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CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Although it may now be less appropriate than earlier this year to characterize the U. S. economy as one of general materials scarcity, reports from the Reserve Banks continue to emphasize this problem. A fair generalization may be that shortages of materials and components are still generally severe, although the availability of some items seems to be easing. Cleveland and Chicago both emphasize the tightness of supplies, and the spotty nature of the improvements. In the Richmond and Kansas City Districts, some materials are now more easily obtainable but only at much higher prices. The New York Bank reports no lessening of pressure on productive capacity. Its respondents expect some further moderation in basic commodity prices, but continued upward pressure on finished goods prices.

The situation in the steel industry, as reported by the Chicago and Cleveland Banks, is of special interest. A shortage of steel is expected to be a major barrier to output increases in other industries, as demand for steel continues to exceed supply. (1974 shipments are now expected to be below the 1973 total.) According to the Chicago Bank, "shipments have been maintained at recent high rates by further reducing mill inventories below levels thought to be rock bottom." The situation could tighten further because of equipment bottlenecks, and shortages of ore and coal. Demand for coal, from utilities as well as steel companies, is strong; their stocks are low; and the overall supply situation is tight. Steel company officials are concerned about the possibility of a coal strike in November, which would severely disrupt operations. (An economist with a coal-producing firm considers it likely

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*Prepared by the Federal Reserve Bank of Kansas City.

that there will be a coal strike in November of from 2 to 4 weeks duration.)

Several Banks—including Chicago, Atlanta, and San Francisco—report increasing numbers of labor disputes and more strike activity. Construction in the Chicago District has been severely hampered by a strike of ready-mix-concrete truck drivers. Interwoven with the increasing amount of strike activity is the increasing number of large wage demands (and settlements), making the intensifying wage-push pressure on prices a matter of great concern.

Capital spending remains generally, though not uniformly, strong. Chicago reports that demand for capital goods is well above output capabilities, and backlogs are rising in spite of all-out production; Cleveland also reports rising backlogs. Plant and equipment spending is behind schedule in the Atlanta District, but only because of capital goods delivery problems; capital spending plans remain strong across the District. In the Philadelphia District, however, manufacturers are taking a closer look at their plant and equipment spending plans and the outlook now is for a smaller increase in capital spending. Dallas, on the other hand, reports no significant revision of spending plans by large firms in its District. However, small businesses there are holding back on long-term expenditures because of the difficulty of getting bank financing and because of the high cost of funds.

Both Chicago and Richmond report that some major electrical utilities are scaling down their expansion plans. Chicago states that financing problems are to a large extent responsible for the cancellation of some projects, and Richmond notes the announcement of cutbacks, postponements, and review of plans by several electrical utilities in its District.

Eight of the twelve Banks refer in this Red Book to the continuing serious plight of the residential construction industry. The Chicago report is most blunt: "Housing is in a severe recession, with hopes dashed for a revival in 1974." The story is much the same for the Districts commenting: building permits off drastically; savings inflows to, and mortgage lending by, thrift institutions, very weak; construction sluggish and no recovery in sight. Indirect effects are also mentioned. San Francisco notes that the lumber and plywood industry is "marking time", waiting for a pickup in housing. Richmond reports that the sustained decline in residential construction has meant a 20 percent reduction this year in orders to the furniture industry.

Only Minneapolis, St. Louis, and Atlanta report some improvement in retail sales, or consumer spending in general. Cleveland and Philadelphia refer to weak or sluggish consumer spending, as does Richmond for big-ticket items. Several Banks report that retail inventories are considered excessive by their respondents. Views of a number of retailers range from uncertain to pessimistic for sales during the rest of the year. Tourist business has been "lackluster" in New England and slow in the Mountain states of the Kansas City District, but tourism is on the upswing all across the Atlanta District and the industry's outlook for the rest of the summer is good in the Minneapolis District.

Loan expansion by commercial banks continues to be limited by tight credit conditions, with deposit growth slowing down. Philadelphia reports loan demand as firm, held down primarily by restrictive loan policies rather than by adverse publicity. Business loan demand is characterized as strong by Atlanta, and by Minneapolis, where no let-up is foreseen. Richmond and Cleveland also report strong demand for business credit, with their banks becoming increasingly selective in allocating scarce funds. Kansas City and St. Louis detect some weakening in the rate of growth of demand for commercial loans. "Lackluster growth" summarizes the comments on recent deposits behavior, by Philadelphia, Atlanta, Kansas City, St. Louis, Minneapolis, and Richmond.

Boston's Eckstein and Samuelson warn of the dangers of overly tight money. New York respondents worry that the country is nearing serious trouble as the strains on liquidity increase. In Atlanta, apprehensive businessmen are reacting to the rumors of little liquidity in banks, while nonbank respondents for San Francisco call commercial banks "dangerously illiquid." Meanwhile, most Philadelphia banks have been able to roll over their CD's without major difficulties.

Concern with the agricultural price situation is recorded by several Districts. Richmond and Atlanta report that poultry and cattle producers are caught in a severe cost-price squeeze. Kansas City, Dallas, and San Francisco comment further on the troubled cattle industry. Minneapolis and Kansas City explain the recent turnaround of grain prices as being partly due to the uncertain effects of unfavorable spring weather on the corn and soybean crops. Offsetting the bad farm news, San Francisco points to the high price for sugar beets, and Kansas City reports a good wheat harvest in progress.

FIRST DISTRICT - BOSTON

Our directors report that business continues to be good, although off somewhat from the peak. There is widespread concern about inflation, but the concern has only led to doubts about the economy, not to fear about its viability. According to our directors, employment is holding steady. In New England, the unemployment rate in May was 6.8 percent, seasonally adjusted, up a point from a year ago, with Massachusetts continuing to have the highest unemployment rate in the area at 7.6 percent.

Business is reported as generally doing pretty well. The recreational vehicle industry is picking up as the gasoline scare fades, and the motor boat industry is expecting a similar revival soon. Carbon black shipments, although off from their peak rates in June, and now only at year ago levels, have held up very well considering that carbon black's major use is in the manufacture of tires. The speciality chemicals area is reported as operating at capacity. Silicone output is at capacity because users are switching from the now more expensive petrochemicals to silicone.

