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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Moderate recovery, based mainly on strength in residential construction and some consumer outlays, continues to epitomize the course of the economy. Optimism prevails despite widespread slack in employment and business loan demand. The range of response from Reserve Banks is small. At best, the economy is expanding "on a broad front" and "at a steady pace." Superlatives were confined mainly to demand for consumer household durables, heavy trucks and building materials. At worse, there are "some signs of recovery," though the upturn "can barely be perceived" in the eyes of some.

Phase II has been "generally accepted" and has been regarded as helpful so far in aiding competitive forces to limit price increases. Some criticisms have developed, however, which may menace its future. Numerous declines in interest rates, particularly on mortgages and consumer deposit accounts, are reported. Savings flows have held up well. While some concern was expressed over the size of the Federal deficit, most were centered on the fear that large deficits will become a fiscal "way of life," which could not be abandoned as the economy approaches full employment.

Anticipated business investment remains very strong, though the concrete signs that have already emerged are mixed. In a survey of the corporate treasurers of Fortune's 650 nonfinancial firms, the Philadelphia bank found planned spending on plant and equipment will increase by 10 percent in 1972. That bank, along with Atlanta and Chicago, found numerous incidents of plant expansions and new plants. Neither New York, Cleveland, St. Louis, San Francisco, or Boston, however, found signs of a surge in capital spending. While the high level of unused capacity is typically cited

*Prepared at the Federal Reserve Bank of Boston.

as the cause, St. Louis found sluggish capital expenditures among some firms experiencing higher operating to capacity ratios. Although a majority of firms reporting to the New York bank anticipated higher inventory outlays, Kansas City encountered "further inventory reductions, and no inventory buildup - sometimes in spite of increased sales expectations." Neither Richmond nor Boston reported systematic inventory replenishment.

There was a pickup in the pace of manufacturing orders, shipments, and backlogs in the Philadelphia, Atlanta, Richmond, and Chicago Districts. Steel companies in the Cleveland District expect first quarter shipments to outstrip last quarter's by 25 percent. Steel orders have picked up in recent weeks in Cleveland, and in Chicago they show the broadly based gain which had been expected.

Most of the increases in employment were recorded in the East. Philadelphia found that 10 percent of manufacturing firms surveyed had increased employment and 17 percent had increased average hours. Richmond noted shortages of skilled and unskilled labor. Scattered gains also occurred in upstate New York and in the Cleveland and Atlanta Districts. Elsewhere the employment picture remained bleak, either stagnating or deteriorating. Little improvement was the story in Boston, St. Louis, and most of New York, while some layoffs appeared in Dallas, Cleveland, and Minneapolis.

Continued strength in construction, primarily residential construction, and heavy output of lumber and wood products were both mentioned often. Financing proved not to be a problem, as savings flows were reported to have held high or even accelerated, while mortgage rates have either fallen, as in Richmond and Minneapolis, or downward pressure has developed, as in St. Louis. Some demand problems, resulting from overbuilding, have popped up for apartments, in Atlanta and in the Twin Cities, and in retail selling and office space, in Atlanta and in the Chicago loop district.

A fear of competition from savings and loan associations has kept commercial banks in the Atlanta, Chicago, Minneapolis, and Cleveland Districts from cutting rates paid on consumer time deposits. Several banks have indicated to the Cleveland bank "that a further reduction in the prime rate would probably force them to cut their deposit rates, regardless of whether other institutions followed. Most banks maintained that they could not successfully cut deposit rates unless they were convinced that savings and loans would follow, but they see no reason to expect savings and loans to reduce deposit rates as long as mortgage rates remain at current levels."

Variations abound in the sales performance of consumers'goods. Good gains in general retail sales materialized in San Francisco and in Richmond. Demand was vigorous for consumer household durables in Chicago, and new orders were encouraging in Boston. Strong durable goods sales in Minneapolis accompanied only modest increases in the sale of nondurables. Mixed patterns were also experienced in St. Louis, where services were strong and department store sales were weak, and in Dallas, where department store sales were up and new automobile registrations were down.

Kansas City and Richmond reported buoyancy in consumer loan demand, but they, along with Philadelphia, Chicago, Boston, and San Francisco, continued to report weak business loan demand.

The three academic respondents contacted by Boston agreed that an expansive policy should be continued until additional signs of strength appear.

FIRST DISTRICT - BOSTON

Our directors can barely perceive an upturn in business activity. With the exception of a few business lines connected with consumer goods, their businesses have experienced neither rising new orders, higher desired inventories, longer workweeks nor increased capital spending plans.

There has been little improvement in the labor situation. With the exception of two industries connected with consumer goods, no directors reported that their firms were adding workers or lengthening workweeks through increased overtime. Aerospace firms were either still laying off workers or had just arrived at the point where they were no longer anticipating further cutbacks in employment. There was a general feeling, however, that productivity was showing increases over last year.

All our directors indicated that they still were maintaining a "tight ship" in regard to inventories and were not trying to raise their inventory to sales ratios. In line with higher consumer goods sales, an increase in consumer inventories was reported by a few manufacturers. The two major New England department stores reported that January sales were up strongly over last year's weak January sales and were about as strong as December's sales, on a seasonally adjusted basis.

The directors reported being encouraged by the good performance of new orders for consumer goods, but new orders in the aerospace and machine tool industries were still below a year ago. One director whose company manufactures helicopters said he was not encouraged by the higher obligational authority in the fiscal 1973 budget for the defense department because this would not be translated into payments for a long time. He expects the aerospace industry, therefore, to remain on a plateau for several more years.

