CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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This month's Redbook reports indicate that there are areas of weakness in the economy, but also that evidence of a recession is not widespread. The major area of decline has been automobile manufacturing. Other manufacturing activity -- particularly capital goods production -- appears to be holding its own. Residential construction remains weak, but its losses have been offset by gains in non-residential construction. Record crops are reported in most parts of the country, and no petroleum supply problems have been noted. Demand remains strong for most types of credit, and with the exception of thrifts, lending institutions report relatively strong deposit flows. Widespread price inflation continues, however, apart from declines in prices of certain farm products. Also, most businesses surveyed remain pessimistic about the future strength of the economy.

Virtually all of the districts reported continued weakness in retail sales, although back-to-school purchases have added temporary strength to the figures. New York was the major exception to this picture; one large chain headquartered there reported sales 20 percent ahead of last year. The more typical response was that of Boston, which reported "disappointing" retail sales volume.

Automobile sales have recovered somewhat in most districts. The manufacturers' program of rebates on large cars generally has stimulated sales and pared inventories, although St. Louis and Minneapolis still

*Prepared by the Federal Reserve Bank of San Francisco
report excessive inventories. Small-car sales are especially brisk in Atlanta and New York. Heavy truck sales appear to be holding at record levels, but the recreational-vehicle market is still very weak.

Automobile manufacturing, however, shows pronounced signs of weakness. All three plants in St. Louis have reduced their work force substantially. Chicago reports that about one-third of Chrysler's hourly workforce is on indefinite layoff. It is feared that at least one major plant will be closed permanently.

Most other manufacturing activity has been flat or growing, although Philadelphia observes deterioration in the industrial sector. Capital-goods manufacturers in the various districts generally report increases in sales and backlogs. Machine-tool manufacturers in the Cleveland district, for example, report delivery times extended well into 1980. Although new orders for steel dropped sharply in August -- in line with the cut in automobile production schedules -- shipments to most other industries remain above last year's level, and the industry does not expect a worsening picture.

Residential-construction activity continued its slide from last month in most districts, although there are spots of strength in areas such as Florida. Nonresidential-construction activity has compensated for this weakness in many districts, however.

As a result of the relatively stable condition of the non-automotive sector, employment remains high in most areas. Several districts -- notably San Francisco and Kansas City -- report shortages of specialized labor. Demand is particularly strong in commercial construction, aerospace, aluminum and tool-and-die manufacturing. The continued rapid growth of the
Pacific Northwest economy has particularly strengthened the demand for labor in that region.

Farm production reports are generally favorable. Kansas City and Chicago expect record crops in such commodities as wheat and soybeans, although storms recently damaged grapefruit crops in Florida and 600,000 acres of cotton in Texas. Pork and poultry production have increased. As a result of the increased production in many commodities, farm prices have fallen, so that farm incomes are likely to fall considerably short of earlier Department of Agriculture forecasts. The Rock Island strike and the grain-handler’s strike at Duluth/Superior pose grain transportation problems.

Most districts report continued strength in demand for all types of loans. However, Atlanta reports slack loan demand, and Dallas reports resistance to high residential-mortgage rates. The supply of funds at commercial banks appears to be holding up, with money-market certificates compensating for outflows from other savings categories. Cleveland and Richmond observe, however, that thrifts are experiencing more difficulty obtaining funds. Atlanta sees a "softening" of deposit flows in general.

Although the economic picture remains relatively good at the present time, the business community generally appears pessimistic about the future. Respondents to Philadelphia's Business Outlook Survey appear to be bracing for a further slowdown. Boston reports that business firms have learned a lesson from the last recession, and that they are watching inventories closely; throughout the districts, this is reflected in moderate levels of inventories in most industries. Meanwhile, reports of continued inflation in input prices are widespread.
FIRST DISTRICT — BOSTON

Respondents in the First District report increasing signs of weakness but not all see evidence yet of a recession. Retailers are generally the most pessimistic; sales are disappointing. Some manufacturers report a fall off in the demand for certain products, but for many business is still good. In the banking sector, loan demand remains brisk although there has been a slight softening in the last couple of weeks. Growth in demand deposits has picked up significantly.

Retailers throughout New England report that sales are weakening. However, experiences have been quite varied, with the softening much more pronounced for some than others. The heads of two general merchandise chains believe that inventories are too high, but that a good fall season could bring them back into line without the need for major readjustments. One of these companies is part of a national organization; its figures indicate that the slowdown in New England has been greater than for the country as a whole.

Among manufacturers, business is still quite brisk for the most part. The defense business is an important source of strength and international sales of many different products are doing well. A diversified company producing automotive products, products for the home, and small appliances sees no change in the volume of activity. Home cleaning and related products have also been unaffected, while in northern New England the electrical machinery, machine tool and wood products industries continue to do well. On the other hand, a manufacturer of industrial safety equipment, sales of which are considered indicative of future changes in manufacturing activity, has been a noticeable
weakening in sales during this month. A producer of large household appliances also reports disappointing sales. All manufacturing respondents believe that they have learned from the experience of the previous recession and are watching inventories closely; however, no major adjustments are planned.

Banking directors report that loan demand is strong, although in northern New England there has been a slight softening. All have experienced a significant increase in demand deposits. At one medium-sized bank regular savings deposits have just increased for the second month in a row for the first time in a year. Despite current high interest rates, the head of one large bank reports that large borrowers who can shop around and use the commercial paper market can still get funds at very attractive prices. The big banks are extremely competitive and are reducing balance requirements and commitment fees and are charging less than the prime rate for these customers. Foreign banks are taking the lead in reducing commitment fees.