The recreation areas in New England had a lackluster June, with the number of tourists generally below year ago levels. However, this may well have been caused by the cool and rainy weather.

Our directors report a general concern about inflation, but the doom and gloom articles which have appeared in the financial press and the Franklin National episode have only planted a few seeds of doubt about the viability of the economy; decisions have not yet been affected. There was the feeling, however, that a few more incidents could make the difference. Actual nervousness is very slight, although manufacturers have revised down their expectations of growth for the rest of this year.

Professors Eckstein and Samuelson were available for comment this month. Eckstein points out that nonborrowed reserves have not increased so far this year; money and RPD growth have come entirely from increased bank borrowings. In this inflationary setting, money growth of 6 to 7 percent is producing a money crunch which will damage the financial system, and ultimately the economy. Continuation of recent policies would, Eckstein says, cause a financial collapse. There has already been substantial disintermediation and a few bank collapses (here and in Europe) which have been explained away as localized; "but this is just the Government's great capacity for self-deception—it is really playing with fire." The policymakers' objective should be control and regulation of the financial system, the channel between savings and investment, not just control of the narrow money stock. The heart of the matter, Eckstein argues, is that the policy will not succeed in stopping inflation. That could be done only if the unemployment rate were raised to 8 percent and left there for several years with the severe damage to the economy. If the Federal Reserve insists on further credit restraint, it must adopt a system of credit control—limits to the amounts and uses of banks' business loans. Disintermediation has taken place through the big banks, and that is where the restraint should be applied. In order to achieve an orderly unwinding of inflation, some attention must be paid to interest rates in the current context. Eckstein's short-term policy target is a Federal funds rate of 11 percent in the third quarter.

Samuelson is more concerned that tight money will be overdone than that it will be underdone. He notes the deterioration in the economic forecasts in recent months. In light of the very high projected rates of inflation, nominal GNP would need to grow at a 10 to 12 percent rate over the next year in order to achieve even a modest recovery in real growth. In this situation, "tight money" would have to be defined as anything below 8 percent. "If money growth is below that, the money shortage is going to be eating into the real strength of the economy." Those who seek a stagnant rate of real growth as their objective will reassess their objective when we start to experience the cost/benefit ratio of a stagnant economy. The money supply numbers ought to take into account the concern for the quality of credit—loanable funds have been funneled to the large banks. As a result of that concern and high bond rates here and abroad, much borrowing has been rechanneled through large New York banks. In the current situation, Samuelson would not be alarmed by money growth of 8 to 9 percent for a few months. He sees a real danger to the S & L's and feels it is advisable to raise the maximum amounts they can pay on their deposits.

SECOND DISTRICT - NEW YORK

Second District Directors and other business leaders who were recently contacted generally foresaw some moderation of inflation, particularly among basic commodities. However, some expected prices of finished goods to continue under strong upward pressure as earlier increases in raw material costs are passed on. It was generally agreed, moreover, that increased militancy on the part of labor will intensify cost-push pressures on prices. The respondents observed no evidence of a lessening of pressure on productive capacity during the past month. Some concern was expressed over the mood of uneasiness pervading the business community concerning the liquidity of both financial and nonfinancial firms. It was generally agreed that the overall liquidity situation had not reached crisis proportions, but some observers felt that serious trouble may lie ahead.

While most respondents expected inflation to moderate somewhat, the degree of relief which was expected varied. A number of directors reported they did not anticipate further excessive price boosts and looked for some decline in food prices. Moreover, the respondents in general expected the recent softening in some commodity prices to continue. The chairman of a large textile concern thus reported that prices of cellulose fiber had stopped rising and that he expected some decline in these prices. A senior official of a large multinational concern based upstate expressed the opinion that prices in international markets of certain raw materials and agricultural products would continue to decline with the tapering off of demand in many countries. Similar sentiments were expressed by other respondents.

On the other hand, there were no reports of any easing of pressures on productive capacity. Indeed, among the comments obtained, the chairman of a large chemical firm felt there would be no such easing in the chemical industry for four or five years. Similarly, the chairman of another large chemical corporation stated that chemical companies must continue expanding to keep up with demand. Both of these respondents commented on the high cost of construction; one reported his firm was paying 50 percent more for plant construction than three years ago and the other characterized such costs as "unbelievable."

The respondents in general expected increased militancy on the part of labor to secure "catch-up" wage increases. Some of the respondents, notably the two chemical officials mentioned above, looked for wages to go up at a "considerable rate." Similarly, the upstate industrialist felt labor pressure would be intense, and that wage-push pressure on prices would prevent the rate of inflation from declining significantly for several years. Most Buffalo Branch Directors, on the other hand, felt that while wage-push pressures are to be expected, they might not cause prices to rise sharply.

Regarding liquidity positions, the Buffalo Branch Directors expressed concern over the strains on the liquidity of both financial and nonfinancial firms. The present situation is felt to be especially difficult for banks in view of the publicity surrounding the financial troubles of Franklin National Bank. The president of a large Buffalo bank expressed concern over the emergence of two-tier markets for Eurodollars and large CD's, where the money center banks could still raise funds but where regional banks had more difficulties in doing so and had to pay higher rates. The chairman of a New Jersey bank pointed to the fairly serious problems confronting many real estate investment trusts, while the chairman of a textile firm stated he feared that the smaller companies in his industry were also experiencing serious liquidity problems. It was generally agreed that the liquidity situation had not yet reached the crisis state, although some observers felt somewhat apprehensive about the future.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District continues to move along at a slow pace. Production activity is about at the same level in July as it was in June, and manufacturers anticipate little change in this trend in the coming six months. Employment, too, remains stable. This slow-paced business activity is reflected in a general leveling in inventories, and in conservative plans for boosting investment in new plant and equipment. Normally strong retail sales were off in June, and the somber outlook for retail prices (as well as manufacturing prices) could also mean soft sales in the fall. Although area banks have been the subject of some adverse publicity, loan levels remain firm and deposit levels are up somewhat. Area savings banks appear equipped to withstand their current disintermediation problems.

