

CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the  
Federal Open Market Committee  
by the Staff

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## SUMMARY\*

The REDBOOK reports this month indicate that business activity is holding quite steady in most districts, with few widespread signs of weakness. High technology and defense-related industries are performing particularly well. The major exceptions to this pattern are the housing and automobile industries, which are exhibiting considerable weakness. Most districts report very strong volumes of retail sales -- a phenomenon which several reports ascribed to a pervasive "spend it now" psychology on the part of consumers. Reports of continued inflation are also widespread. With the exception of home mortgages, loan volumes were reported to be strong in most districts prior to the recent runup in rates. Spotty current reports indicate a subsequent weakening of loan demand. Financial institutions are experiencing considerable conversion of savings deposits into money-market liabilities, and there is widespread concern about the consequent effect on the cost of funds and institutional profitability. The agricultural sector is apparently in good shape in most districts.

Most districts report generally strong industrial activity. New York, for example, reports brisk new orders and generally steady activity. Minneapolis finds industrial output and employment expanding; manufacturing employment is up 4 percent from a year ago. Dallas finds continued, but slowing, growth in manufacturing. Activity related to high-technology, defense and energy-saving products is reported to be particularly vigorous by Boston, New York and San Francisco. Dallas finds high levels of activity in the petroleum industry.

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\* Prepared at Federal Reserve Bank of San Francisco.

In contrast to these reports, Philadelphia describes weakening manufacturing activity and the trimming of factory payrolls. Kansas City and Richmond also find some softening in the general level of business activity. The automobile industry continues to be weak, evidenced by a pattern of temporary furloughs of workers. Chicago calls the industry "seriously depressed."

The housing industry has been hit hard by recent high interest rates. Starts are reported down 20 percent or more by Kansas City, for example, with prices weakening on new homes. Chicago and San Francisco report that homebuilding activity has been sensitive to interest-rate movements; softening of rates earlier in the quarter caused some builders to develop new tracts but the recent runup in rates has curtailed this development. Dallas reports that non-residential construction is helping to offset the impact of the housing decline on the construction industry.

Throughout the economy, retail sales have been holding steady or growing relative to this time last year. Boston reports "good" sales volumes. Department store sales were 8 to 20 percent over last year according to Philadelphia. Some New York retailers report "staggeringly good" sales, although this is partly ascribed to the exceptionally mild weather in the region. The volume of sales in the Dallas district has held up well in real terms. Kansas City describes sales gains as "moderate," and Minneapolis reports "spotty" or "steady" sales volumes. Throughout the districts, sales of large automobiles are weak, however, with 15 percent declines in overall sales reported by Minneapolis and San Francisco despite vigorous small-car sales.

Loan demand generally appears strong, except for mortgages. Philadelphia, for example, finds commercial-loan volumes up 5 to 18 percent over

last year. Richmond and St. Louis find that demand is particularly strong on the part of corporations for interim financing rather than long-term credit. In locations where usury limits are not binding, consumer loan flows appear to be strong. Chicago reports an increase in consumer-credit delinquencies, however, and Philadelphia notes that repayments are slowing. The high interest rates have had a significant effect on the mortgage market. Applications for mortgages are down 75 percent in Tennessee, for example, and New York describes a "collapsed" mortgage market.

Many of the reports for the REDBOOK this month were received before the recent runup in interest rates. However, a few very current reports suggest that high rates have sharply reduced credit demand. New York City recently withdrew a \$125 million bond offering, for example. Chicago reports that the "bite" of high rates is particularly apparent from reports from car dealers. San Francisco indicates that frozen-food processors and other industries for whom inventory is important are being hurt by high rates.

Financial institutions throughout the various districts are experiencing conversion of savings accounts to money-market forms of liabilities. Deposit outflows are not widely reported, although Dallas and New York report some disintermediation at district S&L's. Kansas City reports that S&L's are pessimistic about deposit inflows, and St. Louis finds that fears of a "liquidity bind" are growing at financial institutions.

The agricultural sector appears to be relatively healthy in most districts. Strong Pacific Rim export demand is helping farmers in the San Francisco district. Also, grain prices have not been depressed by the embargo of sales to the Soviets, according to San Francisco and Minneapolis. Atlanta reports that the Florida citrus crop escaped major damage from recent frosts, but Richmond reports extensive damage to poultry operations in North Carolina.

Reports of continued inflation are widespread. Boston reports that a large food chain has experienced price increases from a greater number of vendors than ever before. Philadelphia's poll of manufacturers reveals that three-quarters of the respondents report paying higher prices for raw materials this month, and 70 percent plan price hikes for the goods they sell. Chicago notes that rumors of wage and price controls abound and that this has triggered anticipatory price increases.

