

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 indicate continued expansion of the national economy but at a moderate pace. Retail sales growth continues in most Districts but at varied rates. Expanding manufacturing activity and generally strong loan demand continue to be major sources of strength to the economy. Construction activity is on the upswing despite some labor and materials shortages in the midwest. With the exception of cotton, crop prospects are reported to be favorable.

Retail sales volume is growing in all Districts in September, but at various rates. Boston, Richmond, Chicago and Minneapolis report strong sales growth, while the other Districts indicate only modest or marginal gains after accounting for inflation. Automobiles and/or big-ticket items are mentioned as particularly strong areas by New York, Cleveland, Richmond, Chicago, Minneapolis and San Francisco. There is scattered concern that inventories may be becoming excessive. As for the future, retailers have mixed opinions. Several Reserve Banks mention that merchants are concerned about the possibility of overextension of consumer credit within the next few months.

Manufacturing activity is reported to be generally strong. Although New York and San Francisco report little or no growth in this sector, an actual decline in activity is not observed anywhere. Supplies of most commodities appear to be adequate at this time. For the longer term, manufacturers seem to be considerably less optimistic and a little more uncertain than they have been in recent months. In fact, Philadelphia and Richmond report that

*Prepared by the Federal Reserve Bank of Philadelphia.

manufacturers in those Districts are anticipating a decline in economic activity within the next six months.

Expansion in the construction industry is indicated across the board, despite an acute shortage of cement noted in Chicago, Minneapolis, and Dallas. Although no wholesale shutdown of work has been observed in those areas, some cutbacks are noted and jobs are being delayed. Nevertheless, gains in residential and/or nonresidential construction are noted in these three Districts, as well as in Atlanta and St. Louis.

Economic conditions in the agricultural sector are generally favorable. Farm income is reported to be rising and crop prospects, with the exception of cotton, are said to be good. Hot, dry weather has been a problem in cotton producing areas for some time now and the cotton yield is expected to be well below normal. The prolonged drought has also led to the liquidation of cattle in the St. Louis and Dallas Districts, affecting prices in those markets.

In the banking sector, loan demand is reported to be generally strong. Consumer borrowing, especially for mortgages, is reported to be particularly heavy. However, the demand for business loans, while strong overall, is showing signs of weakness in Atlanta and Richmond. Looking ahead to 1979, bankers are generally projecting continued loan demand growth and foresee little difficulty in meeting that demand. Although tight money conditions currently prevail in Minneapolis and San Francisco, these conditions may be, at least in part, only seasonal. Bankers do not generally foresee funds drying up as a result of disintermediation in the coming months.

FIRST DISTRICT - BOSTON

The level of economic activity in the First District remains high and signs of a coming slowdown are limited. The retail sector, particularly the automobile component, is doing very well. Manufacturing production is well above last year's levels; new orders are high by historic standards although there appears to have been some slackening recently. While prices of industrial materials are continuing to rise, no significant acceleration has been observed. There are no serious supply bottlenecks although some delivery lead times have lengthened and labor markets appear tight. Loan demand remains high. Despite this generally favorable experience, businessmen are deeply concerned about the future direction of the economy.

Consumer demand continues to be a source of strength in the New England economy. Northern New England just saw the conclusion of one of its best summer tourist seasons. All the associated retail outlets did very well. Back to school sales throughout most of the District were very successful. The head of a major New England department store chain reports that sales in August substantially exceeded expectations and the early days of September look similarly good. Sales of automobiles have also been stronger than expected. The region's banks have seen no weakening in the demand for consumer loans. There are, however, scattered indications of some slackening. One retailer notes that consumers appear to be more cost conscious; in food purchases there is greater interest in generic brands and the use of coupons. Another retailer has observed some slowdown in the rate at which credit is repaid; however, the head of a large utility reports that uncollectible bills are continuing to decline. Several local consultants and the head of a large department store expressed concern that

retail inventories may be excessively high if there is any softening in demand.

Manufacturing shipments are substantially above a year ago. Several surveys of the region's manufacturers suggest that there has been a slight fall-off in new orders in the past month; more firms reported a decline in orders than an increase. However, most firms contacted were very pleased with their recent performance. A large chemical manufacturer said August shipments were the highest ever. Orders for producers' durables and heavy capital equipment are also very strong. Housing related products are continuing to do well, although one firm has seen a weakening in the demand for major appliances. Firms are not experiencing any serious difficulties in obtaining materials although several report a slowdown in deliveries of steel and aluminum. There has been no substantial change in the rate of price increases. Manufacturers appear to be keeping inventories under tight control. A large machinery producer reported that his inventories were a little higher than desired; however, this was based upon concerns about the future course of the economy, not actual experience.

In the financial sector, consumer loan demand remains high throughout the region. For a large bank in southern New England, commercial loan demand is strong and above expectations; in northern New England, commercial demand is also strong but has fallen off slightly during the past month.

Professors Eckstein, Houthakker, and Samuelson were available for comment this month. None of the three believes that monetary policy is an appropriate tool to stabilize the exchange value of the dollar, nor do they feel that the devaluation experienced so far is sufficient justification for the sacrifice of domestic policy goals. All agreed that the outlook for inflation is discouraging, and all were critical of the government's present approach to dealing with the

problem. More optimistically, all three were pleased to see the recent slowdown in money growth rates.

Professor Eckstein noted that although the U.S. does have an obligation to its creditors (particularly OPEC) to prevent an excessive decline in the dollar, domestic interest rates are not responsible for the dollar's current weakness. He fears that further interest rate increases will produce a recession in 1979 without eliminating the inflation or energy imbalances that are the source of the dollar's problems. Given the large interest rate increases that have already occurred, Eckstein feels that "it would be rash to raise rates further before determining if the economy is or is not slowing, if inflation is or is not decreasing, and if the trade balance is or is not improving." It is Eckstein's view that the government's time would be better spent gaining control of the budget than worrying about stop-gap dollar support measures.