According to this month's business outlook survey of manufacturers in the Third District, industrial activity is continuing to move along at a sluggish pace. Almost 60 percent of the executives polled report no change in new orders, shipments and unfilled orders in July, and regional manufacturers expect this trend to last into January. Twenty percent more of the respondents expect an increase in these key indicators than expect a decrease, with the remainder anticipating no change at all through the end of the year.

Despite this lack of growth in business activity, manufacturers continue to report little change in employment opportunities. The number of executives reporting an increase in the number of their employees and the length of their average workweek in July just about equals the number reporting a decrease. Respondents expect this trend to continue into the six months ahead. However, little change in the number of jobs available in the area will likely mean higher unemployment in the region as the work force continues to grow.

Ten percent more executives decreased their inventory stocks this month than increased them. However, just about as many respondents expect to add to their stocks by January as expect to cut them, which implies a general leveling in inventory stocks in the next six months. In addition to inventories, manufacturers may well be taking a closer look at plant and equipment investment plans. The outlook for increased investment in capital goods is lower than it has been in several months, and almost half of the responding manufacturers expect to maintain current spending plans through January.

The value of nonresidential construction contracts in the Third District is up 30 percent over this same period last year and up 5 percent for the year to date. However, residential contracts are down 9 percent from last year's levels and 28 percent for the year to date. Higher prices and interest rates, plus some shortages, are having an impact in the residential market. Public works construction is moving at a rapid pace. The value of public works construction contracts in the region is up a total of 186 percent for the year to date.

A cool, wet June damaged sales at area department stores. Consumers were not interested in the traditional summer purchases of air conditioners, light clothing, and barbecuing accessories. However, the quick settlement of the newspaper delivery strike and hot weather so far in July have combined to make retailers more bullish in their outlook. Traditional season-end sales also play a major role in their expectations for higher sales figures this month. Area manufacturers are still uncertain about the impact of higher prices on fall and winter sales. Most department store items will display higher price tags in the months ahead, but clothing, and particularly men's wear, will post larger increases than most other goods.

The outlook for prices in manufacturing also remains bearish. Over 85 percent of the executives polled expect to pay higher prices for raw materials through January and over 78 percent expect to receive higher prices for finished goods.

Several Philadelphia banks were plagued with adverse publicity in recent weeks as rumors abounded and their stocks declined. However, the rumors were mostly unfounded. Most banks report an ability to roll over their CD's although one bank did have minor difficulties with some especially large maturities last week. A large Philadelphia bank also had $5 million on deposit at the defunct Herstatt Bank. However, the bank now has expectations of getting approximately 75 percent of that sum returned. Loan levels are about the same as last month, primarily because of restrictive loan policies at area banks. Although deposits are up somewhat over last month's levels, borrowing at the discount window by a few regional banks is reported heavy. Savings banks see no liquidity problems at this time despite deposit outflows. A survey of savings banks found most of them able to withstand substantial outflows of funds without incurring severe liquidity problems.

FOURTH DISTRICT - CLEVELAND

Manufacturing activity in the District apparently strengthened in June for the third straight month; supplies of raw materials generally remain tight. Capital spending and steel production are key supports of industrial activity, while weakness in retail sales is contributing to an overhang of inventories. Savings and loan associations in northeast Ohio report large withdrawals of deposits since the third week in June.

Early returns from our monthly survey of District manufacturers indicate that the recovery continued in June for the third consecutive month. All key series posted further gains. Inventory accumulation, however, has shown signs of slowing in recent months. Price increases remain pervasive.

Some of our industrialist directors in capital goods industries report a recent easing in the supply situation for a few materials. As a general matter, however, the availability of raw materials continues to be tight. One director commented that they still have a "lot of people out on the road rounding up raw materials at whatever price they have to pay." Business conditions in the capital goods industries remain good, and backlogs are still rising. A director in the machine tool industry said they are now quoting some machinery for delivery in late 1976. The industrialists mentioned that the high cost of money is beginning to be a major problem for their firms.

Petrochemical products, steel, and coal continue to be commodities in tight supply. An economist for a major petrochemical firm in the District remarked that removal of price controls has done little to improve the supply of basic materials they use. The improvement that has occurred in availability stems from a reduced volume of exports. He anticipates no softening in demand for plastic and chemical products and reports that his firm is allocating orders based on 73-75 percent of 1973 sales.

Casting and steel products remain in tight supply and an official with an automotive supplier reports that his firm has been reallocating materials in critical supply from one plant to another in order to maintain production schedules. Steel economists report that demand for steel continues to exceed supply and that situation could tighten further because of equipment bottlenecks and coal shortages. One major producer reports that a breakdown in equipment sharply curtailed their raw steel output in the Youngstown District during most of June. Lower quality of coal has also held down steel output, and suppliers have not been able to fill long-term contracts for coal. Another steel producer apparently has sufficient supplies of coal to last through July. But company officials are concerned that low coal stocks will curtail operations in the event of a mine strike. The company's economist also asserted that the latest round of steel price increases was aimed at improving profit margins necessary to finance capital expansion programs. Previous increases were to recover higher costs that were not permitted to be fully passed on to steel consumers during wage-price controls. Despite four increases in steel mill products so far this year, domestic prices for steel are still well below average world prices for steel.

Coal supplies are tight. Demand from utilities and steel industries remains strong, and both of these users report unusually low stocks of coal, which would disrupt their operations in the event of a coal strike in November. An economist with a major coal producing firm considers it likely that miners will strike for at least two weeks but not more than four weeks when their contract expires in November. Freight car shortages are a limiting factor in coal output.

Retail sales of two large department store chains in Ohio showed little improvement in June, and officials with these firms were pessimistic about second half sales. The president of a major department store chain in Cleveland stated that consumers' buying interest must be "stirred" by frequent sales promotions, and that collections have slowed while delinquencies have been rising. He reported that his stores' inventories are now excessive and that the usual summer clearance sales dates were advanced this year in order to attract consumer buying. In contrast to his cautiously optimistic tone of two months ago, he sees little basis for improvement in retail sales unless real purchasing power picks up sharply and financial developments take a turn for the better. An economist with another major department store chain also reported that consumer buying remains sluggish. He asserted that consumers have traded down in quality and have not reduced unit purchases as much as suggested in the deflated retail sales data. He feels that retail inventories are now excessive, whereas as recently as April, his sales management complained of inventory shortages. "In less than a few months, we moved from scarcities to excesses of all kinds." He expects unit sales to fall by about 1 percent during the second half of the year.

