

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Severe weather conditions and the potential effects of the coal strike dominate this month's Current Economic Comments. Because of unfavorable weather, retail sales throughout much of the country were below expectations. However, respondents in most districts believe that consumer demand is basically strong and expect to make up the lost sales in the spring. Manufacturing was up but again somewhat less than expected. In the financial sector, deposit inflows to thrift institutions have slowed while mortgage demand remains strong. Consequently, mortgage rates have risen in approximately half the districts. Fears about disintermediation vary considerably among districts, but most report that lending institutions are fairly confident they can meet the demand for mortgages. Thus far, the coal strike has had only minor secondary effects on the economy, but this is likely to change as widespread power curtailments now appear imminent.

Almost every District reports that economic activity during the past several weeks was adversely affected by severe weather. Winter storms had their greatest impact in the northern districts, although Atlanta also experienced significant negative effects. Boston reports that much of southern New England was literally shut down for almost a week. Chicago describes the impact of the storms on sales and output as greater "than in any previous winter in memory."

Boston, New York, Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, Dallas and San Francisco all report that retail sales were depressed by weather conditions. In most cases retailers expect to make up the losses in later months. Philadelphia retailers are looking forward to a strong spring season; Dallas store executives are optimistic about the impact on sales of rising income levels and the proposed tax cuts. Such expectations seem to be supported

*Prepared by the Federal Reserve Bank of Boston.

by the experience of retailers before the winter storms and in unaffected areas. Chicago reports that retailers were very pleased with their experience until mid-January and the onset of the bad weather. Richmond, which did not report severe storm impacts, observed increases in both total sales and the proportion of big ticket items, and Atlanta reports that those areas least affected by bad weather experienced strong sales growth. In northern New England, the ski industry is enjoying another great year. According to San Francisco and Atlanta, automobile sales which had been slow began picking up in mid-January. Retail inventories were not seen as a problem in any district except St. Louis where stocks of new cars were larger than desired. Chicago notes that weather-caused shutdowns at the auto plants substituted for layoffs otherwise needed to hold down excessive inventories.

Manufacturing activity appears to be increasing, although in most districts dealing with this topic, the experience of the past month fell short of expectations. Again weather was thought to be the major cause of the slowdown. San Francisco observes that production levels are steady or growing in most industries and that some industries have largely achieved full capacity. The aluminum industry, in particular, is operating at capacity and there is actually a shortage of capacity at the rolling stage. Richmond's survey of manufacturers finds a general increase in new orders and rising backlogs. Dallas notes that sales in the apparel industry have strengthened; chemical sales remain weak but improvement is expected. St. Louis reports that aircraft manufacturing and industries serving the housing market are experiencing strong demand, although overall the rate of growth in manufacturing has slowed. New York and St. Louis both find that capital goods producers are making small gains but are not doing as well as expected. New York manufacturers do not

expect the tax proposals to improve this situation. Chicago reports that the demand for capital goods has picked up, with construction equipment the leading sector. Steel orders have also increased, primarily because of the capital goods demand. According to Cleveland, capacity utilization in the steel industry will rise to the mid-eighties from about 75 percent in the previous quarter. The most pessimistic report comes from Philadelphia, which finds no change in new orders and a small increase in shipments. Richmond, Atlanta and Philadelphia report slight increases in manufacturers' inventories. Excessive automobile inventories have been reduced by planned shutdowns in the St. Louis district and storm-caused disruptions. Cleveland, Dallas and San Francisco note that refiners' inventories of petroleum products are above desired levels.

In the financial sector, almost all districts report that the inflow of deposits to thrift institutions and other mortgage lenders has slowed. Kansas City finds that deposit growth has actually picked up since the fourth quarter but is below that of two years ago. The demand for mortgages has remained strong. As a result, in over half the districts mortgage rates have increased in recent months. The greatest increase seems to have occurred in the Sixth District; Atlanta reports that conventional rates have risen 1/2 percentage point in one month. This increase seems to have attracted borrowers hoping to avoid higher rates in the future. Chicago reports some savings and loan institutions have begun to reduce maturities and increase fees; some are lending only for single-family, owner-occupied dwellings. Some California thrift institutions have also limited loans to single-family dwellings and in Oregon a number of thrifts have adopted a temporary moratorium on lending. In most districts, however, the thrift institutions believe that they can meet

the mortgage demand by supplementing regular deposit inflows with other funds. Chicago, St. Louis, Minneapolis and Kansas City report that thrift institutions in their districts plan or have already begun to borrow at the Federal Home Loan Banks. In the Cleveland, Dallas and Kansas City districts a number of thrifts are planning to sell mortgages in the secondary market. Atlanta reports that saving and loan associations there have launched campaigns to promote savings and are offering ceiling rates on certificates of deposits.

The extent of concern about disintermediation varies considerably from district to district. Institutions in New York and Philadelphia are particularly worried that higher interest rates will lead to serious disintermediation. One Philadelphia mutual savings bank believes an increase in short-term rates of only 25 basis points will cause a significant shrinkage in mortgage funds. As mentioned above, San Francisco reports that several thrifts have already left the mortgage market. On the other hand, institutions in most districts seem to feel that they can meet projected demand with higher rates and by seeking non-deposit funds. Boston thrifts believe disintermediation will not be a serious problem unless short-term rates rise 100 basis points.

Districts with substantial involvement in agriculture report that price increases are likely in 1978. In California rains ended drought conditions but damaged crops. Consequently, prices of vegetables like lettuce and carrots have risen sharply. Atlanta reports that orange prices are "sky high" and that cotton prices are rising. Kansas City and Chicago both believe that pork prices will be higher than previously estimated and Kansas City thinks that there may be "rather explosive price increases in the cattle industry." There is still some talk of a farm strike, but interest has dwindled.

Finally, Philadelphia, Cleveland, Richmond, Atlanta, Chicago and

St. Louis are very concerned about the potential economic impacts of the coal strike. To date the impact has been largely confined to the direct effects in the mining and railroad industries. However, supplies of coal have run low and these districts fear that there will soon be power curtailments which will in turn result in widespread layoffs. Richmond and St. Louis report that utilities in their districts may have to begin curtailments within two weeks. As Atlanta and Philadelphia point out, even those coal users with relatively large stocks are worried because after the strike is settled there will still be a considerable delay before deliveries start up. The most critical situation appears to be in Indiana where utilities have already requested a cutback in lighting and will soon reduce power to large industrial users. The steel industry, however, has adequate supplies of coking coal as long as the strike is settled by April 1.

FIRST DISTRICT - BOSTON

The experience of the First District during the past month has been dominated by adverse weather conditions. These have reduced retail sales and disrupted production. However, respondents are generally confident that the underlying trend for the region's economy continues to be one of steady growth. On the financial side, thrift institutions report some slowing in deposit inflows but mortgage rates remain stable.

New England has experienced two major snowstorms during the past month. The second was the most severe in the region's history and literally shut down much of southern New England for almost a week. All but emergency travel was prohibited in eastern Massachusetts and Rhode Island, so that almost no one was able to go to work or visit retail establishments for four to six days. In addition, flooding in coastal communities destroyed many homes and businesses.

