CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

November 12, 1975

TABLE OF CONTENTS

NATIONAL SUMMARY*

The economy has continued to recover, according to this month's Redbook reports, but the recovery has been uneven due to a persistent sluggishness in several regions and industries. Retail sales improved this fall, and retailers expect a good holiday season. With some exceptions, manufacturing activity has improved in recent weeks, but building activity has remained off nationwide, and business loan demand has been slow in most districts. Opinions vary concerning effects of a possible default by New York City. Favorable weather conditions have resulted in better than expected crop yields in many areas.

The nation's retailers were generally optimistic about their holiday sales prospects because of improved retail sales this fall. However, their optimism was guarded, resulting in tight inventory policies. Consumers were still usually characterized as "trading down" or "bargain-hunting" and as being "quality conscious" and "exceptionally cautious."

Retailers in the Boston and Cleveland districts experienced disappointing sales this fall and were therefore less optimistic about holiday sales than their counterparts in other districts. For example, a November survey by the Richmond bank indicated substantial sales gains and the first increase in sales of big-ticket items in over a year. Sales of big-ticket items, except furniture, remained weak in most other districts, while clothing was apparently selling well nationwide.

Automobile sales presented a mixed picture, with sales increases reported by St. Louis, San Francisco, and Minneapolis. The two latter

---

*Prepared at the Federal Reserve Bank of Minneapolis.

districts also noted an improvement in truck sales. New York indicated that the new small cars met with a good reception, while the reverse was true in Kansas City. Despite a slight increase in new car sales, Cleveland noted a lack of enthusiasm for the new 1976 models.

Present inventory positions were regarded as satisfactory by most retailers, and caution had prompted only modest restocking. Retailers in several districts stated that they preferred the risk of running out of some goods rather than facing an overstocked position after Christmas. Prices were reportedly steady to increasing slightly in most districts, although retailers in Philadelphia noted some easing in prices.

Although reports varied, manufacturing activity appeared to be slowly recovering. Surveys by Richmond and Philadelphia indicated improvement, and St. Louis, San Francisco, and Cleveland stated that manufacturing shipments had advanced. Other indicators also denoted better conditions. Richmond, for example, found that inventories had been brought into line with sales. Chicago, however, pointed out that many manufacturers were still cutting inventories but indicated some stocks appeared to be "approaching leanness." Philadelphia, St. Louis, and Richmond reported increases in manufacturing employment, but Chicago indicated few companies were actively hiring. Furthermore, while Philadelphia indicated capital expenditures by manufacturers were beginning to pick up, several districts said capital goods producers and steel producers were experiencing continued difficulties.

Construction continued to be depressed nationwide, although St. Louis noted a substantial increase in building of single-family units. There was little evidence of a recovery in nonresidential construction.

Most districts reported that business loan demand was slow, though seasonal lending needs were up in some districts. Kansas City and Dallas attributed flat loan demand to the moderate pace of inventory rebuilding, while Philadelphia cited present excess industrial capacity and substantial corporate liquidity. Boston and Philadelphia both anticipated little significant increase in loan demand for the next three to six months.

Banks were divided in their assessments of a possible default by New York City. Chicago and Kansas City expected the impacts would be relatively minor, and many San Francisco directors felt the market had largely discounted the default. Boston, however, believed that a constructive workout prior to default would save "some anguish" and that the Administration had "underestimated the wrangling, chaos, and cash drain that default would entail." New York said its district was being adversely affected by the city's difficulties, though directors within the New York district were split in their assessments of the impacts of default.

The nation's harvest had been nearing completion ahead of schedule under near-perfect weather conditions. Yields had been better than expected in many areas, and Dallas, Richmond, San Francisco, and Minneapolis were among the districts noting improved farm income prospects. Kansas City and Dallas stated that there had been a sharp upturn in cattle feeding, and Atlanta said that the movement of range livestock to market had been progressing at a record pace.

FIRST DISTRICT--BOSTON

The directors of the First District remain as unsettled as they were last month. They are not convinced that the recovery possesses either vitality or durability. The fundamentals appear to be lacking for recovery in New England. The unemployment rate for the region increased again in September to 12.6 percent. For Massachusetts and Connecticut, the September unemployment rates were 14 and 11.8 percent, respectively.

Retailers report weaker October sales than they expected from their July and September experience. Consequently, they are stocking inventories rather conservatively, preferring to know with certainty that the sales volume is there before buying. Previously, the experiences of various retailers throughout the region varied widely, but our directors report that business has been much more uniform in recent months. One retailing director comments that suppliers have begun pricing more aggressively. He notes that a return to a more normal business volume will entail higher prices. The pressure is on to increase prices whenever the market can absorb them: otherwise profits suffer.

The capital goods industry continues to live off order backlogs. Defense contractors in Connecticut, oil field equipment suppliers, and super alloy metal producers continue to report good business, but these areas remain the only bright spots. Tool and die manufacturers connected with the auto industry had hoped that even the modest improvements in Detroit's sales would have brought more activity than they have to date.

Housing construction has improved almost in step with the gains nationally, but the collapse was so deep that the industry remains exceedingly weak. Landlords continue to convert apartments to condominiums, despite an overhang of housing in this market, in an attempt to sell property. The outlook for taxes and interest rates has tempered interest in leasing apartments.

The recent break in interest rates is a hopeful sign to all directors. Ironically, one banker notes that the prime rate cuts have further eroded bank profits, and therefore he is even less interested in municipals than before.

Most bankers report that loan demand has remained slack. There seems to be little customer interest in taking on new obligations, since business conditions have yet to show material improvement. Discussions between loan officers and borrowers indicate that it may be three to six months before cash demands will exhibit significant growth. One banker is using correspondent federal funds to buy treasuries instead of reselling the balances; so far, the bet on falling rates has been rewarding.

The employment picture is beginning to show some signs of improvement. Job openings and work orders are reappearing, but employers are being very selective. Individuals with very specific professional and technical expertise are in demand. Job opportunities for others remain sparse.

The New York City problem has raised much interest among directors. They feel a constructive workout prior to default would save some anguish. According to observers here, the Administration has underestimated the wrangling, the chaos, and the cash drain a default would entail. The uncertainties are frightening.

Professors Houthakker, Solow, Tobin, and Eckstein were available for comment this month. All are less comfortable than they were a month before with recent economic developments.