Some banking directors report they are becoming increasingly selective in accommodating loan demand; more loan applications (business, real estate, consumer instalment) are being turned down. An economist with a major bank in Cleveland stated that demand for mortgage loans remains strong despite further tightening of loan terms (down payment of 25 percent for 20 year loans). He reported loan demand from finance companies and commercial loans remain strong. An investment officer with another bank in Cleveland expressed concern that the floating rate note of Citicorp would attract savings deposits from deposit type institutions. It was remarked that the Cleveland office of First Boston Corp. has sold out their $28 million allotment of these notes, the bulk of which, according to a local broker, would be financed by withdrawals of deposits from savings and loan associations. The investment officer was also concerned that major money market banks in the country would be the only institutions able to roll over CD's that will be maturing in the weeks ahead.

Savings deposits in S & L's in northeast Ohio about equaled withdrawals since the third week in June, according to an official in the savings and loan trade association. S & L's are making very few new mortgage commitments. Mortgage terms generally range from 9-1/4 percent to 9-1/2 percent (plus one point) based on 20 percent down payment, and applications exceed ability to make loans. S & L's have stepped up their marketing programs to attract depositors with a variety of gifts. Two S & L's in Cleveland are now offering services similar to checking accounts, with another advertising no fee checking to depositors with $250 in savings accounts plus an additional monthly deposit of $25 or a $1,000 initial deposit. The chairman of a $150 million S & L in Cleveland reported that customers' response to their variable mortgage rate, which is now about 1/4 percent below the prevailing market rate in Cleveland, has been good but less than expected.

FIFTH DISTRICT - RICHMOND

The current monthly survey of Fifth District business shows little change in business conditions since the previous reporting period. Manufacturers responses suggest little or no change in the level of shipments and further declines in the volume of both new orders and backlogs. As in June, one-third of the manufacturers view current inventories as being above desired levels. Among District retailers, sales appear to have leveled off during the month and most respondents report a continued weakness in sales of big ticket items. The sustained decline in residential construction is leaving its mark on the District's large furniture industry, where orders are reported to be off 20 percent from a year ago. Fifth District commercial banks surveyed report continued strong demand for business credit and increasing selectivity with regard to extensions of credit. In the agricultural sector, cash farm income remains well ahead of a year ago, but the rate of increase is slowing.

For the fifth consecutive month, more manufacturers have reported declines in new orders than have reported increases. Seventeen of 53 firms reporting indicate further accumulation of finished goods inventories while 15 of 55 report increases in raw materials inventories. Additionally, there are significantly fewer comments concerning materials shortages. The emphasis seems to have shifted to prices, with 48 of 55 respondents reporting increases in prices paid. An additional point of obvious concern continues to be the prevailing level of interest rates. One manufacturer reports that customers are "substituting dollar limitations for unit limitations on inventories."

Despite some current difficulties and weaknesses, District manufacturers remain moderately optimistic. Eighteen of 54 feel that current inventory levels are too high, but 17 regard current plant and equipment capacity as inadequate and none feels that current expansion plans should be cut back. The respondents are fairly evenly divided on their expectations for the national and local economies, but 19 of 54 expect their own businesses to improve over the next six months.

The electric utility industry may be one significant exception to the view that current expansion plans are no more than adequate. Citing a slower growth in customer demand and investor unwillingness to provide needed capital, one major electric utility company has announced a 31 percent cutback in expansion plans for the three-year period ending in 1976. One other utility firm has announced delays in plant openings and is considering postponement of several planned construction projects. The reasons given in this case are the same, but with the addition of environmental factors. At least one other firm in the industry reports undertaking a review which might result in reductions of its own expansion plans.

The retailers surveyed were evenly divided as to the performance of sales. A majority reported a decline in the sale of big ticket items relative to total sales. There was also some apparent increase in inventories and half of the respondents now feel that inventory levels are too high. The retailers were unanimous in indicating upward movements in both prices paid and prices received during the month of June. None of the respondents in this category feels any need to alter the number or size of outlets, and most expect that there will be little change in business conditions over the next six months.

In the banking field, Fifth District banks report a continuation of strong demand for business credit, and a majority of those surveyed have already announced an increase in the prime lending rate to 12 percent. In view of the strong demand, banks are becoming increasingly selective with regard to credit extensions. One bank indicated having difficulty allocating limited credit among many qualified applicants. On the other hand, these banks generally indicate that demand for consumer credit has remained flat since the beginning of the current year. Meanwhile, growth of demand and time deposits is characterized as disappointing. CD's are still the major source of funds, but bankers increasingly characterize that market as more competitive. The slow growth of deposits is also affecting the thrift institutions.

Farmland values soared to new record-setting levels during the year ending March 1, 1974. Virginia, West Virginia, and South Carolina were 3 of 12 states in the nation that showed gains of 30 percent or more over a year earlier. Cash farm income continues to run well ahead of a year ago in the District as in the nation, but the rate of increase appears to be slowing. Low prices and spiraling costs of production have brought about a statewide economic squeeze on both poultry and meat producers in Virginia. Many reportedly will be forced out of business if the situation continues much longer.

SIXTH DISTRICT - ATLANTA

While business activity is on the upsurge in most parts of the District, inflation continues to worry most area businessmen. One Tennessee director described the general economic outlook as one of "frightened optimism." Agriculture, banking, and residential construction are areas most severely affected by today's inflation. With the continued rise in material costs, recent large wage settlements, and an expected drop in agricultural output next year, little letup in inflation is anticipated. Tourist activity continues to rebound in most parts of the District. Retail sales are showing some strength, and announcements of new industrial plants continue brisk.

