

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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by the Staff

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SUMMARY*

Reports from the twelve District Banks this month unanimously indicate an expanding economy. The effects of a severe winter appear to have been largely overcome, and economic activity in the regions affected by the now-settled coal strike has returned to normal levels. Retail sales are generally strong, as is the manufacturing sector. Crop prospects for this year are good, but spring planting is reported to be behind schedule, a result of the harsh winter weather. Construction activity is strong overall. Mortgage demand is maintaining its strength, but business loan demand is mixed. The fear of accelerating inflation is pervasive, and is seen as a major stumbling block to continued real growth.

Retail sales are a major source of strength in the renewed expansion, according to this month's reports. Boston and Cleveland observe some softness in this sector, but virtually all of the other Districts indicate a strong uptick this month. Chicago notes that big-ticket items are the best sellers. In addition to gains in department store sales, automobile purchases are also reported to be up substantially. This, however, stems partly from suppressed demand in the first quarter.

Expansion in the goods-producing industries is evident in all Districts with a sizable manufacturing sector. Durable goods industries are particularly strong. Capital goods production is said to be on the upswing in Boston, New York, and Chicago, while Richmond indicates consumer goods output to be strong also. Improvement in the steel industry is cited across the board, a result of both the surprisingly effective trigger-price system, instituted by the

*Prepared by the Federal Reserve Bank of Philadelphia.

Administration earlier this year, and a generally rising demand for steel in recent months.

Construction activity is generally strong in April. Atlanta and Cleveland report optimism among builders that 1978 will be a good year for housing. Nonresidential construction is expected to fill any gap that may occur in the housing market later this year. Chicago, on the other hand, expects commercial and industrial construction to lead the way, and housing starts to decline.

Economic conditions in the agricultural sector are favorable. Kansas City, Atlanta, and Richmond all report stronger farm prices, and farm income is projected to increase in 1978. Adverse weather conditions have delayed spring planting to some degree, but this is not thought to be a serious setback.

In the banking sector, District reports show business borrowing to be mixed this month. Minneapolis, Richmond, and Boston say demand for C&I loans is strong, while New York and Philadelphia banks show softness. Future loan demand projections are no less varied. At the same time, deposit growth in most Districts is slack. Although cash flows are said to be tightening in some areas, disintermediation doesn't appear to be a major cause for concern at this time. The mortgage market is reported to be generally tight. San Francisco and Cleveland say some S&Ls are now refusing mortgages on certain types of dwellings. Mortgage rates have risen recently and now stand in the 9 1/4 - 9 3/4 percent range.

Several Districts commented on the widespread fear of accelerating inflation in the near future. Boston, Cleveland, Minneapolis, and Atlanta all indicate concern among businessmen about a higher rate of price inflation later this year. Higher price increases are deemed a deterrent to both consumer and business confidence, and therefore to continued economic expansion. Moreover,

half of the District reports indicate that inflation is, in fact, expected to heat up as we move into the second half of 1978. One reason for the upward revision of price forecasts is the coal settlement. As Chicago points out, many consider the pact to be inflationary in itself, and expect it to set the tone for labor negotiations in the future. Other factors feeding the fires of inflation are recent steel price hikes and utility rate increases.

FIRST DISTRICT - BOSTON

Directors and other Redbook respondents of the Federal Reserve Bank of Boston report continued healthy economic growth but expressed much concern about inflation. Several respondents are of the opinion that the economy is growing significantly faster than the published data indicate. Production in the District's factories is expanding and there has been a healthy increase in commercial loan demand. Retail sales may be beginning to soften.

The chief economist of a large electrical machinery manufacturer reports that sales of all lines are very strong with back orders growing. Orders for major appliances are up about 20 percent over last year although some slowdown is anticipated if the demand for housing declines. Orders and sales of producers durables are also increasing strongly except for electrical power systems. Despite this strong performance, this manufacturer is still operating at less than 80 percent of capacity and has no major capital outlays of its own scheduled. The chief executive officer of a diversified chemical company reports that all industries he is associated with had a vigorous March.

The chairman of a large money center bank reports strong increases in commercial loan demand both in New England and nationally. This trend is expected to continue throughout the year. This banker anticipates some upward pressure on interest rates but feels that continued strong competition for loan business will have a moderating effect. Deposit inflows remain healthy although there has been some indication of a move out of savings by sophisticated depositors. Northern New England bankers also report strong commercial loan growth as well as significant increases in consumer borrowing and in construction lending activity.

Retail sales present a somewhat mixed picture, remaining fairly strong in some areas but beginning to slow in others. The Chairman of the Board of a large department store chain expects the real rate of increase in retail sales to fall by about one-half this year. He expects auto sales to be affected most, with significantly smaller drops in soft goods. According to this source, retailers expect a decline in consumer confidence later this year caused by worsening inflation, and as a result are becoming increasingly pessimistic themselves.

All Redbook respondents expressed growing concern over inflation and several reported that most businessmen they talk to are becoming increasingly worried. Inflationary expectations are increasing and some industries are said to be considering defensive price increases because of a fear of controls. None of those contacted reported any difficulties with bottlenecks or shortages, although there is some concern about aluminum and paper next year.

Professors Eckstein, Houthakker and Samuelson were available for comment this month. None saw a contradiction in striving for both further gains in employment and lower inflation. Samuelson and Eckstein noted the relatively low capacity utilization rate, the lack of shortages of materials or skilled labor, and the ready availability of intermediate inputs as evidence against the view that the economy is near full employment. Samuelson especially deplored the practice of redefining the natural rate of unemployment to always equal the current rate in the absence of confirming indicators of labor market tightness. None of the three was particularly concerned about the recent runup in the inflation rate, noting that most of the increase is due to pressure from the highly volatile food price sector and to adjustments emanating from acts of Congress. They felt that the monetary authority should be careful not to overreact

to the inflation uptick, since neither of its proximate causes are amenable to correction through aggregate demand management policy.

Houthakker cautioned against intervention on the foreign exchange market to support the value of the dollar, although he preferred massive gold sales if a support operation were to be attempted. In his view, monthly offerings of a few hundred thousand ounces of gold would be useless, nor did he favor the sale of European currency denominated Treasury bills as a support device. Houthakker is not convinced that more inflation will result from the devaluation, as evidenced by the stability of dollar prices of those raw materials traded in international markets.

