CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

August 10, 1977

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SUMMARY*

The rate of growth in business activity may have slowed recently according to this month's District reports, but the trend continues moderately upward. Consumer spending continues to increase; however, demand for soft goods was reported to be weak in some of the Districts. Inventories are generally being maintained at satisfactory levels. Business loan demand remains relatively weak at the larger centers, but some pickup in demand is reported by a few Districts. Mortgage funds are ample at current interest rates. Strong loan demand and high loan-to-deposit ratios were reported in some of the agricultural communities. Residential construction continues at a high rate and signs of rising industrial construction were noted. Upward price pressures remain strong, particularly for construction materials. Prospects are for a relatively large output of farm commodities, lower average farm product prices, and little growth in cash farm receipts from a year ago.

Consumer spending generally continues up, but signs of weakness were noted in some of the Districts. Apparel and soft goods sales were reported to be weak by Chicago and St. Louis. Reduced sales were reported in the rural communities by Minneapolis. Prior to an upsurge in July, an overall trend toward slower retail sales growth in the second quarter was reported by San Francisco. On the other hand, sales of hardware, excluding automobiles, continued persistently upward and a recent upturn in total retail sales was reported by Philadelphia, Cleveland, and San Francisco. Automobile sales

* Prepared by the Federal Reserve Bank of St. Louis.

were mixed with Dallas and San Francisco reporting continuing strong sales while Cleveland and St. Louis reported some easing off of such sales in July.

Business inventories, with a few exceptions, are in satisfactory condition. Continued shortages and delays in delivery are still found in the construction industry. Chicago and St. Louis, for example, reported some delivery lags for insulation, brick, drywall, plumbing fixtures, lumber, and millwork. San Francisco reported that automobile dealers are having difficulty in stocking all types of cars. Somewhat fewer "shortages," however, were reported in inventory items than heretofore, especially for raw materials used in making tools and metal fixtures. Also a few inventory excesses were reported. New York reported that mounting inventories are becoming a problem for some businesses, and Cleveland reported that, while inventories are not excessive, they are sufficient to dampen further inventory growth this quarter.

Manufacturing activity continued strongly upward according to most District reports. Boston reported rising capital goods output and a buildup in order backlogs. Further gains in the manufacturing sector were reported by Philadelphia, Atlanta, Chicago, St. Louis, Kansas City, Dallas, and San Francisco. Somewhat counter to the general movement was the mixed situation reported by New York and some leveling off by Richmond.

Those Districts commenting on construction indicate a continuing uptrend in residential building and the beginning of a recovery in commercial and industrial building. Construction of homes was reported at virtual capacity by Chicago, strongly upward by St. Louis, and strong by Minneapolis and Dallas. New York reports tentative signs of a recovery in real estate and construction, and San Francisco reported early indications of a pickup in nonresidential construction.

The comments on price expectations varied greatly from District to District. However, the prices of construction materials appear to be rising rapidly and prices for most farm products are declining. Boston sees no escalation in the rate of price increases. Less widespread price increases were reported by Richmond and a leveling off of housing prices was reported by San Francisco. Lower farm commodity prices were reported by a number of Districts. Nevertheless, generally upward price pressures were reported by Chicago, and sharply higher construction materials prices were reported by St. Louis and Kansas City.

The financial sector is characterized by relatively high demand for consumer and farm loans, but sluggish demand for business loans. High or rising demand for consumer loans was reported by Philadelphia, Richmond, and San Francisco. Chicago, Minneapolis, and Kansas City report farm loan demand to be exceptionally strong. Strong real estate loan demand was reported by Richmond. While most of the Districts report that business loan demand remains relatively weak, there are indications that such demand is beginning to pick up. Boston reported some rise in industrial loan demand. Richmond noted some increased demand for loans by wholesalers and retailers. Sluggish business loan demand in New York has prompted several banks to seek out medium-sized regional borrowing customers. Some New York banks have already established out-of-state loan production offices and others are contemplating similar action. Some moderation in the rate of savings growth was indicated by reports from Philadelphia, Cleveland, St. Louis, Minneapolis, and parts of the Dallas District. Kansas City, however, reported strong deposit and loan growth.

No upsurge in interest rates is expected. Philadelphia reported that the prime rate was expected to move up to about the 7 - 7-1/4 range by the end of the year.

Overall prospects for crop yields and production this year are generally good. An abundance of grain and lower cost livestock feed is in prospect for the year ahead. These developments point to rising supplies of livestock products. Drought has had some adverse impact on crop prospects in parts of the Richmond, Atlanta, Chicago, and San Francisco Districts, but recent rains have improved the outlook for crops. Of great concern to the farm sector, however, is the decline in prices of major farm commodities and the impact on farm incomes. The generally unfavorable farm income outlook was expressed by Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. The lower farm commodity prices, especially grains, are already having an unfavorable impact on bank credit conditions in rural communities in a number of the Districts. Chicago reported that deposit growth in agricultural area banks has slowed, that loan demand is exceptionally strong, and loan-to-deposit ratios are above desired levels. Kansas City reported some serious farm cash flow problems.

FIRST DISTRICT - BOSTON

Directors and other Redbook respondents in the First District report continued strong but not spectacular growth in the regional economy. Retail sales have been good and there has been some pick-up in the production of capital goods and in industrial loan demand. Although inventories are being monitored closely they are not at disturbing levels. No escalation in the rate of price increases has been seen nor are capacity problems or shortages in evidence.

A director from a large department store chain indicates that sales in late July were about 8 percent above the same period in the previous year. Economists for this chain's parent corporation are forecasting a continuation of strong sales through 1977 but with some slippage expected after the turn of the year. A Connecticut director reports that retail sales in that state were unexpectedly strong in July, especially in downtown areas, and that retailers are more optimistic than they have been in some time. In northern New England retail sales are also strong, in part because of a particularly successful tourist season. Retailers are said to be watching inventories closely. They are somewhat higher than desired but not excessive; so there is not likely to be a need for major corrections.

Several directors report that tourist activity is very strong. In northern New England it looks like the busiest season in many years. The America's Cup trials are creating a boom in parts of Rhode Island, and Cape Cod is also doing very well.

In manufacturing, several producers of capital goods report that sales are picking up and that order backlogs are building. Among the areas mentioned are heavy capital equipment, commercial airplanes, machine tools and equipment used by the auto industry. Sales of a product used in building chemical plants, which had been weak earlier, are improving. However a director of a large chemical company reports that firms had a significant decline in sales in July.

