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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Latest Redbook comment suggests that the recent business slowdown has bottomed out and that the economy may now be in a mild, though fragile, recovery. Heavy demands for capital goods appear to be the main element undergirding the current level of activity. Fuel shortages are reported to have eased substantially, although shortages of industrial materials, most notably steel, remain a serious constraint on production growth. Reports on consumer spending are spotty, with some Districts reporting retail sales as "good" or "holding up well" while others note a softening of demand for big-ticket items and a leveling off in sales of nondurables. The housing sector is uniformly described as weak and, in the light of recent interest rate behavior, as likely to weaken further. All Districts report persisting inflationary expectations, which along with recent sharp price increases and fears of acute materials shortages, are causing large demands for inventory financing. Current comment contains many more references than usual to financial stringencies and liquidity problems, in both the business and banking communities.

The most bullish area of the economy clearly is the capital goods sector. Chicago reports that the capital goods boom in the Seventh District "continues at full throttle" and this theme is echoed in the reports from Cleveland and St. Louis. The New England machine tool industry is also reported as operating at capacity. Materials and other shortages, however, are mentioned as seriously impeding output

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*Prepared by the Federal Reserve Bank of Richmond.

growth in this sector. Chicago, for example, notes shortages of metals (especially steel), chemicals, packaging materials, components, trained manpower, and transportation as factors limiting output. Output in the Chicago District was also reported to have been hampered by strikes.

As regards the consumer sector, several Districts report an improvement in sales of medium-sized and large automobiles, and Chicago notes that automobile firms "are pressing for delivery of additional steel for large car production which has increased." Atlanta and Chicago also report increased demand for recreational vehicles. While retail sales are in general characterized as good, some Districts note that price increases account for much, if not most, of the reported gains. Boston, Dallas, Richmond, and St. Louis report a leveling of sales, with the last two indicating a softening of demand for big-ticket items.

Reports on inventories suggest efforts in some industries to build stocks of materials as a hedge against both rising prices and future shortages. A Cleveland survey found stocks depleted in some steel, coal, oil, machinery, chemical, and packaging firms, with respondents indicating that they would like to rebuild their inventories. Capital goods producers are said to be unable to build inventories because of heavy demand pressures and shortages of materials and components. Minneapolis reports some involuntary accumulation of goods in process due to materials and component shortages. In some lines, however, reports suggest inventory accumulation may be leveling off. Dallas reports that retail inventories are being held down while Boston and Minneapolis indicate that high interest costs may be discouraging stock building. Also Richmond reports a significant increase in the number of manufacturing respondents indicating general satisfaction with the current level of inventories.

Districts reporting on housing indicate continued weakness in this sector, with prospects that the recent sharp run-up in interest rates will pinch off any recovery that may have been underway. Most Districts report extremely tight mortgage market conditions, with six Reserve Banks reporting a significant amount of disintermediation at either thrift institutions or commercial banks or both. New York characterizes the disintermediation at Second District thrift institutions as severe.

All District reports describe business loan demand as "strong" or "very strong," although Boston and Kansas City indicate some leveling of demand at a high plateau. Inventory financing is generally reported as a major factor behind this demand. Most reports suggest that increases in demands for this purpose are attributable mainly to higher prices of inventoried goods although some Districts indicate that expanded stocks of materials are also a factor. New York and Chicago also report that delays in construction projects and sizable inventories of unsold houses may be contributing to loan demand. Some shifting of capital market borrowing to banks was also reported as a factor behind business loan demand by New York and San Francisco. Several Districts noted increased demand for accounts receivable financing and a substitution of bank credit for commercial paper sales, especially by REIT's, as contributing factors. Chicago, Richmond, and Minneapolis reported strong demand for farm credit because of increasing difficulty being encountered by farmers in arranging trade credit.

Several Districts cite increasing liquidity problems for businesses as well as for thrift institutions and commercial banks. Boston and Kansas City report vigorous complaints against tight money

policies in some quarters, with Boston indicating financial stringencies for public utilities and insurance firms. A number of Districts report that banks are becoming increasingly selective in screening loan applicants and some Districts indicate a growing reluctance on the part of the banks to finance loan expansion through high cost CD financing.

The agricultural outlook is reported generally good for crops, but low market prices and high production costs are a problem in the livestock sector. St. Louis reports that resulting production cutbacks could mean higher red meat prices later this year.

FIRST DISTRICT - BOSTON

The pace of business activity is mixed, with large corporations reporting strong gains, and small business hurt by shortages and high money costs. Utilities are also reported as under heavy financial strains and a large Boston bank director cites concerns in the financial markets that the Federal Reserve's "brinkmanship" would cause another Penn Central crisis.

One large bank director reports that for the last two weeks there has been concern in the financial community that the price of money has pushed some borrowers to the breaking point. He fears that the Federal Reserve is exercising a degree of "brinkmanship" which will cause another Penn Central episode. He believes that it is time for the Fed to ease up and that the economy could end up paying a high price if the Fed does not. In addition to disintermediation at thrift institutions, he notes that insurance companies are very worried about their liquidity problem caused by heavy policy loan demand.

This Boston banker reports that his business loans leveled off about 10 days ago. He notes that there is some evidence that small wholesalers, retailers, and manufacturers who had been borrowing for inventory financing are now trying to pay off their loans because the interest charge is too burdensome. (Although his small business prime is 8-1/2 percent, most small business loans are being made at 11-1/2 percent.)

Despite press reports of public concern about financial markets, none of our other directors has heard any similar rumors. One of our directors, who serves on the Board of a major Boston electric utility, does

report that this utility is facing very heavy financial pressures, in part because of the large drop in usage of electricity. Another director who is connected with a major utility also cited problems stemming from unusually slow growth in usage. Business directors, however, report that their own businesses are strong especially in machine tools where the industry continues to operate at capacity. Consumer lines, however, especially apparel sales, are soft.

The unemployment rate for New England held steady at 6.7 percent in March, it rose in Massachusetts to 7.8 percent, and is now 1.5 percentage points above a year ago. Except in Connecticut, unemployment rates in all the New England states are higher than a year ago.