Professors Eckstein, Samuelson, and Tobin were available for comment this month. According to Eckstein, there is no doubt that a recession is underway; real GNP in late 1980 will be no higher than it was in the beginning of this year. Eckstein also sees disturbing parallels between the present and past recessions: first, monetary policy tightens until the economy is "on its back," "inviting" the Congress to cut taxes, then easy monetary and fiscal policies "pump the system full of liquidity." He noted as another danger, a reversion to "the disastrous exchange rate regime of the 1950s and 1960s" using the taxpayers' money to attempt to support the exchange value of the dollar at an "indefensible" level.
Tobin also suggested we are repeating the 1974 experience, although he believes the recession may not be so severe this time. Recent one-shot shocks have temporarily raised the rate of inflation but, because wages have not accelerated, have not increased the "core" inflation rate. The Fed has not only refused to accommodate them but actually is trying to drive down the inflation rate. Tighter monetary policy will primarily hurt output and reduce inflation little more than would have happened anyway once the price shocks work through the economic system. Tobin agrees with Eckstein that a stringent monetary policy will simply foster an undesirable monetary-fiscal policy mix.

Samuelson feels that higher interest rates are warranted because recent money growth has exceeded the targets. He insists, however, that monetary policy be linked to domestic objectives and warns that tying policy to defending the "prestige of the dollar" places the Fed in an "unnecessary and unfortunate box."
SECOND DISTRICT - NEW YORK

Business activity in the Second District appears to have regained some of the ground it had lost earlier in the summer, according to recent comments of directors and other business leaders. Consumer spending strengthened from its summer doldrums. Using heavy promotions and large price markdowns, department stores registered record sales and pared inventories to leaner levels. Sales of new automobiles also posted a strong gain, helping dealers get out from under their bloated large-car inventories. Outside of retailing, most respondents remain cautious. New orders have been sluggish, but production schedules have been adjusted to prevent an excessive inventory buildup. Although there is widespread agreement that the economic slowdown will not bottom out until next year, most capital spending plans remain unchanged. On the financial front, business loan demand continues strong with little evidence of tightening in credit standards or nonprice lending terms.

Consumer spending in the Second District turned in an unexpectedly healthy showing in August. Retailers chalked up record sales; one nationwide chain reported that its sales were more than 20 percent ahead of last year. As in recent months, sales at New York City stores outpaced those at suburban branches; but with the easing of the gas shortage, the suburban branches have lately made a strong comeback. Still, retailers are unanimously conservative in their outlook for coming months, expressing some concern that the upturn may be the shortlived result of heavy promotions and markdowns. Thus, while stores are planning to replenish their depleted inventory stocks, they intend to keep inventories on the lean side.
In recent weeks, there has been a noticeable improvement in the automotive sector. Small-car sales continue to boom, with no letup in sight. Lately, moreover, there has been an advance in the sales of intermediate- and full-size vehicles. Dealers attribute this pickup both to an easing of the gas shortage and to heavy price promotions. Price incentives have reportedly been running about $700 per GM car, and to as much as $1900 per Chrysler car. Used car sales have been brisk. As a result, the bulging stocks of new and used larger-size models have now been brought down to more manageable levels. Truck sales are also up, though they remain well below the rapid pace of early 1979. Respondents are not aware of any financing problems, and consumer credit seems readily available. It does appear, however, that consumers are lengthening loan maturities. Four-year auto loans now are becoming quite common.

Outside of retailing, business activity appears to be holding up fairly well. New orders do seem to have weakened a bit, but most businesses report no change in their capital spending plans. One major steel company feels that it will be well insulated from an economic downturn, as any future slackening which may occur in capital goods production will be compensated for by a rebound in the production of consumer goods. In general, however, the consensus forecast is for a relatively mild slowdown, brought on by sluggish consumption spending and lasting through the early part of 1980. Yet, apart from the auto sector, there is little evidence of a recession in either western New York or the downstate region. Nor are there reports of any involuntary inventory accumulation. Indeed, one metals company has been running such a tight inventory policy that it experienced stock-outs of certain items. Other companies report that they are shipping goods out about
as fast as they are producing them, maintaining their inventories at comfortable levels.

On the financial front, there were no signs of a let up in credit demands. Senior loan officers at major New York City banks indicate little change in bank lending policies on business loans and do not expect a near-term slowdown in the demand for such credit. While a few respondents expressed less willingness by their banks to extend loan commitments at predetermined interest rates, most revealed no tendency to tighten the criteria used to screen business loan applicants. The consensus of respondents expects business loan demand to continue at the present rapid pace. Inventory investment was the factor most frequently cited as bolstering loan demand. With respect to mortgage markets, financing in New York State is extremely tight according to the comments of the Buffalo branch directors. Because of the state usury ceiling, the state-chartered lending institutions are committing little, if any, new money to mortgages while the national banks are allocating limited new funds at 11 1/2 percent interest which are being absorbed very quickly.
THIRD DISTRICT - PHILADELPHIA

Indications from the Third District are that economic activity is mixed in September. Representatives of the industrial sector report further slippage this month, but at a reduced rate, and retail sales are sluggish. Bankers, however, report strong loan volume. For the longer term, contacts in all three sectors are bearish. A further downturn in manufacturing is anticipated, along with continued softness in retail sales. And, bankers expect that, as we move into a recession, loan demand will taper off as well.

Respondents to this month's Business Outlook Survey report further deterioration of general business conditions in the industrial sector, but at a reduced pace from that recorded in July and August. New orders are off fractionally in September, while shipments are up slightly. Consequently, producers' backlogs continue to shrink and inventories have taken another dip. Factory labor remains unaffected by the three-month old slowdown though, as neither payrolls nor weekly hours have been cut in September.

As for the future, responding manufacturers look for continued dampening of the business climate over the next two quarters, and appear to be bracing for a further slowdown. With both new orders and shipments projected to take significant drops between now and March, survey respondents are planning to trim the size of their work forces and cut working hours as well. Moreover, expenditures on plant and equipment are expected to be no higher in six months than they are right now, possibly indicating that manufacturers are finally taking the threat of a recession seriously.
On the inflation front, prices are up again in the local industrial sector. Two thirds of the executives polled in September report paying more for raw materials than they did in August, and half are charging more for their finished products. For the longer term, more of the same is expected. Nine out of 10 manufacturers are projecting higher inputs costs six months out, and 3 out of 4 are planning to boost the prices of the goods they sell.