When asked, none of our directors reported that the investment tax credit had made them raise their capital spending plans since last summer. Several directors noted, however, that their firm's capital spending would be above last year's levels.

Our bank directors reported that there continues to be a large inflow of savings deposits and that the demand for mortgages at current rates is very strong. A large area bank, which accepts unlimited deposits, has been so inundated by large savings deposits, averaging $2-3 million each, from hospitals and universities that they are lowering interest rates by 1/2 percentage point on deposits above $100,000 as of mid-February. The bank directors said that it was very difficult to discern any increase in the demand for business loans, despite lower interest rates.

Some of our directors noted that they were paying significantly higher prices to their suppliers. Steel price increases of 7-8 percent were noted. Another director said that large price increases were posted by small suppliers, while the prices charged by large suppliers have remained stable. One director reported having received approval from the Price Board to raise prices on a number of goods, but most of our directors said that they had not raised prices, "yet." One director noted reducing the price of marble due to stiff foreign competition.

Four new wage agreements were reported as having been settled. Settlements ranged between 5 1/2 percent to 8 percent. Despite the moderate wage increases, one director stated that his firm had had "their ears beaten back on work rules and operating nonunion plants."

The three respondents who were contacted, Samuelson, Shapiro and Tobin, agreed that monetary policy should "keep pushing on the string."

None shared the concern, which has been expressed in the press, that lower short rates would have adverse implications for the international monetary situation. Samuelson conjectured that continued expansion of reserves will help the money supply to take off in less than six months. Samuelson would require tangible signs of a successful recovery - more than two months of strong industrial production or a GNP gain of over $30 billion - before he would "ease off." The pace of real recovery, not a target number for interest rates or money supply, should be the policy guide.

Tobin argued that recent experience has made the public less quick to accept the monetarist view as their basis for forming inflationary expectations. Samuelson pointed out that first quarter inflation will reflect more upon the strength of Phase II than the possible "excessive" increases in the money stock. Since the "whole purpose" of controls, Tobin noted, was to "step on the gas," it would be particularly unfortunate to hold back demand in order to make the controls work. He felt it would be at least mid-year before evidence of a boom momentum could be sufficient to cause a policy reversal.

Shapiro felt that the fiscal 1972 deficit has been overestimated by $3 to $6 billion and that, with a $95 billion GNP gain, the estimated 1973 deficit may also turn out too high. He did feel that it was a tactical mistake not to have lowered the discount rate at the time the deficit was announced. The long market is currently frightened, he noted, but the long term trend will be down, and any rate increases would be transitory. Samuelson feels the relatively high current discount rate poses no problem so long as free reserves are kept around $200 million and repurchase agreements are conducted at low rates.

SECOND DISTRICT - NEW YORK

Mixed opinions were expressed recently by the directors of this Bank and of the Buffalo Branch as well as other local businessmen regarding the current economic situation. Most were disturbed by the implications of the President's budget message, but on balance felt that so far Phase II was having a beneficial effect on the economy; only scattered improvement was reported in the unemployment picture. In general, it was felt that the prospects for increased business outlays on plant and equipment had not materially improved over the recent past. However, the majority looked for increased inventory outlays, reflecting in good part a strengthening of consumer confidence, as reported by the retailers that were contacted. Most directors that expressed an opinion felt that the international currency realignment had not had, but eventually would have, a beneficial impact on the country's trade balance.

Concern, in varying degrees, was expressed over the President's recent budget message. All of the Buffalo Branch directors saw the deficit as adding to inflationary forces, although the majority felt that its likely stimulative effect on the economy would not be excessive. One of these directors, however, the Vice President of one of the largest up-state firms, saw a greater danger of over-stimulation from the projected deficit for fiscal 1973 than from the current year's deficit. The chairman of the board of a large New York City bank thought that the $87 billion of deficits compiled in three years could signal that huge deficits were becoming a fiscal "way of life," which would make inflation difficult to check while other directors also were concerned over current fiscal policy. Among the local businessmen contacted for an opinion on this issue, the senior partner of a leading accounting firm felt that the "last-minute disclosure" of the size of the projected deficit has shaken public confidence, and had left many businessmen "dismayed." A leading New York City banker doubted that expenditures and the deficit would reach projected levels, but in any event felt that the release of these figures had generated uncertainty in the financial markets.

Sentiments were mixed regarding the effectiveness of Phase II. On balance the respondents felt that it was having a constructive effect. Most regarded the Price Commission as being more effective than the Pay Board in reducing inflationary pressures, but a member expressed the opinion that the Pay Board has had some psychological effect in reducing the size, as well as the number, of wage increases demands, a fact which is not reflected in statistics it releases. Among the specific comments made, the President of a large copper firm said that the Pay Board "hasn't demonstrated that it had things under control," a feeling that was shared by the chairman of the board of a large New York City bank. Several of the Buffalo Branch directors pointed to apparent inequities in the Board's rulings, which they felt resulted from the use of different standards for particular labor groups. On the other hand, the president of a large liquor manufacturing firm reported that the "Board had been a definite factor" in keeping down the wage increases for his firm in a recent wage settlement, while a Rochester businessman noted that fewer of his employees have been asking individually for wage increases.

Regarding the employment situation, the vice-president of one of the largest up-state firms expected the increases in hours worked to foreshadow additional hirings. The job situation in Rochester was reported to have shown a steady improvement since last May. Other directors and other business leaders, however, were unable to detect an improvement in the current unemployment picture.

With respect to outlays for plant and equipment, the directors and other business leaders expressing an opinion on this subject continued to look for little change, in good part because of the high rate of unused capacity.

