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CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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Summary*

This month's District reports strongly suggest that the "pause" in the current recovery has ended and that the pace of business activity is regaining momentum. Virtually all reports indicate some improvement in economic activity. Retailers generally enjoyed a good to excellent Christmas season, with sales strengthening markedly toward the close of the season and with continued strength evident in early January. Business inventories appear to be in line with desired levels, except for scattered exceptions. There is additional evidence of strengthening in residential construction. While the capital investment picture remains mixed, there appears to be mounting evidence of an impending improvement in that sector. Prices, however, continue under upward pressures. The demand for commercial loans remains generally sluggish, and inflows into savings deposits continue at a high rate.

As it has throughout the current recovery, consumer spending continues to provide the main thrust to the upswing. Retailers on the whole enjoyed a good Christmas season, with general merchandise sales rising above year-ago levels, in line with or exceeding expectations. The retail sales performance varied widely, however, ranging from unexpectedly strong and generally excellent (Boston, Chicago, St. Louis, and San Francisco) to above last year (Phildelphia, New York) and to a more restrained slightly improved (Richmond) and not overly strong (Kansas City). Auto sales, particularly those of standard or large size vehicles, are also mentioned as being particularly brisk by several Banks (including Minneapolis, Atlanta, Kansas City, and

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San Francisco). Although several Banks note that the improvement was achieved at least in part by dint of markdowns and other aggressive promotional activities, Chicago and New York report that by and large such activities did not reach exceptional proportions. A number of Banks report that the uptrend in sales that emerged as Christmas approached has continued in evidence in the immediate post-holiday period and early January. Atlanta and St. Louis thus report excellent results in post-Christmas promotions, and retail respondents in several Districts are reported to be cautiously optimistic regarding developments over the coming months. Respondents in the Minneapolis District feel that consumer confidence has improved since the election, but retailers in the Philadelphia District look for only moderate growth during 1977, with a sluggish first half.

Those comments that were received on residential housing suggest that consumer outlays for new homes continue to gather momentum. San Francisco reports that the residential housing market is very strong and continues to strengthen each month, and Minneapolis notes that District authorizations of new housing are close to 1972's record levels. St. Louis reports homebuilding made considerable progress in that District in 1976 and that prospects are for further gains this year, while Dallas respondents expect homebuilding will continue to be a major source of strength in the southwestern economy. Boston, however, characterizes residential construction as a major weak spot in the New England economy.

Inventories at the retail and/or manufacturing level were generally regarded to be about in line with sales and at desired levels, although there are scattered reports of undesirably high stocks of certain items, including some nonferrous metals, furniture, T.V.s, and smaller cars. Few indications of shortages were reported with the exception of an actual or potential dearth of natural gas mentioned by Richmond, Cleveland, and Minneapolis, as well as fuel oil in the Minneapolis District.

Turning to business expenditures for plant and equipment, the pace of such outlays by and large continues to lack vigor, but there is growing evidence that a pickup in this sector might be getting under way. Thus, among others, Cleveland reports rising activity in the machine tool, communications equipment, printing equipment and heavy duty truck industries. Chicago reports a pickup in orders for mining equipment, a further expansion of planned equipment purchases by auto companies, and alludes to the prospects that various major projects kept on the "back burner" by the food processing, paper, chemical, and glass industries might be activated this year. Although St. Louis characterizes prospects for capital spending as mixed, it reports several announcements of sizable investment plans for 1977, and Atlanta reports that new industrial expansion continues rapid in its District. About one third of the manufacturers surveyed monthly by Philadelphia plan increases in capital expenditures over the coming months. Respondents in the San Francisco District feel that tax incentives would have positive, albeit slight, effects in stimulating capital investments, if such incentives were made a permanent part of the tax structure. Respondents in Dallas and New York felt that major capital outlays would be deferred until the direction of government policy became clearer.

On the dark side, indications of increased upward pressure on prices were reported. Respondents in the Philadelphia monthly survey report that higher prices and costs are somewhat more widespread than in December, while in the latest Cleveland survey, the proportion of respondents expecting price increases remained as high as in the previous two months. Recent price increases in the steel industry are reported to be sticking, according to observers in the Chicago and New York Districts, although respondents indicate discounting of steel prices in the San Francisco District. Reports from agricultural areas of the nation note the relatively low prices currently paid producers for grains and certain other agricultural commodities as a result of record crops. Kansas City reports that earlier concerns over the District's winter wheat crop have been allayed by an extensive snowfall that has provided needed moisture as well as a protective snow cover. While grain prices may thus be held down, farmers are reported to expect rising cattle prices.

The demand for business loans at commercial banks generally continues sluggish, although loans to agriculture strengthened. Inflows into time and savings accounts continue at a high level, with consequent downward pressure on mortgage rates. Several District reports indicate reductions in rates paid on consumer time certificates, or consideration being given to such cuts, and Cleveland reports reductions in rates paid on passbook accounts at banks in several cities of the District.

FIRST DISTRICT--BOSTON

The mood of directors and businessmen in the First District is markedly more optimistic than last month. Retail sales were unexpectedly strong in the two weeks before Christmas. A major utility reports a substantial drop in uncollectible revenues. A number of large manufacturers are experiencing increased sales and new orders, and the recent awards of several large defense contracts to Connecticut firms will have substantial employment effects throughout that state in 1977.

Contacts throughout New England report that retail sales were very strong in the second half of December. In some cases this followed a sluggish November and early December, but even here total December sales were better than expected. Two of the largest retailers note that this trend has continued into the new year. Reflecting these developments, business deposits and consumer loans have picked up sharply in some areas.

Manufacturers of fabricated metal products, particularly those supplying the housing market, indicate that sales and new orders are increasing. A manufacturer of sewing products reports a significant improvement over the past few months and, on the basis of information from the garment manufacturers, is looking forward to a strong spring. A supplier to tire makers is selling ahead of production. In general, however, capacity is not yet an important consideration.

Connecticut firms wound up an extremely successful year in bidding for defense contracts by winning a several billion dollar contract to build helicopters. These new contracts will have a substantial impact on employment both directly and through subcontractors. The latest contract alone will add 2,000 jobs in 1977, many in the most severely depressed areas of the state.

