

CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

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SUMMARY*

This month's District reports indicated that the economy did not show any distinct signs of slipping further. The business situation actually strengthened a bit in some districts, although it did little more than hold steady in most areas of the country. Department store sales remain lackluster, but automobile sales have rebounded somewhat from their recent lows. Automobile and steel production continues to be sluggish, but strength in other industries such as aerospace and capital goods has buoyed the economies of many districts. Inventories remain generally in line with anticipated sales. Total construction activity remains strong with increases in non-residential building offsetting declines in residential. Farm income is expected to rise with the recent bumper harvest. Although inflation continues unabated, some letup is expected before the end of the year. Demand for business loans continues at a high level.

Department store sales remain mixed across the country. Boston and Kansas City have recently experienced some modest improvement, and New York reports fairly robust gains. In many districts, the increases in retail sales have outpaced inflation. However, retailers are anxious about the future, and in Cleveland where sales growth has slowed there is concern over falling profit margins and rising loan delinquencies and bad debt losses.

Automobile sales have recently picked up, and appear to be quite strong in New York. In several districts, it is feared, though, that the recent spurt in sales was the result of the extensive price incentives and that sales will weaken once these incentives are ended. Other vehicle sales

*Prepared by the Federal Reserve Bank of New York.

remain weak, particularly for the larger cars, recreational and four-wheel drive vehicles, and light trucks. Meanwhile, Chicago reports that auto assemblies in October are scheduled to be 12 percent lower than last year and truck assemblies 33 percent lower, thus continuing the pattern of the third quarter.

In certain parts of the country, tourism has rebounded from the nadir reached during the gasoline shortages. Recent increases in northern New England may even be sufficient to offset earlier losses. In Atlanta, tourism is now about equal to last year, and the recent groundbreaking in Florida for Disney's Experimental Prototype Community of Tomorrow bodes well for the future there. In contrast, tourism remains depressed in San Francisco.

Other business activity appears to be holding up fairly well. Automobile production and steel orders have stabilized at lower levels. Strength in aerospace, electronics, and small appliances has led to input shortages in Kansas City. Conditions in Boston have improved, partly as a result of increased export sales. San Francisco reports continued strength, but industrial output slipped again in Philadelphia. In Richmond, although employment fell, it did so at a slower rate than in the two previous months.

In general, the capital goods industry remains strong despite a slowdown in orders. Order backlogs are still high, and St. Louis reports that in some companies they have continued to increase. Capital spending plans continue undiminished, although investment activity is not uniform across sectors. Boston reports capital spending by industries producing consumer appliances and electrical equipment for the home is already weak, but that spending by the chemical, rubber, and non-automotive transportation industries is at record levels.

Inflation continues rampant, but the rate of increase varies by industry and section of the country. For example, robust building activity in Dallas has contributed to the rapid price increases of building materials there. In contrast, the decline in the demand and hence the price of steel scrap has helped to lower steel prices. Overall, there seems to be the feeling that price increases for the rest of the year will be less dramatic than they have been. However, continued inflation combined with the recent GM-UAW settlement has raised some concern over the future level of wage demands.

Inventories are still reported to be on the lean side, as firms continue to be extremely cautious. Those few cases in which retail inventories are reported to be somewhat high are not expected to result in any large or sudden corrections. In fact, the moderate build-up previously experienced in St. Louis has already been worked off. Even the large auto inventories have been greatly reduced. Business inventories range from "adequate" in Chicago to a level somewhat-above-desired for materials in Richmond. Still, in Richmond and other districts, inventories of finished goods seem, if anything, to be a little on the low side.

Recent declines in residential construction seem to have been largely offset by increases in non-residential construction. In St. Louis, for example, housing permits are down but total construction employment is at or above last year's level. In some districts such as Chicago and Atlanta, speculative housing starts have been dampened by the very high financing costs. Many banks and financial intermediaries are also becoming much more restrictive in issuing mortgages. In Dallas, although the burst in non-residential construction has been welcomed, it has raised concern of a future oversupply of commercial space.

In many areas of the country, farm income is higher than anticipated. Bumper crops, however, have created storage and transportation problems; the

recent settling of the grain haulers' strike should, according to Minneapolis, provide some relief. Production is down in Southern California, but price increases have more than compensated for the smaller volume. In contrast, Atlanta reported some farm areas were severely hurt by hurricane Frederic. Losses are also being experienced by those farmers raising hogs and broilers.

In most districts, business loan demand remains strong. Cleveland considers this a bad sign, fearing that the borrowing reflects a deterioration in the financial condition of industry. Many of the loans in New York are not for expansion but are for added inventory and acquisitions. Although the higher interest rates have not yet choked off overall demand, Minneapolis is concerned that small businesses are now being hurt. Consumer loans have weakened, but, in Philadelphia, they have not weakened as much as expected.

FIRST DISTRICT - BOSTON

Reports from the First District are mixed. A growing number of respondents see signs of weakness but there continue to be areas of strength. Retail sales are disappointing but have recovered somewhat from the very depressed levels of the summer. More and more manufacturers are reporting a deterioration in orders but most have some product lines which are still doing well. In the banking sector loan demand remains strong.

Retail sales seem to have picked up recently but they are still quite weak. In northern New England a resurgence of the tourist industry has boosted sales volumes. One director from an area heavily engaged in tourism thinks that the current strength may completely offset the losses caused by the gasoline shortage. In southern New England, the head of a large department store chain reports a significant improvement in sales during the last couple of weeks; a major promotional effort seems to have been an important contributing factor. This retailer thinks that inventories are too high but a large correction will not be necessary if the present level of activity continues. State sales tax collections are generally lower than expected because of the slow growth in retail sales.