Rebounding from a slow first quarter, the economy should grow at a 7.5 percent rate this quarter, according to Eckstein, although a mild slowdown during the rest of this year and into 1979 is likely. Eckstein sees a decline in housing as a virtual certainty at current interest rates and, noting that there is no example of successful gradualism, cautions that using monetary policy to produce a decline in inflation would probably lead to a credit crunch and an even more severe housing cycle. It is very dangerous for the Government to pursue a one-objective policy, therefore Eckstein advocates top-of-the-range money growth as a balanced, cautious approach.

Samuelson also fears that the next recession will be caused by a pre-occupation with inflation. He argues that the recent slow growth in the monetary aggregates brought about by slow real GNP growth allows the Fed some leeway to pursue a near term monetary policy a little less tight than might otherwise have been appropriate. On the other hand, Houthakker feels that further progress on both the inflation and the unemployment front can be achieved with money growth averaging near the midpoints of the current rangers.

SECOND DISTRICT - NEW YORK

Business activity in the Second District has largely recovered from the winter doldrums and is expected to grow at a modest pace in coming months, according to recent accounts of Directors and other business leaders. Retailers reported their sales had risen sharply in recent weeks, rebounding from the lackluster performance of the first two months of the year. While most merchants are looking forward to gains in the months ahead, they generally expect these increases will be of moderate proportions. Auto dealers, too, have lately experienced an upsurge in new car sales, but much of the rise is believed to be a bulge due to deferred purchases. While retail inventory stocks still seem to be on the high side, merchants do seem to have managed to whittle down these excesses, more or less according to plan. Outside of retailing, the other sectors of the regional economy seem to be improving. Inventory stocks are lean; inventory spending remains cautious; and new orders for durable manufactured goods are expanding at a fairly brisk pace. On the financial scene, business loans at large New York City banks continue to be sluggish.

Consumer spending in the District strengthened appreciably in March and early April. In New York City, department store executives reported substantial gains in sales as compared with the depressed levels of January and February. The improvement in retail activity was aided by the earlier-than-usual Easter holiday. Auto dealers also reported a substantial pickup in new car sales in recent weeks. Nevertheless, none of the dealers sounded exuberant about the outlook for the rest of this model-year. Apparently, they would be satisfied if their car sales for 1978 were just to match those for last year.

In contrast, the other retail merchants are more upbeat in their forecasts. This will be, as one retailer put it, a "good solid year," but nothing "dazzling."

The pickup in retail sales helped to trim inventory stocks at retail establishments. Earlier in the year, merchants had said that they were counting on strong spring sales to enable them to pare their excess inventories. To a large extent this has occurred, although a few retailers are still saying their stocks are higher than they would like. Elsewhere in the regional economy, inventory stocks appear to be lean in relation to sales. The general feeling seems to be that inventories are either "adequate" or running a bit on the low side. While there may be some rebuilding of inventories in coming months, businesses do seem to be in a fairly cautious mood and are keeping a tight rein on their stocks.

In other sectors of the District economy, the pace of business activity seems to have picked up in recent weeks. Indeed, there are widespread reports of sizable gains in new orders for manufactured intermediate goods--ranging from paper to forged iron and steel to machine tools. This could be an advance indicator of a speedup in the recovery of the District economy. It seems likely, however, that some part of these recent gains in orders is simply the result of the resumption of normal business patterns following the end of the prolonged coal strike and the unusually severe winter weather. In any event, the overall tenor of the responses suggests that the outlook for capital spending remains cautious.

Business loan demand at large New York City banks has yet to show any sustained strength. Senior lending personnel at five large New York City banks were queried concerning the reasons for this phenomenon. All five

respondents emphasized the importance of corporate liquidity of large firms that have experienced strong cash flow and, with fresh memories of credit stringency in 1973-74, have secured long-term financing unusually far ahead of anticipated needs. Looking at various competitive sources of funds, there were mixed opinions as to the quantitative importance of Eurodollar borrowing by large multinational customers. One respondent cited heightened competition from the commercial paper market, while two stated that they had not seen increased competition from that source lately. There were also mixed perceptions of the importance of competition for large customers from regional banks, with three respondents claiming more aggressive regional competition while two others did not rate it a very important factor. Among less publicized factors, two respondents cited competition for term loans from insurance companies, while another reported stiffer competition from finance companies. All respondents indicated that an acceleration in capital spending would certainly help loan demand, although they differed concerning the relative significance of this versus competitive and liquidity factors. Personnel at the two banks doing an appreciable amount of local business lending observed that loan demand by smaller Second District customers was stronger than that of the large national firms.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that economic activity is generally expanding. Retail sales are up substantially over year-ago levels according to area merchants, and local manufacturers say business is on the up-swing. Although retailers expect the pace to slow somewhat, both groups look for expansion to continue over the next six months. The now-settled bituminous coal strike had little effect on the Third District economy. Less than one-quarter of the firms responding to a special survey reported power cutbacks which forced them to reduce output. Despite these optimistic reports, commercial bankers say business loan demand is soft. Although loan volume is above April 1977 levels, it is lower than anticipated for this period. For the longer term, bankers are generally bearish.

District industrial activity is on the rebound according to the April Business Outlook Survey. Thirty-eight percent of this month's respondents note an improvement in general business conditions, while only 6 percent say the pace of business has slowed. This "margin of improvement" of 32 percentage points is the highest in almost a year. Looking to their own firms, responding manufacturers indicate upticks in new orders and shipments, while inventories remain stable. At the same time, the employment picture is reported to be a little brighter in April, with both a small increase in the size of factory payrolls and a slight lengthening of the average workweek reported.

Looking ahead six months, about half of the responding manufacturers anticipate continued expansion, along with higher levels of new orders and shipments. Inventories are expected to increase somewhat between now and October. Despite this relatively optimistic outlook though, executives polled

have reservations about employment and capital spending over the next six months. Only a slight increase in the number of factory employees is forecast, and the length of the average workweek is expected to remain unchanged. Concurrently, less than one-third of those polled report plans to hike plant and equipment expenditures over the next two quarters--down from the levels of the last few months.

