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CURRENT ECONOMIC COMMENT BY DISTRICT

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SUMMARY*

Continuing expansion at uneven rates characterizes this month's economic reports. Although capacity utilization is high in several major industries, shortages of raw materials, components, and finished goods remain the exception. The pace of consumer spending slackened somewhat in most areas in late April and May. However, opinion varies widely concerning the implications of this tendency. A positive outlook persists but is heavily tempered by caution in inventory building and capacity expansion. Price behavior appears fairly normal for a cyclical expansion; increases are primarily in sectors where spot shortages or a need to adjust to rising costs exist. Demand for business loans is flat or increasing slightly. Adverse weather conditions have affected yields of several major crops.

Major industries report generally high capacity utilization rates. Yet, capacity is regarded as adequate for the next 6 to 12 months in almost all industries. Shortages are expected to be temporary in most cases or confined to a relatively limited sector affected by unique conditions. With some exceptions, and a caveat concerning comparability of reports, high utilization rates are found in paper (90 to 100 percent), wood products, steel (80 to 90 percent), textiles (85 to 100 percent), apparel, chemicals (80 to 100 percent), oil refining (85 to 90 percent), and automobiles (80 to 100 percent). Low utilization rates are confined to furniture, aluminum, machine tools, and agricultural chemicals.

In each industry, however, a more meaningful impression is obtained by differentiating between particular products. In the steel industry, for example, flat-rolled steel used in consumer durable goods is in fairly tight

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*Prepared by the Federal Reserve Bank of Atlanta

supply, as are foundry products such as castings. Abundant capacity and supplies exist of other products used for capital goods and heavy construction.

Current shortages are few, across the board, and generally reflect special conditions. Foundry products, for example, are frequently mentioned as an area of potential shortages. Both Chicago and Kansas City note that closing of foundries because of EPA regulations is reducing capacity in this industry. Other facilities which are similarly affected are coke ovens and forging operations. Several responses indicate that coke supplies are a potential raw material problem for steel producers.

The primary current bottleneck in most Districts is the supply of natural gas to users on interruptible contracts. Uncertainty concerning natural gas supplies is widespread and has resulted in substantial capital investment in stand-by energy systems. Concern also exists about the reliability of natural gas liquids used as feedstocks in chemical processes.

Slackening consumer spending, beginning in about mid-April, is noted in a number of reports. In most areas, durable goods sales, especially automobiles, remain strong; nondurables, particularly apparel and department store sales, have weakened. Explanations include cool weather, smaller tax refunds, a shift from nondurable to durable purchases, as well as a return to a sustainable growth rate. Boston reports some retailers are cutting back on future commitments, while Philadelphia expects such action to follow, should the present tendency be confirmed. Dallas reports that the fall apparel market, held in May, was weak for women's and some men's clothing lines. Richmond and Philadelphia note continued optimism among most retailers; Cleveland finds that some remain positive, but one director fears a spending decline serious enough to "trigger a double-bottom recession." Each of these three Districts notes an excessive level of retail inventories.

The inventory condition of manufacturers varies greatly. Dallas finds factory inventories manageable, and Kansas City notes attempts by many firms to retain a lean inventory position. Philadelphia finds a decline in inventories of manufacturers for the first time since January, but Chicago reports cautious inventory building. One-third of the manufacturers in the Richmond District report an excessive inventory level, with most others indicating satisfaction with their condition.

Capital spending remains static. Boston finds a disappointing demand for machine tools. Chicago notes an improvement in capital goods orders but expects no uptrend until late in 1976. Cleveland expects little gain in the strength of fixed investment during the second half. An exception exists in the case of capital investment in agriculture, where strength is noted by Minneapolis and Chicago. New York, Chicago, Kansas City, and Cleveland find environmental regulations to be a source of uncertainty and a major disincentive to capacity expansion.

Price behavior is consistent with a normal cyclical pattern. Spot shortages have caused sporadic price increases, as in newsprint; but in cases such as heavy crude oil, chemical fertilizer, and carpet yarn, oversupplies are causing price shading. Prices are generally expected to behave normally within the context of a cyclical recovery.

Loan demand continues to increase slowly. Business loans have "inched up," according to St. Louis, Richmond, and Kansas City but have not increased in Philadelphia. Gains in consumer loans are widespread. St. Louis reports moderating savings inflows. Kansas City finds some banks beginning to rebuild certificates of deposit.

Minneapolis reports that the recent drought will almost certainly curtail crop yields in Minnesota and has now spread westward into the Dakotas. The main impact is expected on prices of barley, oats, flax, and durum wheat. San Francisco reports weak demand, low prices, and surpluses of beans, potatoes, and wheat. However, a possible beef shortage is foreseen for late 1976. Richmond notes a sharp decline in the winter wheat crop and freeze damage to the peach crop.

FIRST DISTRICT - BOSTON

The New England directors reported a "pause in the recovery." Although they did not anticipate a growth recession in 1976, they continued to monitor with concern housing and new machine tool orders for signs of recovery. Retail sales were also sluggish in the weeks following Easter. Except for shortages reported by lumber suppliers, regional productive capacity is generally excessive.

For the past several months, requests for quotations have been more numerous in the machine tool industry. However, the expected improvement in orders has not materialized. The machine tool suppliers have been maintaining relatively high operating rates by filling order backlogs, but a continued lack of new sales would entail significant layoffs in the second half of the year. One director, who has been observing the very gradual increase in orders for short-lead tools, was hopeful that quotations will begin to generate new business.

Retailers have become uncertain about the outlook for their trade. Believing that the economy is fundamentally sound, they were surprised that "business is falling off against expectations." In fact, a director comments that retailers are becoming considerably more conservative and that "typical retailer stocks are way too high." Even though this weaker sales experience may be the product of recent seasonal distortions, our director reports that merchandisers are cutting back on future commitments.

Industrial capacity is generally more than adequate in relation to sales throughout the region. Normal operation rates are based on the assumption that overtime is modest and that one and one-half or two shifts

of personnel are employed each day. Although increased sales will now require more hiring (productivity gains have been fully exploited), new orders have a "long-long way to go" to absorb existing space and equipment in most industries. Directors typically asserted that capacity utilization is about 80 percent.

Lumber suppliers were the major exception to this rule of excess capacity. Sawmills are fully employed, as are the existing kilns, and yet the suppliers cannot meet the demand for dry lumber. Although many machine tooling firms are operating at normal capacity, they vary order backlogs rather than production schedules in response to changing demands; at this time, the backlogs are small.

Professors Eckstein, Samuelson, and Tobin were available for comment this month. All noted the weaknesses in the current data--for the first time in several months forecasts are being revised downward. In addition to the weakness in retail sales, the Commerce Department's survey of capital spending suggested that the first quarter figures will be revised downward and that the year as a whole will not be as strong as in the McGraw-Hill survey or the previous forecasts. The next DRI forecast will show business fixed investment rising only about 4 percent in real terms. According to Eckstein, the recent data show the upside risk has diminished while the downside risk remains slight; they confirm that this recovery is a "modest" one and there is no danger of a "runaway boom."

All agreed that the Federal funds rate should be held at its present 5 1/2-percent level. To Samuelson, prudent policy is to stand pat until we see whether the weakening is a minor aberration in a strong general pattern. To Eckstein, the economy should be allowed to follow its own dynamic, with

no stimulus or restraint from monetary policy: He recommended a monetary policy "as uninteresting as possible." While Tobin was willing to accept the current level of short-term rates, he opposed the recent rise because it was apparently based not on the state of the economy but on monetary growth in excess of the targets.