Among our academic correspondents, Professors Eckstein, Samuelson, and Tobin were available for comment this month. Eckstein expects a fairly vigorous recovery (with real growth averaging about 4 percent) over the remainder of the year. Even with a recovery of this magnitude, the unemployment rate is expected to rise to close to 6 percent. Eckstein acknowledges that his forecast is at the optimistic end of the range of forecasters and that most of the risks lie on the downside. The housing sector is the most dubious part of his forecast. He assumes that the Fed "will have to back off by July" as "the financial market can't stand it" and that the bill rate will fall to about 7 percent in the second half of 1974. With the bill rate above 8 percent throughout the year, he believes that no amount of ingenuity by the Federal credit agencies could offset the consequent disintermediation and that housing starts will fall to about 1.3 million in mid-1975. His policy recommendation, therefore, is to move the bill rate below 8 percent.

Tobin is much more pessimistic on the economic outlook and highly critical of current policy. He points out that the strength in the latter part of the year depends on a revival in housing and that, with current policy, there is no prospect that housing will come back. Reflecting the state of lack of confidence, the depressed stock market indicates that the cost of capital funds remains high. He also cites Thomas Juster's pessimism about prospects for the savings rate. He suggests that the Federal funds rate should be brought down to about 8 percent.

While Samuelson personally feels we are at the bottom of the recession, he points to a respectable body of opinion which doubts that. His primary policy recommendation is to ease until we are sure that the turning point has been reached. He grants that there is sufficient strength in basic industries such as steel and paper to preclude a dangerous downward spiral but is apprehensive about choking off a business recovery before it is even underway. While pleased with the latest wholesale price figures, he speculates that the first quarter inflation rate will be revised upward. In this inflationary setting, higher-than-normal rates of growth in the monetary aggregates will be necessary to achieve a recovery. There will be a 6 percent "base load" rate of inflation plus whatever catch-up comes from ending controls plus whatever bad luck we have on items like food and fuels. It will take a protracted period of time to cut into the basic 6 percent rate without a recession of a magnitude which, in the present political climate, "no one is in a position to stand." He is skeptical about the inflation gains from a period of stagflation. The 1969-1970 experience illustrates that very little is gained from a few years of real growth a few percentage points below normal capacity growth. In the present situation,

money growth below 8 percent would dampen real output growth and, if the Franklin bank situation gets more dangerous, even more money might be required.

SECOND DISTRICT - NEW YORK

Second District directors and other business leaders who were contacted recently on the whole felt that the recent slowdown in business activity would be followed by some improvement in the latter part of the year, although some expressed doubts about this prognosis. The respondents generally expected further significant price increases. Consumer outlays remained relatively strong in the New York City area, but some weakening was noted upstate. Construction is expected to be further adversely affected by the rise in short-term interest rates and the resulting outflow of funds from thrift institutions. Views regarding the prospective demand for short-term business credit were mixed but on balance pointed to a sustained strong demand.

The directors in general agreed that the slackening in business activity which has occurred in recent months is likely to be followed by an improvement as the year wears on. The president of a large chemical corporation thus characterized the slack in the economy as minor, and the president of a large nationwide retail concern looked for some improvement in the second half of the year. The president of a multinational nonferrous metal concern expected a moderate increase in real GNP for the year as a whole. Another director reported strength in the airline, semiconductor, and media industries. An upstate banker expected continued strong demand for goods and services and expressed the view that, if inflation can be controlled, the economy would look much better by the end of 1974 or early 1975. Several respondents, however, stressed the uncertainty surrounding the prospects for the recovery.

Among the businessmen who were contacted prior to the termination of remaining price controls on April 30, most anticipated a further surge in prices--led by copper, steel, and other raw materials--following the already large increases which had occurred during the progressive relaxation of controls. Others expected no explosive surge in prices as a result of the full elimination of price controls, but did look for large selective increases in previously controlled areas and more moderate increases elsewhere. The Buffalo branch directors contacted during the past week anticipated a continuation of upward pressures on prices and wages principally as a result of catch-up price increases for those industries where price controls had created distortions and where wage and salary increases were needed to make up for increases in the cost of living that had already occurred.

Concerning consumer spending, a senior official of an upstate department store reported some softening in retail sales in western New York. However, as noted above, an upstate banker saw a continued strong demand for goods and services. Moreover, a recent survey by a local newspaper of major New York City department stores with branches in the suburbs revealed that April retail sales in the New York metropolitan area had been signficantly higher than in April 1973, both in real and in dollar terms, and that most big-store executives had become more optimistic regarding the retail sales outlook.

Perhaps the weakest spot in the District's current economic picture is found in the construction industry. The respondents expressing an opinion on this subject generally expected the rise in short-term interest rates to have a serious adverse effect on residential construction. The cost of new housing and the shortage of building materials continued

to be cited as adverse factors. However, according to several local savings banks, the major adverse factor has now become the unavailability of funds as a result of "severe" outflows of funds from thirft institutions to higher yielding money market instruments--notably short-term Treasury securities. As a result, thrift institutions have substantially tightened their already tight lending terms and have become "very selective" in making new commitments.

Views were mixed regarding the outlook for demands for short-term credit by businesses. A number of observers attributed the very strong credit demands of recent months primarily to inventory accumulation as a hedge against inflation and shortages. Some felt that such demand will taper off. The majority of the respondents, however, expected continued strong demands for short-term credit. Among those respondents, the president of a large chemical firm thus anticipated a continued strong demand for credit stemming from the impact of inflationary pressures on business working capital needs, and another director felt the same factor would sustain credit demands in the agricultural sector. The president of a large nonferrous metal producer stated that one factor contributing to the demand stemmed from the financing requirements related to the extended delays on major industrial construction projects. Another director noted that the high rates in the long-term capital markets were inducing firms to draw upon their bank lines of credit. The need to finance rising accounts receivables was also cited as a factor likely to sustain credit demand. There were also reports that purchasers of commercial paper have been upgrading their portfolios, with the result that firms whose credit ratings fall short of the highest rank have found it increasingly difficult to sell commercial paper.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third Federal Reserve District is showing some hopeful signs. The downward slide of business activity experienced during the first quarter of 1974 has been stemmed, and the local economy may be preparing for a modest recovery. Production activity and employment have both been stable during the last month, and most manufacturers are anticipating a pickup in the next six months. Retail sales are already showing strength. Rising prices are still a problem for area businessmen as well consumers, and their long-run expectations are for more of the same. Bankers report exceptionally high loan demand and see little short-term softening in the credit needs of their customers. Disintermediation is not yet serious, but there is some indication that it may become more of a problem in the weeks ahead if money market rates remain high.