Price increases in the industrial sector are no more widespread than they were last month. Half of the respondents to the April survey say they are paying higher prices for inputs, while slightly less than one-third report increases in the price of their finished products. A Director of this Bank in the manufacturing sector says his firm is feeling cost pressures primarily from the energy industry and labor, and that such rising production costs are starting to put a pinch on profits.

The coal strike had little effect on the Third District economy, according to manufacturers responding to a special survey made in the latter part of March and early April. Only 1 out of 5 of those surveyed said they'd had to reduce output as a result of power cuts stemming from the coal strike. Moreover, production cuts that were necessary were minor, generally less than 10 percent. What little impact there was though did find its way into employment numbers, as many of the manufacturers forced to cut output trimmed payrolls as well as hours. Although the output loss was small, prospects for catching up are not good, with over 60 percent of the executives who cut production saying they expected to make up none of the lost product.

Current dollar retail sales are reported to be between 10 and 15 percent ahead of last year, according to area merchants contacted this month, with downtown Philadelphia stores doing better than their suburban branches

overall. These figures may be exaggerating actual conditions though. At this time last year, the large price cuts of a major competitor going out of business cut into the sales of other area retailers. A public transit strike last April also helped to keep the lid on sales. Nevertheless, business is said to be slightly better than planned. Retailers attribute the pickup to several factors, including an early Easter and better weather conditions.

For the longer term, area merchants see slower growth over the next six months, with current dollar sales projected to be between 5 and 8 percent ahead of year-earlier figures.

Area bankers report the volume of C&I loans in April to be higher than it was for the corresponding period last year by 3 to 4 percent. This is generally below planned volume. Some banks in the region are making fixed rate loans and lending at "lower than usual" rates in an effort to keep loan volume up. The primary problem, according to contacts, is widespread uncertainty among entrepreneurs about future business conditions, and particularly about the future course of inflation. Businessmen appear to be unwilling to commit themselves to investment projects in the face of such economic uncertainty.

Bankers are not optimistic about future business borrowing. Although one banker looks for loan volume six months down the road to be about 7 percent over year-earlier levels, most look for little or no improvement in 1978.

Short-term interest rates remain steady in April, with the prime at all of the banks contacted at 8 percent. Interest rate projections for the next six months are widely varied, with forecasts for the October prime rate ranging from 8 1/4 to 9 percent.

FOURTH DISTRICT - CLEVELAND

Businessmen and economists anticipate that the expansion will continue through 1978, despite the slow start in the first quarter. Retailers, however, are skeptical that first-quarter sales losses will be recouped. Industrial production should further rise this month as a result of a sharp comeback in coal production and a continuing pickup in steel and machine tools. Housing starts should recover sharply this quarter, but savings and loan associations are limiting mortgage commitments.

Financial officers and economists have not altered expectations for the economy in 1978, although their forecasts on inflation have been revised upward. There is some doubt, however, that a pickup in output and spending this quarter will fully recoup earlier losses. Moreover, several express concern that the overall rate of inflation will increase to about a 7 percent annual rate by the fourth quarter as higher coal prices, utility rates and recent steel price increases are passed on to final users. A few Directors emphasized that the accelerated rate of inflation is a dominant topic to their customers and should be considered a deterrent to business confidence.

Some retailers of general merchandise report substantial improvement in sales in March from February, but others indicate little improvement, because their pickup in sales occurred in February. Generally, none anticipate more than a seasonal gain this quarter. Spring merchandise has not been selling as well as expected, and apparel sales have slumped since last December. Inventories, especially of apparel, are judged as higher than desired and are being watched carefully. An economist with a major department store chain was disappointed that the increase in March sales was no larger than it was in view of Easter

and sales promotions. The 8.8 million annual rate of new car sales last quarter was consistent with the expectations of several Fourth District economists associated with the auto industry. But sales fell about 5 percent short of the projections of an economist with a major auto producer who pointed out producers cannot easily make major downward adjustments in production schedules this late into a model year.

Coal production is increasing rapidly since the strike settlement. Output in the second full workweek following the settlement rose to nearly the record pace of last October. The industry expects to operate at capacity--16 million tons weekly--on a sustained basis. A Director cautions shipments from mines are a problem because of the poor condition of some highways in Appalachia and inadequacy of rail facilities that can also be a deterrent to new mine capacity. According to an economist with a major coal producer, the first year of the coal contract will result in a 10.2 percent increase in the price of utility and industrial coal, a 7.3 percent increase in the price of steam coal, and a 4.6 percent increase in metallurgical coal prices. Increases of about half as large are expected in the second year.

Steel operations continue to strengthen despite earlier expectations of a drop in orders following the coal settlement and price increases in February and March. March shipments were unusually strong, partially in response to weather-induced delays earlier this year. One steel economist expects production this quarter will rise to about 90 percent of effective capacity, compared with nearly 80 percent last quarter. Substitution of domestic for foreign steel because of the trigger price system is apparently providing this unexpected strength. Steel service centers which have purchased at least a third of their requirements abroad have sharply increased orders from domestic producers in

recent weeks. Economists have been skeptical that this price system would curtail steel imports, but some now feel that imports after April will begin to drop sharply from recent peak volumes.

Officials and economists have not changed their forecasts that the increase in real capital spending this year will at best equal last year's increase. One official described his company's position for 1978 as still cautious. He attributed this to ample capacity, memories of high debt and low liquidity during the last recession, Government safety regulations and his company's phasing out a 25 million dollar investment for a new automotive product.

Recovery in medium trucks used especially by small businesses is still well below peaks reached in 1973, and inventories are judged to be ample because sales have fallen short of expectations. Machine tool builders, however, have become more optimistic following a peak in new orders last quarter and further gains are expected this quarter. One builder said backlogs for some highly technical lines have expanded to 85 weeks compared with 50-60 weeks a few months ago. They are operating near 90 percent of capacity.