Houthakker is very unhappy with recent money growth. He favors 5 to 6 percent money growth, but he feels that gyrations in the pattern of growth are harmful. He questions the value of using a short-term interest rate as an operating target to achieve monetary policy; changing money market outlooks end up influencing the money supply more than is desirable. He is also disappointed with third quarter investment; the seeds of a sustained recovery are absent. But he does feel that a flood of money would be inappropriate to stimulate investment. A New York default would not be a calamity, only an opportunity for reappraisal of state and local finances; however, the present bankruptcy law will inflict more hardship than necessary.

Solow questions the degree to which third quarter GNP strength is borrowed from later quarters. Although his assessments of 1976 have been raised a little, he is still very concerned about the recovery. The reduction in the federal funds rate is welcome, and a return to 6 percent will not be warranted until the economy and the money stock have shown sustained growth.

Tobin notes that the Fed seems to be having trouble keeping money from falling. Aside from the inventory-fueled GNP growth, he finds no other indicator of economic strength especially striking. He is less optimistic than a month ago: for such a deep, prolonged recession, and for at least four months of recovery, we have very little to show; the recovery is not in the bag. Investment, state and local government spending, and, perhaps, federal spending are showing very little strength.

Also, investors are discovering that borrowers do not necessarily pay lenders back. A shift in liquidity preference toward safe instruments may imply that the Fed needs to be even more aggressive in expanding the money stock just to maintain an unchanged policy position. The Fed should be ready to fulfill the lender of last resort function for the New York situation without causing the desk to offset bank borrowings.

Eckstein, too, is bothered by patterns of money growth. The stagnation of money since July indicates that interest rates have to be kept moderate with easing credit conditions until the money supply confirms the continuity of the recovery. He, too, is worried about the increasing risk premia in interest rates. New York cannot help but tighten bank loan policy and increase the investor preference for treasuries and liquidity. New York City is already tightening the credit market despite reductions in the funds rate--risk premia have increased--and is threatening the Baa rating or municipal borrowers' abilities to obtain funds. A full default would undoubtedly increase these risk premia even further for a time.

SECOND DISTRICT--NEW YORK

Concern over the New York City financial crisis and its possible repercussions was generally expressed by Second District directors and other business leaders that were contacted recently. A number of the respondents, however, felt that the impact of the crisis has now been discounted in the financial markets. The retail sales picture continued to improve, with merchants looking forward to a good Christmas season. There was no evidence of a change in businessmen's cautious attitudes toward capital investments. Business inventory adjustments, in general, were thought to be at or near completion, with scattered exceptions--notably some basic metals.

The district economic outlook continues to be adversely affected by the financial difficulties of New York City and New York State which, as noted by several respondents, are now inextricably linked. The chairman of a large New York City bank, a director, reported that he and a number of other leading bankers felt that a default might have a grave impact on the market for tax-exempt securities throughout the nation and on financial institutions holding such securities. The president of a nationwide chain of department stores thought a default might have a strongly adverse impact on the current business recovery. Some observers noted that the layoffs associated with the city's budget cuts were adding to the already serious unemployment situation in the area and might well have secondary effects on the job situation in private industry. Similar sentiments were expressed by several other respondents. The Buffalo branch directors, however, were on balance somewhat less concerned. While they generally agreed that a New York City default would create some problems upstate, most felt that these problems would not be overwhelming and that much of the possible impact of a New York City default had already been discounted. Moreover, these directors saw a healthy sign emerging from the situation in the increased awareness of the importance of fiscal responsibility on the part of both voters and government officials.

On the brighter side, the retail sales picture continued to improve. A survey by a local newspaper indicated that sales at large New York department stores in October were about 5 percent higher than in October 1974, despite the unseasonably warm weather in the latter part of the month that tended to hold down sales of fall and winter apparel. The chairman of the large chain of department stores mentioned above expected a good Christmas season, with sales at least 10 percent higher than last year. Another leading retailer noted that retail business had been accelerating over the past four or five months, a development he felt augured well for the holiday season. Indeed, most of the respondents expressing an opinion on the subject looked for a good Christmas buying season. A number of directors noted that the new automobile models had been well received, especially the smaller cars emphasizing fuel economy. These directors felt the outlook for auto sales was favorable, at least through mid-1976. According to a number of respondents, there has been no significant change over the past month in business plans for plant and equipment outlays, with caution remaining the prevailing attitude. One director, however, saw evidence of some pickup in longer-range capital investment planning.

Regarding inventories, most respondents agreed that there now is generally very little evidence of excessive inventories, that most inventory liquidation is completed or nearing that point, and that whatever additional adjustments are still needed should be completed by mid-1976. The chairman of a large department store chain stated that textile inventories were low and reported that his firm recently had difficulties in obtaining some of the more popular retail items. There were reports, however, of still-excessive inventories in some sectors, including some basic metals, electric machinery, lumber and construction items, tires, and console televisions.

THIRD DISTRICT--PHILADELPHIA

Economic activity in the Third District is growing, but at a slow pace. Manufacturers in the region report that business conditions are better than they were last month, but there is little evidence of any substantial gains. New orders are up slightly from last month, and inventory liquidation continues. Manufacturing employment is also marginally higher, and the average workweek is a shade longer. On the inflation front, prices paid and prices received are both higher.

Businessmen expect economic activity in the region to expand over the next two quarters. They look for new orders to be higher, and they plan to stop reducing their inventories. Manufacturing employment and the average workweek are both expected to be higher, and some increases in capital expenditures are anticipated. But the higher level of business activity is expected to be accompanied by higher prices as well.

Area retailers report that sales volumes are higher compared to a few months ago and that they are looking for a strong Christmas season. Retailers also report an easing of price pressures in their sector. Bankers in the region note that demand deposits have remained about level while savings accounts have increased slightly in recent months. Bankers also indicate that loan volume is essentially flat.

Manufacturers responding to this month's Business Outlook Survey report an improvement in business over last month. Forty percent of the respondents report an increase in business activity this month, but there are few signs of any vigorous expansion. While new orders are higher, on balance, the increase is substantially below the gains reported in each of the previous three months. The proportion of respondents reporting increases in new orders this month exceeds the proportion reporting declines by only 8 percentage points compared to about 30 percentage points on average in the August-October period. At the same time, cutbacks in inventories continue with almost 30 percent of the manufacturers polled reporting fewer stocks on hand. Employment is slightly higher for the fourth consecutive month, and the manufacturing workweek is fractionally longer.