According to the executives responding to this month's business outlook survey of manufacturers in the Third District, business activity in the local economy has been steady in the last month. New orders, shipments, delivery times and inventory were all relatively stable. This represents progress of sorts since the economy has been in a slide for the last several months. Employment is also holding steady with four out of five businessmen surveyed reporting no change in either the number of employees or in the average workweek.

The outlook for general business activity in the future, however, is much brighter. Over half of the survey's respondents predict that the economy will be stronger six months from now. While hopes are high for increased manufacturing activity, less than ten percent of those surveyed

expect delivery times to increase. This suggests that the supply constraints that have been such a problem in the manufacturing sector for many months may be less binding in the future. The employment picture is not expected to improve in the foreseeable future. The number of firms planning to hike their payrolls is exactly matched by those planning to decrease employment during the next six months. Capital spending plans remain strong and have increased slightly in each of the last three months. Retail sales in the Delaware Valley have picked up recently. The depressing effects that the energy crisis has on consumer buying of general merchandise are reported to have worn off, and business is brisk. Virtually all spring and summer merchandise lines are selling well. Prices continue to be a difficult problem for area businessmen. More than eight out of ten claim that they paid more for their purchases this month than they did last month. Six out of ten of these businessmen charged more for the goods they sold to their customers. Very few of these executives expect any relief in the next six months.

The region's largest commercial banks are experiencing very heavy demands for credit. The bulk for the lending activity has been precipitated by inventory and capital investment and increasing substitution of bank loans for commercial paper (especially by the REITS). The recent Treasury note issue caused some deposit outflows at local institutions. However, the bankers report that disintermediation has been building gradually over the last month and a half, and they expect it to be a more serious problem in the weeks ahead unless money market rates drop soon.

FOURTH DISTRICT - CLEVELAND

Business conditions remain strong in certain basic industries such as coal, oil, steel, and machinery, but shortages are still hampering output. Some firms are coping with inflation by increasing the use of escalator clauses. Inflation is contributing to some hoarding and speculation in inventories. Recent strength in business loan demand largely reflects the need to finance higher-valued inventories and rising accounts receivable at a time when real cash flow is deteriorating.

According to our directors, materials shortages continue to constitute a major problem. One machine tool executive reported that nondelivery of vital components has slowed the entire production process. A director from a large business machines firm, however, said that the raw materials situation is improving. Another director indicated that basic materials industries are going to expand capacity significantly (until now, pollution control expenditures have absorbed a high percentage of their capital equipment spending. One director noted there is no longer an oversupply of large cars, in fact, it appears that the auto companies may have over-reacted in their shift to small car production. Demand in the coal industry is so intense that, according to one director, "coal at $35 a ton includes logs, bone, slag...anything." A banker reflected that coal machines, which formerly would have been financed over 5 years, are now financed over 2 years. One banker was concerned over increased personal loan delinquencies and the alarming moves of some individuals to consolidate loans and then take our new lines of credit. Consumers appear to be maintaining a high level of spending according to one of our directors associated with a major retail chain.

A number of large industrial firms in the District were questioned on recent developments in pricing policies, working capital positions, inventory situations, and capital spending plans. The responses suggest an increased use of escalator clauses in long-term contracts for products bought and sold. Indexing (in one form or another) is also increasingly common in contracts and orders involving long lead-time items. The steel industry continues to quote prices at time of delivery rather than at time of booking. A major coal producer said that since last month coal prices have been quoted at time of shipment with all cost increases based on an escalator clause. In addition the firm recently wrote several long-term contracts calling for upward price adjustments whenever the rate of return on investment falls below the rate specified in the contract. Liquidity positions are mixed. Some businesses report ample cash positions (steel, oil, coal, chemicals, nondurable consumer goods). They have been net suppliers of funds to the commercial paper and CD markets. Firms in the machinery, tire and packaging industries have been borrowing heavily from banks and the commercial paper market to finance inventories and accounts receivable. Virtually all firms report increasing receivables, which they say is typical during periods of tight money and rising prices. Several machinery companies commented on a general tendency for their customers to delay paying bills as long as possible. One major oil company by contrast has reduced its receivables and improved its liquidity position by withdrawing about 2.5 million credit cards since September, thus forcing its customers to pay cash. In turn the firm is required to make immediate payment to the Arab countries for purchases of crude.

Firms contacted generally want to build their stocks--mainly to protect current production and sales schedules but in some instances as a hedge against price increases. Steel producers would like to rebuild depleted stocks but find it impossible because of strong customer demand. Some of the steel inventory accumulation by customers has been price-hedging according to the steel mills. Steel producers are also desperately in need of coal supplies. Oil companies have been unsuccessful in trying to build stocks. Machinery companies report inventories must be built before production can be increased. Shipments are being held up for lack of materials and component parts. Shortages of raw materials have also prevented chemical and packaging firms from increasing their inventories as much as they would like. Several firms however pointed to the growing risks of speculating on certain price volatile raw materials.

Capital spending plans are not being altered as a result of current financial or economic conditions. Several firms mentioned that shortages of materials could possibly result in their spending being stretched out. As a general matter, firms intend to finance fixed capital investment from external sources of funds. One steel company with large spending plans said it would be reluctant to borrow now. They will first liquidate some of their marketable securities and use reserves set aside for capital programs before resorting to external financing at current interest rates. A rubber-chemicals producer said high interest rates might adversely affect spending plans for the tire industry, but borrowing costs are easily recovered for investment in chemicals and plastic goods because of higher returns.