## FIRST DISTRICT - BOSTON

Respondents in the First District report that business is holding steady at a high level. The most notable change has been acceleration in the rate of price increase. Retailers are generally pleased; sales are keeping pace with inflation. Manufacturers report little change from the production and order rates of the past several months; what was strong before is still strong and the weak sectors have not deteriorated any further. Loan demand has levelled off, but the volume is still very high. Bankers are looking at loan customers very closely for signs of cash flow difficulties.

Retailers report that sales have held steady in real terms since the beginning of the year. This is considered a good performance and is expected to continue through the spring. The prices of sales merchandise have gone up much less than the CPI; however, the head of a large food store chain said that the number of vendors increasing prices in January and February was greater than ever before. An exception to the relatively favorable retail situation is that sector of retailing which is associated with the ski industry. Losses due to a lack of snow have been severe and many small firms are turning to the Small Business Administration for loans.

Manufacturing respondents have seen little change in their operations during the past month. No new weaknesses have been reported other than recreational aircraft, sales of which are sagging sharply. High technology areas are doing very well, especially those related to the defense industry. Sales of industrial safety equipment, which are tied to national production, have come back strongly after a weak fourth quarter. A manufacturer of capital

equipment used in the pulp and paper and chemical industries has record backlogs. High quality appliances are selling well although there has been some slowdown at the lower end of the range. Sales of housing materials for new construction are weak, but sales for repair and remodelling are fairly good. All respondents continue to believe that inventories are under control.

Loan demand is steady at a high level according to First District banking directors. However, one of the region's largest banks reports that there has been a surge in the demand for commitments from corporations which are concerned about the possibility of credit controls. These are firm commitments for which fees have been paid. The competition for loans is still very intense among the larger banks.

Professors Eckstein, Houthakker, Samuelson, Solow, and Tobin were available for comment this month.

Eckstein applauds the recent sharp increases in interest rates. He feels it is prudent to wait a month or two before tightening again, however. As businesses are turned away from the bond market and are driven into bank loans, MIA may surge temporarily. Eckstein, nevertheless, favors reducing money growth: "A reasonable target for MIA growth this year may be less than 5 percent due to the recession." And, if necessary, interest rates should be increased until real aggregate demand declines because "the recession should not be a worry, it is badly needed."

Solow believes we are on the verge of a two- or three-quarter recession; however, he does not believe the recession will reduce the inflation rate significantly. To achieve 5 percent inflation, the unemployment rate either would have to rise to 11 percent for two years

or would have to remain near 7 percent for 10 years. Solow is "not opposed to properly prepared wage-price controls." A short-term (6-month) freeze, for example, has a chance of reducing inflation provided it is accompanied by oil import quotas as well as the appropriate reductions in Federal spending and money growth consistent with lower inflation. He does not favor credit controls: A successful freeze will reduce inflation and nominal interest rates. In any case, Solow strongly emphasizes that the Fed should avoid being "stampeded" into precipitous action by a few months of distressing data representing past oil price and mortgage rate increases.

Tobin favors wage-price controls. Rather than "muddle through" with high inflation or bring about a recession severe enough to reduce the inflation rate significantly, he advocates a policy that couples wage-price controls with a gradual reduction in money growth and Federal spending. Unlike Solow, Tobin does not favor a freeze: inflation cannot be reduced 6 percentage points "in one big blow." A reasonable goal is to reduce inflation by 1 or 2 percentage points per year by a succession of guideposts. Tobin does not favor credit controls because these controls, unlike wage-price controls, "are an unneeded substitute for tools the Fed already possesses."

Samuelson does not favor wage-price controls. He believes these controls can arrest the momentum of inflation only when they are enacted during the first year of inflation and when inflation is driven by irrational speculation or an ordinary cycle of wages pushing prices and prices pushing wages. Our current inflation is too mature and too complex for wage-price controls to work. Samuelson favors reducing

inflation by maintaining real growth near zero, because, in his opinion, any attempt to restrain price increases must also restrain output growth, and slow growth is the least disruptive means of lowering the inflation rate.

Houthakker, like Samuelson, does not favor wage-price controls because they are expensive, cumbersome, and ineffective. Moreover, Houthakker sees no sign that inflation has accelerated. He does not believe the CPI provides a meaningful measure of the inflation rate; the rate of increase of the fixed-weight deflator, a superior index, has been virtually constant in recent quarters. His recent statistical work suggests that "monetary policy is working" so "the Fed should stay on its present course." Though the inflation rate will remain high during the first half of the year, it should decline in the fall. He also sees no sign of a serious recession, although real growth during the year will be nearly zero.