Much of the loss in production and retail sales caused by the storms is expected to be made up in later weeks. However, impulse purchases and purchases of certain services and food away from home are lost forever. If one were to adjust for weather conditions the retail sales situation would be mixed, but on balance favorable. One large department store chain in southern New England reports that through the first week of February - before the most recent storm but after the first - sales in 1978 were 30 percent above the same period a year ago. Retailers in northern New England, on the other hand, have been disappointed with their recent sales experience; however, that sector of the industry associated with ski resorts is doing very well. Once again New England ski areas are enjoying a very successful season. Until the most recent snowstorm retailers' inventories were well under control and stores

were having no difficulty obtaining merchandise.

In the financial sector, one large company reported keen competition among New York banks wanting to lend it money. The company was redesigning its revolving credit arrangements, which involve loans of about three or four years duration. The New York City banks seemed very eager to handle the loans and were offering very attractive terms. A large Boston bank reported that it too is pricing loans aggressively. However, because of recent increases in loan demand, this bank expects the need for price cutting to diminish. Most of the increased demand has been for intermediate-term fixed interest loans. The bank is raising money for these loans with a large note issue and by moving toward longer-term certificates of deposits.

Although savings inflows at mutual savings banks slowed in New England there is no sign of distress as yet. Mortgage rates are remaining stable after declining slightly during 1977. Mortgage demand remains fairly strong and a continuation of present trends is expected. Most thrift institutions are reasonably liquid and are not expecting any crunch in the short term. Disintermediation is not expected to become a serious problem unless short term rates increase by 100 basis points or more. Many thrift institutions in New England are not offering ceiling rates on certificates of deposit now so they have some room to remain competitive.

Professors Houthakker, Eckstein, Tobin, and Samuelson were available for comment this month. All respondents believe that the Fed should not make the stability of the dollar on foreign exchange markets a primary concern for monetary policy. Houthakker, in particular, noted that monetary policy should respond to our domestic needs and that changing exchange rates are the appropriate

market responses which accommodate differing national policies: "It is foolish to acquiesce to foreign monetary policies" which are not appropriate for our needs by attempting to peg the dollar.

All respondents also believe that the adverse weather during the first quarter will have no lasting effect on the economy. Unlike last year, however, real growth during 1978:I will suffer because it will not benefit from pent-up sales of autos and trucks (the Ford strike settlement) and because it must carry the added burden of an extended coal strike. The major legacy of the bad weather may be that many economic indicators will be very noisy for the next several months; it will be hard to identify trends and get bearings.

Houthakker anticipates 4.5 percent real growth during 1978. Although this performance will not reduce unemployment rates dramatically, it does not invite the risk of excessively rapid expansion. Without violating the announced targets, money growth near the upper target is sufficient to maintain healthy economic momentum. He sees little risk of a credit crunch during 1978.

Samuelson believes the Fed should continue the policy of the past few years: grudgingly giving ground both to rising interest rates and to above-target money growth. However, should housing, investment, or durables consumption weaken significantly, further interest rate increases should be resisted. He feels that 4.5 percent growth for 1978 is the lowest defensible goal because many of the signs which mark the late stage of an expansion are not yet evident, the real growth target could be as high as 5.5 percent.

Tobin and Eckstein, noting the gloom of the investment community, report that businessmen fear a credit crunch perhaps as early as this year. The Fed's announced money growth targets appear to put it on a collision course with the Administration's forecast of 4.5 to 5.0 percent real growth. Accordingly,

declining bond and stock prices reflect lower profits forecasts and expectations of higher interest rates. These developments, in turn, jeopardize the outlook for housing and investment. Both Tobin and Eckstein believe that there is no reason for the Fed to validate these forecasts. It would be "foolish" to increase interest rates at the moment - the Fed should convince the business community that the economy is not on a path to a recession.

SECOND DISTRICT--NEW YORK

Business activity in the Second District has lost some momentum, according to recent accounts of directors and other business leaders. In the face of adverse weather, retail sales in the region apparently softened in January and early February. While the slackening in sales was unexpected, most merchants were not alarmed by the rise in inventory stocks, anticipating consumer spending to pick up with an easing in climatic conditions. Outside of retailing, capital goods production remains sluggish. Overall, the recovery in the regional economy continues to lag behind the economic expansion of the nation, but much of the weakness appears concentrated in New York City. Revised labor force data now indicate a widening in the gap between the city's rate of joblessness and that of the rest of the nation. On the financial scene, senior thrift officers reported that weak or negative savings flows have had little effect on mortgage lending.

Consumer spending in this district appeared to slow in January and early February. In New York City, department store executives were particularly disappointed in the sluggish pace of buying. Several national retailers indicated that sales in the New York metropolitan area and the East Coast in general lagged well behind the rest of the country. For the most part, the slowdown was largely attributed to the adverse weather conditions. In upstate New York, merchandising was also sluggish, with sales reportedly falling well short of anticipated volumes. The Buffalo directors were less sanguine about the outlook than downstate merchants, voicing concern over a possible shift in consumer sentiment as well as a lagged response to the retrenchment of

the steel industry. Notwithstanding the overall sluggishness of sales in the district, Rochester area retailers reported brisk post-holiday demand for both durable and nondurable goods.

While the unanticipated softening in sales activity has resulted in somewhat higher-than-desired inventory stocks, most retailers did not appear overly concerned. For the most part, merchants appear to believe that underlying consumer sentiment is strong and that as weather conditions improve, buying activity will pick up. In any case, inventory policies remain cautious. Outside of the retail sector, inventories were generally viewed as in balance with sales.

Capital goods production in the district appears to be sluggish. Several industrialists in upstate New York report orders for new capital goods are only slightly higher than a year ago. At least thus far, the curtailment of steel production in the Buffalo area appears to have had no significant effects on major suppliers. The Buffalo branch directors characterized capital spending prospects over the next several months as "lethargic." Most respondents expected little relief from the Administration's tax proposals, which were viewed largely as an offset to the prospective hike in social insurance taxes. In contrast to this general view, one upstate machine and tool manufacturer expected a good year, with only the potential weakness in the automobile industry possibly troublesome.

With the improvement in the regional economy lagging behind that of the nation, area unemployment rates remain well above the national level. Moreover, as a result of recent revisions in the calculation of joblessness, the unemployment rate in New York City was revised up to 10.5 percent in

January, some two percentage points higher than it would have been under the earlier procedure. Over the past year, the New York City joblessness rate has fallen about half a percentage point, less than half the drop registered for the nation as a whole. While the upstate region has fared much better, the state as a whole posted a 7.9 percent rate of joblessness in January.