The growing concern over inflation was again evident in reports from businessmen and directors from all parts of the District. The farmer seems to be most directly affected by today's inflation. The beef cattle industry is reported as "sick." At the same time feed prices are high, cattle prices have dropped substantially. One large Tennessee farmer reports a year and one-half supply of feeder calves currently on pasture, which may have to be marketed if pastures dry up. Alabama's and Georgia's poultry industries are also facing price-costs squeezes. Some 30,000 baby turkeys were reportedly slaughtered in Georgia because the cost of raising them is much higher than current selling prices. The net impact of this cost-price squeeze will most likely be less meat output and higher prices in the future.

District banks are feeling the impact of tight money, skyrocketing interest rates, and inflation. Though deposit growth is lagging, loan demand continues strong. A Tennessee director reports that consumer and commercial loans are still on the increase. Tennessee municipalities are now turning to commercial banks and adding to loan demand because they cannot market municipal bonds at statutory interest rates. Mobile home loans are beginning to pick up. Tennessee's 10 percent interest rate ceiling on bank loans is also adding to strength in loans from other borrowers. One Alabama bank representative thought that the Federal Reserve Board should force banks to screen credits and curtail lending. Businessmen are apparently becoming apprehensive over the rumors that banks are heavily loaned with little or no liquidity. An Alabama director notes that the president of a large corporation became so concerned that he had their funds scattered among various banks. Another businessman asked this director to recommend banks in which not to carry funds. Reports from Alabama and Tennessee indicate that delinquency rates on business loans are high.

Residential construction remains sluggish in all parts of the District. Savings and loans in Georgia have experienced a sharp decline in inflows of both savings and mortgage loans.

Retail sales seem to be improving and are now giving some strength to the District's economy. Reports from Jacksonville and Palm Beach, Florida, as well as from areas of Tennessee, indicate strong sales, particularly in appliances. A Tennessee director notes that credit cards are being used to their fullest. He believes that the inflation psychology of buying today to beat tomorrow's price increases has really caught hold. Recreation vehicles sales are reportedly improving in Florida and Tennessee.

Tourist activity, as reported earlier, is on the upswing. South Florida's tourist trade is up, with hotel and motel occupancy rates climbing. In Miami Beach, the occupancy rate in April was 71 percent. Tourism is doing well in New Orleans; most guests appear to be arriving by air. There has been a sharp upturn in tourist business in all areas of Tennessee. Smoky Mountain National Park has begun to attract an increasing number of visitors.

Labor markets remain generally strong, despite some rise in unemployment related to energy problems. Although the worst of these problems seems to be over, a large textile manufacturer is closing two plants—one in Alabama and one in Tennessee. Approximately 1,300 workers will lose their jobs from these closings. An increase in strike activity is also temporarily idling workers. Several strikes in the construction trades, particularly in Florida and Louisiana, are now in progress. Workers in Atlanta area auto-assembly plants have been idled by strikes in parts plants outside the District.

Representatives of a large Alabama materials company indicate that their plant and equipment investment is running 15 to 20 percent behind schedule this year, largely because of delivery problems with capital goods. They are having particular problems with rail car deliveries. The high level of interest rates is not influencing their capital spending or inventory plans. But compensating balance requirements on unused commitments have forced them to hold their bank lines to a minimum. The availability of petroleum feedstocks continues to be a source of concern for this company.

Capital spending plans for new or expanded plants were again heavy. The most significant announcement was a $2.7 billion uranium enrichment plant to be built on the Chattahoochee River near Dothan, Alabama. It is the largest single industrial development ever planned for Alabama. Seven thousand people will be employed in its construction, and when completed in 1983 one thousand four hundred people are expected to be employed. A Japanese spinning company will open in October in Columbus, Georgia; the $2.5 million plant will employ about 90 persons. Industrial expansion and new plants are doing well in Tennessee. Twelve new plants were built in the first quarter of this year and 19 expansions occurred. A number of new plants have been announced in Louisiana along the Mississippi and Red Rivers.

SEVENTH DISTRICT - CHICAGO

Business conditions in the Seventh District cannot be generalized as either prosperous or depressed. Capital goods producers report that demand continues well above output capabilities. Housing is in a severe recession, with hopes dashed for a revival in 1974. Shortages of materials and components continue generally severe, although there has been spotty improvement. Strikes are hampering output of many manufacturers, and a ready-mix drivers' strike has paralyzed construction in the Chicago area. Some strikes are unsettled, despite offers in excess of 12 percent. Some major utilities are scaling down plans for future expansion. Price increases for manufactured goods continue at a rapid pace.

The latest reports still find capital goods producers working all-out to contain rising backlogs. Some of these companies, e.g., builders of frieght cars and heavy trucks, and manufacturers of machine tools and presses, are gearing up to provide additional capacity.

Manufacturers are being warned that shortages of steel and aluminum will last for several years. Steel is the major barrier to higher output, overall. In most applications, there are no practical substitutes. Steel shipments are expected to be limited to 108-109 million tons in 1974, down from 111 million tons in 1973. Shipments have been maintained at recent high rates by further reducing mill inventories below levels thought to be rock bottom. "Next we may be dismantling the plant and shipping it." The main bottleneck in steel is in hot pig iron to charge steel furnaces. This is because of limited blast furnace capacity which, in turn, partly reflects shortages of ore and coke. Heavy charges of scrap now used limit steel furnace capacity. Availability of foreign steel has been reduced despite very high prices, and the incentive to export is strong.

Many components such as bearings, electric motors, drives, and forgings are short. Most important are castings because so many foundries went out of business in recent years. Major expansions of foundry capacity started early this year and lead times on molding machines were rapidly pushed out by many weeks.

Strikes, some of several weeks' duration, are halting output of forgings, motorcycles, locks, lawn equipment, and other products. In one case, a union rejected a company offer for a 13 percent first year wage boost (15 percent for skilled workers), a 40 percent rise in pension benefits, longer annual vacations plus a one-week Christmas shutdown, and other improved benefits. The obstacle to a settlement is the demand for a full COLA next year, rather than just a 9 percent wage boost.

A continuing strike of 2,500 ready-mix drivers in seven Illinois counties, including Chicago, began May 16. A large number of building trades workers have been laid off because construction projects have been halted awaiting concrete. With no settlement in sight and the best weeks of summer passing, the cement strike is said to be one of the most costly construction strikes in the history of the region.