Professor Houthakker agrees that the dollar should not be a consideration for monetary policy. Arguing that the inflationary effects of the weak currency are minor, he feels that appropriate domestic policies will lead to a stronger dollar by themselves. Houthakker is less than sanguine about the short-term inflation outlook. He deplores the government's tendency to rely on "cosmetic" anti-inflation policies (jawboning) rather than to attack such underlying causes of inflation as unnecessary import restrictions and business regulation.

Citing the disappointing domestic results of the British pound support programs, Professor Samuelson feels that "little blood should be shed" in a dollar defense effort. He is particularly concerned that such policies could turn the "soft landing" expected next year by many forecasters into a German-style soft economy with a strong exchange rate but weak profit and output growth. Since Samuelson believes that the economy will generate a minimum of 5 percent

inflation through 1980 in any case, he sees little benefit from a policy-induced recession at this time.

SECOND DISTRICT - NEW YORK

Business activity continued to advance in August at a moderate pace, according to recent comments of directors and other business leaders. Retailers chalked up only modest gains, but with a pick up in sales in early September merchants remained optimistic about autumn sales prospects. Outside of retailing, economic activity seems to be expanding with slightly less vigor than in recent months. Respondents reported ample supplies of materials and most kinds of skilled workers, so that production apparently could be increased in the event that the tempo of economic activity were to pick up. There is little indication that business demands for external financing will change materially in the near term. Loan demand at New York City banks has firmed up a bit, reportedly in part due to a "spillover" of demand from regional banks.

Retail sales in the Second District registered only modest gains in August. A spokesman for one national retailer noted that his company's sales in the Second District have lagged behind those rung up elsewhere in the country. Several other retailers in New York City mentioned that their sales last month fell short of what had previously been projected. None of the merchants felt that the City's newspaper strike had contributed to the sluggishness of sales. Notwithstanding the modest overall gains, consumer purchases of appliances and new cars reportedly held up fairly well in August, and several retailers indicated that sales receipts had "snapped back" in the first week of September. Indeed, merchants appear to be generally optimistic about the prospects for autumn retail sales.

Business activity outside of retailing turned in a mixed performance in August. Some businessmen reported that their new orders were growing at a healthy clip, but others experienced a bit of a slowdown. Likewise, some

businessmen reported that delivery lags were lengthening slightly, while others saw them shortening. There was virtually unanimous agreement among respondents that there were no materials shortages or bottlenecks. One director did mention that the petroleum industry had recently had a little difficulty in purchasing lime and oil well cement. Isolated shortages of certain kinds of skilled workers were mentioned by several businessmen from the New York City region who faced problems in hiring.

While the directors and other business leaders were disturbed over the recent pace of inflation, they are in general agreement that a slowdown is in the offing for the second half of this year. Nevertheless, there are a few scattered reports that materials prices are beginning to rise at a somewhat faster rate--though evidently not so fast that the price rises are perceived to be symptomatic of any underlying shortages. One director was especially concerned about the unusually big price hikes that have occurred in the new equipment sector in recent years. According to another director, some manufacturers have lately tried to hold down their output prices through substitution of materials and compromising somewhat the quality of their goods. Despite the outlook for a slowing in inflation, the rate of price increases remains worrisome.

Business demands for external financing are not expected to change substantially through the remainder of 1978 and early 1979. Most respondents foresee little change in the pace of business borrowing. On the one hand, one director thought that there might be a decline in such borrowing because of a slowdown in economic growth and a consequent reduction in the rate of inventory accumulation. In contrast, other directors felt there would be an increase in borrowing. One director indicated that the firms with which he was acquainted

appeared to be borrowing short term to finance their capital expansion in anticipation that interest rates will be turning down in the foreseeable future.

A survey of business loan developments at several major New York City commercial banks suggests a firming in loan demand. Only one respondent failed to register an increase in loans during August, a month which was cited by two respondents as typically being a somewhat slack month for commercial and industrial borrowings. All five respondents reported various signs of loan demand "spilling over" from regional banks who for reasons such as liquidity strains or capital limitations were either unable or unwilling to fully satisfy specific customers' loan demand. Currently, the "spillover demand" has most commonly taken the form of loan participations offered by smaller regional correspondents, although some respondents also cited outright loan purchases and instances in which a correspondent referred customers directly to the respondent New York City bank. Despite some firming in loan demand at New York City banks, most respondents noted that some below-prime lending continued. One bank emphasized that agencies and branches of foreign banks in the U.S. had used "cut rate" loan terms to attract existing business of large New York City banks. Looking to the near-term business loan demand, nearly all of the respondents expected either continued moderate expansion or some pick up.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business conditions are generally good. Manufacturers note continued expansion and gains in local employment, but are not nearly as optimistic for the longer term. For the first time since early 1974, respondents to the Business Outlook Survey foresee a downturn in economic activity within six months. Retail sales are reported to be sluggish this month, but the slowdown can probably be explained by some unusual conditions. Merchants are less bullish about business conditions six months out than they have been recently, some citing overextension to the consumer as a cloud in the sales picture. Area bankers say loan demand is strong and expect it to remain so through early next year. Interest rates are expected to rise between 25 and 100 basis points over the next six months, but there is little agreement about when a peak will occur.

Manufacturers responding to this month's Business Outlook Survey say business continues to pick up steam in September. One-third of this month's respondents say general economic conditions are better than they were in August while less than one-tenth say the business climate has worsened. In terms of specific indicators, new orders and shipments are substantially higher in September, while inventories have reportedly stabilized. On the job scene, the continued expansion has been good news for local labor. Both the size of factory work forces and the length of the average workweek are growing in September.