Both a medium sized bank in northern New England and a large Connecticut bank report increases in industrial loan demand. In the north this increase comes after several months of quite strong demand; whereas in Connecticut the pick-up is very recent. However, this improvement in the Connecticut situation is confirmed by reports that a number of firms in the state are planning substantial capital programs later this year and in 1978. However, most spending is expected to be for machinery for modernization rather than for plant expansion.

No capacity constraints or bottlenecks were reported. However one consulting firm economist expressed concern about specialty bearings and a director indicated that he expected water problems in the west to constrain aluminum production. All of the First District Redbook respondents expect prices to continue to increase at approximately a five to six percent rate.

Professors Houthakker, Samuelson, and Tobin were available for comment this month. Houthakker is encouraged by the recent behavior of commodity prices. He urges the Chairman to speak out more strongly against import restrictions; steel prices must be driven down, even if some U.S. firms are driven to bankruptcy. Houthakker opposes an increase in the discount rate at the present time in order to avoid the impression that the Fed has brought about a slowdown, if there is one. He believes it is important to get M1 growth back down into the target range. This step is also all that needs be done for the dollar. Intervention to support the dollar at unrealistic levels is not necessary at present when there are no clear distortions.

Noting a trend among monetarists to place greater weight on M2, Samuelson argued that M2 is a preferable target--M1 should be allowed to rise so long as M2 is not grossly misbehaving. If there is a conflict between interest rates and aggregates, both sides must "compromise on the purity" of their positions. A possible desirable compromise would be a sharp rise in the discount rate, as a signal of the seriousness of our intentions to curb inflation, but a relatively permissive posture on reserves. Admittedly, any compromise will be criticized by those who dwell exclusively on either target.

Tobin takes the sluggishness in labor markets and the weakness in the stock market as indications that the economy is not booming. This suggests that velocity may have begun to slowdown. If the slowdown in velocity does occur, the present monetary growth targets may come into conflict with sustained economic growth. The targets, however, are self-imposed and could successfully be abandoned if accompanied by an eloquent statement by the Chairman on the looseness of the relationship between GNP and money growth. Tobin opposes increases in the federal funds rate or the discount rate.

SECOND DISTRICT-NEW YORK

Recent comments of Directors and other business leaders in the Second District indicate a continuation of moderate expansion of business activity. At the same time, responses reveal anxieties over the outlook for trends in employee compensation and in profitability of business enterprise. Among notable current developments, activity in the real estate sector has quickened considerably, and at least a modest revival of construction activity appears to be under way. Consumer spending has been fairly strong despite a stifling heat wave and the loss of one business day due to a blackout in the New York City area. Nevertheless, mounting inventories have become a problem for some businesses. Several respondents also voiced concern over an apparent stiffening of wage demands and increasing pressures on profit margins. On the financial scene, the continuing lag in business loan demand in New York City has prompted several major banks to consider measures to seek out medium-sized regional customers.

In spite of the forced closing of stores in the New York City area by the loss of electrical service in mid-July, department store sales generally strengthened last month. In the view of the leading retailers contacted, merchants generally recouped lost sales upon reopening. Indeed, one retailer reported the sales at its city branches continued to outperform its national stores. Among product lines, apparel sales were strong. Merchants differed in interpreting this strength, however. Some expected the stepped-up activity to continue while others expected it to wane with the end of summer markdowns and promotions. Sales of other consumer products also rose strongly in July. Pacing the gain in consumer durables were sales of air conditioners and fans, which swelled in the wake of the heat wave that gripped the District.

Respondents generally reported that inventory levels were building up. While some retailers professed little concern over this development in view of the favorable outlook for merchandising, others were less sanguine. One executive of a national retail chain indicated that all divisions had exceeded their budgets, tying up more funds in inventories than was desired. Industrial respondents also reported increases in inventories. For the most part, inventory levels were not felt to be seriously out of line with shipments, although some metal fabricators did regard their stocks of raw materials as excessive. A director noted other scattered instances of unwanted inventory build-up.

Reports on capital spending were mixed. On the one hand, several upstate machine and tool makers found new orders increasing smartly. One firm attributed the upward trend in orders to the strengthening of the automotive sector in western New York State. In response to a pickup in demand, one steel maker recently reactivated a blast furnace that had been closed since late last year. Oil well drilling activity has picked up, and overall capital spending in the petroleum industry was expected to rise by 18 percent this year compared with an earlier planned increase of 12 percent. Notwithstanding these signs of strengthening demand, several respondents cited a general sluggishness in shipments and orders. An agricultural director reported that spending on farm implements and equipment was down due to weak farm prices.

Tentative signs of a recovery in real estate and construction appear to be emerging. Recently, plans were announced to develop a new office building in Manhattan without a specific corporate tenant. This represented the first major speculative project in several years and comes on the heels of recent reports of rising rents and of a scarcity of large blocks of desirable office space. Elsewhere in the District, building activity appeared to be gaining momentum as well. The Buffalo Branch reported that construction contracts in the Niagara Region have strengthened recently. One branch director reported plans for a new shopping center on a plot that had been on the market for a number of years in his rural community.

Respondents displayed varying degrees of pessimism over the outlook for profits. One director noted that recent weeks have seen a softening in sales and prices of aluminum--previously the one bright spot in the otherwise depressed nonferrous metals sector. Another director observed that some steel fabricators and users are likely to encounter trouble passing along recent steel price hikes to their customers. Part of the lackluster outlook for profits, moreover, reflected concern over the growth of labor costs. Several respondents perceived a stiffening in wage demands as well as increased union emphasis on fringe benefits and work rule concessions. A director expected brass processors to take a tough stance in forthcoming labor negotiations because of poor business. The chairman of a major bank foresaw wages at his bank rising by one percentage point faster than prices over the balance of the year. A Buffalo director felt that the increase in unemployment compensation benefits recently approved by the New York State legislature would add to the upward pressure on wage rates. Respondents also cited the high costs of energy and of pollution control as retarding the growth of profit margins.

The continued sluggishness of New York City business loan demand has apparently led several major banks to consider reorienting their marketing strategies toward medium-sized regional customers. A few New York banks already have out-of-state loan production offices and several others are actively contemplating the establishment of such offices. The Chairman of a major bank indicated that his bank had posted a "good" gain in its share of national lending during the seven weeks when its prime rate was one quarter percentage point below the generally prevailing level, despite reports of price cutting below posted rates by some other banks in seeking business loans.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District is expanding at a slightly quicker pace than in July. Department store sales have picked up somewhat, and reports of improvement in the manufacturing sector are more widespread than they were last month. New orders and shipments are up in August, and inventories are stable. Employment and the workweek in the industrial sector are unchanged. For the longer term, however, both retailers and manufacturers are less optimistic. Most retailers anticipate a continuation of their recent trend of sluggish sales growth. In addition, plans for increases in capital spending are reported by a smaller proportion of sampled manufacturers than at any time in the past two years. Bankers indicate that the consumer loan market remains active, but that business loan demand is still weak. Interest rates are holding steady, but a gradual rise is expected.