The outlook for increased inventory outlays, however, seems to have improved on balance. Buffalo Branch directors shared a feeling expressed by one of them that "inventory downward adjustments have bottomed out." Moreover, the local retailers that were contacted, while reporting that January sales were below expectation in the New York City area, in general looked for a good year and indicated that they were planning to increase their inventories accordingly. A senior executive of New York City's largest department store was most optimistic, and looked for a "very very" good year.

Concerning the impact of the international currency realignments, the Buffalo Branch directors felt these measures were a step in the right direction but that it was still too early to detect signs of an improvement in the competitive position of United States goods in world markets. The chairman of the board of a large New York City bank expected no real change in the trade balance before 1972. Other respondents felt that the realignments would ultimately have a favorable impact on their firms' competitive positions, but it was noted that they did not seem to have much effect on imports from Japan.

THIRD DISTRICT - PHILADELPHIA

On balance, economic conditions look brighter in the Third District than in recent months. Area manufacturers experienced a pickup in new orders and shipments during January and expect it to continue during the next six months. Capital spending plans are up and liquidity positions seem to be adequate. Bankers reported sluggish loan demand for January but expect some seasonal increases by March. Interest rates are expected to be on the upswing shortly, especially at the short end of the maturity structure. The price picture remains mixed. There is some concern regarding the size of the budget deficit.

District manufacturers polled in the bank's monthly business outlook survey find the economic picture much brighter than in recent months. While November and December saw essentially unchanged conditions, January brought increased activity on many fronts. Over 40 percent of the respondents experienced increases in new orders and shipments during January. While no firms were adding employees in November, over 10 percent did so last month. Over 13 percent of the respondents increased the average employee workweek in January, the largest percent to so indicate in several months. This pickup in activity is expected to continue through February.

Also, the manufacturers remain optimistic about the picture six months out. Approximately three-fourths of the respondents see business activity, both in general and at the firm level, to be increasing in the next half year. This intermediate-term optimism leads nearly 40 percent of the manufacturers to plan increases in capital expenditures.

The bank's annual nationwide survey of corporate treasurers also picked up increased capital spending projections. The firms canvassed (Fortune's 650 nonfinancial firms) plan to increase their plant and equipment by around 10 percent during 1972. Also, the survey found that most financial managers now feel that liquidity has returned to an acceptable level, and they look forward to more than adequate liquidity this year.

Area bankers report that business loan demand has been sluggish. The greatest activity has been in consumer loans with autos giving the most support. The real estate loan picture generally seems weaker. A majority of bankers are hoping for some seasonal help in March.

On the interest rate front, area bankers feel rates are bottoming out and will start an upturn in the near future. Corporate treasurers also see some upward movements for short-term rates as the year progresses. However, the treasurers expect longer-term rates to hold fairly steady. They note that pressure from the corporate sector should be minimal, if internally generated funds live up to current forecasts. Also, they believe inflationary pressures are diminishing, thus helping to reduce the pressure on long-term rates even more.

Members of the bank's board of directors and some area bankers expressed concern over the size of the government deficit. Although they feel the current deficit may be appropriate for a slack economy, they fear that the size of the deficit may not be trimmed back as the economy nears full employment.

The area price picture remains mixed. Although prices paid were generally steady during the past three months for District manufacturers, about one-fourth of those canvassed reported price increases for January. Furthermore, over 35 percent expect price increases for February.

FOURTH DISTRICT - CLEVELAND

According to reports from our directors, business economists, and bankers, the pace of economic activity in the District is showing some signs of recovery from the depressed level of activity last fall. Insured unemployment has declined, nonfarm employment has increased, steel orders have risen recently, and residential construction remains strong. Near-term prospects for a significant improvement in manufacturing employment are not particularly good: major firms are counting mainly on productivity gains to achieve higher output. The steel industry, which is beginning to experience a sharp recovery, is a case in point. Capital goods producers are experiencing some increase in activity, but as yet there are no signs of a broadly-based recovery in this industry. In the financial area, commercial bankers report that they are reluctant to reduce their rates on consumer time and savings deposits because of competition from savings and loans, which appear to be uniformly paying the maximum rates permitted.

The District's insured unemployment rate peaked last September and has been declining since then. The drop in January was almost one percentage point. Nonfarm payroll employment has recovered moderately from its cyclical trough of last October. Employment in the District was lower in October 1971 than during the trough of the nation's recession in November 1970. Prospects for a substantial gain in manufacturing employment during 1972 are not encouraging, however. Many of our industrial directors and a number of economists representing large manufacturing firms in the District reported that they plan to increase output this year with their existing labor force, or with only modest increases. In some instances, firms are planning employment reductions, even though output is expected to rise.

The steel industry, in particular, plans to achieve sharp increases in output and shipments through productivity gains. Economists from three major steel companies in the District expect this quarter's steel shipments to rise at least 25 percent from the depressed level of the fourth quarter of 1971. In recent weeks, there has been a pickup in steel orders from a number of industries, although orders for steel products from capital goods producers and from the auto industry remain disappointing. Termination of steel inventory liquidation, probably in February, is the main reason for the pickup in orders and shipments: consumption of steel products has been relatively unchanged over the last few months. The three steel economists report that their respective firms plan little increase in their work force, and that non-production workers (especially supervisory and management employees) are still being cut back. Despite the recent alignment of foreign currencies, none of the steel economists expects an appreciable improvement in the nation's foreign trade deficit in steel products, which rose to a record high in 1971. The reasons mentioned include nontariff barriers to steel trade, sluggish world demand for steel, and continuation of a sizeable cost-price differential vis-a-vis foreign steel producers.