Third District retailers report some growth in sales in September, but not enough to yield an increase after adjusting for inflation. Reports of current sales levels range from 3 to 6 percent over year-ago figures -- about as expected on average. Merchants point to higher outlays by consumers for gasoline and an overall lack of confidence in the economy as factors that are keeping a lid on sales at this point. Retail inventories are in basically good shape despite the apparent sluggishness, a direct result of cautious planning in earlier months.

Looking ahead to the first quarter of 1980, local merchants are generally pretty cautious. They expect some gains to be posted between now and March, but none large enough to offset inflation, which they expect to be in the 8-10 percent range.

Area bankers say total loan demand is strong in September, with much of the strength coming from a pickup in business borrowing. Real estate and construction money is still very much in demand, and C&I loans are up between 10 and 14 percent from September '78 levels. Consumer loans are doing well also, in fact, too well, for bankers who are trying not to make many fixed-rate loans in anticipation of further interest rate hikes. Bankers contacted
believe much of the strength in the business loan area stems from unplanned inventory accumulation in the industrial sector. A tapering off of loan demand towards the end of 1979 is projected, as manufacturers enter an inventory liquidation phase and consumers stop spending for autos and other durables.

A Director of this Bank confirms the reports of soaring loan demand, particularly for consumer and mortgage loans, and he sees no immediate slowdown.

The prime rate at all of the banks contacted this month is at 12 3/4 percent and expected to go higher soon. An increase of about 25 basis points is projected within 4-6 weeks, followed by a plateau lasting at least through the first 3 months of 1980.
FOURTH DISTRICT - CLEVELAND

Business conditions in the Fourth District have shown evidence of further inventory accumulations in August, but the consumer-centered recession has not yet spread to the capital goods sector. Most businessmen and economists forecast a shallow recession extending into the second quarter of 1980. Manufacturers report that inventories have been accumulating at a slow rate, but few are concerned that inventory liquidation would pose a serious problem for the remainder of this year. Bankers and retailers have mixed viewpoints over prospects for a moderate comeback in consumer spending, but even those more optimistic do not expect a comeback that will be strong enough to reverse the downward trend of the economy. The housing market has continued to show surprising strength as mortgage loan demand has remained unchanged from last month. The city of Cleveland has slipped deeper into default.

Most manufacturers report that involuntary inventory accumulation has been occurring in the Fourth District. However, most had expected some accumulation to occur as consumer spending slowed, but have been unable to alter production schedules in anticipation of a decline in orders. The inventory buildup, so far, has been concentrated in material parts and components related to the auto industry. A producer of consumer items reports that his inventory buildup resulted from special market conditions for those items. The standard view remains that tight controls on inventories over the past year have kept inventories at satisfactory levels which can be adjusted by slowing the rate of accumulation into the first quarter of 1980.

Capital goods producers, in general, have experienced little direct effect from the recession. An official in the machine tool industry reports
no major change in new orders, although the peak in orders occurred early in
the year. Some softness in machine tools is expected over the next six to
twelve months and one official expects a "sudden" softening in the fourth
quarter of 1979. However, because delivery times are extended well into
1980 and backlogs are still increasing, layoffs have not occurred. A manufacturer
of truck parts notes some weakness in heavy-duty trucks which can be attributed
to the general slowing of the economy. He also states that a rebound in light
truck sales could lead a recovery in the second quarter of 1980. A steel economist
reports that new orders for steel dropped sharply in August, but are not expected
to get worse. However, he is apprehensive that declines in the demand for metal
building materials may be a preliminary sign of the recession spreading into the
capital goods sector. The steel industries' operating rate is likely to drop
sharply next quarter to about 70% operating rate, according to one economist.
Most producers are concerned that capital goods spending will soften over the
remainder of the year if availability of money tightens and the consumer recession
spreads.

Retailers report some improvement in consumer demand related to back-
to-school purchases, which are predominately seasonal, and to new car sales.
Although operating at a satisfactory level, one manufacturer of apparel notes
that unit sales are off 20% for the Fall season and are expected to be about 6%
off this year from last. Sales of nondurables have been on a down-trend all year,
but one supermarket official expects that any further retrenchments by the consumer
will be concentrated in durable goods. Consumers have been increasingly shifting
purchases away from inflationary items and one retailer is concerned about the
effect of income redistribution in consumer buying, especially from rising food
prices. However, a District banker reports that consumer loan demand has been
strong in his area and has suggested that final demand will remain strong
enough through the Christmas season to spark a temporary consumer comeback. A few others have taken a less sanguine view. They expect consumer spending to worsen, because of increased consumer resistance to high prices. In response to declining real incomes, one retailer expects GAF sales next quarter to show about a 4% year-over-year increase, about half of the increase that he expects for the third quarter.

Housing market conditions have continued to experience relative strength despite the recession. Building suppliers state that 1979 has been better than expected, but they are skeptical about 1980 prospects. A major regional builder of homes reports that housing starts have been accelerating since June and are expected to be "rapid" through October. Although a banker is concerned about housing inventories being increasingly financed through borrowing, a builder reports no excess inventories at this time. Sales of existing houses have continued to be slow in August, with a rising number of requests by home owners for banks to finance both the old and the newly purchased house until buyers can be found.

Mortgage and consumer loan demand has been strong in August, but S&Ls are still having trouble competing with commercial banks for loanable funds. Bankers report increasing funds flowing into the banks, but S&Ls continue to borrow heavily from FHLBs. Mortgage loans over the remainder of 1979 are expected to be below last year's peak and interest rates on 80% mortgage loans are set to increase by another twenty five basis points to 11-1/4% in some parts of the District early in September. Consumer installment loan demand has picked up, according to one area banker, because of a switch from vacations to home recreation purchases. A banker notes that even auto loans have made a comeback from April to June levels.

