

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

This month's REDBOOK reports carry a clear message: a general softening in activity began in the second quarter, and no early reversal is in sight. The decline has centered in housing and consumption spending, but attempts to prevent buildups of inventories, and dimming prospects for capital spending are also factors. Despite weaknesses, total activity is still at or near record levels and job markets remain surprisingly strong. Motor fuel supplies have improved, but sectors affected by shortages are not returning to normal. Inflation continues unabated. Credit is tight, but generally available. Agriculture is prosperous, but transport problems are hampering movements of grain.

Pessimism is widespread as reflected in consumer attitudes, surveys of executives, and opinions of directors. The main causes of pessimism are continued inflation and concerns associated with the long-term availability of energy.

Philadelphia's survey of manufacturers shows a decline in activity after "three months of no growth." Richmond's survey reveals declines in shipments, new orders, and order backlogs.

Most districts reported that gasoline and diesel shortages had eased significantly in the past month, because of both increased supplies and conservation induced by sharply higher prices and concern over availability. The main direct adverse impact of fuel shortages has been on low-mileage vehicles and tourism. A number of districts, notably Atlanta and Dallas, remarked that tourism had recovered significantly as fuel supplies improved, but summer tourism certainly will be off substantially nationwide except for some favorably located areas.

*Prepared at Federal Reserve Bank of Chicago.

Although scattered layoffs have occurred, most districts reported demand for labor still strong. San Francisco finds that layoffs in some manufacturing industries have been offset by continued gains in other manufacturing industries.

Virtually all districts reported sluggish retail sales, especially of items adversely affected by energy. New York was particularly concerned. Some districts, for example Richmond, found offsets in increased sales of items used in and around the home. Consumer credit use has been curtailed along with purchases of big-ticket items. St. Louis reported an increase in instalment credit delinquencies and personal bankruptcies.

Residential construction and sales of existing homes are off almost everywhere, but the impact varies substantially. Chicago reports residential permits down 40 percent, while Cleveland is "encouraged by the strength of the housing sector."

Shortages of materials have eased as activity has slowed, particularly in the case of building materials. Inventories are not generally excessive except for products such as big cars where sales have dropped sharply. However, steps taken to prevent the buildup of burdensome inventories are reflected in reduced demand for manufactured products. Both Cleveland and Chicago report a decline in new orders for steel, but output prospects are favorable for the short term.

Vigorous activity in nonresidential construction contrasts with the residential picture. San Francisco mentions a shortage of office space.

Demand for capital equipment remains strong overall, but some weak spots are appearing. Boston, New York, and St. Louis report some manufacturers scaling back expansion plans. Among the capital goods sectors that remain

strong are commercial aircraft, railroad equipment, electronic controls, machine tools, and energy-conserving items.

Demand for most types of credit remains strong. Terms are stiff, but good risks are readily accommodated. Usury ceilings which had limited activity in Texas and Louisiana are being liberalized. Business loan demand is reported as "exceptionally strong" by both Boston and New York, but Philadelphia says business loan demand is "mixed." Several districts comment on the lack of deposit growth.

Farm income prospects are favorable with high prices and excellent yields indicated for wheat, corn, and soybeans. Kansas City believes that "outstanding" wheat yields imply the USDA has underestimated the crop. Facilities to move and store grain are fully utilized. Minneapolis fears that a strike at the port of Duluth will cause loss of one-third of the area's wheat crop.

FIRST DISTRICT - BOSTON

Redbook interviews in the First District indicate that business conditions continue to be mixed but that signs of softness are becoming more widespread. Bank loan demand remains very strong. Orders for products of most of the region's factories are still quite healthy although some manufacturers are scaling back expansion plans in anticipation of a later weakening. Retail sales range from soft to very poor with inventory accumulation beginning to become a problem. Although a variety of specialized materials and electronic components remain in short supply, lead times for deliveries are beginning to stabilize.

A large money market bank reports exceptionally strong loan demand across all segments of its business. The chief executive officer of this bank feels that much of this expansion is accounted for by more firms borrowing short-term now in the anticipation of lower long-term rates in the future. Deposit growth at most large banks in New England has been slow resulting in increased reliance on purchased funds to finance expanded loan activity. Smaller northern New England banks also report strong loan demand but have resorted to rationing credit because of slow deposit growth.

Reports from the region's manufacturers are varied. A supplier of wiring harness to the auto industry has experienced significant reductions in orders. Similarly a furniture manufacturer indicates that new orders have fallen dramatically in the last few months as a result of dealers attempting to drastically reduce inventories. A large tire manufacturer reports that sales are very slow in the replacement market as well as to Original Equipment Manufacturers. Furthermore the improvement in gasoline supplies does

not seem to have brought about an increase in tires or auto accessory sales.

On the other hand, both current sales and new orders are very strong for the region's electronics and mini-computer manufacturers. Similarly, both military and commercial demand for aircraft engines and related components is brisk. Overseas orders are an important source of strength by both electronics and defense goods producers, a pattern that is expected to continue. Despite the fact that many of the regions high technology manufacturers expect to be little affected by the national recession, uncertainty has caused some of them to scale back expansion plans. For example, one director has cancelled the construction of a new plant even though his own sales remain healthy.

The Chairman of the Board of a large department store chain reports that sales are lower now in nominal dollars than in the same period last year. While other retailers have not seen this degree of deterioration they also report a general softening in sales. Most retailers believe the increase in gasoline availability is bringing some improvement in sales but not enough to affect a significant deterioration in buyer confidence. Retail inventory levels are beginning to become a problem. Bankers, manufacturers and retailers also report substantial increase in bad debts and other collection problems.