On the financial front, the rise in market interest rates has finally begun to have a significant effect on thrift deposit flows in the area. Senior officers at New York City thrift institutions reported weak or negative net new savings flows in January. In upstate New York and New Jersey, deposit flows were somewhat stronger, although still below the levels of a year ago. All New York City respondents expect continued weakness in deposit growth for the rest of 1978, while upstate institutions anticipate some slowdown relative to 1977 but less weakness than in New York City. However, few respondents reported actual or expected tightening in lending requirements for residential mortgage loans in New York, due in large measure to the 8 1/2 percent usury ceiling which has already raised non-price terms of residential mortgage lending. The executive vice president of a major New Jersey savings bank expected some tightening in commercial and residential lending. None of the respondents expected to liquidate self-initiated, whole mortgages during 1978 in order to raise funds. Moderate disintermediation was expected to be met through selling securities from their portfolios. Many respondents echoed the concern of the president of one of New York's largest savings banks that a further rise in interest rates would pose a serious threat of substantial disintermediation.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that economic activity is generally slow. Manufacturers say that business is unchanged from January, and inclement weather has put a damper on retail sales. Executives in both of these sectors look for renewed expansion over the next six months. Area bankers say that business loan demand is seasonally slow, and that it too should gain strength in the future. They express a belief, though, that higher short-term interest rates could have repercussions in the mortgage market. The nationwide coal strike also threatens to cut into the District economy if striking miners do not ratify a contract soon.

Manufacturers responding to this month's Business Outlook Survey say that the general business climate is unchanged from January, continuing a now four-month old slowing trend. Supporting the claims of a slowdown in growth, respondents indicate no change in new orders this month, and only a weak increase in shipments. Consequently, there is no improvement reported on the employment front, and inventories are up fractionally.

As for the future, although manufacturers are still generally bullish, the overall optimism continues to diminish as the industrial sector fails to gain real strength. New orders and shipments are projected to pick up over the next six months, but these expectations are also less widespread than they have been recently. Despite the dampened outlook though, manufacturers in the District continue to foresee gains in employment and increases in capital spending. In the current Survey, 40 percent of the respondents say they anticipate adding to their work forces by August, and a like proportion plans to increase plant and equipment expenditures.

Prices increases in the industrial sector are no more widespread in February than last month. About half of those polled this month report paying higher prices for raw materials, while about one fourth say they are charging more for their finished products. Looking ahead six months, over 80 percent expect to be paying more for inputs, while only about 60 percent think they'll be able to get higher prices for the goods they sell.

The nationwide bituminous coal strike could seriously affect the Third District economy if an agreement between striking miners and management is not reached quickly. Although the strike does not have a direct effect on employment, since less than 1 percent of the District labor force is involved in coal mining, the local economy could be impacted if coal shortages develop. Over half of the original stockpiles that the major coal users, mainly utilities, had accumulated before the strike are now gone, and users have begun to substitute more expensive fuels for coal. As stock piles dwindle, power cutbacks could have serious repercussions in the industrial sector and therefore on employment. A Director of this bank representing the energy industry believes that the crucial point has already been passed, and that this area will start to feel real employment effects in a matter of days.

Retail sales in the area are reported to be mixed. Reports of current dollar sales range from 1 percent below to 5 percent above year-ago levels, and sales are generally below planned volume. The major reason for this, according to contacts, has been extremely adverse weather which has helped to keep the lid on sales since the middle of January. In addition, two of the worst winter storms to hit the area in twenty years caused merchants, along with other business people, to shut down and lose a total of three selling days. Inventories are somewhat thicker than they were last year at this

time, partly as a result of slow winter sales, and partly as a result of a management decision to add to stocks.

For the longer term, retailers are looking for a "healthy" spring buying season, hence the decision to increase inventories. Moreover, they believe the recent slowdown to be a temporary setback, and expect to recover lost sales over the next two months. Overall, mid-summer sales are projected to be between 6 and 9 percent above year-earlier levels.

Reports from commercial bankers in the region indicate that business loan demand is slow, but no worse than seasonal patterns would lead one to expect. In terms of levels, commercial loans are between 2 and 5 percent ahead of the corresponding period in 1977. Consumer loan demand remains strong. Over the next six months bankers expect a slight pickup in C&I loans with August levels about 4 percent ahead of year-earlier figures.

The prime rate is currently 8 percent at all of the banks contacted, and is generally expected to be pushed into the 8 1/2 to 8 3/4 percent range by late summer.

Bankers contacted say that higher short-term interest rates will definitely have an effect on the market for mortgage funds. Some have already noticed some disintermediation on the part of depositors as higher earning assets became available. One official at a local MSB notes that there is still a net inflow of deposits at his institution only because the rate on large CDs was recently hiked. He believes that if the short-term rate rises another 25 basis points, this region will see a significant shrinkage in the supply of available mortgage funds. In addition to this, most of the commercial bankers contacted say that as short-term rates go up, lenders will shift away from mortgages into short-term assets. It is generally felt that this would

also happen at institutions committed to financing the housing market, such as MSBs and S&Ls, but that they would take a longer time, perhaps 4 to 5 months, to make such alterations in their loan portfolios.

FOURTH DISTRICT - CLEVELAND

Blizzards and the effects of the coal shortage have distorted District economic activity for the past several weeks. Retail sales have weakened partly in response to prolonged sub-freezing temperatures throughout most of the District. The coal shortage has hampered manufacturing in some areas, and while layoffs have been minimal, mandatory curtailments in electrical power will cause considerable layoffs when imposed. Savings flows into savings and loans continued to soften in February and while commitments are not being cut back, officials are cautious over prospects for both commitments and mortgage loans for 1978.

Retailers of general merchandise and automobiles attribute some of the weakness in retail sales to severe winter weather. While recent poor performance of sales has not discouraged retailers, some appear less confident than they were a month or two ago. One official of a large department store chain, who remains optimistic for the short run, expects a 15 percent gain in first quarter sales over last year. Sales increases are expected to taper off as the year progresses. An economist with a national retail chain expected some let-up in sales this quarter following an unsustained rate of increase in the fourth quarter of 1977. Despite the large drop in sales during January, he still expects a 9 to 9 ½ percent increase for the year. A banker noted that retail sales had been depressed directly and indirectly by the coal strike.

Auto producers and auto suppliers differ on expectations for auto sales and output this year. An economist with a major auto producer expects new car sales of 10.9 million units in 1978, only slightly below his original forecast of 11.2 million last fall. He believes that bad weather over a larger part

of the country this year than last has been an important factor in holding down car sales. Auto suppliers, including producers of flat glass, tires and auto components, expect sales in a range of 10.5 to 10.7 million units this year. While suppliers generally note some easing and setbacks in orders from auto producers, none consider this of consequence.

The coal shortage has resulted in only scattered production cutbacks and layoffs, but worsening conditions can be expected if mandatory controls on electricity are imposed this week in some large metropolitan centers of the District. Of 9 major utilities in the District, all but 3 have plans calling for mandatory cutbacks in power usage that range from 25 to 50 percent when coal stocks fall to a 40-day supply. Three utilities that serve Toledo, Cleveland and Dayton have coal stocks that range from 52 to 60 days. Three utilities that have a mandatory cutback when stocks fall to a 40-day supply have a 43 to 50 day supply. Three utilities have coal stocks that range from 25 to 33 days' supply and plan mandatory cutbacks of 50 percent perhaps early this week. One of these utilities serves the Pittsburgh area and another serves northern Ohio.

The situation is of course fluid because of daily changes in supply conditions. A principal problem is that several utilities cannot physically increase purchased-power, and supplies of non-union mined coal has either dwindled sharply or has virtually ended. Although coal production this month is estimated at about 25 million tons, compared with a typical monthly average of 60-65 million tons, utilities claim these supplies are not available.

