St. Paul retailer said that after a disappointing August business picked up in early September. In Western South Dakota retail sales were fairly strong this summer and tourist spending was 20 to 30 percent ahead of a year ago. And two directors reported good auto sales in their areas. Consumer spending was curbed somewhat by layoffs and labor disputes in the Upper Peninsual of Michigan, and tourists there were spending less than in other years. But several directors said retailers in their areas expected a good fall and winter.

Even more strength was reported by District manufacturers. According to our August survey, current dollar sales of manufactured goods grew 20.3 percent over a year-ago in the second quarter, the most since the recovery in this sector began in the fourth quarter of 1975, and this is much more than the gain expected in the previous survey. Manufacturing gains were fairly evenly distributed among durable and nondurable goods industries, which were up 21.6 percent and 18.7 percent, respectively.

Their strong second-quarter sales gains probably caused District manufacturers to revise upward their expectations for the next three quarters. In the previous survey last May, they saw sales gains tapering off in the fourth quarter of 1976; but in the latest survey, they looked for fairly substantial advances over a year ago through at least early 1977: 16.3 and 16.0 percent increases in the last two quarters of this year and a 14.9 percent increase in the first quarter of 1977.

Bank directors unanimously said material shortages were not a problem here in early September. Although some concern was expressed about the long-term situation, energy supplies were considered adequate for the winter. The District's farm implement shortages have substantially eased. One director did report some delays in receiving merchandise, but they were termed not excessive.

TENTH DISTRICT - Kansas City

The moderation in national economic activity is not readily apparent throughout the Tenth District at this time. Most purchasing managers contacted report that demand remains strong, although their inventory investment policies, for the most part, remain conservative. The protracted hot, dry weather has taken its toll in the District's agricultural sector, with continued deterioration in the condition of corn and soybeans observable in many parts of the Midwest since September 1. However, current estimates of crop losses suggest that significant upward price pressures for these commodities are unlikely. Business loans fell slightly at Tenth District banks contacted, while the overall level of negotiated certificates of deposit in the District continues to decline.

Discussions with a number of Tenth District purchasing managers suggest that the moderation in national economic activity has not impacted on the District. With the exception of several purchasing managers whose companies are in the consumer durables area, the majority of respondents reported that sales were good. Demand for steel storage facilities is currently fairly strong; and except for demands related to highway construction, sales strength for steel fabrications and other construction materials appears to be holding up. Although lead times from their suppliers have not lengthened much, most purchasing managers do express some concern over steadily increasing prices from their suppliers. One respondent questioned whether the recently announced steel price increases were based on demand and near-capacity operation or were the result of pressure from the auto industry to have steel hikes coincide with price increases on the 1977 models. The recision of those steel price increases reinforced his belief that the order books of the steel industry are still soft and that they backed off in order to strengthen their position. Despite the generally expressed concern over price increases, inventory investment plans remain cautiously conservative. Most purchasing managers contacted indicated that their inventories were adequate and little, if any, shortages were being experienced. No major alterations in inventory are planned unless there appears to be some firming-up in consumer sales.

In conversations with a number of Kansas City Federal Reserve Bank directors, there was little, if any, pessimism expressed regarding economic prospects. One director commented, "there is no feeling the recovery is about to be aborted." Another expressed the view that "the psychology is not gloom," even among farmers who were still angry over the earlier ban on exports which took money out of their pockets.

United States corn and soybean production projections have been reduced as a result of continued warm, dry weather across the Midwest. September 1 conditions indicate a corn crop of 5.89 billion bushels, down from a 6.19 billion bushel projection a month earlier, but still slightly above the record 1975 harvest. A 1.27 billion bushel soybean drop is projected, down from 1.34 billion bushels a month earlier, and 16 percent below 1975 production.

The condition of corn and soybeans has continued to deteriorate in many parts of the Midwest since September 1. In a number of areas some corn fields intended for grain harvest are instead being chopped for silage. Missouri farmers, experiencing weather even drier than last summer, expect yields substantially below normal for both corn and soybeans. Nonetheless, it presently appears that reductions below earlier output projections for corn and soybeans may result primarily in stemming price declines, rather than in sharply increasing prices.