The city of Cleveland has gone into its second default after failing to roll over $3.3 million in city-held waterworks notes. The first default last December amounted to $15 million. A second default became certain when City Council refused
to allow the transfer of general operating funds to the waterworks fund, 
because of the questionable legality of the transfer. A third default on 
$14 million in city-held notes, also held by the waterworks fund, is now 
probable in October. However, the city was able to pay about $500,000 in 
interest payments on the original default.
Fifth District business and financial conditions remained spotty during the past month. The slowing of manufacturing activity seems to have spread. Manufacturers surveyed this month indicate declines in shipments, new orders, backlogs of orders, and employment. On the other hand, inventories rose only very slightly and price increases became less widespread. Retailers, however, report business gains over the month. Sales were up and, except for autos, big ticket items apparently kept pace. Consumer loan demand may have firmed somewhat in recent weeks while business loan demand has fallen off a bit. USDA's crop production estimates as of August 1 indicate that the District's 1979 harvest of tobacco, peanuts, some of the small grains, and apples will not be as bountiful as in 1978. But bumper harvest of soybeans, wheat, and corn are in prospect.

Of manufacturers responding to our survey nearly one-half experienced declines in the volume of new orders in the past month and over one-third had reduced shipments. In addition, there was a slight decline in order backlogs. Employment and the length of the workweek were down substantially. Current plant and equipment capacity is increasingly viewed as excessive and there is virtually no sentiment in favor of enlarging current expansion plans.

With some significant exceptions retail sales continue firm. Department stores are doing respectably but with notable weakness in some apparel lines. Building materials are doing well and consumer durables are holding their own. District retailers surveyed this month report gains in total sales with big ticket items keeping pace. Automobile sales have improved, apparently
stimulated by recent promotions. Employment among retailers also rose over the month. These retailers note extensive price shopping by consumers and keen competition among sellers. The action remains in the moderate and higher quality lines, however, as bargain hunters seek lower prices but not cheaper merchandise.

Inventory accumulation still does not seem to have become a problem. Inventory levels among survey respondents rose moderately over the past month, but without any commensurate rise in concern over positions. Nearly two-thirds of the manufacturers surveyed are comfortable with current stocks as are all retail respondents. Three-fourths of our Directors queried on this point see no evidence of inventory problems in their respective areas. Instances of inventory problems were almost exclusively related to the automobile sector. Consequently, there is little evidence of any explicit action on the part of district businessmen to reduce current stocks or even to prevent further accumulation.

Despite their mixed views of where the economy stands, our respondents are largely in agreement as to where it is headed. An overwhelming majority expect the level of activity nationally to decline over the next six months and a clear majority expects similar developments in their respective market areas. Nonetheless, only about one respondent in three expects production in his own firm to fall over that period.

In the financial sector, consumer nonmortgage credit demand has shown signs of strengthening, although this strength appears limited in terms of the uses of funds borrowed. The recent improvement in automobile sales has resulted
in increased demand for instalment financing, while borrowing for other purposes continues to moderate. Also, larger and metropolitan area banks seem to be experiencing stronger consumer loan growth than smaller rural banks. Business loan demand has weakened in recent weeks, with loans to retailers showing the largest decline. Loans to both durable and nondurable goods manufacturers have also softened. There are indications that banks are making occasional price concessions to stimulate commercial loan demand. Commercial banks still appear to be active mortgage lenders. It appears, however, that there is growing caution in approving construction and land development loans.

Deposit flows continue to be adequate to support loan growth at banks, and the liquidity condition of larger commercial banks is good. Area thrift institutions are still experiencing outflows of deposits other than money market certificates, and reliance on this source of funds is increasing steadily.

Market demand for flue-cured tobacco this season has generally been weaker than a year ago. A stronger market and better quality offerings have been in evidence in recent weeks, however, and prices have improved. The season average price as of August 30 was running about 5 percent above a year earlier, but with the volume of gross sales down by 5 percent the value of gross sales was fractionally below the same period last year. The size of the 1979 flue-cured crop is now expected to be 15 percent below 1978's output, so, unless there is a sharp improvement in prices during the remainder of the season, flue-cured tobacco earnings for the year may well be significantly below those a year ago.
SIXTH DISTRICT - ATLANTA

District businessmen generally feel that they are in a recession, that it will be mild, and that it will have very little effect on inflation. Alabama directors see the current recession concentrated in middle-income buyers. Luxury goods and discount stores are doing very well, but chain stores in middle-income markets report very sluggish sales and rising delinquencies. Many directors think inflation is here to stay and that counter-recessionary policies to come will only worsen inflation.

District-wide, retail sales gains continued to fall behind inflation. Rebates are succeeding in bolstering sales of larger automobiles. Loan demand is slack and delinquencies are up. Residential housing construction remains stable despite some notable declines. Gains in commercial and industrial construction helped offset residential losses. Employment held firm. Tourism activity recovered from early summer declines. Plentiful rainfall augured well for agriculture throughout the District.

Most contacts reported increases in retail sales not commensurate with inflation. Back-to-school sales were helpful. A few contacts reported considerable softness in big-ticket items such as furniture and appliances. Inventory levels are considered manageable. One contact is even keeping inventories high in anticipation of brisk sales. Rebates on mid-sized and large-sized 1979 models boosted sales after several sluggish months. Demand for compact cars remains intense. Many dealers are reporting very low inventories.

Generally speaking, loan demand was weak. A few contacts, however, reported strong demand. Deposit inflows have moderated, with increased money
market certificates offsetting sagging passbook savings. Delinquency problems appear to be on the increase, particularly among middle-income families. Consolidation loans are reported up.

Residential housing construction remains stable, mainly because of strong increases in Florida. New Orleans, Baton Rouge, Nashville, and central Mississippi experienced notable declines. In Nashville, inventories of higher-priced homes are excessive. A Knoxville savings and loan executive reports that mortgage funds are drying up, but his report is not typical. District-wide, mortgage money is generally available, and applicants are being screened very closely.

In the states registering declines in residential construction, commercial and industrial construction gains are compensating. New Orleans, Baton Rouge, Nashville, and the Mississippi Gulf Coast are all experiencing good growth in office buildings, shopping centers, and new plants and expansions. In Florida where residential construction is good, commercial and industrial construction is strong. The International Minerals and Chemical Corporation will spend approximately $450 million on a major expansion of its phosphate rock and chemicals production.