Looking ahead to early 1979, local manufacturers continue to lose confidence. In fact, for the first time in over four and a half years, Survey respondents are predicting a fractional decline in general business

conditions within six months. Consistent with this bearish outlook, new orders are expected to fall, and shipments and inventories are projected to remain at their current levels between now and March. Respondents don't see the anticipated slowdown as having a large impact on employment or capital expenditures, however. Factory payrolls will remain at their current sizes, according to the Survey, but the workweek could be trimmed marginally. At the same time, manufacturers plan to hold the line on plant and equipment expenditures.

Inflation continues in the local industrial sector in September as price hikes become more widespread. Of the manufacturers polled, 3 out of 5 report paying higher prices for inputs this month while 2 out of 5 say they're charging more for their finished products. For the longer term, about 80 percent of the respondents expect the cost of raw materials to be boosted within the next six months, and half plan to raise the prices of goods they sell.

Area retailers say sales are sluggish in September. Although moderate gains over year-ago levels are reported, sales volume has not quite kept pace with the retailers' optimistic expectations. Merchants offer a variety of reasons for the shortfall. Year-ago sales figures reflect the opening of a new shopping complex in central Philadelphia and are considered to be unusually high and difficult to match. Moreover, ongoing political demonstrations in the downtown area have kept many shoppers away, possibly depressing sales figures below what they would otherwise be,

Retailers contacted have mixed views regarding the course of economic activity over the next six months. Forecasts of sales volume at the end of the first quarter of 1979 range from "flat" to 6 percent over year-earlier levels. Those merchants whose projections are at the lower end of the range

foresee overextension of the consumer becoming a problem by early 1979, probably after the holiday shopping season. Retail inventories are unanimously reported to be in good shape currently, with no changes in the inventory-sales ratio planned.

Local bankers say loan demand is strong in all categories. Business loan volume is up as much as 20 percent over September '77 levels and generally "on target." Similar increases are noted in consumer loans. As for the next two quarters, bankers expect loan demand to continue to be strong.

The prime rate at all of the banks contacted is currently 9 1/4 percent. Interest rates are projected to rise over the next six months but contacts differ as to how high they will go. Although all expect to see a peak between now and March, estimates of that peak range from 9 1/2 to 10 1/4 percent. There is widespread concern that the peak will be only temporary and that subsequent rate hikes will be observed and a cyclical peak will be reached late next year.

Deposit flows appear to be satisfactory at this time with no disintermediation problems observed or anticipated. Bankers expect to continue to be able to meet loan demand between now and March '79.

FOURTH DISTRICT - CLEVELAND

Consumer spending in the Fourth District has been spotty, and retailers, except for automotive, are uncertain over prospects for the balance of the year. Scattered signs of inventory adjustment are apparent in major appliances, steel and some soft goods. Steel prospects next quarter are also uncertain because of imports. Capital goods spending still lacks pervasive strength but mortgage loan demand remains strong.

Consumer spending continues strong in automotive buying while spending for other consumer goods has either shown little movement or has tapered in recent months. Automotive producers and suppliers are reasonably optimistic over sales and production prospects at least until the 1979 models are in abundant supply. Auto suppliers, including steel, glass, and tires, report orders are strong into next quarter. Uncertainty marks responses of retailers and producers of other consumer goods. Retail sales have not shown much movement in recent months, according to an economist with a major department store chain. He expects that year-over-year increases in retail sales will probably fall from a recent 10% rate to as low as 7% to 8% by year-end as the personal savings rate rises by about 0.5%. Sales of some major appliances fell in the last few months. Another official with a large department store chain noted lack of sales strength in their northeast Ohio store and remarked that consumers have responded to higher prices by moving down to lower priced, mass merchandising chains. Difficulty in gauging consumer buying attitudes has led to scaling down in inventories and buying plans this fall. An official with a major grocery chain noted a consumer shift to lower priced, generically labeled products.

Some adjustment of business inventories appears in the making. Stocks of some major appliances, steel and soft goods are probably more than ample and may tend to hold down production gains. Apparently the unusual strength of appliance sales last quarter resulted in some false perceptions of underlying market strength, according to a major appliance producer. Recent weakness in sales, however, has not been across the board. Steel stocks have been built more rapidly than expected as a result of the continued surge in imports, and some adjustment has been underway. On the other hand, stocks of petroleum products are expected to be built again, in response to an expected OPEC price increase and to a need to build home heating and other fuel stocks.

Steel economists have revised downward their expectations for steel production for the balance of this year. Orders have slowed and the operating rate has eased to about 85% of capacity, down from about 90% in the second quarter. Auto orders are strong and are likely to continue so through most of the fourth quarter unless production schedules are cut back. Though orders from machinery and aircraft industries are satisfactory, they have weakened in the shipbuilding and appliances industries, the latter apparently because of large inventories. Steel imports are a major uncertainty in the outlook. One steel economist said if imports continue at July's high volume, this will be a record year and will cause a sharp drop in steel production similar to the second half of 1977 when the operating rate fell to the range of 70% to 75% of effective capacity. Another economist believes, however, that the bulge in imports may be over and if the yen continues to rise, trigger prices will be pushed above domestic prices.

There is still little indication that gains in capital spending this half will be as large as during the first half of this year. An economist with a major capital goods producer, whose forecast of P&E spending called for a real gain of 6.5% this year, is now skeptical because of the higher cost of capital and slower growth in the economy than originally anticipated. Strength in producers' durable goods is in railroads, aircraft, and trucks. Industrial and commercial construction orders are strong. Heavy construction work remains a mixed bag, according to an official with a major design construction and engineering firm. Orders from steel and chemical industries continued weak but awards for terminals and barges for hauling grain rose sharply last quarter. Energy-related business has not been up to expectations because of continuing uncertainty over energy legislation.