The outlook in manufacturing for the next six months is optimistic. Eighty percent of the executives surveyed anticipate further gains. New orders are expected to be higher, and no additional reductions in inventories are planned. At the same time, employment is expected to grow. Almost 40 percent of the respondents expect to add to their work forces, and close to 30 percent of them plan to lengthen the average workweek. In addition, capital expenditures are beginning to perk up. Of the manufacturers surveyed, 35 percent expect to increase their spending for plant and equipment by May, while only 5 percent of them expect to reduce that spending. This difference of 30 percentage points is the largest net increase since June 1974.

Retailers in the area report that sales are moderately higher than they were a few months ago; there are mixed reports on the relative strengths of durables and nondurables. One retail executive notes that sales are in line with his forecast of last March but below his revised forecast of midsummer. All of the retailers contacted are looking for a strong Christmas season and a healthy spring. One merchant notes that his optimism for next year rests largely on continuation of the current tax cut. There is general agreement that inventories are at desired levels. One contact is anticipating spot shortages of some goods around mid-December. He feels that with strong Christmas buying the stocks of some items will be depleted and, with the presently conservative attitude on inventories, retailers will be reluctant to reorder.

On the inflation front, manufacturers report higher prices this month compared to a month ago for the goods they buy as well as for those they sell. Fifty-eight percent of the respondents report paying higher prices, while 15 percent are receiving higher prices for the products they sell. The outlook for the longer term is for additional increases. Almost 90 percent of the manufacturers polled expect to be paying more for their supplies by May, and close to 70 percent expect to be charging more for their finished goods. Conversely, area retailers report some easing in prices. There is general agreement that the upward climb in prices has leveled off to some degree, and one merchant notes that the prices he pays for a few products have fallen.

Area bankers report that loan volume is flat, and they foresee no substantial increase through the middle of next year. Most feel that excess capacity and substantial corporate liquidity will restrain business borrowing in the near future. One financial executive expects his bank's volume of both business and consumer loans next year to average about 4 percent above year-end 1975 levels. Bankers expect the decline in short-term interest rates to be temporary, with the prime rate dropping to 7 1/4 percent before turning back up as the end of the year approaches. In addition, none of the bankers contacted feel that the recent reduction in reserve requirements on long-term time and savings accounts will have any significant impact on available funds.

There is general agreement that the situation in New York City has not caused any substantial shift in the attitude of area banks toward holding municipal securities. Most of the bankers report that municipal bond holdings are being reduced, but the primary motive for this, they say, is unrelated to New York City. Soft profits have curtailed their need for tax-exempt income.

FOURTH DISTRICT--CLEVELAND

Manufacturing activity in the Fourth District improved, except in steel where a sharp liquidation of steel inventories was underway. Retailers reported that consumers were still buying cautiously. Deposit inflows early in November were described as excellent by S&Ls contacted, and some S&Ls expressed concern that the supply of mortgage credit will be greater than demand. Forecasts submitted to this Bank by economists with firms in this district showed larger gains in real GNP in the second half than in the first half of 1976 and continued high rates of inflation throughout 1976.

Manufacturing activity in the district improved, and in some industries recovery was strong. Rubber and chemical industries rebounded strongly, while recovery in household appliances was slow. Tire production and sales also rebounded strongly from the first-quarter low. One producer reported that sales in the last quarter were 50 percent higher than in the first quarter. A petrochemical producer reported that orders for chemical products rose 15 to 25 percent since the trough earlier this year, and another expected that sales this quarter will exceed year-ago levels for the first time this year.

Production of major appliances was recovering slowly. One producer reported that output rose 6 percent in the last three months compared with the three preceding months, but further gains are heavily dependent upon a recovery in housing. Another appliance producer stated that production of most appliances was boosted about 20 percent in recent months because of the best volume of orders in two years.

Comments from capital goods producers suggested that some recovery is under way, but from the very low levels of last spring. A major machine tool builder who reported that backlogs were cut by one-half over the past year also said that while orders were rising for the past several months, it will take many months of further improvement just to get back to the recession lows of 1960-1961. An economist with a heavy-duty truck producer also reported that orders were picking up from the low of early last spring and that he expects it may not be until well into 1977 before orders will recover to the peak levels of 1973-1974. A director with an office equipment producer reported business was below expectations, following very good months in May and June.

Steel orders and production, which were boosted in September by hedge-buying, sagged since then with little indication that improvement may come before next quarter. An economist with a major steel producer said that orders for November were up a little from a depressed October and that December order books were weak. Another steel economist stated steel inventory liquidation was cutting demand about four million tons this quarter and another two million tons next quarter. Production was expected to rise 15 to 20 percent next quarter as inventory liquidation nears completion.

Both economists reported that recent steel price increases were holding, despite weak steel markets. One commented that customers were not fighting for price concessions typical of past recessions because of concern over inadequate steel capacity that can only be increased by higher steel prices.

There was still no indication of a sharp rebound in retail sales in this district. Automobile sales rose mildly since last spring, but the new 1976 models were not yet generating much consumer interest. In Cuyahoga County (Cleveland) a dealers association reported that sales in October--considered a weak month--rose 7 percent from a year earlier. A director with a bank in southwest Ohio reported that auto sales and financing picked up substantially in recent weeks, and another director reported some pressure from auto companies to extend loan maturities to 60 months.

An economist with a national department store headquartered in the district reported that soft goods sales were improving since May and that unit sales of hard goods this quarter were expected to exceed year-earlier sales for the first time this year. A financial officer with another department store reported consumers were still cautious. Business at that store was boosted last month by an anniversary sale, but sales were less than expected. A large producer of soaps and detergents reported improvement in sales since late last summer, and further but moderate gains were expected in the fourth quarter. Some upgrading in consumer purchases of food since August was noted by the president of a large national grocery chain, but he remarked that consumers were selective, cautious, and bargain-hunting.

Net deposits rebounded in October, and all savings and loan associations contacted reported that deposit inflows were excellent so far in November. Fears of disintermediation dissipated for the time being. An officer with one association reported a possible need to borrow in order to finance their aggressive lending policy, but two others reported liquidity was higher than desired. They commented that the supply of mortgage credit will probably exceed demand, at least until next spring. High mortgage rates have deterred some borrowers, according to two of our directors.