Reports of capital goods producers are mixed. Directors and economists mentioned a recent improvement in some product lines and continued weakness, or a slowdown, in other lines. Our industrial directors say their firms plan little or no increase in capital expenditures during 1972, citing little need for additional productive capacity as the main reason. In addition, the directors were nearly unanimous in reporting that they expect to be able to finance the planned level of capital outlays from internal sources of funds and, therefore, have no plans for major external financing in 1972.

Commercial bank contacts in the District report that they would welcome a reduction in rates paid on consumer time and savings deposits, because of the unfavorable margin between deposit rates and the prime rate. However, competition from savings and loans, which are uniformly paying maximum permitted rates, prevents the banks from cutting their deposit rates. Several banks indicated that a further reduction in the prime rate would probably force them to cut their deposit rates, regardless of whether other institutions followed. Most banks maintained that they could not successfully cut deposit rates unless they were convinced that savings and loans would follow, but they see no reason to expect savings and loans to reduce deposit rates as long as mortgage rates remain at current levels.

FIFTH DISTRICT - RICHMOND

Our latest survey of businessmen and bankers in the Fifth District suggests a further moderate improvement in business activity in recent weeks. Survey respondents indicate continuing gains in general retail sales but no great strength in automobile demand. The manufacturing sector continues to register advances, with manufacturing respondents reporting further increases in shipments, new orders, backlogs, employment, and hours worked per week. Results of a special survey of inventory plans suggest that both manufacturers and retailers are currently in the process of making small to moderate increases in their inventory positions. Bankers, however, report no notable improvement in inventory loans or in business loan demand in general. On the other hand, consumer and real estate loans remain strong.

Compared with recent surveys, an unusually large fraction of manufacturers in our latest survey report increases in new orders and backlogs. A smaller fraction indicate increases in shipments, employment and hours worked per week. Interestingly, nearly a third of the manufacturers in our survey report less than adequate supplies of unskilled labor in local labor markets while nearly one half report less than adequate supplies of skilled labor. Of 26 manufacturing firms participating in a special survey of inventory plans, 9 indicated a change in plans in view of recent changes in sales and sales prospects. Of these, 5 reported upward adjustments in planned inventory positions and 4 reported downward adjustments. Eleven of the 26 indicated that their inventories will rise slightly to moderately in the current quarter while 6 plan inventory cutbacks in the same period.

A large majority of respondents in the trade sector report further recent gains in retail sales, although reports suggest no great bouyancy in sales of new automobiles. Employment in this sector has changed little in recent weeks, although hours worked per week are reported up. Only 6 major retailers were included in our special survey of inventory plans, but of these half indicated that planned inventory positions had been adjusted upward in light of recent changes in sales and sales prospects. Four of the 6 indicated slight to substantial increases in inventory positions in the current quarter while one indicated a slight decrease.

Responses from District bankers suggest some slight further increases in both residential and nonresidential construction during the past month. Approximately 40 percent of banking respondents reported increases in the demand for mortgage loans. Mortgage funds, however, apparently continue to be plentiful and some District banks recently announced reductions in mortgage rates, to 7 percent. Bankers report continued bouyancy in consumer loan demand, although the rate of increase in consumer outstandings appears to have tapered off somewhat in recent weeks. Many District bankers, however, appear concerned over what they consider to be unusually sluggish demand for business loans.

In our special survey of inventory plans, a sample of bankers was queried concerning current demand for inventory loans and their expectations concerning this type of loan demand during the first quarter. Current loan demand was reported as normal by 8 respondents, weaker than usual by 9 respondents, and stronger than usual by 2 respondents. Eleven bankers expect demand for business inventory loans for the first quarter of 1972 to be about as usual, 5 expect weaker than usual demand, and 3 expect stronger than usual demands.

Respondents are generally optimistic about the economic outlook. Approximately 60 percent of banking respondents believe that economic activity in their area will increase in the immediate future.

SIXTH DISTRICT - ATLANTA

There has been a noticeable increase in optimism among businessmen and bankers throughout the District, and this more confident mood has spread to consumers. Retailers surveyed have a more optimistic outlook now than they had last year at this time. The tempo of manufacturing and the rate of capital spending also appear to have picked up. On the other hand, there is a glut of apartments and retail selling space in Atlanta. In banking, scattered reductions in rates paid on consumer time and savings deposits have been the most notable development.

The Florida tourist industry has benefited from the increased consumer spending. Attendance at Disney World has exceeded expectations, and attendance at several other Florida attractions is up. Because of Disney World, motel occuapancy in several tourist areas has greatly increased. During the holidays, motels along Florida's main north-south artery were unable to accommodate the influx of tourists. One central Florida attraction reports attendance 30 percent above a year earlier.

Atlanta is reported to be overbuilt, at least temporarily, in apartments and retail store space. A surplus of space in office parks was reported earlier. A very large increase in the number of apartments coming onto the market is occurring in Atlanta. The glut of apartments has prompted two large mortgage banking companies to discontinue financing additional multifamily housing in Atlanta. There has been one foreclosure on a new complex in the Atlanta area. It is also reportedly difficult to place participations in mortgages on Atlanta apartment complexes. However, there seems to be no glut in single family housing in Atlanta. Retail store space has also increased sharply in Atlanta in the past year.

Existing space, according to a major retailer, is sufficient for at least five years. On the other hand, apartment building is strong in the Birmingham area, where construction was recently started on a $100 million planned community. A shortage of apartments is reported in the Jackson, Mississippi area.