A major weakness in the New England economy continues to be construction. Even where business loan demand and commercial mortgage activity are strong, contractors are experiencing difficulties. In some areas there appears to be a lot of buying and selling of existing homes, but as yet this activity has not led to much new construction.

Professors Eckstein, Houthakker, and Tobin were available for comment this month. Each foresees slow growth for 1977, and none advise that monetary policy be tightened. Eckstein is concerned that the recent favorable economic news may induce the Federal Reserve to tighten monetary policy prematurely. The forecasts of real economic growth of 5 percent in 1977 have been based on the presumption that the economic pause would be temporary and would be followed by a "spontaneous reacceleration" of activity. The recent encouraging news simply confirms that consumer spending and the economy are on the forecasted moderate growth track. No tightening is called for. Eckstein advised that the Federal Reserve should not allow the Federal funds rate to increase and, unless there is some reason to expect continued rapid increases in M1 velocity, should be prepared to accept higher rates of monetary growth.

Economic prospects for 1977, according to Houthakker, are "neither alarming nor encouraging". Recent data suggest a period of slow growth ahead, with almost no chance of inflation reaccelerating sharply. While Houthakker supports some fiscal stimulus, he would prefer a greater reduction in business taxes than appears in the Carter proposal. He is concerned that, unless business investment grows more rapidly than has been forecast, the economy will experience a slowdown in the future. He favors M1 growth near the upper end of the 5 to 6 percent range.

Although the investment survey insures continued slow growth, Tobin notes that the probability of a recession in 1977 has decreased recently. The

$15 billion fiscal stimulus package will not, however, be sufficient to realize the 6 percent growth target. Monetary policy will need to assist fiscal policy in setting the stage for full employment with a balanced budget. Tobin observes that the timing and size of the recent stock and bond market rallies have closely coincided with reductions in the Federal funds rate. By reducing the Federal funds rate to 4 percent or below, monetary policy can reduce the cost of capital and encourage investment spending.

SECOND DISTRICT--NEW YORK

Economic conditions in the Second District have continued the moderate improvement noted in recent months, according to directors and other business leaders contacted recently. Retail sales ended the holiday season with a flourish after some sluggishness early in the season. With a few exceptions, inventories seemed to be at desired levels. While orders for capital goods have been coming in slowly, this was partially attributed to businesses awaiting the policy decisions of the incoming administration. The recent price increases of steel and other materials and products were generally expected to hold. On the labor scene, there were predictions of moderation in wage demands this year but more emphasis on improvements in non-wage benefits.

The consensus among retailers in the Second District was that Christmas sales turned out very satisfactorily. As judged by historical patterns, consumer spending started out slowly in December but picked up sharply as Christmas neared. Many retailers characterized the week before Christmas as unusually strong. Within the New York metropolitan area, sales were generally regarded to be stronger in the suburbs than in the City. Upstate, one department store executive labeled the Christmas season as excellent. Directors of the Buffalo Branch, on the other hand, characterized the holiday season as good but not up to original expectations. In their view, exceptionally severe weather may have had a dampening effect on sales. While some merchandise was marked down prior to Christmas, most retailers indicated that markdowns were no greater than customary. On the other hand, two department store executives reported extra promotional activity this Christmas. Early reports on post-Christmas sales were very encouraging, and most retailers were optimistic in their outlook. Nonetheless, the high level of gift certificates purchased this Christmas was interpreted by some as a sign of lingering consumer caution.

On the whole, inventories were thought to be in good shape. A few scattered exceptions were mentioned. For example, one director pointed out that inventories of nonferrous metals continued to be extraordinarily high. At the same time, there remained problems with the mix of automobile inventories. Stocks of small cars were too high although they were improving, aided by the rebate programs; stocks of intermediate and full-size cars continued to be tight. Overall, the consensus was that inventories were or soon would be reasonably balanced. One business leader, however, predicted that inventory targets would soon be raised, thereby fostering a moderate step-up in inventory accumulation.

Capital goods producers in the district generally reported that new orders have been coming in at a relatively slow pace of late. In the view of two respondents, this sluggishness stemmed in part from businesses waiting to see what programs the new administration would propose. Of particular interest was the decision as to whether or not to raise the investment tax credit--an issue that was left unresolved in the announcement of President-elect Carter's proposed program of fiscal stimulus. Capital spending was not expected to rise sharply over the next quarter or so, but some business leaders did predict a speedup later in the year.

Concerning the price increases recently posted on various basic materials and products, most business leaders contacted thought the higher prices were generally sticking despite some reports of discounting. An economist for an automobile company reported that although steel prices had been discounted in early December, posted prices seemed to have been holding since then. An executive in the capital goods industry agreed that price increases for flat-rolled steel products appeared to be holding, but added that discounting could begin if the automotive industry did not expand production as much as expected. With respect to stainless steel and aluminum, a director reported that recent price hikes were sticking.

Although there was no consensus concerning wage increases for 1977, most business leaders anticipated some moderation from 1976. The rate of inflation was expected to be an important determinant of wage increases. A corporate economist pointed out that some of the wage settlements expiring in 1976 were negotiated during the period of wage controls. The contracts expiring in 1977, in contrast, were negotiated after the wage control program ended, implying that the workers covered by these latter contracts have less "catching up" to do. Some respondents expressed the view that a high unemployment rate will have a smaller than usual moderating effect because the current high rate of unemployment reflects rapid labor force growth rather than sluggish labor demand. Nonwage issues, including job security, fringe benefits, and pension provisions, were seen by some as especially important in 1977. Indeed, one executive thought that while wage increases would moderate, there would not be much relief from cost pressures. Another business leader predicted that the recent contract negotiated by the automobile workers would make labor negotiations tougher than usual this year. On the other hand, directors at the Buffalo Branch thought that the willingness of labor to work with the new administration would help to prevent serious labor disruptions.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District are improving. Retail sales are up over year-ago levels, and manufacturing activity shows a modest uptick, after faltering in December. New orders, shipments, and inventories are higher this month, and the average workweek is longer. At the same time, factory employment has stabilized after declining in the three previous months. Additions to work forces in nondurables are balanced by cutbacks in durables. Over the longer term, both retailers and manufacturers are looking for additional expansion. Higher prices and higher costs in manufacturing are somewhat more widespread than in December. Bankers report that business loan demand remains weak, and no substantial increase is expected before the third quarter. In addition, bankers say they are considering a reduction in rates paid to savers.