Twenty-one economists associated with firms in the Fourth District indicated that between the fourth quarter of 1975 and the fourth quarter of 1976 real GNP will increase about $45 billion (5.5 percent), industrial production will increase 8.5 percent, and the unemployment rate will ease from 8.2 to 7.5 percent. The group, which will meet at this Bank on November 14, expected the rate of inflation to rise by 5.9 percent in 1976. The vast majority of participants expected that gains in real GNP will be larger in the second half than in the first half of 1976.

FIFTH DISTRICT--RICHMOND

The November survey of Fifth District business conditions shows improvement in many areas of activity. Manufacturers report increases in shipments, orders, and backlogs, while inventories continue to decline across a broad range. Overall, inventories appear to have been brought into line with desired levels, but there remain firms and industries which view current levels as excessive. In manufacturing, the number of employees and the length of the workweek are up from the previous month, and increases in average hourly earnings are widespread. Some upward price pressures continue in evidence. Over one-third of the manufacturers surveyed view current plant and equipment capacity as excessive, but there continues to be little interest in revising current expansion plans. Retailers surveyed report sales improved substantially and sales of big-ticket items relative to total sales increased for the first time in well over a year. The district's farm income has improved further, gaining 2 percent over a year earlier for the January to August period. At Fifth District banks, business and consumer lending grew moderately in October but real estate lending leveled off. Investments have declined, and bank credit has shown little change.

Of manufacturers participating in the November survey, over 50 percent report increased shipments during the month and nearly as many show increases in new orders. Backlogs appear to have increased slightly; inventories of both finished goods and materials have declined further. Compared with earlier surveys, fewer firms are now reporting reduced materials inventories and more are reporting reductions in finished goods. The diffusion of survey responses suggests that inventories have been brought into line with desired levels, although only about one-half of all respondents view current levels as satisfactory. The remaining one-half are almost evenly divided between those who view current inventory levels as excessive and those who view them as inadequate. Textile mills surveyed generally view inventories as being in excess, while apparel manufacturers hold the opposite view. Furniture and chemical manufacturers feel current levels are about right, while in the machinery and equipment industry responses vary from firm to firm.

Survey responses of manufacturers further suggest some increase in employment and a lengthening of the workweek since the last survey. Nearly one-third of the respondents report increases in these areas. Employee compensation and prices paid continue to move generally upward, joined this month by prices received. Over 35 percent of manufacturers continue to view current plant and equipment capacity as excessive, but there is still no strong sentiment for altering current expansion plans. Seventy percent of manufacturers, a higher percentage than last month, expect the level of business activity nationally to improve during the next six months, while half of them foresee improvement in the level of production in their respective firms.

The November survey of district retailers shows a strong upward movement in sales and the first relative increase in sales of big-ticket items in well over a year. Inventories at the retail level apparently have increased somewhat, but three-fourths of the responses indicate that current levels are about right. Despite little change in employment, over 85 percent of the retailers report increases in employee compensation. Prices, received and paid, are generally up over the previous month. Survey responses further indicate a basically optimistic feeling about the outlook for the next six months, as almost two-thirds of those surveyed expect improvement nationally, locally, and in their own firms over that period.

In the banking sector, business loans outstanding for weekly reporting banks have increased moderately compared to the past several months but currently stand 7 percent below last year's level. What strength exists is centered in seasonally strong industries, especially retail trade and the food processing and tobacco areas. Loans to public utilities, however, have also experienced a recent spate of activity. Consumer lending continues to increase at a sluggish but steady pace. Total investments of weekly reporting banks declined by 1 percent from September to October but are still 15 percent above year-ago levels. Holdings of treasury bills have increased, but those of longer-term U.S. government securities have declined. Savings deposit flows have picked up after falling off in September. CD attrition has stopped, even though rates offered by district banks have not increased appreciably in recent weeks. Borrowings from the Fed by member banks have declined to their lowest level since June. Net federal funds purchases have remained about level.

Farm income for the first eight months gained 2 percent over a year ago. This increase contrasts with a 4 percent decline nationally. This season's flue-cured tobacco prices have continued to average 5 percent below a year ago, but marketings have picked up sharply in recent weeks and are now running a little ahead of last year. The value of gross sales has therefore risen significantly but is still around 2 percent, or some $27 million, under a year earlier.

SIXTH DISTRICT--ATLANTA

A varied economic picture emerges in current reports from the Sixth District. Consumers appear to be economizing by changing their buying habits. However, retailers expect a strong holiday selling season, with the exception of more expensive merchandise. Inventories of some retailers may be inadequate should strong growth occur in demand. Divergent trends are apparent in recent price developments. Production cutbacks are still occurring in certain industries, while others are operating at peak capacity. In the district's agricultural sector, record numbers of livestock have been sold and harvests have progressed rapidly.

Evidence has appeared in several areas of the Sixth District that consumers are "trading down" in their purchasing decisions. A large furniture company reports a preference for more economical furniture. Medium-priced furniture lines appear to be doing particularly well. Similarly, apartment dwellers are moving from more to less expensive apartments. A large department store, which has enjoyed strong sales increases since August, reports that the results of its discount operation exceed those for the parent store. A major sporting goods retailer reports that good quality merchandise of all kinds is selling well but that sales of expensive goods are slow. A supermarket chain reports that customers have been switching from brand names to less expensive private label products. Finally, a nationwide distributor of automotive replacement parts attributes a strong sales increase directly to the tendency of people to maintain and repair their present cars during periods of economic weakness rather than buy new automobiles.

Retailers, in general, express the opinion that consumers are reluctant to purchase big-ticket items. They expect this reluctance to continue through the Christmas season. In other types of merchandise, retailers expect a strong holiday selling season. Retail store inventories are described by several sources as thin. Shortages due to cautious inventory rebuilding may result in missed sales during the holiday buying season. A representative of one major department store believes inventory may be low; that store is not poised for a strong business expansion. A nationwide retail chain reports that it is rebuilding its inventories at a modest pace. Sporting goods and fashion goods retailers report that deliveries are slow.

Reports concerning nonretail inventories include the note that steel and aluminum are in abundant supply. Also, a large construction company reports difficulty in obtaining delivery of large dump trucks because manufacturers are producing the most easily made goods. Bottlenecks are noted in mining equipment, heavy equipment in general, and transformers, because of limited capacity in these industries.