The experience of manufacturers in the First District is highly varied. On the positive side, a recent survey of purchasing agents in the region indicates that production, new orders and backlogs all picked up in September. This was at least partly a seasonal phenomenon; but even taking this into account, the responses were still positive. A manufacturer of heavy capital equipment for the chemicals and rubber industries reports record new orders. Orders for non-automotive transportation equipment are also strong, with exports

responsible for much of the strength. One company in the instruments industry which had reported a downturn last month has since seen demand pick up; again export sales are a contributing factor. Defense orders are very strong. More negatively, a manufacturer of consumer appliances reports a substantial weakening. Orders for electrical equipment associated with housing construction are down, as are orders for shoe manufacturing equipment, fasteners and instruments associated with investment in the process industries. Some of the manufacturers with declining orders are beginning to lay people off. These same firms also feel that inventories are higher than they would like, although not yet seriously out of line. The chief economist for one of the nation's largest companies, headquartered in New England, reports an easing in the prices of a number of commodities, particularly cobalt, copper and sheet steel. Price premiums are coming down in some cases; discounts are being offered in others.

According to banking directors, loan demand is still strong in all categories. Demand deposits are growing quite rapidly at a large bank in southern New England and a small bank in the northern part of the region reports a strong inflow of large CDs.

Professors Eckstein, Houthakker, and Solow were available for comment this month. All three respondents agreed that the moderate third quarter rebound does not signal the end of the recession, although there is disagreement about the appropriate course for monetary policy at the present time. They are puzzled about the recent turmoil in the foreign exchange, gold, and commodity markets, and they offer conflicting advice on how to deal with it.

Professor Eckstein believes that the third quarter's growth was achieved at the cost of a more severe downturn in the months ahead. He

expects inflation to continue near its current pace for several more months, however, despite the imminent slowdown. In Eckstein's view, the decline of the dollar on foreign exchange markets is primarily the result of domestic economic performance. He cites the high U.S. core inflation rate as one important contributor to the dollar's weakness. Eckstein is as "uncertain as everyone else" about the "spooky" international situation, although he is concerned that the weakness of the yen is more damaging to American interests--particularly those of automobile producers--than is the speculation in gold and other commodities. Warning that further funds rate increases will only make the recession worse and lead to overreaction later on, and that the attempt to use monetary policy to support the dollar is doomed to failure, Eckstein would like to see the funds rate held in the 10-11 percent range throughout the slump.

Professor Houthakker believes that the excitement in the foreign exchange markets has been "overdone." In his view a sharp increase in gold sales by the Treasury would be effective in calming international currency and commodity speculation. Houthakker argues that a primary goal of domestic policy must be to reduce inflationary psychology. Accordingly, he is sympathetic with the present stance of monetary policy. Concerned about recent rapid growth in the monetary base, Houthakker thinks that significant further funds rate increases may be necessary. He believes a rate as high as 15 percent would not cause major problems for the economy and may be warranted unless money growth begins to fall fairly soon.

Professor Solow thinks that the third quarter uptick is due mainly to involuntary inventory accumulation. As a result, he now expects the recession to be longer and deeper than he did formerly, not as bad as in

1973-75 but somewhat worse than the postwar average. Solow is disturbed by the "minor hysteria" over the exchange value of the dollar. He argues that the November 1 package was a good risk given the fundamental factors at the time, but that subsequent events--weak productivity and relatively high inflation in this country--may have lowered the equilibrium value of the dollar. Solow is uncertain whether or not the dollar's current value is appropriate, but he finds foolish the spectacle of the United States trying to attract a capital inflow in order to shore up its balance of payments. Arguing that there currently is little to be said for tighter credit, Solow warns against sacrificing domestic policy goals by succumbing to foreign efforts to improve their exports.

Second District--New York

Business activity in the Second District has lately turned in a moderately strong performance, according to recent comments of directors and other business leaders. Consumer spending appears to be holding up overall, but there are scattered signs of incipient weakness. Businesses have kept a tight lid on their inventories, and their stocks currently seem to be well in balance with sales. On the financial front, business loan demand has lately surged at the New York City major banks, and the funds are reportedly being used to finance inventory and acquisitions requirements.

Retail sales of many items have been strong in recent weeks. Most of the large department stores reported that their sales receipts have been running ahead of plans; some went on to say that they foresee a year-over-year gain amounting to 4 or 5 percent in real terms. Two large national chain stores did indicate, however, that their sales had flattened out, falling below what had been planned. A spokesman for one of these chains thought that his company's relatively weak performance might have occurred because its clientele tends to be less affluent than those of the other retail chains. Actually, the problem appears to be more general. Even among the retailers which recorded satisfactory gains in total sales, there were more than the usual number of complaints about weaknesses in particular product lines or in particular areas within the New York region. In any event, all retailers unanimously reported that their inventories were still "in balance" with sales. The exceptionally high cost of financing is impelling some merchants to consider cutting back their inventories. It should be mentioned, however, that the retailers which were contemplating such a move were the same ones which had experienced a weakening in sales receipts.

Automobile sales in the District continue to be brisk. Sales of small cars are booming, and the inventories of certain foreign makes are now down to rock-bottom levels. Moreover, the sales of intermediate and full-sized models have also been robust, and it appears that dealers have succeeded in eliminating their former excess inventories of large cars. Indeed, the domestic dealers contacted were eagerly awaiting delivery of the larger-size 1980 models. Truck sales, however, remain flaccid. In the face of mounting economic uncertainty, of course, these are the kind of capital goods which are among the first to be postponed.

Outside of retailing, the business situation appears to be fairly resilient. While most companies still foresee a near-term recession, they have not themselves been touched by the slowdown. A few businesses do report, however, that sales in certain consumer product lines are beginning to slip. Most firms still maintain that their inventory positions are "well managed" and in line with anticipated sales levels. Companies also generally report no change in their capital spending plans.

Companies in the Second District are worried, however, about the deteriorating price situation. Many foresee that the recent UAW settlement is likely to encourage labor unions to strive for larger wage settlements in the near-term. At the same time, there is also a distinct feeling that, by granting exceptions to particular industries, the Administration has greatly weakened its voluntary wage-restraint program.