Manufacturers responding to this month's Business Outlook Survey report that economic activity is up somewhat from last month. Twenty-four percent of the businessmen surveyed indicate improvement while 16 percent say that business is worse--a reversal of the December survey results when 16 percent reported increases and 23 percent reported declines. New orders and shipments are higher this month after being flat in November and December, and slight increases in inventories are reported for the second month in a row.

The improvement in the manufacturing sector is evident in employment. Work forces are unchanged after declining since October, and the average workweek, which was shortened in each of the past two months, is lengthening in January.

Over the next two quarters, manufacturers look for additional expansion. Three-fourths of the executives surveyed anticipate better business conditions by July. New orders, shipments, and employment are each expected to increase over the period. At the same time, increases in capital expenditures are planned by one-third of the firms sampled--down marginally from last month. Inventories, however, are projected to be at current levels six months from now.

Inflationary pressures in manufacturing are more widespread this month. Higher prices for supplies are reported at 44 percent of the firms surveyed while 16 percent report higher prices for their finished products. Both of these are up somewhat from December. By July, 9 out of 10 businessmen in this region expect to be paying more for their inputs, and 3 out of 4 anticipate higher prices for the products they sell.

Retailers in the area report that sales in December were above last year's levels. Most of the merchants contacted put dollar gains around 4 percent. The last two weeks in the month were reportedly very strong, and most retailers say that the two additional shopping days this year helped boost sales. All of those contacted indicate that this latest sales activity was in line with their expectations, which in some cases had been reduced from projections made earlier in 1976. For 1977, retailers are looking for moderate sales gains over last year, and most anticipate a relatively sluggish first half. Competition is expected to remain intense, and merchants feel that they will have to be aggressive in order to raise annual sales by more than 5 percent. Inventories will be "watched closely" in '77, and it is expected that the sales outlook over the next two quarters will not be greatly altered by any of the fiscal measures currently under discussion.

Bankers in the region report continued weakness in business loan demand. By the end of this year, the outlook for business loan volume ranges from 4 to 10 percent. Slower growth is projected in the first half of the year and then faster growth in the final two quarters. Most bankers note, however, that they expect loan demand to lag any pickup in the pace of recovery. The forecasts for interest rates call for a prime of 7-7 1/2 percent by the end of the year.

Bankers indicate that a reduction in the rates paid on savings is under consideration. One respondent doubts that such a move will actually occur in the Philadelphia market, and another feels the chances are 50-50. Most of those contacted say they are ready to follow a reduction of rates by one or more competitors, but don't want to initiate it themselves.

FOURTH DISTRICT--CLEVELAND

The pace of economic activity will apparently quicken this quarter. Most inventory corrections in steel, chemicals, and major appliances are apparently completed, although some adjustment may continue into this quarter. Recovery in capital goods remains mixed. Natural gas supplies have tightened but have not caused plant shutdowns. Prices remain under upward pressures. Many deposit-type institutions in Cleveland have cut their rates on passbook savings accounts. Thrift institutions in several major metropolitan centers of the District have tightened terms on savings certificates.

Rising activity characterizes several key industries in the District, including steel, machine tools, rubber, communications equipment, printing equipment, and heavy-duty trucks. Last month's increase in orders for steel reversed a downtrend that began in the second half of 1976. Machine tool orders, according to an economist associated with a producer, were the highest for any fourth quarter on record although, in real terms, orders were still only 75 percent of their peak in 1973. A producer of communications equipment and printing equipment reports its order rate in the last two months was nearly double its sales in 1975.

The bulk of the inventory correction in the same key industries was completed last quarter, but manufacturers and retailers are likely to reduce their stocks again this quarter. The sharp rise in steel orders last month is attributed partly to near completion of inventory liquidation of steel products. Order and shipments are forecast to trend upward throughout 1977, according to steel economists. Manufacturers' stocks of major appliances are still high despite recent cutbacks in production, according to an economist with a major appliance producer. His estimates indicate that the worst of the inventory adjustment is over and that production will begin to rise in line with sales. Shipments in 1977 are expected to rise 7 percent from last year. Production of plastic resins rose again last month as a result of a virtual end of inventory correction, but a financial officer with a large chemical producer expects some of its lines to remain sluggish until later this quarter.

Some retailers still have excess stocks. Retailers described sales during the Christmas season as ranging from good to better than expected but not boomy. Several commented that markdowns spurted sales in the two weeks before Christmas and helped bring stocks more in line with planned levels. A large discount chain reported that sales were excellent, but stocks were still somewhat higher than normal.

Curtailed production of small cars and spotiness in capital goods continue to hamper production and employment gains in the District. GMC's Lordstown plant announced another three-week shutdown of small car facilities this month because of poor sales and excess stocks. Manufacturers of construction machinery, heavy equipment used in the utility industry, and mining machinery report business is still soft.

Well-below normal temperatures throughout the District since last fall have tightened supplies of distillate fuel and natural gas. Consistent curtailment of supplies of natural gas by one major distributor has so far affected schools and small businesses, and a recent 50 percent curtailment affecting major users will apparently hurt the tomato greenhouse operation in the Cleveland area. A large distillate fuel producer reports that supplies from December 1976 through March 1977 will be adequate unless temperatures average more than 15 percentage points below normal for that period. An officer with another major natural gas distributor stated that industrial firms it serves have not been affected by short supplies. He indicates that reserves will be insufficient if well below normal temperatures persist. He noted that natural gas consumption in 1977 is not expected to exceed 1976 because higher prices have cut consumption.

Upward price pressures remain strong. Preliminary results of this Bank's latest monthly survey of manufacturers show that the proportion of respondents who expect price increases is as high in January as it had been for the past two months. The recent price increases for flat-rolled steel products are apparently sticking, and several producers of welded tubing steel products announced a 6 percent price hike for those products effective January 15. A steel economist expects a price rise on tinplate and tin mill products in February. Iron ore prices are also scheduled to be increased next month, according to a major ore producer in the District. Natural gas prices will probably increase 20 cents a cubic foot this year and another 20 cents in 1978, according to an officer associated with a major gas distributor.