Business loans fell slightly at Tenth District banks contacted in the September survey. Loans to construction companies and agribusinesses were mentioned as two areas of decline, as were loans to national accounts. Consumer loans, which are usually fairly slow in August preceding a September rise, were generally flat in August. Bankers expect near-term auto sales to be much improved over last year, but several expected the strength to come from sales of the remaining 1976 line, rather than from the 1977 cars. Bankers have kept their local prime rate at 1/4 to 1/2 percent above the 7 percent national prime. Several banks, preferring to make loans mainly to local customers, have set for their national customers a 7 1/4 percent rate. Most bankers expect the prime rate to remain constant for at least the next month.

The level of negotiable certificates of deposit is still declining overall in the District. A few banks, though, have been rebuilding their CD portfolios to lock in funds for an anticipated increase in loan demand. However, most bankers contacted--including a director of this Bank--have preferred to stay in Federal Funds because of their uncertainty regarding the timing and strength of the expected rise in loan demand.

ELEVENTH DISTRICT - Dallas

Increases in manufacturing output account for the bulk of economic strength in the Eleventh District, although much excess capacity is still evident. Total employment in the District continues to be soft, and total construction activity remains weak. Department store sales are up moderately from a year earlier, and automobile sales exhibit continued strength in the full-size and intermediate-model ranges.

Department store sales in the Eleventh District continue to grow sluggishly and are falling short of many retailers' expectations. The modest growth in sales is shared by both hard and soft goods. Retail inventories are being held in line with current volume of sales. Nevertheless, if real sales gains do not materialize, an involuntary inventory buildup may occur before yearend, according to several retailers.

Automobile sales are good as full-size and intermediate-size cars lead the sales advance. Truck and van sales are also doing quite well. Car sales are being limited by two factors. First, overwhelming demand for full- and intermediate-size cars has resulted in a shortage of the more popular models. Second, there has been some softening in overall car demand as consumers wait to assess the 1977 models. Small car sales continue weak, and inventories have risen to undesirable levels. Most automobile dealers surveyed do not feel the announced price increases will adversely affect sales. Financing is readily available, and a movement toward extended term (42 and 48 months) automobile financing is gaining momentum.

Primary metal production has begun to accelerate. The aluminum industry is operating at approximately 77 percent of capacity, but output is up because of the recent reactivation of idle capacity at two major plants. Inventories are at low levels, and production bottlenecks are not anticipated. The cost and availability of energy will continue to be a potential constraint upon production levels.

Most steel plants are operating at between 75 and 80 percent of capacity. Inventories here, too, are at reasonable levels, and no immediate shortages are expected. Prices remain relatively low as a result of continued weak demand for construction steel products. Steel producers, however, are anticipating stronger sales in the fourth quarter.

Petroleum refining production in Texas has increased to nearly 90 percent of capacity. Inventories are currently in line with the volume of sales, but a buildup by the middle of the fourth quarter is predicted. The prices of primary inputs have increased over the past year, and the increases have been passed on to customers with little impact on demand.

Apparel production in Texas has increased following a summer lull, and the industry is attempting to gradually reduce current excess capacity. Manufacturers in Dallas and Houston report good sales. Both input and finished goods prices are up. El Paso manufacturers, however, indicate sales are sluggish and are cutting prices to move out older inventories. The industry is anticipating a steady rise in sales during the fourth quarter.

Demand for oil field equipment is being dampened by the continuing uncertainty resulting from the Federal ruling to raise the price ceilings for natural gas. Output has increased somewhat, and inventories are generally in line with sales. Production is running at approximately 75 percent of capacity, but price increases for many products are being planned.

Chemical production is above last year's level but has failed to exhibit real strength in recent months. Capacity utilization is estimated at 85 percent. Inventories are being kept tightly in line with anticipated sales to prevent involuntary buildups. Demand is expected to strengthen in the next few months.