In construction a large company reports that the major sources of its jobs are the Alaska pipeline and projects for chemical and nuclear power companies. Small jobs are hard to come by. An absence of new speculative construction activity is noted in southeastern office construction and residential construction.

A mixed pattern of price information includes a report by one large municipality that the price of buses is rising at a rate of 1 1/2 percent per month. A large furniture company anticipates an increase in furniture prices of 5 to 10 percent in the near future due to increasing petrochemical prices. A major retailer notes that some price increases for apparel have occurred, but nothing dramatic. Coal prices are reported to have softened recently. A fertilizer manufacturer reports that his prices have decreased lately, reflecting reduced usage of fertilizer because of high prices and increased capacity in the industry; but supplies of fertilizer products which use natural gas as a feedstock are likely to be curtailed next spring. A construction company indicates that environmental protection requirements add 15 to 20 percent to the total cost of construction. A large paper products company reports cancellation of new capital spending plans because the investment was made uneconomical by increases in the cost of pollution control. A sign manufacturer complains that OASHI fines and costs of compliance have resulted in price increases of 7 percent and have also caused him to close one plant.

A construction company reports that steel companies are demanding escalator clauses in contracts for delivery next year. Construction companies note an abundance of steel products and declines in prices. Low steel production levels and recent cutbacks in production are also noted. A manufacturer of cast iron confirms these tendencies. Orders have declined since 1973, with no sign of recovery. The company continues to trim its work force and feels inventories are still excessive. But the overcapacity problems and output reductions in the steel industry appear to be specific to the construction-related sector.

A foundry which specializes in products used in mining reports a six-month backlog and is operating at full capacity after recent expansions. A casting operation reports a large increase in orders for products used in aircraft, automobiles, and earth-moving equipment. A furniture manufacturer reports an upward movement in its business throughout the third quarter, with strength concentrated in the medium-to-high end of the business. Finally, a producer of reading and education materials reports that sales to tax-supported institutions are declining as a result of cutbacks induced by a falloff of tax revenues.

Cattlemen are moving range livestock to market in record volume in an apparent effort to avoid expensive feeding through the upcoming winter months. Light calves continue to bring the lowest prices, typically ranging from 15 to 20 cents per pound. This is a reversal of the previous pattern of market prices, which declined with increases in the weight of animals. Crop harvests, though starting late, have progressed rapidly in the southeast's near-perfect weather during late October and early November.

SEVENTH DISTRICT--CHICAGO

The recovery continues to lag in the Seventh District, and job markets remain relatively weak. Mainly this reflects declining sales and backlogs for producer goods and a less-than-vigorous revival in demand for consumer hard goods. Inventories are still being brought into line, and buying policies remain cautious. Except for some monetarists, most economic analysts are confident that a broad and extended upswing is under way. But many businessmen are skeptical. Prospects for an early revival in construction remain dim despite lower short-term interest rates. Bank loan demand remains very slow. Reverberations from New York's financial difficulties have not been significant in the district. The rapid progress of the excellent corn and soybean harvests has caused transport and storage problems. Farmland values have increased sharply since midyear.

Most economic analysts in this region believe that the economic upswing will continue at a favorable pace throughout 1976 and perhaps into 1977. Many business and financial executives have not bought this forecast and have remained very cautious in their planning. Recently some prominent monetarists have predicted a general letdown if a more vigorous growth in aggregates does not occur.

New claims for unemployment compensation continue to exceed the advanced levels of a year ago by a generally wider margin in the district than in the nation. Few companies are hiring actively, and voluntary separations remain at a low level. In industries such as motor vehicles and appliances where layoff lists have been reduced more or less substantially, employment remains well below 1973 peaks--20 percent in the case of motor vehicles--and overtime is rare. Enrollment at Illinois colleges and universities is up 11 percent this semester--19 percent at community colleges--and the surge is attributed commonly to lack of employment opportunities.

A general reversal of the letdown in spending on capital goods does not appear likely until mid-1976. Order backlogs for virtually all producer equipment and related components continue to decline with no early sign of a reversal. Material-handling equipment, lumbering equipment, smaller construction equipment, and heavy trucks have been particularly hard hit. There is some early evidence of a revival in demand for heavy trucks and trailers, but from a very depressed level. One large steel company has delayed work on a huge new plate mill in the Chicago area, but another large steel company appears to be pushing ahead with its basic expansion program. Some machine tool builders are obtaining new orders from construction equipment companies for production machines. Other machine tool builders report a rise in inquiries and quotes but little in the way of firm orders.

The majority of manufacturers are still cutting inventories. Order lead times remain very short, and buyers are able to shop around for the best terms on materials and components. Some inventories appear to be approaching leanness, however. Price cuts are much less common, and price increases are more frequent. It is possible that plans to cut inventories further will be altered quickly as lead times begin to stretch out again. Distributors of paper products, for example, report a surge in orders attributed partly to strikes in Canada and partly to a desire to rebuild a LIFO base by year-end for tax purposes.

The financial problems of New York City have had little observable impact in this district. A recent nationally publicized report that Chicago could not sell a certain bond issue because of the New York situation was erroneous. There have been widespread complaints by government officials, however, that rates on all municipals have been inflated by the crisis. Quite apart from outside influences, virtually all state and local governments in the district are closely restricting expenditures to prevent unbalanced budgets and/or additional borrowing. Recent increases of 10 percent and more in compensation of teachers and workers and increases in other costs have required cutbacks in municipal programs. Various states are planning to increase taxes on employers to rebuild depleted unemployment compensation funds.

The recent decline in short-term interest rates has surprised most analysts but is regarded as a healthy development. Mortgage rates have not softened and are reported to have increased further for commercial properties. Fears of disintermediation have moderated, but S&Ls remain cautious on new commitments. Business loan demand at banks continues to be slow and less than expected.

The corn and soybean harvests are well ahead of schedule, and grain is in excellent condition. Large crops and the rapid completion of the harvest have created an abnormal pileup of grains--some on the ground--and rail cars are a bottleneck. Hog prices have dropped very sharply in recent weeks with a temporary bulge in marketings, consumer resistance to high prices, and the (probably groundless) nitrite cancer scare all playing a role. Our survey of farmland values shows a 9 percent rise in the third quarter to a level 17 percent above a year ago. Early this year land values were expected to level off or even decline.