Officials at some of New York City's major banks described September's surge in business loans as broadly based. The strong demand was mostly attributed to requirements for financing inventory and for acquisitions. All respondents reported that the terms of compensating balances have not firmed and that some big loans were still made below prime. Banks appear to possess

much more liquidity now than they did in 1974. Most respondents expect business loans to remain strong for the remainder of the year.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business activity is mixed again in October. In the industrial sector, manufacturers have reported a fourth consecutive month of production cutbacks. At the same time, local retailers say sales are sluggish. Looking ahead, representatives of both sectors see softness in business conditions continuing throughout the year and on into 1980. Both production and retail sales are expected to hold their current levels through April. Bankers are a little more optimistic, however. Loan demand, which is currently soaring, is expected by many to remain strong as the nation slips into a recession and businesses turn to banks to meet their working capital requirements. The prime rate is currently 13 1/2 percent in the Third District.

Manufacturers responding to the October Business Outlook Survey report another major dropoff in local industrial activity. This is the fourth consecutive month in which business has significantly slowed for manufacturers. In terms of specific indicators, shipments are unchanged from September levels while new orders are off substantially. Thus, manufacturers' backlogs continue to shrink as they have done since June. The slowdown in production has led over 40 percent of the manufacturers surveyed in October to make further cuts in inventories. Local labor has yet to really feel the pinch though. Although the workweek has been trimmed at many area firms, payrolls have not as yet been cut as a result of the slippage.

Looking ahead to the next two quarters, survey respondents foresee further slowing in the industrial sector but expect recovery by April. By that time, manufacturers expect overall business activity to be about the same as it is now. New orders should be higher in six months than they are now, but shipments will remain steady, causing a build-up of unfilled orders. Plans to increase capital spending are also reported. No inventory

rebuilding is forecast, however. In fact, further paring of stocks is anticipated. Local labor is expected, by April, to have felt some of the effects of the slowdown, too. Payrolls are forecast to be fractionally smaller by then, and the workweek will likely be shorter.

Inflation appears to have picked up in October in the local industrial sector. The cost of raw materials is up from September at over three-fourths of the firms surveyed this month, and the prices of finished goods are higher at over half. By April, 9 out of 10 respondents expect to be paying more for inputs, and 3 out of 4 plan to be charging more for the goods they produce.

Area bankers say business remains brisk in October. Consumer loans have not taken the dip many expected to see by now, and commercial loans are up from 7 to 25 percent over October '78 levels. It's difficult to say how much of the strength in business loan volume comes from a basically strong market though, as the banks reporting the biggest gains have been following aggressive pricing policies recently. This activity may be taken as an indication that no signs of a credit crunch have been observed as yet. However, it is the general opinion of the bankers contacted that the loan market will begin to tighten up within two months.

For the longer term, bankers contacted had differing views on where loan demand will be going over the next six months. Projections of business loan volume for early spring range from 8 to 9 percent below year-earlier levels to 18 percent above those levels. In favor of continued strength in demand are higher input costs that businesses will face as a result of continued inflation, the need to finance involuntary inventory accumulation, and slower turnover of receivables over the next two quarters. Moreover, interest rates will probably remain too high in the coming months for firms to want to refinance current obligations at fixed rates through nonbank sources. Thus, they will probably continue to go to their banks for money.

The prime rate at all of the banks contacted is currently 13 1/2 percent. Consistent with a wide range of loan demand forecasts, a broad range of interest rate forecasts is also reported. At one end of the spectrum, some bankers foresee the prime being bumped another 25 to 50 basis points in the near future, and then dropping to about 12 percent by April. Other forecasts, however, predict no reduction in the prime, but do see less frequent hikes. The prime rate may, according to those forecasts, hover around 14 percent six months from now.

Area retailers report some nominal growth in sales in October, but, after adjusting for inflation (by the LIFO price index) sales volume is just about even with year-ago levels or a little off. Current dollar sales are reported to range from 3 to 5 percent over October '78 sales. Merchants cite a general slowing of the economy as the cause of recent sluggishness, and point to slower collection rates on installment debt at their stores as evidence supporting this assertion. Retail inventories remain in good shape despite several months of soft sales, as merchants keep a sharp eye on their stock levels.

As for the future, local retailers remain cautious overall. They generally believe that the U.S. is in for a recession that may last a bit longer than many forecasters have been predicting, and are planning accordingly. Nominal sales next spring are expected to be 2 to 3 percent over year-earlier figures—probably flat in real terms. Retailers contacted plan to keep inventories trim in the coming months.

FOURTH DISTRICT--CLEVELAND

Business conditions in the Fourth District have improved during September, but most respondents view a positive third quarter as temporary. Strength in retail sales is credited to a comeback in auto sales which is not expected to carry over into the fourth quarter. Production of capital goods is expected to remain strong this quarter, but reduced operating rates in steel are anticipated. Bankers report strong loan demand, which may reflect the weakened financial position among businesses and consumers. Despite a stronger than expected level of housing starts, several housing market officials believe the marginal buyer is being squeezed out of the housing market by continuously rising prices and interest rates. Continued high rate of price increases will prevail in the fourth quarter with only a few exceptions.

Growth of retail sales has slowed in the District, but department store officials are skeptical that the economy is in the midst of a recession. One retail economist noted that real sales of department store-type goods have flattened, but have not yet declined. Other retailers assert that price-adjusted sales are biased downward because consumers have been responding to differences in relative prices. Apparel sales, for example, have been excellent in recent weeks, reflecting a price increase of only half the 13 percent increase in the consumer price index. However, retailers are concerned about diminishing profit margins, rising loan delinquencies, and bad-debt losses. Indeed, most respondents stated that retail sales would have been negative in September except for the pickup in auto sales. The strength in auto sales, which was induced by rebates, may have come at the expense of fourth-quarter sales, according to some officials.

Durable goods manufacturing has tended to hold up better than had been expected, partly because housing and related industries have been better than expected. However, a supplier to the appliance industry reports that orders have tended to weaken and backlogs reduced in recent weeks. An economist for an aluminum producer views the decline in orders for packaging materials as an indication of a further slowdown. Finally, a retailer believes some softness in overall business sales stems from tight control over inventories, and hence new orders, by retailers.

