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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

The general thrust of this month's commentaries is that expectations concerning the near-term outlook for business have deteriorated considerably. Prospects for dampening inflation are viewed with various degrees of skepticism and pessimism; some businessmen fear wage-price controls. District reports emphasize supply-demand imbalances in labor, product, and financial markets. The supply situation is improving in some product lines, while conditions remain abnormally tight or have grown worse in others. Qualitative statements suggest that aggregate economic activity is registering little if any real improvement in the current quarter. Consumer spending remains sluggish, except for a recent spurt in auto sales. Inventories held by retailers generally are considered excessive. Housing is depressed throughout the nation, with indications of a further weakening in store. The capital spending picture may require reevaluation, as industrial firms and utilities announce cutbacks or postponements in their plans for expenditures. Agricultural prospects for crops and feedgrains have improved somewhat since early August, but the situation in the livestock industry is dismal. Savings outflows from thrift institutions continued in August, and banks in some Districts are also experiencing losses in deposits. Business loan demand remains strong, but is being curbed as bankers are becoming more selective in allocating credit. There is widespread concern among businessmen, bankers, and economists over the current and prospective effects of tight money.

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*Prepared by the Federal Reserve Bank of Cleveland

Consumer spending is described as sluggish or weakening in almost every District. Sales of appliances and home furnishings, in particular, are depressed. Philadelphia reports widespread consumer resistance to higher prices on the new fall line of soft goods. Chicago says spending on discretionary goods is slow, and that recovery in recreational vehicles has ended. A number of Districts mention problems of excessive inventories at the retail level. New car sales seems to be an exception in the generally lackluster consumer sector. Dallas, Cleveland, Kansas City, St. Louis, and San Francisco all report recent strength in sales of 1974 models stemming from the publicity given to price increases on the 1975 models. Expectations are that new model year cars will suffer from buyer resistance to higher prices.

In the capital goods sector, some weakening tendencies are developing in an otherwise strong market. San Francisco says high interest rates are thought to be depressing capital spending. Philadelphia sees signs of weakness ahead. Minneapolis reports some cutbacks in planned expenditures on machinery and equipment in farming areas where crop prospects are uncertain and cattle prices are depressed. Atlanta says the volume of commercial and industrial building is declining. A number of Districts (Boston, Richmond, Cleveland, Chicago, and Minneapolis) commented on reductions in capital spending by utilities or emphasized their current financial problems.

Residential construction appears to be depressed in every District, and prospects for recovery before 1975 are bleak. Thrift institutions continued to lose deposits in August, according to St. Louis, Dallas, San Francisco, New York, Richmond, and Cleveland. High interest rates have caused postponements and cutbacks in major condominium projects in Atlanta.

In the agricultural sector, early summer drought has severely damaged crops in many parts of the nation. Recent rainfall has improved the situation, however. Chicago mentions that now the major concern for the corn crop is cool weather and an early frost. The livestock feeding industry is experiencing its own recession, according to Kansas City, Dallas, San Francisco, Minneapolis, Chicago, and Atlanta.

Banks continue to face strong business loan demands in San Francisco, Philadelphia, Richmond, and Kansas City. Those Districts all report that bankers are becoming increasingly selective in granting loan requests, particularly from new borrowers. Kansas City, however, notes that loans to new customers in energy-related fields are being accommodated. Dallas mentions a problem of loan delinquencies in real estate and heavy construction.

FIRST DISTRICT - BOSTON

Our directors' reports continue to vary. Some report that "business is good, but not great" while noting that "despite the economists' forecasts of gloom--everyone's smiling." Other directors are becoming anxious about the health of the economy. All express a concern about interest rates and problems with balancing patterns of demands and supplies, and they see price increases as symptoms of shortages in finance, raw materials, and factors of production.

An important theme is balance. Softening of demand is noted in many lines, while orders have backlogged for as much as two or three years in others. Notably, carbon black, auto parts, lumber, certain recreational vehicles, large motor boats, housing ("the bottom fell out of the bottom"), and retailing are experiencing various degrees of decline in demand. On the other hand, various metals and alloys, some steel intermediate goods, skilled labor, sail boats, and private aircraft are in short supply. Our directors also report that the tourist trade recovered significantly in August, despite a poor start at the beginning of the season: "tourists seem to be travelling less and when they get here they spend more money."

Employment prospects for the young are assessed as bleak; and a director from Connecticut, noting the rising number of layoffs, furloughs, and small business failures, anticipates worsening conditions. A Massachusetts director involved in job placement indicates that the unemployment rates are largely symptomatic not of a dearth of opportunities, but a pattern of skills which does not match that sought by employers. A scramble for the qualified seems to be occurring.

Most directors comment that price increases are reflecting higher costs of business. Increases in finance, raw material, and labor charges prod many firms to pass on the expense, and the assessment is that demand is solid enough to support this tactic. Retailers and auto dealers, facing high finance expenses on Christmas inventory and floor plans, are raising prices (cutting discounts) in spite of weak sales: "those who are shopping have the money" and "decreasing prices would not raise revenue anyway." Basically, business is attempting to "get what it can for what it can sell."

High interest rates are cited for increases in small business failures in Connecticut, and directors from all regions comment on the burden, especially to small firms. A New England utility seeking $75 million for five years managed to draw only $60 million by offering a record 12.5 percent. A director indicates that there is a real concern for utilities obtaining a reasonable rate of return on capital. In general, those close to financial markets express gloom.

All of the academic correspondents contacted this month, Dr. Shapiro, Professors Eckstein, Samuelson, and Tobin, agree the effects of restrictive monetary policy are being felt in the economy. Samuelson says that if the 1975 model autos fare poorly and housing remains depressed, the weakness will spread. Eckstein feels that continuation of present policies will produce a recession of exceptional depth and duration. He recommends Chapter 7 of Friedman's Monetary History of the United States on the role of the Federal Reserve policy in the Great Depression. Tobin recalled his earlier statement of how continued restraint would weaken the securities market and ultimately business fixed investment. Shapiro notes that there has been scaling back in capital spending and cancellation in financing, and that "the financial community is terrified." Maintaining the present policy would mean no reduction in short-term rates by year-end and higher long-term rates.