EIGHTH DISTRICT--ST. LOUIS

Business activity in the Eighth District continues to recover from the recession, according to reports from district businessmen. The recovery is proceeding on a fairly broad front, as most retail, manufacturing, and residential construction representatives indicate improving business conditions. Exceptions to this general trend are the steel industry and large commercial building contractors. Employment has picked up in the district, reflecting a sharp turnaround in manufacturing employment. Loans outstanding at large banks increased somewhat in October. The prime lending rate has recently declined at district banks. Favorable fall weather conditions have been conducive to the prompt harvesting of generally large crops.

Retail sales continue to improve for both durable and nondurable items. Durable items for which increased sales are reported include automobiles, home furnishings, and some appliances. Wearing apparel items are among nondurable items which are selling well. Retailers are optimistic about Christmas sales, since they sense that the general buying mood of consumers is improving.

Manufacturing activity continues to improve over a broad front, as inventories have stabilized and final demand has picked up. Reports from industries associated with homebuilding indicate a continuing increase in demand. Such items as metal connector plates used in construction, paints and coatings, and durable items used in homes are showing improved sales. Chemical manufacturers indicate a slow improvement in plastic and fiber demand buoyed by increased sales of homes and automobiles. One manufacturer reports that in his efforts to buy certain industrial equipment he discovered substantial lag time in delivery of equipment, whereas only a few months ago the lag was less. A manufacturer of equipment used in the petroleum industry indicates a strong turnaround since last May. Reports indicate a pickup in metal fabrication industries as well. On the other hand, a major aircraft manufacturer reports order backlogs are below a year ago, and a steel representative now expects that a strong recovery in this industry may not get under way until next year.

The construction picture is mixed. On the one hand, construction of single-family dwellings has increased substantially in the district, while multi-family dwellings and other types of commercial and government construction are generally in a depressed state. Multi-family home construction in St. Louis is at a virtual standstill. Occupancy rates, however, are increasing on existing structures, and substantial increases in rents are expected in the next few months. While a substantial amount of commercial construction is now occurring in the St. Louis area, other areas in the district report that prospects for new contracts are not very promising. An Arkansas construction firm representative reports an almost total lack of large contracts at the present time, and none are expected in the next few months. Contracts currently being let in some areas have four to five times the normal number of bidders. A construction representative in the Louisville area expects building projects and highway construction to be down in 1976 and utility construction to be about the same as this year.

Latest employment data for the district show an upturn in overall employment in the third quarter. Manufacturing employment gains were especially large compared with the increase in the nation as a whole.

Business loans increased slightly at large commercial banks in the district during October, but in line with the national trend toward lower rates, several banks in the district cut their prime lending rate. Consumer installment loans also rose in October, probably reflecting the pickup in consumer durable purchases.

Reflecting very favorable fall weather, the harvesting of crops in the district is nearing completion and is much ahead of last year. In addition, fall plantings of wheat are proceeding at a rapid pace. Indications are that relatively large crops of corn, wheat, soybeans, and rice have been harvested. Rice production in Arkansas is now expected to be less than anticipated earlier due to lower yields per acre. Nevertheless, production will be relatively large in view of the large increase in acres planted. This production combined with large rice crops in other areas and an uncertain world demand has led to depressed rice prices. On the livestock side, prices are generally strong, especially for poultry and pork.

NINTH DISTRICT--MINNEAPOLIS

Economic conditions continued to show improvement in the Ninth District. Retail sales have been quite strong this fall, and prospects are for a good holiday season. District automobile sales have also strengthened. Many district businesspeople have brought their inventories into balance. Another encouraging development was the third-quarter improvement in district farm income. Finally, loan demand has increased at district commerical banks in recent months.

District retail spending improved this fall, and the outlook is good for the holidays. A recent survey of major Minneapolis-St. Paul area retailers reported stronger sales of clothing, home improvement materials, and big-ticket items like appliances and furniture. This sales pickup has made the Twin Cities area retailers optimistic about their sales prospects for the holiday season and next year. One director, whose company manufactures consumer products, indicated that consumer spending has accelerated and stated that his firm's sales to retailers point toward a good holiday season. Directors from outside the Minneapolis-St. Paul metropolitan area reported that fall retail sales have generally been good in their areas and the outlook is for sales to continue strong through the holidays.

Growing strength was apparent not only in general merchandise sales but also in automobile sales. A Montana director described recent automobile sales in his state as "super." A southern Minnesota director reported this fall's auto sales improved after being down this summer, and in western South Dakota consumers have been showing considerable interest in the 1976 models. In addition to the strength in car sales, one director reported that truck sales in his area were up considerably.

Excess inventories have no longer been a problem for many businesses. One Minneapolis-St. Paul area director expressed the view that most businesses have pretty well adjusted their inventories. Two directors indicated that retailers have been cautious about inventories and may encounter some difficulty obtaining merchandise as merchants seek to obtain goods to meet unanticipated demands this holiday season. A western South Dakota director, on the other hand, stated that business-people in his area have still been trying to cut inventories.

According to our October Agricultural Credit Conditions Survey, farm income prospects in the Ninth District improved in the third quarter over previous quarters. In this most recent survey, 29 percent of the district's bankers reported farm earnings above year-ago levels; in the first half of 1975, fewer than 10 percent of the bankers reported improved farm earnings.

A number of factors contributed to the recently improved income prospects. High prices from hogs and fat cattle boosted some farmers' profits. Other farmers' incomes were increased by higher dairy prices. Better yields were also a factor in raising farmers' earnings, most noticeably in the wheat belt of North Dakota.

By no means all bankers reported farm earnings higher than those of 1974. Earnings have been down from last year in the flood-ravaged regions of the Red River Valley, and midsummer drought conditions reduced crop yields through areas of South Dakota and southwestern Minnesota. Finally, earnings remained low for the district's cow-calf operators, who are in the second year of an adjustment process that many bankers expect will continue through 1976.

Loan growth--apart from seasonal advances--was much stronger in September and October than earlier in the year at district banks. Part of this increase has occurred in business loans at large banks in the Minneapolis-St. Paul metropolitan area. Outside the Twin Cities the situation has been mixed. Three directors located near the Twin Cities reported that loan growth has been quite strong in their areas. Two cited strong real estate loan demand, and one indicated that installment lending was up in his area. On the other hand, a Montana director indicated no increase in loan demand in his area. The poor outlook for the livestock industry and the lingering effects of the recession are expected to hold down loan demand in western South Dakota.