Capital goods producers, except for auto and truck-related industries, report that business has been buoyed by a need for additional facilities, and production is expected to remain strong in the fourth quarter. According to one District economist, high utilization rates and sluggish investment during most of the expansion have made the need for fixed investment apparent. However, a durable goods manufacturer expected businessmen to be cautious because of a lack of funds for investment. A steel economist states that steel orders have dropped to about half the rate in the first two quarters of 1979, when orders exceeded shipments and backlogs rose rapidly. Probable shipments for the second half of 1979 are 7.5 million tons, compared with 8.5 million tons in the first half. Operating rates in the steel industry will hover around 80 percent in the second half, compared with 90 percent in the first half of 1979. However, demand for steel from energy, freight cars, heavy construction, and machinery remains strong.

Continued strength in business and consumer loans can be attributed in part to deterioration in the financial position of businesses and households. A banker expresses concern that strong commercial loan demand was the result of a weakening cash flow position among producers. External financing for new

model changeovers is cited by one auto economist as a source for increased demand for business loans. On the consumer side, a banker mentions consolidation of debt as a source of consumer loan demand. Indeed, delinquency rates have been climbing. But most of the consumer demand, according to one banker, has been for instalment loans and credit card usage. Several bankers note a rise in precautionary borrowing by business and consumers as a hedge against higher interest rates.

Higher interest rates are having a noticeable effect on both borrowers and lenders in the mortgage market, and are expected to contribute to a decline in mortgage demand and housing starts. Several bankers and housing economists expect 1.5 million and 1.6 million in starts during the fourth quarter. However, several savings and loan associations report growing difficulties in financing mortgages because of weak deposit flows and narrowing profit margins brought about by a negative yield curve. One savings and loan official explains that the appearance of adequate liquidity may be misleading because a great reliance on jumbo certificates of deposit (CDs) requires savings and loan associations to maintain a higher liquidity position in case the jumbo CDs cannot be rolled over. Although the cost of funds has been high, a savings and loan official states that mortgages are still being made on the expectation that mortgage interest rates will decline next year and that profits can still be made on points during the first year of a new mortgage.

Moderation in the inflation rate has not yet occurred, but businessmen look for some relief in response to a slowdown in economic activity. A steel economist believes that steel scrap prices will drop further because of lower operating rates in the steel industry. However, a durable goods producer expected little change from double-digit inflation until 1980. An energy economist believes that gasoline supplies in most parts of the District will

probably exceed demand this month, and the price in the near term will rise less rapidly than natural gas and electricity prices. The rise in food prices is expected to be near the overall inflation rate in 1980.

FIFTH DISTRICT - RICHMOND

Business activity in the Fifth District seems to have stabilized somewhat over the past month. Our survey of manufacturers reveals some further declines in shipments and new orders, but the declines narrowed substantially from earlier months. Further, stocks of materials held by manufacturers rose only very slightly while finished goods on hand were actually reduced. Inventories remain above desired levels, however. Richmond directors, though, see few signs of excessive inventory buildups other than in such lines as autos, farm machinery, and recreation equipment. Retail sales also held their own in September. Lending at Fifth District banks is increasing moderately, especially business and real estate lending.

Shipments by our manufacturing respondents showed only a very slight decline in September. About half the respondents report no change at all while the remainder are very nearly evenly divided between gains and reductions in shipments. The volume of new orders also appears to have slipped somewhat, but, again, most respondents experienced no change. Backlogs of orders were essentially unchanged. Reductions in employment and the length of the workweek were decidedly less widespread in September than in the two previous months.

Only 15 percent of our manufacturing respondents had further accumulation of materials inventories in September, down substantially from a month earlier. Survey responses further suggest some reduction in stocks of finished goods over the month. Richmond directors, for the most part, are aware of little rapid inventory accumulation in their respective areas. A few mentioned specific lines in which problems may exist, however. Specifically, autos, farm machinery, recreation goods, building materials, and furniture were mentioned, in isolated cases, as possible problem areas. Survey respondents, manufacturing and retail,

still view current stocks as somewhat above desired levels, however. Pessimism remains pervasive among our survey respondents. A majority anticipates declines in the level of business activity nationally and in their respective market areas over the next six months. Nonetheless, about two-thirds expect output of their own firms to hold steady.

Contacts with several large regional banks suggest that business loan growth is a bit stronger than would be expected from seasonal factors alone. Seasonal demand from nondurable goods manufacturers, commodity dealers, and wholesalers as well as retailers, has boosted commercial and industrial loan volume over the past month. In addition, however, there has been some broadly based demand for working capital and expansion loans. None of our contacts has seen any significant line of credit usage due to inventory accumulation. Rather, bankers see firms as being extremely cautious on the inventory front, with the textile and apparel industries frequently cited examples. Depressed 1980 apparel sales are being forecast and conservative inventory building has reduced the current financing requirements of manufacturers.

Consumer instalment lending has weakened after a brief spate of activity related to increased auto sales. Our directors are unanimous in attributing reduced consumer loan demand to a general weakness in durable goods purchases. Some banks have tightened their credit standards on consumer loans, but our directors are not aware of any difficulties being encountered in obtaining such loans.

Real estate is perhaps the most active lending area for Fifth District banks at this time, partly due to reduced participation by thrift institutions. Banks appear generally willing to take on mortgage loans. Real estate lenders note, however, that higher mortgage rates have narrowed the eligible market for residential mortgages to higher income borrowers. Demand for mortgage

financing is firm. Construction lending is slowing somewhat as a result of both reduced demand and tighter standards. Demand seems to be the major restraining factor as home builders become more concerned about the willingness of potential home buyers to pay high mortgage rates and the continued availability of mortgage funds. Several of our directors, however, cite the availability of credit to builders and contractors as a factor in this slowing of construction lending.

SIXTH DISTRICT - ATLANTA

Consumers seem increasingly cautious and bargain-conscious but are continuing to buy. Softening is evident in auto sales and residential construction (except in Florida). Expectations within the tourist industry are more upbeat. Florida, in particular, was buoyed by the start of a massive expansion at Disney World. Employment continues to hold firm. Except for poor broiler and hog prospects, agriculture is in good condition.