Professors Eckstein, Houthakker, Samuelson, and Solow were available for comment this month. Eckstein feels that the forecast announced by Chairman Miller and the one "leaked" from the Administration are so "unwarranted by current evidence" that it is "irresponsible [for] a government or a central bank [to issue them]." On the basis of the current data, he feels it would be "a grievous error to launch a \$20 billion tax cut in the near future." In

his view, "the economy had been overstimulated, ran into supply problems which produced a 'supply recession,' so that to apply traditional stimulus would be damaging." Solow's "best guess" is that this recession will be "at least average," though not as severe as 1974-75. However, in his judgment the downside risks are much greater than those on the upside. The primary downside risk is that the anticipatory consumer buying binge, which was atypical anyhow, will be reversed and that the savings rate will rise dramatically. An additional risk is the danger of "policy overkill"--the possibility that monetary and fiscal policy will remain tight throughout the recession. Solow emphasized that fiscal policy has become increasingly tight. For example, with a roughly constant unemployment rate, the federal deficit has declined dramatically over the past year. The implication is that monetary policy need not shoulder the entire burden of restraint. Samuelson warns that we cannot have full confidence in either the "mild" recession or the "worse than average" recession viewpoints. Policy should aim for small, but positive real growth. He notes that problems originating on the supply side have secondary impacts on aggregate demand. He reminds us that no one is expecting a generalized demand pull situation. Houthakker feels the economy is "in a relatively mild, rather prolonged recession." He anticipates no major changes in the rate of inflation. Houthakker feels there has been no serious weakness in the dollar and sees no terrible problems ahead. He grants that there has been some shift into sterling because it is backed by oil. Houthakker would be sympathetic to an increase in short-term rates.

SECOND DISTRICT--NEW YORK

Business activity in the Second District appeared to weaken in July, according to recent comments of directors and other business leaders. The weakening was most pronounced in consumer spending, with department store sales and new car sales falling well short of respondents' expectations. Outside of retailing, new orders have slowed and inventory stocks have grown. The unintended inventory accumulation generally appears to be relatively modest and only a few manufacturers plan to lower production levels. Nonetheless, some businesses have responded to the weakening in business activity by curtailing planned capital spending. On the financial front, the demand for bank credit has burgeoned, apparently bolstered by the need to finance higher stocks of inventories and by reduced corporate cash flow.

Consumer spending in the Second District slowed in July. Almost without exception, merchants reported that department store sales were well below planned levels. While the impact of the gasoline shortage was generally considered to have been concentrated in June, respondents judged that some effects spilled into July. Reflecting the lingering effects of the gasoline shortage, sales of stores located in suburban shopping malls have been noticeably weaker than at city branches. Retailers also noted a drop in Sunday sales and an increase in the average size of each transaction as consumers consolidate their shopping trips. Inventories of most general merchandise stores appear to be on the high side relative to sales, but most respondents professed little concern over the level of stocks. An

exception appeared to be apparel lines that had experienced an unusual softening in demand. For these lines merchants are considering additional markdowns and clearances. The directors of the Buffalo Branch were little concerned with the effect of the availability of gasoline on consumer spending. They were anxious over the longer term effects of the energy problem on inflation and the impact of higher fuel bills on discretionary spending.

New car sales in the District remain weak. While small cars are selling briskly, sales of larger cars and trucks are stagnant. The inventory situation reflects these divergent sales patterns. New car dealers report that small car stocks are almost nonexistent, while large car inventories are bulging. In order to spur sales and reduce the backlog of unsold large cars, dealers in New York and New Jersey noted that substantial price breaks were being offered on new large cars.

Outside of retailing, respondents expect the slowdown in economic activity to continue, but most see little immediate impact on their production. Most respondents reported that they are attempting to keep inventories at "lean" to "reasonable" levels. While there apparently was some unintended accumulation of inventories, most felt that inventories were not excessive at the present time. Confirming this viewpoint, a senior official of a major New York City bank noted that manufacturing inventories have grown, but maintained that they were still generally in balance. Because of a growing cautiousness on the part of business, capital spending plans in several industries have been reduced as a result of the business slowdown. In other industries, however, plans have been unaffected.

A major steel producer and an upstate machine tools manufacturer reported no change in capital spending. In addition, the Buffalo Branch directors noted that planned capital expenditures were going ahead on schedule in the Buffalo and Rochester areas. In New Jersey, however, a machine tools manufacturer and a diversified chemicals company announced cutbacks in spending plans. Some of the directors at the head office reported that businesses were reassessing their capital spending programs, while others had not detected any deferral of previously planned outlays.

Business loan demand at New York City banks has been exceptionally strong in recent weeks. Officials at the banks contacted cited firms' needs to finance higher levels of inventories as an important factor underlying the rapid growth of loan demand. Other factors mentioned included weakened corporate cash flows, continued capital spending, and mergers and acquisitions. Most respondents expected growth in loan demand to continue strong for most of this year before moderating or even declining in late 1979 and early 1980.

Third District - Philadelphia

Third District economic activity is mixed this month. Industrial executives report a decline in manufacturing which follows three months of no growth in that sector. Retail sales have improved slightly, however, after the gasoline shortage induced a June lull. Area bankers report moderate loan demand. As for the future, representatives from all three sectors agree that the next six months will bring a substantial decrease in business activity.

Manufacturers responding to this month's Business Outlook Survey report a decline in area industrial activity during the month of July. Thirty percent of the firms polled indicate a decrease in overall business activity, the largest drop recorded in over 4 1/2 years. However, this figure may somewhat overstate the actual decline inasmuch as July is typically a slow month for local industry.

Turning to specific indicators of current business activity, shipments were reported to be fractionally higher, but new orders remained unchanged and inventories slipped substantially, marking the ninth month in a row of declining inventory levels. As far as local labor is concerned, factory employment grew slightly during the month but this gain was offset by a fractional shortening of the average workweek.

The gasoline shortage experienced in the region during late June does not appear to have contributed significantly to July's slowdown in manufacturing activity. Responses to a special gasoline-effects inquiry indicate that local manufacturers felt little or no impact on shipments, deliveries, or overall production levels as a result of the gasoline crunch. The majority of respondents expect tight gasoline supplies throughout the summer and the balance of 1979, but again anticipate minor effects, at most, on production.

Over the longer term, survey participants predict a further dropoff in business within the next six months. A substantial number of manufacturers surveyed foresee decreases in both new orders and shipments between now and January and are planning to decrease inventories accordingly. The situation does not appear favorable for local labor either, inasmuch as survey respondents indicate plans to reduce payrolls and cut the length of the workweek within the next six months.