The October Agricultual Credit Conditions Survey also indicated that agricultural loan demand was not expected to increase in the third and fourth quarters. Short-term loan demand has slowed considerably since the July survey. With earnings slightly improved over the first half of 1975 and with slower farm spending, farmers' financial positions have stabilized. Farmers have been paying off old debts, and refinancing of farm loans has declined. Also, farm credit needs have turned down seasonally. Advance stockpiling of inputs may also be lower than last year, when fears of input shortages appear to have encouraged extensive stockpiling.

With farm income prospects improving, bankers have been viewing farm lending more favorably. Sixty-one percent of the bankers reported that they actively sought new loan accounts during the third quarter, the highest percentage since the second quarter of 1974. Only 8 percent of the bankers reported that they had reduced or refused a loan due to a fund shortage, and only 4 percent anticipated problems meeting loan demand in the coming months.

TENTH DISTRICT--KANSAS CITY

Retail sales in the Tenth District were generally strong in the early fall, and sales in November and December are expected to be stronger yet. Soft goods sales tend to be outpacing durables sales, and retail inventories have been expanded in line with strong sales anticipation, but inventory policy overall is still described as cautious. New domestic auto sales are well above those of a year earlier, with stocks apparently ample. Business loan demand at Tenth District commercial banks remains weak, however, even among retailers. Fall crop production was historically large and better than expected earlier, and recent rains have improved prospects for next year's winter wheat crop.

Retailers in metropolitan areas of the Tenth District have generally experienced strong sales this fall. Major exceptions seem to be in sales of seasonal items, ranging from winter coats to snow tires, because the weather has been unseasonably warm. Nearly all respondents reported expectations of very strong sales in November and December (including the Christmas season), making for a good fourth quarter. Although there seems to be a tendency for improving sales in durables, soft goods sales are apparently outpacing them. Among durables, furniture was singled out by several retailers as selling very well. Among non-durables, clothing sales were particularly noteworthy, especially men's clothing across the whole range from sports and leisure to business and dress clothing. Some respondents noted that consumers have continued to be "exceptionally cautious" and "value conscious."

It is somewhat more difficult to generalize about inventory policies and level of stocks. A number of retailers stated that their expectations for strong sales had led them to stock up heavily, but they regard those stocks to be about where they want them right now. In relation to anticipated sales, others spoke of inventories being under "tight rein" or "tight control" and described themselves as being "very conservative on inventories." Several mentioned no problem in getting deliveries of goods; only one complained of slowness in deliveries. Finally, one respondent noted that, to avoid the risks of being over-stocked should sales turn sour, his firm had "plenty of inventory--all we want--yet our inventory levels are low."

Sales of new domestic automobiles in the Tenth District are doing very well compared to a year earlier, according to reports received from dealers in several district cities. There seems to be no clear pattern of any particular size group taking command, although there is some inkling in the reports that small cars are perhaps not doing as well as expected. Stocks are generally reported as adequate, with no shortages other than for a few specific models.

Nearly ideal weather has pushed the fall harvest in the Tenth District well ahead of both last year and the ten-year average. Corn and soybean yields are better than had been expected, and final production figures for these two crops may well exceed October 1 estimates. Welcome rain over Oklahoma and Kansas last week substantially improved winter wheat crop prospects in those states. Rapid completion of drought-delayed wheat planting is expected, with seeded acreage in the Tenth District about equal to last year. However, the generally dry conditions throughout the winter wheat area will severely limit wheat-pasture grazing, which may hasten the movement of cattle into feedlots.

Expectations for favorable profit margins have already resulted in a sharp upturn in the number of cattle placed on feed. October 1 data for cattle on feed indicated that Tenth District placements for the third quarter were 2.5 million head, 19 percent above a year ago. For the 23 major feeding states, the increase was 22 percent. As a result, the number of cattle on feed on October 1 in the Tenth District and in the 23 states was 14 percent and 9 percent higher, respectively, than 3 months earlier, a trend counter to usual third-quarter declines. Although pork supplies are expected to remain tight for several more months, the expansion in beef output implied from the above data may be sufficient to stabilize red meat prices during the first half of 1976.

Loan demand at Tenth District commercial banks was generally reported as weak at most banks surveyed. In areas such as retailing, where there is typically a strong seasonal demand, loan demand was smaller than usual. Bankers said that business borrowers appear cautious about rebuilding inventories. Most bankers did report a seasonal increase in agricultural lending, with some mentioning stronger demands for cattle loans. The bankers surveyed have experienced little gain in auto loans with the introduction of the new car models.

Most respondents thought that a default on New York bonds would cause relatively minor short-term effects in financial markets. They felt a default might result in a favorable reappraisal of the creditworthiness of municipalities having good financial management and thereby allow those municipalities to borrow at relatively favorable terms.

ELEVENTH DISTRICT--DALLAS

Lending activity at the district's largest banks continues to weaken. Total loans at weekly reporting banks have edged downward since the first quarter of this year. The lackluster pace of lending is reflected in the aggregate loan-deposit ratio for these banks which continues to fall and now stands 11 percent below the cyclical peak in February 1974. Although loan demand is weak, bankers admit that restrictive lending policies are playing a major role in holding down the volume of loans. In fact, a veteran Fort Worth loan officer has said that today's borrowers are facing the most stringent credit requirements he has seen in his career with the bank.

Commercial and industrial loan demand are running well below the level most loan officers expected during this phase of the recovery. There appears to be little inventory accumulation in progress. One reason for this is that many manufacturers are finding materials and unfinished goods readily available from suppliers. They are taking advantage of this favorable supply situation by keeping their own stocks low, thereby reducing working capital requirements. In addition, the high level of earnings generated over the past couple of years by many energy-related firms, particularly suppliers of oil field equipment, has reduced the need for bank credit.

While the volume of business loans remains low, the composition of demand for funds has shifted markedly. Loan officers report they are being besieged by applications for term loans. Moreover, these requests are altogether different from the type of term-loan demand bankers saw in the early seventies. Then, customers sought term loans for "productive" purposes--to finance plant and equipment expenditures and for corporate acquisitions. But today, according to these bankers, virtually all such applications are from customers with depleted working capital who are seeking to improve their liquidity positions by converting much of their short-term bank borrowing to term debt. Loan officers maintain that these firms have not been able to "get their house in order" following the severe dislocations of the past couple of years. The vast majority of these term-loan requests are being turned down.