Output by the paper industry has weakened with the end of a 6-month strike in the Canadian paper industry. Production, however, is still above last year's levels, and demand is expected to grow at an average rate by historical standards. Finished goods prices have remained relatively stable, and inventories are well within manageable levels.

The devaluation of the Mexican peso had an immediate effect upon the border economy. Retail sales to Mexican Nationals have dropped substantially. In El Paso, total sales are off a third, and many lay-away purchases by Mexicans have been cancelled. Moreover, many Mexicans who have made purchases on time are either requesting extensions of their contracts in order to cut their monthly dollar payments or are having their purchase repossessed. The largest beneficiaries of the devaluation are the twin plant industries along the border whose total wage bills have been cut sharply. This windfall savings to American businessess is expected to decline, however, as Mexican labor unions are currently pressuring for increases in their country's minimum wage.

TWELFTH DISTRICT - San Francisco

In the Twelfth District the economy is continuing its moderate rate of expansion. Consumers remain the major source of demand and business spending is cautious. After a mid-summer pause, retail sales have resumed their steady growth. Automobile sales of the larger domestic models are particularly good. Home-building activity is increasing, and the demand for forest products has improved. In most agricultural areas of the District, production has been good, but there is concern about the effect of declines in prices on farm income. Bankers report steady demand for consumer and real estate credit but little strength in commercial loan demand.

Retail sales appear to have resumed their climb after a pause in June and July and are running at 10 to 15 percent above the same period a year ago. The greatest strength has been in nondurables. Customer acceptance of back-to-school sales and fall lines has been described as good. Retailers are generally optimistic about prospects for the rest of the year, but they are being careful in building inventories. Consumer durables are relatively weak and large-ticket items are moving slowly in most areas. The Western tourist industry has experienced an excellent summer. In Oregon, tourist expenditures are up 10 percent over last year.

Automobile sales have been strong through August. Domestic large models have been selling well; so that by the end of the month, many dealers had sold out some lines. Domestic economy car sales have been weak. The market for foreign cars has been mixed, but sales have jumped in the last month.

Home-building activity is increasing in many areas. Reports from Southern California and Utah indicate good demand for new homes. The market for existing homes is also strong. This activity in housing has stimulated more retail sales by lumber dealers; plywood orders have increased and some building materials are in short supply. With this recovery in domestic construction and foreign orders increasing, the forest products industry is expanding production. Another indicator of the improved demand for housing is that many of our banking directors report increased loan demand for mortgage and for construction financing. These indications of a strengthening order pattern support expectations of a stronger upward trend in construction by the end of the year.

Agriculture production in most parts of the District has been good. Fruit crops in Oregon and Washington have escaped serious weather damage and are of excellent quality. Rain and cool weather have hurt wheat in Eastern Washington, but in Oregon yields are expected to be high. Drought has caused serious problems for California ranchers but heavy reliance upon irrigation has limited losses of most field crops so that the overall impact on State agriculture has been small. Prospects for farm income, on the other hand, are less promising; and concern exists over declining or low prices for dairy products, cattle and many vegetables. Nonetheless, banks in agricultural areas report steady demand for loans to expand storage capacity and to buy new equipment.

In California, recent Federal legislation has allowed increased production and drilling for oil in the Elk Hills reserve. This is the largest reserve left in the United States except for Alaska. Production is expected to reach 300,000 barrels a day by 1980, and refinery capacity in the Bakersfield area is being expanded.

District banks are reporting a steady increase in loans for real estate and consumer credit. A large California bank describes the demand for credit from overseas as being firm. The demand for commercial and industrial loans, particularly in national accounts, remains flat. According to one large bank, "The crucial reason for soft demand from the largest companies is their inability to foresee an adequate return on new investment--and they have adequate cash from

(a) rising long-term money and (b) current porfits." In contrast, loan demand by smaller businesses and homebuilders is relatively strong.