If policy remains on its present course, according to Shapiro, the pass-throughs of unit labor costs are going to terminate. Eckstein believes that the present strategy will produce a recession of considerable severity but will not suffice to bring inflation to an acceptable level.

Eckstein, Tobin, and Samuelson feel the emphasis put on Federal budget restraint is misguided. Tobin argues it is part of a misdiagnosis of the present sources of inflation, "a knee-jerk reaction." Eckstein says real Federal expenditures have declined since the 1972 election, and the present crusade is an attempt to atone for previous sins. Samuelson argues the psychological effects of tough talk on the budget are exaggerated. The three agree that marginal expenditure adjustments would have minimal effects on inflation abatement. None of them feel that current demand is excessive.

Eckstein and Tobin want the Federal funds rate lowered quickly. "Anything above 8 percent is disintermediation territory," said Eckstein. Shapiro recommends continuation of a 6 percent rate of money growth. Samuelson would be frightened with another six months of 6 percent money growth. Five to six percent money is tight enough to abort a recovery in construction, and to cause bankruptcies and severe disintermediation.

Samuelson urges a cost/benefit analysis of continued tight policy; what is gained, by what mechanism, and what is paid for it? He feels present policy is politically in a more and more exposed position. The political dynamics of six quarters of positive but near zero growth are the same as an "official" recession. He notes the backlash to such a policy in West Germany.

SECOND DISTRICT - NEW YORK

Second District directors and other business leaders who were contacted recently, in general, felt that the recent change in the Administration would have a favorable, if only mild, effect on the business outlook. The respondents, however, were less than sanguine regarding the probable effectiveness of the Council on Wage and Price Stability in curbing inflation. There were reports of easing shortages in a number of lines, alongside continued tight supply conditions in other lines. Excessive inventories were reported to be becoming a problem for some firms, especially in the retail field. The residential construction picture in the District remains bleak.

The respondents in general looked for little immediate change in the fundamental economic outlook as a result of the recent change in Administrations. The reaction, however, on the whole was favorable. For example, a senior official of a large upstate bank felt that the Government would now be able to give fuller attention to economic problems. Similarly, the president of a large nationwide department store chain noted that the new President had already indicated that economic problems would receive his prompt attention and that the present cooperative atmosphere between the Administration and the Congress could lead to substantial progress as far as the business outlook is concerned. In his view, the President's decision to call the economic "summit conference" was a positive first step.

Most respondents expressing a view on the subject, however, felt that the new Council on Wage and Price Stability would be relatively ineffective in holding down inflation. The respondents in general were opposed to the reimposition of wage and price controls. In this context, the president of a multinational firm expressed the belief that firm guidelines for wages and prices tend to become "floors" and interfere with the proper operation of the economy.

Views were mixed regarding the impact on current pricing policies of fears of a return to jawboning or price controls, but the majority of the respondents expressed the view that such fears were not a major factor in firms' pricing decisions. Most of the Buffalo branch directors thus felt that competition prevented such practices. Similarly, the president of a large retail chain reported that his firm's pricing decisions were only based on traditional considerations such as costs and the competitive environment, and the president of a non-ferrous metal concern stated that pricing behavior in the metals industry reflected supply and demand conditions and not fears of a return to jawboning or price controls. The senior official of a large upstate manufacturing firm, however, thought that fears of price controls had influenced businessmen who wanted to "get ahead of the game" before controls were reinstated, and a similar view was expressed by a New Jersey banker.

Regarding shortages of materials, there were a number of reports of easing in certain lines, but of a continuing tight supply picture in others. The retailer mentioned above thus reported signs of an easing in several areas of his firm's business, notably textiles. Most of the Buffalo branch directors reported some easing of shortages, as did a number of other respondents. A senior official of a multinational petroleum concern reported that petroleum was no longer in short supply, but that a possible coal strike this fall could increase oil demand.

He also reported a shortage of drilling equipment. Other respondents mentioned continued shortages of chemicals, steel, alcohol, paper boxes, and certain replacement parts.

Regarding the inventory picture, the respondents on balance felt that the buildup of inventories has begun to become a problem in some lines. Among others, the president of the large department store chain mentioned above reported that inventories were building up at the retail level as well as at the wholesale level and, in some instances such as big-ticket appliances, at the manufacturing level. An upstate retailer also stated that high inventories have become a problem in the retail line. The president of a non-ferrous metal firm noted that while stocks of metals are still very low, inventories of some metal products are building up. Another observer indicated that stockpiling of raw materials and work-in-process items had been attractive when expected cost increases were much greater than carrying costs, but that the situation was now reversing.

Residential construction in the District, particularly in the New York City metropolitan area, remains very weak. Thrift institutions have suffered a massive outflow of funds and in many cases are granting no new mortgage commitments or are requiring large downpayments and other stiff terms. One large New York City savings bank, for example, is granting mortgage loans only to depositors of two years' standing, requiring that at least $5,000 be maintained in the account from the time the application is received to the closing of the loan, and stipulating that the rate be renegotiated every five years.

THIRD DISTRICT - PHILADELPHIA

Business conditions in the Third Federal Reserve District are showing conflicting signals, picking up a bit in the manufacturing sector and weakening in the retail sector. During the last few weeks new orders and shipments at local manufactureers have shown some strength, and the outlook for early 1975 is also positive. At present, there is no forecast of any significent downturn in manufacturing employment. However, area retailers report that inflated prices are taking a heavy toll in the sales of nearly all lines of merchandise. No relief from inflation is expected by any of the merchants or manufacturers surveyed. The banking community reports that its business is relatively stable compared to the uncertain conditions of the spring and early summer. Loan demand remains strong, and access to the national money markets is adequate to meet current needs.