A pickup in the pace of manufacturing is occurring. Increased production and employment is reported in industries such as apparel, automotive and trucking, boating, and health equipment. There also appears to be an increase in the number of plant expansions and new plant locations. Reports have reached us that the Huntsville, Alabama area has more prospects for new industry than ever before. New plants and plant expansions are reported for industries such as furniture, mobile homes, chemicals, and small aircraft. A large increase in capital outlays is accompanying oil exploration in southeast Alabama and northwest Florida.

Banks in Nashville and Knoxville have generally cut time and savings deposit rates by 1/2 percent. The largest savings and loan association in Knoxville announced plans to reduce its passbook rate from 5 percent to 4 1/2 percent on April 1. One Birmingham bank has reduced its savings deposit rate from 4 1/2 percent to 4 percent. Three banks in Jacksonville and two in New Orleans have shaved time deposit but not savings deposit rates. One other New Orleans bank has discontinued accepting deposits with over one year maturity. Isolated reductions in some consumer time deposit rates have been detected in Tampa, St. Petersburg, and Miami. However, the movement to lower rates does not seem to be gaining momentum, and there evidently is no rush by savers to extend maturities on time deposits in order to lock in high rates. Several bankers mentioned that they would like to cut rates but could not for competitive reasons. Bankers in Jackson, Mississipppi and Atlanta have no plans to reduce rates.

Inflationary pressures currently seem the greatest in telephone and other utility rates and in real estate in south Florida.

SEVENTH DISTRICT - CHICAGO

For the most part economic sentiment in the Seventh District continues to lack exuberance, but total activity probably is rising moderately, and some firms producing consumer durables and capital goods are very pleased with the recent trend of their orders. Job markets continue slack and local labor offices foresee only seasonal changes in employment in the first quarter. Liquidity of consumers, business firms, and lending institutions has improved substantially in the past year. Increasingly, the credit sectors have become "buyers' markets."

Demand for consumer household durables -- virtually all major appliances, furniture, and television (especially color) -- has been vigorous in recent months. Producers expect further gains in 1972, and are encouraging inventory building by dealers and distributors. We are unable to reconcile heavy factory orders and shipments with the modest increase in retail sales shown for the furniture and appliance stores in the department of commerce report.

GM recently announced another increase in employment at auto assembly plants (the third in about two months). But other auto producers have cut production schedules for some models because of high inventories. The realignment of currencies, together with rising costs abroad, have about eliminated the price advantage of imports, despite the end of the surcharge. Plans are underway to increase domestic procurement of components for subcompacts. Production of small cars directly competitive with foreign subcompacts is being pushed to capacity, but labor unrest is threatening current output schedules. Styling changes have been deferred for U.S. full-sized cars, apparently because of attempts to conform to safety and pollution standards.

Demand for heavy trucks (gross vehicle weight of 26,000 pounds or more) for highway transport and construction work is extremely strong. Producers of major components, including engines and rear axles, are operating at capacity. Demand for highway trailers also has increased. Gains in highway traffic volume, higher profits, and larger total cash flow for trucking firms are expected to maintain demand for transport vehicles for many months.

Other capital goods sectors show signs of revival. Orders for capital goods components improved markedly in the fourth quarter and have continued strong thus far in 1972. Some tool and die shops, and some producers of machine tools, are reporting modest improvement in orders from very depressed levels. Demand for construction machinery from domestic customers is fairly good. Foreign demand for virtually all exported capital goods nose-dived about mid-1971 and has not recovered.

Orders for steel have increased as expected and Chicago area producers are pleased with recent trends. One large mill is now operating at "normal" levels. Auto companies are buying steel again, partly because excess inventories have been exhausted, but also because of price concessions. Demand for steel plates has increased, and a substantial backlog exists for fabricated structural steel for large buildings. Producers of household appliances are now buying steel at a good rate. Steel requirements for facilities for the oil and chemical industries have exceeded expectations. The anticipated rise in demand for railroad equipment, however, has not yet materialized.

Although total manufacturing employment in the District appears to have stabilized, announcements of plant closings continue, especially in the Detroit and Milwaukee areas. Multi-plant companies are consolidating operations in fewer locations in an effort to cut costs. Also, there is a strong tendency to locate new facilities in the South (or abroad) to benefit from lower taxes, lower labor rates, and a more docile (more "cooperative") labor force. In some cases, labor unions are showing greater willingness to negotiate problems.

Prospects remain good for a high level of housing starts in the District in 1972. But concern is growing over problems in the FHA subsidization programs. Some large new office buildings have been announced recently for the Chicago Loop, in the face of a reported large overhang of unrented space, in existence and under construction.

The meat-producing rural areas of the District have been cheered by high prices for cattle and hogs. Recently, prices of meat animals have edged down, however. Larger numbers of cattle on feed are expected to increase marketings and lower cattle prices somewhat further. Cutbacks in hog production are likely to moderate further declines in hog prices. Farmland values increased about 4 percent in 1971, and a growing number of bankers expect further increases in 1972.

District banks -- large and small, city and rural -- have an ample supply of funds and are actively seeking loans. Business loan demand is reported to be very weak with more than seasonal declines in outstandings underway. Savings inflows continue very strong, both at banks and S & L's. Except for Detroit (where pass book rates were cut to 4 percent in 1971), savings rates offered by large banks remain at the ceiling. Many rural bankers would like to have Regulation Q ceilings reduced, but large city banks fear S & L competition. A prominent Chicago bank executive stated recently that no cuts in savings rates are planned for the near future, and his bank probably would have to lead the parade. Negotiable CD money is not actively sought, especially with maturities of less than six months. Many comments relate to the "cost-squeeze" on banks resulting from continued high costs of money, and high expenses generally, in the face of lower market rates. Attempts are being made to hold down employment and other operating costs.