Uncertainty about the demand for money is too great at present to base financial policy rigidly on aggregate targets. He favors symmetric repetition of the flexibility with respect to the targets that was shown earlier, when money growth fell short of the targets. In that instance, the Chairman eloquently and correctly explained that the deviation from the target was temporary and based upon the performance of velocity. The same point can be made in the present context--deviations from the target range need not indicate that the Fed has "joined the inflationists." It can mean that, given the expected path of velocity, above-target growth will be associated with conditions in the financial markets which are conducive to a revival in fixed investment in 1977. By then, the fiscal stimulus to consumption and the inventory rebound will have ended and strong fixed investment will be needed to sustain the recovery toward full employment.

SECOND DISTRICT - NEW YORK

Overall capacity constraints are not expected to materialize this year or early next year, according to Second District business leaders, directors, and industrial analysts. Current production rates are below most industries' capabilities, and the few shortages that exist appear limited to isolated product lines. Respondents appear less sanguine about the longer-run outlook, however. One after another, they complained of the disincentives to investment caused by environmental and safety legislation. Consequently, little outright addition to capacity is foreseen, and many observers are apprehensive over bottlenecks and shortages emerging toward the close of 1977.

While on the whole, substantial plant capacity remains to meet increased production, high utilization rates in some industries--notably paper, steel, and textiles--suggest that some capacity problems could develop within the coming year. A senior official of a trade association expected full capacity utilization in the paper industry to be reached by mid-1977. In this official's view, high utilization rates were already building inflationary pressures. The chief economist of a major paper producer felt certain lines, especially newsprint, were already at capacity but expected production to stabilize as inventory building subsided. One director felt there were clear indications of possible steel shortages, largely owing to tightness in foundry capacity. An industry analyst of a leading securities firm, however, discounted the current evidence. He emphasized that while production was tight for steel products associated with automobiles, substantial slack existed elsewhere. He argued that since auto production is

unlikely to accelerate, steel capacity should remain adequate. Textile industry respondents generally felt that capacity utilization, while high, would not reach its upper limit in the near term.

In the wake of the severe bottlenecks created by shortages a few years ago, everyone surveyed appeared to be sensitized to signs of developing shortages. On the whole, business leaders and industrial economists reported that raw materials are currently plentiful, and they generally did not anticipate near-term shortages. The few exceptions cited--some chemicals, such as chlorine and possibly cotton fibers--were not viewed as likely to create significant bottlenecks. The Buffalo Branch directors generally discounted the risk of a reemergence of shortages of industrial materials in the foreseeable future. In their view, the lengthening of lead times for steel and for certain chemical and paper products was attributable to an unwillingness on the part of firms in those industries to activate marginal facilities and to rehire marginally productive workers until the upward trend of orders became more pronounced.

An official of a major auto manufacturer and other observers felt that, barring an exceptionally long walkout, the rubber workers' strike would not substantially impinge new car production. Inventories were expected to hold through the end of July, as auto manufacturers have acted to conserve their stockpiles, and tire production has not been cut as drastically as originally estimated. Moreover, due to the model-year changeover, auto plants will be idle for two to three weeks over the summer. Thus, our respondents did not expect auto production to be seriously affected before the end of July. One, however, did mention the likelihood of short supplies of some types of truck tires before then.

On the energy front, supplies look ample, except for natural gas. The chairman of a major oil firm emphasized that shortages of natural gas were likely if the winter were severe. His fears were echoed by a major industrial user of natural gas who recognized the likelihood of service interruptions that would curtail production in the winter. Natural gas prices were seen as rising rapidly. The president of a major international oil firm felt that minor production problems could be created because of the changing mix of sour-sweet crude (high-low sulfur content crude) resulting from increased imports. Spot gasoline shortages were expected by the senior economist of a petroleum firm, but he felt they would be temporary and localized. Over the longer term, the chairman of a major coal mining firm felt price pressures in his industry would intensify as a consequence of safety and environmental mandates.

Concerns over the impact of environmental legislation on capacity growth dominated the discussion of the longer-run outlook for capacity utilization. Although respondents felt that real capital spending would increase, they discounted the potential impact on capacity, citing requirements for increased "unproductive" spending on pollution abatement and safety equipment. This legislation was also viewed as blunting the incentives for increasing capital investment. In addition, uncertainty over constantly changing environmental laws and regulations was viewed by the vice president of a diversified chemical firm as hampering effective planning of long-term expansion projects and raising the riskiness of investments. In the textile industry, one company analyst felt that additions to productive capacity would decline 5 to 10 percent in the coming year. The Buffalo Branch directors stressed additional influences prompting businessmen

to approach plant and equipment investment with caution and reluctance. In this regard, they mentioned fears of a possible resurgence of inflation and lack of confidence in government.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District are improving but at an uneven pace. Retail activity has softened, while the manufacturing sector continues to expand. Increases are reported in new orders, shipments, and employment, while inventories in manufacturing are lower. The longer-term outlook both in retailing and manufacturing remains optimistic. Bankers report that consumer loans are inching up but see no signs yet of any pickup in business borrowing. Businessmen indicate that prices continue to rise, but inflationary pressures are about the same as last month. Major manufacturers in the District report no current bottlenecks in production and expect no significant problems within the next 12 months.

District manufacturers, responding to the latest business outlook survey, report a higher level of economic activity than last month. Close to one-half of the businessmen surveyed see an improvement in general business conditions. Specifically, 38 percent of the respondents indicate gains in new orders and 36 percent note increases in shipments. This is similar to the proportions reporting increases last month but below the gains reported in March and April. Employment in manufacturing shows additional improvement this month. The factory workweek is longer for the fourth month in a row, and work forces are rising at 17 percent of the businesses surveyed. The proportion of firms indicating fewer jobs dropped from 16 percent in March to only 2 percent in the latest survey. At the same time, inventory levels declined this month for the first time since January. The outlook in manufacturing for the next six months is for

further expansion. Of the executives polled, 79 percent look for an improved business climate by December. Further gains are expected for employment as well: One-fourth of the respondents project a longer workweek and four out of ten expect to hire additional employees. At the same time, 43 percent of the manufacturers surveyed anticipate increases in inventories. This is down somewhat from last month, when 53 percent were projecting gains six months out. Plans for increases in capital expenditures are off slightly as well. Thirty-four percent of the respondents in the current survey plan to hike their spending for plant and equipment, compared to 46 percent last month.

On the price front, manufacturers report paying and receiving higher prices, but there is little change in the distribution of responses from last month. Forty-nine percent of those surveyed report paying more for their inputs, and 17 percent are charging more for their finished products. By December, 87 percent expect to be paying more for supplies and 72 percent anticipate higher prices for the products they sell. In the retail sector, prices are currently reported to be increasing "moderately."

Area retailers report a slowdown in sales but continue to be optimistic for the rest of this year. Merchants are unanimous in labeling retail activity as "disappointing" in the latest sales period. Reported sales volumes range from 2 percent above to 4 percent below the same period last year. Most of the retailers note that the whole spectrum of wearing apparel was especially weak. One merchant notes additional weakness in draperies, housewares, and major appliances. Several reasons are offered for this softening in sales: a stretch of unseasonably cold weather, the

necessity for consumers to begin paying for instalment purchases made in the first quarter, and the absence of a boost to spendable income like that provided by the tax rebate last year. Despite current sales performance, retailers continue to be optimistic for the remainder of 1976. However, as one executive put it, "If the next sales period turns out to be as disappointing as the current one, we'll have to adjust our sights for the fall."