The increase in business loans by District banks continues to be strong, although at a slightly reduced pace from March. Bankers indicated that loan demand involves, in large part, takedown of lines-of-credit to finance inventories and increasing accounts receivable. The commercial paper rate differential and delay in going to capital markets also help to explain the strength in business loan demand. A number of bankers, however, report that some loans are not being repaid at stated maturity. Corporations are caught in a cost squeeze due to the underestimation of increased costs. Bankers report a decrease in foreign commercial bank lending and some slowdown in loans to nonbank financial institutions. As a general matter, banks are being conservative and selective in accommodating loan demand by REITs.

There seems to be mixed opinion on prospects for bank credit. Some of the bankers contacted see little letup in business loan demand because businesses will increasingly feel a liquidity squeeze. Also, they expect continued heavy demand for financing capital programs. On the other hand, a few expect a letup in bank credit as the spread between the commercial paper rate and the prime rate narrows.

FIFTH DISTRICT - RICHMOND

Results of our most recent survey of businessmen suggest some softening of recent strong demand pressures in the Fifth District. Reports from manufacturers indicate some easing in the pace of new orders and perhaps also of inventory accumulation. The retail sales diffusion index for the District suggests little change in sales, which is a substantial shift from the sizable and general increases recorded in previous surveys. Reports from retailers suggests that sales of big-ticket items are less buoyant than was the case earlier in the year. Bankers continue to experience heavy demand for business and agricultural loans and, given the high cost of CD funds, many have begun to screen loan applications more carefully. Some banking respondents express serious concern over what they consider to be groundless rumors that banks will be unable to roll over their CD's.

The survey results from 56 manufacturers showed new orders down in 17, and up in only 6, which is a significantly worse diffusion than shown in earlier surveys this year. Until recently, manufacturers had been reporting that inventories were lower than desired. The recent survey, however, shows that although 15 respondents believed that inventories were too low, an equal number believed they were too high. In spite of an apparent softening in orders, an increasing number of respondents thought that their current plant and equipment capacity was too low. This suggests that they do not expect a continuation of whatever softening of demand may be occurring. This conclusion is also supported by the responses on production expectations. Twenty-one expect production to expand in the next few months, and only 6 respondents expect production to decline.

The easing of new orders appears to be concentrated in textiles, apparel, furniture, electrical equipment and supplies, and lumber and wood products. Sales of textile producers may have been adversely affected by the inability

of textile converters to find financing. Primary and fabricated metals producers, however, appear to have burgeoning orders, as do food processors. Employment in manufacturing firms is reported unchanged from last month, and most firms continue to entertain buoyant expectations for future production.

Our retail sales survey indicates that sales may be leveling from their previously high rates of growth. Big-ticket items, especially, seem to be selling somewhat less well than they did in March or April. Sales expectations for the next six months, however, appear to have improved since last month's survey.

The agricultural outlook for the District remains generally optimistic, with most crops coming in on time or ahead of time. Some soft spots may be developing in livestock production, however, because of declining prices and high costs. Because of low market prices and high production costs, some North Carolina turkey producers are reported to be selling their breeder flocks and destroying eggs. While cash receipts of District farmers have been rising, the increase has lagged behind that for farmers in the nation as a whole.

District bankers continue to report heavy loan demands, with strength centered chiefly in business and agricultural loans. Fertilizer dealers and other farm suppliers are reported to be reluctant to extend trade credit to farmers and as a result farm credit is apparently being pushed increasingly into the banking system. Heavy inventory financing is reported as the principal factor behind business loan demand. Bankers attribute most of the recent increase in inventory borrowing to higher prices rather than to expanded stocks. Several large banks reported that they are no longer making real estate loans and are limiting consumer loan growth to what can be financed by increases in consumer time and savings deposits. Bankers generally show a reluctance to go to the CD market to raise funds at the

current high rates and some indicate that they will accommodate only as much loan demand as can be financed through "regular" deposit growth. Most bank respondents appear to have tightened up their lending practices rather substantially. Consumer loan delinquencies, which have risen nationally, appear to pose no major problem in this District, according to most respondents. Several respondents were quite exercised over news stories of diminished public confidence in banks and mentioned the dangers of "groundless rumors" that many banks will not be able to roll over their CD's.

Mortgage funds have become scarce indeed, as District savings and loan associations are experiencing sizable deposit outflows. Preliminary data indicate the April outflow may have been as much as $100 million. This compares with a $200 million inflow in April 1973. Residential building and the building supplies industry are feeling the crunch.

Businessmen and bankers in the District continue to express optimism regarding the six months outlook for business in their local markets. But most feel that the national economy will show little growth over this period.

SIXTH DISTRICT - ATLANTA

Inflation seems to be the top item of concern of most businessmen and directors in the District. Consumer spending is apparently holding up well. However, much of the increase in spending is related to higher prices. Record high interest rates are causing commercial banks' lending rates to bump up against state usury ceilings in some areas. Although some soft spots still exist, no new job layoffs of any consequence have been recorded. Tourism, particularly in Florida, is now beginning to improve as gasoline becomes more readily available. The volume of new and expanded plants announced during the past month was one of the largest ever recorded and reflects the pace of capital spending in the District. On the agricultural scene, bumper cotton crops are expected, although some crops are behind in their planting schedules.

Inflation is uppermost in the minds of many. An area businessman, who surveyed several of his associates, summed it up in typical fashion:

"The general consensus of most businessmen interviewed during the last thirty days is that they expect higher prices and more and larger wage demands. This they expect to lead to more and continued inflation. Most expressed concern for the condition of the economy but were apprehensive of the ability of the nation to reverse the trend (i.e., inflation in a short period of time)."

Retail sales continue to expand as indicated by reports from Alabama, Florida, and Louisiana. However, most of these increases are related to higher prices. One Alabama businessman suggests that people are convinced that inflation will continue and, consequently, are purchasing now rather than paying higher prices later. The three largest department stores in the Birmingham area report that sales for the first quarter of

1974 are up by approximately 11 percent from the same period a year ago; but they indicate that price increases accounted for over one-half of these gains. Shortages of wool and wool-blend fabrics may raise apparel prices but depress overall sales. Auto sales, particularly in the mid-to-large size class, have apparently nearly recovered from their earlier slump, according to reports from around the District. Used car sales have also picked up.