On the price front, inflation continues as 67 percent of the respondents report paying higher prices for inputs again in July and nearly 50 percent are charging more for their products. No relief is foreseen over the next six months with 90 percent of the manufacturers anticipating higher raw materials costs and 64 percent intending to raise the prices of the goods they sell. Survey participants feel that gasoline shortages and rising fuel prices will be at least partially to blame for upward pressure on prices in general.

Area retail activity has improved somewhat this month after a sluggish June. Reports of current dollar sales for late July indicate volume to be approximately 5 percent above the corresponding period in 1978. Sales are generally reported to be on target and, consequently, inventory levels are good. Suburban branches of department stores appear to have returned to normal business volume once again, after a slow June owing to gasoline problems. Merchants feel the odd-even rationing plan in effect in all three states in the Third District has helped suburban sales somewhat.

Looking ahead to the next two quarters, retail merchants are generally pessimistic. Caution is being exercised and merchants predict that they will be fortunate to meet last year's sales levels as they expect to end the year on a sluggish note.

Business in the banking sector is generally good this month, according to area bankers. Total loan volume is about 5 percent above late July 1978 levels. Most of

this strength comes from consumer loans though, while business loan activity is mixed. Bank executives contacted foresee a decline in both business and consumer loan demand over the next six months as the overall economy slips into a recession.

The prime rate in the Third District is back to 11 3/4 percent after a drop to 11 1/2 percent last month. Projections for the future indicate a decline in the prime by January 1980, possibly to as low as 11 percent. There is some speculation that the prime may increase 25 basis points before the drop begins though.

FOURTH DISTRICT - CLEVELAND

The majority view among area businessmen and economists is that the recession began in the second quarter and will continue through the second quarter of 1980. The recession will be slightly deeper and longer than previously believed, mainly because of recent energy developments. Most manufacturers continue to operate close to capacity on the strength of backlogs. Capital goods producers report that capital spending has lost some momentum, but most do not expect a decline in spending until the fourth quarter. A slight rebound during the third quarter is expected in the consumer sector, but not enough to reverse the negative second quarter numbers. Gasoline flows are improving and may aid in the deceleration of price increases. Mortgage loan demand remained strong over the last few months. The city of Cleveland may be unable to meet its own repayment schedule on defaulted notes.

Several area economists have revised their forecast to show a slightly deeper and longer recession lasting through the second quarter of 1980 in the absence of fiscal stimulus. They attribute the downward revision primarily to recent energy developments. An economist in the energy industry is optimistic that consumers will adjust quickly to the higher energy costs. A producer of major appliances expects that the decline will be gradual with a relatively mild inventory adjustment occurring primarily in the fourth quarter.

Among primary metals producers, production continued at "effective" capacity, but with emerging signs of a slowdown. Steel economists report only small declines in production over the past few weeks and backlogs are

still high. However, steel orders booked three months in advance have slowed considerably and backlogs are expected to be declining by September. The aluminum industry has not experienced a severe turndown in demand, but production is slightly slower than last month. Modest declines have occurred in production lines related to housing, auto and other consumer sectors. An aluminum economist reports that the industry is still below its optimal level of inventories and is expecting a record year in shipments.

A mild recession forecast is based upon the capital goods sector remaining strong at least until the fourth quarter. An official in the machine tool industry reports that production at his plant has returned to a more normal capacity with the recent elimination of overtime. He feels that capital goods spending is no longer in an expansionary phase, but that production should remain steady through the third quarter on the strength of order backlogs. Most manufacturers report that investment projects already underway should continue, but projects where money has not been appropriated are being postponed. Exceptions are aerospace and energy industries.

The Fourth District, especially Ohio, fared better than most of the U. S. during the energy crisis. An economist in the petroleum industry explained that access to Alaskan crude oil provided adequate supplies that could be traded for better gasoline-making crude. Refineries have been operating over 100% of capacity for the last six weeks. No closings or disruptions were reported by industries due to fuel shortages.

Prices remained strong, but many officials expressed optimism that price pressures would be weakened by the recession. Improved gasoline supplies should contribute to a slowing in the rate of gasoline price increases. However, an economist in the consumer durables sector calculated

the underlying rate of inflation (less food and energy shocks) at 10%. He expects double-digit inflation for the remainder of the year, but some moderation in 1980.

The consumer sector may experience a marginal rebound in the third quarter, but not enough to reverse the negative growth in the second quarter. Retail sales started to soften in May and continued through June. Although July sales are slow, they are still almost even with the pace during July of last year. However, a supplier to the auto and appliance industries feels that consumers are glutted with cars and appliances because of heavy anticipatory buying between August of 1978 and May of 1979. Manufacturers fear that auto inventories are too heavy and that other durable goods will soon follow.

District officials were encouraged by the strength of the housing sector. A severe downturn is not anticipated because the underlying demand for housing remains strong. Although housing sales have slowed and mortgage demand is down relative to last year, mortgage demand has stabilized in recent months and still exceeds supply. Consequently, S&Ls report some tightening of terms of mortgage loans. S&Ls continue to report difficulty in raising money since March, although the overall amount of savings has been quite strong over the first half of 1979. Barring further rises in money market rates and severe disintermediation, S&Ls anticipate a relatively mild housing turndown.

Cleveland's financial situation has shown little improvement despite the optimism after the March income tax hike. Rescue legislation has slowed in the State Senate and is unlikely to emerge before the mayorial campaign begins this fall. City financial records show that four special divisions in the city's budget have overspent by \$4 million so far this year. Most

sewer and street repairs have been halted. A special ordinance was required to allow a last minute roll-over of city notes using Water Department improvement funds. The city's own plan to repay the \$14.5 million in defaulted notes with \$1.5 million installments beginning in August may have to be abandoned due to the lack of funds on hand.