Bankers in the District report that loan volume continues to be soft. Consumer loans are moving up slightly, while business loans are characterized as "flat." Bankers are unanimous in citing high levels of corporate liquidity and a very cautious approach to building inventories as reasons for soft business loan demand. There is general agreement that loan volume will be higher by year-end, but bankers are uncertain about the timing and degree of the pickup. The consensus is for a mild increase in the third quarter and for "somewhat more strength" in the final quarter of the year.

Interest rates are expected to move upward gradually. The majority of bankers contacted anticipate a prime rate of 8 percent by the end of this year, with one seeing the possibility of 8 1/2 percent. None of the financial executives contacted feel that the anticipated rise in interest rates through the first quarter of 1977 will hamper economic expansion. However, several are concerned that the recovery in housing may be slowed if long-term rates continue to move up.

The question of capacity utilization and bottlenecks in production was explored with executives in the food, apparel, chemical, petroleum, steel, nonelectrical machinery, and electrical machinery industries.

Estimates of present capacity utilization by these businessmen range from 55 percent at one steel company to 95 percent at a firm in the apparel industry. However, not many of the firms contacted report current rates close to these extremes. Most of the reported current operating rates lie within the 70-85-percent range. In general, capacity utilization is now about 20 percentage points above levels recorded in the first and second quarters of 1975.

Manufacturers report that they are presently experiencing no constraints on production. There are no reported problems with raw materials, labor, or fuel requirements. There are scattered reports of large price increases for some raw materials, but these are not considered to be hampering production. For example, one clothing manufacturer notes that piece cloth prices are now 160 percent above two years ago, but he adds that this is causing him no problems. In addition, a producer of nonelectrical machinery reports that cotton imported from the Far East costs twice as much today as it did a year ago. However, he is still ordering with relatively short lead times for delivery. In 1973 and 1974, this businessman was ordering cotton from the Far East a year ahead of the desired delivery time, whereas now he is ordering only three months out. At the same time, some manufacturers report an improvement in their supply picture. A producer of canned foods indicates that it is easier to obtain tinplate now than it was in 1974, and a chemical manufacturer notes an improvement in natural gas supplies. According to this executive, "We were under the threat of a natural gas shortage in the fall of 1975, but we've been informed that supplies will be adequate at least through this winter."

For the longer term, most of the manufacturers contacted feel that they can meet anticipated increases in demand. The clothing manufacturer, whose firm is running at 95 percent of capacity, has recently enlarged an existing plant by 50 percent and, along with subcontracting, expects to be able to meet customers' needs through the fall. All of the manufacturers contacted project higher operating rates by year-end, but there are no concrete expectations of plant and equipment constraints within the next 9-12 months. There is more uncertainty about the second half of 1977, however, and some executives see the "possibility" of running into capacity constraints by late 1977. Nevertheless, those who see such a threat are not expecting a return to the severe conditions of 1974.

FOURTH DISTRICT - CLEVELAND

Economists who attended the June meeting of the Fourth District Round Table at this Bank forecast more improvement in output, prices, and employment in 1976 than they did at a similar meeting last March. Several retailers and directors remain optimistic and have not yet lowered their sales forecasts, although another month of declining sales may bring about this result. Reports on key industries in the District suggest ample capacity for most industries during 1976 and 1977, but supplies have been tightening in steel, rubber, and chemicals.

Economists who attended the recent meeting at this Bank raised their forecasts of output and lowered their estimates of inflation and unemployment in 1976. The median forecast of real GNP for 1976 was revised to 6.6 percent from 6.2 percent in March, the GNP price deflator was revised to 5.3 percent from 6.0 percent, and the unemployment rate was lowered to 7.3 percent from 7.6 percent. The median forecast of the group also showed considerable slowing in the rate of recovery from the first quarter. Recovery in business fixed investment during the second half of the year is still not expected to be much stronger than during the first half. Some members were skeptical over projected gains in personal consumption expenditures because of the recent drop in retail sales. However, all eight economists who submitted auto sales forecasts raised their estimates for the March meeting, with the median forecast at 10.3 million units for 1976.

Retailers still appear optimistic that sales will rebound despite the drop since April. A director with a national retail chain headquartered

in the District commented that retail inventories are huge. He fears a continued drop in consumer spending may trigger a double bottom recession, such as in 1957-1958. An economist with a retail chain reported its sales have declined for the last seven weeks, an unusually long period. Declines were largely in apparel and appliances, but sales of carpeting, draperies, and housewares were sustained through May. He speculates that abnormal weather and smaller tax refunds in 1976 compared to 1975 account for the unexpected decline in sales. Other retailers and producers of consumer goods remain optimistic. A director associated with home remodeling and modernization materials commented that demand is still strong and that its plants in Ohio are still operating seven days a week for the first time in five years. Another director reported his company's consumer business is still good, that capacity will be increased about 15 percent this year, and that it is advancing its planned expansion for plastic housewares from next year to this. The chairman of a large department store commented that sales leveled off to a rational and sustainable level. Finally, a major discount chain reported that sales in the last two weeks picked up, following a decline that began in mid-April. It expects the pickup to continue, although at a less vigorous rate than in the first four months of 1976.

Manufacturing capacity is expected to be ample to accommodate projected increases in output during 1976 and 1977, according to reports from directors, financial officers, and economists in the District. Shortages, such as experienced during 1973 and 1974, are not likely to surface, although tight supplies will again mark some key industries, especially steel, rubber, and chemicals. Metalworking industries, which recently

were operating at an estimated 75 percent of capacity, are not expected to reach the October 1973 peak for another two and one-half years, according to an economist associated with a major durable goods producer.

Steel is one industry where supplies have tightened, lead times have lengthened, and operations have rebounded close to desired levels of capacity. Steel operations, which rose from 80 percent utilization in the first quarter of 1976 to 90 percent in May, are expected to hover around 90 percent by year-end, according to several steel economists. The industry should have about 159 million tons of capacity available by the end of this year, compared with 153 million tons in 1975. Flat-roll products are in very tight supply, but structural steel, plates, and line pipe are in ample supply. Steel economists expect supply conditions for a broad range of products to tighten by early 1977, as the industry operates close to capacity. One economist expects steel shipments at 105 million tons in 1977, compared with 110 million tons of finished steel capacity. A director who is a raw material supplier to the steel industry states that capacity limitations in steel stem from tight supplies of raw materials, such as ore, and that steel producers will sharply step up expansion of mining and materials facilities. A director with a steel company agrees that capacity problems in steel lie in basic raw materials.

Tire producers are likely to operate at capacity for 12 to 15 months after a labor settlement in the rubber industry, according to an economist with a major tire producer. Operations last quarter were at about 90 percent of capacity, in contrast to a recent low of 65 to 70 percent in the first quarter of 1975. Prior to the strike, spot shortages of truck tires and radial tires for passenger cars surfaced. The industry

has adequate capacity for passenger car tires until 1980, but capacity for truck tires is reported to be tight.