Directors of this Bank and manufacturing executives in the District had mixed reactions to questions about current business conditions. Manufacturers responding to the latest Business Outlook Survey report that conditions are better than in July. Thirty percent of the executives surveyed say that business has improved this month while 6 percent say it has worsened. This "net improvement" of 24 percentage points is up from last month but still well below levels set during the preceding three months. New orders and shipments, which were both unchanged last month, are higher in August, and manufacturers' inventories are stable for the fourth consecutive month. At the same time, employment and the average workweek in the manufacturing sector are unchanged. Factory employment showed only slight improvement last month. Directors' comments suggest wide variation in economic conditions among industries. One Director, whose company manufactures chemicals, reports that business is slow and is not expected to improve much in coming months. But another, whose firm depends heavily on the auto industry, says business is better than hoped for, and has planned to increase capital spending over the next five months.

For the longer term, manufacturers are less optimistic than they have been in recent months. About half of the survey repondents expect business to improve by February--down from 73 percent indicating such expectations last month, and 67 percent in June. Increases in new orders, shipments and inventories are projected, but at a smaller proportion of the sampled firms than in July. Gains in employment continue to be forecast, but these expectations are also less widespread than in the previous survey. Eighteen percent of those polled anticipated expanding their work forces by February, and 24 percent expect to lengthen working hours. Last month these proportions were 25 and 28 percent respectively. Increases in expenditures on plant and equipment are planned at one quarter of the sampled firms. This is the lowest proportion reporting such plans since September 1975.

Prices in manufacturing continue to increase, climbing at a somewhat faster pace than in July. Over forty percent of those surveyed report paying more for raw materials, while 30 percent say they are receiving higher prices for the products they sell. Almost 9 out of 10 foresee higher prices for inputs by February, and 7 out of 10 anticipate receiving higher prices for their finished products.

The retail sales picture in the area is improving. Department store executives contacted report that current dollar sales range between 6 and 25 percent above August '76 levels. Generally, sales are at or above expected levels. Stores in the downtown Philadelphia area have seen recent improvement in sales, but not of the magnitude experienced by suburban stores. Merchants attribute the pickup in center city business to the recent completion of construction in the central business district, allowing better access to the stores, and to large price reductions by a major competitor trying to reduce stock before moving to a new building. Retailers say that, in general, inventories are slightly higher than year-ago levels, but satisfactory. Most see a mild buildup of inventories over the next six months.

Merchants generally look for only a modest rise in sales during the remainder of the year. While one expects year-end sales to be about 14 percent above December '76 levels, most foresee gains in the 4-8 percent range. The merchants contacted do not appear to be concerned over the current economic slowdown. The general consensus is that it is a pause in the expansion, and does not warrant changes in buying plans over the next six months.

Bankers in the region report that while consumer loan demand remains strong, demand for business loans continues to be weak. Those contacted say that current levels of C&I loans are between 2 percent above and 2 percent below year-ago levels. While local business borrowing is as anticipated or better, the national market continues to lag behind expectations. The prime rate has been held at 6 3/4 percent at all of the banks contacted.

Bankers appear to be mildly concerned about deposit outflows as their "wild cards" mature. Some have recently raised CD rates in an effort to retain their share of "wild card" holders. One banker, whose bank was already paying the legal maximum on CDs, notes that "about one-third of the wild cards have been rolled over into other types of time deposits at this bank. The other two-thirds have been lost."

For the rest of the year, bankers expect little change in business loan demand. Virtually all of those contacted anticipate year-end volume to be no higher than at the end of 1976. Interest rates are expected to move up gradually with a prime by the end of this year in the 7-7 1/4 percent range.

FOURTH DISTRICT - CLEVELAND

Comments from Directors, financial officers, and economists suggest a reduced pace of activity in the Fourth District this half, although it is generally believed that business will be considerably stronger than in the second half of 1976. Retailers remain cautious about sales prospects despite July's surge in sales. Although total inventories are not considered to be excessive, ample stocks of some products probably will dampen inventory growth this quarter. Capital goods producers do not expect acceleration in business for the balance of the year. Several banks experienced little or no growth in total deposits last quarter. Most expect to roll-over maturing 4-year certificates.

Last month's surge in retail sales has not bolstered retailers' expectations for future sales. Retail executives and economists are apprehensive that consumer spending in the second half will not be as strong as in the first half although none expects a sag in sales similar to last year. A chief executive officer with a major department store chain remarked that consumers are cautious and are expected to remain so. An economist with another major chain tended to discount double-digit sales gains in July. He pointed out that sales last year were weak, and that retailers had to resort to larger than usual promotions last month to stimulate sales. He expects year-over-year gains this quarter to be about the same as last quarter. An official with a large discount chain, which did not record double-digit sale increases, was cautious about sales prospects because extensive markdowns failed to spark sales as strongly as expected. A major appliance producer expects second half sales gains will amount to about 14% higher than the second half of 1976. This compares to a 20% gain experienced during the first half of 1977 over the same period in 1976. A lag in housing completions relative to new starts accounts for expected smaller gains.

Economists with two major auto producers expect total new car sales during the second half to range between an 11.0 to 11.4 million annual rate compared to the 11.6 million rate during the first half of 1977. The reduced pace of sales in July probably resulted from heavy sales contests in June, according to one economist. Another did not believe new car sales would be weakened by the rapid growth in consumer debt or by easing in used car prices.

Some executives and economists expressed a view that inventories will not increase as rapidly this quarter as last quarter. Growth in business stocks generally will be dampened by ample inventories of such goods as oil, steel, household, and automotive products. Crude oil and gasoline stocks at midyear, 10 to 12% above a year earlier, were judged to be ample. But, stocks of distillate and residual fuels are less than desired, according to key oil producers in the District. Steel inventories are somewhat larger than necessary and may be run off this quarter although not to the extent of last year's liquidation. Retailers believe stocks are now generally balanced and in much better condition than a year-ago. Still, one large retailer expects there may be some reduction in certain consumer goods during the summer and fall months. One of the largest producers of appliances viewed inventories at both manufacturers' and distributors' levels as a "little heavy," which could result in production slowdowns this fall. Although auto inventories are also larger than a year ago, industry economists expect little difficulty in working off these stocks. The rubber industry has rebuilt tire stocks to normal levels and production schedules will now be aligned to match sales.