Lower savings deposit rates by some banks and savings and loan associations reported in last month's Redbook have spread through several major metropolitan centers of the District. The most competitive area has been Cleveland, where a major bank triggered the changes by reducing rates paid on deposits by businesses. That Bank has since reduced rates on home improvement loans, used car loans, and boat loans. Presently, passbook rates paid by major

Cleveland banks have been cut to 4 1/2 percent. Some large savings and loan associations in Cleveland reduced the rate on passbook savings to 5 percent, but a few are paying 5 1/4 percent. Maturities and yields on savings certificates vary considerably, and some associations stopped offering certificates of less than one or two years in maturity and reduced rates on all certificates. Reductions in rates on passbook savings of about 1/4 percent are also reported in Columbus, Akron, and Canton. In Pittsburgh, neither banks nor savings and loan associations have decreased rates on passbook accounts, but the associations have lowered rates on certificates, and a few are no longer offering higher yield certificates. A major bank in Pittsburgh plans to retain maximum rates on certificates but will lengthen maturities.

FIFTH DISTRICT - RICHMOND

Responses to our latest survey of Fifth District business conditions suggest little change in overall activity in December. Manufacturers' responses suggest no change from the previous month in either shipments or the volume of new orders, little change in inventories, and declines in order backlogs across a broad front. In contrast with national data, District retailers report only slight improvement in sales, with sales of big ticket items relative to total sales apparently down sharply. Manufacturing employment also showed little change and a number of firms worked fewer hours per week. Prices paid by retailers and manufacturers moved upward in December but neither group of respondents indicated any change in prices received. Inventory levels, at both manufacturing and retail, continue to be viewed as excessive, as does manufacturing plant and equipment capacity. The number and size of retail outlets, however, are in line with desired levels.

The retailers surveyed were unanimous in expecting no change in the general level of business activity nationally over the next six months. One-half of our manufacturing respondents, on the other hand, expect to see some improvement in that period. Much the same holds true for expectations concerning activity in the respondents' respective market areas and individual firms; manufacturers remain essentially optimistic while retailers foresee little further improvement within six months. At least two District states are beginning to experience tight supplies of natural gas and interruptions in deliveries to some commercial users are expected. Continued cold weather is likely to lead to actual cutbacks in some areas.

The overall picture presented by our manufacturing respondents was essentially neutral, with equal numbers reporting increases and decreases in both shipments and the volume of new orders during December. Nearly one-half of the respondents report reduced backlogs of orders during the past month. The responses suggest that inventories of finished goods were unchanged and stocks of materials were up slightly. Over one-third of the manufacturers continue to view current inventory levels as excessive. Reports of price increases were less widespread than in recent months, particularly with respect to prices received. Concerning expectations for the next six months, approximately one-half of the manufacturers surveyed see at least some improvement nationally, locally, and in their own firms. One producer of consumer electronics equipment anticipates a pick up in sales with the introduction of new models in the second quarter.

With two notable exceptions, the experiences of individual industries represented in our survey seem to match the overall picture. In the primary metals group, nearly 85 percent of our respondents report an increased volume of new orders in December and almost as many report a larger volume of shipments. Metals producers report backlogs of orders, inventories, and prices unchanged and current inventories and plant and equipment capacity at desired levels. One respondent views current capacity as inadequate. On the other hand, responses from the furniture industry, are surprisingly pessimistic in view of the sharp recent improvement in housing. Eighty percent of respondents in this industry report declines in both new orders and backlogs of orders in December and one producer reports facing short time despite having cut prices and run specials. Producers' inventories and plant and equipment capacity in the industry are reported to be excessive. In addition, furniture men seem to expect no significant improvement in their business over the next six months.

Retailers responding to our survey suggest little change in the overall level of activity in December although individual responses varied considerably. Total sales seem to have been stable to slightly improved, although sales of big ticket items relative to total sales declined. Inventories were also unchanged and apparently remain above desired levels. Prices paid by retailers rose after showing little or no change a month ago. One retailer has experienced or anticipates significant price increases in several basic lines, including leather goods, drapery and home furnishing fabrics, and men's clothing. Consumer concern over prices and favorable response to price reductions are also noted.

In the banking sector, commercial loan demand continues to show some halting improvement although the pattern is still uneven from week to week. Increased commercial loan volume in recent weeks appears to be due mainly to demand from transportation companies and food and agricultural products processors. In connection with this demand, banks are returning to the CD market. The demand for consumer loans remains healthy.

SIXTH DISTRICT--ATLANTA

Gradual expansion continues in the Southeast. Retailers cite widely varying gains in sales; some of the increases are attributed to particularly favorable external factors. Turbulence continues to buffet the hotel business. Free ports and new international banking offices are being established in Georgia. Construction activity includes shopping centers and, in some areas, office buildings. New industrial expansion continues to be rapid in the southeastern states. Growth is picking up in the well-established textile, apparel, and carpet industries. The pace of offshore oil exploration is accelerating.

Most retailers report sales improvements during the holiday season, but the degree of improvement varies widely. An official of a leading department store estimated Atlanta's gains at about 5 percent in real terms for 1976, with record Christmas sales volume. Spokesmen credit favorable weather conditions and the occurrence of a weekend holiday, which provided maximum opportunity for both pre- and post-Christmas shopping, as factors which stimulated sales. A few stores report customer reluctance to make big-ticket purchases. Light tourist traffic during December resulted in declining sales in West Florida, after respectable gains in prior months. These merchants are somewhat apprehensive but report excellent results in their post-Christmas promotions.

Auto sales are very strong in all areas; dealers in Nashville reported equaling or bettering 1973 sales results. Oldsmobile and Cadillac dealers are experiencing no loss of their regular customers to Ford and Chrysler as a result of model size decreases.

The District's hotel business is experiencing ups and downs. In Miami, a hotel workers' strike began on Christmas day and has spread to at least eight hotels. There is no evidence that tourist businesses have been seriously affected. Other unions have not honored the hotel employees' picket lines. The Colony Square development in Atlanta has reached an agreement with a new managing company to operate the Colony Square hotel, following an earlier decision by the Fairmont Hotel Company to terminate its role as manager.