Petrochemical producers in the District expect adequate capacity of feedstocks to produce chemicals for 1976 and 1977. Demand for petrochemicals in 1976 will approach or surpass record levels of 1973 and 1974, and supplies are expected to be adequate to meet demand. Demand for plastics has rebounded sharply over the past year. Polyvinyl chloride sales in 1976 are estimated at about 10 percent below peak levels in 1974. Plastics producers were operating at about 80 percent of capacity last quarter and expect to be in an 80- to 85-percent range during 1977. One industry economist noted that capacity for polyvinyl chloride rose about 30 percent between January 1974 and January 1976, but effective capacity rose only 20 percent because of OSHA restrictions. Analysts expect that the industry has adequate capacity through 1978.

Sources associated with energy producers in the District--oil and coal--foresee little problem meeting anticipated demands for their products over the near term. An oil economist commented that there are no shortages of oil but expressed concern about the increasing U. S. dependence on foreign sources of crude oil. His estimates show crude oil demand is likely to increase 5.5 percent from last year (7 percent if growth in the economy exceeds the standard forecast). The industry can accommodate an 8-percent increase in gasoline demand in 1976, but supplies, although adequate, will tighten, especially for lead-free gasoline. Refineries are operating at 86 percent of capacity and should remain in the high 80's for the balance of 1976. Crude capacity by year-end 1976 will be increased about 1 million barrels from the end of 1972, but not much additional capacity is scheduled

for 1977. For the longer term, capacity expansion plans are uncertain because of high costs of refining crude oil and stringent Federal regulations that have had the effect of reducing rig activity in the U. S. in recent months. Capacity for producing coal is more than ample, at least for the short run. The industry is now operating at about 10 percent below its desired rate. Capacity is expected to increase from 740 million tons in 1976 to 880 million tons in 1981, with half of the growth to come from low sulfur coal in western states. This predicted growth in capacity assumes that the industry can meet environmental standards.

Other industries for which capacity appears to be more than ample are aluminum, automotive, and metalworking. An economist with a major aluminum producer reports that its projections indicate output is not likely to reach capacity before 1979 or 1980, if then. Operations by year-end are expected at about 84 percent, compared with 80 percent currently. The only bottlenecks that may surface are in sheet rolling capacity and in melting capacity, the latter due to OSHA and pollution controls. Similarly, the auto industry is currently operating at about 80 to 85 percent of capacity, about 10 percent below optimum levels. Finally, there is ample capacity in metalworking industries, according to an economist associated with the industry. Utilization is projected to be 80 to 85 percent of capacity in 1976 and 1977.

FIFTH DISTRICT - RICHMOND

Responses to our June survey of Fifth District Business Conditions suggest a leveling off of the rate of recovery. Compared to recent months, fewer manufacturers reported improvement in such areas as shipments and volume of new orders. Whether because of these developments or not, respondents' expectations for the next six months appear less optimistic than in previous months, particularly with regard to the level of production in their respective firms. Retail sales seem to have shown little change in May, an obvious departure from the rather rapid rate of improvement experienced earlier this year. Employment in the Fifth District continues to follow the trends set in the first quarter, as sizable monthly gains remain the rule. Neither current capacity nor availability of supplies and materials appears to present immediate problems. What supply problems have arisen were apparently related to differential rates of recovery which caused some supply channels to be drained. Such problems have already begun to subside.

Of the manufacturers responding to our latest survey, fewer reported increases in shipments, orders, and backlogs than did so in the two previous months. Backlogs of orders, in fact, seem to have shown little change in May. Inventories of materials held steady, while stocks of finished goods apparently grew somewhat. Most manufacturers responding to the survey report current inventory levels "about right" to "too high," with nearly one-third reporting the latter. Employment and weekly hours were also expanded somewhat, although these changes were less widespread than a month ago. Reports of price increases were more common than last month, with one-half of our respondents paying higher prices this month. Although nearly three-fourths of the

manufacturers surveyed view current plant and equipment capacity as about right, over 20 percent continue to feel it excessive.

The performance of several key industries has permitted relatively rapid recovery, at least in terms of employment, in most areas of the District. Textile manufacturers, in particular, have experienced great improvement in the level of business activity and remain among the more bullish Fifth District industries. This very rapid return to high levels of production in the textile industry apparently caused some short-term shortages, particularly of machinery and equipment. Recent contacts with industry people, however, support the view that these problems are largely past. Other than some normal lengthening of delivery times, our contacts in the industry foresee no immediate symptoms of capacity or supply constraints. The apparel industry, heavily dependent on the textile mills, is apparently experiencing some lengthening of delivery times and some spot shortages. They seem, however, to view these problems as transitional, related to rapidly increasing rates of production and capacity utilization.

The furniture industry experienced little change in May, as new orders, shipments, and backlogs were essentially flat. Respondents expect, at worst, some lengthening of delivery times over the next six months. There is no indication of more than some isolated lengthening of lead time in the paper and paper products lines. Lengthening lead times in some lines and more aggressive selling, suggesting weak sales in others, seem to typify the situation.

Among primary metals producers and users, no problems are currently being experienced nor are any anticipated in the immediate future. Contacts with industry personnel turned up several comments about capacity

limitations and possible difficulties developing as early as the fourth quarter; but even in these cases, no serious problems are expected. As in other industries, there has been some extension of lead time and may be more, but this is apparently not viewed as serious either by producers or users. Producers of electrical equipment and supplies report some delays in obtaining supplies, particularly electrical components, but here again the problems are not considered serious.

So far as potential supply bottlenecks are concerned, the major uncertainty among District producers is with regard to the availability of energy, particularly electricity and natural gas, over the coming months. The failure of projected shortages to develop so far has eased some of the concern but perhaps intensified the uncertainty, particularly among industries heavily dependent on these types of energy.

Retailers responding to our latest survey report a relatively flat month in May. There was little change reported in sales and sales of big-ticket items. Relative total sales held steady. Inventory increases were reported by most retailers, and a majority now view current inventory levels as excessive. Prices, including employee compensation, continued to rise, but this too was less common than in recent months. Retailers remain essentially optimistic, although not to the extent noted in the first quarter. Despite the rather flat performance in May, retailers expressed little disappointment. They seemed resigned to the fact that sales could not possibly continue to grow at recent rates. Unit sales remain well above year-ago levels, despite unusual weather and higher prices. Specific comments from survey respondents suggest that sales are firm at all price points but that the consumer retains an eye for quality.

In the banking sector, business lending at large Fifth District banks has declined about 2 percent so far this year. In a mid-May survey, one-half of the respondents reported no change in the strength of business loan demand over the past three months. One-third reported demand moderately stronger, while one-sixth reported it weaker. Respondents expect loan demand to be unchanged to moderately stronger during the current quarter.

District farmers' cash income from farm marketings during the first quarter of 1976 was up about 2 percent over the same period in 1975, compared with a 10-percent gain nationally. Smaller acreage and weather-reduced yields per acre have combined to cut the winter wheat crop 23 percent below a year ago--a much sharper decline than that forecast for the nation. Spring freeze damage reduced 1976 peach prospects sharply in all District states except South Carolina.

SIXTH DISTRICT - ATLANTA

The southeastern economy continues to expand, although the advance remains uneven. Capacity utilization rates are high in most major industries. Yet manufacturers report no unusual shortages or bottlenecks of raw materials, with the exception of natural gas. Consumer spending remains strong in some areas but has weakened in others. Florida's phosphate industry began layoffs; the continuing rubber strike also reduced employment.

Consumer spending in the Southeast has become ambivalent. Autos and trucks are selling well throughout the District, and mobile home sales are strong in some places. Sales of soft goods, however, have leveled off in several areas. This development may reflect a weakening of business activity or simply a growing emphasis by consumers on durable goods purchases.