Reports from central Alabama and mid-Louisiana indicate a continuation of strong loan demand. In Tennessee, rising interest rates have forced bank loan rates up against ceilings imposed by state usury laws. Alabama bankers indicate that mortgage loan delinquencies have increased and are now at record highs. Consumer instalment loan delinquencies have also been on the rise in many parts of the District. Several automobile dealers have reportedly failed, and some banks are finding themselves in the car business.

Labor market conditions appear to have stabilized. Florida's and Georgia's mobile home and recreation vehicle manufacturers are beginning to note a pickup in sales and production. Some mobile home manufacturers forecast a bright future for their industry for the next ten years because of the skyrocketing cost of residential construction. In South Florida, one electrical parts manufacturer is expecting to add substantially to his labor force in coming months. However, in east Tennessee, several large nationally known television manufacturers expect a downturn in sales and some job layoffs. Tourist activity is showing a strong comeback as gasoline supplies become more available. In central Florida, Disney World, Cypress Gardens, and Circus World have reported increases in business in the last

month. These attractions, as well as areas in south Florida, are forecasting a good business for the summer months. They reason that part of the business lost earlier will come this summer as a bonus. On a side note, Tampa has become the first city to receive an NFL football franchise since the AFL-NFL merger several years ago. City officials feel that this will provide a boost for the tourist activity. In Tennessee, however, attendance at the great Smokey Mountain National Park remains below par.

Announcements of new and expanded plants were at record levels. Apparently, the energy shortage has stimulated some of these announcements. A $3 billion nuclear power generating plant has been announced by the Alabama Power Company. Louisiana Power and Light Company announced plans for the construction of a $1.2 billion nuclear generating station, with initial operations scheduled for 1982. Gulf States Utilities announced plans to build Louisiana's first coal-fired electric generating plant. It will cost $150 million. Tennessee Valley Authority recently sold $100 million in five-year power bonds. The funds would be used for expansion of the TVA power system. Other new plant announcements are as follows: a $213 million container board mill in Mississippi; a $150 million cigarette manufacturing plant in Macon, Georgia; and a $96 million chemical plant in Mobile, Alabama. Two large plant expansions were also announced: a $160 million expansion of an Alabama aluminum manufacturer and a $100 million plant expansion of a Louisiana pulp and paper processing plant. Business investment in pollution control equipment continued to receive top priority in many instances. An Alabama paper company reported capital expenditures of $25 million in April. Of this total, $18 million is going into pollution control.

Bumper farm crops are expected in many areas of the District. In Tennessee, the largest cotton crop since 1954 is expected. Mississippi also

expects a large cotton crop. Florida's sugar cane industry expects the second largest crop in the industry's forty-nine year old history. However, bad weather has delayed planting of crops in some areas of the District. One of Alabama's most prominent cattle dealers reports that there is a definite surplus of beef cattle, and the prices of live cattle are down nearly 30 percent from earlier highs.

SEVENTH DISTRICT - CHICAGO

Seventh District capital goods producers report that the capital goods boom continues at full throttle. Shortages of metals, chemicals, packaging materials, components, trained manpower, and transportation continue to impede output in many sectors, with no improvement in sight. A variety of strikes also have slowed output growth. Fuel shortages are no longer an immediate concern to businesses and consumers. Retail sales generally have been better than expected. The market for large cars has improved, and the boom in small cars may have ended, at least temporarily. Sales of recreational vehicles have increased sharply from the extremely low level of the start of the year. Price increases for manufactured goods and services have come "thick and fast" since the end of controls on May 1. Hopes for a revival of homebuilding have been hard hit by high interest rates and substantial outflows of savings from S&L's since the last third of March. Prospects for record crops in the Corn Belt are excellent with field work well ahead of normal.

Aside from homebuilding, very high interest rates are causing widespread apprehension. Apparently to allay fears, the large Chicago banks made statements on May 13 that emphasized that funds will be available, although at high cost. There are private reports that builders have not repaid construction loans on schedule, because of large inventories of unsold houses. Otherwise there is little evidence that collections on business receivables have slowed. In fact, some firms report that collections have improved.

Many firms are experimenting with new escalator clauses to cover rising costs, having found that existing arrangements were inadequate. On long lead-time items, one firm has announced that prices will be advanced one percent per month after the fourth month. Other firms have abandoned fixed prices, quoting only "estimated" prices, or, more commonly, "price at time of delivery."

Commonly, business firms that had expected a slump in demand for their products in the first quarter found that actual results were relatively favorable. This is true of both producer and consumer goods. Although some businessmen are worried about a renewed decline in the general economy, they appear to be a relatively small minority. Nevertheless, there are persistent reports of small firms hard-pressed because of problems of obtaining materials and workers and rapidly rising costs.

The increase in the minimum wage on May 1 seems to have been absorbed without a noticeable impact on the demand for workers. The recent steel settlement is said to increase labor costs by 40 percent in three years, and this package is likely to be demanded in other areas. There has been upward pressure on white collar wages and salaries since decontrol. Many of the large firms had been following the guidelines "more or less." New claims for unemployment compensation eased in District states in April, as compared with the first quarter, but were still above last year in most localities. In most areas, these claims have been boosted mainly by lay-offs in the motor vehicle and petroleum-related industries and do not appear to have spread in a cumulative fashion.

The most important material shortage clearly is now steel. Because of production difficulties earlier in the year many steel deliveries have been behind schedule. As a result, allocations to most users have been

reduced for the third quarter. Output of steel will be lower in the third quarter because of needed maintenance and vacations. The auto firms are pressing for delivery of additional steel for large car production which has increased. Foreign steel is much less available despite prices far above domestic levels. Exports of steel have increased somewhat, but this is not a large factor in the supply situation, particularly in the Midwest.