Several manufacturers have indicated that they can manage their operations with a 25 percent cutback in electrical power possibly by diverting production to other plants, reducing overtime, reducing the number of shifts,

and perhaps, using small generator facilities. Larger cutbacks would result in sizable decreases in both production and employment.

Supplies of other fuels range from adequate to excessive. A large natural gas supplier in northeast Ohio expects supplies are adequate to accommodate continued below normal temperatures into mid-March, unless temperatures fall much below zero. Another supplier has requested voluntary conservation by its largest customers in order to assure adequate supplies for the coming month. Despite recent cutbacks in refining, inventories of crude, distillate fuels and gasoline are still well above normal levels.

Steel operations this quarter appear to be much improved from last quarter. Capacity utilization will probably rise to the mid-80's compared with about 75 percent last quarter. The improvement in part represents price hedge buying, stronger than expected orders for March represent some hedging against the possibility that steel operations will be curtailed by severe cutbacks. Recent steel price increases have been holding, which again is viewed as customer concern over steel supplies. The record volume of steel imports in December is the result of efforts to ship as much steel as possible before the effective date of reference pricing of steel on February 21. One steel economist estimates that the selling price of EEC steel shipped into the U.S. should be about \$60 per ton higher than the U.S. price, rather than \$80-\$90 below U.S. prices.

Executives with thrift institutions are cautious about the outlook for mortgage credit. They have not cut commitments on new mortgage loans and do not expect to curtail commitments unless net savings flows deteriorate further. Officials generally feel there is room for further reduction in liquidity. The main source of concern is volatility of deposit flows, especially in

passbook accounts. Most associations had a small gain in net deposits during January, although some larger associations had negative flows. Inflows so far in February are generally positive although outflows were experienced around February 16 when the two-year 7.7 percent Treasury note was offered. Despite positive inflows, several officials noted cash flow this year has been falling behind expectations and in some cases below the volume of commitments.

Mortgage loan demand in the District is described as strong or stronger than last year and one official explained the recent 1/4 percent rise in mortgage lending rates in Cleveland (generally 9 percent for an 80 percent loan) as an effort to restrain demand. Some associations expect to maintain lending by tapping the secondary mortgage market, and some others plan to either step-up or undertake sale of mortgage backed securities as an additional source of capital.

FIFTH DISTRICT - RICHMOND

Fifth District business activity generally picked up in January judging from our latest survey. Such measures of activity as new orders, backlogs of orders, and employment improved among manufacturers surveyed. Only shipments, apparently held down by adverse weather conditions, showed no gain. Retailers also noted improved conditions as reflected by rising total sales and relative sales of big ticket items. Nonetheless, manufacturing respondents are less optimistic than they were a month ago. At least part of this change in attitudes is possibly due to apparently imminent curtailments of power consumption dictated by dwindling coal stocks. Despite the recent implementation of emergency measures in some areas, however, actual effects of the coal situation so far have been minimal. In the financial sector, mortgage demand continues to be strong on a seasonally adjusted basis. To date, supplies of mortgage funds have been adequate. In some areas terms of lending are tightening in response to slower deposit growth.

Conditions among Fifth District manufacturers firmed over the past month with one-third of our respondents reporting an increased volume of new orders and rising order backlogs. Despite the fact that inventories, of both finished goods and materials, expanded over the month, there was no increase in the number of respondents reporting excessive inventories. Employment among manufacturing respondents also rose slightly but hours worked per week remained stable. Prices, meanwhile, continued to increase generally, although several manufacturers report declines in prices received.

Among retailers responding to our survey, both total sales and the relative sales of big ticket items improved over the past month. Retail inventories apparently declined slightly and are now essentially in line with

desired levels. One respondent, however, views current stocks as lower than desired. Prices and wages were generally higher than a month ago according to the retailers surveyed. Most Fifth District directors now anticipate that 1978 automobile sales in their areas will be somewhat weaker than in 1977.

Although the expectations of our respondents regarding future business activity remain basically optimistic, manufacturers' expectations seem to have weakened somewhat over the past month. Fewer than one-third expect the general level of business activity, nationally, locally, and in their respective firms to improve over the next six months. On the other hand, more than one in six now foresees some deterioration of conditions over that time period.

Other than the direct employment impact upon workers in a few industries, e.g., miners and railroad workers, and some secondary impact in such areas as local retail sales and state government revenues in coal mining areas, the coal strike has had little effect on the District economy to date. Dwindling coal stocks, however, have led to some minor power curtailments by electric utilities serving West Virginia and parts of Maryland and Virginia. If these utilities are forced to rely on their current coal stocks and are unable to tap outside sources of electrical power, major curtailments are possible within the next ten days to two weeks. The utility regulatory body in West Virginia has already initiated an emergency plan which will institute gradual service curtailments as needed.

Comments of our directors and industry sources suggest some tightening in mortgage markets, at least in some areas of the District. A slowing of deposit inflows at lending institutions coupled with a seasonally vigorous demand for mortgage loans has created a general impression that a continued

tightening of market conditions will be increasingly reflected in lending terms over the next several months. To date, however, adjustments have been scattered and apparently concentrated principally in the larger cities.

The volume of credit extended by large Fifth District banks has been unchanged since the beginning of the year. Consumer loans, other than mortgages, have increased only modestly while business loans have been essentially flat. At the same time inflows of deposits appear to have been slow. There has been no gain in savings deposits, and the growth of large negotiable CD's has leveled off.

Replies to our fourth quarter farm credit survey revealed that last year's drought-reduced crop output and the tightening cost-price squeeze combined to create cash-flow problems for many Fifth District farmers. Bankers as a result have experienced much slower loan repayment rates and a sharp increase in requests for renewals and extensions. Farmers' demand for credit from traditional lenders continues fairly strong even though many farmers have been able to qualify for Federal drought disaster loans. Bank supplies of loanable funds seem to be adequate for the demand, but they are apparently at the lowest level since this survey began more than two years ago.

District farmers may cut 1978 cotton acreage 26 percent from last year but are likely to offset this reduction partially by increasing soybean plantings 9 percent. Planned feed grain acreage is down 5 percent as was the acreage seeded to food grains (wheat and rye) last fall. These intended plantings are as of January 1 and may change considerably by planting time.

SIXTH DISTRICT - ATLANTA

Even the Sixth District felt some ill effects of recent severe weather. Low temperatures added to the strain on already questionable supplies of coal. Construction activity was interrupted and retail sales were slowed in some areas, but strength in unaffected areas and earlier last month gave the District a satisfactory January record in both respects. Damage to winter crops was minimal. Thrift institutions have taken steps to compensate for smaller deposit inflows and generally feel capable of meeting continued heavy demand for home loans. But recent mortgage rate increases have been met with a flurry rather than a flight of home buyers. Foreign capital has become increasingly significant in the District's commercial and industrial development and more frequently discussed.