FIFTH DISTRICT - RICHMOND

Our latest survey of Fifth District business conditions suggests a marked slowing of activity over the past month. Manufacturers report month-to-month declines in shipments, new orders, and order backlogs. Inventories generally expanded both in absolute terms and relative to desired levels. More than two manufacturing respondents in five view current stocks as excessive. Retail sales showed little change over the month, but a majority of our directors feel that real sales are down slightly from a year ago. The directors anticipate little change in sales over the remainder of the year. Aggregate credit demand in the region continues to weaken, with consumer nonmortgage credit leading the decline. Business borrowings have been moderate in recent weeks. Our second quarter survey of farm credit conditions, however, reflected strong demand for agricultural loans, a continued rise in interest rates, and renewed pressures on liquidity at some banks.

Of manufacturers responding to our latest survey more than one-third experienced a decline in the volume of new orders and nearly as many had reduced levels of shipments during the past month. Backlogs of orders declined moderately. Respondents also report significant inventory accumulation during July. Over one-third indicate larger stocks of finished goods now on hand and over one-fifth report similar gains in materials inventories. Additionally, over 40 percent view current inventory levels as excessive while only six percent consider them inadequate. Nonetheless, a large majority of these manufacturers still feel current plant and equipment capacity and current expansion plans are at or near desired levels. Employment among District manufacturers declined slightly in recent weeks, and reductions in the length of the work week were widespread.

The District retail sales experience has been mixed in recent weeks although pervasive weakness in some consumer durables, notably autos, has given the entire retail sector a negative tone. It is the view of our directors that real retail sales are down only slightly from year ago levels, and most of them cite automobiles as a significant depressant. Weakness is also perceived in sales of recreational vehicles, boats, and tourist related lines. Recreational items for home use have shown some compensating strength and department store sales continue to hold up well in some areas.

Pessimism has become pervasive among our manufacturing respondents. More than ninety percent expect the general level of business activity nationally to worsen over the next six months and nearly two-thirds are anticipating further slowing of activity in their respective market areas. Over one-third expect the level of production in their own firms to decline over that period. There is less agreement among retailers as to the outlook for the rest of the year, but on balance they do not expect any improvement and seem to be preparing for some further weakening of sales. Our directors generally expect retail sales to be essentially unchanged for the rest of the year. Price increases continue widespread as over three quarters of all respondents report paying higher prices in the past month. On a brighter note, survey responses suggest a possible slowing of price increases in building materials lines.

As noted, aggregate credit demand in the region continues to weaken. It is in consumer lending that banks have noticed a clear softening in the demand for credit. Installment lending in particular has slowed as auto sales, and especially sales of recreational vehicles and power boats, continue weak. Moreover, there are some reports that consumer revolving credit is softening. At

the same time, second mortgage loans are doing well, with debt consolidation being a major factor explaining demand for such credits. Home improvement loans, however, are also fairly strong. The market for residential mortgage loans is somewhat confused. Both banks and thrift institutions report strong to moderate demand for residential mortgages. At the present time banks appear more willing to extend such credit than do the thrifts. In fact, real estate has been the strongest lending category at large District banks in recent weeks. Commercial and industrial lending is moderate, with utilities, construction related businesses, and both wholesale and retail trade accounting for a major share of new loans at larger banks. Some longer term loans for fixed investment are being made, but short-term lending predominates. Deposit flows are adequate to support the current demand for funds, although recent changes in Regulation Q do not appear to have significantly strengthened the deposit gathering power of financial institutions.

The second quarter survey of farm credit conditions in the Fifth District indicates that loan repayment rates and requests for renewals were running about normal. Supplies of farm loan funds at banks declined further, and there was a slight increase in the proportion of lenders having difficulty meeting the credit needs of their farm borrowers. Moreover, there was a fairly sizable decline in the share of banks who were actively seeking new farm loan accounts. Loan-to-deposit ratios of reporting banks rose to an average of 68.1 percent, only fractionally below the record level a year ago. Bankers who indicated they were requiring more collateral than usual rose to a new high.

SIXTH DISTRICT - ATLANTA

The gasoline crunch hit hard in only a few parts of the District but adversely affected much of the tourist sector. Now that gasoline supplies are adequate, some recovery in tourism is in prospect. Consumer spending has been soft, and there have been some layoffs in manufacturing. Residential construction continued its shallow decline, except for Florida and Georgia. Mortgage credit remains in good supply. Bank lending is growing at good, but less than boomy, rates, and commercial construction continues at a brisk pace.

Gasoline availability problems, which eased several weeks ago, left a negative imprint on the District's important tourist sector. Florida's Governor stated the gasoline crunch cost the state 20 percent of its normal tourism, the state's number one industry, from mid-June to mid-July. In Georgia, many motel operators with businesses along the major north-south route through the state reported an appreciable drop in occupancy rates compared to last year. Nashville businessmen involved in tourism estimated a decline in business anywhere from 10 to 35 percent. Although long distance driving was down, resort areas along the Georgia coast and within a day's drive from surrounding metropolitan areas received a near-record influx of tourists. Also, Latin American tourists have been coming to Miami in record numbers and staying longer because of actual or perceived inadequate gasoline supplies throughout the rest of the state.

Near-term prospects for tourism have improved. A massive and apparently successful campaign to boost tourism in Florida began in mid-July. Also, many hotel and motel operators in central Tennessee report

reservations are already up for August. Thus, sagging tourist trade within the District seems to have bottomed out.

Considerable softness in consumer spending was evident in most sections of the District. However, a notable exception was a real increase in sales at most large shopping malls in the Atlanta area where consumers substituted trips to area shopping malls for out-of-town weekend trips and consolidated several shopping trips into one. Automobile sales were sluggish because of continued slackened demand for mid- and large-sized cars; interest in fuel-efficient compacts remained intense.

Because of sagging sales, over 1,400 workers in the Atlanta area were placed on indefinite layoff, some with long seniority, at the Ford LTD assembly plant. U. S. Steel in Birmingham recently announced a severe cutback and the possibility of closing a plant there.

Inventories appear to be at manageable or even lean levels. Expectations of recession and, therefore, flat or slightly declining real sales in the third and/or fourth quarters of this year induced many retailers to trim stocks well in advance of the downturn.