Redevelopment efforts are under way in Miami, in the hope of increasing the area's attractiveness to tourists. Legislation is being introduced to legalize casino gambling. A new hotel and merchandise mart is to be built near the Miami Beach convention center. Also, a proposal for construction of an amusement park halfway between Miami and Miami Beach has been approved by the Miami City Commission.

Acting under a recently enacted constitutional amendment, the first free port has been established in a Georgia county south of Atlanta. The amendment allows counties to exempt certain types of goods from property taxes as a means of attracting industry.

International banking activities are on the increase in the Southeast. Officials of Credit Suisse have announced plans to open a regional office in Atlanta during April. Barclays Bank opened the first foreign-affiliated office in Atlanta last November. A recently enacted state regulation permits lending and other financial services to business firms by offices of foreign banks.

Despite a vacancy rate of about 25 percent, construction of additional office space is being planned in Atlanta. Delta Airlines will construct a new building close to its present facilities at the Atlanta airport to house headquarters offices and a reservations center. The state government is planning to construct a new office building at a cost of about $40 million.

In other parts of the District, there appears to be widespread construction of retail facilities in Louisiana, Mississippi, and Georgia. New apartment construction, however, continues to be held back by first, the low return on investment and, secondly, changes in the tax law requiring funds to be placed "at risk" before the advantages of the tax shelter are realized. Industrial development activities during 1976 added $850 million of new and expanded plants in Georgia, surpassing the 1973 record, and $1.65 billion of investment announcements in Alabama.

In both the textile and apparel industries, there are recent signs that the slowdown which began last spring is ending. Production is recovering. The carpet industry experienced a respectable recovery in 1976; continued gains are foreseen for 1977.

Shipping activities are on the rise. Cargo handled by the state port in Mississippi has risen 14 percent. Tonnage at the state docks in Alabama set a new record, but activity at the Port of Mobile fell slightly. A shipyard reports a sharp increase in inquiries about marine repair services. A Louisiana company which repairs and coats the interior and exterior surfaces of railroad tank and hopper cars is expanding its capacity by 30 percent.

Oil industry sources indicate that, regardless of uncertainties about Carter Administration energy policies, they must begin exploration, drilling, and production to realize revenue from valuable offshore leases which have been dormant for several years. Increased pipeline construction and a scarcity of offshore drilling rigs indicate growing activity.

SEVENTH DISTRICT - CHICAGO

The economic outlook in the Seventh District continues to improve, overall, although demand for some types of consumer goods and producer equipment remains poor. Sales of general merchandise stores in the Christmas and post-Christmas periods were excellent and exceeded expectations. Inventories are generally in good shape. More firms are attempting to raise prices as market conditions permit. There are signs of renewed strength in capital spending and nonresidential construction. All classes of lenders have ample funds to invest and mortgage terms have eased.

Business and financial executives are in virtually unanimous agreement that total real growth and general inflation will be about the same in 1977 as in 1976. Moreover, a very large proportion expect that their own sectors will share in the improvement. In part, more confident attitudes reflect increases in sales and encouraging economic news, but there is also less concern that governmental policies will create an unfavorable environment, e.g., a return to price controls.

Large general merchandise stores were very pleased with Christmas sales which were "above budget" in most cases. A favorable trend has continued in early January. Inventories "on hand and in sight" are "lean" and markdowns of standard merchandise have been less common than is usual at this time of year. Among the lines which have been most vigorous are consumer electronics, microwave ovens, dishwashers, recreational equipment, and auto parts. Sales of fashion apparel have been somewhat disappointing, and sales of color TV sets are reported to have slipped recently with a resultant buildup of inventories. District producers of TV sets are very disturbed about "unfair" Japanese competition which is taking a much larger share of the market.

A larger retailer expects its sales to rise 8 percent in 1977--9 to 10 percent if consumer taxes are reduced. Prices of general merchandise average about 4 percent above year ago. One large retailer believes that the prices it pays and receives will rise about 3.5 to 4.5 percent in 1977. Another retailer has raised its estimate of the prospective price rise from 4.5 to 4.8 percent. Various retailers and manufacturers report an increase in the number of suppliers who are trying to push through price increases, following the lead of steel.

A gas utility serving 1.3 million customers in Northern Illinois now predicts that home heating bills will average 45 to 50 percent higher this winter because of higher rates and colder weather. A month earlier an increase of 35 to 40 percent had been predicted. December was 35 percent colder than year ago and 23 percent below normal. Gas supplies in the district are expected to be adequate, unless the federal government orders diversions to other areas, a step that would be strongly opposed.

A local steel company reports an increase in orders for flat-rolled products, especially from auto companies who are paying "full price" despite some publicity to the contrary. Steel shipments are expected to rise 11 percent in 1977 to about 100 million tons. Inventories of steel users and steel service centers have been reduced to desired levels. The precise level of steel shipments in 1977 will depend on the volume of imports, mainly from Japan, which is expected to increase.

Most analysts now expect sales of both cars and trucks to increase in 1977--to a new record in the case of trucks. Sales of recreational vehicles are also expected to show another large rise. The sharp contrast between very poor sales of small cars and strong sales of intermediate and standard size types continues. The smallest auto company, which produces small cars almost exclusively, admits to a very precarious financial position. It is feared that this company's Milwaukee plant will be closed down for good. This company hopes to escape the full impact of the labor settlement agreed to by the large auto and farm equipment producers, valued at 13 percent for the first year.

Demand for farm equipment has fallen off, and a decline in sales is expected for 1977. Bankers note a buildup of farm equipment inventories in the hands of dealers, including the heaviest tractors, which had been on allocation until recently.

The capital spending picture is somewhat better. Orders for mining equipment have picked up again after a slowdown. The major auto companies have expanded their plans, already large, to purchase equipment to produce redesigned models. A producer of controls and components, in a strategic position to evaluate trends, believes that various major projects kept on the "back burner" by the food processing, paper, chemical, and glass industries will be activated this year. There are early signs of such a trend, which is expected to be more clearly evident in the second quarter. Sales of environmental control equipment have been very strong all along. Producers of capital goods and related components have ample reserve capacity to handle new orders, having solved most of the bottlenecks that limited output in 1973-74.