According to executives surveyed for the business outlook survey of manufactures in the Third Federal Reserve District, economic activity showed a slight improvement in August. New orders, shipments, and unfilled orders were all above their levels of the previous month. Inventory stocks were lower, but employment was steady.

In addition, more than half of the businessmen polled anticipate some improvement in general business conditions by early 1975. Even though inventories may decline, new orders are expected to rise. However, this bullishness noes not extend into the capital spending area. The weakness that has been developing in this sector for several months is still evident. Only one quarter of the firms surveyed plan to increase their spending on capital goods in the next 6 months. At the same time, employment in the region's manufacturing sector may be stronger than most economic forcasters are currently predicting. The 6-month outlook reported by area businessmen is for stable employment with just as many firms planning to add new workers as to reduce their work force. Retailers in the Third District are feeling a significent sales pinch. There are reports of widespread resistence to price increases on the new fall line of soft goods. Sales of case goods are still strong, but higher dollar sales totals are attributed to rising prices rather than greater volume. Store management expressed the opinion that buyers are no longer willing to reduce their savings to maintain their standard of living. Consumers have also avoided any increase in the proportion of purchases made on credit, even though the real cost of revolving charge account credit has declined. Major price promotions are being planned for the fall in an effort to boost sales volume. The regions banking sector reports general stability in its operations. Loan demand is still high, but the bankers surveyed report that they are trying to restrict the expansion of their loan portfolios. They are also restructuring their asset holdings by moving out of "impersonal" investments and low-yielding credits such as real estate and consumer loans (public disclaimers to the contrary notwithstanding). The banks suffered some deposit losses when the Treasury and the floating rate capital note issues reached the market, but the outflow was not severe. The bankers also report that they have been able to meet their needs for the new money in the liabilities markets even though rumors occasionally hamper these operations. Finally, the inflation picture continues to be grim. Nearly two-thirds of the manufacturers surveyed experienced increases in the prices they paid for goods during the last month, and over half of them increased some of their own prices. The outlook for early 1975 is overwhelmingly for still higher prices. The only ray of hope is a very modest increase in the proportion of survey respondents who claim that they will be able to hold the line on prices for the foreseeable future. These executives are still a small minority, but any growth in their numbers is an encouraging sign.

FOURTH DISTRICT - CLEVELAND

Reports from economists, directors, and other businessmen suggest limited improvement in nonautomotive retail trade and a recent stimulus to new car sales. There are scattered signs of price declines among some industrial commodities and increased availability of raw materials. Demand for steel remains strong, partly because steel users are hedging against a coal strike. Coal business is booming, while output is being hampered by shortages. A number of electric utilities are shifting their capital spending from atomic power plants to coal and oil plants. S&Ls in the District continue to lose deposits in August.

Retail sales of a major department store chain in the northeast Ohio area have improved recently, following a virtually flat to declining level of sales for several months. The president of that chain attributes the recent spurt to extensive sales promotions. Their inventories, which have been more than ample in recent months, are being brought into better balance. He expects that remaining excess stocks could be worked off over the next few months if the recent pickup were sustained. However, he felt that the unit sales would do well to hold even, at least in the near term.

An economist with another major retail chain reported that the physical volume of sales remains flat. Their inventories, which were considered excessive two months ago, have increased. The firm expects a decline in unit sales of one to two percent during the balance of the year.

Auto dealers in the Cleveland area are experiencing an increase in sales of 1974 models as a result of the recently publicized price increases on 1975 models. Supplies of full-sized and intermediate models have been drawn down, but stocks of small cars are said to be abundant. Dealer sentiment is that the typical new car buyer will be reluctant to purchase a 1975 model, primarily because of the price factor, but also because of uncertainties concerning the availability of unleaded fuel.

An economist for a major tire producer reported that recent declines in prices for natural rubber, cotton, and propane lead him to conclude that industrial price pressures will moderate, albeit gradually. According to this source, capital spending plans of his firm have not been scaled downward because of the cost or availability of borrowed capital. Inventory plans have not been deterred by interest rates and their inventories are now being held in check as a result of a more abundant supply of raw materials and declines in some commodity prices. Their short-term debt has "soared" in part reflecting financing of inventories, and they have relied heavily on commercial paper to satisfy working capital needs.

Sources in the steel industry say they are having difficulty in maintaining production due to shortages of raw materials and downtime for maintenance. Steel mills are also experiencing a critical shortage of freight cars. New orders for steel products have been highly erratic, and almost meaningless, because order books are filled so fast each time a new quarter is opened. One major firm mentioned that its order intake was dropping sharply and should be reflected in national figures. The drop in orders stems from an effort by the firm to return to more realistic delivery schedules, rather than any weakening in demand. Steel shipments are expected to decline about 10 percent in the second half; as a result, there may be some involuntary liquidation of inventories by steel users.

The first real test of steel inventories, according to one economist, will come after the coal settlement. If there is a coal strike, severe cutbacks in steel output are expected within a week. One major steel firm has only a few days supply of low volatile coal needed to operate their coke ovens.

An economist with a large coal company commented "it would be prudent to factor in a two to three-week miners' strike in any economic forecast." Expansion of capacity and output in the coal industry is being hampered by environmental factors, long lead times on machinery, and shortages of construction crews, drilling equipment, and railroad cars.

A director who is a supplier to a major electrical equipment company said the firm has a nine-year backlog of turbines and generators. The firm does not plan to expand capacity, however, because they fear that the orders may be cancelled. The same director noted that many businessmen are expecting wage-price controls and therefore are retrenching on their capital spending. Another director with a utility expressed deep concern that "utilities are in a liquidity crisis, which may provoke an energy crisis." According to this director, electric utilities are cancelling atomic plants because of their high capital costs, and substituting less capital intensive coal and oil plants. The irony is that atomic plants have fixed fuel costs, while coal and oil plants have rising fuel costs--so the shift away from atomic plants is inflationary in the long run. A second director confirmed this, noting that both atomic and fossil plants have been cancelled because of the high cost of financing and load demand running below expectations. A number of these facilities were slated for completion after 1980. In addition, because of rising construction costs, there is a rush to complete those plants currently under construction.