Mortgage demand continues strong, although some seasonal weakening is noted by lenders. One S&L reported a record volume of loans in August but believes last month represented the peak in both lending and mortgage rates. Some others report loan activity so far this month equals that of the past two months and that unless there is a let-up in commitments, they may have to discourage new applications by raising rates. Mortgage rates in some areas are as high as 10½% for an 80% loan, although 10% appears to be the most common rate.

S&L interest in six-month certificates has not waned, although some complain of the higher cost of funds associated with the new certificates. Another view, however, is that S&Ls are better off in the current market than a year ago when mortgage rates were about 1 percentage point lower but many were paying 7 3/4% for long-term certificates.

FIFTH DISTRICT - RICHMOND

The level of business activity in the Fifth District was little changed over the past month, but most areas of activity can still be characterized as firm. The volume of new orders received by District manufacturers was essentially unchanged, but shipments continued to expand and backlogs of orders were up slightly. Retail sales gained broadly, with relative sales of big ticket items registering a slight increase over the month. Retailers continue to experience widespread price increases, while some manufacturers apparently experienced some relief in this area in recent weeks. Business loan demand has moderated substantially in recent weeks, but area bankers expect demand to strengthen in the fourth quarter.

Results of our survey of manufacturers are generally positive, suggesting continuing expansion at a moderate pace. New orders changed little over the summer, but remain at the level reached during a burst of growth last spring and backlogs are large. Shipments continue to expand at a good pace. Stocks of materials and finished goods apparently declined slightly in August and although one-third of our respondents view current levels as excessive, recent performance of inventories suggests they remain well within manageable limits. Manufacturers' employment and weekly hours worked both continued to expand during August. Manufacturers' responses suggest some improvement in the price situation. Reports of price increases were less widespread in our latest survey than in recent months and there were scattered reports of declines in prices received.

A strike against a principal coal carrying railroad is depressing coal output and employment in southern West Virginia and southwest Virginia. The

impact of the strike on coal output has been difficult to assess, but production remains well below the pre-vacation second quarter level. It has been estimated that from 20,000 to 25,000 miners have been idled as a direct result of the lack of transportation for mined coal. There is no evidence to date, however, of coal shortages developing within the District.

Survey responses of retailers suggest continued strength in sales as well as a recent pickup in relative sales of big ticket items. Reports from our directors, however, suggest that sales in some parts of the District are not as strong as they were in early summer. Retailers responding to our survey report increases in employment, some further inventory accumulation, and widespread price advances during the past month.

A majority of manufacturers participating in our survey continues to hold to the view that business conditions, nationally, will turn down within six months. A sizeable number also expects some decline in activity in their respective market areas although some are more optimistic concerning the outlook for their own firms. Retailers generally expect little change in the level of activity through the first quarter of 1979, and a majority of our directors share this view.

Commercial and industrial loans have been flat over the past several weeks. The heavy loan demand of late spring and early summer, especially demand for intermediate and long-term loans, has moderated substantially. This is true of virtually every industrial classification, including both durable and non-durable goods manufacturers and the retail trade sector. Bankers are expecting demand to strengthen in the coming quarter, however. Bankers have also been looking for signs of a turnaround in the unusually strong consumer instalment loan demand but these signs have not yet materialized. Automobile sales continue

to explain the strong instalment loan demand and there is some feeling that Christmas sales will help sustain high levels of consumer lending. Second mortgage loans are a moderately important form of consumer financing in some areas, but these loans do not appear to be a significant element in supporting current consumer expenditures.

Residential construction activity is healthy and banks are not reluctant to finance speculative housing projects. Builders seem to be doing a good job of gauging their own markets and banks are apparently not fearful of a sharp reduction in the demand for new homes. Reports of tighter mortgage markets, however, are increasing. Thrift institutions in the District of Columbia and Maryland, for example, have not experienced significant deposit increases recently.

District farmers' cash receipts from farm marketings have continued to improve over last year's level, recording a 5 percent gain during the first half of the year. Further improvement in District farm income can be expected as the flue-cured tobacco marketing season progresses. With the season's sales volume through August 31 heavy and prices averaging 20 percent above a year ago, the value of gross sales is up some 47 percent over that in the same period last year. Harvesting of fall crops has begun and is moving at a fairly rapid pace in southern areas of the District. Crop prospects generally range from fair to good, while pastures are in fair to excellent condition.

SIXTH DISTRICT - ATLANTA

Growth has clearly slowed in many sectors of the District economy, and the price outlook remains dim. Consumer spending has decelerated throughout the summer, making many retailers uneasy about sales prospects and stock levels. Loan growth has slackened with a downturn in business loans. Home sales and starts have faltered in some areas. Still, substantial strength remains in many segments. Nonresidential construction is on the upswing, and housing is still booming in the major growth centers. Tourism has been breaking records. Crop prospects are good.

Although talk of advance buying has toned down, the price outlook has scarcely improved. Building supply firms are expecting sharp increases, perhaps double the inflation rate, in materials prices. The Jacksonville port will raise its charges 10 percent on October 1 to cover a wage hike. Prices of fall apparel are at least 7 percent higher than last year. Although they're presently discounting much of the increases away, food processors have lifted list prices. On the brighter side, a steel fabricator expects steel prices to stabilize.

Retail sales are generally regarded as strong, although year-over-year gains have continued to shrink. Big-ticket items appear to be moving slower in several areas; grocery store sales seem to have rebounded. Inventories may be a shade higher than desired. Many major retailers are uneasy about fall sales prospects; others are reported to be buying extensively for the Christmas season.

A slowdown in new car sales has been widely attributed to extremely short inventories rather than a faltering of demand. Late-model used cars are

at a premium and are becoming difficult to get. Truck sales continue very good. Auto dealers generally expect moderate sales growth in the 1979 model year.

Large banks' business loans have declined significantly in recent weeks (their first drop since the credit expansion began), but consumer installment and real estate loans continued to advance robustly. Consumer deposit gains have been exceptionally strong; checking accounts, six-month CDs, and other personal time and savings deposits all have increased briskly.