EIGHTH DISTRICT -- ST. LOUIS

Eighth District businessmen are generally confident that the recovery will continue in 1977. The lull in business activity last summer and early fall has continued into recent weeks for some industries, but a number of other firms report that activity has gained momentum. Retail sales have been strong over the holiday and post-holiday season. Prospects for capital spending, on the other hand, are mixed. In general, such spending is expected to increase in 1977, but in some industries little change from a year ago is foreseen. Homebuilding made good gains in several areas of the District in 1976 and further gains are anticipated in 1977. Thrift institutions continue to experience large increases in deposits on a seasonally adjusted basis and mortgage rates have edged downward.

Major retailers report that sales were generally excellent over the Christmas season. One major department store in the St. Louis area reported 3 to 4 percent gains in real terms, although aggressive merchandising was necessary to move goods. Reports from smaller retailers in the nonmetropolitan areas over the District were mixed. An appliance and stereo equipment retailer in the St. Louis area noted that sales were more sluggish than anticipated over the early part of the Christmas season, but a surge of buying in the last few days before Christmas made up for the earlier slowness. Also recent reports indicate that post-Christmas sales have been excellent.

A sizable number of manufacturing firms indicate improving economic conditions in recent months. A paper industry representative reported that year-end business was very strong with sales 10 percent larger in December than a year earlier. A small manufacturer of welding and cutting equipment has had a marked improvement in sales beginning in mid-November, and additional workers have been added to the work force. Part of the demand for this firm resulted from increased export sales. Other firms noting improvement in recent weeks include a manufacturer of apparel, a food processing firm, and a manufacturer of refrigeration equipment.

Some notable exceptions to this improving picture can be cited, however. For instance, a representative of a large chemical firm states that sales have been flat recently, although 1976 sales averaged above those of 1975. Among industrial chemicals, sales of detergents are flat and polystyrene sales are described as quite weak, but some other plastic products are doing fairly well. The outlook is bright for sales of agricultural chemicals this year. The steel industry continues in a lull according to a local representative. Considerable excess capacity continues to plague this industry, although shipments are expected to increase 6 to 7 percent this year. A large boost in investment spending is needed before the steel industry will gain much momentum.

Prospects are mixed for capital spending. A representative of a major capital producing firm reported that no major increase in spending is foreseen for 1977. Investment spending in the paper, steel and chemical industries is at a relatively low level. Particularly flat is nonresidential construction spending. A number of firms in the food processing industry, however, have announced sizable investment plans for 1977. In the St. Louis downtown area, several capital investment projects have also been announced for 1977. Spending on such projects may total as much as in the past two years combined. Many of the projects are related to a new convention center which is scheduled for opening later this year.

Homebuilding made considerable progress in most areas of the District in 1976, and prospects are for further increases this year. In the St. Louis metropolitan area 6,000 single-family homes were built in 1976, up from about 4,000 in 1975. Apartment building, however, remained at generally low levels throughout the District. Some projections for 1977 homebuilding in the St. Louis area point to a 15 percent increase this year from the 1976 level. Apartments, however, are expected to total less than 10 percent of the new units built this year. Memphis has continued to unwind from the overbuilding of earlier years, but construction of single-family homes is running above year earlier levels.

The bright prospects for homebuilding are partially related to favorable developments at thrift institutions. These institutions continue to report large deposit gains. Some institutions report net gains during the Christmas season, a period usually characterized by net withdrawals. Smaller passbook accounts apparently behaved in the normal seasonal pattern, but increases in time certificates more than offset these declines. Deposit gains have also been strong in early January and are generally expected to continue upward through the spring months, reflecting the favorable rates offered by savings and loans relative to other market rates. Effective rates on time certificates offered by these institutions, however, have been edging downward over the past six weeks, as both rates and terms have been adjusted. Mortgage interest rates have also been inching downward over recent weeks, another favorable sign for the homebuilding industry.

NINTH DISTRICT - MINNEAPOLIS

Economic indicators are mixed as the Ninth District economy enters 1977. Sources of encouragement are reports of good holiday spending and strong homebuilding activity. District employment resumed its advance in late 1976, and unemployment declined modestly. Also, livestock prices have recently gained strength. Nevertheless, the region continues to be troubled by a lack of growth in manufacturing and construction jobs. And in contrast to livestock prices, low grain prices are worrying district farmers. However, weather is probably the biggest source of concern to most people. The drought-induced reductions in last season's production will have their full impact on farm spending this year, and many farmers are disturbed about the additional consequences of inadequate moisture in 1977. Cold weather is also straining the district's fuel supplies and curbing winter recreational activity.

Major retailers in the Minneapolis-St. Paul area generally report good holiday sales with December sales up about 10 percent from a year earlier. Furthermore, retailers' comments indicate that January is off to an encouraging start, and post-holiday sales are expected to be good. Also, the view is expressed that sales have been helped by the improvement in consumer confidence since the election. In addition, good holiday business has left retailers with no burdensome inventories.

District auto sales have also been quite good, with sales gains about in line with the national gains. Large and intermediate models are selling very well; small and compact cars are moving more slowly. Inventories are in line with this sales pattern; that is, supplies of large and intermediate cars are tight and many dealerships have overstocks of smaller models.

Homebuilding in the Ninth District was quite strong during the second half of 1976. District authorizations for new housing units were quite close to 1972's record levels; this is in contrast to a fairly large shortfall nationally. Most of the improved district housing activity was concentrated in the single-family sector, but some gains in multifamily authorizations occurred after midyear.

The district's active homebuilding sector has been partly responsible for the impressive increase in mortgage loans made at district S&Ls during the second half of 1976: up nearly 75 percent from a year earlier. This advance was much stronger than the national increase. However, part of the district's growth stems from a shifting of existing loans to S&Ls from other lenders, since Minnesota's 8 percent usury ceiling on conventional loans was lifted last April. Outstanding loan commitments at S&Ls also climbed impressively in 1976 and during the second half of the year were about 25 percent greater than in the first half.

District labor markets in late 1976 were bolstered by employment gains. Additional jobs checked the rise in district unemployment which had occurred since last spring. These employment gains have occurred in the trade, service, and government sectors; manufacturing employment did not increase, and construction jobs were down from a year earlier.