A Federal Home Loan Bank official reported that, on the basis of the preliminary sample of 35 reporting associations, savings flows in August deteriorated further, especially in the second ten days of the month. He remarked, however, that the situation does not appear to be as bad as August 1973 when wild card certificates were introduced.

Some bank economists in the Cleveland area described their net deposits in August as exceeding the year ago volume, despite some run-off at the time of the Treasury note offering. One expressed concern that the Fed might well be overstaying restraint and that continued restraint will result in a recession. Another stated that although there is danger that the Fed will be restrictive too long he did not feel that the time had come for a change in policy. Both of these economists expressed concern that Merrill Lynch's offering will cause another run-off on savings deposits and hinder their ability to issue CDs since that firm advertises that the CDs are insured by the FDIC.

FIFTH DISTRICT - RICHMOND

Responses to our latest survey of business conditions indicate that sluggishness and uncertainty continue to characterize the Fifth District economy. In manufacturing, shipments remain steady while new orders show continued weakness and order backlogs continue to decline. Inventories of finished goods apparently rose further during August, but growth of materials inventories appears to have leveled off. There remains, however, a general feeling that current inventory levels are excessive. Increasing pessimism is indicated by responses concerning expectations for business actitivy over the next six months, although most respondents anticipate, at worst, no change in production levels within their own firms over that period. Among retailers surveyed, sales continue to hold up reasonably well, although big ticket items continue to move slowly. The latest survey of District banks suggests a persisting strong loan demand, especially in the business sector, with banks becoming progressively more selective in their loan policies. In the agricultural sector, crop conditions in many areas have improved somewhat as a result of rains since the first of August. Complaints of the depressing effects of tight money and high interest rates are widespread throughout the District.

The August survey of business conditions shows little or no abatement of the slowing trend which has characterized much of 1974. At no time this year has the survey suggested an increase in the volume of new orders, and the latest survey marks the seventh consecutive decline in this indicator. Shipments showed little change during the month; but as in previous months, production seems to have been buoyed by existing backlogs of orders rather than by new orders. Forty-nine percent of the manufacturers responding to our survey report further declines in backlogs. Despite the relatively stable level of shipments, inventories of finished goods continue to accumulate, with forty-three percent of manufacturing respondents reporting further increases. There are fewer reports of increases in material inventories than in recent months, but in no month this year has a decrease been indicated. Over 50 percent of respondents now feel that inventories exceed desired levels. Manufacturing employment has remained relatively stable during the first eight months of the year, but the average workweek continues in a mild but persistent decline.

Expectations of District businessmen have taken a distinctly pessimistic turn in recent months, and fewer respondents now expect any nationwide improvement than at any time in the past six months. Expectations for local business conditions also remain on the bearish side as almost 45 percent of the manufacturers surveyed expect local business conditions to worsen over the next six months. Expectation patterns among retailers do not differ significantly from those among manufacturers.

In the retail sector, the dollar volume of sales i. reported as firm, although sales of big ticket items relative to total sales apparently continue to weaken. Retailers in our survey indicate some further inventory accumulation during August, and increasing numbers view current inventory levels as excessive.

A recent survey of Fifth District bank lending practices suggests a further tightening of credit conditions, continuing a situation which has persisted for several months now. Additionally, loan demand remains strong, led by demand for commercial and industrial loans. In the face of this continued strong demand and the high marginal cost of loanable funds, financial institutions are applying increasingly strict standards to loan applications, and interest rates and compensating balance requirements are also becoming firmer. Established and local service area commercial customers continue to receive favored treatment on loan requests, while requests from new business customers receive more stringent review. Savings deposits are at the lowest levels since late May, but CD positions have remained stable. Savings and loan associations report continuing losses of deposits.

The District's major public utility corporations continue to announce cutbacks in capital plans. The latest such announcement by a major company involves a two-year delay in the construction of two nuclear power plants, and a $1.5 billion decrease in the company's five-year construction plan. The latter reduction will result in a cut of approximately 1,000 construction jobs. These changes in plans were attributed to rising costs and high interest rates.

In the agricultural sector, crop conditions in many areas of the District have improved as a result of rains since August 1. At that time, production prospects for peanuts, soybeans, and corn were somewhat below last year's record output, and smaller crops of hay, sorghum, grain, and fruit were also indicated. Strong demand and better quality tobacco have combined to produce record breaking flue-cured tobacco prices in recent weeks.

SIXTH DISTRICT - ATLANTA

Signs of weakness in the Region's economy are becoming more evident. Several major construction projects in the Atlanta area have been temporarily shelved or scaled down. Raw material shortages remain a problem, forcing plant shutdowns and production alterations in some cases. The volume of new industrial and commercial projects appears to be declining, although several new projects were announced. District cattlemen are feeling the pinch of soaring feed grain prices.

Construction on a $40 million luxury high-rise condominium planned for the Atlanta area is being delayed nine months. Officials said that construction start-up will be delayed until interest rates go down and permanent loan money becomes available. Another large Atlanta condominium project has been scaled down to permit a 43 percent reduction in the size of the project. Mid-August was to be the groundbreaking day for a $34 million luxury hotel and office complex in Atlanta, but plans have been shelved for the time being because of the weakening economy. Construction plans on two proposed new office buildings have also been postponed. One construction contractor believes that an overabundance of office space is developing in the Atlanta area. Residential construction remains in the doldrums. A representative of one large building concern indicates that it is currently living on remodeling business. The downturn in residential construction has apparently stimulated a boom in "do-it-yourself" sales. Several businesses specializing in "do-it-yourself" items report soaring sales.