Housing starts are expected to recover sharply from weather-depressed activity earlier this year. Last quarter's losses should be recouped this quarter. Some S&Ls claim demand for loans is even stronger than last summer because some banks appear to be less interested in mortgage lending than they have been. Mortgage rates have risen 1/4 to 1/2 point since March. To attract funds, a few S&Ls have instituted continuous compounding of interest on all deposits. Several report that they do not plan to limit mortgage lending in coming months, despite slowed growth in deposit flows, which, for some institutions, strengthened in late March and early April. Liquidity at some associations

has fallen to reserve requirement limits. In view of tightening cash flows, a few are no longer writing loans for new customers or for multiple dwellings and are not lending to marginal builders. Some S&Ls also have eliminated 95 percent loans.

FIFTH DISTRICT - RICHMOND

Business activity in the Fifth District picked up substantially during March. Particularly in West Virginia, where coal production had been most severely curtailed, the end of the miners' strike apparently created a burst of activity. Around the District manufacturers indicate a widespread increase in shipments and new orders. Backlogs of orders continued to expand moderately and inventory accumulation slowed somewhat. Manufacturing employment showed little change over the month while the work week lengthened only slightly. Prices generally continued to rise across a broad front. Bank credit activity in the Fifth District has been weak in recent weeks, although the slowdown appears to be largely seasonal in nature. Land preparation for spring planting is generally behind last year. Small grains are reportedly in fair to good condition and are responding to the warmer weather and top-dressing.

Of manufacturers responding to our monthly survey one-third report increases in shipments and in the volume of new orders over the past month. Increases in inventories, of both materials and finished goods, were less widespread than in the previous two months, but current stocks continued to grow relative to desired levels. The general improvement in manufacturing activity was widely dispersed among individual industries, but the strongest performances seem to have been in the textile, apparel, and building materials groups. Reports from the furniture industry, on the other hand, suggest some weakness, in apparent conflict with indications from broadly based industry associations and retail outlets.

Reports from retailers and from our Directors suggest some improvement in retail sales during the past month. This improvement has apparently

extended into consumer durables with improvement noted in sales of furniture, appliances, and automobiles. Some of the recent activity is being attributed to aggressive marketing, particularly on the part of automobile dealers.

Prices continued their broad advance in March. In particular, 60 percent of the manufacturers surveyed report paying higher prices in March than in February. Increases in prices received and in employee compensation were less widespread than for prices paid and were also slightly less common than in the preceding month. Comments by our Directors, however, suggest that recent price increases have had no significant effect on price expectations to date. The general outlook of our manufacturing respondents has improved somewhat during the past month but still has not regained the firmly optimistic tone which prevailed early in the year. More than one-fourth of these manufacturers now anticipate some improvement in business activity in their respective market areas and individual firms over the next six months. Nonetheless, the prevailing view seems to be that current plant and equipment capacity and expansion plans are in line with desired levels or slightly above.

In the banking sector, consumer and real estate lending have continued their sluggish pattern but show signs of picking up. Personal loans for automobile financing are reported weak in some areas, while financing of big ticket retail items is somewhat offsetting this weakness. Bankers in several areas note that use of credit cards is heavy. Also, our contacts suggest that real estate construction lending is beginning to revive. Bankers expect larger demands for such credit in the near future.

The pattern of business loan demand may be changing somewhat. Commercial and industrial lending at the larger District banks has been strong of late, and there is some evidence that national accounts are becoming more active. At the

same time, demand for short-term credit shows signs of rising relative to intermediate- and longer-term loans. While the picture here cannot be described as robust, it is certainly healthy. Deposit inflows at large banks seem to have weakened, with time deposits on the plateau reached earlier. Nevertheless, credit demands have not been strong enough to cause any appreciable rise in negotiable CD's.

Stronger farm prices, coupled with probable continued heavy use of the government loan program, helped to improve farmers' cash receipts from farm marketings in January. Compared with a year ago, total cash receipts were up 3 percent in the District and 11 percent nationally. Below-normal temperatures have delayed fruit tree blooming. As a result, bud kill from weather extremes has been relatively minor to date.

SIXTH DISTRICT - ATLANTA

The District economy has bloomed with the warmer weather. Florida tourism was extremely good through the spring holidays. Finance companies have reopened in Tennessee. Consumers spent freely in March, but retailers are reserving judgment on spring sales for the time being; auto sales have continued to improve. There's no letup in sight for oil and gas exploration. Housing reports have frequently mentioned extensive home improvement activity. The outlook for nonresidential construction has brightened, but uncertainties about energy supplies and prices temper optimism. Higher prices for farm products have boosted farm incomes. Businessmen are universally concerned about inflation.

All parts of Florida enjoyed an excellent holiday tourist business, with hotel and motel occupancy rates near or at 100 percent. Tampa noted the best season since 1973; visitors to northwest Florida set a record; Eastern Airlines' passenger arrivals and departures at Melbourne Regional Airport surpassed previous highs by a sizable margin. Disney World closed its gates early on several days when attendance reached capacity. In southeast Florida, car rentals, restaurant business, and race track attendance passed Easter 1977 levels by nearly 20 percent.

When the removal of Tennessee's constitutional usury ceiling took effect on April 1, finance companies reopened to face a flood of credit applications. They're now loaning at 18-27 percent. The state's banks seemed relieved to get out of the small loan business, and several set minimums of \$1,000. It's generally expected that the banks will return to pre-August consumer lending practices, although some hope to maintain

the stricter standards for small borrowers that developed in the seven-month credit slowdown. Many lenders want to resume charging interest rates in excess of 10 percent on loans made prior to the court ruling that declared them unconstitutional; the State Securities Director has said no, but the State Department of Banking will rule on the issue shortly.

Retail sales have apparently been fairly brisk in most areas. But since the early Easter stimulated March sales, many retailers are waiting for April sales figures before they judge the strength of spring spending. Car sales have revived quickly in the past few weeks; modest to moderate gains from the strong year-earlier pace are indicated. A few dealers, mainly in Florida, have complained that low stocks have restrained sales all through the first quarter, but current District-wide inventories appear to be at normal levels. Some expect a shortage of large models by early summer; GM dealers hope that their "big season" (May and June) will help make up for the styling resistance they've encountered thus far in the model year. Used car markets remain active; the reopening of finance companies in Tennessee has spurred these sales to a pitch that one director characterized as "wild." Sales of trucks, both small and large, are heavy.