In real estate lending, reducing exposure to potential REIT losses continues to be the dominant concern of loan officers at the larger banks. Nevertheless, bankers appear somewhat more optimistic about these loans even though there are only a handful of sound REIT lines among the banks surveyed. Although payouts have been slow, in a number of cases they have been running well ahead of the pace predicted earlier this year. A Houston loan officer, for example, says his bank has reduced REIT loans to $40 million, down from $48 million just a few months ago, and none of these lines are currently being carried on a nonaccrual basis. According to an El Paso banker, the payback from a REIT bankruptcy has reached 25 percent and is expected to go higher, reducing that loss to less than the amount the bank had already charged off.

Bankers report a favorable outlook for expansion in consumer credit during the coming holiday season in light of growing indications that consumers are stepping up their spending. One positive sign has been a sharp decrease in the number of applications for debt consolidation loans this year. Credit card usage is on the rise, and suburban bankers note that automobile loans have picked up. In addition, there are numerous reports of banks offering comprehensive service packages in attempts to rekindle consumer borrowing.

Good harvests, increased marketings of cattle, and higher average prices since midyear have bolstered crop and livestock sales in the Eleventh District. Consequently, cash flows to farmers and ranches have improved, and rural bankers report the rate of loan repayment has increased while the number of renewals and extensions has declined. Although flush with funds, agribankers continue to be very cautious in granting credit. Uncertainty over markets and weather and the carryover effects of depressed incomes in 1974, particularly among cattle feeders, serve to keep collateral requirements firm.

Nevertheless, agricultural lending this fall is above year-earlier levels. Rising production costs and slightly more acreage in cultivation have increased the farmer's demand for bank credit. And, as a result of good harvests, the volume of crop storage loans is up substantially. Also, improved income prospects have led to more farm machinery loans.

Livestock lending has been bolstered by a large increase in the number of calves on feed since midyear. However, strength in the livestock sector is being tempered by a reduction in cattle purchased for grazing, owing to the dry weather that has lowered the prospects for winter foraging. In addition, dairymen continue to trim capital outlays in response to the severe cost-price squeeze in that industry.

The men's and women's spring apparel shows held at the Dallas Apparel Mart in October attracted a record number of buyers and sellers from across the country. Sales were termed brisk as retailers attempted to replenish their depleted inventories. Some manufacturers felt that many buyers were double-ordering to insure delivery of goods. Double-ordering stemmed from the fact that shortages of some piece goods have appeared, and some firms are finding it difficult to meet delivery schedules.

Apparel manufacturing in Texas continues to recover, as production is now 15 percent above the March low. Sales to the national retail chains, which represent most of the state's output, have rebounded strongly. Several new manufacturing facilities began production last quarter, and one of the state's largest garment makers reopened a large plant last month that was closed down in February.

TWELFTH DISTRICT--SAN FRANCISCO

In the opinion of our directors, the recovery is proceeding at a slow, steady pace. Although merchants are optimistic about consumer willingness to spend, ordering for the Christmas season has been cautious. Demand for new passenger cars has strengthened, especially for compacts, and the used car market is very active. New construction remains in the doldrums, resulting in depressed conditions for its main suppliers, but most manufacturing industries have recovered from recession lows. High crop prices and a good harvest have assured a strong income performance for district farmers this year, and lower feed grain costs in 1976 should improve income for livestock, poultry, and dairy producers. Some possible economic repercussions of a New York City default are cited and discussed below.

The trend in retail sales through the end of 1975 is generally viewed optimistically, but no extraordinary surge in Christmas sales is anticipated. Soft goods sales, especially of apparel, are being cited as especially strong, while large-ticket items continue to move sluggishly. Appliance sales, however, are said to be picking up.

Sales of motor vehicles are continuing to follow patterns established for compacts, with foreign makes maintaining their market shares. In some areas, imports constitute about 40 percent of new cars sold. One director believes that in a few years middle-to-small class cars will account for 80 to 90 percent of the new car market. The used car market, especially for late models, is very active. In agricultural areas, spurred by good income expectations, demand has been growing for new cars, pickups, and trucks.

One director is especially concerned about the future of utilities and the costs of environmental protection. He believes that realities are such that kilowatt output will flatten over the next few years, placing a limit on capital expansion. To achieve anything like full employment in future years, he believes that conversion to coal and nuclear power should be encouraged.

Except for lumber, most district manufacturing industries are reporting slow, steady improvement. Some large steel companies, however, have announced postponements of capital spending plans which might backfire as operating ratios approach capacity.

Estimates of net farm income for 1975 in Twelfth District states keep improving each month. The harvest has been bountiful, and prices have been maintained partly because many frozen food packers curtailed inventory positions last season and will have little carry-over into 1976. In a few crops, such as grapes, oranges, and possibly sugar beets, there has been overproduction which will probably generate a lowering of prices.

Livestock cash receipts are down this year, but the lower feed costs now anticipated for 1976 should contribute to increased returns for livestock, poultry, and dairy producers. At the same time, the prospects for wheat and feed grain producers are less favorable, owing to the large 1975 crops. "The economic recovery in the U.S. as well as the world should serve to stimulate demand for agricultural products in general and in particular for specialty crops produced in California and other western states." Although gross farm income is expected to be up in 1976, increased production costs are forecast to more than offset this rise, resulting in a decline of 10 to 20 percent in net income from 1975.

Many of our directors believe a New York City default would now be a case of "dropping the other shoe" since the financial markets have largely discounted the event. These directors take the position that the long-run effects of default would be positive in that it would force all municipalities to become more fiscally responsible and to gear improvement plans to revenues.

In the other camp are those who believe that some form of federal assistance is in order. Their arguments are mostly moral and psychological. They cite such probable effects of a New York City default as "loss of confidence in government and loss of international prestige." Favoring aid to maintain essential services is a moral attitude, and yet behind it is anxiety over a possible antisocial reaction by the city's residents. The loss of confidence in government would evidence itself through a diversion of monetary policy that "could prove damaging to the well-being of our economy and the future course of inflation and interest rates" as well as the value of the dollar.

A default would lower income flows in many areas, and decisions must be made as to how this burden will be shared. The goal should be achieving a feasible modus operandi for New York City with the least disruption and inequity possible.