Florida's phosphate industry has begun layoffs because export demand and domestic fertilizer sales are low. High prices and the Midwest drought have reduced fertilizer applications. Phosphate inventories are at a five-year high. Two companies have laid off 350 workers, while a third has idled 1,000 of 1,300 workers. The ongoing rubber strike has reduced employment in Alabama.

The shortage which primarily concerns southeastern industries is natural gas. There is little worry about the supply of electric power, although in some areas the cost of electricity is uncertain because natural gas curtailment necessitates substitution of more costly fuels. In one area of the District, gas cutoff to customers with interruptible service is expected for 320 days in 1976 compared to 50 days in 1974; there is concern that this makes the locality unattractive to manufacturers seeking plant locations.

Many companies report programs for energy conservation and installation of stand-by energy systems, so their major worry is the impact of a gas shortage on costs rather than continuity of production. However, these programs absorb capital which might otherwise be used to enlarge production capacity.

Three automobile assembly plants in the Atlanta area, which manufacture intermediate- and full-size cars as well as light trucks, report production at record levels. Yet, with the obvious exception of tires, no supply problems are reported. A small tiremaker expects the current strike-induced shortage to persist because of the difficulty of replenishing rapidly depleting inventories while meeting new vehicle production requirements, as well as seasonally high replacement demand. Mobile home manufacturers are still operating with significant excess capacity, and no raw material shortages are occurring.

A major steel producer estimates industry operations at 80 to 90 percent of capacity but reports no shortages. Lead times are increasing on flat-rolled steel used in consumer products, and some talk is heard of allocations in late 1976. Steel grades used for capital goods manufacturing and heavy construction are in abundant supply. A large distributor of metal products notes an excess of goods and states that shortages of flat-rolled steel caused by increased automobile output have been relieved by production adjustments. This source foresees no serious stringencies until the capital goods and heavy construction industries resume higher operating levels.

Among companies using metal products, a manufacturer of school buses and a distributor which stocks over 90,000 automobile replacement parts find no unusual supply problems. Other steel users have current shortages of some steel products or are expecting them. Some firms are building inventories in

anticipation of shortages and higher prices. In nonferrous metals, shortages are reported for aluminum sheets and aluminum plates used for printing.

Large chemical companies are utilizing 90 to 100 percent of capacity; this level is expected to continue. No shortages other than natural gas are reported or expected. Most firms are constructing sizable additions to capacity.

Textile mills are now operating at 85 to 100 percent of capacity, based on three daily work shifts. New capacity for denim production is currently under construction. Prospects for cotton prices have caused some worry in view of crop forecasts and strong foreign demand, but no raw material bottlenecks are reported or foreseen. In apparel, present levels of production vary but are expected to reach full capacity use by year-end. Output is being increased by hiring rather than by plant expansion. The only evidence of shortages is longer lead times for synthetic and spun yarn fabrics. Some reports suggest that retailers' and manufacturers' reluctance to build inventories may result in an influx of last-minute orders for fall goods which will be impossible to fill.

In the carpet industry, unused capacity is abundant and should not be exhausted in 1976. Plant investment is primarily in the form of product line changes and additions to distribution facilities, although one latex manufacturing plant is being built. Transportation is adequate, but truck carrier costs are a major source of price increases. Overcapacity among fiber producers has recently led to some price reductions.

Paper producers' capacity use has risen sharply during the past year and is approaching full utilization; it is expected to remain high. Price increases and some shortages have recently occurred for newsprint; cardboard

containers have also been reported in short supply. Some producers regard restriction of timber cutting in national forests as a potential threat to raw material supplies. No reports of pulpwood or chemicals shortages have been received.

Wood products companies present a contrasting picture. A manufacturer of pine and paper chemicals, with capacity usage at 75 percent, finds no raw material problems. But a lumber exporter is experiencing bottlenecks in raw materials and finished goods, which he expects to continue for the remainder of the year despite operating levels well below capacity.

SEVENTH DISTRICT - CHICAGO

The uptrend continues in the Seventh District. The rubber strike that began April 21 has had much less impact than had been expected. Retail sales appear to have softened somewhat in the past six weeks, but retailers do not appear to be particularly disturbed. Inventory building is proceeding cautiously. Orders for capital goods are generally improved, but the picture is mixed and no pronounced uptrend, overall, is anticipated until late this year. Order lead times have lengthened, but significant shortages and bottlenecks are not yet evident. The improvement in real estate is still confined to single-family homes. Some observers are hopeful that the general inflation rate can be held at 5 percent or less, but those who fear an acceleration in price inflation are probably more numerous.

Tire inventories at all levels proved to be much larger than almost anyone had estimated. Shipping vehicles without spares has conserved supplies. Also, the industry has been operating at a higher rate during the strike than had been thought possible. Supervisors and the clerical staff are operating most of the tire plants that are on strike--in one case at 35 percent of capacity.

Some of the slowing in sales of general merchandise in May is attributed to cool weather. Consumer attitudes are improved. They are using credit freely and are paying bills more promptly. Demand for appliances is not as strong as had been expected. One observer now expects sales of appliances to be up 10 to 12 percent this year, rather than the 15- to 20-percent gain expected earlier. Strength in auto sales may be adversely affecting appliances. Orders for furniture are sharply above last year, and factory

backlogs are up about 40 percent. The boom in sales of RV's continues, and boating equipment also is very strong. Airlines traffic is up 13 percent from last year's depressed period, and a gain of 10.5 percent is now expected for the year--up from 8 percent forecasted earlier.

Inquiries concerning shortages and bottlenecks revealed few immediate problems. Much depends on how rapidly inventories are increased which could cause lead times to lengthen markedly and possibly bring back double ordering. Most producers of capital goods and components have increased capacity significantly since 1973. Castings and forgings may become short again but only if capital spending accelerates.

Restrictions imposed by regulations of EPA, state and local bodies, and private legal actions have hampered expansion of capacity. A large share of capital spending is channeled into environmental and safety facilities. Many foundries, forging operations, and coke ovens have been closed down and others will be. Restrictions have been placed on start-ups of oil refineries which take three to four years from go-ahead to completion and electric utility plants which have even longer lead times. Some new coke ovens, which meet operating rules, are not producing efficiently. Restrictions on operating rates hold down output at nuclear power plants--usually the lowest cost units.

Steel may prove to be the major limiting factor on industrial production again. Steel is expected to be in tight supply in the fourth quarter and in 1977. Shipments from U. S. mills probably are limited to 100 million tons this year and 105 to 108 million next year. At present, foreign suppliers can be counted upon to supplement supplies. The potential bottlenecks in steel production are availability of coke and high-grade ore pellets. Various steel companies slowed expansion programs during the recession.

Oil would soon be a serious problem in case of any interruption of supplies from abroad, which now account for over 40 percent of domestic supplies. A 5-percent increase in OPEC prices is expected by year-end. Spot shortages of gasoline are expected this summer, particularly of lead-free gasoline which is highly susceptible to contamination and must be produced and distributed with great care. Oil refineries are operating at 89 percent of capacity, currently, and 92 percent (by this measure) is considered to be the practical maximum.

Most industries interviewed thought that capacity is adequate except for special developments such as long strikes. Nevertheless, purchasing managers are continually checking primary and secondary sources as to future availability. Most observers believe that price/wage controls were a major factor causing the shortage in 1973-1974 and would be again if reinstated.