EIGHTH DISTRICT - ST. LOUIS

Leading businessmen in the Eighth District continue to view business prospects for the months ahead with optimism. They report that activity is now expanding on a broad front. Construction on a seasonally adjusted basis and sales of building supplies and home furnishings continue the uptrends established last year. Factory output is approaching capacity levels for some industries. The hotel, restaurant, and airlines businesses are rising. Most managements, however, continue to hold the line on number of employees and plant capacity. They report that new investments are largely on labor-saving machinery and equipment. Savings are plentiful at current interest rates, and some reductions in mortgage rates are expected by early spring. Counter to the general trend was the relatively low volume of department store sales in January.

Construction activity continues at very promising levels, and the outlook is for a good year, especially for residential construction. Some builders who dropped out of the business in 1970 are now coming back into production. Along with the rise in building has been a pickup in sales of building materials, home furnishings, appliances, and all types of controls for appliances, heating, and air conditioning equipment.

Manufacturing firms have taken up much of their slack in operating capacity. One firm in the paperboard and packaging industry was reported to be operating at 95 percent capacity. Another in the hydro-air-engineering business was reported to be operating at capacity. Others indicated that much of the slack had been taken up and that any further gains in output would require additional expenditure on more efficient equipment or new plant capacity.

Despite the higher operating to capacity ratios in manufacturing, sluggish capital goods expenditures are reported. One businessman reported that profit margins are still insufficient to provide an incentive for major capital expenditures.

Employment is likewise being held at a minimum in the manufacturing sector. Of those interviewed, few reported any increase in their labor force. No additional layoffs are in prospect, but there is apparently greater than normal substitution of labor-saving devices for manpower as the economic upswing gathers momentum. Some reporters indicate that manpower will be added only when large backlogs of orders develop.

The extent of the recovery is indicated by the pickup in the service industries such as the restaurant, hotel, motel, and airlines business. While slack in these areas is being removed rapidly, they are not ready to place orders for additional equipment or facilities. This hesitancy may be critical in the case of new aircraft where orders must be placed two years ahead of delivery.

On the financial front, savings continue at a high level. Rates paid savers are generally unchanged but are a little lower at a few institutions. Downward pressure is beginning to develop in mortgage rates. To date, however, mortgage rates have remained sticky, and few reductions have been announced.

The agricultural industry is quite optimistic. Cotton supplies are short and prices relatively high. Soybean demand is good. Livestock prices have risen in recent months providing great incentive for feeding more grain which is now at a very low price relative to livestock product prices.

NINTH DISTRICT - MINNEAPOLIS

According to bank directors, District commercial loan rates have fallen in response to cuts in the prime interest rate while consumer and mortgage interest rates have declined slightly, if at all. Competition from savings and loan associations has prohibited District commercial banks from lowering their consumer savings rates. Although the outlook for non-residential construction is mixed, District residential construction in 1972 is expected to equal if not exceed 1971's record level. An expansion in District employment is not foreseen by bank directors. District manufacturers foresee their sales improving during the first three quarters of 1972.

The directors reported that commercial loan rates have fallen in the District in response to recent declines in the prime interest rate, but little change has occurred in mortgage and consumer interest rates. The decline in commercial loan rates has taken place primarily at the District's large urban banks, as loan rates have either remained the same or declined only slightly at rural banks. As a result of strong competition from production credit associations, one director reported that commercial banks in his area have slightly reduced the price of agricultural credit. Another director reported that public awareness of declines in the prime interest rate have forced banks in his area to make modest reductions in their mortgage rates.

Competition from savings and loan associations has prohibited District commercial banks from lowering their consumer savings rates. A Montana director indicated that savings and loan associations in his state would like to lower their savings rates, but fear out-state competition.

District housing unit authorizations reached an all-time high of 39,000 units in 1971, and District bank directors generally felt that residential construction in 1972 will at least equal 1971's record level. One director revealed that banks in his area now have more mortgage applications than they can handle. Some directors, however, did express some doubts about homebuilding matching 1971's performance in their local areas. In the Minneapolis/St. Paul metropolitan area some overbuilding of apartments may have occurred. The FHA has temporarily suspended guaranteeing apartment financing in one portion of the metropolitan area and an FHA official reported that apartment construction may have exceeded growth in demand in other portions of the twin cities metropolitan area.

In contrast to the directors' generally favorable outlook for residential construction, their prospects for nonresidential construction varied. In some areas of the District noticeable gains are expected, but no improvement is foreseen in others. The outlook for commercial/industrial construction in the Minneapolis/St. Paul metropolitan area was characterized as weak.

Employment in the District has not advanced during the past year, and, in general, no increase is foreseen by bank directors. In northeastern Minnesota, U. S. Steel's announcement that it is permanently closing the hot side of its steel plant in Duluth has cost that city 1,600 jobs. Part of the Air Force base at Duluth may also be closed down. Smaller crop planting due to the new acreage diversion program will probably reduce the summer demand for farm labor in South Dakota. The Anaconda Company's decision to close its zinc operations will cost Montana approximately 700 jobs, and the copper smelting facilities at Helena may be closed if state Board of Health pollution standards are not met.