The onshore drilling boom continues in Louisiana. Rig activity in the first quarter was the heaviest since 1957; completions and workovers were actually stronger than drilling. Only the rig supply is likely to limit activity this year. Offshore in the Gulf, drilling has been intense but probably won't reach boom proportions for a year or so, depending on wellhead prices of natural gas. Pipe-laying and construction are surprisingly active. The turnout for the recent sale of Atlantic Coast leases was small, as expected; \$151 million was bid for 57 of the 224 sites offered.

Home builders remain optimistic that 1978 construction will surpass the 1977 pace. The outlook for single-family homes is good, but apartments and condominiums are expected to be the growth sectors in metropolitan areas. Climbing prices have prompted some builders to begin omitting frills on new homes in the Miami area. Several directors from throughout the District commented on the strength of repairs, remodeling, and additions to existing homes. Funds for home improvement loans are plentiful and being pushed by banks. Sales of garden supplies, nursery plants, "do-it-yourself" items, and furniture have been reported as heavy, too.

Commercial and industrial construction is expected to take up any slack that may occur in housing in late 1978. In several major cities, office vacancy rates have declined to the point where real estate analysts foresee a revival of building in the near term. In some areas, particularly Alabama, the prospect for utilities construction is rather dim, as the investment required for new facilities is becoming prohibitively huge. The inadequacy of present capacity for large industrial users has already deterred prospective plant relocations in the state. However, the construction of a giant \$135-million terminal to receive imported liquefied natural gas off the coast of Georgia will help ensure District supplies of that fuel.

Builders continue to experience shortages of construction materials--cement, insulation, fabrics, sheetrock, and bricks. Deliveries have been extended for pipes, valves, and construction equipment. The only oversupply problem of late has been farm machinery.

A shortage of rainfall has delayed plantings in many areas of the District and provoked forest fires in the timberlands of Mississippi. Beef

and soybean prices have shown particular strength. Higher soymeal and corn prices have put upward pressure on feed costs, but fertilizer prices have been falling. Cotton prices turned down in late March when the early responses to new land-diversion provisions indicated that they would be ineffectual in reducing acreage. Florida grapefruit growers recently approved a new tax to raise advertising funds in hopes of shoring up slow demand. In contrast to the decline reported a month ago, orange juice demand appears now to be near normal levels, though prices continue at a record high. South Florida vegetable growers have expressed concern over dumping of Mexican produce.

Georgia-Pacific projects an 8 to 10-percent increase in plywood and lumber prices in 1978 without the erratic movements of last year. A Tennessee director remarked that paper prices are rising so rapidly that mills won't quote prices until orders are received. She blames limited supplies and an advance in demand generated by an uptrend in advertising. Consumers are paying higher spring electric bills, as utilities pass on the costs incurred in providing normal services during the coal strike. Inflation is far and away the greatest worry of the District's business leaders.

SEVENTH DISTRICT - CHICAGO

Informed observers in the Seventh District expect no downturn in general activity before 1979 at the earliest. Accelerating inflationary pressures are seen as the greater danger. Sales of autos, farm equipment, and housing starts, however, are expected to decline. The direct effects of the hard winter and the long coal strike are being overcome rapidly, but higher costs were incurred to maintain production. The coal pact is deemed inflationary in itself, and also because of its effect on other negotiations. Retail sales are generally favorable, but strength varies both by product and among retailers. Capital expenditures continue to rise at a good, but unspectacular, pace, with much variation by product. Airline travel has been well above projected levels. Railroads are having serious problems moving goods. Demand for steel is vigorous again. Housing starts are expected to decline, but nonresidential construction is certain to rise substantially. Mortgage credit terms have tightened further. Business loan demand is now clearly on the uptrend. Farm income prospects are brighter because of higher prices for crops and animals, and concern over farm credit has lessened.

The coal strike directly affected activity (other than mining and transportation of coal) in the District only in Indiana, and even there the impact was slight. Some companies were able to maintain production despite shortened workweeks. Many companies incurred additional expenses, however, especially for self-generated power.

The generous labor settlement in the coal industry presages emulation by other unions. Observers here are disappointed that mine operators were not able to reassert better control over productivity, which has been declining in

recent years in union mines. A new pact for Chicago CTA bus drivers boosts pay to \$8.63 per hour now, with further gains in benefits over two years-- plus an uncapped, quarterly COLA clause.

The rail unions are working without a contract and any new pacts will be costly. As in the case of coal, the railroads have been having trouble maintaining productivity, particularly the Eastern roads. Movements of grain and other commodities have been hampered by "critical" shortages of hopper cars and, on some lines, locomotives as well. Problems caused by poorly maintained trackage are widespread. Orders for freight cars and locomotives are strong. Some plants have been converted to produce hopper cars.

It is difficult to generalize on retail sales from varying reports of individual retailers. "Fierce" price competition on general merchandise is hurting some chain stores. The strongest product lines are auto parts, home improvement items, and appliances.

Sales of pickup trucks and vans continue to lead other motor vehicles. The recreational vehicle market has been weak, but the industry expects a rise in sales for the year as a whole.

Airline traffic has been well above projected trends with gains of 10-12 percent over year ago. Orders for larger aircraft and more efficient aircraft will remain strong.

Orders are running 15-25 percent above last year for various diversified capital goods producers. Strength in capital goods is also indicated by large gains in orders for electrical and mechanical components, castings, and steel plates. Construction equipment is the star performer, especially smaller units. One large producer of earth-moving equipment is said to be

operating at virtual capacity. Lead times on machine tools have been lengthening. Shortages of skilled workers, e.g., machinists and welders, help sales of sophisticated machines. The fall in the dollar is helping capital goods producers, both by encouraging exports and by discouraging imports. Nevertheless, most capital goods producers could handle a substantial rise in volume. Most have not increased employment or overtime, preferring to let backlogs build up. Capital outlays by the two largest motor vehicle producers are projected to remain very heavy for several years to come, with new plants accounting for a larger share of total spending.