These positive areas of district activity are in contrast to several weaker sectors. Weather is a source of particular concern to the district's agricultural sector. Not only are last season's drought-induced reductions in production expected to have their full impact on farm spending this year, but many are worried about this year's moisture conditions. Drought conditions have prevailed in the post-harvest months, and the long-range weather forecast predicts lower than normal precipitation for January. As a result, concern is mounting about moisture conditions in 1977. One tactic will likely be acreage diversion from corn to wheat, sunflowers, or other drought-resistant crops.

Low farm prices resulting from record nationwide crops have adversely affected the district's farm economy. However, the cattle industry appears to be stabilizing, so increased beef prices are likely. Unfortunately, increased feed costs could offset this benefit. Since hog producers are planning higher farrowings, the pig crop should increase for the second year in a row. This potential supply would tend to depress hog prices again in 1977.

In addition to affecting agricultural output, recent weather conditions have adversely affected district energy supplies. Much colder than normal temperatures have markedly increased natural gas curtailments in this region and have strained available fuel oil supplies. The fuel oil situation has been termed "quite serious," and current inventories are at the lowest point in five years. Consequently, if cold weather persists in January and February, it is possible that some district businesses would have to disrupt or alter usual activity.

Resort owners throughout the midwest are suffering from the combination of a scarcity of snow and extreme cold. Despite snowmaking machines in most Minnesota ski resorts, cancellations are running high and business is poor. Lack of snow is also a problem for other businesses which depend on snowmobiling and cross-country skiing.

TENTH DISTRICT - Kansas City

Retail sales during the Christmas season were reported as not overly strong in the Tenth District, with the exception of the Denver area. Reports from several larger District cities showed a generally favorable view of the sales of 1977 autos to date, with the outlook for the next several months fairly optimistic. A good deal of the concern expressed last month over the lack of moisture and snow cover for the District's winter wheat crop has been allayed by a very extensive snowfall. Regarding scattered reports of increasing interest rates on farm loans, contacts with two dozen agricultural banks in the Tenth District showed a variable pattern of change with rates being charged averaging nearly the same as 3 months earlier. Tenth District bankers presented a mixed picture for business loan demand, with some banks reporting strong loan demand and others only seasonal increases. While banks have been considering cuts in offering rates on consumer savings deposits or consumer CD's, only two institutions have, thus far, reduced rates selectively by one-fourth per cent. At the same time, there were no outright instances, from among a number of savings and loans contacted, of reductions in rates paid on passbook deposits. However, in several cases, it was reported that issuance of 7 3/4 and 7 1/2 CD's had been discontinued and that possible future rate reductions were under consideration.

Telephone calls to a number of major retailers in the Tenth District regarding sales over the recent Christmas season elicited generally restrained responses, with the exception of the Denver area where such terms as "outstanding" and "fantastic" were used to describe the December sales picture. Elsewhere, sales were reported to be up over the period last year, but gains were not seen as exceptional or up to some of the more optimistic projections. Most respondents indicated that their inventories were at, or close to, desired levels, and all respondents reported no recent change in prices, either from their vendors or to their customers. District auto dealers reported a generally favorable response to date on the part of the public toward the 1977 models. Intermediates and full-size cars are in strongest demand and shortest supply, and the outlook for sales over the next several months appears to be optimistic.

With the exception of southern Oklahoma, the District's winter wheat crop is largely covered by a protective blanket of snow which fell very recently. In addition to providing badly needed moisture, the snow will offer protection to the dormant wheat from wind erosion and winterkill.

Following scattered reports about increasing interest rates on farm loans, a telephone survey involving 24 District agricultural banks was conducted to determine both the extent to which they are loaned up as well as their most common interest rates on four different types of farm loans. Loan to deposit ratios of the respondents ranged from 12 to 80 per cent, with a mean of 58 per cent (little changed from October 1). Interest rates ranged from 8 per cent on feeder cattle and other operating loans to 11 per cent on intermediate- and long-term loans. In the last 3 months, 10 banks increased rates on at least one kind of agricultural loan by 25 to 100 basis points. At the same time, seven banks lowered interest rates on at least one kind of farm loan between 25 and 100 basis points. On balance, interest rates being charged by the respondents averaged nearly the same as 3 months earlier.

Tenth District bankers contacted in January presented a mixed picture of changes in business loan demand. Some banks reported strong gains in business loan demand while others said that loan increases in December were only seasonal. Several of the banks reporting strong gains had increases in all areas of business loan demand, while one reported that strength resulted primarily from agribusiness overlines at smaller banks. Strong gains in consumer instalment lending were recorded, with above seasonal gains in bank card use noted by most banks. Agricultural loans continued to be a source of strength in overall loan demand at the larger Tenth District banks. Loans for grain storage have been particularly strong although new cattle loans are at a low level.

With the fall of short-term market interest rates below passbook rates, most banks have been considering cuts in offering rates on consumer savings deposits or consumer CD's. However, only two institutions have reduced rates so far--one reduced by one-fourth per cent the offering rate on certificates with maturities from 30 days to 2 years, while another cut by one-fourth per cent the rate on 90-day certificates. One bank plans to reintroduce service charges on passbook accounts and another is putting a cap on the amount which can be placed in a consumer CD.

Savings and loans throughout the Tenth District were contacted, and none of them reported any outright reductions in interest rates paid on passbook deposits. However, in several cases, issuance of 7 3/4 and 7 1/2 CD's had been discontinued. In addition, several savings and loans were considering taking such an action in the near future, or lowering the rate on deposits, if competitive conditions permitted. There were a number of reports of recent reductions in mortgage rates and terms, in some instances to an 8 1/2-8 3/4 per cent range on 75 per cent to 80 per cent contracts. Further possible reductions were under consideration, depending upon the emerging competitive situation.

ELEVENTH DISTRICT - DALLAS

The rate of economic recovery in the Eleventh District has slowed. Manufacturing output is down slightly, and the unemployment rate has risen to 6.2 percent after two months of decline. Total employment, however, continues to climb, and the oil and gas industry in Texas is being buoyed by increased drilling activity. A survey of the directors of this Bank and agribankers was conducted this month. The results show that economic growth in the Southwest in 1977 will be bolstered by further increases in construction activity and steady improvements in manufacturing output, which should stimulate business fixed investment. Bankers report farmers are in a severe cost-price squeeze, and demand for loans is strong.