Savings and loan associations, faced with mild to moderate reductions in savings inflows and the smallest paydowns in many years, generally believe they will be able to meet expected strong demand for home mortgages. Campaigns to promote savings are under way; more associations are offering ceiling rates on certificates, advertising, and giving premiums. The Atlanta Home Loan Bank president feels that the good earnings and liquidity positions of southeastern associations will allow them to pay higher rates and still meet housing demands; however, mortgage rate hikes have been common in the past six weeks. The going conventional rates are 9 percent for 80 percent loans and 9 1/4 to 9 1/2 percent with 10 percent down payments, up from 8 1/2-8 3/4 percent a month earlier; closing costs have moved up about half a point as well. The currently prevailing rates in Florida are slightly lower, but some cities report top-of-range rates and a number of associations have announced increases to take effect on March 1.

Announcements of coming increases in mortgage interest rates have brought home buyers out of the woodwork, according to a director from South Florida. Yet in Atlanta, where higher rates are already in effect, buyers are coming out in force to head off possible further hikes. Indeed, the only sign of slackening of surging housing demand has been a leveling of single-family home construction in a few areas of Florida where lots have grown scarce and some recent building has been speculative. There, and in other parts of that state, condominium starts and sales have been quite brisk, stimulated by negligible apartment vacancy rates and high rents. Poor weather nationwide has induced a spurt in preretirement home buying and in requests for rental housing in southeast Florida.

With no end to the United Mine Workers' strike in sight, coal supplies have become strained in some areas. Mining operations have virtually halted in Alabama, where 12,000 miners are off the job, although only 70 percent are union members. Severe weather has hindered nonunion production in northeast Tennessee, putting further pressure on prices that are already \$10-\$15 per ton above usual. Electric utilities and major industrial users, most of whom are relatively comfortable with 30-60 day supplies, fear that delivery start-up will not be timely unless settlement and ratification come quickly. Although the TVA has systemwide supplies of about two months, reserves at five of its twelve coal-burning plants are down to three weeks or less; power supplies have been curtailed in at least one rural area of Tennessee. Deliveries to TVA are running about 20 percent of normal; a spokesman says that shifting of coal between plants is not practical. U. S. Steel in Birmingham has undertaken conservation efforts; a coal "loan" from the Redstone Arsenal was required to keep Huntsville area schools open. On

the other hand, Mississippi Power carries a 150-day supply, and one TVA plant is flush with reserves adequate for 250 operating days. A director in the coal industry expects that negotiated wage increases and higher severance taxes and related costs will add at least 25 percent to the price of coal.

Icy roads and extreme cold put a damper on consumer spending in the northern portions of the District; consequently, month-end retail stocks weren't as light as expected. However, a fairly strong sales pace continued in areas that were least affected by the cold, and heavy early January buying kept monthly sales estimates even with January 1976 or better in the worst afflicted locations. Auto sales were generally slow but picking up in late January.

Damage to citrus crops from two freezes was mainly limited to specialty fruits and should have little or no impact on the availability of orange concentrate. Fresh orange shipments are running about one million boxes behind last year this season. The late start and projected high returns for processed fruit have been restraints, but the primary reason has been sky-high prices: FOB prices have risen 60 percent over the year, and on-tree prices have quadrupled. Cotton prices continued the uptrend which began in early December, despite the release of reports of heavier-than-expected 1977 production and planting intentions for 1978 and of declines in mill consumption and advance sales for export. A director attributes the price strength to the depressed exchange value of the dollar. He also expects near-record marketings (and thus some price weakness) of fed cattle in the next three months. In Louisiana, the trickle of sugar mill closings continues and threatens to grow; producers say they want out of raw sugar. Processing operations, however, are expanding. As regards

the farm strike, some 200 Georgia farmers have promised to withhold 50 percent of their land from production this year; they claim that their counterparts have promised to set aside at least 25 million acres nationwide.

Foreign investment, actual and suspected, has become a hot topic of discussion among southeastern businessmen. A regional real estate firm headquartered in Atlanta described foreign investment in income-producing properties as heavy and primarily from European interests. A director notes that foreign investors bought two-thirds of the shopping centers, one-third of the office buildings, and one-fifth of the large apartment buildings sold in Florida's Dade and Broward Counties last year. There are 55 foreign-owned projects currently under construction or planned in that state, compared to 4 at this time last year. The list includes Siemens-Allis Chalmers' huge electric generator plant recently announced for the Bradenton area. Miami banks have been hard pressed to put to work their recent strong inflows of South American capital. However, business analysts in Georgia indicate that foreign investment in farmland has been insubstantial, despite rumors to the contrary.

Inventory accumulation appears to be accelerating modestly after slowing through year-end. A Georgia survey of purchasing agents indicates that stocks, both current and expected in the near term, are rising, particularly of finished goods. Deliveries are slowing, lead times lengthening. Goods in short supply in the District include a number of building materials, paper for web offset presses, and oil-drilling rigs.

SEVENTH DISTRICT - CHICAGO

The big economic news in the past 30 days has been the impact of severe weather on sales and output. Strike-depleted coal reserves of electric utilities are requiring power usage restrictions in Indiana. Retail sales were strong prior to mid-January when the storms began to take their toll. But sales are expected to snap back as weather improves. Inventories are generally on the low side. Prices of manufactured goods are rising more rapidly. Demand for capital goods continues to increase overall. Orders for steel have improved since December. Mortgage credit is tightening, and home starts are expected to decline in 1978. Farm credit conditions have improved slightly. The recent rapid rise in hog prices reflected a surprising decline in marketings.

Bad weather hampered sales and output in much of January and February to a greater extent than in any previous winter in memory. Heavy snow, ice, and high winds caused widespread worker absenteeism, particularly in Illinois and Indiana. Activity was affected in the retailing, construction, manufacturing, and service industries. Trucks often were unable to move, at least not at normal speed. The railroads also had problems with widespread freight car shortages. Heavy ice on the waterways has drastically slowed or halted traffic. A record number of airline flights were canceled. Among the industries affected significantly by weather were steel, paperboard, motor vehicles, and appliances. In all cases losses in sales and output caused by weather are expected to be recovered in the months to come.

Electric utilities serving most of the district will be able to supply their customers despite the long coal strike. This is because of large starting

stockpiles, and heavy use of western coal and nuclear power. Problems are mounting in Indiana, however, except for the steel producing area at the foot of Lake Michigan. Strike-affected utilities in the rest of Indiana have requested a sharp cutback in lighting. Mandatory cutbacks for large industrial users are expected shortly. Some factories can supply a portion of their power needs from self generation. But power cuts of 50 percent or more would shut down or curtail the operations on a massive scale. Many district manufacturers with ample power available emphasize that they are dependent on components made in Ohio and other power-short areas.

Large retailers were very pleased with sales prior to mid-January. Snow and blizzards since then have had an unprecedented impact on volume. Customers and clerks often could not get transportation, and deliveries of merchandise were hampered. Some winter-related items are now in short supply. Rising incomes and evidence of consumer optimism (despite some surveys to the contrary) probably assure a rapid rebound in sales as weather improves. Prices of general merchandise are expected to rise 4.4 percent on average in 1978, somewhat more than last year. Airlines credit discount fares with large gains in passenger traffic, weather adjusted.