Hurricane Frederic wreaked \$1.5 billion in damages to Florida, Alabama, and Mississippi, equalling the losses in 1969 from Hurricane Camille. Thirty counties were declared federal disaster areas, making them eligible for massive federal assistance. The Alabama State Docks in Mobile were shut down by up to \$40 million worth of damages. Two miles of Alabama's Dauphin Island causeway were completely wiped out. In Pascagoula, Ingalls Shipbuilding and the Chevron USA refinery suffered \$10 million damage each. The storm hit the Mississippi seafood industry hard, inflicting losses to processing plants and possibly dealing the oyster industry a new setback on top of reef pollution caused by spring floods. Shrimp and crab populations, however, were unaffected. Further Mississippi contacts reported storm damages in excess of \$100 million to the timber industry and expect the increased volume resulting from salvage cuts to substantially depress timber prices. Destruction to homes throughout the three-state area was severe and widespread.

No significant downturn in retail sales is yet apparent, but no contacts reported strong sales. Consumers in general were becoming more price and value conscious, and retailers were exercising strict inventory management. Heightened interest in gold, silver, and large diamonds were

noticeable developments. An Atlanta jeweler notes that older people are liquidating their jewelry to meet inflation. Auto sales, overall, are sluggish. Rebates and promotions continued to boost sales of mid-size and full-size automobiles, although one Florida dealer suspects the rebates have created a "false prosperity."

Residential construction, except in Florida, has slowed down. Speculative building, even in some parts of Florida, is virtually at a standstill because interest costs make it financially impossible for builders to hold a home for any length of time before it is sold. The consensus in Birmingham was that the single-family market will not improve until the third and fourth quarters of 1980. Savings and loans are still providing mortgages but only to very well-qualified applicants.

Interest rates continued to soar, but loan demand has not, as yet, been significantly affected. Demand for six-month money market certificates was strengthened by record yields. Bankers in several different locations reported worsening delinquencies. Some northern Alabama bankers are having to work harder to collect payments and have also noted a decline in the quality of applicants.

Expectations regarding tourism, except in hurricane devastated areas, for the remainder of the year are positive, with most contacts projecting volume to approximate last year's. Disney World continues to prosper. Groundbreaking for the EPCOT Center, part of the Experimental Prototype Community of Tomorrow, was held recently. The project, also encompassing two theme parks, World Showcase and Future World, totals \$500 million in construction costs and, upon completion in three years, should bring 8 to 10 million visitors per year.

Unexpectedly, unemployment remained stable or improved throughout much of the District, partly because employers had been cautious about hiring earlier. However, the vulnerable auto-related industries experienced a slowdown. In Tennessee, for example, tire cord and truck transmission manufacturers reduced employment. In Birmingham, approximately 1,000 employees were laid off at the U. S. Steel facility.

Discounts on steel and aluminum are being offered. The discounts on steel prices reflect a slowdown in the automotive sector. An Atlanta area contact reports no large excess in aluminum inventories as experienced in 1973. One Atlanta paper products manufacturer reports strong growth, together with a recent buildup of inventories because of a slowdown in orders, while two Florida paper manufacturers report no inventory accumulation. No one foresees a significant decline in demand.

Harvesting is under way and increased yields of soybeans, cotton, peanuts, and corn are evident. Abundant rainfall is the primary reason. Hurricane Frederic missed major cropping areas. However, row crops and pecan groves were severely damaged in the relatively narrow path of the storm. Markedly higher feed costs continue to squeeze profits and, in many cases, enlarge losses on broilers and hogs. A northwest Alabama contact reports disastrously low hog prices.

SEVENTH DISTRICT - CHICAGO

Except for housing, motor vehicles, and other sectors directly affected by rising fuel costs, the impact of the economic slowdown has been moderate in the Seventh District. Nevertheless, job markets have eased, and retail sales are sluggish. Some capital goods producers still report rising backlogs, but others note a distinct slackening in demand. Inventories are generally quite adequate, but not burdensome. No significant shortages of materials, components, or services are evident. Availability of skilled workers has improved. Nevertheless, the rate of increase in prices and worker compensation remains about as rapid as earlier this year. The dichotomy between strength in nonresidential construction and weakness in housing is increasingly evident. Bumper corn and soybean crops seem assured, but storage and transportation facilities are serious bottlenecks.

Most informed observers in the district believe that real GNP will decline moderately into the spring of 1980. Business managements have been warned about the impending recession for a year or more, and most have conducted their operations in such a way as to avoid becoming overextended. Double-ordering, rampant in 1973-74, has been avoided, and manufacturers have allowed backlogs to build up, rather than schedule additional overtime and use other high-cost expedients.

Settlement of the GM-UAW confrontation without a strike was greeted with mixed feelings. Disruptions associated with a major auto industry strike were avoided, but employers were locked into a very expensive three-year contract. Information on the details of the auto pact is still somewhat vague, but it appears that the three-year boost in worker compensation will

be about 35 percent, assuming an 8 percent rise in the CPI, and more if prices rise even more rapidly. This would raise average total labor cost per production worker from \$30,000, currently, to \$40,000. Compensation of nonunion employees will rise about in step. This comes at a time of poor sales and heavy layoffs which might have stiffened company bargaining in the pact.

The auto pact will set the basic pattern for the farm and construction equipment workers this year, and steel next year. Since October 1, about 55,000 workers have been on strike at Deere and Caterpillar. International Harvester workers have agreed to extend their contract awaiting developments. Layoffs have occurred at plants not on strike because of parts shortages. The issue in the strikes is said to be additional time off and other technicalities, rather than the basic package. In these industries, as in the case of autos and steel, the strongest firms can pay higher compensation at levels that might threaten the viability of weaker competitors. For some months prior to the strike deadline, production of farm and construction equipment had been maintained at higher rates than were justified by current sales so that inventories of finished goods could be increased as a strike hedge.

The market for larger cars and light trucks continues very weak with some new models selling so poorly as to require temporary plant closings. The industry's ability to produce more small cars will be quite limited for at least six months. Total auto assemblies are scheduled at 12 percent below last year in October, while truck assemblies will be off 33 percent. Similar year-to-year declines had been reported for the third quarter.