Tightness in supplies develop from time to time in such industries as paper and wood products when Canadian supplies are interrupted by strikes. Lumber prices, for example, spurted recently. Other problems develop when older, higher-cost facilities are reactivated.

The trucking industry is estimated to be operating at 91 percent of capacity and is expected to be at 95 percent by year-end. Retail sales of heavy trucks improved recently and are expected to go much higher. Orders for major truck components are up sharply, and a producer of diesel engines is operating at virtual capacity.

Orders for bearings, controls, electric motors, and other components have increased significantly, partly to restock dealers. Demand for replacement is also higher. None of these industries have immediate capacity problems and do not expect any for this year. Sales of farm equipment are excellent

but not so ebullient as two or three years ago. Small construction equipment sales are up, but large earthmoving equipment remains depressed. Operating rates of most machine-tool producers are well below capacity.

EIGHTH DISTRICT - ST. LOUIS

Business activity in the Eighth Federal Reserve District continues upward, according to reports of area businessmen. Consumer demand remains strong, especially for automobiles and other durable goods. Manufacturing activity, though still somewhat below capacity, is improving. Increased operating ratios for manufacturing firms have so far had little impact on prices. Financial institutions report some increase in interest rates as loan demands inch up. Savings flows into thrift institutions continue to increase but at a more moderate rate than in the first quarter of the year.

Retail sales continued to register overall gains in recent weeks, but department store representatives report that increases in sales have not been as large as expected. Sales increased in May at only about one-half the expected rate of gain. Analysts point out that comparisons with year-ago sales may be biased by the expenditures associated with the tax rebates last year. In addition, the slower rate of growth in department store sales may reflect the rising consumer preference for automobiles and other durable goods. Appliance and automobile sales are reported to have been excellent in recent weeks.

This month's interviews with manufacturing firms were conducted with special emphasis on current operations as a percent of normal capacity and the pressures that rising operating levels have had on prices. In general, firms are reported to be operating somewhat below normal capacity. Lack of demand is the reason most often given for this less-than-capacity level of output. But demand is continuing to increase and

excess capacity is declining. A steel representative reports current utilization is slightly over 80 percent of capacity. Price increases for steel products, which go into effect this month, were reported to be necessary to cover capital costs. A major feed and food processor reported operations in this sector to be about 70 to 75 percent of capacity, with upward pressures on prices not expected until at least 90 percent of capacity is attained. A manufacturer of welding equipment is operating currently at 90 percent of capacity on some items while at full capacity on others. A representative of this firm noted that raw material prices are increasing rapidly and that his firm's prices will be increased soon. An auto assembly plant in the St. Louis area has plans to operate at full capacity for the first time since 1974 by adding a second shift this fall. A manufacturer of electric motors for appliances also reported operating at virtual capacity in recent months.

Representatives of a few industries reported a shortage of capacity at the present time, and large price increases for products of these industries are expected. A distributor of hydraulic equipment parts noted that a seller's market has developed for these products. Capacity has not been increased substantially in this industry during the past few years, and rising demands have resulted in order backlogs up to six months. Some products used in the oil and gas industry were also reported to be in short supply, though price increases for these products have so far been moderate. However, increases in basic raw material costs for this industry are expected to contribute to price increases in the near future.

Interest rates are beginning to inch up again, according to reports from area bankers and thrift institution officials. The most prevalent

mortgage rate in St. Louis is still 8 1/2 percent on an 80-percent loan, but 8 3/4 percent is becoming increasingly common. One savings and loan representative predicted that 8 3/4 percent would become the dominant rate within another month. The pressure for mortgage rates to rise locally is said to reflect higher-yielding investment opportunities in national markets rather than any sharp upturn in local mortgage demand. Business loan demand at commercial banks has inched up in recent weeks, according to representatives of larger banks. Gains in volume of real estate, consumer instalment, and agricultural loans were registered in May. One bank predicted an increase in loan demand through the summer, with an accompanying increase in rates charged.

Statistics for the St. Louis area show no growth of savings deposits at savings and loan associations in April, but reports indicate some increase in May. Reports from other areas also indicate savings deposits continue to make gains but at a reduced rate from earlier in the year. Minor changes in rates offered on deposits at several savings and loan associations were noted in recent weeks. Minimum amounts for long-term certificates at some associations were raised from $1,000 to $10,000 or more, and the rates paid were reduced by one-fourth of one percent. The recent tendency for mortgage rates to rise is expected to forestall further rate reductions on deposits.

NINTH DISTRICT - MINNEAPOLIS

Capacity bottlenecks are not currently a major problem in the Ninth District economy; and in general, capacity problems are not expected to arise in 1976, though there are exceptions. In most industries, there is still excess capacity. In other industries, such as coal and taconite, firms are responding to demand pressures by adding to capacity. Lead times for some products such as brass and steel continue to lengthen, but these longer lead times are not seen as evidence of capacity bottlenecks. Industrial raw materials prices are up, but the increases have been modest. Gasoline prices have also increased, but supplies are ample. Overall energy supplies appear adequate for the rest of 1976. Drought conditions in the District have worsened in the last month; some farming regions are now in critical need of rainfall, and farm prices are rising.

There is more evidence of underutilized capacity than of supply bottlenecks in the Ninth District economy. A copper plant in upper Michigan is now running at 50 percent of capacity and is expected to be at 75 percent of capacity by year's end. A paper mill in the same area has recently expanded its plant and is operating below its new capacity. A representative from a major food processing concern says he is unaware of any capacity problems in this region's key industries. A director from a major manufacturing firm which buys inputs from national markets says that his firm's operations have not been hindered by capacity problems among suppliers.

Only about 1 in 7 of the 175 firms responding to this Bank's May survey of District manufacturers says that existing plant and equipment

is inadequate in light of current backlogs and prospective sales over the next year. Nearly half of those firms are in food processing; for several of the firms, capital outlays would be used to update and improve existing facilities rather than to increase capacity. In the paper industry, considered by some to be a likely bottleneck in the coming month, most survey respondents say that capacity is adequate to meet anticipated sales over the near term.

Purchasing agents report only scattered problems in obtaining inputs. One exception is that electronic firms say integrated circuits are currently in short supply; suppliers reportedly have a 90-day backlog of orders, and only orders from preferred accounts are being accepted. Capacity of circuit suppliers is reportedly being expanded, but the increased supply will not come on line in the near term.

Another exception is a manufacturer of steel castings who says that heavy demand from the District's expanding taconite industry is pressing on his firm's supply capabilities. Smaller orders are not being accepted, and the firm is taking on only those customers who show promise of developing into major accounts. The firm is considering construction of a new foundry, which would come on line in 1979. The foundry would be constructed in Duluth or northern Wisconsin, and its primary purpose would be to meet the rising needs of the taconite industry on the Minnesota iron range.

Except for integrated circuits and castings, most inputs are in adequate supply. A manufacturer of heavy construction equipment says that lead times are lengthening. But he feels that the longer leads are due to the low inventories being held by suppliers rather than to limits on productive capacity. A producer of paper products says that his firm has

integrated vertically to guard against a recurrence of the supply problems of 1973 and 1974; he sees no supply problems developing for his firm over the near term.

Productive capacity is growing in the region's primary industries. Capital inputs in the farm sector have been substantially upgraded in recent years. Coal production is also increasing. Finally, six taconite projects now under way on the iron range will boost capacity 60 percent by 1979. Two of those projects should be in operation by the end of 1976.