Raw material shortages continue to have an impact on the Region's economy. Aluminum Company of America's Tennessee plant will cease production and marketing of Alcoa Wrap products because of a metal shortage. Two other Tennessee manufacturing plants were shut down because of a lack of raw materials. Some smaller Georgia cities hit by the natural gas drought are turning away new industries; some foresee the possibility of cutting off supplies to existing industries by year-end. The Tennessee Valley Authority's coal supply is getting crucial, and new coal contracts are hard to obtain. Major plants are down to 57-day reserves, compared to the normal 90-day reserves.

Announcements of new industrial and commercial projects have slackened off somewhat. The Orlando-Orange County Industrial Board reports nine new or expanded industries in the first seven months of this year. Two major manufacturing plants will be built in Georgia by out-of-state corporations--a precision ball-bearing plant and a facility to turn out metal-building systems. The huge $2.7 million uranium enrichment plant proposed for Dothan, Alabama, may create the need for another new nuclear-powered electric-generating plant in that area. Multipurpose commercial residential projects have been announced for Jacksonville, Florida, Knoxville, Tennessee, and Atlanta, Georgia.

This year's grain forecast (15 percent less that last year) has sent feed prices soaring and reduced livestock prices, particularly of young feeder calves, for District cattlemen. Two area bankers report that calf prices in Florida and Alabama hit a low of 18 to 20 cents per pound, compared to last year's calf price of 57 cents per pound. There is a general reluctance among District bankers to take on new customers in livestock production. A large Atlanta-based agricultural cooperative has announced that it will close its Valdosta, Georgia, cattle feeder lot. This lot serves the major beef-producing areas of south Georgia and north Florida. High grain prices are cited as the reason for the closing. District crop farmers are in much better shape than cattlemen. Although the national corn crop is forecasted to be down 12 percent from last year, in the District the corn crop is expected to be slightly ahead of last year's crop.

SEVENTH DISTRICT - CHICAGO

Although the level of activity remains high in most sectors in the Seventh District, concern for the future has increased. Most observers of the general economy have adopted the standard forecast of little or no overall real growth in the next six to nine months, with some inclining to the view that a serious slump is quite possible. Record high interest rates, tight Federal budget policies, rapidly rising prices and wages, the severely depressed stock market, international monetary instability, poor crop prospects, and the probability of a long coal strike are among the major factors cited. Meanwhile, order backlogs for producer goods continue to rise; strikes have hampered output, especially of motor vehicles; consumer spending on various "discretionary" wants is sluggish; residential construction sinks deeper into its trough; and supplies of many scarce items have eased, although the situation is far from "normal."

Frequent reports indicate an easing of availability of purchased materials, components, and various finished goods. This is most clear in building materials (such as lumber, cement, and gypsum board), appliances and home furnishings, many nonferrous metals, petroleum products, and paper. In some cases, such as oil and paper, very large price increases (25 to 40 percent or more) have helped to balance the market. On the other hand, most capital goods producers continue to exert a major effort on expediting deliveries of items they purchase, and they complain of "huge" price increases demanded by suppliers.

Forecasts of steel shipments for 1974 have been raised to almost 110 million tons, close to the 1973 record. Order books are full for the rest of the year, and capacity operations are expected to continue into 1975. More foreign steel is available, but prices continue higher than for domestic products, and steel exports also are rising. Plates and structurals are "extremely tight." Most steel companies have only a month's supply of coking coal, and a coal strike next November, especially of a month or more duration, would seriously hurt steel output. Some coking coal has been purchased on the spot market recently at $80 per ton, compared to $10 per ton last year.

We are warned that price increases announced for many capital goods after decontrol will not show up significantly in shipments until August and September or later. Large price increases for equipment and motor vehicles and sharply higher construction costs are expected to slow purchases and new projects in the months ahead.

Some electric utilities have reduced capital spending to the extent that thousands of construction workers have been released from projects well underway. The auto companies also are canceling or deferring important capital spending projects. But most capital goods producers report no letup in demand. In fact, they are pushing their own expansion plans for farm, construction, and mining equipment, and heavy components. Some of these companies insist they would maintain these programs even if demand for their products slowed down, because cutbacks in expansion programs effected in 1969-70 proved, in retrospect, to be a mistake. Orders for heavy trucks continue very large, and a diesel engine producer is working on a three-shift, seven-day basis. Nevertheless, one expert predicts a drop in heavy truck sales in late 1974 and in 1975.

Announced negotiated wage increases appear to average well over 10 percent, with 12 percent or more very common. Some agreements are reached only after strikes of a month or more, and often after the rank-and-file have rejected the contract originally proposed by their bargaining committees. One "bellwether" contract, which covered 7,500 factory workers in Milwaukee, calls for 12.5 percent this year and 10 percent in the second and third years--plus additional COL adjustments, longer vacations, more holidays, voluntary overtime, dental insurance, and a more liberal retirement plan, including "30 and out." New contracts for public school teachers in Illinois call for a pay increase of 11 to 12 percent for the new term.

Except for construction, where under-capitalized builders have been paying up to 18 or 19 percent on construction loans, there has been no sharp rise in businesses or consumers in financial distress. Business receivables, in fact, are turning over more rapidly than last year, probably because prompt payment is required on goods in short supply.

Car dealers report short supplies of some types of large cars, but a glut of small cars. Many buyers are said to have traded-in the small cars they had purchased at premium prices last winter. Consumer demand for appliances, furniture, and airline travel has slowed recently, and the recovery in sales of recreational vehicles is said to have aborted.

Cool weather across the Midwest has increased concern over the size of the 1974 corn crop, already seriously affected by adverse growing conditions. Development of the crop continues to lag badly, and an early frost could cause large additional losses. As a result, livestock feeding activities--cattle, hogs, and poultry--are being curtailed sharply. Demand for feeder cattle is said to be "nonexistent."