The region's forestry-related sector was strengthened by several recent announcements. Kimberly-Clark, a diversified paper company, will construct a division headquarters and research facilities near Atlanta. Outside the Jacksonville area, a large sawmill for pine dimensional lumber will be built by Owens-Illinois and a large wood chip handling facility by Georgia-Pacific. In the Florida panhandle, the St. Regis Paper Company will expand substantially its paper manufacturing complex and a new company will develop a wood-processing plant to produce fiber pellets for use as fuel.
Employment throughout the District is fairly steady so far, but many contacts believe unemployment will trend upward in the coming months. Additionally, new Comprehensive Employment Training Act regulations that limit CETA employment to 18 months, effective October 1, and heavy federal budget cuts will nudge unemployment even higher at a time of anticipated slow economic activity. For example, more than 1,500 CETA workers in Atlanta are expected to be laid off by the end of the year and 182 are scheduled to lose their jobs in East Baton Rouge Parish.

After appreciable declines for June and July, attendance at many attractions showed reassuring increases in August. Tourists dealt with higher gasoline prices by continuing to visit attractions within a shorter driving range. Campground business remains very weak throughout the District because of a reluctance to travel too far with gas-guzzling recreational vehicles.

Abundant rainfall throughout the District has enhanced yield prospects for crops, particularly soybeans, corn, peanuts, and cotton, and improved pastures. Resultant higher quality pastures helped maintain the good physical condition of cattle herds during the hot summer months. Pork and poultry producers are experiencing a profit squeeze, resulting from declines of approximately 15 percent for pork and 20 percent for broilers from year-ago levels. Hurricane David did not seriously damage most major cropping areas of Florida and Georgia; however, an estimated 10 to 20 percent of Florida's sugarcane crop was lost and, according to early reports, the grapefruit crop along the Coast also incurred appreciable losses.
The view that the economy has entered a recession is widely held in the Seventh District, but many companies have not been affected directly and foresee no crisis. The dichotomy between weak consumer markets and relatively vigorous capital spending continues. However, orders for equipment are slowing and backlogs of some companies are declining. Labor markets have softened in most areas. Price inflation has not abated. The farm sector is generally prosperous.

Most executives in the district apparently accept the view that the economy is in a recession that will be "short and shallow." Frequently, they state that they have seen no sign of a decline themselves, but, nevertheless, they are taking the usual precautions of tightening up on new hiring, inventory investment, and, in some cases, capital appropriations. They insist that their operations are not as vulnerable as in late 1974, because of "lessons learned" in 1975.

Although employment has probably leveled off overall in the district, substantial layoffs have been confined to the motor vehicle and recreational vehicle industries. Even in the depressed residential sector, there are few signs of idle workers. But new hiring is down. Help-wanted ads in Chicago papers dropped sharply in August, after remaining at a high level through June.

Consumers continue to show caution on major purchases, but they appear to have ample funds for "back-to-school" items and everyday purchases. Lower-priced general merchandise chains appear to be benefiting at the expense of luxury-oriented stores.

Substantial price cuts on overstocked autos have stimulated sales in
recent weeks. Nevertheless, 1980 model production schedules for larger cars are still being reduced with periodic shutdowns of assembly lines. Demand for light trucks and recreational vehicles continues very weak. Sales of heavy trucks are holding at record levels, but analysts are convinced that a decline is inevitable with 1980 down 20 percent or more.

About one-third of Chrysler's hourly workforce is now on indefinite layoff. Chrysler's future is of particular concern to the City of Detroit where it is the largest employer. There are fears that at least one major obsolete plant will be closed permanently. With supplementary benefits, laid-off auto workers receive up to 95 percent of their normal take home pay. However, depletion of Chrysler's SUB fund threatens this portion of the benefits.

Orders for steel from the motor vehicle industry have been cut in line with production schedules. Shipments to most other industries remain well above last year. However, new orders, especially advanced bookings, are well below shipments and backlogs are declining.

While most capital goods producers continue to operate at high rates, the picture is increasingly spotty. Sales of farm equipment continue very strong, and above earlier estimates. Electrical components are still vigorous. Demand for construction equipment and materials handling equipment, however, has eased off. New orders for metal-cutting machine tools have leveled off, but backlogs are expected to keep most producers going full blast into next year. Orders for freight cars dropped suddenly in June. The freight car backlog is large, but cancellations are possible.

Gasoline supplies appear adequate if not ample. Many gas stations have extended operating hours, but not to normal standards. Much of the improvement reflects reduced driving. Summer traffic on Interstates in
Illinois was 14 percent below last year, compared to a 22 percent shortfall in early June. The month of May had been even with a year ago.

Heating oil supplies are further below desired levels in the Midwest than elsewhere. However, experts believe that no serious shortages will occur this winter, unless some new supply problem develops.

Nonresidential construction is still vigorous, especially for office buildings and hotels. Builders are rushing construction of at least 10 large office buildings and hotels in downtown Chicago. Recently another large office building of 1.1 million square feet was announced. Some of the first buildings started in the current wave will be occupied soon. Leasing is said to be proceeding at a rapid pace. Existing high quality space is in tight supply. Rents are reported to be up 25 percent from last year and 60 percent from 1977, partly because of escalation contracts. Hotel occupancy is also strong and room rates are up 20 percent in about 18 months.

The market for single-family homes in the Chicago area is probably the weakest of any large metropolitan area. This situation does not reflect a depressed local economy because employment and unemployment data compare fairly well with national trends. Moreover, mortgage money has been available, at about 10.5 percent on 20 percent loans. The weak home market is blamed partly on three successive severe winters, which may have encouraged net out-migration and a rapid expansion of the condominium market.

Chicago area residential permits were 42 percent below year ago in July, and off 40 percent for seven months. Single-family permits were off 45 percent for July, and off 49 percent for seven months. An unusually large number of existing homes are listed for sale, and houses remain unsold for unusually long periods. Meanwhile, the inventory of finished new homes is slim
as few starts have been made without firm orders. Prices of existing homes have declined in many areas, especially on higher-priced units and units located away from built up areas. Prices of new homes have continued to rise with costs of labor and materials. Similar reports are heard from other large urban areas in the district.