Prices of industrial raw materials have edged upward in recent weeks, but the increases have not been sharp, and directors expect that any increases over the summer months will be moderate. In the farm sector, prices of feed inputs have also been rising; one director, for instance, says that soybean meal prices in his area are up substantially since April.

Gasoline prices in the region are up, with the increases generally ranging from one cent to three cents per gallon. Nonetheless, gasoline remains in ample supply, as do all petroleum products. The purchasing agent of a major regional corporation says that there are currently gluts of heavy fuel oil and, consequently, considerable price cutting. Overall energy supplies in the region are seen as adequate into 1977, unless the coming winter is unexpectedly harsh.

The crop situation in the District has worsened since the last Red Book report. Normal crop yields are now very unlikely in Minnesota. Corn and soybeans are making some progress but remain under great stress, and a shortfall in hay production has sent livestock producers scrambling for existing supplies. In addition, drought conditions have spread westward in the District and large areas of the Dakotas are now in need

of additional rain. The anticipated shortfall in production can be expected to have the greatest impact on prices of barley, oats, flax, and durum wheat, products for which this area is the major supplier.

TENTH DISTRICT - KANSAS CITY

Tenth District businesses reported no indication of impending shortages and stressed their intention to avoid an overbuying spree like that which preceded the recent recession. Similar positive results were obtained in a survey of major agribusiness firms. These optimistic findings contrast markedly with results reported in a national survey of purchasing managers. On the financial front, business loan demand has increased slightly and some banks have reported that they have begun to rebuild their CD levels.

Contrary to the results reported in a recent national survey of purchasing managers, Tenth District purchasing managers, executives, and business economists do not anticipate the approach of capacity constraint problems, shortages, or major price increases. The only potential problem areas mentioned were those of iron castings and uranium. On the other hand, several important observations were repeated by a number of respondents. For example, an economist for a major building materials manufacturer expressed serious doubts as to the development of capacity shortages in the national economy. Noting that while some industries were tighter than others, this was due both to cyclical factors and to customers being encouraged to buy (or even to overbuy) in the first quarter by promotions, price breaks, or announced price increases. In his view, these promotions explain the first quarter GNP inventory changes. In the unlikely event that second quarter inventory changes are also strong, he would consider this grounds for concern. Similarly, an energy economist pictured an oscillating inventory picture, with overliquidation in 1975 yielding strong compensating first quarter data, a situation unlikely to be repeated.

The major consensus, however, held by a broad range of purchasers and producers of aluminum, steel, paper, wood, textiles, plastics, and various petroleum products was that overbuying was not anticipated and that they themselves would not participate in it. One packaging executive expressed a "quiet optimism that things are moving along with strength and stability." A major paper purchaser noted "much resistance to stockpiling" because of the recent experience and saw no evidence of any attempt to hedge against future shortages. A large plastics and textile purchaser was firm in stating "We're not overbuying, we're playing it lean." Similarly, a major steel user stressed that "Nobody is really going out to buy just anything they can get" as was the case a few years ago. Instead, he felt that everybody was trying "to run as lean as possible." In line with these beliefs, it was generally felt that price increases would fall in the 5- to 8-percent range in 1976.

The one area where near term concern was expressed was in iron and steel castings. If the economy continues to pick up, the possibility of a severe castings shortage by mid-1977 was noted. Currently, customers of foundries serving automobile manufacturers are on allocation. The major reason for this impending problem, stressed the respondent, was the tremendous impact on foundry costs introduced by EPA and OSHA regulations. According to this source, this factor has led to 20-30 small foundry closings a year and to a significant cancellation of new facilities by existing foundries. Also because of EPA, a paper products manufacturer indicated there is a possibility of tightness in the supply of paper in 1-2 years. Likewise, many other manufacturers complained about EPA and OSHA regulations and costs.

A longer-term problem was said to exist in uranium production, where the low price in the early 1970's discouraged exploration and, though the price has risen significantly, the 8-year lead time points to a possible capacity crunch in the late 1970's.

Two other comments by respondents were noteworthy. Three producers, one of nylon textiles (supplied by DuPont), one of polyethylene resin (supplied by Exxon), and one of steel, suggested that artificial scarcities and rumors of shortages might have been introduced by the suppliers themselves rather than being due to excess demand. Finally, a large secondary manufacturer of aluminum from scrap stressed that, while processing capacity is ample in his industry, scrap is somewhat short. This situation is being aggravated, he contends, by export of scrap and a "ridiculous Senate bill to give tax credit for building unneeded recycling capacity which will only increase demand for and drive up the price of scrap already in short supply."

Conditions in the agribusiness complex tend to mirror these developments in the rest of the economy rather closely. The inventory situation here is being scrutinized very carefully to avoid the problems encountered two years ago. Reporting firms indicated that they are either keeping inventories at minimum levels or are instituting tight controls. However, a few firms mentioned that they have done some hedge-buying recently on steel products in anticipation of impending price increases, but the quantities involved were not excessive. For the moment, very few firms are encountering difficulties in procuring raw materials. Lead times are reported as "normal" in most cases, although there is some evidence that lead times are beginning to lengthen for steel, paper, and a few plastics. However, no one seemed to be overly concerned about input shortages in the foreseeable future. The

reports on capacity utilization were mixed. Feed manufacturers did not seem to be pressing against capacity limits at all, and the same thing was generally true for agricultural chemicals. Utilization rates were typically under 70 percent. However, a few agribusiness firms were operating at "full bore" and had plans to expand capacity. Included in this group were a large farm supply cooperative, a farm equipment facility that assembles combines, and a firm manufacturing on-farm storage buildings. Virtually all agribusiness firms in the survey reported price increases for both raw materials and manufactured products, though again, generally in the 5- to 8-percent range.

Tenth District banks contacted for the June survey reported small increases in business loan demand over the last month. In most cases, demands were made by local rather than national accounts. Industries mentioned as showing increased loan demand varied--manufacturers, retailers, energy-related businesses, and agribusinesses were all mentioned. One bank said that participation in smaller banks' loans was an important factor. Real estate loans are still weak, although interest does seem to be picking up in commercial projects. Consumer instalment loans have been either steady or increasing slightly, with credit card sales holding up better than auto or other consumer loans.

Negotiable certificates of deposit were run off during the month of May, reflecting the slowness of business loan demand and continued inflows in savings deposits. However, most banks reported that their CD levels had reached their low point, and several reported they were rebuilding their CD levels.

ELEVENTH DISTRICT - DALLAS

Despite a steady decline in mining output since November 1973, industrial production in Texas has recovered to a level near the pre-recession peak. Manufacturing output has more than made up for the ground lost during the recession. The recovery in output, however, has largely been centered in the production of nondurable goods. Output of chemicals, oil refining, and apparel has fully recovered, while paper production has been slower in recovering. In durable goods production, which has not fully recovered, the strongest industries are fabricated metals and nonelectrical machinery. The weakest continues to be primary metals.

This month's survey found no production bottlenecks of consequence, and factory inventories were at manageable levels. Manufacturers look to improved business conditions but at the same time remain reluctant in most industries to expand production capacity beyond what they now have or what is currently under construction. Their major concern is the future strength of the recovery, but also important are future environmental guidelines that will affect business decisions.