Capital spending probably will not accelerate from this year's first half pace. Some capital goods producers report orders continue to improve gradually while others state recovery remains slow. In the foundry industry some producers of large castings are operating near capacity, while steel foundries are at 70% of capacity with little expectation for improvement this year. Machine tool builders report continued strong gains from a year earlier period. For example, both a large and small producer in machine tools reported that orders last quarter rose 40% and 55%, respectively, from the same period in 1976. On the other hand, a major producer of industrial bearings expects decreased gains in orders for the third and fourth quarters because of weak recovery in industrial construction and railroad freight-car building. Continued softness in heavy construction, including sewer, water, and utility projects, is dampening recovery in construction machinery, particularly excavators and cranes. Similarly, a major construction and engineering firm that designs and builds chemical, steel, and power plants expects no surge in heavy industrial construction, at least for the balance of this year. A large producer of steel mill equipment and textile machinery reports that orders remain weak because of poor profit performance for these industries.

Steel economists expect production this quarter will decrease from last quarter despite recent increases in steel prices. Profits are expected to show little improvement over last quarter. Some economists believe that the break-even point in profits is as high as 80% because of steady increases in fixed costs. Steel firms are expected to operate at about 85% capacity next quarter. Major producers do not expect the iron ore strike to interrupt steel operations because mills have as much as a 4-month ore supply in stock.

A survey of 4 large banks with deposits of $1 billion or more and 6 intermediate-size banks with deposits of $300 to $800 million indicates that 7 banks have experienced little or no growth in time and savings deposits during the second quarter, and deposits in 2 of the largest banks declined during July. Both passbook and time deposits failed to grow, primarily because of interest rate differences, especially with savings certificates offered by savings and loan associations that are generally at Regulation Q ceilings. Seven banks also reported that they have been able to roll-over 4-year certificates, although most indicated that the majority of those certificates will mature beginning in August. One bank reported that it has retained about 55% of matured certificates, and that it will make little effort to retain the balance of these funds. Two others indicated they probably will not retain these funds because rates on 4-year and 6-year certificates, which are below Regulation Q ceilings, are not expected to be raised. Other banks, however, have taken such steps to retain funds.

FIFTH DISTRICT - RICHMOND

The pace of business activity in the Fifth District showed little change in July, judging from responses to our latest survey. Levels of manufacturers' shipments, new orders, and backlogs of orders were essentially unchanged from a month earlier. Inventories of materials also showed little change while stocks of finished goods continued to grow. Nonetheless, a majority of the respondents now feel current inventories are in line with desired levels. Price increases were less widespread than in most recent months. The outlook of the manufacturers surveyed, while still less optimistic than that of several months ago, has changed little since May and remains basically positive. Loan activity at District weekly reporting banks has slowed somewhat in recent weeks, but consumer and real estate loan demand remain strong. Directors of the Richmond Fed and its Branches report that retail sales in July were little changed from June except for increases in sales of cooling equipment and sale merchandise.

According to a majority of our manufacturing respondents, shipments were unchanged in July as were backlogs of orders. About one third reported increases in new orders but nearly as many reported declines. The textile industry continued to report a relatively weak orders picture while the electrical equipment group reported some strength. Results from most other industries were mixed. Reports on inventories were also uneven. Stocks of materials apparently rose very little while finished goods stocks expanded across a broad front. While most respondents are satisfied with current inventory levels, there is some disparity among individual industries in this regard. The textile industry appears to be holding larger inventories than desired, but there is some indication that stocks in the paper, chemical, and buildings supplies industries may be below desired levels.

Employment among manufacturers surveyed seems to have risen very little in July and the length of the average work week may have declined slightly. Employee compensation continued to rise across a broad front as did other prices paid and received, although the increases in prices paid by manufacturers were less widespread than in recent months. Current plant and equipment capacity remains basically in line with desired levels as do current expansion plans.

Our Directors report good prospects for a substantial pick up in apartment building during the second half of the year. Several Directors cited evidence that this pick up is already under way in their areas. Concerning the prospects for energy supplies, most of the Directors anticipate at least some shortages over the next year, but there is no indication that any serious problems are expected to arise.

Business loan activity at major banks in the District has been soft recently, due mainly to reduced demand from the manufacturing sector. Larger District banks have also run off holdings of bankers' acceptances, and this has acted to depress the recent loan data. Wholesale, and especially retail businesses have increased their demand for bank loans. Recent data notwithstanding, the general feeling seems to be that business credit demands will strengthen in the months ahead. A large North Carolina bank, for example, expects its textile customers to seek inventory financing. A Maryland bank sees a continuation of strong business loan demand, especially in term lending. One area of concern is the agribusiness sector, especially the tobacco industry. A Virginia bank that normally provides heavy credit support to this sector expects drought conditions to disturb the seasonal lending patterns to the tobacco industry.

District cash farm income for the five months ending in May showed an 8 percent increase over a year ago, compared with about a 2 percent gain nationally, but it seems unlikely that this margin of difference will be maintained as the year progresses. Drought conditions worsened considerably during July and early August, cutting prospective crop yields, reducing quality of the tobacco, and causing a sharp decline in pasture conditions. Beef cattle farmers, especially those in North and South Carolina and Virginia are selling their herds -- reportedly in record numbers in the Carolinas -- in an effort to cope with the lack of forage. Corn has been especially hard hit, and some of the drought-damaged crop is now being harvested for silage and hay. Soybeans have also been hurt seriously. Moreover, flue-cured tobacco prices thus far are averaging significantly below a year ago because of the lower quality of offerings. Although there may be some improvement in average prices as the marketing season moves along, production as of July 1 was expected to be around 13 percent short of the 1976 crop.

SIXTH DISTRICT - ATLANTA

Continuing improvement characterizes the southeastern economy. Agricultural producers have received a drought-breaking rain, but the ill effects of hot weather on corn, cattle, and egg producers persist. The outlook for reliable energy supplies is improving as a result of two projects which provide port facilities and emergency storage for petroleum. A utility company has successfully tested a clean-burning fuel derived from coal. Manufacturers of carpet and industrial gases report continuing gains in their industries. Competition is growing among financial services firms.

The agricultural outlook has brightened in recent days as a result of sustained extensive rainfall. The corn crop appears to be almost entirely lost, but tobacco, peanuts, and soybeans will benefit from badly needed moisture. Some portions of the District report an upturn in retail purchases in response to an improved crop outlook.

Livestock producers remain in a precarious position. The impact of the drought on pasturage, as well as the high cost of feed, is maintaining the pace of herd reduction by cattle producers. It appears likely that producers will enter the winter season with very limited reserves of feed, even if improved moisture conditions are conducive to the growth of forage crops. Thus, limited cattle numbers and high feed costs are likely to result in sharply higher cattle prices early next year.