In many of the District's smaller, slower growing cities, housing markets have begun to soften as buyers and builders resist high prices and financing costs. But in the rapidly expanding areas, home sales and residential starts continue at a record pace. Demand for raw land remains strong. Inflows to thrifts have been satisfactory and mortgage rates relatively stable.

Commercial real estate markets are also quite active. A substantial amount of office space is under construction or on tap, and warehouse space is tightening rapidly. Relocations or expansions of out-of-District and foreign firms are contributing significantly to both commercial and industrial expansion in Florida, Alabama, and Georgia.

It looks like a record year for tourism is in the making. Off-season traffic has been unusually heavy throughout Florida; even the long-ailing Miami Beach area has had its best season since 1967. The Mississippi coast and the inland areas of the District have also enjoyed a pickup in recreational visitors. Discount air fares have certainly contributed to the influx, possibly drawing off some highway traffic. An all-night, fast-food chain whose primary locations are highway interchanges blames its recent sluggish business on increased air travel. At destination spots, the restaurant business is booming--but higher wages and food costs are virtually eliminating profits.

Weather conditions have been favorable for crops in most of the region, but dryness has been damaging in some cotton-producing areas. Reductions of the cotton crop there, in Texas, and in California are likely to accelerate the recent gradual uptrend of cotton prices. The latest small declines in feed cattle prices will probably be erased this fall. Harvest of the 1978-79 citrus crop has just begun. The orange crop appears to be of good quality and substantially larger than last year's.

SEVENTH DISTRICT - CHICAGO

The expansion in the Seventh District doubtless has slowed since the catchup period of last spring, but there is no sign that a reversal is likely in the near future. Consumer spending continue to advance with rising incomes. Demand for workers remains strong and increases in compensation may be accelerating. There are few indications that inventories are excessive, and some items are in tight supply. Demand for capital goods is generally, but not universally, strong. Residential activity is holding up better than had been expected. Prospects for commercial and industrial construction are favorable. Corn and soybean crops are developing well.

Informed people are deeply concerned about inflation, the foreign trade deficit, high taxes, and high interest rates, but there is no evidence of a rush to the storm cellars. In September 1974, just before the sharp recession, there were significant signs that both consumers and businesses were holding back on spending decisions.

Local polls of consumer sentiment reflect the widespread pessimism reported nationally. There is no clear evidence, however, that people are restraining their desires for goods and services.

Retail sales remain vigorous, overall. The largest national retailer has been reporting very narrow volume gains from a year ago, but last year this firm was offering deep discounts to stimulate sales and profit margins were affected adversely. Among the products selling especially well are autos and light trucks, recreational equipment, TV sets, dishwashers, home remodeling items, and gasoline. In the non-retail sectors spending is very strong for air travel (helped by discounts), telephone usage, and insurance.

Consumer credit delinquencies are very low, below the best levels of 1972-73, despite some concern expressed earlier this year. In 1973 some deterioration in collections was already in evidence, and conditions worsened in the 1974-75 recession.

Demand for gasoline has been running well ahead of expectations in recent months. Refineries have been operating at 94-95 percent of capacity, which is "all out" for practical purposes. Gasoline stocks are low and prices have strengthened recently, in contrast to the usual post-Labor Day decline. No serious shortages are foreseen, however, because large additional supplies of gasoline can be obtained from abroad, although at higher average cost.

Demand for workers continues strong in most areas. Few layoffs have occurred in recent months. Strikes also have been relatively unimportant, except for the usual rash of teachers' strikes. Chicago City College teachers recently rejected a 7.5 percent boost (plus 3 percent longevity increases for most), and are demanding 12 percent. Increases this year by private employers have ranged from 7.5 to 11 percent with most concentrated in the 8-10 percent range. Union members and nonexempt personnel tend to get larger increases. Job offers to recent college grads were the best in several years, especially those technically trained, particularly women and blacks. Demand is especially strong for engineers, programmers, electricians, skilled metalworkers, auto mechanics, restaurant workers, office workers, domestics, and, as always, sales people.

The capital goods sector continues mixed but generally vigorous. Among the strongest lines are heavy trucks, rail freight cars, locomotives, machine tools, power shovels, heavy tractors, front-end loaders, farm equipment,

small power generators, and diesel engines. Demand for electric motors, often a "leading indicator" for equipment, generally shows no sign that a "turn" is imminent. Demand for heavy mining equipment (shovels and draglines) remains slow, but inquiries suggest an improvement. Demand for electrical generating equipment for utilities is below expected levels.

Most machine tool producers have full order books with planned deliveries stretching into 1979 and beyond. Demand for very large machine tools, advanced technology tools, and automatic transfer machines are especially strong. Motor vehicle industry orders for downsizing new engines (both gasoline and diesel) and other components are a major factor, but all equipment producers are said to be "in the market."

The 10-day International Machine Tool show opened in Chicago September 6. The show will be the largest ever. Of the 1,000 exhibitors registered, one-third are foreign. U. S. producers fear that orders for imported machines will benefit because of shorter lead times.

Major producers of electrical generating equipment complain of a lack of sizable new orders. Partly this is because equipment produced for some utilities "in the last cycle" has not yet been installed because of construction delays caused by litigation and/or regulatory roadblocks.

A serious cement shortage developed in midsummer and has become steadily worse. "It's a crisis," according to one spokesman. Residential and commercial construction has been delayed as ready-mix producers have placed customers on allocation. The reasons are several: strikes at cement mills, problems with barge and rail transport, closing of older plants, and, of course, high usage. Nevertheless, a problem of this dimension had not been anticipated.