Output by the chemical industry in Texas has surpassed the 1974 prerecession high, and new production records will likely be set for some items this year. Supplies of such basic chemicals as ethylene, propylene, butadiene, benzene, toluene, and xylene are readily available. No production bottlenecks are anticipated by the industry as output rises, but a couple of potential problems are being monitored. Plants dependent upon natural gas liquids for feedstocks may have to look harder for their inputs by year-end, and the rubber workers' strike and a delayed recovery

in the market for rubber products are slowing the output of butadiene. A firming in chemical prices has improved prospects for industry profits, and plans are made to expand capacity in a number of areas. A chemical engineering consulting firm notes, however, that plant expansions could be hampered by shortages of castings.

Inventories of agricultural chemicals are high, and production has been cut until stocks are reduced to more manageable levels. A major producer states that ammonia, potash, and phosphate are now selling near producers' costs. With inventories high, the Texas-based company has closed down one of its phosphate plants in Florida. Prices for agricultural chemicals are expected to remain weak, and only if there is a significant increase in fertilizer exports would prices move up.

Apparel production in Texas has recovered to the prerecession level of output. Most plants are operating at 100 percent of capacity, and many firms have given as much as 20 to 25 percent of their current business to apparel contractors. The busiest firms have experienced two- to four-week delays in receiving the more popular piece goods. But some signs of softening in the apparel market have been noted recently. The fall market for women's clothing, held in Dallas in May, was rated as only "fair" compared to earlier markets that were "hot." And although the sales of men's slacks continued strong, demand for leisure jackets has weakened. Apparel manufacturers are not planning significant increases in plant capacity this year.

Paper production appears to be the weakest industry in nondurable goods manufacturing in Texas. A major producer, however, states business is relatively good, as the rate of capacity utilization has increased to

85 percent from a low of 70 percent. There are shortages of Kraft paper and linerboard. Raw materials costs are going up at a 10-percent annual rate, but some softening in prices is expected this year. Plant expansions are likely in some segments of the industry, but everyone seems to be hedging their positions until future economic conditions can be more clearly ascertained.

Production of color television sets should continue to increase rapidly. In light of current demand projections, a major manufacturer plans to increase production of subassemblies by one-third at its border plant in Cuidad Juarez, Mexico. Employment at the plant stands at 3,800 workers, up from a recession low of 2,400. The higher level of production would mean a 10-percent increase in the number of workers on the first shift and a doubling of the second shift. No production bottlenecks are anticipated, but some deterioration in the quality of ceramic capacitors purchased from far eastern suppliers has been noted. The failure rate of these components is expected to decline, however, after foreign manufacturers adjust to higher production levels.

Production of primary metals is running a little above the recession low. Most metal plants are running 75 to 80 percent of capacity, but there is more strength in steel tubing used in drilling. The weak construction market continues to hold down production of steel, aluminum, and copper. Structural steel firms are concerned that no new highway construction contracts are being let in Texas, and one aluminum smelter has remained idle since last summer due to high energy costs. Few additions to capacity are seen in this industry. A couple of new energy-efficient steel and aluminum plants are coming on-stream to replace older plants, and a large

diameter steel pipe mill is to be constructed by 1978. Other investment outlays planned are to meet the EPA's 1978 standards, which in the case of one copper plant will exceed the value of its present facilities. A potential bottleneck is the future market for scrap steel. World demand for scrap is soft, but should it firm before construction activity recovers, scrap prices could rise to unprofitable levels for some structural steel manufacturers.

Despite a sharp four-month decline in the number of active drilling rigs, the outlook for drilling remains optimistic. One major equipment supplier feels that, with the exception of last year, total activity in 1976 could be at the highest level since 1962. Output of oil field equipment is holding up, although current production of oil rigs is coming largely from the backlog of unfilled orders. Because of the slack in new orders, production could be affected by next year. Demand is strong, however, for such items as handling equipment, high pressure valves, and "fishing" tools. The oil field equipment industry has no plans to increase capacity and, like the mining sector, is waiting for Congress to outline a national energy policy which would determine much of the future course of production.

A survey of the transportation equipment industry found a wide range of capacity utilization rates among major segments of the industry. The District's only auto assembly plant--a producer of intermediate-size cars--is running a six-day week. That workweek was established in February by an expanded overtime schedule that required hiring few new employees. The only bottleneck being experienced is a shortage of tires which requires new production units to be delivered without spares. A helicopter manufacturer is experiencing a slackening in nonmilitary sales and, as a result,

has permitted its work force to decline 4 percent through attrition. Aircraft sales are expected to firm by year-end, but no additions to capacity are planned.

TWELFTH DISTRICT - SAN FRANCISCO

According to our directors, operating rates are generally well below capacity at the present time and, except for natural gas, they foresee few supply shortages until mid-1977. New plant construction appears to be at a standstill, and there are only a few instances of modernization. The supply situation, however, is being monitored carefully, especially by steel and aluminum users. There is some concern that an upsurge in construction expenditures, added to a vigorous automobile market, would be sufficient to create supply shortages.

With continued real growth around 5 percent for the remainder of 1976, there is evidence that the chemical and pulp and paper industries will begin to experience some capacity and raw materials shortages by year-end 1976 or early 1977. No significant shortages are anticipated in agricultural commodities, except perhaps in beef, which might be in short supply by year-end. The textile and apparel industries are in a situation of excess supply.

The current situation in the basic steel industry continues to be one of excess capacity. However, here, more than in most industries, fabricators are reporting high operating rates and this is expected to put pressure on the steel industry by year-end. It is anticipated that shortages will be confined to certain product lines, such as wire, plate, and reinforcing bars, creating temporary bottlenecks but that a general resurgence of construction demand on top of a strong automobile year could cause heavy price pressure by mid-1977.

Demand for aluminum is very strong and is expected to increase 30 percent over 1975 to the 1974 level. Most of the increased demand is from

the transportation industry, which is seeking both to reduce vehicle weights and increase vehicle mileage. No shortage of aluminum is anticipated until the second half of 1977.

The copper industry continues to operate at low rates. The market has been depressed but should receive some stimulus from a more active construction industry.

The forest products industry as a whole appears to have ample capacity for supplying demand currently. Looking first at solid wood products, domestic softwood lumber and plywood mills are currently running at about 90 percent of capacity. Lumber imports from Canada are down and could readily respond to any dramatic pickup in U. S. softwood lumber consumption, although the housing outlook makes such a pickup appear unlikely. Although softwood plywood is not imported from Canada, modest additions to domestic capacity are planned for servicing anticipated demand increases.

For pulp and paper, world pulp mill operating rates are depressed at about the 80-percent level and a large overhang of pulp inventory exists. Domestically, including the western states, paper and paperboard mills are currently running at about 92 percent of capacity, with enough new capacity planned to keep most of the markets in balance over the near term. The segment of the pulp and paper industry with the tightest supply situation currently is in publication papers.

Production in this segment is sold out several months in advance, and rationing is taking place. The reasons behind this situation appear to be the combination of resurging demand and attempts by customers to rapidly replenish their below-normal inventory levels. It is possible that once inventories are replenished, the call on production will moderate. None of the other segments of the industry appear to have this problem.

Operating rates in the aircraft industry continue to be quite low. Parts suppliers report that a recent increase in demand has already turned soft.

Potato processing plants are not running at full capacity and have no plans for plant expansion. Farming acreage is at an all-time high. There is a surplus supply of beans, potatoes, and wheat. Demand is weak, and prices are low for these products. There is some evidence that beef will be in short supply by year-end.