Housing permits in both the Chicago and Milwaukee areas are off about 50 percent from last year. Apartment projects are especially hard hit, with Chicago area permits at the lowest level since 1958. With overhangs of unsold new units, it is surprising that prices of existing homes have increased further on average—with well-located units up 10 percent from last year. It is not clear that improved inflows of savings to S&L's would help new construction this year. The S&L's wish to build liquidity, an especially attractive move with high rates on money market instruments. The Illinois legislature passed a bill to raise the state usury ceiling on mortgages from 8 to 9.5 percent, but the governor has not signed the measure.

Fewer purchasing managers report increases in new orders and backlogs, but a Milwaukee report emphasizes "we are seeing a reduction in the rate of acceleration." Output and employment continue to rise in most centers. Delivery dependability and product quality continue to worsen.

A large Chicago paper distributor says price increases are leveling off after boosts of 20 to 30 percent since decontrol. A few paper producers or jobbers are now offering limited additional "tonnages," but the general supply picture remains very tight. In this, as in other industries, there are continued complaints of "slow pay" even, and especially, in cases where ability to pay is not at issue.

Some major electric utilities have encountered financial problems in recent months, arising from cost overruns, forced shutdowns of nuclear plants, failure to get rate increases, and other regulatory difficulties associated with "consumerism." One utility has large bank borrowings at "two points over prime" which it has been unable to fund. Another announced the first layoffs in its history. Large utilities in Michigan and Illinois have announced cancellations of projects to go on stream two or three years hence, citing downward estimates of long-term demand. Power sales have been less than expected this year, but recent hot weather caused reductions in voltages and cutoffs of interruptibles.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth Federal Reserve District remains generally strong. Manufacturing activity and retail sales continue to exhibit strength, and employment remains at a high level. However, the automobile, housing, and housing-related industries are experiencing a slackened demand for their products. Growth of time and saving deposits has slowed, especially at commercial banks, compared to the rapid growth earlier in the year, and loan demand is somewhat less strong than earlier.

Manufacturing activity generally continues at a rapid pace in the District. Firms in the steel, chemical, paper, and capital goods industries report production at capacity levels. Many firms in these industries also continue to report order backlogs, with the situation only "modestly improved" from recent months, despite large price increases. Representatives of some firms noted the necessity of large price increases to provide incentive for financing increases in capacity.

The volume of retail sales in the District continues to be "better-than-expected." A considerable part of the sales volume appears to be the result of increased prices rather than number of units sold.

Employment in the District remains in a generally "tight" condition, with the unemployment rate for most SMSA's and states well below the national average. Several areas, especially smaller cities and rural areas, even report labor "shortages." Reports of factory lay-offs have been very scattered, except for the automobile and construction industries. Some housing-related manufacturing firms, however, anticipate lay-offs if the housing situation does not turn around soon.

Residential construction activity in the District is considerably below the level of a year ago. Housing permits issued in St. Louis County in the first six months of this year, for example, were less than half the number issued in the first half of 1973. The low usury ceilings, particularly in Missouri, have significantly contributed to the housing slowdown. With single and multi-family unit construction both down, apartment building occupancy is reported to be nearing capacity levels. As a result, apartment rents are beginning to increase rapidly.

Demand for bank credit has been strong but considerably less robust than earlier in the spring. Business loans have continued to increase in the St. Louis area in recent weeks while in many of the other SMSA's in the District this demand has slackened. Smaller banks are apparently enjoying "good times", reflecting the large deposit inflows based primarily on the higher incomes of farmers in 1973, and the high returns available in the Federal funds market.

Growth of total time and saving deposits at commercial banks was at a somewhat slower rate in recent weeks than earlier in the year. However, in the first six months of 1974, total time and saving deposits at commercial banks in the District increased considerably more rapidly than in the first half of 1973, with gains mostly in higher-yielding time certificates. On the other hand, net inflows into savings and loan associations in St. Louis for the first half of this year were only about one-half the net inflows for the comparable period last year.

NINTH DISTRICT - MINNEAPOLIS

Most sectors of the Ninth District's economy performed fairly well in the first half. With the prospect of lower farm incomes and continued high interest rates, however, several sectors face a somewhat less promising second half. Retail sales gains have been favorable so far this year, but several District retailers are unsure of their future sales prospects. District automobile sales are expected to improve, however. A slowdown in savings inflows at District S & L's, combined with statutory loan rate limitations, indicates that little improvement can be expected in the District's already depressed homebuilding industry. Loan demand at District banks is strong and no letup is foreseen. Time and savings deposit growth at District banks has been faster than in the nation but is expected to slow.

According to a survey of major District retailers, consumer spending continued to expand in the second quarter. Cool weather early in the season hurt sales of clothing and other summer merchandise, but several respondents look for a good summer. Some respondents did express reservations. A regional representative for a major national retailer expects his firm's catalog sales to drop in July and August, due to large price increases, but recover by fall. A spokesman for a major retailer headquartered in the Twin Cities said his firm is quite uncertain about the future and is watching inventories closely. An economist with another retailer indicated that farm income developments would have a major impact on his firm's sales in coming months. In addition, he looks for a squeeze on spendable income as more money is allocated for food and gasoline. The outlook for the District's tourist industry this summer remains good.

District automobile dealers seem better off than their national counterparts.

Seven upper midwest regional sales managers said the prosperity in the District's rural areas and the fact that the region was not hit severely by the energy crisis have helped their business. They reported that car sales have improved in the second quarter and that excessive inventories are not a problem. Several respondents even said they will be unable to satisfy customer demand this summer.

The bad weather of May and June and the current dry spell have undermined hopes for a bin-bursting harvest of corn and soybeans. The full extent of the damage to these crops is not yet known, so prices are likely to remain unsettled until a full assessment has been made. Farm prices in the second half of 1974 are expected to lag behind last year's prices, and since input prices have risen constantly throughout 1974, net farm incomes will probably be down from 1973 levels.