EIGHTH DISTRICT - ST. LOUIS

The pace of economic expansion has continued at a moderate rate in recent weeks according to Eighth District businessmen. Retail sales continue up and inventories remain at satisfactory levels. Increases in orders are reported by some manufacturing industries and, overall, the construction industry continues to register some gain over a year ago. In the financial area, saving inflows continue above the expectations of many financial officials, and interest rates on mortgages have declined slightly in some markets. In the agricultural sector crop yield prospects are near normal despite adverse weather conditions in some areas.

Retail sales continue to post modest gains after inflation is taken into account. Department store sales varied among respondents, but, on average, sales remain on an upward trend. Some store managers, whose sales have been stagnant recently, noted less aggressive sales promotions as one reason for their lackluster performance. Managers of those stores having gains, noted that the largest sales gains were among fashionable dresswear for men and women, jewelry, and higher quality stereo equipment. Inventories are near desired levels given the sales outlook. Retailers generally believe the sales outlook is encouraging although some sentiment was expressed that "high" levels of consumer credit might dampen consumers' ability to maintain spending. Automobile sales are reported to be quite good in the District. The primary complaint of automobile dealers was the inability to obtain enough larger-sized cars to meet customers demands.

The pace of manufacturing activity continues unabated. A major chemical firm representative reported that larger than expected sales gains were registered in the past month. A box board company also reported that increases in sales occurred in recent weeks and that supply constraints are causing substantial increases in prices. Manufacturers of building products report a continued high level of demand, although gains, in general, have not been as rapid this year as last year. A building products manufacturer expects residential housing construction to remain near current levels through next year. Exceptionally strong increases in sales were reported in oil and gas industry products, with growing backlogs as a result of the worldwide surge in drilling. One representative reported that production is being hampered by long delivery schedules for forgings and certain semi-processed metal products.

Overall the construction industry has continued to advance in the District. Nonresidential construction has made gains over last year while housing construction has remained at a high plateau. In the St. Louis metropolitan region housing starts are holding at approximately the same level as a year ago. However, more of the new homes are being built in outlying areas.

Banks and thrift institutions report greater than expected inflows of savings deposits. These institutions report that the new higher-yielding certificates are partially responsible for the continued high level of inflows. Some, however, expressed concern about the effects of the higher

yields on profit margins. However, none of the officials contacted contemplated a change in policy relative to the new certificates.

Overall loan demand remains generally strong although demand for some types of loans has apparently lessened in recent weeks. For example, business loan volume at large commercial banks was unchanged in August after registering large gains in earlier months. Nevertheless, the prime lending rate for District banks rose along with the rate in the larger money markets. The growth in demand for agricultural loans has subsided in recent months, due, in part, to improved income in the agricultural sector. Continuing to register large increases in loan volume during August were real estate and consumer loans. Quoted rates on home mortgages have remained steady at 9-3/4 percent for an 80 percent loan and 10 percent on a 90 percent loan; however, lenders in some parts of the District reported that the actual lending rate had declined slightly.

Farm income prospects continue to be more favorable than a year ago, largely based on higher crop and livestock prices. Recent prices for cotton and soybeans provide farmers an opportunity for a profit and forward contracting is reported to have increased. In some areas, for example, farmers have already sold as much as one-third of their soybean crop. Abnormally hot and, in some areas, very dry conditions in August damaged crop prospects in some southern portions of the District. Reports indicate, however, that, on the whole, crop yields will be near normal. Reports indicate that dry pastures in West Tennessee have led to liquidation of some cattle.

NINTH DISTRICT - MINNEAPOLIS

Developments in the real sector indicate that the Ninth District's economy may be somewhat stronger than the nation's as the third quarter draws to a close. However, continued high farm loan demand plus low seasonal deposit inflows are contributing to tightness in district money markets.

According to this Bank's August survey of district manufacturers, sales in the second quarter averaged 15 percent more than a year ago, with most of the gain coming in durable goods. Durables producers expect their sales growth to be nearly 20 percent in the last half of the year, while nondurables manufacturers are looking towards 10 percent gains. This would mean that district sales of nondurables will increase about 11 percent for the year, compared to an expected growth rate of 9 percent nationally (reported in McGraw-Hill's May survey). And durables sales here should increase about 19 percent in 1978, compared to the national expectation of 11 percent.

Construction activity, including mining and energy projects in Michigan, North Dakota, and Montana, has been very strong this year. Residential building continues at a record pace despite rising mortgage rates, and commercial construction is doing very well according to several sources. Low commercial vacancy rates have encouraged this activity and should sustain commercial building.

However, shortages of cement are producing some spot reports of job shutdowns or slowdowns. Major cement plants in the region have had maintenance problems and have been operating below capacity. Contractors have been placed on allotments, causing them to look for additional supplies from other parts of the U.S. and from Canada. A secondary market for cement is said to have developed.

The generally good picture in construction and manufacturing has kept the district's unemployment rate well below the national average. The July rate was 4.6 percent. Tight labor markets were reported by several Reserve Bank directors, and even the chronically high unemployment area of upper Michigan is having problems finding skilled labor.

Excellent crops, improved prices, and government programs have greatly benefitted the district's agricultural sector. Dairy farming in central Minnesota is said to be as profitable as it has been in the last five years. Dairy observers expect a robust picture for the next two years. High prices are holding in the livestock sector, where profitable operations are once again expected.

The resulting higher farm income is showing up in improved spending as many farmers upgrade their operations after several years of low (or negative) profits. Implement dealers are enjoying good sales, and Minnesota farmers are also investing in irrigation equipment and crop storage facilities.

Retail sales, especially for durables, are generally good throughout the district. But several of our sources reported some easing of soft goods sales. Very warm weather has delayed purchases of fall clothes, and retailers seem to be in a cautious mood. Although fall sales are expected to pick up, retailers are keeping inventory positions at lean, manageable levels.

Financial sector developments are not much different than in the nation. A generally tight money situation is having the predicted impact on mortgage funds. About 25 to 50 percent of the "Treasury bill" CDs are said to represent new deposits.