EIGHTH DISTRICT - ST. LOUIS

Business activity in the Eighth Federal Reserve District continues generally upward. Businessmen indicated some slackening in the rate of growth of consumer spending while business investment and government spending remains strong. Employment is generally unchanged in the District. The unemployment rate remains stable and relatively low. Construction activity is mixed, with home building down and commercial construction continuing strong. Crop prospects have improved somewhat due to recent heavy rainfall in the District.

Growth of consumer demand has slackened in recent weeks. Some major retailers report sluggish sales in August, and manufacturers of consumer items such as clothing, appliances, shoes, and household furnishings report some slackening demand. Automobile sales, however, have picked up considerably from earlier in the year, and capital goods sales continue strongly upward. This strength in automobiles may partly reflect special factors such as seasonal price cuts, the announcement of large price increases on 1975 models, and apprehension attributable to the potential difficulty of obtaining unleaded gasoline for the new models.

Manufacturing activity remains strong in several industries such as steel, aluminum, and machine and other capital goods. Some of these industries continue to report large order backlogs and long delays in delivery of component items. One machine manufacturer reported an order backlog of two years, and delivery delays of nine months or more was commonly reported. However, manufacturing of consumer durables, especially housing-related items, has slowed. For example, a representative of a home furnishing manufacturer reported sales increased only 4 percent in 1974.

Construction activity also follows a divergent pattern. Housing permits and starts in the District are down considerably from last year. In some cases declines of 40 percent or more were reported. Government and commercial construction, however, continues fairly strong. One exception was road building which was reported to be down, partially reflecting the near completion of the Interstate Highway System.

Employment in the Eighth District remains at a relatively high level. Total employment has remained virtually unchanged since last year, compared with rapid growth in the previous two years. The unemployment rate has risen from year-ago levels, but has remained stable for the past six months and generally remains below the national rate. Reports of layoffs were heard in manufacturing employment, particularly in housing-related industries. Also strike activity in the District has been at much higher levels in recent months than a year ago.

Time and demand deposits at commercial banks have continued to increase in the District in recent weeks, but savings and loan associations in St. Louis have suffered a net withdrawal of deposits. Both types of institutions reported a movement toward higher yielding time deposits and a decline in passbook savings accounts. State usury laws, particularly in Missouri, have virtually stopped home financing loans, thus contributing to the housing slowdown in the area. Savings and loan associations in the St. Louis area report that they are making local loans only on homes built by contractors whom they service with construction loans. A special legislative session is currently being contemplated in Missouri to consider the relaxation of the State's usury law.

The agricultural situation in the District has improved as a result of heavy rainfall recently. Crop yields, particularly soybeans and late corn, and pastures may be somewhat improved. Some parts of the District, particularly the eastern sections where the drought was not as severe, expect below normal yields from recent years; but due to the larger acreage planted, crop production may still be slightly above that of last year. The prospects for cotton and rice crops are generally good, and cow-calf operations have improved due to the favorable prospects for fall pastures.

NINTH DISTRICT - MINNEAPOLIS

The prevailing mood among Ninth District directors is one of moderate pessimism. There is no longer talk of a strong economy in the second half of 1974. Instead, directors foresee high rates of inflation coupled with modest rates of real growth continuing at least into the first quarter of 1975. Directors generally feel that traditional fiscal and monetary policies provide the best way to bring inflation under control. They are opposed to the reimposition of wage and price controls.

Some directors believe that a depressed housing industry and possible cutbacks in planned outlays on plant and equipment will hold down the rate of increase in gross private domestic investment in the second half. Consumer spending should pick up if workers register real income gains, but the increased spending may not lend much buoyancy to the economy.

Directors feel that high prices for farm crops may help insulate the District economy from national fluctuations in income and employment. But one director cautioned that this insulating effect may be less than perfect since low cattle prices have already resulted in reduced spending by some of the District's ranchers and farmers.

Crops in the Ninth District are in fairly good condition, the main exception being large portions of South Dakota, where drought conditions have cut yields far below normal. Crops in Minnesota are good but will be late in maturing, raising the possibility that an early frost could do major damage. Provided that weather conditions are favorable through the fall months, many District farmers should do well, since farm prices are expected to remain at very favorable levels.

There is less hope for the livestock producer, however. According to one director, the market for feeder cattle is bleak. The contract buying of feeder cattle has been the slowest in years. Many producers will either be holding their animals over until spring or will be forced to sell their animals at auction.

Some directors indicate that consumer spending in the District has held up fairly well into the third quarter of 1974. In current dollars the gains over 1973 are sizable. For example, respondents to our August Industrial Expectations Survey reported that second-quarter sales were up 26 percent from a year ago; sales gains of 20.5 and 17.6 percent are expected in the third and fourth quarters. In real dollars, the advances were substantially lower.

Capital spending had been expected to bolster the second-half economy, but directors now feel that capital expenditures may fall short of earlier expectations. There have apparently been some cutbacks in planned expenditures on machinery and equipment, especially in those farming areas where uncertain crop prospects and low livestock prices have had a depressing effect on spending.

Inventories in the District have been increasing, and at least one director feels that the rate of inventory accumulation has been excessive. Another predicts that the rate of accumulation will fall off sharply by the end of 1974. On the other hand, according to the Industrial Expectations Survey, many firms still feel that their inventories are less than adequate.

Two directors expressed concern over the current financial problems of utilities. Capital flows have dried up at the very time that utilities are being called upon to expand capacity and to provide environmental safeguards to their operations. Investment credits and loan guarantees are being considered as possible ways to increase the flow of capital.

Ninth District directors see inflation as a primary concern, and they generally feel that traditional fiscal and monetary policies offer the best hope of bringing inflation under control. Directors are opposed to the use of wage and price controls, at least under current conditions. They have mixed views about jawboning. Some view it as an imprecise and ineffective economic weapon; others say it has favorable psychological effects; and yet another feels that jawboning can be effective in curbing monopolistic elements in the economy. A savings incentive program was proposed by one director as a policy alternative to complement fiscal and monetary policy.