District housing unit authorizations during the first five months of 1974 were down 10.2 percent from a year ago. Because of the financial situation, a housing recovery is not in sight. Savings inflows to District S & L's slowed markedly in the second quarter which, coupled with a statutory limitation of Minnesota loan rates, has curtailed the supply of mortgage funds in the District. Consequently, current terms on new mortgage commitments in the Twin Cities are quite stiff. One large Twin City S & L requires a 40 percent down payment on conventional mortgages with a maximum amount of $20,000. Another requires 50 or 60 percent down, depending on whether the house is located in the city or the suburbs. The supply of FHA-insured mortgages is somewhat more plentiful because of the relatively high effective interest rate—presently 8-3/4 percent plus 5 points. However, the current maximum mortgage amount of $33,000 on FHA loans is insufficient for many homes on the market.

Loan demand has remained strong at District banks; loan growth at District member banks during the first half increased about as fast as at national banks. Much of this demand originated outside the District as real estate investment trusts and other national borrowers unable to obtain funds in the commercial paper market used lines of credit at District banks. Regional loan demand was also strong. Construction loans at Minneapolis/St. Paul area banks grew especially rapidly because of problems with cost overruns, material shortages and cancellations of take-out loan commitments by permanent lenders. District bank consumer credit, on the other hand, was quite weak. In general, loan demand at District banks is expected to remain strong.

Consumer-type time and savings deposit growth at District banks in recent months outpaced comparable national increases. This difference can be explained by the fact that District banks draw a greater proportion of their savings from rural areas where farm incomes have been high and interest rate sensitivity is perhaps lower. If farm incomes decline later this year, deposit growth can be expected to slow.

TENTH DISTRICT - KANSAS CITY

Tourism has started the summer somewhat weaker than last year. Farm prices have turned up after declining for several months, and a good wheat harvest is in progress. Although cattle prices have improved, producers still face a rocky road in the period ahead. Production by manufacturers still is limited primarily by the availability of materials, which remain scarce and are increasingly expensive. Deposits and loans at Tenth District commercial banks increased less than seasonally during June. Most bankers do not want Regulation Q rate ceilings removed at this time, although they would favor removal as a long-run objective.

The tourist season has started slowly in western Tenth District states this summer. State travel commissioners in Colorado, New Mexico, and Wyoming report fewer out-of-state visitors this June than last. Traffic and spending are down at small motels and other tourist-related businesses near several popular vacation areas. While some tourist spots and certain businesses may be doing better than last year, the tourist industry as a whole needs a strong July and August to finish even with the summer of 1973, much less approach the 1972 peak.

Farm prices have generally strengthened following four months of steady declines. Compared to a year ago, the farm-price index was off 4 percent as of June 15, marking the first time in three years that this measure had fallen below year-earlier levels. The recent turnaround has been broadly based with price increases occurring in both the livestock and crop sectors. Contributing to the run up in grain prices have been growing concerns over weather problems in the cornbelt and a smaller-than-expected winter wheat crop. The rise in livestock prices apparently has been triggered by a decline in beef and pork slaughter which, in the case of hogs, has been significant.

Nevertheless, most cattle feeders still face serious financial problems because of current losses and uncertainty about the future, despite recent price improvements. On this note, the emergency credit bill before Congress has elicited a mixed response within the cattle industry. While some groups obviously favor the bill, several feeder associations have taken a neutral position. Finally, the wheat harvest in the District is winding down as nearly ideal weather conditions have permitted rapid progress in most areas. However, the crop—while good by most standards—is apparently falling below anticipated levels.

Purchasing managers throughout the District continue to complain of tight supplies and rising prices. A few feel the worst is over, as indicated in the national survey, but most see no let up in the months ahead. "We've got nothing but problems, problems, problems," said one agent. Two respondents said that their firms' expansion plans were cancelled because of materials shortages. Two others reported going to the black market to get around allocations. But a buyer for a major tire manufacturer feels that some raw materials are more easily obtainable, at much higher prices, since controls were lifted.

Major producers of agricultural supplies report good business, but they, too, are held back by shortages. Agricultural industries enjoy some priority for certain raw materials, but their businesses still are limited by available supplies. Although strong, demand is somewhat weaker than last year because of lower farm income. In particular, the market for products for the cattle business has dried up in recent weeks.

Total deposits at District weekly reporting banks increased less than seasonally during June, as a slight decline in time deposits was more than offset by an increase in demand deposits. None of the banks contacted noted a significant difficulty in issuing large CD's, although several did report that national corporations were limiting their CD acquisitions at regional banks to specified percentages of a bank's capital. All agreed that the recent ability of Federal savings and loans to issue negotiable CD's has had little direct effect.

While banks felt that loan demand was still very strong, total loans increased substantially less than seasonally during June. The strongest demands were noted for commercial and industrial loans and for instalment loans. The strength in business loans was primarily to finance inventories, accounts receivable, and oil and gas exploration or refining facilities. Agricultural credit demands were mixed, reflecting the reduced number of cattle on feed and the sharp increase in the credit needs of grain firms. The demand for real estate credit was generally weak throughout the District. About half the banks noted that loan delinquencies had risen over the last three quarters, but all agreed the level was low and several reported delinquencies were now declining.

In view of the capital note offerings of two New York banks aimed at consumers, reporters were asked about the desirability of lifting or removing Regulation Q interest rate ceilings. While most felt these ceilings should be removed over the long run, a strong majority felt this was not an appropriate time to make any significant change. However, the survey did turn up two interesting developments. One bank reported that it had recently initiated an arrangement under which individuals purchasing small CD's would receive maximum interest rates and also have an additional 1 per cent donated to the charity of their choice. Another indicated that a national insurance company was considering pooling the funds of small savers, and for a small fee, would invest these in large CD's.

ELEVENTH DISTRICT - DALLAS

The majority of our Directors believe that monetary policies are not sufficiently restrictive to bring the inflation under control within a reasonable time frame. A sizable minority, however, are very concerned over the present high level of interest rates and the difficulties in obtaining financing for productive capital expenditures. They believe some form of credit allocation other than by higher rates will be necessary.