Southeastern poultry producers state that reports of poultry losses due to excessive heat have been exaggerated. In reality, the percentage loss by broiler producers has been minuscule. Instead, the major effect of the weather has been to retard weight gains. Slow gains in weight usually result in low returns to producers and higher costs per pound to consumers as a result of fixed costs of production and processing. Commercial egg producers are suffering because of drastic declines in egg size, which sharply reduce revenues. A glut of small and medium eggs has resulted in more eggs being sold to processors of liquid egg products; as a result, the price of this important food ingredient has fallen.

Several events have occurred which may enhance the reliability of energy supplies. In southern Louisiana, imported oil is now arriving for storage as part of the nation's emergency energy reserve. The oil is being pumped into subterranean salt dome formations. Another petroleum-related development is the announcement by participants in the Louisiana Offshore Oil Port (LOOP) venture that the deepwater oil port will proceed as planned despite the withdrawal of one company. This announcement follows the cancellation of plans for a similar oil-receiving facility which was to have been constructed off the Texas coast. Construction on the LOOP project is expected to begin in early 1978; operations are scheduled to begin in 1980.

The Southern Company, a major southeastern electric utility holding company, announced the successful test burning of solvent-refined coal. This experimental fuel, consisting of coal which has been chemically processed to remove pollutants, reportedly offers improved reliability in addition to reduced air pollution. Although the fuel is now prohibitively expensive, production in commercial quantities should reduce its cost substantially.

Industry sources cite steady improvement in key sectors. Georgia's carpet industry, which produces nearly 60 percent of national output, reports continuing solid gains in shipments and may equal the previous peak set in 1973. This industry is experiencing no shortages or bottlenecks. Although plants are producing at maximum output, additions to capacity are very limited. Most manufacturers have completed provisions for use of stand-by fuels to avoid a repeat of last winter's debacle. Processes are being developed to use manufacturing waste materials as a fuel source.

A leading producer of industrial gases has experienced improved business in recent months. Its sales of gases and materials, closely linked to activity in a variety of metal fabricating industries, including construction and transportation equipment, are well above last year's levels. Its equipment sales, consisting of capital investment items, have also participated in this advance.

In the financial sector, several significant developments are resulting in increasing competition. First, Atlanta has been selected as one of three locations for tests of Merrill Lynch and Company's new package of consumer financial services. Their "cash management account," to be inaugurated in September, will permit customers to use balances held in margin accounts by means of drafts and credit cards and will provide the ability to borrow up to 50 percent of the value of securities on deposit with the firm.

Also, a large Mississippi savings and loan association, whose difficulties precipitated last year's closure of the state's privately insured savings and loan associations, reopened in mid-July. The remaining associations have either obtained Federal insurance, have merged with federally insured institutions, or have liquidated without losses to depositors.

International banking activity continues to grow in the Southeast. A leading Swiss bank has recently received approval to open an agency in Atlanta. Two foreign banks have opened Atlanta facilities within the past year, while three other institutions have been granted approval to open facilities. The State of Florida's banking regulations were changed in late May to allow foreign banks to locate facilities there.

SEVENTH DISTRICT - CHICAGO

Although clouded by plant-wide vacation shutdowns and other seasonal developments, Seventh District business activity appears to be trending upward, but probably at a slower pace than in the second quarter. Retail sales of consumer hard goods have been excellent, while apparel sales have lagged expectations. Order lead times have lengthened moderately on average. However, except for residential building materials, shortages are not hampering output. Strikes in the steel, coal, and iron ore industries pose a serious threat. Upward price pressures remain strong. With some notable exceptions such as heavy trucks, the improvement in demand for capital goods has not matched forecasts. Crop prospects deteriorated in some parts of Iowa in the past month. The surge in farmland prices slowed in the second quarter. Lower crop prices have disturbed some rural bankers.

Retail sales of cars, light trucks, appliances (especially refrigerators and air conditioners), sewing machines, auto parts, and various hot weather merchandise have been excellent. However, sales of apparel, especially "fashion goods," have been "below budget." Two very large general merchandise firms reported July sales to be about 20 percent above year ago. This large gain partly reflects more aggressive merchandising. Sales of these chains were relatively poor in July 1976.

Chicago purchasing managers reported further gains in output, new orders, inventories, and employment in July, but with somewhat smaller margins than in May and June. Delivery lead times slowed somewhat further. Two-thirds of the companies reported paying higher prices, compared to three-fourths in earlier months.

Few companies are currently concerned about shortages of purchased materials. In home building, however, construction delays are reported because of slow deliveries of insulation, bricks, dry wall, and plumbing fixtures. Shortages of skilled workers--especially carpenters, but also bricklayers, plumbers, and operating engineers--are impeding some jobs. Homebuilding activity, therefore, is at virtual capacity. In part, this reflects the late start caused by the severe winter, but also the fact that some suppliers and tradesmen left the industry during recent years of reduced demand. Mortgage credit availability appears to be ample.

A local steel company lost orders for sheet from auto producers because of a recent strike threat, now resolved. This episode reveals the pressure placed on suppliers to meet demands in labor disputes. Although steel producers have a three-to-four month supply of iron ore pellets, continuation of the recent strike at the Minnesota iron mines could have a serious effect on steel output if stocks are not rebuilt before ice halts Lake Superior traffic.

During the July heat wave the electric send-out of the utility serving the Chicago area topped the 1976 peak on seven occasions. The new peak was up 8 percent. Maintenance was a problem as generating units "tripped out" temporarily. A New York-style blackout is believed to be remote in Chicago or other district areas because of lesser dependence on purchased power and many more interconnections with neighboring systems.

The recent depreciation of the dollar relative to foreign currencies is helping U.S. steel and equipment producers who must meet competition from Germany and Japan. The effect appears to be more through holding down imports, rather than through increasing exports.

Business managers are displeased with the energy program that appears to be shaping up in legislation now under consideration. They insist that incentives to develop new supplies are inadequate and that proposed measures to reduce consumption would be inefficient and vary costly to implement.

While capital equipment output appears to be rising overall, demand for heavy capital goods related to capacity expansion remains sluggish. Sales of most types of farm equipment are running below last year. Heavy trucks, trailers, light construction equipment, and various components are relatively strong. Sales of energy-related equipment are good, but not up to expectations. Orders for machine tools, especially those for auto companies, are well above last year and further gains are expected in 1978.

Recent declines in crop prices have caused concern at district agricultural banks. While deposit growth has slowed, loan demand (primarily for operating and crop storage loans) remains exceptionally strong. Nearly 40 percent of banks surveyed consider their current loan to deposit ratios to be above the desired level, the highest proportion in five years. Evidence on loan repayments and loan renewals suggests further deterioration.