Bad weather and strikes have reduced motor vehicle output substantially in the past 30 days. In part, these output cuts merely substituted for layoffs which would have been required to hold down excessive inventories of cars and trucks. Temporary shortages of models that have been selling well are expected, however.

Steel orders have increased in recent months. One company projects 1978 shipments at 97 million tons, assuming a 3 million ton cut in imports. Auto company orders are down, but orders for plates, bars, and structurals for

capital goods are up. Orders have also increased at steel service centers. Weather problems on deliveries reduced shipments 10 percent in January. Coking coal supplies are adequate if the coal strike ends by April 1. User inventories of steel are believed to be very thin.

Although there are important exceptions, demand for capital goods, overall, has continued to improve. Construction equipment is the strongest sector. Farm equipment continues very weak, but one tractor plant has reopened as scheduled after a January layoff. Producers of castings, axles, transmissions, valves, controls, motors, and other components sense that demand for most types of equipment is rising. Design-engineer companies that handle major long-lead time projects say that their workload has increased in recent months, after a long dry spell, and they find the outlook "very promising."

Demand for homes has held up well in recent weeks, in view of severe weather. Nevertheless, analysts anticipate a 10 percent decline in starts in 1978 to about 1.8 million (with a drop in singles more than offsetting a rise in apartments) because of recent and prospective disintermediation. S&Ls around the district say that net inflows of savings have been "below expectations" this year. The average drop from a year ago was 30 percent in the Chicago area, but much more at some institutions. Some officers in downtown areas reported "red figures." Interest rates have increased by as much as a half percentage point in the past two months, and are now in the 9 to 9 3/8 percent range on 20 percent loans. Further increases in rates are expected. This week some S&Ls have tightened other terms by reducing maturities and by increasing fees. Some are limiting new loans to single-family owner-occupied dwellings. Borrowings at the FHLBs are up significantly. Commitments have been made more cautiously in recent months, and fees have been charged more frequently.

Despite the points cited above, no drastic curtailment of new loans is anticipated unless disintermediation accelerates sharply.

Our survey shows that farmland prices increased moderately in the fourth quarter, offsetting a decline in the third quarter. The increase for 1977 was 13 percent, smallest since 1972. Credit conditions at rural banks improved slightly in the fourth quarter, halting the rapid deterioration of the third quarter. Higher crop prices in recent months reflect, in part, a record movement of grain under CCC loans. Margins of livestock producers have improved as prices rose in recent months. The very rapid rise in hog prices since year end has surprised most analysts. Hog marketings have been well below expectations. Partly this may reflect weather conditions, but earlier projections of a 5-7 percent rise in hog slaughter in the first half are being scaled down.

EIGHTH DISTRICT — ST. LOUIS

Business activity in the Eighth Federal Reserve District made modest gains in January although production and sales were hampered by adverse weather conditions. Retail sales registered small increases. Inventories were generally at or near desired levels. Manufacturing activity in most industries continues to increase. Home construction remains at high levels, spurred by a backlog of new home sales. Net savings inflows of consumer-type time and savings deposits into commercial banks and savings and loan associations continued to increase, but the rate of growth has slowed substantially. Mortgage interest rates have risen on both commercial and residential loans.

Retail sales registered modest gains in January compared with a year ago. Sales were reportedly hurt by adverse weather conditions, although last year's January sales were also adversely affected by severe weather. Department store representatives reported somewhat larger sales gains for durable goods than soft goods. Automobile sales in the St. Louis area this year were about equal to the January and early February sales of last year but inventories of new cars are generally above desired levels. No significant inventory problems were reported by other retailers.

The rate of growth in manufacturing appears to have slowed somewhat in January from the December level, reflecting in part some weather-related problems and a slowdown in automobile production. Severe weather slowed the delivery of raw materials and parts to a number of plants in the District. Some automobile assembly plants were temporarily shut down in order to make inventory adjustments in models where sales had not met expectations.

Representatives of some capital goods manufacturers reported small gains in production, although demand has not been as strong as had been expected. Production of housing-related goods, including building materials, construction equipment, and wall coverings, remains generally strong. Aircraft manufacturing continued strong as substantial order backlogs were reported.

A large backlog of orders continued in the home building industry, although a slowdown in new home orders has occurred in recent weeks. Homebuilders were generally optimistic despite the slowdown, given the existing backlog of orders and the generally good prospects for new home sales this year. Contributing to the large number of unfilled orders was the severe weather in part of December and January which hampered construction.

Commercial banks in the District experienced little change in consumer-type savings deposits, but relatively large increases in other time deposits, primarily large certificates of deposits, in January. Savings and loan associations generally reported that net inflows of savings were positive, but the rate of gain had slowed noticeably. The slowdown was attributed to rising rates on alternative investments, but disintermediation is not believed to be a serious problem at this time. It was pointed out, however, that further increases in short-term rates could have significant effects on savings inflows in the coming months. Borrowings by savings and loan associations at Federal Home Loan Banks were reported to be increasing, but the level of such borrowings was still relatively low.

The rate of interest on mortgage credit has risen in recent weeks. Mortgage rates on new homes in the St. Louis area are now generally at 9 percent on an 80 percent loan, up from 8-3/4 percent a few weeks ago.

However, a few savings and loan associations in St. Louis are still making such loans at 8-3/4 percent. Mortgage rates on commercial building have also moved up one-eighth to three-eighths of a percent. In general, mortgage money is reported to be available at the higher rates. However, some directors of the Little Rock Branch reported that in parts of Arkansas savings and loan associations were fully loaned up, that funds for commercial building were not now available, and that new home buyers were having difficulty in arranging permanent financing.

The coal strike may soon have a sizable impact on overall economic activity in the District. Union Electric, the leading electric utility in the St. Louis area, reported that mandatory cutbacks may have to be considered within the next two weeks unless the voluntary cutbacks proposed last week work or the strike ends. However, representatives of this firm report that it has greater coal supplies than most utilities as much of its coal comes from the western states. The Governor of Kentucky has made a plea to residential, industrial, and business customers to voluntarily reduce their use of electricity. The TVA (Tennessee Valley Authority), which supplies electric power to west Tennessee and most of Kentucky, expects to require reduction of current usage by all customers about March 1st unless the strike is settled. Representatives of utilities in the area report that the TVA plan will likely involve some layoffs at manufacturing plants.

Farm commodity prices and the farm income outlook have improved somewhat in recent weeks. Farm commodity prices average about 6 percent higher than last September. Nevertheless, a small percent of the farm operators still talk about a farm strike during the current year.

NINTH DISTRICT - MINNEAPOLIS

Homebuilding broke records and was a major spur to the Ninth District's economic recovery in 1977, but our Bank's directors don't think it will be quite that strong in 1978. Even though disintermediation is not expected to affect credit terms much soon, small upward shifts in the mortgage funds supply curve and rising materials and labor costs are expected to slow new homebuilding somewhat. This probable slowdown hasn't dimmed directors' 1978 outlook for most labor force groups. But they are concerned about continuing high unemployment among minorities and women and about the longer-term impact of recent legislation on the composition and growth of employment.