A growing number of contractual payments, not only wages, but rents and other outlays are automatically escalated. Many contracts cite the local index. In July, when the all-city CPI was 11.3 percent above last year, the indexes for Chicago, Detroit, and Milwaukee were up 13.5, 12.8, and 14.9 percent, respectively.

At this point, corn and soybean crops in the Midwest appear to be heading for records or near-records. However, a severe early frost could cause losses because of late plantings. Transportation tie-ups in moving grain have been worsened by the Rock Island strike.
According to interviews with District businessmen, overall economic activity in August was unchanged from July, but is below that of the first quarter of the year. The decline appears to be mild, except for the automobile and housing industries. Consumer spending, which has been sluggish in recent months, registered gains at about the current rate of inflation. Inventories are being closely watched as several businessmen expect the economic slowdown to continue for several months. Output in the manufacturing sector appears unchanged in recent weeks following a decline in the second quarter. Construction activity, as a whole, remains strong with losses in residential building offset by gains in other types of construction. In the financial sector, inflows into savings and loan associations continue to register small but positive gains. Reports indicate that mortgage loan demand has slowed in recent weeks, whereas reports are mixed about the strength of commercial loan demand.

Indications from area retailers are that real consumer spending was unchanged from July to August. Some large department stores posted nominal gains of 10-12 percent and a few retailers noted some improvement in sales of household appliances and back-to-school items. On the other hand, other retailers reported only small gains and expressed disappointment about their recent sales volume. Automobile sales improved in August as incentive programs offered by dealers and manufacturers to reduce heavy inventories helped generate sales. Car sales in the St. Louis District (eastern Missouri and southern Illinois) of one major U.S. manufacturer were down only slightly in August compared with a year ago.
However, sales on a year-to-date basis were down about 15 percent from a similar period last year.

In general, inventories are reported to be at satisfactory levels but inventories of automobiles, certain types of appliances, and some apparel items are considered excessive. Automobile inventories, however, are down substantially from a month ago as a result of recent sales efforts. Some firms reported efforts to reduce inventories in order to cut carrying costs and to bring them in line with expected slower sales volumes. Some expressed the reservation that an unwanted buildup of inventories may occur, since consumer purchases did not seem strong enough to sustain current production levels. Also, some respondents reported more hand-to-mouth buying of raw materials and fewer long-term commitments.

Manufacturing activity appears to have stabilized in recent weeks after noticeable declines in the second quarter. The declines occurred largely in the automobile, lumber, furniture, textile, and apparel industries. Layoffs have occurred at most District automobile assembly plants. All three plants in St. Louis have reduced their work force, with one plant cutting back workers by one-third. Some manufacturing firms, particularly those producing capital goods, continue to report strong activity. A major capital goods manufacturer noted that incoming orders continue at "good" rates. Several smaller manufacturers of such items as industrial motors, lubrication equipment, pumps, welding and cutting equipment, and machine tools noted continued increases in sales and, in some cases, growing backlogs.

Construction activity in the District remains at a high level, despite declines in homebuilding. Housing construction appears to be down
about 15 to 20 percent from a year ago. Nonresidential building activity, however, has registered sizable gains, and decreases in labor employed in home construction have been largely absorbed in the nonresidential building.

Savings and loan association representatives reported some gains in savings inflows in August, but the rate of gain was slower than in the first half of the year. Among individual S and Ls, however, the pattern varied substantially, with those offering premiums and advertising heavily attracting most of the new funds. The slower growth of savings deposits is attributed to increased competition from Treasury bills, money market certificates at banks, and money market funds. Mortgage loan demand was reported to have slowed in the past two months, but with fewer loanable funds, rates on 80 percent loans remain relatively high at 11-1/4 to 11-1/2 percent. Some commercial bank representatives reported brisk demand for commercial loans while others noted a recent slowing in demand for such loans. Arkansas banks have cut back drastically on consumer lending due to the high cost of funds relative to the "low" usury ceilings on such loans.

The agricultural picture remains generally favorable for farmers. Crop production is expected to be relatively large. However, as a result of the recent decline in farm product prices, farm incomes may not be quite as large as anticipated earlier in the year.
NINTH DISTRICT - MINNEAPOLIS

Although the national economy appears to be in a recession, the Ninth District economy remains relatively strong. Last month, our report indicated that the district's economy was not yet in a recession, but that several developments were threatening it. The consumer and agricultural sectors, in particular, are still worrisome, but a strong industrial sector is allowing the district to avoid a recession.

Consumers Buying Less

District consumers are still reluctant to spend. Several directors indicated that retail sales, which were weak in July in comparison to a year ago, continued to be weak in August. Close to half of the merchants responding to a University of Minnesota survey also reported that their sales were down from a year ago. Even in South Dakota, where the dollar value of retail sales was about equal to what it was a year ago, fewer goods were sold.

Auto and home sales continue to be weak, too. In August, car sales fell below year-earlier levels, as they did in June and July, and large car inventories are still excessive. District consumers likewise continue to be hesitant to purchase homes; in August the number of homes listed for sale was up substantially from a year ago.

Farmers' Earnings Threatened

The agricultural sector, like the consumer sector, has problems. District farmers' earnings are threatened by transportation problems and poor weather. Last month a grain handlers' strike at Duluth/Superior aggravated the district's already strained grain transportation system, and this dispute has
yet to be settled. Even if the grain handlers begin working soon, the remaining shipping season will not be long enough to move all the grain that would normally have been shipped from this port. This grain will have to be either stored or shipped overland to other ports; either alternative raises costs and reduces earnings.

Farmers' earnings also could be reduced by smaller-than-expected crops. A month ago district farmers were expecting a good harvest, and many still are. But in Minnesota, the district's largest crop-producing state, wet and cloudy August weather has kept crops from maturing, and an early frost now could substantially reduce crop yields.

No Recession in Sight

Despite the continuing weaknesses in the district's consumer and agricultural sectors, the district's economy is not yet in a recession. None of the signs usually associated with a recession have yet appeared in the district.