Although a large corn crop is anticipated, growing conditions vary greatly from area to area. While conditions in Illinois are generally excellent, crops in some portions of Iowa are in very poor condition.

Our survey of 600 agricultural banks shows a marked slowing in the surge in farmland values in the second quarter. Prices averaged 4 percent higher, compared to an 8 percent gain in the first quarter. Illinois, which had placed the uptrend for the past two years, showed approximate stability in the second quarter. Nevertheless, farmland prices at midyear averaged 30 percent above last year.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth Federal Reserve District continues to increase, but at a reduced rate from that in the first half of the year. Consumer spending continues to increase, but at a somewhat slower rate recently. Inventories of most goods are reported to be lower than desired; however, some planned reduction is occurring in software in a number of retail establishments. Manufacturing activity, with the exception of automobile output, continues to increase. Construction continues strongly upward, particularly for single-family homes. In the agricultural sector crops are generally good, but average prices for most crops are well below those of a year ago. Loan demand has increased somewhat in recent months, but remains relatively weak at the large District banks.

Consumer spending at major stores leveled off in July from the growth rate in the first half of the year. Sales of software, such as clothing, leveled off in the early summer. Sales of automobiles also have leveled off in recent weeks. Part of the slowing in automobile sales was seasonal since model change time is near. Demand for hard goods, other than automobiles, remains strong. Also, purchases of new homes have increased from the June and early July levels but have not regained their February-April level.

Inventories are relatively low with the exception of soft goods at the retail level where inventories were built up unintentionally in the early summer. Reductions of soft goods inventories are now being made through price cutting at a number of major retail stores. Automobile production was reduced as orders declined in July, and there was little buildup of inventories. A machine tool manufacturing firm reported that inventories are well below the desired level. A major home builder in the St. Louis area reported a time lag of a month to six weeks in obtaining some types of lumber, millwork, and insulation materials. Shortages of a number of building materials were reported in Arkansas.

With the exception of the seasonal slowdown in automobile output, manufacturing activity continues to expand. A number of manufacturers of building materials reported very large orders in June and July. A major manufacturer of electric equipment reported a record volume of orders and shipments of both consumer and capital goods. A welding and cutting equipment manufacturer reported rising orders through June and July, and that June sales were 22 percent above a year ago.

Construction continues to expand throughout the District. Home building has risen sharply for more than a year and is reported to be "booming" by most reporters. Commercial and industrial building was in a trough from early 1975 until the second quarter of this year. Now, however, construction representatives report that commercial and industrial construction is beginning to pick up. As a consequence, a number of construction materials are becoming increasingly scarce. Prices of such materials are rising sharply and deliveries are slow -- often a month to six weeks is required for delivery. Most builders report that they are hiring everybody who can work.

The prospects are for a relatively large production of farm products. Crops are generally good. Somewhat less beef is expected to be slaughtered in the second half of this year than a year ago, but this will be more than offset by rising production of pork and broilers. Rising production, however, does not portend any rise in farm incomes, since farm prices have declined in response to the rising output and the slower than expected increase in demand. Average prices received for all farm products were about 2 percent lower in July than in June of this year and about 7 percent below the average of a year ago.

Representatives of the financial sector report a moderate increase in loan demand. Banks outside the major cities have experienced a relatively high loan demand for several months, but demand has been relatively weak at the larger banks in the major cities. Loans, however, have slowly increased at these banks. Mortgage companies report that there is plenty of mortgage money and they would like to make more good loans at the current interest rate, but that high quality mortgages are difficult to obtain at the going rate of 8-3/4 percent with a 20 percent downpayment. A major savings and loan company reported that savings inflows have slowed somewhat in the past month but that no further increase in mortgage rates is expected. Financial representatives in the area do not expect a major rise in most nonmortgage rates despite the recent boost in Treasury bill rates.

NINTH DISTRICT - MINNEAPOLIS

Nonagricultural developments in the Ninth District are still favorable. Concerns remain about the farm sector, however. Consumer spending is quite good in urban areas but off in farming communities. Businesses, except farm implement dealers, are satisfied with current inventories. They are taking care to avoid unwanted accumulation. Homebuilding is strong. Although many district farmers are looking for a good harvest, they expect low prices to depress farm income. Finally, farm income declines have slowed both deposit inflows and loan repayments at rural banks. But most rural bankers are still able to meet customers' credit demands.

Consumer spending continues to be quite good in the district's urban areas. But weak farm income has caused it to drop off in rural areas. Around 45 percent of the bankers' respondents to our July Agricultural Credit Conditions Survey report farm spending down from a year ago. They look for lower farm spending over the coming months too. Respondents say that most farmers are still spending only the bare minimum. In many cases, they are purchasing used equipment where replacement is necessary. Also, the current strike by iron ore workers could lower consumer spending in northeastern Minnesota and the Upper Peninsula of Michigan if it's prolonged.

District businesses appear to be pretty well satisfied with their inventories, while cautiously avoiding unwanted accumulations. Retailers expect sales to remain quite good in the Minneapolis-St. Paul area. But they are looking for some slowing in sales growth and are keeping a close eye on inventories. Outside of the Twin Cities area, retail sales have not been as strong. But inventory buildup is not a problem. One exception: several of this Bank's directors report a buildup in farm implement inventories.

Homebuilding remains strong throughout the district. One director, whose firm sells temperature controls for residential housing, illustrates this strength by stating that new single-family home costs in the district are rising very fast. New home price increases have been much more rapid in this region than in the southeast and eastern parts of the United States. But new home prices here have risen only about half as fast as on the West Coast. Home prices are not expected to increase as rapidly in the coming year, as the above mentioned firm's outlook is for some slowing in housing demand for the balance of 1977 and for a further easing in 1978. Shortages of labor and materials are not expected to be a factor in any slowing. Further, mortgage funds are thought to be ample to support a high level of residential building.

Even though district crop prospects are quite good, concern over low prices continues to dampen the agricultural situation. Sixty-seven percent of recent ag credit survey respondents report farm earning in their areas to be lower than last year. Fifty-four percent look for farm income to remain below last year's level during the next three months. The situation is particularly acute in North Dakota with its relatively greater dependence on wheat. Ninty-six percent of that state's respondents report lower earnings in July than last year.

Poor farm income has slowed deposit inflows and has adversely affected farmers' ability to repay debt. Fifty-five percent of the bankers responding to the July survey observe unusually high demand for refinancing. Sixty-two percent of them characterize the current rate of farm debt repayment as "slow." And 60 percent expect an adverse change in area farmers' ability to repay debt. Finally, 55 percent of the bankers report a greater than usual number of farmers at their debt limits.