The single-family residential construction pattern continued unchanged. Florida and Georgia, specifically the Atlanta area, recorded increases in building permits; the other District states experienced declines. Mortgage money remained generally available. Nonetheless, high mortgage rates dampened demand except for the more active areas in Florida and Georgia. And while some potential customers were priced out of the market, inventories of single-family dwellings are nowhere uncomfortably high.

Business and consumer loan demand continued on a stable path, with most District bankers experiencing satisfactory increases. However, a large

Georgia bank reported that demand for business and consumer lending has not been particularly strong, as businessmen are delaying future plans because of the recession. Weakness in consumer loan demand resulted from a downturn in automobile loans. Some bankers report an increase in applications for debt consolidation loans, but it is too early to tell whether a trend is developing.

Savings inflows to banks since April have been positive but slight, supported primarily by moderate but stable increases in money market certificates. Two recent financial developments within the District concern the raising of the usury ceiling on mortgages in Louisiana from 10 to 12 percent and the offering of variable rate mortgages by two Florida banks. The two banks offering VRMs report very active interest and substantial additional business from this innovation.

The brightest spot with respect to commercial and industrial investment continues to be Florida. Projects included a five-year, \$200-million downtown redevelopment in Jacksonville and new pharmaceutical and paper bag manufacturing facilities and a large convention center and condominium complex in the Tampa Bay area.

SEVENTH DISTRICT - CHICAGO

Although total business activity is probably slipping moderately in the Seventh District, trends are mixed from one sector to another and often within sectors. Weakness in the residential sector is contrasted with strength in nonresidential construction. Most types of capital goods remain vigorous. Consumer spending on lower priority goods and services is sluggish, especially for low mileage vehicles. Demand has eased for steel, nonferrous metals, building materials, and paperboard. Shortages have eased in sectors where demand has declined, but inflation is as strong or stronger than before. Lenders are cautious and selective but credit remains available to sound borrowers. Prospects for farm income are favorable.

Despite level or declining total activity, labor markets remain relatively tight. Reductions in employment have occurred in the motor vehicle and RV industries, but such workers are not readily absorbed elsewhere. Although residential construction is down sharply, experienced building trades workers are in demand for nonresidential projects and repair and modernization.

All eyes are focused on the upcoming UAW/Big Three labor negotiations. Labor's demands and initial company offers are said to be far apart. Some 700,000 workers are involved in contracts expiring September 14, and about as many more will follow their lead. The "word from Detroit" assigns a 30 percent probability to a strike of some duration, but such guesses have proved to be of little value in the past. Aside from heavy demands for compensation, many local issues and the prestige of various personalities present roadblocks to a timely settlement.

Most unions representing private and public workers are emphasizing

demands for full COLA adjustments plus other contract "improvements." Automatic COLA adjustments are raising many incomes each month. (The Teamsters will get a further 5 percent pay boost in October.) Some contracts are tied to local CPIs, despite problems of accurate measurement. The national CPI was 10.9 percent above year ago in June, but the Chicago index was up 12.1 percent. The Milwaukee bimonthly index was 15.1 percent above year ago in May.

Consumers turned cautious in recent months--particularly on purchases of large cars, trucks, and RVs. They are spending more on goods and services used at home. Demand for bicycles and roller skates is straining capacity. Discount stores and catalog sales are doing relatively better than the traditional retailers. Some tourist areas have been hard hit, but those closer to population centers have done well. Airline travel has leveled off after very rapid growth aided by fare cuts. Slowing sales of fast food chains are attributed to fuel stringencies, higher prices, and market saturation. Some bank credit card plans and some individual banks report increased consumer delinquencies, but big retail chains and big auto finance companies observe little or no deterioration.

Supplies of gasoline and diesel fuel have improved. Hours of some gas stations have been extended, but the situation is still far from what had been normal. Higher prices (in the Chicago area gas is generally \$1 and up) and continued concern about availability have curtailed longer auto trips. Improvement in availability of diesel fuel, at much higher prices, partly reflects a significant fall-off in tonnage hauled by truck.

Local oil experts believe that "serious" oil product shortages will be avoided through year end assuming (1) no new disruption of supply, (2) continued conservation, (3) a leveling or decline in general activity, and

(4) freedom for market forces to work. Natural gas availability is believed to be adequate assuming a normal winter and the absence of a stampede by industry to convert back to gas from oil. Heavy residual fuel is in good supply. Prices of all fuels will move up further from current levels, even if no new boost is decreed by OPEC. A move is gathering strength to subsidize fuel bills of lower income families on a broad scale. Public transport charges are almost certain to rise substantially soon.

Aside from retail trade, industries that have noticed a slowing in demand lately include steel, nonferrous metals, airlines, trucking, motor vehicles, and paperboard. Inventories had not been excessive overall, but new buying has become increasingly cautious. Forty percent of the Milwaukee purchasing managers, many capital goods oriented, reported new orders in July to be lower than in the previous month, compared to 20 percent reporting higher orders. The proportion reporting lower order backlogs in both June and July was twice as great as the number reporting higher backlogs, thereby reversing their reports for May 1979 and July of 1978. Over 80 percent continued to report paying higher prices.

District crops (concentrated in corn and soybeans) range from "good" to "excellent" following recent beneficial rains. Bumper harvests appear likely. Probable record grain and soybean shipments for the next several months imply that transportation and distribution facilities will be under stress. Grain shipments out of the Great Lakes region have been slowed in recent weeks by labor disputes at the ports of Chicago and Duluth/Superior.

District farmland values rose 3 percent in the second quarter and were 13 percent above year-ago levels. Prospects of high farm earnings this year help sustain the uptrend.

EIGHTH DISTRICT -- ST. LOUIS

According to Eighth District businessmen, sluggish economic conditions continue in a number of important area industries. Real consumer spending and manufacturing output remain unchanged from a month ago. Sales of automobiles, appliances, and some chemicals remain quite slow. On the other hand, capital goods manufacturing and nonresidential construction continue strong. Some reports, however, indicate a reduction in the growth of demand for capital equipment. Although layoffs of industrial workers have occurred in the automobile and certain durable goods industries, layoffs are not generally contemplated by most businessmen at present.