1977's homebuilding record won't be matched this year

Homebuilding in the Ninth District set a new record in 1977, and it's likely to stand through 1978. Last year's rate beat the 1972 record by 4 percent and the 1976 rate by 17 percent. Although directors generally expect this year to be pretty good for homebuilding, they expect more moderate growth than in 1977. The most pessimistic outlook, based on a projection by the National Association of Homebuilders, is that housing starts in the district will fall as much as 20 percent.

Directors believe supply shifts will cause most of this slowdown. Some are particularly concerned about rising building costs making new housing units "unaffordable." Most also think upward shifts in the supply curve for mortgage funds will push up the price of housing services.

The reason the supply curve for mortgage funds is expected to shift up is that deposit growth at district thrift institutions has been slowing and can be expected to continue to slow as incentives for disintermediation persist. An official of the Federal Home Loan Bank of Des Moines estimates that net savings inflows in January were 60 percent less than a year ago in the Des Moines district (which includes Minnesota and the Dakotas). One large thrift institution in the Minneapolis/St. Paul area reports a 50 percent reduction in net inflows in January, while another reports a net outflow. Directors suggest that disintermediation is a factor in this reduced deposit growth and that continued or widening differences in market and Regulation Q rates will exaggerate it.

Despite this deposit situation, directors observe that thrift institutions are currently augmenting traditional deposit sources with alternative sources, including borrowings from the Federal Home Loan Bank. As a result, they expect the impact of disintermediation on mortgage supply to be small in the near future.

The employment outlook is good--for some

Directors don't seem to think the homebuilding slowdown will reduce district employment much. District construction employment increased 4 percent during 1977, contributing a lot to the 3 percent increase in total employment. By December the district's overall unemployment rate had fallen to 5.2 percent, its lowest level in three years. Despite the expected homebuilding slowdown, directors do not expect any employment changes in the next few months, and the current high level of help wanted ads supports their view.

However, directors indicate that unemployment among some labor force groups is still very high. For example, minority youth unemployment in the Twin Cities is said to be about 40 percent. Native Americans are having particular difficulty finding jobs. And job opportunities in Minnesota recently appear to have been greater for men than for women.

Moreover, directors believe that the higher minimum wage could cut opportunities further for those having the most trouble finding work. Some think the higher wage will reduce youth and summer employment in their areas. Others think it will reduce job entries in the trade and service sectors, which traditionally have provided the most opportunities for those having problems finding employment.

Directors also believe the social security tax increases will hurt total employment growth here in the next few years. Since these increases will boost employers' costs and reduce take-home pay, some directors think business investment outlays may suffer, retarding employment growth in capital goods industries. Others suggest that these taxes will raise per unit labor costs which will induce business to substitute capital for labor. This substitution might improve employment in capital goods industries but would reduce employment in final goods industries.

TENTH DISTRICT--KANSAS CITY

Heavy snows and long cold spells have undoubtedly held back Tenth District business activity, but the economic outlook remains bright. This is the consensus, at least, of principals in the homebuilding industry and of bankers in the District. Homebuilders and executives of savings and loan institutes are virtually all in agreement that funds will be adequate to support another year of high mortgage demand. In one important District sector--agriculture--the outlook has improved as new forecasts now project higher prices for cattle and hogs. In banking, loan demand continues at very high levels.

Builders of homes continue to enjoy very high demand throughout the District. They say that they cannot build fast enough, and wish they could find the labor to put together additional crews. Most builders still are having problems getting certain materials, but half say that the shortages seem to be less severe. Housing starts so far this year are off a bit from the same period last year in some parts of the District, but only because of worse weather. Homebuilders expect 1978 to be as good a year for their business as 1977. All see interest rates rising, especially in the second half of this year, and several express concern about Federal Reserve policies. Most homebuilders, however, believe that sufficient funds will continue to be available for mortgage lending.

Savings and loan associations in all parts of the District report very high mortgage demand. All associations, except one whose mortgage rate is higher than its competitors, say that loan demand is equal to, or higher than, last year's. All report lower deposit growth, particularly in passbook savings accounts, than during the comparable period in 1976. However, one-third

say that deposit growth so far this year is substantially improved from the last quarter of 1977. None expects to be able to meet its 1978 mortgage demand with cash flow from deposit increases and mortgage repayments. However, all expect to be able to meet mortgage demand by obtaining funds from other sources. Two-thirds plan to increase their borrowings from the Federal Home Loan Bank. One contemplates issuing mortgage-backed bonds and another may issue a pass-through security. Several plan to increase sales of mortgages in the secondary market, while others have already cut back on, or stopped, purchasing mortgages or participations.

Mortgage rates in the District have increased from $3/8$ to $3/4$ per cent in the last year, with current rates ranging from 9 per cent in some cities in the eastern part of the District to $9\ 1/2$ per cent in the western cities in the District. An additional $1/4$ per cent increase in the next few months is generally anticipated. The respondents are not tightening nonprice terms or credit standards, nor do they plan to do so in the next 6 months. All believe that some combination of increasing rates and obtaining funds from nondeposit sources is preferable to changing underwriting standards, and that this combination of higher rates and nondeposit sources of funds will prove sufficient to meet the expected high level of mortgage demand.

Tenth District bankers generally report continued strong loan demand. Demand for business loans, particularly for energy-related industries, remains high. Demand for construction and other types of real estate loans is also very high. Banks in Albuquerque, Kansas City, and Omaha report strong deposit growth, but banks in Denver and Tulsa have recently experienced losses of funds and they expect to borrow in either the Federal funds or CD market to obtain the funds necessary to meet their strong loan demands.

Recent reports on livestock inventories contain a number of surprises which have important implications for prospective production levels and prices. Based on the December 1 Hog Report, it was expected that pork output in the first quarter would rise enough to effectively hold the lid on prices. Although some of the current strength in the hog market is related to weather-delayed marketings in the Corn Belt, the general tone of the market suggests that numbers in the December 1 report may have been overestimated and that hog prices in 1978 will not decline as much as originally anticipated. The probability of hog prices falling below \$35 per hundredweight anytime this year now appears small.

Similarly, the outlook for cattle prices has improved in the past few weeks. A recent report on the cattle inventory shows that numbers declined about 5 per cent in the past year. At 116 million head, the cattle inventory is about 2 or 3 million head smaller than most analysts thought it would be on January 1. The stage is rapidly being set for some rather explosive price increases in the cattle industry, and if pork production fails to expand as rapidly as currently projected, stronger cattle prices could easily occur in 1978. Although production estimates for 1978 must now be shaved down in light of this new information, total meat supplies should still match--and will probably exceed--last year's record. In 1977, prices for both hogs and fed cattle averaged about \$40 per hundredweight. Average prices for cattle in 1978 should run \$3 to \$5 per hundredweight above last year's figure, but hog prices are expected to average somewhat lower. Nevertheless, in both instances, the new forecast price levels are several dollars higher than originally expected. While this is good news for the farm producer, consumers will hardly be overjoyed by this prospect.