Heavy truck sales will set a record for 1979 as a whole. However, new orders have dropped sharply in recent months, and inventories have increased. Production schedules have been reduced accordingly. The downward

phase of the heavy truck "cycle" is expected to continue to mid-1980 with reductions in sales and output of about 30 percent.

Steel orders have leveled off at a lower rate with virtually all of the decline traceable to motor vehicles and oil country goods. Steel orders for capital goods remain vigorous. Lead times are now "normal" compared to abnormally long periods last spring. An industry analyst expects mill shipments of 23 million tons in the fourth quarter, down from 24.5 in the third quarter and 26.6 in each of the first two quarters. Users are trying to reduce inventories which are not generally excessive.

Orders for machine tools and freight cars have slowed substantially, but order backlogs remain very large. Some machine tool producers expect orders from the auto industry to keep their operations at full capacity into the 1980s. Demand for construction equipment, especially types associated with home building and site development, have declined significantly. However, orders for some types of mining equipment, mechanical power transmission units, and industrial cranes have continued to exceed shipments, somewhat to the surprise of the producers.

Dry weather during September hastened the maturity of district corn and soybean crops which are now safe from frost except for the northern fringe. Harvesting is only slightly behind normal progress, despite late plantings. Apparent settlement of the Rock Island Railroad strike will help move grain which has been piling up. Liquidity pressures are still widespread at rural banks.

Home construction and sales are off much more sharply in the district than in the nation. Single-family permits in the Chicago area are running 50 percent below last year. Some builders have halted all speculative starts.

EIGHTH DISTRICT - ST. LOUIS

According to Eighth District businessmen, economic activity remains at about the same level as a month ago, with the only signs of slowdown centered in the consumer-oriented durable goods sectors of automobiles and housing. Because they expect demand to slacken in the months ahead, businessmen are closely watching their inventories which they feel are at satisfactory levels. Real spending at department stores is reported to be about the same as a year ago. Manufacturing activity continues strong in many industries, especially those related to capital spending.

Consumer spending in real terms is approximately at the year-ago level according to area retailers. Department store sales improved somewhat in the August-September period from the early summer months, and the moderate inventory built-up in that period has been largely worked off. Retailers noted that back-to-school sales were generally "good" and that fall and winter clothing items, particularly outerwear, are selling well. They also reported that inventories for the Christmas season will not be increased as much as last year in view of the uncertain economic outlook.

Automobile sales, according to St. Louis car dealers, improved in the August-September period. Currently, inventories vary substantially from dealer to dealer with some dealers reporting excessive inventories (as much as 300 percent above a year ago), while others reported inventory shortages. One dealer complained that the increased interest costs of the excessive inventories were wiping out profit margins.

Declines in manufacturing activity were reported in the automobile and related industries, and in major appliances. On the other hand, a number of industries including chemicals, paper, apparel, and capital goods have experienced little or no slackening in demand; and in some cases, increases have occurred. A major chemical firm, for example, reported that demand has unexpectedly continued to climb and that sales volume is 20 percent above a year ago. Also, capital good firms reported strong activity and, in some cases, growing backlogs.

Overall, construction activity continues at a high level, especially in nonresidential building. Some weakness in residential building was reported compared with a year ago, but further deterioration has not been apparent in recent months. In the St. Louis area, new housing permits are down about 20 to 25 percent from those of a year ago, in line with the industry's expectations. Nonresidential construction has taken up the slack, and the total number of construction workers employed equals or exceeds that of a year ago. Builders expressed concern, however, that higher interest rates and unavailability of credit may cause postponement or cancellation of some building projects.

Deposit growth continues to slow at District thrift institutions. Several saving and loan associations have experienced net outflows of deposits in recent months; overall, however, the industry continues to post small gains in deposits. Only a few associations currently are accepting mortgage loan applications from new customers and many associations report that they are restricting their lending to established borrowers. S and L representatives report that nearly all their new funds are obtained though

money market certificates, and expressed concern about the growing portion of deposits represented by these interest-sensitive accounts. Time deposits at commercial banks have continued to increase rapidly, reflecting the issuance of large CDs. Banks have bid aggressively for these funds in view of the continued strong demand for commercial, agricultural, and consumer loans. Loan demand at St. Louis banks is not as strong as nationally, and more loans than usual have been made recently at interest rates below the prime rate.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District economy appears generally better now than a month ago. Agricultural conditions were improved by the recent settling of the Duluth/Superior grain handlers' strike and by excellent weather, and nonagricultural conditions continue to be favorable, as they were last month.

An Improved Situation for Agriculture

The district's agricultural situation has brightened in the last four weeks. Farmers can market their grains easier now, because the grain handlers' strike, which had closed down an important outlet for Upper Midwest grains since early July, was settled in late September. In addition, farmers are going to have more crops to sell than was expected in August. Due to the late maturity of the district's corn and soybean crops, many farmers feared that frost or rainy weather in September would significantly reduce their yields. But last month's warm, dry weather has allayed their fears.

A Generally Favorable Situation for Other Industries

These heartening agricultural developments complement the district's nonagricultural developments. The nonagricultural indicators show that the district is not in a recession, as they did last month. Our September Redbook Report stated that district labor market developments, corporate earnings, loan requests, and manufacturing sales indicated considerable strength in the regional economy. Information on corporate earnings and manufacturing sales is not available this month, but recent information on district labor markets and loan requests reconfirm last month's observations.

District firms are still hiring workers instead of laying them off, as the district's current large volume of help wanted advertising suggests. The absence of layoffs last month is reflected in the low number of workers

presently claiming unemployment compensation. Loan requests at district banks also reflect the strength of the district's economy. Most bank directors report strong business loan demand at their area's commercial banks and attribute this demand to the district economy's current strength.

This strength is also confirmed by indicators of capital spending and inventories, which we did not cover last month. The usual easing in capital spending that accompanies a recession has not occurred. In the Minneapolis/St. Paul area, a sizeable number of large commercial construction projects is under way. Outside the Twin Cities, several directors indicate that their area's businesses are either expanding or improving their facilities. In addition, the unwanted inventory accumulation that characterizes a recession has yet to occur in the district. With the exception of large automobiles, directors report that district firms are not confronted with excess inventories. In fact, two large manufacturing firms located in the Minneapolis/St. Paul area indicate that their inventories of finished goods are lower than desired, and three of the area's largest retailers report that present inventories are satisfactory. Due to sales promotions, even the troubling auto inventory situation is better now than in July and August.