Steel orders have improved in recent months. One company expects industry shipments to reach 97 million tons this year, up from 91 million tons last year with imports down 3 million tons. Lower imports, the need to replenish inventories at both the mill and user levels, and a pickup in equipment needs provide the basis for optimism. (One leading steel producer is operating at near capacity rates.) Sales of steel to the auto industry are expected to decline, however, because of both lower production in units and a lower average weight per car.

Improved auto sales in March encouraged producers to increase output schedules of their more popular models. Inventories will be ample in the peak sales months ahead. Although the winter's gloom is over, most forecasts for auto sales this year are lower than last fall.

The desire for better gas mileage is expected to increase the speed of replacement of the existing stock of cars in the next few years. Some experts believe that a sharp curtailment of oil imports, however caused, would soon require gas rationing, which, in turn, could lead to panic buying of smaller cars, as in early 1974.

EIGHTH DISTRICT — ST. LOUIS

Business managers in the Eighth District report that economic activity has increased in recent weeks. Retailers in St. Louis noted that sales began to improve around mid-March, and the excess inventories built up earlier in the year are expected to be worked off in the next few weeks. Construction activity has increased sharply with the improved weather conditions. Home sales remain at a relatively high level. Manufacturing activity has also gained momentum with the settlement of the coal strike. In the financial sector, net saving inflows into savings and loan associations have slowed further in recent weeks and with continued strong demand for mortgage loans, interest rates have moved up. In the agricultural sector, field work is somewhat behind schedule, but this is not a serious problem at this time of year.

According to area retailers, sales picked up strength around mid-March, after a relatively severe winter slump. A major St. Louis department store representative reported that March sales were about 5 percent above a year ago, and that the sales were accelerating in the last half of the month. Inventories are excessive in some soft goods items, but the excess is expected to be worked off within a few weeks. While some retailers were fairly optimistic about sales in the next few months, others remain apprehensive about the future course of consumer spending. One representative noted that fear of inflation by consumers may inhibit their spending while another observed that consumers are "nervous" and seem only willing to buy at special sale events.

Construction work has accelerated in recent weeks as weather

conditions have improved. Order backlogs for new homes remain at a high level and new orders continue to come in at a brisk pace. With the large backlog of orders as well as the new orders expected, builders look forward to a high level of construction activity this year.

Manufacturing activity apparently has picked up some momentum in a number of industries recently. One major manufacturer of appliances and capital goods reported improvement in sales throughout its line of products in the past month. Also, a major chemical firm reported overall improvement in sales in March, with strong sales for agricultural chemicals, phosphates, and plastics. A steel industry representative reported that orders on the books for the second quarter are very strong, especially from capital goods firms, and that overall steel shipments are estimated to be up from last year's level. It was pointed out, however, that world wide, the steel industry is suffering from excess capacity. A representative of the paint and coatings industry reported very strong sales in recent months, up 15 percent from a year ago, and that a strong second quarter is expected for this industry. Production in this industry is near capacity. A firm making connector plates used in construction reported poor sales early this year, but that sales recovered nicely in March and are expected to make up for the early 1978 losses later in the year. Other firms reporting strong business activity included manufacturers of air filtration equipment, lighting fixtures, and cutting tools.

Savings and loan institutions reported some further slowing in net deposit inflows during recent weeks from the January-February levels. Gross inflows of deposits continue at a relatively high level, but withdrawals have increased, leaving smaller gains in net savings. S and L's

are increasing nonprice competition for funds by boosting advertising budgets and premium offerings. Representatives of the industry point out that 4-year certificates, first offered about 4 years ago, are now subject to withdrawal and these funds are beginning to move into alternative investments. Counter to the experience of the S and L's, total time deposits at large commercial banks in the District have continued to increase in recent weeks.

With the demand for home mortgages continuing quite strong, and with slowing in savings growth, interest rates have risen further. The prevailing mortgage rate in the St. Louis and Memphis areas is now 9 percent for an 80 percent loan. Not only are loan rates increasing but in some cases more rigorous loan policies are being implemented. Some institutions now require prospective mortgage customers to hold savings at their institution before being granted a loan. One S and L representative reported a reluctance to make new loans or loan commitments at current interest rates since he believed that rates will go higher in the near future. Demand for most other types of loans also remains at a high level. Commercial banks reported large increases in commercial and industrial loans in March, and the demand for farm loans continues up from the very high levels of a year ago.

NINTH DISTRICT - MINNEAPOLIS

Economic activity in the Ninth District continues to improve, but there is a growing uneasiness over wage and price increases. The encouraging economic signals evident last month still show up in retail spending, labor market conditions, and loan demand. However, directors believe inflationary expectations have been revised upward, although no significant changes in inventory accumulation, investment plans, or capital goods sales have occurred yet. Most directors think that the coal settlement will set the tone for subsequent labor negotiations here.

According to our recent surveys, retail sales are doing well, and retailers are fairly optimistic. Most auto distributors in the region report that sales in March were ahead of last year, with full-size and subcompact models both selling briskly. Dealer inventories are adequate but could become tight for certain "hot-sellers" by summer. Retailers of other goods also are pleased with current sales, report no serious inventory difficulties, and expect a good summer season. Resort owners report that inquiries and reservations are up from last year; they expect an excellent summer too. No gasoline shortages are showing up; in fact, prices have dropped in Montana and South Dakota.

Reflecting strength in manufacturing and homebuilding, the district's unemployment rate has improved dramatically in recent months. Seasonally adjusted unemployment for the first two months of the year averaged 4.5 percent, compared to 5.2 percent in the fourth quarter of 1977 and 5.6 percent a year ago. Although the labor force increased 4 percent over the past twelve months, jobs increased at a 5.5 percent

rate. As a result, the number of people looking for work declined 17 percent. Substantial increases in the help wanted advertising index and reductions in initial claims for unemployment compensation both suggest no deterioration in joblessness in the next few months.

District loan demand has been strong again this year, and banks have been responding in several ways. Some apparently are selling off some loans; others are raising interest rates and tightening other credit terms. Large city banks, however, which are experiencing strong business borrowing, seem to be slightly easing price and nonprice terms on those loans.

Heavy demand is expected for all types of loans this year, according to directors. Agricultural bankers who may have been reluctant to lend last year expect ag lending to pick up this year in response to recent improvements in grain and livestock prices.