Consumer spending remained relatively low in recent weeks. On balance, July department store sales in real terms were about the same as in June but down from July 1978. Department store representatives noted that sales of big-ticket items were well off their 1978 pace. Only selected items, such as products for home repair, registered gains. A major retail chain representative noted that sales at large conventional stores were holding up better than at discount stores. Retail representatives also noted increased difficulties in collecting accounts and a sharp rise in personal bankruptcies.

Automobile sales are down from year-ago levels, but reports from some dealers indicate that sales improved somewhat in the past two weeks. Sales increases at fast food establishments were also reported to have slowed substantially in recent weeks. An industry representative blamed this slowdown on the recent sharp increases in their product prices rather than the gasoline problem. Spending on tourism was also reported to be well below

normal, having adverse impacts on local areas largely dependent upon this business. Tight gasoline supplies and consumer uncertainty over gasoline availability are blamed for the decline. However, the gasoline supply situation in the District has eased considerably in recent weeks. Service station hours have increased and the long lines of a few weeks ago have disappeared.

Output in the manufacturing sector, on balance, appears to have remained unchanged in recent weeks. Declines have occurred in automobile and related industries, appliances, home furnishings, and building products. But production of chemicals used by the oil industry and agriculture and a number of home supplies remain strong. One major chemical firm reported that the recent slowing in sales probably indicates a recession. This firm is cutting back on production schedules to avoid a buildup of inventories. A firm manufacturing apparel for a major retail chain noted that orders have been lower than expected and that production schedules have been trimmed.

Capital goods manufacturing activity is still quite strong and large order backlogs remain unfilled. However, one large capital goods firm noted that the outlook for this sector is not as favorable as two or three months ago. Some manufacturing firms in the chemical and appliance industries have trimmed their capital expenditures budget in expectation of a sluggish economy.

So far only a few industries have announced a layoff of workers. Among the most affected by layoffs have been the automobile and related industries. Scattered reports of layoffs were also reported in the appliance and apparel industries. However, most firms with sales declines apparently are coping with this situation by reducing hours worked.

Construction activity continues at a high level in the District despite sizable declines in residential housing. The volume of nonresidential construction continues well above year-ago levels in most of the District, although some weakness has apparently developed in the St. Louis area. Here, nonresidential contracts let in the second quarter were well below year-ago levels. Representatives of the residential housing market noted that home sales in recent weeks have also been well below year-ago levels. Homebuilders report that current traffic looking for new homes is very light, but that more of those looking are serious home buyers. Housing permits issued in the St. Louis area so far this year are down about one-fourth from a year ago. Carpenter hours worked were reported to be down only about 10 percent from a year ago, which indicates that builders are working on earlier orders.

In the financial sector, some net savings inflows into financial institutions occurred in July, but the rate of increase remains at a much slower pace than a year ago. Savings and loan officials report that money market certificates are the primary means of attracting new funds. However, they have been less successful in attracting these funds since the regulation change removed the differential rate paid by S and Ls over similar instruments issued by banks. The new usury law in Missouri, which was passed by the state legislature in June and which permits higher interest rates on loans, became effective in early July. Home mortgage rates in St. Louis have subsequently increased to a range of 10-7/8 to 11-1/4% for 80 percent loans, in line with national rates. Subsequently, availability of mortgage funds was reported to have improved and the terms of loans relaxed somewhat.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District economy is still not in a recession, but problems in several industries continue to threaten it. District nonagricultural output continues to expand, and the region's labor markets have not softened. However, energy-related problems, a slowdown in consumer spending, and a softening in housing markets remain troubling. And agricultural earnings are now worrisome.

The district economy is still not in a recession

The decline in nonagricultural output that accompanies a recession has yet to occur in the Ninth District. Directors in the Upper Peninsula of Michigan, Wisconsin, Minnesota, and South Dakota say that industrial output in their areas remains strong. Considerable investment spending is also occurring; during the first half of 1979, nonresidential construction contract awards in these areas were up about 25 percent from a year earlier. And in Montana and North Dakota, energy exploration and mining are boosting output.

Furthermore, the softening in labor markets that characterizes a recession has not happened here. Layoffs at Minneapolis/St. Paul firms are no higher than a year ago when the number of initial claims for unemployment compensation was low. In fact, many district employers are still seeking workers, for district newspapers continue to carry a record amount of help wanted advertising.

But last month's threats to the economy are still here

All of the troubling developments reported last month remain, however.

Even though the trucking strike has ended and fuel supplies are more plentiful than last month, concern about energy is still restricting activity in two district industries. The energy situation continues to hold down travel.

Although business is now better than in early July, directors from tourist areas report that anxiety about gasoline availability is continuing to keep many tourist-related businesses from even matching last year's sales. In South Dakota, for example, this summer's tourist business is expected to be down about 35 percent from a year ago. The energy situation also continues to hurt auto dealers. Worries about gasoline availability and price are still causing large car sales to sag, and dealers' inventories are mounting. Two directors believe that the situation is serious enough to start driving dealers out of business.

But, just like last month, cars aren't the only thing people have been hesitant to buy. In recent weeks about 10 percent fewer customers than a year ago have been shopping at the Minneapolis/St. Paul area's major shopping centers. And directors from other areas say their communities' retail sales continue to be weak.

The housing industry is still slowing too. Fewer people are buying homes; Minneapolis/St. Paul area mortgage loan applications are down substantially from a year ago. As home sales slow, the number of new and used homes on the market continues to climb. And a few homebuilders are beginning to run out of work.

A new concern

Since last month, a new problem area has developed in the district: farm income.

Grain producers' earnings have been hurt by a recent labor dispute. A month-old strike by Duluth/Superior grain handlers is seriously aggravating an already seriously strained grain transportation system. Thus, at a time when grain prices are high, district farmers are having trouble moving their crops to market. The situation will worsen as farmers attempt to store and market what

is expected to be a good harvest. According to Minnesota's governor, one-third of the Upper Midwest's wheat crop could be lost because of overtaxed storage and transportation facilities if the strike isn't settled soon.