Several directors did report some encouraging developments, however. The construction of Cleveland Cliffs' new iron mine and pelletizing plant in upper Michigan will stimulate that area's economy. Also, Mount Rushmore's designation as part of the bicentennial celebration is expected to boost tourist spending this summer in South Dakota. In Montana, the construction of the ABM missle site at Great Falls may help offset some of the decline in other sectors of that state's economy.

According to the preliminary results of our fourth quarter industrial expectations survey, District manufacturers continue to expect that their sales growth will improve during the first three quarters of 1972. District manufacturing sales are expected to surpass year earlier levels by around 7.5 percent during the first nine months of 1972 after advancing 6.6 percent in the fourth quarter of 1971. The current sales predictions are very close to those made for their respective quarters in the last two surveys.

The optimistic outlook for District manufacturing sales can be attributed to a rejuvenation in durable goods sales. In the fourth quarter, District durable goods sales exceeded earlier levels by 10.1 percent, its strongest year-to-year advance in two years. District durable goods manufacturers expect to maintain this rate of gain during the first three quarters of 1972. Much of this expected improvement can be traced to the District's lumber and wood products, electric and nonelectric machinery and scientific instruments industries. No significant increase in the rate of sales gain is foreseen by District nondurable goods manufacturers.

TENTH DISTRICT - KANSAS CITY

Phase II policies, and competitive market forces operating in an economy performing well below its potential, are apparently combining to moderate the pace of rising prices. A survey of purchasing agents and managers in the Tenth District indicates that they perceive (1) a somewhat slower rate of price rise for materials they purchase, (2) generally good compliance by vendors with Phase II guidelines, and (3) the existence of market forces also acting to restrain price increases. Inventory policy is quite conservative, with little buildup of stocks now anticipated, almost regardless of industry. Among District banks, consumer instalment lending and agricultural loan demand remain strong, while local business loan demand has shown little change in recent weeks from its basically weak position.

The view from the desks of purchasing managers in the Tenth District seems to be favorable to Phase II, with overall understanding and compliance felt to be generally good. Specific comments suggest that, as far as purchasing agents are concerned, vendors generally appear to be following the Phase II guidelines. Purchasing agents for a number of firms regularly review suppliers' prices for compliance, some require invoices to be stamped as in accordance with Price Commission rulings, and others report that notices of price rises are accompanied with word that they have been cleared with the Price Commission. Yet increasing prices continue to dominate the scene as the purchasing managers see it. Although they may report that they see no evidence of unauthorized price increases, there is also some muted criticism of extensive price rises that have received approval from the Price Commission. Finally, it should be noted that several purchasing managers expect further significant price increases in the months ahead.

There is, however, evidence of a positive influence of competition in restraining price increases. Although some purchasing agents have received "feelers" from vendors for price increases, these have often been withdrawn following challenge by the buyers. Other purchasing agents report that cash discounts are now somewhat more readily available than in 1971. With market conditions apparently tending to moderate the upward movement of prices, the overall situation (as given by the results of this survey) may be summarized in the comment from one purchasing manager: on balance, prices show "an inching forward (but) not the mass increases of a year ago." There are, of course, significant exceptions such as textiles (both cotton and rayon) whose rapidly rising prices were noted by two firms that are heavy users of textiles.

Reports are mixed concerning the nonprice conditions surrounding the sale of materials. Some individual buyers note that suppliers have maintained their services and have made no attempt to modify their contract terms. However, many suppliers now are often cautious about quoting prices very far into the future, and unwilling to enter into yearly contracts.

The continued performance of the economy below its potential is reflected in the widespread absence of delivery problems across several very different kinds of industries. At the same time, virtually none of the firms interviewed expect at this time to add substantially to inventories except on a seasonal basis. Major users of metals report they are still working down substantial carryovers of steel inventories. Reports of further inventory reductions, and no inventory buildup -- sometimes in spite of increased sales expectations -- came from a number of firms in widely disparate industries such as electrical cable and wiring manufacturing, sewage treatment equipment, metal building manufacturing, pesticide production, rubber belting makers, private aircraft manufacturing, and a large chain of drug-and-sundries stores. All in all, inventory policies are expected to be "conservative this year."

The decline in the prime rate at New York banks has not been fully reflected in the lending rates of Tenth District banks. Of necessity, most banks must follow the New York prime movements on the accounts of their national customers. However, many District banks have established, or are attempting to establish, a "local" prime for their large regional borrowers. This rate is not only higher than the national rate, but has not been dropping as rapidly. Those banks that have not adopted this tactic are simply making fewer lonas at prime.

Consumer loan rates have not been adjusted downward at all in most banks, and only moderately at the others.

Local business loan demand has not changed significantly in recent weeks from its basically weak position. Several banks report a slackening in the use of credit lines by national companies. Local real estate loan demand is showing some signs of tapering off, but remains strong. Especially strong agricultural loan demands have been experienced by Omaha, Denver, and Kansas City banks. Consumer instalment lending continues at a high level.

An accelerated inflow of time deposits was noted by most area bankers. Several banks have suspended issuing consumer CD's beyond six months or a year, but this has not deterred the buildup of consumer time and savings deposits. Flows into large certificates of deposit have also picked up.

ELEVENTH DISTRICT - DALLAS

Recent trends in the major indicators of economic activity within the District were mixed. Some sectors continued to advance, but areas of sluggishness were evident. Employment in the five southwestern states fell in December, and the unemployment rate rose slightly. Industrial production in Texas slipped in December, after advancing to a record high in November. Construction activity in the five-state region continued its upward trend. In the retail sector, department store sales showed further strength, but registrations of new automobiles were down.