One large regional bank in the Twin Cities is currently showing good increases in all major loan categories but expects some slowing this year in two types of loans. It thinks consumer loan growth may slow as consumer's debt repayment schedules become more burdensome and real estate loan growth may slow as interest rates rise and mortgage credit tightens.

The major concern in the district right now is inflation. Almost all respondents report that businesses have revised inflationary expectations upward. Food price increases, higher import costs due to a weakened dollar, and increased unit labor costs are all cited as reasons for this revision.

The revised inflation expectations have not yet shown up in business actions, however. A few isolated examples of inventory accumulation exist, but there is no evidence of widespread attempts to increase inventories in order to beat future price increases. In fact, several respondents noted that businesses, apparently fearing a slowdown later this year, are very cautious about increasing inventories now. Similarly, inflation has not caused cautious businesses to change investment plans, although one respondent suggested that business spending plans appear to have been revised upward because of economic strength in the fourth quarter.

Most respondents believe that general price increases plus the coal settlement and the increase in the minimum wage will push up wage demands in this area. They think governmental pleas for voluntary restraint will probably be disregarded since the Administration had a major role in the coal settlement. Those who do not see any immediate wage consequences from the coal settlement expect it to set a pattern for wage negotiations in future years.

TENTH DISTRICT--KANSAS CITY

Current and anticipated sales are generally good, inventory levels are mostly satisfactory, and delivery times for items purchased are not lengthening, according to purchasing agents at a number of leading Tenth District firms. Prices of materials and other inputs are rising in the 5 percent to 6 percent range for most buyers, but several report increases of 6 percent to 8 percent. Spring planting of feed grains is being delayed in the District by wet soil conditions. Market prices for grain have strengthened, partly due to new farm program measures. Demand is strong for all types of loans at Tenth District commercial banks. Deposit growth is slack, but bankers expect to find funds from nondeposit sources to meet loan demand.

A large majority of Tenth District purchasing agents surveyed report no significant recent changes in delivery times or availability of items purchased. The greatest exception was in the case of steel, with several respondents noting some lengthening of lead times. Many firms experienced slight delays in deliveries during the worst of the winter weather, but it is no longer a problem for them. Reports of any large impact on production from materials shortages and transportation problems, or of back-orders and lost sales, were few in number.

Most respondents report prices of their materials and other inputs to be rising in the 5 percent to 6 percent range, but several note increases of 6 percent to 8 percent. Expectations of price increases for the rest of the year appear to center on the 6 percent to 8 percent range.

Only a very few purchasing managers stated that their materials inventories were other than satisfactory. A paint manufacturer reported

heavy inventories due to sales being weaker than expected. Other firms with slightly high or slightly low inventory positions expect to take no special action to adjust them.

Satisfactory inventory levels, or the lack of special efforts to adjust for small discrepancies therefrom, probably reflect the generally good sales picture--both current and anticipated--for most firms surveyed. Exceptions to the generally good sales picture include the paint manufacturer already mentioned, several firms whose markets are in the agribusiness sector, and at least one steel firm which is feeling the effects of weakness in private investment in nonresidential structures. A manufacturer of private aircraft notes that its sales abroad are sluggish in spite of the fall in price of their planes because of the weaker dollar. One respondent is concerned that the "constant refrain" he hears from businessmen--"that the fourth quarter will be bad and 1979 will be lousy"--may become a self-fulfilling prophecy. He believes the pessimism is unwarranted, certainly for his firm and elsewhere as well.

Melting snow and recent rainfall have delayed spring fieldwork throughout much of the Tenth District. Barley and oat seeding is reported to be about 30 percent complete in the District, although 60 percent is considered normal for this time of year. Moreover, field preparations for corn and soybeans are as much as 4 weeks behind schedule in some areas. Generally, if corn is not planted by May 10, large yield losses are frequently experienced. Although they can perform field operations quickly, farmers are likely to reduce their feedgrain planting and increase the production of other crops, particularly soybeans, if weather conditions do not soon improve.

Farm program measures announced recently by the Department of Agriculture are expected to boost 1978 net farm income \$3-4 billion above

the 1977 level of \$20.4 billion, according to official reports. Farmers will be allowed to graze cattle on some of their winter wheat and to take additional feedgrain and cotton cropland out of production, for which Government payments will be made. Higher target prices for wheat are also being considered. Partly as a result of these measures, market prices for grains have strengthened. These developments, coupled with any new legislation that Congress may pass, are likely to keep upward pressures on retail food prices for the rest of 1978.

Tenth District bankers contacted report that demand has been very strong for all types of loans, particularly agriculture and agribusiness loans. Several bankers report that elevator companies are borrowing heavily because railcar shortages have delayed shipment and sale of grain. Cattle loans have increased at most banks, and so has lending to country banks by correspondents for agricultural financing. Loans for natural resource development and to energy-related industries continue strong. Real estate and construction loans have increased sharply, and auto loans are picking up in most parts of the District.

Deposit growth is slack at most banks, and many bankers report moderate outflows in consumer time and savings deposits. Although most bankers expect to have sufficient funds to meet loan demand in the near term, they are planning to purchase funds in the money market and to arrange financing through large correspondent banks to meet the anticipated credit demands; some plan to borrow from the Federal Reserve under the seasonal borrowing privilege. Large banks contacted report that many country banks are already heavily loaned up.

ELEVENTH DISTRICT--DALLAS

The return of warm weather has quickened the pace of economic activity in the Eleventh District, according to the Directors and businessmen interviewed in this month's survey. Spring sales at department stores and auto dealerships are up sharply, and the goods-producing industries show advances following a lackluster performance during the first quarter of the year. There is concern among many respondents, however, that residential construction may weaken as deposit inflows continue to slow at both savings and loan associations and banks. Much of the current strength in business loan demand is attributed to a growing number of plant acquisitions and business takeovers. Although financial conditions of farmers remain tight, price increases have improved the situation for ranchers and dairymen.

The pace of consumer spending during the first weeks of spring has surpassed the expectations of many retail executives. Department stores reported excellent Easter sales. Some of the sales gains, however, were due to promotional efforts by retailers trying to draw down high inventory levels accumulated during the cold winter months. Many stores now find themselves slightly understocked. Department store executives say that sales are expected to remain strong through the summer. Auto dealers describe recent sales as "exceptional." Domestic and foreign cars of all makes and sizes appear to be selling well, and inventories are generally below desired levels--especially stocks of foreign cars.