The majority of directors are optimistic about the economic outlook for the nation and the Southwest. One indicated that the outlook will be largely dependent upon the extent and timing of proposed government actions. Another predicted that once business and consumers are given "good economic signals," the economy will pick up significantly.

Stronger than anticipated retail sales in December are being interpreted as slightly bullish for 1977. Moderate to strong growth in retail sales is expected in the District this year, which should reflect continued improvement in consumer confidence and growth in disposable income.

Homebuilding will continue to be a major source of strength in the southwestern economy. A strong stimulus to more housing is an abundant supply of funds that is now exerting downward pressure on sticky mortgage rates in many areas. One director predicted new starts will rebound faster across the nation than most analysts anticipate--certainly well above 1.6 million units.

Industrial production is expected to show steady improvement throughout this year. Businesses are expected to continue the strategy of a gradual accumulation of inventories. Shortages of materials are not anticipated, and overall productive capacity is adequate to accommodate the expected increase in output. However, the rise in capacity utilization should be sufficient to stimulate a new wave of capital spending. But as one director points out, major capital outlays will be deferred until business determines exactly what direction government policy is headed.

Overall loan demand is not expected to increase significantly until the pace of economic recovery gathers more momentum in the second half of the year. One director estimates the pickup will begin in approximately two months as firms start to finance inventory accumulation, and another predicts that business loan demand may climb 7 to 8 percent. Foreign loan demand is expected to be strong, largely due to recent oil price increases by OPEC.

Most respondents indicated that short-term interest rates would ease down a bit more before reaching bottom. A turnaround will likely occur sometime this quarter, as inventory accumulation develops momentum. Short-term interest rates are expected to rise 1 1/4 percentage points above current levels by year-end. According to some directors, the prime interest rate will range from 7 to 8 percent by late 1977. If the pace of economic activity accelerates suddenly, one director predicted that short-term interest rates could rise much more sharply.

Agribankers, responding in the latest quarterly credit survey, report that the financial conditions of many grain producers and cow-calf operators have weakened in the Southwest. A banker in the High Plains of Texas notes that high costs of production and low prices for corn, grain sorghum, wheat, and cattle have placed producers in a severe cost-price squeeze. Another banker indicates that wheat prices are below costs of production, and corn and grain sorghum prices are at break-even levels. Farmers are optimistic about the outlook for cattle prices but are less encouraged about grain sorghum, wheat, and corn prices. High prices and generally favorable yields, however, have enhanced incomes and have improved the equity position of most cotton and soybean producers.

Demand for farm loans is strong. Operating expenses and machinery prices have risen somewhat, and the volume of crop storage loans is up as farmers withhold grain from the market for higher prices. The number of renewals and extensions has increased, particularly in major wheat producing areas.

TWELFTH DISTRICT - SAN FRANCISCO

In the opinion of our Directors, the year ended on an upbeat as consumer spending met or exceeded expectations during December. Automobile sales were strong with imports accounting for an increasing share. There is still little bouyancy in capital spending plans and businessmen hope for some form of permanent tax incentive to stimulate growth in this area. Residential construction is very strong and savings inflows at savings and loan associations reached record levels in November and December. In response to the strength in housing, lumber demand has increased, but activity remains slow in the paper and pulp and steel industries. Orders for new commercial aircraft have risen and builders are expanding payrolls. The agricultural economy is quite depressed with prices for wheat, potatoes and sugar beets at very low levels.

Most areas of the District reported a year-end surge in retail sales activity that has prompted a cautiously optimistic view of consumer spending over the near-term. Automobile demand remained strong, especially for intermediates, but a trend towards a rising market share for imports was noted. Contrary to the over-all bouyancy, sales of ski equipment and apparel were down drastically and business was very slow in resort areas servicing winter sports. Moreover, sales gains were below average in agricultural areas where income gains this year were slight.

In response to a question which asked whether an investment tax credit or an accelerated depreciation schedule would stimulate capital spending in their industries, most Directors reported that either move would have a slight positive effect in activating marginal projects. For those industries with long lead-times for new construction and installations, the effect would be minimal unless made a permanent part of the tax structure. As one Director states, "Capital spending plans are generally dependent on demand outlook and expected rates of return based on projected prices," and another, "What is necessary to assure success is that ... (either) be enacted in an atmosphere that is perceived by business to offer it fair and reasonable expectation to prosper and profit." On the other hand, a television and radio station owner believes that tax relief would provide the incentive to purchase electronic news cameras, the cost of which, along with associated equipment, is $500,000 per station.

The residential housing market continues to strengthen each month, especially in California. Although there are real demand factors at work such as active resales and lowest vacancy rates on record, the market was supported somewhat last year by the January 1, 1977 deadline on land to be added to California's coastal zone. To the extent that the redefinition of the coastal zone "borrowed" some activity from 1977, some softness may be apparent in the early months of 1977. However, savings inflows to California savings and loan associations continued to set records in November and December assuring the means to support high levels of residential construction.

The lumber industry, fed by the strength in housing, has stepped up operating rates and is optimistic about 1977; logging operations have continued uninterrupted through the fall and early winter. But pulp and paper business continues weak including industrial products, such as cartons. Steel demand continues slow and no revival is expected until capital spending picks up. The steel price increases announced in late Fall have been offset by Special discounts. The main source of demand is automotive and there is a growing trend towards using more plastic and aluminum in building automobiles to reduce weight. The aircraft industry is picking up in the Pacific Northwest on the strength of both government and commercial demand. Boeing Co. expects to add 4,500 employees to its payroll this year.

Due to over-production, the agricultural economy is depressed on a broad front. The price of wheat is about one dollar a bushel compared with $2.40 a bushel a year ago; potatoes are now selling for $35 to $40 a ton while the cost of producing potatoes is roughly $50 a ton; sugar beets are selling at $22 a ton now while in 1974 the price was $45 a ton. There is, however, a strong export market for many commodities and for processed foods. Potato processors are working at 105 percent of capacity to satisfy Japanese and European demand. There continues to be over-production of dairy products and, in California where the listing of state-established minimum prices for fluid milk was ended, vigorous competition is anticipated.

Our Directors have expressed concern over high labor force participation and unemployment rates and would favor government-sponsored programs along the lines of the CCC. Unions are making attempts to "share the work", but, since this raises costs and results in plants being built elsewhere, they would prefer a solution outside the private economy.