The earnings of other ag producers have been hurt lately too. According to Montana and South Dakota directors, recent drops in cattle prices are significantly reducing livestock producers' profitability. And a Minnesota director says that recent price decreases are also cutting hog and poultry producers' earnings.

TENTH DISTRICT—KANSAS CITY

Nonfarm business in the Tenth District is beginning to show some of the nation's general weakness in economic activity, but the farm sector remains strong. Retail sales are generally weak, and input availability problems in manufacturing are lessening. Farm income will be high because of high grain prices and good crops. Deposit growth at commercial banks is weak, but loan demand continues strong.

According to Tenth District retailers, sales in current dollars are generally down about 10-12 per cent over this time last year. During the second quarter of this year, sales improved on a month-to-month basis, but remained below second quarter 1978 levels. In recent months homefurnishings, ready-to-wear, ladies sportswear, do-it-yourself items, bicycles, and garden supplies have recorded the strongest sales gains, while large ticket durable goods have shown the slowest gains.

Tenth District retailers have mixed views of their inventory levels, with many being led by the prospect of a recession to move to a lower acceptable level of inventories. But most District retailers expect sales to be strong this fall, because they believe the midwest is less sensitive to recessions and because farm income will be good this year.

One of the Bank's directors who is close to the energy business reports there should be no more than isolated spot shortages of gasoline and diesel fuel through the center of the nation for the rest of this year. Another director notes that the tourist business has suffered significantly this summer in the mountain states of the Tenth District.

Tenth District purchasing agents report that major input prices

are up significantly over this time last year. Even without petroleum product increases, raw materials have generally risen about 8-10 per cent, and some exceptional increases were noted in chemicals prices. For the remainder of this year, input prices are anticipated to increase very little. Most purchasing agents contacted felt that the major increases had already occurred for this year since many of their prices are locked in by contracts.

Input availability for most industries contacted has been a problem throughout this year, but has been easing through the summer months. For the second half of 1979, a continuation of the improving availability trend is anticipated by a majority of District purchasing agents. Overall, material inventory levels are satisfactory for the industries contacted. Most industries have been either maintaining or trimming their inventories throughout the second quarter of the year in an effort to keep them in line with recent sales trends. For the rest of the year, inventory levels are anticipated to remain unchanged unless the predicted recession alters fall sales dramatically.

Reported yields in most Tenth District wheat areas have been outstanding, which implies that total U.S. wheat production may exceed the USDA's most recent estimate of 2.1 billion bushels. With the sharp runup in grain prices, the income prospects of the District's wheat farmers have improved greatly for the 1979-80 period. The picture for other grains is also promising because of recent rainfall. Crop supplies for the 1979-80 marketing year should remain ample, and the high prices will boost crop income well above year-ago figures.

Recent reports on livestock numbers point to reasonably stable prices for the rest of 1979. Beef supplies will continue to shrink, but a substantial gain in pork production will temper any upward price pressures in the meat sector. Furthermore, data from the July 1 cattle inventory report provides

solid evidence that breeders are beginning to rebuild their herds, which may produce greater price stability in cattle markets next year.

Agricultural credit conditions in the District appear to be tightening somewhat. Loan demand remains quite brisk, but adequate funds can generally be found to meet credit requests. Nevertheless, the average loan-deposit ratio of rural banks moved up to 64.1 per cent as of July 1, which compares with 62.8 per cent on April 1 and 62.6 per cent a year ago. Interest rates on farm loans moved up about 30 basis points in the second quarter.

Tenth District bankers contacted report that deposit growth has been weak during the past month, with demand deposits as a major source of weakness. Demand deposits have apparently been affected by high short-term interest rates and by a below normal tourist season in resort areas. On average, bankers report moderate growth in money market CD's. All bankers contacted are offering the new ceiling rate on both savings accounts and the 4-year variable ceiling account, but savings deposit growth is weak throughout the District. Some banks are requiring minimum balances ranging from \$500 to \$1,000 on the 4-year deposits. Inflows to the 4-year account have been from all types of deposits, with savings deposits the most frequently mentioned source.

Loan demand is reported to be strong throughout the District. Several bankers note that a strong demand for commercial loans reflects a slowdown in receivables and an increase in inventories. Both real estate and consumer loans—except instalment loans for automobiles—are reported to be fairly strong. Some bankers report that in spite of strong loan demand agricultural loans were down, due to selloffs of participations to correspondents. Most bankers contacted have recently increased their lending rates, and are still trying to improve the quality of their loan portfolios.

ELEVENTH DISTRICT--DALLAS

Signs of a slowing economy continue to appear in the Eleventh District, but most Directors and businessmen think the Southwest will be affected only mildly by recession. Retail sales are lackluster as auto and department store sales remain largely unchanged from last month. Manufacturers report further sharp increase in production costs and slower output growth. Mortgage lending activity is slow but is likely to improve following easing of usury ceilings in Texas and Louisiana. Lending activity at large banks continues at a brisk pace, but rural banks report slower loan demand.

The effects of the gasoline shortages, declining consumer confidence, and shrinking real incomes are all combining to hold down retail sales according to respondents. Modest gains in large car and recreational vehicle sales are noted, contributing to a small increase in unit sales in recent weeks. Small cars remain in short supply. Year-to-year gains in real department store sales are small but steady, although unit sales of home furnishings and apparel are slowing.

Tourist trade in District resort areas is returning to more normal patterns following an easing in the gasoline shortage. Amusement and recreational establishments currently report good attendance levels. South Texas trade is being enhanced by a growing number of tourists from Mexico.