Seasonal factors are affecting rural banks, however. Deposit growth at ag banks has been flat during summer months but should improve as cash flow from harvesting steps up this month.

The upgrading of farm operations has resulted in heavy loan demand at banks and production credit associations. So rural bankers are experiencing a tight money situation for factors in addition to national phenomena. Apparently this tightness has produced many requests for loan participations, and daily average borrowing from the Reserve Bank was three times higher than in August 1977.

This situation has left district ag banks with limited but adequate liquidity. Rural banks are still accepting reasonable loan requests.

However, a major banker in the region expects strong loan demand to exceed deposit growth at many rural banks next year. Higher operating costs, equipment upgrading, and rebuilding of livestock herds are expected to fuel loan demand. As a result, this banker expects increased use of "outside funds," that is, correspondent borrowing, Federal Reserve discount window activity, and referral to the Farm Credit System.

TENTH DISTRICT—KANSAS CITY

Business activity and inflation are both strong in the Tenth District. Price increases continue to be in the 6 to 8 per cent area for most inputs. Neither input availability nor capacity utilization currently appear to be major problems. Retail sales are generally reported as sharply higher than last year, but expectations are for a sales slowdown in the fourth quarter. On the agricultural front, credit conditions and farm income have greatly improved over last year. Bankers in the District report a mixed loan picture in general, but sharply higher consumer instalment loans.

The economies of Oklahoma and Nebraska are doing very well, according to directors from those states. The Oklahoma City area is thriving due to energy development, agriculture and, especially, a new GM plant. The general business climate is good, capital investment is very high, and there seems to be a "buyer's panic" in housing. In Nebraska, too, the economy is strong, bouyed by an especially good agricultural situation. Businessmen there are expressing a "cautious optimism."

Purchasing agents for firms in the machinery, drug and medical equipment, transportation, electrical goods, and furniture industries report that prices for most of their inputs have risen about 6 to 8 per cent over the year. Aluminum and steel prices, however, are each up about 15 per cent. Over the past 3 months, primary metal products have increased about 5 per cent and paper packaging products have gone up 6 to 7 per cent. With the exception of paper products, which are anticipated to increase an additional 6 to 7 per cent, no major price increases are expected for the remainder of the year. Input materials availability has not presented any major problem

for the industries surveyed this month. Lead times for inputs in the nonfarm transportation equipment industry, however, have been increasing and are expected to increase further this year. Currently, most purchasing agents consider their materials inventory levels to be adequate for meeting upcoming demands, or perhaps even slightly higher than needed. Tool and dye makers are still in short supply, but this shortage has not created any bottlenecks in production. Plant capacity is adequate in most industries contacted, but near full capacity is reported for some furniture, truck-trailer, and medical supply manufacturers.

Retail sales in the Tenth District are generally up sharply over year-ago levels. It appears that major appliances, home furnishings, and other big ticket items are selling rather slowly, except in the Denver area. Sales strength appears to be in new fall and winter clothes, school apparel, and other seasonal items. Most stores indicate that those price hikes that have occurred have been in the 3 to 7 per cent range. However, half of the stores said they had to absorb some of their increased costs simply because of increased competition. Most stores report that their inventory levels may be a "little" high, but are much better than last year. Retailers believe that consumer resistance to higher prices will be strongly felt in the fourth quarter and that competition will be exceptionally keen. As a result, some managers expect softening in consumer purchases and slowdowns in sales volume. Inventory levels are expected to remain in good condition.

Agricultural credit conditions across the Tenth Federal Reserve District have shown continued improvement since late last year. Although the demand for farm loans remains strong and District agricultural banks continue to have high loan-to-deposit ratios, farmers' cash flows have shown

substantial improvement and this has been reflected in their ability to service outstanding loans in a timely manner. This cash flow improvement is partly a result of government assistance, and partly of loan refinancing. A more important factor has been improved farm income. Paced by increased beef prices—up more than 40 per cent from a year ago—and record farm export sales for fiscal 1978 (estimated at \$26.6 billion), realized net farm income is expected to be about \$25 billion this year compared to \$20 billion in 1977. Cash receipts from farm marketings for the first 6 months of 1978 in Tenth District states have exceeded year-earlier levels by 18 per cent.

Most bankers contacted in the Tenth District report moderate loan demand. Bankers in Colorado and Oklahoma report heavy demands for real estate loans, and most bankers in other areas are experiencing moderate increases. Agricultural loans are up moderately in Kansas and Missouri, apparently due to loans for agricultural inventories. Other areas are experiencing either flat or decreased agricultural loan demand. Commercial and industrial loan growth is mixed in the District, with a slackening of loan demand by national accounts. Consumer instalment lending is up sharply throughout the District. All bankers contacted indicate that they raised their prime lending rate in September, and some expect it to peak in the fourth quarter of 1978 at about 10 per cent. Deposit growth is moderate at most banks contacted. Demand deposits are down throughout the District. Time deposits are up sharply, especially in Denver and Kansas City, but savings deposits are flat. Most large city bankers attribute the lack of disintermediation to the money market CD's. While all bankers contacted are currently offering the ceiling rate on money market CD's, some may not if the 6-month Treasury bill rate increases further.

ELEVENTH DISTRICT--DALLAS

On balance, economic activity in the Eleventh District continues to show moderate growth, according to the Directors and businessmen surveyed this month. Current demand for factory output remains strong but does not appear adequate to produce significant gains in total manufacturing activity. Residential construction appears to be headed down as home prices continue to climb and mortgage markets remain tight. Savings and loan associations and banks report little change during the past month in either the inflow of deposits or demand for loans. Department store sales showed a slight advance in August from July's high level. Drought conditions in some areas are causing farmers to plow under damaged cotton crops and ranchers to liquidate cow herds.