Nevertheless, most industrialists in the Eleventh District have not yet made significant revisions in their capital spending plans for 1974 in response to tight credit conditions, rising prices, and material shortages. The firms interviewed covered a wide range of industries and included companies financing capital expenditures wholly from internal funds as well as those heavily dependent on external sources. Corporate executives who are relying on debt financing said they are going ahead with needed improvements since they believe "higher interest rates are here to stay." There were no cases of stepped-up spending plans in anticipation of rising prices, or reports of project delays due to shortages of building materials. The majority of firms interviewed said capital expenditures for 1974 will be at roughly the same level as last year. However, big increases in spending are planned by the oil field machinery and public utility industries. Two large utilities in Texas, for example, are spending about 30 percent more this year on plant and equipment, despite the fact that both claim internal financing will account for only 40 percent of the total funds required.

Tight credit markets are having a substantial impact on the long term expenditures of small businesses in the District. Consultants to small businesses in Dallas and Houston report that capital expenditures by their clients are sharply lower.

Many of these firms, heavily dependent on bank loans, are having difficulty obtaining financing. Moreover, when loans are available, the cost has been prohibitive. For the most part, smaller businesses have chosen to make do with their present equipment and facilities.

A survey of leading savings and loan associations in the state reveals that large deposit losses are continuing, resulting in further tightening of the mortgage market. The most pessimistic accounts come from Houston where the inventory of unsold new homes has climbed to 6-8 months' sales, as compared to the normal 2-3 months' sales. That city's two largest S & L's have stopped accepting new commitments and are only making additional loans to cover outstanding commitments. Although the rate of net deposit outflow at these institutions slowed in June, managers say a resumption of loan activity is impossible until they experience a positive savings flow. A more representative response came from a financial holding company with affiliated savings and loan associations across the state, where lending activity is down "drastically" from the first of the year, but financing is still available at 9-1/2 percent—the prevailing rate in Texas on 80-percent conventional loans. The high offering rates necessary to attract deposits will hinder any substantial reduction in mortgage rates. For example, one lender reports he is becoming "locked in" at a minimum rate of 9 percent since most of his deposit inflows in recent months have been in the form of 7-1/2 per cent certificates, and he estimates that a 1-1/2 percent margin is necessary to operate at a profit.

Depressed cattle prices are having a substantial impact on the ability of cattlemen to repay loans at banks in cattle feeding areas. A recent survey of such banks revealed that one-fourth of them were taking losses on loans for cattle feeding, but none were in any danger financially. These banks, with deposits ranging from $15 million to $30 million, described their losses as "big," "substantial," and "sizable."

Although the rest of the banks contacted reported no current losses on loans for cattle feeding, several expressed doubt as to how long they could continue under current market conditions without experiencing some losses. A very pessimistic outlook for the repayment of some working cattle loans was shared by most of the bankers interviewed. They felt that the most critical period for repayment of loans will be during the next several months. One banker anticipates that several banks that he is familiar with will be under severe financial stress by fall unless conditions change markedly.

The attitude of bankers toward their cattle feeding customers is generally accommodative. Most expressed a desire to stay with their established customers through the current depressed cattle market. However, one banker felt he would have increasing difficulty discounting loans made to cattle feeders because of the low equity positions of these feeders. All bankers interviewed indicated they were not "calling in" any loans but several have advised some customers to sell a portion of the cattle they now have on feed. A few bankers are also asking for additional collateral on old loans in anticipation of losses. Many loan officers are taking a very conservative attitude regarding new loans for placement of cattle on feed and will require much more stringent terms on these loans.

TWELFTH DISTRICT - SAN FRANCISCO

About two-thirds of this District's respondents expect the inflation rate to continue at 10 to 11 percent for the remainder of 1974; three anticipate a decline to 7 to 8 percent by year-end and three look for the rate to go higher. Although materials shortages are cited in some instances, the main concern is with cost-push inflation. Labor-management disputes are increasing and recent settlements in many cases have exceeded the present inflation rate.

In evaluating the probable course of the economy over the next six months the respondents put new emphasis on the role of the consumer and their analyses place them in one of two camps. The first sees signs of growing consumer resistance to high prices, postponement of large-ticket purchases and growing difficulty in carrying present debt burdens (there has been a three-percent decline in California's per capita fluid milk consumption and a decline in gasoline consumption per car in Idaho.) The second considers that consumers are accommodating to inflation as a way of life, maintaining current consumption levels and purchasing homes as an inflation hedge in spite of high mortgage rates.

Agricultural output continues to be a positive factor in the Twelfth District's economy. The crop outlook is good and prices remain strong because of the worldwide shortage of sugar, flooding in the midwest and drought in the south. Growers in Idaho, however, curtailed sugar beet acreage by 25 percent and planted grain; sugar beets are currently selling at $50 a ton compared with $36 a ton a year ago whereas the contract price on grain is now $6 per cwt. compared with $7 per cwt. last year. Cattle feeders are sustaining heavy losses as large supplies have driven beef prices down 15 percent since January. In spite of this, agricultural income is expected to show a sizeable gain in 1974.

Lumber prices, plywood especially, have softened and some small plants have shut down or limited output in other ways. The industry continues to mark time awaiting a pick-up in housing construction. Pulp and paper manufacturers, on the other hand, are experiencing vigorous demand and prices are climbing rapidly. One manufacturer in the food industry stated that the price of milk cartons is now 30 percent higher than a year ago and it is expected to increase another 10 to 15 percent in the third quarter of this year.

The Branch banks report increased activity at the credit window, but less than would be accommodated. They reason that the commercial banks are being selective about loans, especially new accounts. Some nonbank respondents, however, believe that the commercial banks, especially the larger ones, are dangerously illiquid and yet continuously strive to extend new loans in order to maintain profit margins over CD rates. One bank has lowered its earnings forecast to 5 to 8 percent over 1973. The Salt Lake City Branch reports record Treasury bill purchases by individuals and a bank in southern California, on the hearsay level, quotes customers as saying that they "intend to put their money into governments or quasi-governments until this era of insecurity passes."

An independent oil producer claims that there is currently an oversupply of petroleum products in the United States. He avers that most major oil companies are using devious methods to hide their true net income figures.

Overall, there appears to be a feeling of dismay and helplessness over the direction the economy is to take. One banker states, "there are growing fears that very high financial costs, pervasive loss of liquidity, slow economic growth worldwide, and much deep negative psychology will cause a new economic downturn soon unless policy changes are made to improve confidence."