Some Problems

Despite this generally rosy assessment of the district's economy, there are some problem areas. Last month our Redbook Report indicated that district consumers were reluctant to spend, and this situation hasn't changed. Two large Minneapolis/St. Paul retailers report weak September sales. Several directors from outside the Twin Cities report that their area's retailers are still having difficulty moving merchandise. Home sales also continue to be slow. In many communities home listings are up substantially from a year ago.

Finally, some directors say that high interest rates are causing problems for some small businesses.

TENTH DISTRICT—KANSAS CITY

Agriculture and energy-based industries are providing support to the Tenth District economy, but signs of weakness remain. Retail sales are stronger, but still slow in real terms, and retailers are not optimistic. Most manufacturers consider materials supplies to be adequate, and many plan to cut inventories in anticipation of declining sales. Farm prices are expected to contribute less to inflation in the months ahead, although they rose sharply in September. In District banks, loan demand continues strong, but deposit growth is weaker than a year ago.

Retail sales in the Tenth District are showing substantial improvement over earlier this year, and the dollar volume is up 5 to 10 per cent over this period last year. Most kinds of goods are selling well, although business is slow in shoes and children's apparel. Clearance sales did not begin any earlier this year, except in the Denver area. Most retailers are satisfied with their inventory levels but are ready to trim stocks if sales do not hold up. Few expect sales to increase further during the next three months, but all expect wholesale prices to continue to rise, forcing more increases in prices at retail.

Purchasing agents in the Tenth District report increases in input prices of 7 per cent or more over last year. The electronics industry and industries using petroleum-based inputs are experiencing especially steep price increases. Most buyers note an acceleration in price increases since July. About half, however, do not expect any substantial price hikes during the remainder of the year. Inputs are still in short supply in the aerospace, electronics, and small appliance industries. Half of the purchasing agents

in the other industries plan to cut their stocks of materials soon, because of high interest rates and expected sales slowdowns.

Prices received by U.S. farmers rose 1.5 per cent in September—because of improvement in prices for hogs, beef cattle, calves, wheat, and milk—and now stand at 11 per cent over year-earlier levels. Increases in prices received by Tenth District farmers were somewhat greater than for the U.S. as a whole because of the importance of livestock and wheat to District agriculture. Prices paid by farmers for goods and services rose 1 per cent in September to stand at 14 per cent over a year ago.

For the balance of 1979, farm prices are expected to remain fairly flat. Continued increases in U.S. pork production will temper upward pressure on meat prices. The September 1 U.S. Department of Agriculture hog and pig report indicates producers in the 14 major states—accounting for about 86 per cent of the U.S. hog and pig inventory—are still expanding production. The breeding inventory was up 10 per cent and the market hog inventory was up 17 per cent from year-earlier levels. Moreover, the summer pig crop increased 16 per cent over a year ago while fall and winter farrowing intentions were up 13 and 10 per cent, respectively. These data indicate abundant pork supplies through mid-1980.

Grain storage and transportation continue to concern farmers and the grain industry. However, principally because of increased onfarm storage, it appears that Tenth District farmers will find adequate storage for the record soybean and corn crops to be harvested this fall. Transportation problems are more persistent, with farmers and country elevators making greater use of trucks—at increased transportation costs—to transport grain to elevators and terminals on main rail lines or barge lines.

Transportation bottlenecks, such as continued delays in getting the Rock Island Railroad moving, could jeopardize the ability of U.S. grain merchants to supply the potential export demand during the 1979-80 marketing year.

Except for some bankers in metropolitan areas, most Tenth District bankers report continued strength in loan demand. Agricultural loans at country banks are particularly strong, as are energy-related loans in Oklahoma and New Mexico. Other categories in general are growing at rates similar to a year ago. Some larger metropolitan banks are experiencing weaker demands for commercial loans in particular, but also for real estate, consumer, and construction loans. All bankers report raising their prime or base lending rates in the last month. Most metropolitan banks currently have prime rates of 13 1/2 per cent, following the lead of the large money center banks. Further increases in the prime rate of 1/4 to 1 percentage point are expected by year-end. Most bankers say they are more selective now than a year ago, and some express concern over their ability to meet existing customers' loan demands in the near future.

Deposit growth at Tenth District banks generally appears weaker than a year ago. Savings deposits are growing moderately or are down at most banks. Large CD's and money market certificates, however, are continuing to increase at nearly all banks. Some bankers also report increased purchases of Federal funds and discount window borrowings in recent months. Most bankers expect deposit growth to improve soon due to seasonal factors. However, except for some country bankers, they generally believe this growth will be less than in past years. Stronger growth than usual may occur at country banks due to unusually strong agricultural conditions.

ELEVENTH DISTRICT--DALLAS

The economy of the Eleventh District continues to expand at a moderate pace. Recent gains in auto sales have bolstered retail sales, although department store sales are lackluster. Nonresidential construction activity continues to be a major area of strength in the District economy, while residential construction remains below year ago levels. The pace of lending activity at banks is essentially unchanged from recent months. Manufacturing output is on the rise with nondurable goods industries showing recent improvement.

Retail sales are advancing on the strength of improved auto sales. Rebates and price cuts account for the improvement and helped raise unit auto sales near the year ago level. As a result, dealer inventories have been substantially reduced. Department stores sales appear to be waning following the back-to-school sales promotions. Real sales are lackluster and are about even with the level a year ago.

Nonresidential construction activity remains at a high level throughout the District. Construction of office buildings, hotels, and shopping centers appears to be well ahead of last year in most urban areas. Activity is especially robust in Dallas and Houston where many projects are well on their way to completion, and many more are scheduled to begin. Hotel construction accounts for much of the activity in Fort Worth's downtown area.