Few manufacturers report significant increases in production, as demand for many products appears to have leveled off. One notable exception, however, is the production of drilling equipment. Lead times now extend up to two years on some drilling equipment in response to the heaviest demand in 20 years. One equipment manufacturer complains that high employee turnover is restricting production.

Construction activity remains strong in the District, especially in Houston and Dallas. Overall, however, total housing starts have declined below the level of a year ago. Inventories of unsold homes do not appear excessive in most cities, although some observers indicate San Antonio is nearly overbuilt.

Shortages of material and labor continue to plague the construction industry. Acute shortages of cement have forced some contractors

to eliminate Saturday work schedules but otherwise have not caused serious work stoppages. Residential builders, however, have found the cement shortage a hindrance to scheduled completion of sidewalks and streets in some developments. Small contractors appear to be bearing the brunt of the shortages. A new cement plant just began operating in Central Texas which should help ease the supply situation in that part of the state. Other materials in short supply are sheet rock, insulation, and plywood.

Net new savings received at District S&L's continue to improve slowly, extending the trend of recent months. The gains are attributed largely to the new money market CD's ability to aid the retention of funds, but they have not substantially improved the availability of mortgage credit which is expected to remain tight well into 1979. Mortgage loan demand has leveled off, and conventional mortgage rates remain unchanged at the 9 3/4-percent level. S&L's continue to rely heavily on FHLB borrowing, which has been running at nearly twice the level of last year. Some respondents reported a reluctance to continue this form of borrowing.

Total loans at some weekly reporting banks appear to have eased slightly in mid-August. As a whole, loan demand appears healthy and reflects a high overall level of business activity in the District. Business acquisitions continue to account for much of the strength in business loan demand. Growth in deposits, however, is largely limited to large-denominated CD's. Liquidity positions appear to have improved in recent weeks. Some banks that had been experiencing a squeeze in

liquidity in recent months were able to improve their positions in August by moving more heavily into government securities.

Sales at department stores showed only slight improvement in August as year-to-year gains have been slim for the past several weeks. Inventories remain in line at most stores, although a few respondents reported a higher level of stocks than current sales warrant. The sales outlook is good, but some retail executives expressed concern about the relatively high level of consumer debt. These executives feel that consumers may be more cautious in their spending and that retail sales may slow. One large national conglomerate of department stores is planning on recession in the first and second quarters of 1979.

Hot, dry weather has caused severe stress to the cotton crop in the major producing areas of the District. A greater than normal amount of dryland cotton has been plowed up in the southern High Plains of Texas, and yields are expected to be far below normal. Ranchers continue to liquidate cow herds in drought-stricken areas, but marketings of slaughter cows appear to be slowing down. It does not yet appear that many cattlemen have begun to rebuild their herds. Cow and calf prices are at high levels with some stocker calves reportedly sold for \$1 a pound. Feed cattle marketings are expected to be heavy in the next two months, due to a relatively large number of feedlot placements in the second quarter. This may dampen or delay any seasonal upward movement in feed cattle prices.

TWELFTH DISTRICT - SAN FRANCISCO

Some of the wind appears to have been taken out of the western economic boom. Retail sales are growing at a hair above the rate of inflation. There is no apparent slowdown in plant and equipment spending. There appears to be a slight weakening in the real estate market and associated construction industry, and this may be reflected in a softening in mortgage interest rates in a few areas. There are also indications that western consumers are beginning to spend less and save more.

Retail sales in the district appear to be increasing right at, or just a notch above, the rate of inflation. Domestic auto sales continue strong but foreign car dealers complain that their sales are down due to the declining dollar. In southern California, Cadillacs and other luxury cars are selling as fast as dealers can get them. Some softening of sales is reported for hard goods, furniture and adult clothing. Several directors felt that some current retail sales, especially those of foreign goods, are in anticipation of increased inflation and a further decline in the dollar.

Twelfth District Directors tend to feel that the decline in new factory orders observed nationally is not reflected in the western economy. Boeing's growth continues in Seattle. A large manufacturer of chain saws and power tools plans continued expansion of plant and equipment. A large food distributor in the Pacific Northwest plans expansion of both its retail and wholesale distribution centers and will complete construction of its first restaurant within 60 days. Agricultural reports from all over the region note good crops, stable prices and incomes considerably better than last year's. Even pulp manufacturing is picking up after two years of heavy inventories.

Reports on residential construction and housing sales are somewhat mixed, but the general trend appears to be toward a weaker market. Southern California, where the housing market had been the most feverish, now exhibits the most visible signs of softness. Homes which used to sell in less than a month now stay on the market two to three times as long. Houses priced above \$100,000 are taking even longer to sell and sellers are settling for prices even less than the 5 to 10 percent below asking price observed for less expensive homes. Residential construction permits in the 5-county area of southern California are being requested at a slower pace, partly due to a pre-July bulge in permits as people scrambled to avoid the implementation of energy conservation requirements. Reports from the rest of the district indicate that demand is still strong, but that it does take a bit longer to sell houses and there is a modest decline in both permits and starts in some areas.

The District savings picture is somewhat mixed. The majority of reports indicate that consumer loan demand remains strong while consumer savings remain weak. However, one California and one Oregon bank are beginning to notice a reversal. The Oregon bank noted that consumer time deposit inflow rose back to normal levels in June and set a record gain for July. The California bank did not notice any real growth in savings until August. The experience of these two banks could signify the beginning of a district trend.

The mortgage picture is also mixed, since while most areas are still experiencing high and stable mortgage rates of about 10 percent, a few areas have noticed a 1/8 to 1/4 of a percent softening. An Oregon banker explains his rate reduction as being due to a seasonal weakening in demand. Reports

from southern California are mixed since some bankers claim there is a weakening of demand while another claims that the new money market certificates have worked so well for S&L's that they no longer need to ration mortgage funds as strictly as before.