These developments are reducing liquidity at agricultural banks. Loan to deposit ratios have been rising more than the seasonal amount. And 29 percent of our ag credit survey respondents feel their bank's ratio is too high. Further, 12 percent of respondents report reducing or refusing ag loans because of fund shortages. The situation is more severe in North Dakota, where twenty-three percent of the responding bankers report reducing or refusing ag loans. To help ease the situation, rural banks are taking the following steps. Some are encouraging farmers holding two or three years of inventories to sell crops. Others are either increasing the amount of loan participations with large correspondent banks or selling Small Business Administration guaranteed loans to other financial institutions. Finally, some banks are urging farmers to refinance their real estate to pay for operating expenses.

Despite these problems, most ag bankers appear to be able to meet agricultural credit demands. Fifty-eight percent of the respondents are still actively seeking new farm loan accounts and only 7 percent expect problems in meeting loan demand in the coming months. This Bank's directors feel the situation is serious, but manageable. The important question at this point is whether fall farm receipts will be substantial enough to reverse the order of growth between loans and deposits at ag banks, thus improving bank liquidity.

TENTH DISTRICT--KANSAS CITY

Purchasing managers at Tenth District manufacturing firms generally expect continuing strong sales to yearend. Nearly all respondents report satisfactory inventory levels, with no drastic adjustments planned. No problems of unavailability of inputs or lengthening of lead times are evident. Prices of materials and other inputs are generally reported to be rising in the 5 per cent to 8 per cent per year range. Farm prices, however, declined for the second consecutive month, with declines for grains more than offsetting increases for livestock. Both loan demand and deposit growth are reported to be strong at Tenth District commercial banks.

Officers and purchasing managers of Tenth District manufacturing firms all report no problems with the availability of any items that they purchase. With very few exceptions, they also report no lengthening of lead times for purchased inputs. Exceptions identified are for certain chemicals--caustic soda, chlorine, and hydrochloric acid--and for some metal castings.

Prices of materials and other inputs are reported by most respondents to be rising within a range of 5 per cent to 8 per cent per year, with users of steel and of petrochemicals reporting higher percentage increases. A producer of grain bins and metal buildings estimates that prices for their inputs have risen about 10 or 11 per cent in the last year, and indicates that they intend to pass most of the increase on to their customers. A major agricultural chemicals producer reports, however, that they are finding it difficult to pass on their higher cost increases because the cash flow problems of farmers are leading them to restrict purchases of pesticides. A large producer of fabricated rubber products notes very large recent increases in prices of petrochemicals occurring in spite of what he perceives as excess capacity among petrochemical suppliers. A major manufacturer of luggage tells of price increases for polystyrene, magnesium, and rayon, which he attributes partly to monopoly power in those industries. He also warns of the possibility of unavailability of aluminum becoming a significant bottleneck in the economy.

About two-thirds of the purchasing managers surveyed report that their inventories are "about right," "normal," or "on target," and thus no adjustments in inventories are planned. The remaining respondents are divided among those reporting inventories "too high" and those reporting "too low." In no instance does it appear that drastic adjustments in inventories are planned. For example, a gradual working down of stocks, or an expected increase in sales, is expected to reduce any excess in inventories.

Continuing strong sales to yearend are expected by nearly all of the firms surveyed, the major exception being those firms that supply the heavy construction industry. Considerable variation exists among those firms expecting further sales gains. Manufacturers of private aircraft expect their sales to continue to grow especially rapidly, as do producers of metal grain bins. A luggage producer expects sales to be "good but not sensational," and a national supplier of rubber hoses and belting sees some easing of sales in the second half after a "super" first half.

Prices received by farmers decreased 2 per cent in the month ended July 15, marking the second consecutive monthly decline. Although partially offset by higher prices for cattle and hogs, depressed grain prices, due to large carryovers and good-to-excellent crops and crop prospects, are impeding the growth of farmers' incomes throughout the District. In addition, credit conditions remain tight as cash flow problems continue for many farmers. Although farm loan demand is strong in the Tenth District, many rural banks are reporting fewer loanable funds available than a year ago.

With the abundance of grains resulting in lower feed prices, farrowing intentions of hog producers show a marked increase. In the major hog-producing states of the District, farrowing intentions for the last half of 1977 are 1 to 14 per cent above last year. This suggests the possibility of some reduction in pork prices in early 1978. However, the calf crop--down nationally 3 per cent from last year--also appears to be an average of 1 to 2 per cent below last year's levels for the District states. Thus, even though placements of cattle on feedlots are expected to increase, a decline in nonfed cattle is likely to restrict total production. As a result, beef prices are likely to remain near their present levels (or perhaps to rise moderately) for the coming year.

Most Tenth District bankers surveyed report that loan demand remains quite brisk. In response to the strong loan demand and the recent increases in market interest rates, a number of banks have increased lending rates in the past few weeks. A few bankers anticipate further increases in lending rates to some of their loan customers, especially if other interest rates continue to climb.

With few exceptions, survey respondents indicate that overall deposit growth remains strong. Few bankers believe that inflows into time and savings accounts have been significantly affected by recent increases in interest rates. Several say, however, that they anticipate a future slowdown in time and savings deposit growth if money market rates continue to increase. Some bankers report that they will compete more aggressively for CD's if the expected slowdown in the growth of time and savings deposits results in a shortage of funds.

ELEVENTH DISTRICT--DALLAS

The economy of the Eleventh District continues to grow with little evidence that the expansion will slow significantly in the next six months. Industrial production is gaining steadily in Texas, and despite the fact that total employment in the four District states has failed to grow as fast as expected, the unemployment rate has dropped to 5.4 percent. Department store managers report summer clearance sales have reduced retail inventories to seasonal levels, and most continue to be conservative in estimating sales volumes for the remainder of the year. New car sales remain strong. Residential construction activity continues to boom as mortgage funds remain plentiful, but builders indicate some markets could be overbuilt by next summer. Contracts for new chemical plants represent the biggest share of construction of industrial plants. Declining feed grain prices and drouth conditions are contributing to an increase in placements of cattle on feed in West Texas. Summer tourist traffic is reported to be stronger than average.

Summer clearance sales have ended at most District department stores, and retailers term the sales "very successful" since inventories have been trimmed to normal levels for this time of the year. Because inventory levels this summer were lower than a year earlier, price markdowns on sale merchandise were also less than last year. Retailers remain cautious with respect to the strength of sales for the remainder of the year and are keeping close control on inventories of fall and winter merchandise.