Most of the large increase in new office and retail space has been leased in advance of completion, leaving rental markets firm. However, some softness in the rental market for retail space is noted at small shopping centers in Houston. And there is some concern that

some weakening in the office rental market may occur in Dallas after all the projects planned are completed.

Residential construction activity and sales of new and existing homes are down approximately 15 to 20 percent so far this year compared with last year. Several cities, however, recently posted gains in the number of housing permits and sales. Most builders generally expect sales to decline moderately through next spring. Inventories of unsold homes are holding steady at the second-quarter level and remain within manageable limits.

Construction activity continues to keep prices of building materials rising. Structural steel prices are up approximately 20 percent from a year ago, lumber prices are up approximately 25 percent, and cement prices are up about 11 percent. One exception is plywood prices, which are down approximately 40 percent. Lumber wholesalers attribute the decline in plywood prices to increased mill capacity and to slack demand for pulpwood which competes for timber with plywood mills.

Mobile home manufacturers report a continuing high level of shipments. Sales, however, do not appear to be benefitting significantly from higher prices for conventional housing and the tightening in mortgage markets. Manufacturers are concerned that mobile home financing will soon get tighter and cut sales.

High interest rates have not significantly slowed real estate borrowing at District banks. Interim construction loans, for example, remain among the strongest areas of lending activity. High interest rates, however, have slowed mortgage warehousing activity as mortgage bankers face negative spreads between the yields on the mortgages they sell and the rates they must pay for short-term financing.

Lending activity at District banks remains strong in most other loan categories, although the rate of growth has ebbed to the slowest pace this year. Loan demands by customers outside the District remain weaker than regional demands. Several bankers have expressed concern over unfair competition from foreign banks. They cite the ability of these banks to undercut prices because of differences in regulation.

Preliminary results from our latest survey of agribankers indicate the financial positions of District farmers are much improved from a year ago. The improvement is attributed primarily to larger crop yields and higher grain prices. Although farm loan demand remains strong, bankers report fewer loan extensions and an improved rate of loan repayment over the same period last year. The rise of interest rates nationally to levels above usury ceilings on loans to unincorporated businesses in Texas and New Mexico is substantially restricting some farmers' and ranchers' access to credit.

Manufacturing activity has recovered from a first-quarter slump and is now growing at a moderate pace. Production in nondurable goods manufacturing, which fell sharply during the first quarter, is making a strong recovery although output is still below the peak in last year's fourth quarter. Durable goods output is at a high level but is showing very little growth.

TWELFTH DISTRICT--SAN FRANCISCO

The economy of the twelfth District continues to be relatively immune to recession. Consumer spending, construction activity, industrial production, and employment remain at healthy levels. Weakness in specific sectors such as residential construction and motor-vehicle manufacturing appears to be largely offset by the strength of the commercial construction, aerospace, and electronics industries. Loan demand remains strong and loanable funds continue to be available as the result of deposit inflows, money market certificates, and access to the Eurodollar market. The employment and production outlook is optimistic, but price and wage inflation is widely reported.

Consumer spending in the District continues to be strong. Retail sales were generally higher in August in comparison to a year ago, although inflation has contributed to this trend. Sales of small appliances and back-to-school items were reported to be particularly vigorous. The weakness in the sale of automobiles is associated primarily with slack demand for 4-door sedans, recreational vehicles and 4-wheel drive vehicles; small car demand is extremely strong with delivery on some units taking as long as six months.

The demand for single-family homes in the District is very strong, for both higher priced homes and those priced below \$100,000. An exception to this pattern is reported in the southern California area where higher priced units are remaining on the market longer than previously. The effects of the energy shortage earlier in the summer linger in the tourism area. Altered vacationing patterns have weakened demand for recreational vehicle camping and tourist spending on souvenirs, restaurant meals, and other discretionary items associated with touring. Hotel occupancy rates, however, appear to have recovered from their weak position earlier in the summer.

Depressed residential construction activity appears to be more than offset by a high pace of commercial and industrial construction. In Oregon, for example, single-family-building permits are down 26.7 percent, but significant activity is reported in plant and equipment expansion, industrial park development, and office building and motel construction. Several areas in the District report shortages of skilled labor and materials in the construction industry, and the forest products industry is healthy. These developments reflect the net stable position of building activity. Prices of materials and labor continue to rise, however.

Activity in the electronics, aerospace and forest product industries in the District continues to provide strength to overall industrial production and employment figures. The Northwest economy in particular is still considered to be "booming" and national trends in unemployment are barely visible. Employment in Washington, for example, is reported to be growing at two and a half times the national rate. The weakness of national industries, however, is reflected in some regional sectors. A manufacturer of steel strip and blanks, for example, cited a slowdown in sales to the Detroit automobile industry. Furthermore, the August increase in unemployment of 92,000 workers in California can be traced partly to declines in the motor vehicle, transportation, utility, and nondurable goods manufacturing industries. Recalling the 1974/75 experience, producers are reluctant to build large inventories and in some cases are maintaining old equipment rather than purchasing new machinery. The aluminium industry faces a special problem as the watershed dries out, creating power shortages and forcing plant shutdown. Generally, however, the production and employment picture in the District remains relatively good and most do not predict large increases in unemployment or declines in production in the near term.

Agricultural activity presents a mixed picture. The citrus and avocado crops of southern California suffered severe weather damage this season, and the production of peas, lentils, grass seed, and wheat was reported to be below last year's figures in parts of the District. Prices of these products have risen sharply in the past year--by as much as 25 to 30 percent in the case of wheat. Onion and potato prices are reported to be low, however, and low poultry prices are credited with restraining increases in beef and hog prices.

Financial institutions report that loan demand is holding despite record interest rates. Commercial loan demand is particularly strong. The 12 percent usury limit in Washington, however, is beginning to dry up home-mortgage funds and consumer instalment lending has been weakened somewhat by soft automobile sales. Funds continue to be available as the result of deposit inflows, money market certificates, and access to the Eurodollar market. The net inflow of funds to savings and loan associations is reported to be "slight", with disintermediation from traditional accounts offset by money-market-certificate activity. Funds are reported to be generally available for both large and small borrowers.