Several directors feel that a limited public works program may be needed to aid unemployed workers in coming months; other directors believe that there are more efficient ways to assist the unemployed. For instance, one director suggested that income supplements might be a more desirable approach.

Many directors also stressed the importance of curbing expectations in helping to stop inflation. One director said that rates of inflation in the second half and in early 1975 will depend on whether effective economic leadership is exerted at the national level; a failure to exert such leadership, he said, may result in a worsening of inflation.

TENTH DISTRICT - KANSAS CITY

Tenth District bankers and department store executives worry about the trend of business. Although loan demand remains strong, slow deposit inflows are tightening credit, and bankers are becoming more cautious in their lending policies. Retail sales softened in recent weeks at major department stores, where managers now consider inventories to be more than adequate. On the brighter side, the tourist season is finishing strong, recent rains have improved the agricultural outlook, and automobiles are selling fast. The increase in demand for new and used cars, dealers concede, probably will mean a slow starting 1975 model year.

Chamber of Commerce and travel officials in the Tenth District Western states report a rebound in July-August tourist flows following a slow start at the beginning of the season. While through June, tourism in Colorado, Wyoming, and New Mexico was 5-10 percent below that of last year, there was considerable improvement in July and August. Colorado, in particular, expects the late season increases to fully compensate for the slower June. Fear of gas shortages and the lower speed limit have seemingly shifted or possibly compressed the season. The most serious "energy crisis" casualties appear to be the secondary attractions which are being bypassed this season as tourists travel directly to major destinations. Automobile sales have shifted into high gear throughout the District in recent weeks. Most dealers in domestic cars report that their August business was as good or better than last year, and the best month of the model year. Heavy buying continues in the small and intermediate categories, but big cars are selling better, too. "I could have sold another 8 to 10 Thunderbirds this month," said a Ford dealer. The demand for used cars also has jumped, pushing up prices. New car dealers agree that the announcements of higher prices and new devices on 75's have stimulated the surge of interest in 74's. Consequently, they expect a slow start on sales of 75's, although about half of those contacted were optimistic about prospects for the model year as a whole.

A recent softening of retail sales at District department stores contrasts sharply with the current clamor for new cars. The demand for home furnishings and appliances has dropped considerably. "A year ago, you couldn't get enough home freezers. Now everyone is overstocked." Several controllers of major department store chains worry that sales may continue to sour. All noted that the supply situation was much improved--"the best it's been in a year," said one. Inventories are reported as adequate or excessive.

August rains came too late to be of much help to the parched District corn, but in time to revive pastures and to improve prospects for grain sorghum and soybeans. With feed grain production now estimated to be 15 percent below last year, prices likely will stay strong, further compounding the problems of the cattle feeding industry. Additional moisture is needed in Nebraska, Colorado, and Western Kansas to prepare seedbeds for the winter wheat crop.

Deposit inflows at large Tenth District banks remained sluggish in August. Business loan demand continued strong at these banks, although total loans declined somewhat due to a drop in loans to farmers and to financial institutions.

Many of the bankers contacted expressed concern over what they appraised as worsening economic conditions. Reflecting this concern, their overall mood was one of caution with respect to new loan demand. Some of the bankers contacted indicated they have recently changed their policies with respect to new borrowers. Loans to new customers will be sharply curtailed or discontinued, although an effort will be made to accommodate older customers even if they are experiencing temporary difficulties.

Exceptions to this policy were noted for new borrowers in energy related fields. Some bankers contacted specifically noted that loans were growing for extracting oil, shale, gas, and coal and for the manufacture of equipment in these industries. Also, a few bankers indicated that new loans were being made to small independent oil well operators who were reported to be doing well due to the current higher price of crude. Some concern was shown for loans collateralized by securities, which were currently falling in price. Continued falling security prices could lead to a call for additional collateral in a significant portion of these loans.

Bankers reported that real estate and heavy construction loans were experiencing the most delinquencies. On the other hand, loans to cattlemen were reported to be collateralized at a higher level due to an increase in the price of cattle.

ELEVENTH DISTRICT - DALLAS

An informal poll of director opinion reveals a considerable deterioration in expectations tied mainly to the slump in stock market prices. Concern over bank liquidity and credit quality is evident, but primary worries are on the status of the economy. Most directors believe the nation will be facing very difficult business conditions for at least the remainder of 1974. However, most also believe we have no choice but to stay with a heavily restrictive monetary policy to dampen inflation. They believe that possible increased restraint in fiscal policy might permit some modest easing of credit restraint.

Increased output of petrochemicals accounts for much of the continued growth in industrial production in the Eleventh District. Petroleum refining has grown steadily since March when foreign oil began flowing to Texas refineries. Crude runs to stills have now climbed well above the levels that prevailed prior to the Arab oil embargo, and expanded refinery output has increased feedstocks to chemical producers who are hard pressed to meet soaring demand. Industrial production has also been boosted by gains in textile output. Shortages of fibers have eased and have allowed textile producers to replace badly depleted inventories of finished goods. Paper producers, on the other hand, report the availability of wood pulp remains tight, but they have been able to increase output nonetheless.

The boom in drilling continues, although constrained by availability of equipment and trained manpower. Nearly a third of the wells being drilled in the nation are in Texas, and drilling activity in the State is running 25 percent ahead of last year's pace. Despite more drilling, crude oil production in the State is little changed from a year ago, while natural gas production is down slightly. However, total crude production in all of the District states is below year-earlier levels because of reduced outputs in Oklahoma and Louisiana.

Residential construction in Texas continues to deteriorate. Housing starts have fallen sharply for three consecutive months to the lowest level since February 1967. Savings and loan executives report the rate of deposit losses has accelerated, resulting in further sharp reductions in lending activity. For example, the president of the largest savings and loan association in Houston claims he is "completely out of the home lending market."