- In a recession, firms normally lay off workers, but many district firms are now scrambling to hire additional ones. Some labor markets are so tight that one large firm distributed handbills throughout its community calling for more workers.

- In a recession, business earnings normally decline, but this hasn't happened. For the second quarter, the profits of the district's 41 largest companies were up from a year ago—29 percent this quarter.

- In a recession, business requests for loans let up, as businesses consolidate operations. But directors report that the demand for loans remains strong at district banks, as many firms continue to expand.
Industry Doing Well

Probably the main reason the district is not in a recession is that industrial sales are so strong. Manufacturers responding to our Industrial Expectations Survey reported that their second-quarter sales were up 17 percent from a year ago and that they look for a 15 percent gain in the current quarter. Directors from throughout the district indicate that industrial activity remains strong in their areas, confirming the survey's results.
Declining sales, planned inventory reductions, and rapidly rising prices characterize business conditions in the Tenth District. Purchasing agents report continued strong price increases for their inputs. Reflecting in part expectations of declining sales, both purchasing agents and retailers plan to trim inventories in the months ahead. U.S. farmers expect record crops and, as a result, prices received by farmers have fallen recently across the board. Agricultural loan demand continues to show strength, however, as does general business loan demand.

Purchasing agents in the Tenth District report that almost all input prices are up an average of 7 to 12 per cent over last year, with half reporting general increases of 10 per cent or more. A large majority of purchasing agents noted substantial increases within the past three months, and nearly all those contacted expect further price increases for the remainder of the year.

Input availability seems to be stabilizing according to most companies contacted, although several reported delivery problems earlier in the year. Current availability problems are believed to be temporary or seasonal and are expected to be alleviated soon. Materials inventory levels are generally satisfactory in the Tenth District, with only a few companies reporting levels that are too high. However, most purchasing agents contacted are planning to reduce their inventories. Reductions are planned because of expected future declines in sales, and adjustment for prior inventory buildups designed to avoid further price hikes. Most companies surveyed report adequate or excess plant capacity. A shortage of tool and die workers and experienced welders exists in the District, while other workers are in adequate supply.
Tenth District retail sales have generally declined in real terms, in the year to date, with sales in the past three months slowing somewhat further. Some stores had a slight increase in sales during August, probably due to school resuming. Weak items have been furniture and appliances, possibly due to a decrease in demand for new homes. Clothing of all types, especially sweaters and outerwear, and back-to-school items have had strong sales during the past three months. Some stores have scheduled clearance sales earlier this year (2-3 weeks), because of earlier school openings or the need to improve turnover of merchandise. A majority of the retailers have not changed their margins but have passed wholesale price increases on to the consumer. Most stores feel inventory levels are slightly higher than they would like, and thus anticipate some inventory trimming during the remainder of the year. In the final months of 1979, total sales are expected to reach a slightly higher level than in the 1978 period, with prices expected to rise further. Inventory purchases will be approximately the same or slightly lower than in 1978. Overall expectations for the remainder of the year are cautiously optimistic, as retailers are apparently not yet experiencing the full effects of the recession.

Prices received by U.S. farmers in August fell 4 per cent from July levels. All three major U.S. crops registered price declines as record production forecasts for corn (7.11 billion bushels) and soybeans (2.13 billion bushels) and a near record forecast for wheat production (2.13 billion bushels) were released. Prices have declined for meat animals as well, reflecting increased pork and poultry production and lagging consumer incomes. While decreased farm prices may signal future moderation in food prices, consumers can expect an increase of about 11 per cent for this year. Although
farm prices are 11 per cent higher than a year earlier, recent broad price declines—for cattle and hogs particularly—will likely reduce this year's cash receipts from farm sales below earlier projections. Consequently, net farm income this year may be near the bottom of the U.S. Department of Agriculture's forecast range of $30-34 billion. Until recently, net farm income had been projected in the upper end of that range.

Most bankers contacted in the Tenth District report that loan demand is up, both over a year ago and over the last month. Business and agricultural loans are particularly strong in this District. However, some banks report stable or weakening demand for consumer, real estate, and construction loans. All bankers contacted raised their prime lending rates in the last month. As of September 4, most of the metropolitan area banks had prime rates of 12 1/4 per cent, following the lead of the large money center banks. Most bankers contacted expect further increases in the prime rate of 1/4 to 3/4 percentage points by yearend. Some bankers mentioned tightening other lending terms. One bank, for example, has shortened maturities on new real estate loans. Another will only consider floating rates on business loans of over 90 days. Most bankers said that in general they are being more selective. Demand deposits grew moderately or were down at most banks. All banks report declines in savings and small time deposits, but large CD's and money market certificates have increased at nearly all Tenth District banks. Most banks contacted believe that deposit growth will improve in the near future due to seasonal factors.
ELEVENTH DISTRICT - DALLAS

Economic activity in the Eleventh District continues at the reduced pace of recent months according to Directors and businessmen. Sales promotions have helped boost auto sales in recent weeks. Deposit growth at banks is sluggish, and many savings and loan associations report net savings outflows. Mortgage lending in Texas is up slightly, but the availability of credit remains somewhat constrained by the state's new floating usury ceiling. Bank lending is at a high level, but the rate of growth appears to be down from earlier in the year. Manufacturing activity is flat.

Retail sales are improving following a two-month lull. Most of the gains are coming from improved sales of large cars that are heavily supported by advertising and price cutting. Most domestic auto dealers report sales are running at year ago levels. Excess inventories of large cars are slowly being reduced. Department store sales are described by most executives as recently improved, but they express concern that sales will weaken in coming months.

Buyers at the recent apparel market in Dallas were quite restrained in their outlook for clothing sales this coming winter and expressed concern that declining consumer sentiment would lead to a relatively weak Christmas sales season. Overall, new orders at the market were level with last year when adjusted for price increases.