Manufacturing activity generally continues strong, with cost increases of greater concern to most respondents than a drop in sales due to

the recession. Reports of large increases in labor, material, and transportation costs are widespread. Although most manufacturers expect some slowing in their own industries nationally, they expect the overall impact to be milder in the Southwest. Aluminum producers in the region continue to expand capacity as demand strengthens. Output is being sold on an allocation basis, and the backlog of orders is growing. The strong growth in the region's aircraft industry is contributing significantly to demand. Demand for steel appears to be off slightly from a year ago, but production at District plants remains at a high level. Producers report less foreign competition and greater demand for steel products from foreign buyers. A few respondents report a runup of fabricated steel inventories. The smelting and refining of copper, zinc, and lead appears to be on the upswing, and demand continues to improve.

The number of active rotary rigs continues to increase, but remains well below last year's peak. Gains are lagging in East and South Texas where natural gas remains in surplus. Drilling activity in Oklahoma is slowed by a lack of drilling prospects. Rigs capable of drilling deep and offshore wells are in strong demand.

Heavy rains from tropical storm Claudette caused some damage to rice and soybean crops, disrupted transportation, and significantly slowed residential construction activity in the affected coastal areas. The full extent of the damage to agricultural crops is not yet known, but preliminary estimates place losses at \$26 million. Railroads are turning to normal after minor disruptions of service.

New and used home sales appear to be down 20 to 25 percent from a year ago in many areas of the District. The value of residential construction contracts in the four southwestern states is down about 8 percent from a year earlier. The value of nonresidential construction contracts in the first several months of 1979 is approximately 15 percent ahead of the same period a year ago. Builders note some recent softening in the non-residential market although much strength remains. High materials and financing costs are said to be contributing to the recent slowing in activity.

Mortgage lending activity by savings and loan associations in Texas remains slow prior to the lifting of the 10-percent usury ceiling on August 28. The availability of mortgage credit will improve substantially after that date, and mortgage lending is expected to increase significantly. However, the amount of new mortgage commitments lenders are making at the higher interest rates permitted with the new ceiling show only moderate increases over the level of commitments made in recent months. Mortgage lending has improved somewhat in Louisiana following the raising of its usury ceiling to 12 percent on July 6 although borrower resistance to the higher mortgage rates was much stronger than lenders had anticipated. Net new savings at S&L's continue to improve but remain slightly below the volume of last year. S&L's have lost a large segment of MMC's to banks since the elimination of their 1/4-percentage point advantage.

Bank lending activity continues at a fast pace. Many banks report

some recent easing in the rapid pace of consumer and real estate lending. The demand for auto loans and interim construction loans on multifamily projects is down slightly from the levels of recent months. Deposit inflows continue to make moderate gains.

Our July survey of agribankers indicates that agricultural credit conditions are easing in the District. Although the supply of loanable funds remains tight, bankers report a slowing of loan demand growth, higher rates of repayment, and fewer renewals or extensions of agricultural loans. The improvement in the financial condition of many farmers and ranchers in the District is due to above average wheat yields and higher grain and cattle prices. A large number of respondents noted that Small Business Administration and Farmers Home Administration loans continue to play an important role in meeting the credit requirements of area agriculture.

TWELFTH DISTRICT - SAN FRANCISCO

While recent national statistics suggest that the economy is in a recession, 12th District states are experiencing only scattered layoffs and cutbacks in output. Most regional industries are continuing to post gains in production, sales and employment. From Utah's Wasatch Front up to the Pacific Northwest and down to San Diego County in California, strengths are noted in such major industries as aerospace, electronics, pulp and paper, aluminum and agriculture.

Trade and service industries continue to expand in line with the demands of an ever-increasing population. Retail sales in convenience and fast-food stores have increased from dips of May and June. And classified newspaper advertising, always a good business barometer, is up in volume and profitability.

Some layoffs have occurred in the Northwest, as for example in Spokane's recreational vehicle and heavy-duty truck industries, and also in sugar-beet refineries. But these layoffs are offset by continued gains in other manufacturing industries.

The Southern California region is experiencing weakness in the auto and auto-related industries, with General Motors furloughing 1,700 workers at its plant producing full-sized Chevrolets and Cadillacs, and Firestone laying off 475 workers at an auto-tire facility. Also, service-station employees are adversely affected by less shop work and shorter hours worked. Most stations in Southern California are open only to pump gasoline three to five hours a day.

Scattered signs have occurred of weaker retail sales and resultant production cutbacks, as manufacturers and retailers attempt to avoid unintended inventory accumulation. Most firms remain very cautious in ordering, and are keeping inventories under control and in balance. However, some excess inventory accumulation is evident in automobiles, trucks, appliances, furniture and clothing.

Retail sales in Oregon are up some eight percent over a year ago, while California sales also continue to show gains. Problems in Washington retailing can be traced to energy shortages — with sluggish sales and an unwanted accumulation of large-car inventories, with lower gasoline sales due to rising prices and lessened availability, with slightly lessened weekend traffic at suburban shopping malls, and with a dropoff in business at resort restaurants and shops. Tourism is off considerably in Utah, due to both the fear of gas shortages and the present stress on conservation.

The gasoline situation in Los Angeles County has increased the usage of public transportation in that freeway-happy region. The Southern California Rapid Transit District reports that it averaged 1.37 million daily riders last month, more than 15 percent above the previous month's figure and almost 25 percent above the year-ago figure.

The market for industrial and commercial properties in Southern California is very strong, with shortages of office space a pressing problem. Sales of larger homes in that area have slowed down, with owners/builders refusing to lower their prices. In Seattle, sales have remained steady, with a large inventory of homes available. The market for apartments in that area continues to be very tight.

New home construction in Utah is off about 30 percent from a year ago, but non-residential starts are up 60 percent over last summer's figures. Idaho's housing starts are off 40 to 50 percent from year-ago levels. Some homes in the Boise area, priced in the \$100,000 to \$125,000 bracket, have remained on the market for up to a year. A slowdown is also evident in Oregon's single-family housing market, but multi-family housing continues strong.

Throughout the 12th District, increases in bank borrowing have been prompted by expanding business activity and inflation — as well as the anticipation of continued inflation. And this inflationary pressure is causing businesses to purchase now those capital items that they expect to need for expansion and/or efficiency in the future. Borrowers generally expect that inflationary price increases will continue to outpace interest costs.