Although demand for virtually all types of producer equipment is intense, with delivery times streching out still further, the picture is particularly tight for farm equipment, heavy construction equipment, heavy trucks, freight cars, machine tools and traveling cranes needed for new factories and utility generating stations.

Farm loan demand remains exceptionally strong, although demand for feeder cattle loans has slackened. Rural banks are shouldering a larger share of the farm loan demand because trade credit has become less available in a period of tight money and short supplies of fertilizer and other products sold to farms. Farmland values rose sharply again in the first quarter. District bankers reports indicate farmland prices averaged 34 percent above year-ago on April 1. Corn Belt farmers had completed 27 percent of their intended corn planting by May 5, up from only 6 percent a year earlier and the 5-year average of 18 percent. Because of curtailed feeding operations for both hogs and cattle, most analysts expect higher prices for red meat later in 1974.

EIGHTH DISTRICT - ST. LOUIS

The pace of economic activity in the Eighth Federal Reserve District remains moderately upward. Manufacturing activity generally continues strong, especially for firms connected with the capital goods industry. On the negative, construction activity, particularly single-family dwellings, has deteriorated. Some firms supplying this industry also report a slowing in activity. On the agricultural side, a large increase in crop output is still in prospect, but cattle, hog, and poultry feeding operations are unprofitable.

Retail sales have generally continued upward in recent weeks. Some retailers reported increases of 10 percent or more from a year ago. This growth, however, is largely nullified when price increases are taken into account. Retailers report that clothing and other "soft lines" have experienced large sales increases, while some slowdown has occurred in "big ticket" items, such as air conditioners, refrigerators, and other home furnishings.

The pace of manufacturing activity in the District is almost unchanged from the high rate of last month. With the abatement of the energy crisis, manufacturing is outpacing the level of late last year and early this year. Firms in the capital goods industry report production at a record pace and some reported continued increases in order backlogs. Fewer complaints about raw material shortages were voiced than in recent months, however, raw materials prices have increased substantially since the lifting of price controls and apparently the market is clearing at the higher prices.

Home construction is the weakest sector of the District economy at this time. In addition to rising interest rates and higher prices, usury laws in some of the District states have hampered the industry. Apparently hardest hit is Missouri where usury laws restrict interest rates to 8 percent on loans to individuals. This law has led mortgage lenders to seek higher yielding investments such as Federal funds and outstate mortgages and reports from St. Louis indicate that mortgage funds are virtually impossible to obtain. In addition, a labor strike is currently hampering construction in the St. Louis area.

Growth of savings accounts has slowed in recent weeks at both commercial banks and savings and loan associations, apparently reflecting higher yielding opportunities for other forms of investments. Low yielding savings deposits have remained virtually unchanged with some slight growth in the higher yielding small denomination certificates of deposit.

The livestock feeding industry, in the face of high feed costs and deteriorating livestock prices, is reported to be unprofitable. If so, this would lead to a reduction in output of fed animals until some improvement in profit from feeding is anticipated. Crop farmers, however, are more optimistic. Weather conditions in the Eighth District have been more favorable to crop planting compared with the nearly disastrous planting season last year. Reports indicate that farmers are planting larger acreages than a year ago, as had been forecast. In general, farmers are able to obtain fertilizer at the substantially higher prices, but reductions are being made in the amount applied per acre. This practice will lead to somewhat reduced yields, but given normal weather conditions and the larger number of acres planted, total crop output will probably be up.

NINTH DISTRICT - MINNEAPOLIS

In early May the directors were asked about the extent of business inventory accumulation and the outlook for inflation and unemployment. They indicated that businessmen in the Ninth District have been accumulating inventories for at least two different reasons: apparently some businessmen hope to avoid shortages and future price increases by building inventories and others, facing production bottlenecks due to shortages in certain industries, have been caught involuntarily with extra stocks. Acknowledging considerable economic uncertainty, Bank directors nevertheless did not expect either inflation or District unemployment to grow more serious in the months ahead. A few directors even expected inflationary pressures to lessen in the second half. Bankers responding to our second quarter survey of agricultural credit conditions, however, were less optimistic about the outlook for farm income and anticipate some increase in loan demand.

Several directors reported inventory building to avoid shortages and future price increases. One director explained that retailers, in some instances, are paying more to replace an item than they sold it for and that this is encouraging inventory accumulation to avoid price increases. A Twin Cities' banker indicated, however, that high interest rates are "beginning to get to" businessmen, dampening their desire to add to inventories. One director said that the administration could prevent unwanted inventory accumulation with a policy statement that wage and price controls will not be reimposed.

Another kind of inventory accumulation has taken place involuntarily as shortages of key materials and components result in production bottlenecks. Directors from western South Dakota and Montana indicated that although

some inventory accumulation may have occurred in their areas, businessmen are primarily concerned about obtaining sufficient merchandise to satisfy customer demands.

Generally, the directors looked for smaller price increases in the second half of 1974. A director associated with agriculture pointed to the decline in livestock and grain prices--a decline which should not be reversed in the near future--as a sign that food price increases will moderate. This opinion was reinforced by a director connected with the food processing industry who expected an improved supply situation and somewhat reduced production costs in the second half of this year. Also, several directors looked for fuel prices to level off later this year.

Despite these developments which should lessen inflation, directors' comments indicated that many pressures for increased prices may remain. Increased labor costs during the second half of 1974, one director stated, would place upward pressure on prices. Another director looked for some relief from inflationary pressures during the third and fourth quarters but expected prices to be up substantially in the second quarter with the lifting of wage price controls. He indicated that some of his firm's material costs recently rose as much as 30 percent. A Twin Cities' area banker foresees some increase in the price of bank services with the lifting of wage price controls. One director reported that residents in his area appear more pessimistic about inflation than they were a month ago, and another director indicated that he could discern no trend in his area toward less inflation.

Reflecting their views that the District's economy should remain quite strong in 1974, bank directors looked for an increase in District employment this spring and for little or no increase in unemployment.