ELEVENTH DISTRICT--DALLAS

According to this month's survey of Directors and businessmen, the underlying economic conditions in the Eleventh District continue to improve. However, winter weather briefly disrupted some businesses in the northern tier of the District and contributed to a slight weakening of retail sales. Most nondurable goods manufacturers expect production to show modest gains this year, but petroleum refiners report that excess inventories of some refined products may hold down gains in output. Construction of office buildings continues to strengthen, and S&L's report mortgage rates are climbing as net savings inflows slow and mortgage demand remains strong. Rural land values are expected to be fairly stable this year according to District agribankers. The farm strike movement continues to attract only small crowds at its meetings and rallies in the District.

Occasional bouts of unseasonably bad weather have forced department store sales to fall below the expectations of some store executives. Sales are, nevertheless, running 10 percent above year-earlier levels, and inventories are at manageable levels. Although store executives concede that the sales growth recorded in 1977 will be difficult to beat, they point to rising income levels, growing employment rolls, and the proposed tax cut as reasons for expecting another strong sales performance this year.

Auto dealers report few changes in new car sales from last month. Sales continue to run slightly above year-earlier levels, but below earlier predictions by most dealers. Respondents see no major difficulties in selling cars and expect sales to strengthen by spring. Inventories are at "satisfactory" levels.

Apparel manufacturers report a recent strengthening of sales; however, they predict only slight increases in coming months. Rising production costs and buyer resistance to price increases are forcing some manufacturers to operate at only 75 percent of capacity. However, many large efficient firms report production near capacity.

Sales of chemicals are currently soft, but improvement is anticipated in coming months. One respondent forecasts a 10- to 12-percent sales increase this year, down slightly from last year's 15-percent increase. Petrochemical producers seem to be doing better than the rest of the industry. Capital spending plans for this year are on track but are largely limited to projects that conserve energy or convert from natural gas feedstocks to oil or coal.

Inventories of distillate and residual fuel oils are high, and refiners have switched to building gasoline stocks for the summer driving season ahead of schedule. Present capacity levels are expected to be sufficient this year. However, passage of the energy program and EPA approval of construction of new facilities to produce unleaded products would increase capital expenditures in the industry.

Construction of office buildings is on the rise in Houston and Dallas. In Houston, virtually all available office space is occupied, and most of the space in proposed buildings is leased before the projects get underway. Occupancy rates in downtown office buildings in Dallas average 92 percent of capacity. Several projects are under construction, and more are expected to be announced by summer.

Savings and loan associations in Texas report that disintermediation has not yet become a problem, but they do report a weakening of net savings inflows. One executive described the current situation as the "early stages

of disintermediation." With mortgage demand remaining strong, the rate on conventional mortgages has been raised over 50 basis points since November to 9 1/2 percent at many S&L's. That is only 1/2 percentage point below the state's usury rate. S&L's are increasingly more selective in the type of properties they will finance. Many S&L's that had previously stayed out of the secondary market report that they will now enter it to secure funds, and those that were already in it report that market is tightening.

The rise in land values in the District is easing adjustment problems for banks on some real estate loans. Renewal of speculative interest in "raw" land is also reported. Agribankers, responding to our latest quarterly survey, indicate that rural land values could remain fairly stable in the months ahead following the modest 5- to 6-percent increases recorded in 1977. Much of the appreciation of land values is due to inquiries and purchases from non-agricultural investors. Activity in the Red River areas of Texas and Louisiana is particularly strong. However, in many areas of Texas, reduced cash flows and incomes from lower crop prices and higher production costs have slowed the expansion of farm operations, causing land prices to advance more slowly. In fact, the rise of costs associated with fueling irrigation pumps has forced the average value of irrigated cropland on the Texas High Plains to decline in each of the past four quarters.

TWELFTH DISTRICT - SAN FRANCISCO

After a very good fourth quarter, retail sales have slowed -- most notably in Southern California. Western production continues to grow moderately, reaching full capacity in some industries. While some industries have very low inventories and most are at desired levels, the petroleum and natural gas industries are characterized by excess inventories. While there is concern about disintermediation, only a few banks have actually noted savings outflows. Because deposits have been growing less rapidly than lending, several thrifts have temporarily left the mortgage market.

After several months of depressed sales, some auto dealers report a pickup in sales beginning in mid-January. And after a record fourth quarter, retail sales in the Los Angeles area were fairly poor in January -- a phenomenon which might be attributable to the unusually heavy rains.

Production levels remain steady to growing in most western industries; full capacity is close at hand for some; and the inventory picture varies from thin to fat. The primary aluminum industry is producing at or near capacity and there is actually a capacity shortage in aluminum rolling (a stage into which half of all primary aluminum enters). Demand for fabricated aluminum products has been much higher than one would expect during winter months. In the aerospace industry, Douglas recently obtained a government order for 20 DC-10's and Lockheed received a request from Delta Airlines for 5 Tristan jetliners. The employment and income effect of the stimulus should continue for several years.

The energy field appears to be characterized by excess inventories of natural gas and petroleum products, though there is much concern expressed

over the continuation of the coal strike. A mild winter has resulted in large gas inventories (up 25 percent over year-ago levels according to one producer) and an eagerness among gas producers to make sales on favorable terms. There is also reported to be record inventories of petroleum products and an associated increase in competitiveness in that industry.

Agriculture is receiving mixed blessings. With the drought declared officially over in virtually all western states, farmers are assured of all the water they need over the next year. Unfortunately, the storms which brought the rain have caused quite severe damage to a number of California farms. At least one county, in which dirt and dust storms filled irrigation canals as well as some orchards, was declared a disaster area. Because of the damage done to some vegetables, like carrots, green onions and lettuce, local prices have risen sharply -- a reported tripling of price in the case of lettuce.

While construction activity continues at a steady pace in most parts of the District, houses are not selling as quickly as they were a few months ago. In contrast to the queues that were forming outside new developments in Southern California last year, today the average house is not sold until two months after completion. In the market for existing housing, it also takes about two months to sell and sellers are now getting 95 rather than 100 percent of their asking price.

While there is still concern over the possibility of disintermediation, only two banks report having observed any decline in savings deposits. One small Southern California bank noted that its savings deposits had fallen off in January by about 5 percent more than the seasonal norm. A large California bank observed "some degree of outflow of savings deposits from banks and

thrift institutions in November and December," and expressed concern over the Fed's further tightening in January. This bank argued that the housing industry would be jeopardized if the 90-day T-bill rate moved above 7 percent. While most other banks surveyed had observed no savings outflow, some noted a significant slowing in the rate of growth of deposits and others spoke of an increasing frequency of customer inquiry regarding T-bill auctions. Still other banks noted a shift in the composition of savings toward the higher interest rate certificates.

There is some concern in the Twelfth District over the impact of rising money market rates and consequent savings outflows on the housing sector. Mortgage rates have increased by 1/4 percent in many parts of the District, though there has been little dampening of demand observed. A number of Oregon thrifts have adopted a 60- to 90-day moratorium on lending. Thrifts in one area of California have ceased making loans on multi-family or non-owner occupied properties. Several Idaho banks report that credit availability for housing over the coming year will depend largely upon whether the agricultural sector will liquidate its loans on schedule and how heavy agricultural loan demand will be over the coming year. The only dissent from this tight mortgage credit scenario, comes from the CEO of a large bank holding company, who argues that given weak commercial loan demand, banks will continue to remain quite active in granting real estate credit.