Seasonally adjusted, total employment in the five southwestern states edged downward slightly in December. And with the labor force in these states showing a slight increase, the unemployment rate rose to 4.9 percent, compared with 4.8 percent in November. In spite of this increase, however, the unemployment rate for these states was still below the year-earlier rate of 5.1 percent and well below the Nation's rate for December of 6.1 percent.

Nonagricultural wage and salary employment was up slightly over November, with increased employment in nondurable manufacturing and most nonmanufacturing industries accounting for virtually all of the gain. Employment in services, transportation, and public utilities recorded the largest advances, while mining and trade were the only nonmanufacturing sectors to show employment declines.

The seasonally adjusted Texas industrial production index eased slightly in December, after advancing to a record level in November. The small drop resulted from declines in all three major categories of industry -- manufacturing, mining, and utilities. Total manufacturing also fell slightly from November, although the production of nondurable goods increased somewhat. Changes in the output of almost all manufacturing groups were moderate. Among durable goods' industries, only lumber and wood products showed increased output. Production of all other durables declined moderately. Mining output continued to edge downward despite a sizable rise in the production of natural gas. Production of crude oil and natural gas liquids fell slightly. Utility output was also down, as the distribution of electricity fell sharply.

The Texas oil allowable was increased for February. This advance was the largest since October 1970 and the third consecutive rise after seven monthly reductions. The allowable for Louisiana was raised for the first time in three months, while the allowable in Oklahoma remained unchanged.

Construction activity in the five southwestern states, as measured by the value of contracts awarded, increased slightly in December. Residential building continued to be the major emphasis in building activity as it rose in December and remained well ahead of the year-earlier level. Nonresidential building was also up slightly after falling sharply in November. Nonbuilding construction activity, however, declined in December. The cumulative value of contracts awarded in the five-state region in 1971 was more than 20 percent higher than a year earlier.

Recent indicators of retail spending were mixed. Registrations of new passenger automobiles fell 7 percent from the month before in Dallas, Fort Worth, Houston, and San Antonio. But cumulative registrations in the four centers for the year were 20 percent greater than in 1970. Department store sales in the Eleventh District were 11 percent higher in the four weeks ended January 22 than in the corresponding period a year before. Total sales for 1971 were 7 percent higher than in 1970.

The cotton harvest in Texas and Oklahoma, which was the latest in 20 years, is nearing completion. The cotton harvest in Arizona, Louisiana, and New Mexico is also virtually finished. The cotton crop in the District states is expected to total slightly less than 4.3 million bales. That is well below the 4.6 million bale crop in 1970. Higher prevailing prices for all quantities of cotton are partially offsetting the production losses which were attributable to unseasonably cold and wet weather. Livestock conditions are generally good in the District. On January 1, Texas had 20 percent more cattle on feed than a year earlier, but the number on feed in Arizona declined slightly during the same period. The index of livestock and livestock products rose substantially from mid-November through mid-January as beef cattle and hog prices were up sharply.

TWELFTH DISTRICT - SAN FRANCISCO

The general opinion of our directors is that the economy is expanding at a steady pace. Retail sales in particular set records during the past Christmas season. On the other hand, weaknesses persist in other areas; unemployment is still relatively high, and there is no evidence of any jump in business capital expenditures. With certain reservations, Phase II appears to be generally accepted by business and the public. Inflation no longer seems to be regarded as the threat it was earlier in 1971. This acceptance of Phase II, at least for the immediate future, combined with a steady expansion of the economy, points toward a better record in 1972.

Retail sales reached new highs in December. The increases were 8 to 12 percent above the levels of the previous year, and the gains were general across the District. Oregon, where 5 to 8 percent is the estimated gain, is an exception, but Oregon had a better record in the previous year than the other states. A large appliance chain in Utah and Idaho had sales 9.6 percent above those of 1970. Even in the Puget Sound area, where unemployment remains high, strong gains in retail sales up to 12 percent were reported. Most classes of goods seem to have shared in the higher sales; demand was equally strong for both high- and low-priced items. Similarly automobile sales have been good. Domestic makes are reported to be selling relatively better than imported cars.

Construction continues to be a source of strength, principally residential construction and government projects. Derived demand from construction is stimulating production and employment in the lumber and wood products industries in Oregon and Washington. On the other hand, prospects in some kinds of mining are less promising; for example, in Utah copper mines are reducing their workweek and further reductions are possible.

Last year was an excellent one for agriculture in most of the Twelfth District; reports from Washington, Oregon, and Idaho indicate a similar prospect for 1972. Cattle prices are high, and the demand for fruit is good. Wheat prices may be lower because of heavier planting plus the carryover due to the dock strike.

Bankers report a decline in lending rates. CD rates have also fallen and most banks, but not all, have cut the rate paid on passbook savings accounts. There has been no major change in loan demand.

Phase II has been well received as a means of stabilizing prices, and as yet there is no strong discontent with the controls. Two aspects are receiving some criticism which may become more serious. First of all, businessmen seem to feel that the wage increases allowed are more generous than those allowed for prices, and some think that the larger unions will attempt to obtain wage settlements above those permitted under the guidelines. If this occurs one result may be to squeeze profits and restrict investment. The second complaint is about the detailed administration of the guidelines, particularly the ambiguities in the rules and the possibility of an increasing number of exceptions. If confusion builds up, support of the controls may be eroded.

Overall, the consensus is that for the moment the price guidelines are being followed conscientiously by most businesses, and the wage restraints are being accepted by most workers even though their unions may be opposing controls on their wage contracts. Our directors have no general views as to how long Phase II will be needed or how successful it ultimately will be, but they support it at this time.