A Twin Cities' banker stated, for example, that although he expects the national unemployment rate to approach 6 percent later this year, the District's unemployment rate should remain below this level due to continued strength in both the District's agricultural and manufacturing sectors. Directors did not look for any significant skilled labor shortages. A western South Dakota director, however, indicated that uncertainty over the outlook for his area's tourist business could restrict summer hiring.

Concern over the cattle industry has made many respondents to our April survey of agricultural credit conditions less optimistic about the future of the farm sector than they were in January. While 70 percent of the bankers surveyed reported first quarter farm earnings would exceed 1973 levels, Districtwide, 24 percent of the bankers expected short-term loan demand to be greater than normal in the second quarter, up from 6 percent in the January survey. Although the high cost of farm inputs was expected to bolster loan demand throughout the District, much of this increase should come from the slumping livestock industry. Farmers in the grain-producing areas were apparently still flush with cash from last year's crops, and loan demand in these areas was light.

TENTH DISTRICT - KANSAS CITY

High interest rates are serving as a serious deterrent to home buyers while disintermediation is adversely affecting the supply of mortgage funds. No pickup in homebuilding in the second half of this year is expected either by District homebuilders or thrift institution executives, should current conditions continue. The agricultural outlook still includes big crop yields, based on May 1 conditions, but farm income prospects are wilting. The rate of increase of business loan demand appears to be slowing down, although loanable funds have become increasingly tight. Bank credit is being rationed, while banks aggressively compete for loanable funds.

From discussions with several District thrift institutions, concern over disintermediation was readily apparent. Net inflows have shrunk appreciably or have given way to net outflows of deposits. One savings and loan executive said that April was "miserable," and the "Treasury issues are killing them." Another described deposit inflows as "slim and bad." He wants the Board to know that the law of supply and demand still works--that people are withdrawing large CD's before maturity because they can make up the penalty and then some. A third "...sure would like to know what the Fed is planning to do to him next." A respondent who had recently attended a mortgage bankers convention said "everyone there seemed scared and uncertain."

With a few exceptions, homebuilders generally sound just as gloomy as S&L executives about the outlook. Although most expected the year to be slower, pessimism about the months ahead is increasing. While new home sales in the Kansas City metropolitan area held up surprisingly well through mid-April, they have dropped off drastically since, especially in Missouri because of its 8 percent ceiling on mortgages. Two major Kansas City builders

expressed resentment at the apparent willingness of the Federal Reserve System to sacrifice the housing industry this year in an effort to stop inflation. In Colorado, building activity continues to be determined largely by natural gas allocations. Thus, Denver experienced a record number of mortgage commitments in April, a bulge created by the gas company's requirement that, in order to get gas service, new units must be completed by July. A sharp decline in new starts is expected once that deadline is passed. In Tulsa, a builder complained about how high interest rates were hurting housing. "You know," he said, "we had some carpenters looking for jobs recently. Now, that's a change." One hundred miles away, in Oklahoma City, however, the construction of single family homes is off only slightly from last year, and the builder contacted remains optimistic about the months ahead. However, such favorable views were decidedly fewer in this Redbook survey than in the one taken three months ago.

Agricultural conditions in the District continue mixed. Favorable weather has enabled farmers to make good headway with the planting of spring crops. Some difficulty in acquiring fertilizer and chemical pesticides is being reported, but the problem does not appear to be too serious in this geographic area. Winter wheat conditions have deteriorated substantially in much of the District since May 1 when favorable prospects were indicated in the crop report. Dry weather and an outbreak of streak mosaic are hindering the development of the crop. With immediate improvement in the weather, the 1974 wheat crop still could be larger than a year ago. The sharp decline in wheat prices over the last 2 months has removed much of the bloom surrounding income prospects for District farmers, but unless weather conditions improve, the price situation may reverse. Moreover, the livestock industry, which continues in a depressed state, offers little promise of bolstering District

farm income unless slaughter prices improve or costs come down.

Although business borrowing at large District banks increased sharply in the past 4 weeks, reports from a survey of some of the larger banks indicate that recent increases in the prime rate are beginning to have an effect on business loan demand. Several banks reported that, while the volume of business borrowing remains exceptionally large, loan requests do appear to be leveling off or, in a few cases, even declining. Nevertheless, due to the current high level of business loan demand, some banks have begun to ration credit either by rejecting new loan requests or by limiting the size of loans to normal or past amounts. Moreover, in several instances, banks have become more selective with regard to the purposes of loan requests and have rejected speculative loans for land development and "excessive" inventory accumulation. To accommodate the business loan demand, District banks are competing aggressively for CD's and, as a result, are experiencing sharp inflows of deposits. Most banks are also relying upon purchases of Federal funds to supplement loanable funds, but of the banks in the survey, none as of yet have borrowed Euro-dollars. With only two exceptions, the survey banks have not experienced any slowing in the growth of savings deposits or consumer certificates of deposit in recent weeks. One of the exceptions, however, did report a drop of 5 percent in savings deposits and consumer CD's in the last month.

ELEVENTH DISTRICT - DALLAS

In discussing current economic and credit conditions at the May 9, 1974, meeting of our Board, the directors expressed opinions on inventory positions in their own industries, expected business loan demand, status of shortages of supplies and materials, and overall price trends.

Directors, in the retail field, believe inventories to be increasing. largely in the big-ticket items such as furniture and appliances, but think a sizable portion of the increase can be accounted for by price changes as opposed to large increases in numbers of units. The retail business generally has remained fairly strong although there has been some leveling in sales. It was pointed out that goods to be offered for sale in the next 90 days will be at higher prices, and it remains to be seen what consumers' reactions to such prices will be. In looking at the southwestern part of the United States, generally the opinion expressed was that increase in sales are about even with the increase in inflation. The cost of maintaining inventories has increased substantially with higher interest rates, and there is somewhat of a squeeze on profits. Most retailers appear to be holding their inventories a little lower than usual in order to avoid committing too far in advance.

On production, continued shortages of supplies and materials in certain areas are causing disruptions. Business is very active in energy-related fields. While there have been increases in the quantities of units produced, the large dollar figures are accounted for in considerable measure by inflation. New price increases will be a real factor in how

well business fares over the coming months. All directors anticipate further price increases and referred to the fact that prices of a number of items, such as heavy equipment, manufactured goods, and steel products, are set at the time of delivery, rather than at the time of ordering. Concern also was expressed with the ability to finance large projects in the energy field.