Deposit growth at banks and S&L's is slowing with the decline in real disposable income and with savers opting for short-term, high-yielding market
instruments. Respondents report losing savings accounts to money market funds. Money market certificates remain the mainstay at S&L's, while longer-term certificates of deposit meet with little popularity at banks and S&L's. Demand deposits continue to grow at a moderate pace, while activity in ATS accounts remains flat.

Conventional mortgage lending activity in Texas is up slightly following the adoption of a new floating usury ceiling late last month. However, S&L's in Texas continue hard pressed for loanable funds. The current permissible mortgage rate of 11 percent is about 1/2 percentage point below yields in the secondary market, limiting sales of mortgages by local S&L's in the secondary market. In addition, S&L's in the District report either very weak net savings inflows or actual outflows. FHA/VA mortgage lending is very strong. Mortgage rates of about 11 1/2 percent in Louisiana have met with much borrower resistance, and lending activity has not increased significantly since the lifting of that state's usury ceiling two months ago. Mortgage-backed municipal bonds are supporting lending activity in some Louisiana cities.

Bank lending appears to be growing at a somewhat reduced pace compared to earlier in the year as the rise in the prime rate is having a mild effect on loan demand. Commercial borrowing remains strong, while consumer borrowing is tapering off. Real estate borrowing generally remains strong in Dallas, Fort Worth and Houston although it appears to be easing somewhat elsewhere in the District.

Consumer goods industries are posting declines in output, while capital goods industries continue to show moderate gains. The slowing of
retail sales of furniture and apparel is resulting in declining employment and output at the manufacturing level. Most furniture manufacturers report, however, that backlogs remain heavy while new orders are down slightly. Home furniture sales are slowing, but institutional furniture sales generally appear to be keeping pace with increased commercial building activity. One furniture manufacturer noted that thin profit margins are constraining new hiring. Material supplies are tight, and prices continue to rise rapidly. There appears to be no large buildup of inventories at the manufacturing level.

Capital goods industries generally report favorable outlooks. Some slowing of orders for heavy construction equipment is noted, but construction activity remains strong in the District, keeping production of equipment at a high level. New orders for mining equipment are strong with one major producer crediting the large expansion of uranium and lignite mining operations in South Texas for increased bookings. Large backorders of drilling equipment were reduced during the first-quarter downturn in drilling activity, and delivery times have been reduced substantially. Although new orders are once again picking up, there is some concern that the expansion of industry-wide capacity over the past several years may prove to be excessive next year, especially among drill bit manufacturers.

A buildup of inventories near the end of the distribution channel of petrochemicals is expected to lead to a reduction of petrochemical output early next quarter. Inventories at chemical plants remain lean. Several producers expressed concern that current plant expansions will be coming on stream just as new orders begin tapering off, resulting in excess capacity. Exports of petrochemicals continue strong as U.S. producers maintain a price
advantage over the rest of the world. But some softening could occur as more European chemical facilities come on line.

A series of hail storms damaged approximately 600,000 acres of cotton in the southern High Plains of Texas in late August. Corn, soybean, milo, and sunflower crops were also affected by the storms. Total losses are estimated to exceed $100 million.

The out-of-control oil well in the Gulf of Mexico is a cause of much concern for fisheries, resorts, environmentalists, and property owners, and a substantial decline of tourist business has been reported.
TWELFTH DISTRICT - SAN FRANCISCO

Economic strengths continue to overshadow weaknesses in the nine-state area served by the San Francisco District, although many firms are becoming increasingly cautious about the outlook. Capital spending plans for both the immediate and longer-range future have not been altered by fears of recession. Hiring continues strong in most labor markets of the district. Retailers report relatively strong sales, but have become cautious about future sales, especially in Southern California.

A large Washington bank reports that the Northwest is still experiencing very rapid economic growth. A large metals firm says that its capital-spending plans remain unchanged, and that its capital spending in 1980 should exceed even its 1979 record. A Southern California utility reports that the expected slowdown in the housing market has been built into its regional-growth estimates and financial plans. And a major aircraft producer reports that the crucial aerospace industry — a "lagging indicator" — has not been measurably affected by the economic downturn.

Inventories at the manufacturing level have remained relatively constant. Most retail firms are watching their inventories closely, and are attempting to keep them quite lean.

Southern California retailers appear to be feeling more of a pinch than most Westerners, and are becoming increasingly concerned about further softening in sales trends and overaccumulation of inventories. Some of these retailers are scaling back orders for the Christmas season, with the expectation that holiday sales will be weak to mediocre. Financial institutions involved
with auto-dealer loans are watching their dealers more closely, mainly with regard to their stocks of unsold cars.

Employment continues high in the West, with demand for skilled labor skyrocketing, as measured by a continued high volume of help-wanted ads. In Utah and Idaho, businesses are complaining that they can't find enough applicants for available positions. Academic institutions in the Northwest continue to experience significant shortages in the supply of clerical support staff. And a Los Angeles food-products firm finds very few qualified people available to fill recurring vacancies in good-paying positions.

Hiring programs remain strong at Northwest aluminum plants, where operations are running at maximum capacity. Similarly, the Southern California aircraft industry, which has a substantial backlog, continues to hire aggressively. In fact, employment demand remains strong in all components of the regional aerospace industry. Demand is also high for workers on commercial construction projects throughout the West.

Current bank-lending practices remain relatively unchanged, after having been tightened several months ago. Loan demand has continued very strong, while the availability of loanable funds has tightened in comparison with earlier years. Because of rising loan-to-deposit ratios, many bankers are curtailing real-estate lending activities, and are closely scrutinizing the quality of all existing credit lines.

Commercial-loan demand is still strong, reflecting the sustained high levels of business activity. In general, banks have been willing to accommodate the demand for short-term business loans, and in Los Angeles, banks are continuing to compete keenly for this type of loan. In the area of real-estate
lending, however, banks are exhibiting a healthy degree of caution. Still, the availability of mortgage credit has held up quite well in the West, although interest rates have escalated to new highs. Instalment-loan volume is beginning to soften because of both the energy problem and the softening in auto sales. In view of rising consumer-debt ratios, many Western financial institutions are placing additional emphasis on consumer-loan quality.