Output in the goods-producing industries picked up in mid-March with the return of warm weather. The largest gains are in mining and construction, but only moderate gains are reported by the industries supplying the mining and construction industries. During the winter months, many suppliers did not

reduce production levels to match a slackening in new orders. Consequently, manufacturing activity will not rise in step with the recent increase in bookings.

Aided by the trigger price system, domestic steel producers report a growing demand for their products. Some producers are optimistic that trigger pricing will enable them to pass on production cost increases more easily and thus improve their profit margins. Inventories of scrap are below desired levels, and scrap prices are expected to continue to rise. Sand, gravel, and cement plants are allocating output to users because of the strength in construction activity. One respondent believes that residential construction may have reached a peak, but increased nonresidential construction activity is expected to take up any slack that may develop.

Increased concern over inflation and talk of recession is discouraging some firms from making new plant and equipment expenditures. Oil-related industries and electronics firms continue to account for much of the plant and equipment spending, while many outlays are for pollution control equipment or plant modernization. Investments by oil-related firms are said to account for nearly half of all plant and equipment expenditures in the Houston area.

In nondurable goods manufacturing, the growing popularity of suburban newspapers and regional magazines continues to account for much of the increase in printing and publishing. Petroleum refiners report that the seasonal increase in inventories of gasoline is well along, and many have begun to post price increases in advance of the summer vacation season. Chemical production continues to grow at a moderate pace, but capacity utilization remains slightly below 90 percent at most plants. The apparel industry may be getting a boost if the activity at the early fall market of the Dallas Apparel Mart is an indicator. Buyers report orders are up 10 to 15 percent over last year.

Net savings inflows at District S&L's are running 50 percent below year earlier levels. S&L's are expecting a real test this month when a block of "wildcard" certificates matures. Increased advertising of large certificates of deposit is being used to attract funds. The demand for mortgage funds continues to outpace the supply of new funds as rising mortgage rates have slowed demand only slightly. One major S&L recently raised its conventional rate to 9 3/4 percent, but most continue to hold to 9 1/2 percent.

Deposit inflows at banks also continue at a slow pace. Many bankers report demand deposit and savings accounts are declining, while certificates of deposit remain strong. Liquidity remains adequate, and asset growth has not been adversely affected by the slower growth in deposits. Some large banks report increasing their holdings of municipals, and loan growth continues strong, particularly real estate and construction loans. Commercial and industrial loans also continue to grow at a fast pace with much of the growth attributed to a growing number of plant acquisitions and business takeovers.

Financial conditions of Eleventh District farmers remain tight, but higher cattle and milk prices have improved the situation for ranchers and dairymen, according to preliminary findings of our April survey of agribankers. Although the availability of loanable funds at rural banks increased slightly since January, repayments of outstanding loans remain slow, and referrals to nonbank credit agencies continue to edge upward. Several bankers note that because of dry weather and low crop prices more farmers and ranchers are starting the 1978 crop year with a higher volume of carryover loans than has been experienced before.

TWELFTH DISTRICT - SAN FRANCISCO

The Twelfth District economy continues to emit signs of health. Retail sales continue to grow, especially from earlier rain-depressed levels in Southern California. Most firms report that inventories are at desired levels, though two note that policy changes have lowered their target inventory-to-sales ratios. Very strong real estate demand has resulted in recent increases in mortgage rates throughout the West and some observers anticipate even further increases.

Retail sales continue generally strong in the West. In Southern California, March retail sales rebounded from the rain-depressed February levels (by 18 percent unadjusted, according to one survey). Auto sales in that area appear to be much stronger than they have been nationally. Auto sales are also reported to be strong in the Pacific Northwest. An Oregon-based distributor who supplies foreign cars to a five-state area reports that March was his best month since last August. There were, however, reports of slow domestic auto sales. While the depressed farm economy has seriously retarded sales of farm machinery, retail sales in rural areas are said to be respectable. One Seattle-based food distributor reported record sales in March. Another Seattle observer forecast continued strong retail sales in that area due to the immigration stimulated by the Boeing expansion. The only pessimistic note on retail sales comes from Alaska where the economy is said to be adjusting to the post-pipeline-construction era.

Inventories appear to be at desired levels at all stages of production in most parts of the West. Exceptions to this include: larger than desired inventories of domestic autos, many raw farm commodities

(like potatoes and beans), some processed farm goods (like canned tomatoes), coal (due to pre-strike stockpiling), building materials (due to bad weather), and petroleum distillates. Leaner than preferred inventories are reported by a clothing manufacturer and a lift-truck manufacturer. Two firms reported a change in inventory policy, the result in both cases being lower inventory-to-sales ratios. One is an electronics manufacturer which attributed the change to a new accounting procedure, and the other is a large diversified firm which claims that "aggressive inventory management techniques" have enabled it to operate with less inventory than in the past.

Among major manufacturers, Boeing reports increased inventories to accommodate its rising rate of production. Kaiser Aluminum notes that aluminum industry inventories are currently at desired levels, but there is concern about shortages in the near future.

Within the past few weeks, most Western states have experienced increases in the prime residential mortgage rate and most observers and bankers attribute the increase to very strong demand, sometimes accompanied by a slowing in the rate of consumer savings deposits. California appears to be leading the District with 80-percent loans currently costing $9 \frac{3}{4}$ percent; up from $9 \frac{1}{2}$ percent only a few weeks back. Demand is reported to be so strong in Central California that S&L's are refusing loans to buyers who do not plan to occupy the house. In the Pacific Northwest mortgage rates have recently risen from $9 \frac{1}{4}$ to $9 \frac{1}{2}$ percent and are expected to rise even further since they typically lag the California market by 3 - 6 months. Some observers expect rates to reach 10 percent during the year. While a couple of bankers noted increased cost of funds

as a partial reason for the rise, most appeared to feel that this cost increase was inconsequential, and the major reason was that the demand for funds was growing more rapidly than the supply of loanable funds.