The decline in residential construction is also impacting heavily on the sales of home furnishings. At the retail level, department store executives in the District attribute the recent drop in retail sales to sharply lower purchases of furniture and appliances. In addition, furniture production by Texas manufacturers has fallen for three straight months.

There are indications that the eight-month slump in new car sales may be easing. New car sales in Texas' four largest metropolitan counties were 13 percent higher in July than in the previous month. Dealers attribute the turnaround primarily to customers who are scrambling for the remaining 1974 models in order to avoid the higher list prices on the 1975 models.

The labor market in Texas is generally "tight." The unemployment rate is currently 4.0 percent, and initial claims on umployment insurance in the state are at the lowest level since last January. The latest statistics show that employment in manufacturing, which had declined in the spring, has recently registered strong gains. In addition, the average workweek in manufacturing has stablized at a seasonally adjusted 40.7 hours after falling earlier this year. Despite the deterioration in home building, the reduction of construction jobs has been modest, as many workers have been able to find jobs in nonresidential construction. Also, the increase in oil well drilling has resulted in a substantial rise in mining employment.

Crop production in the southwest has been reduced sharply due to severe drought conditions; and therefore, much of this year's harvest will come from irrigated farmland. Based on August 1 conditions, prospects for the dryland cotton, grain sorghum, hay, and peanut crops in the District states were poor, with total crop output expected to lag 1973 levels by at least a fifth. Hardest hit are some West Texas counties where less than 10 percent of the dryland cotton acreage is expected to be harvested. Because of the drought, the Texas Department of Agriculture estimates crop receipts will be $1 billion less than a year ago. An additional $1 billion loss will result from lower cattle prices and leave Texas farmers and ranchers with cash receipts of about $4.4 billion. Recent rainfall has improved range and pasture conditions and has slowed the marketing of livestock to near seasonal levels. However, ranchers fear that limited supplies of higher priced feed will force large reductions in the sizes of breeding herds. The sale of such a large number of cows and calves would initially glut the market and depress cattle prices. But in the long run, cattle production would be hampered by a sharp cutback in breeding stocks, and the price of beef could skyrocket.

Limited supplies and high prices of agricultural inputs, particularly livestock feed and fertilizer, are of deep concern to agricultural lenders. A leading authority on agricultural finance in Texas predicted that farmers, ranchers, and agribusiness firms are entering a perilous new era where financial risks are higher than a few years ago because of larger capital requirements and volatile fluctuations in farm prices.

TWELFTH DISTRICT - SAN FRANCISCO

Our directors report more pessimism and uncertainty about the economy. High interest rates and inflation are singled out as major concerns. The weakest sectors are residential housing and industries such as forest products which are dependent upon housing. Lack of demand is beginning to affect retail sales in some areas, but agriculture, manufacturing, and mining remain strong. Banks face heavy demands for credit, and they are being very selective in making loans.

Our directors expect little recovery in general activity during the rest of 1974, and they report that there is much more pessimism and uncertainty, particularly about prospects for controlling inflation. High interest rates are thought to be slowing business investment spending and further depressing the housing industry. With a few exceptions, inventory holdings do not seem to be excessive, but many firms are building up stocks to avoid delivery delays and shortages.

Residential construction, both for single units and apartments, shows no sign of recovery. This lack of activity is causing more shutdowns by lumber and plywood mills in the Pacific Northwest. The only buoyant sector in the forest product industry is pulp and paper. Business capital spending is being adversely affected by the high cost of funds, so that expenditures are climbing more slowly. Nevertheless, manufacturers in sectors such as steel and electronics, stimulated by large order backlogs, are expanding capacity. Nonresidential construction remains high, but shortages of structural steel are causing problems for contractors. Mining production, expecially copper and coal, is running above last year's levels.

The general slowing of the economy is affecting retail sales. For example, a large Portland department store reports sales declines for the past three weeks. So far, retail inventories have been kept in line by tight controls, and firms do not regard them as excessive. Sales of durable items are mixed; freezers are selling well, but demand is weaker for other large-ticket items.

Automobile sales are improving. Purchases of 1974 models have been stimulated by the announcement of higher prices for 1975. Although sales are still below those of a year ago, they are much higher then in recent months. Because production and dealer allocations had been cut back earlier this year, the recent jump in sales has kept domestic car inventories to reasonable levels. In contrast, inventories of imported cars are quite high. The jump in current sales is likely to be reversed soon. Sales of 1975 models are likely to suffer from buyer resistance to the recently announced auto price increases.

Agriculture throughout most of the District continues to benefit from good crops and prices, with the principal exception being livestock. Oregon had a record winter wheat crop, and shippers are facing a local shortage of storage facilities. The livestock picture is described as unsettled. Feedlot producers are cutting back their operations because of higher costs, and they are bringing cattle to market earlier. Consequently, prices will be weaker, but later in the year higher prices are likely. One element of uncertainty in the livestock situation is the size of the grain harvest and its effects on feed prices.

Banks in the Twelfth District are still facing very strong loan demand, and they are following restrictive policies in allocating available funds. Loans are being limited to productive uses; and in many cases, only current customers' applications are being approved. Several large banks reported that the growth of business borrowing is slowing, due to a combination of high interest rates and restrictive loan policies. Consumer lending is stronger than would be expected, considering the reduced level of consumer durable sales. Problems for borrowers are probably most serious in real estate because saving institutions have been losing funds and commercial banks are not able to meet requests. Interest rates are now reaching 10 1/2 percent, and downpayments of 20 percent or higher are being required. Savings and loan associations in California suffered extremely heavy deposit runoffs in August as their customers have been shifting to market instruments bearing higher yields. Commercial banks also have been experiencing withdrawals from savings accounts, and they have had to rely primarily upon the money markets for funds to meet loan demands.