Although new cars continue to sell well, some dealers report that the recent hot weather slowed sales somewhat. A small number of sales in the Dallas-Fort Worth area are being financed with 60-month loans, but a survey of dealers and banks suggests that such loans account for well under 1 percent of all new cars sold. Most new car sales in Texas are financed on terms of 36 to 42 months. However, the proportion of new cars being financed for 48 months is increasing, as these loans are more profitable than shorter-termed loans according to some respondents. Most auto dealers do not favor 60-month loans because they think buyers would be taken out of the auto market for such a long period of time.

The boom in residential construction in the District shows few signs of cooling. Demand for new homes remains strong, while high occupancy rates are stimulating construction of new apartments. Spot shortages of materials, labor, and developable land persist and are causing delays in completing some projects. To hold down construction costs--especially for apartments--living space is being reduced, but more amenities, such as bookcases and appliances, are being added to attract buyers and renters. With the continued increase in construction activity, a growing number of builders are predicting that some markets will be overbuilt in 12 months.

The rise in prices of new homes also continues to spur mobile home sales. Financing--largely by FHA and VA loans--is becoming more readily available in many market areas. In El Paso, for example, one lender plans to introduce 15-year, no down payment loans by yearend.

A survey of savings and loan associations in Texas suggests there are, on balance, ample mortgage funds to finance commercial and residential loan demand. S&L's in the Dallas-Fort Worth area report a number of S&L's outside the state are eager to participate in mortgage loans in Texas. The only area that reports a weak inflow of savings is El Paso, where S&L's have been forced to borrow from the Federal Home Loan Bank to meet continuing strong mortgage demands. Almost all S&L's note the cost of funds is increasing as maturing lower-priced CD's are being rolled over at higher rates. Despite the rise in costs, no large increases in mortgage rates from current levels are anticipated for the remainder of the year.

Plans have been announced for the construction of two more large industrial plants on the Gulf Coast. Construction of a $240 million pilot plant to test a coal liquification process and a $100 million low-density polyethylene plant is to begin next year near Houston. The chemical industry continues to lead in the dollar volume of construction of new industrial plants. One major company, for example, is currently budgeting $600 million annually for expansion.

Placements of cattle on feed in West Texas have increased, reflecting declining costs per pound of weight gain from low feed grain prices. In fact, placements have outpaced marketings since May, but feed lots are only at about 70 percent of capacity. Because costs of gain have fallen to as low as 34 cents per pound and because feeder cattle prices and fat cattle prices are about $40 per hundredweight, a small profit per head can be made. A further increase in placements is anticipated this fall because drouth conditions have reduced forage conditions and hay supplies.

Tourism in Texas is better than average this summer according to reports received from around the state. Resort areas on the Gulf note a significant increase in visitors from the Midwest and Canada. Attendance at amusement parks in the state are also doing well, and two had record crowds on the Fourth of July weekend. Motel operators along the interstate highways report that "walk-in" traffic, families arriving without reservations, is up substantially.

TWELFTH DISTRICT - SAN FRANCISCO

In the opinion of our directors, the District economy is expanding at a satisfactory pace in spite of the presence of trouble spots. After a second quarter lull, reports are widespread of a strong resumption of consumer spending in July. Automobile dealers are having trouble stocking everything "from Honda Civics to Cadillac Sevilles," and appliances are selling well, although not to match the strength in housing. There are indications that the upward spiral of housing prices, especially in California, has levelled off as higher tax assessments have swelled the supply of large houses up for sale. On another front, there are early indications of a pick-up in nonresidential construction, mostly commercial buildings and power plants. Agricultural prices have plummeted on a broad front as harvests are abundant in spite of reduced acreage this year. The drought is having uneven repercussions throughout the District.

Although a trend towards slower retail sales growth in the second quarter was noted across District states, many areas now report renewed strength in July sales, up about 9 percent over last year. In Southern California, sales of hard goods, primarily automobiles, continue brisk and soft goods too have been picking up. In Orange County, retail sales are running 22 percent over last year. Heavy appliance sales have not kept pace with the rate of new housing starts since most buyers owned houses previously, but sales have been satisfactory nonetheless. In agricultural areas of the District such as Eastern Oregon and Washington, the drought has cut into income and the farmers are making their current stock of durables last longer. A California survey of sales projections for the third and fourth quarters by product line show high expectations for portable color televisions, and sporting equipment and some expected weakness in sales of microwave ovens, small cars and bicycles.

Boeing's backlog of orders is $1 billion higher than last year and earnings have doubled. Boeing's prosperity is generating employment and income throughout the Seattle area, but its capital investment is being directed solely toward productivity improvements. In California, the B-1 decision did not cause "that much of a problem" since the 8,000 workers laid off amounted to only ".2 of one percent of total nonfarm employment in southern California". The forest products industry has reported good profits for the first half of 1977 and the future appears good for the lumber and plywood industry. On the soft side, order backlogs for paper and pulp are beginning to shrink slowly. International pulp demand has dropped and so have prices. High labor costs at mills are squeezing profits and some Oregon lumber mills are closing.

In southern California there is some feeling that the rapid price spiral for housing has wound down and that "real estate inflation has levelled off for at least the next year". More people are now inquiring about home improvement loans. The inflated price situation has caused the placement of many large houses on the block, especially since tax assessments are now being made that reflect the higher sales prices. Unable to afford to live in Orange County where the basic price of a new home is now $100,000, workers have moved to nearby Riverside County.

Although not bouyant, an increase in demand for nonresidential construction is becoming evident throughout the District. Held up largely by difficulties in plant site location, business is running about six months behind in making capital expenditures after appropriations have been approved. Office space is said to be getting tight in Los Angeles and in Beverly Hills as well, the chosen focal location site for the area's international firms. In mid-July a building permit was filed in Kern County, California, for a nuclear power plant west of Wasco; in July, a $2 billion power plant contract was awarded in Arizona. One Director states that building large power projects was the only way to avoid New York's power problems. The short-term gas supply, however, is in good shape with storage at high levels and he believes the situation is good in the East as well.

Across District states, the drought is having uneven effects that change in severity from month to month. The news from the San Joaquin and the Coachella Valleys in California is mostly bad; over the past month the price of cotton declined and the price of alfalfa plummeted. This has been beneficial for the dairies where costs have dropped and profits have risen. Crop production in the Central Valley is 5 to 7 percent higher than last year yet a lot of acreage is out of cultivation. One young farmer has aroused interest by planting peach, plum and nectarine trees 389 to the acre compared with the usual 108 to the acre and using drip irrigation methods which save water and reduce power bills.

Some concern is being voiced by District bankers that the high volume of consumer loans might be a source of trouble in the event of a 1978 economic slowdown.