The bank directors reported that business loan demand at commercial banks is continuing quite heavy in this part of the country, particularly with large national companies calling upon previous commitments. It is expected that such business loan demand will continue quite strong. There is evidence of disintermediation as deposits are trending downward and money is going directly into high yield investments.

There were differences of opinion as to whether interest rates have topped out and whether there will be a sharp decline in interest rates this year. Most of the directors do not expect significant declines in interest rates in the near future. It was recognized that if interest rates are not effective in dampening loan demand, the alternative will be greater restriction on the availability of credit. The principal problem here, of course, is to avoid a credit crunch.

Homebuilding in Texas is being hampered by tightening mortgage markets. A survey of leading savings and loan associations in the state revealed that most suffered sizable deposit losses in April. For example, the two largest savings associations in Houston lost in excess of $1 million each during the month. Many large accounts, those in excess of $100,000, were withdrawn and were reported to have been mostly reinvested in Treasury bills. But lenders feel that the current round of disintermediation has

been less severe than the loss of deposits following the implementation of wild card CD's last summer.

Nevertheless, recent deposit losses are proving difficult to offset from other sources. The secondary mortgage market is currently described by those surveyed as a "buyers market." In addition, the Federal Home Loan Bank of Little Rock, which has jurisdiction in the Southwest, is maintaining a restrictive policy stance. The variable rate on advances was raised on April 30 from 9-1/2 percent to 10 percent, which is equal to the usury ceiling in Texas on primary mortgage loans. Also, by regulation, advances cannot be made to cover the loss of CD's in excess of $100,000. Therefore, savings institutions in the state that are losing these large deposits are now looking elsewhere for funds.

Savings and loan associations across the state are responding to losses of deposits by raising rates and cutting back sharply on loans and commitments. During the last two weeks of April many raised their prime mortgage rates on conventional loans to 9 percent from 8-1/2 percent. Most of the lenders interviewed felt mortgage rates will go higher, probably reaching 9-1/4 percent by mid-May.

Mortgage lenders report home buyers are much less sensitive to the recent rise in mortgage rates than they were when rates moved up at the end of last summer. Buyers generally expect housing prices will continue to climb rapidly, and waiting until mortgage rates decline is no longer viewed as a means of reducing the total cost of a house. However, the president of a large savings and loan association in Texas points out that borrower resistance to rising mortgage rates stiffens as rates approach whole numbers, and he predicts many borrowers will shy away, at least temporarily, from the 9 percent rate. The most noticeable impact of tightening mortgage markets

is that lending institutions are making more conservative estimates of the value of homes and are cutting back on the size of individual mortgage commitments.

TWELFTH DISTRICT - SAN FRANCISCO

Economic activity in the Twelfth District shows continued strength. Inflation remains the main policy concern of our directors, but rising interest rates are expected by some directors to cause additional problems. Business investment expenditures remain strong, reinforced by efforts to build up inventories. Consumer spending is high, and with the exception of autos, sales of durables are good. Banks face strong loan demand, particularly for business loans. The majority of our directors see little sign of any slowing in economic activity after the pause caused by energy shortages in the first quarter. Business spending to expand capacity is a major source of strength, but expansion efforts are being hindered by material shortages and slow deliveries. Shortages are reported by most of our non-banking directors and few expect any major improvement in the supply situation during the next six months. Steel and other metals, chemicals and plastics are the materials which are most difficult to obtain. Consumer spending is good throughout the District for nondurables and durables, with the exception of autos. Although auto sales are still weak, they have been recovering. Sales of full-sized cars are increasing, in part because of the effects of manufacturers' sales incentives programs. Some consumer reaction against high prices is reported. In California, milk consumption has fallen by 10 percent after a 13 percent price increase. Consumer demand for credit is described as strong at most banks, but it is accompanied by rising delinquencies. One large Los Angeles bank reported its delinquencies were at an eleven-year high.

Expenditures on tourism are lower than last year. Concern exists in such states as Oregon as to the impact of travel of possible gasoline

shortages this summer. Spokane, because of the opening of its World's Fair, expects to attract large numbers of tourists with favorable effects on the local economy. The weakest sector in this District remains residential housing. After a low point in the first quarter, housing starts have increased but this recovery is threatened, in the view of some directors, by high interest rates. Commercial construction, while much stronger than the residential sector, is hampered by materials shortages in steel, construction equipment, and builders' hardware. The timber industry is experiencing mixed trends. Pulp and paper mills are working at full capacity, but there has been a weakening in lumber and plywood. In Oregon, the closing of several plywood plants has been reported. The president of one lumber company feels that high interest rates which are causing problems for this industry will also precipitate a turndown of the general economy within the next three to four months.

Agricultural prospects are generally reported as excellent, and farmers are attempting to expand acreage in production. In Idaho farmers are uncertain as to which crops offer the best prospects, but surveys indicate they are shifting to potatoes and grain and away from such crops as beets. Shortages of fertilizers persist, but acceptable substitutes are being used. Agricultural equipment is in strong demand and buyers face delays for weeks before receiving delivery. Banks are experiencing a strong loan demand, particularly by business. The business loan demand is being felt by both large- and medium-sized banks. Much of the demand is to finance inventory accumulation in anticipation of higher prices or to avoid future shortages. Additional demand is for capacity expansion. More banks are facing liquidity pressures and have become more selective in lending or have imposed loan ceilings. In Idaho, business loans are being curtailed for another reason. The state usury laws set a 10 percent ceiling on loans

to proprietorships and partnerships, and this is below the rate paid on Federal funds. Another factor in the heavy business borrowing, according to one bank, is speculation that long-term rates will fall, and therefore businesses are willing to borrow at high short-term rates in order to refinance at lower rates later in the year. The existing high rates are viewed by some bankers as hurting small businessmen and residential housing, but the consensus is that rates will begin to decline.