SECOND DISTRICT -- NEW YORK

Business activity in the Second District appears to have been steady in February, according to recent comments of directors and other business leaders. Retail sales appear to be holding up overall, although there are scattered signs of incipient weakness. Outside of retailing, business activity continues to advance. New orders were generally brisk, and firms show no signs of easing their tight rein on inventories. At this point, there is little evidence that companies are revising their investment plans in light of the recent marked tightening in financial conditions. Activity in the mortgage market, however, appears to have virtually collapsed.

Consumer spending has been somewhat erratic in February and early March. Most of the major department stores reported strong sales in February which were running well ahead of plans. A spokesman for one large national chain store described sales as "staggeringly good." Improved weather was thought to be an important factor, however. The weather this February was so much milder than last year at least one merchant raised the possibility that some of the strong advance in February may have been "borrowed" from coming months. Indeed, the bulk of responses point to a distinct slowdown in sales beginning at the end of February that carried over into early March. In any event, several sources in the fashion industry noted that the high prices for this year's new spring line of women's apparel had run into stiff consumer resistance. In upstate New York, total retail sales were reportedly strong although auto sales had weakened. Throughout the District, retail inventories appear to be in balance with sales and merchants' stocking plans reflect a keen concern over an impending recession.

Outside of retailing, the business situation appears to be fairly resilient. In general, companies expect a near-term slowdown, especially in view of the recent runup in financing costs. Still, individual companies report that they have not themselves been touched by the projected downturn. Indeed, in recent weeks, new orders have been brisk, especially for heavy machinery. One upstate forge reported that business was "booming." Also, high technology defense industries show signs of robust activity in both the Buffalo and Rochester areas.

The recent turbulence in the financial markets has had a diverse impact on business firms. Evidently as a result of the high cost of finance, companies appear to be tightening the rein on their inventories to the bare-bones minimum. They report that their inventory positions are "well managed" and in line with the anticipated slowdown in their sales levels. Companies also generally report no change in their capital spending plans, despite the current tight financial market conditions. Money was said to be amply available, but at extraordinarily high interest rates. As of now, the high financing charges apparently have not proved to be much of a deterrent for firms' planned capital spending. Capital spending appears to be strongly affected by the inflation psychology of spend now since it will cost more later.

Elsewhere on the financial scene, however, mortgage lending appears to have come to a screeching halt. Whereas mortgage interest rates in New York and New Jersey had been subject to usury ceilings which were among the lowest in the nation, the Federal override has freed them at least temporarily. In recent weeks, then, mortgage rates have skyrocketed to levels of 15 percent or more. Indeed, at least one large commercial bank is charging

17 percent plus two points for co-op loans in New York City. At those rates, prospective homebuyers are reportedly postponing their plans -- hoping that rates will decline soon. At the same time, the high cost of funds has led to a worsening in the outflows of deposits at thrift institutions and sharply reduced their profitability.

Within the Second District, state and local governments are encountering financial problems unanticipated at the time of their budget preparations. New York State, which in January proposed an austere budget for the fiscal year beginning April 1, will face sharply higher credit costs next month. At that time, it must sell about \$3 billion in short-term notes. Presently prevailing credit market conditions are expected to cost the state as much as \$80 million more than it had expected. In the case of New York City, adverse market conditions have caused the city to postpone a scheduled sale of \$125 million in bonds. Although some of this borrowing was to be used to finance current expenses, an unforeseen \$275 million cash surplus will be used instead.

THIRD DISTRICT -- PHILADELPHIA

Reports from the Third District indicate that business activity is mixed this month. The recent decline in manufacturing has continued, with businessmen expecting little or no change over the next six months. Retailers, on the other hand, have had an extremely good month with sales even stronger than predicted. Area bankers are experiencing fairly strong loan volume with little change anticipated through the second quarter. Interest rates are expected to increase in the next month, absent strict credit controls.

Area department stores report surprisingly strong sales this February. Current dollar sales are 8 to 20 percent over February '79 volume, which is much better than most retailers expected. Part of the strength stems from the weather which has been relatively mild this past month compared to the heavy snow storms of last year that kept many people away from the stores. Merchants also say that consumers are not curtailing their spending or their use of credit, but repayments have slowed a bit. Inventories are said to be in good shape. Merchants went into the month bearish so stocks are trim.

Retailers anticipate a slight slowdown in the next few months, but are less worried about the recession than they were at the end of the year. They estimate moderate year-over-year increases of 6 to 7 percent in the next two quarters.

In the financial sector loan volume at area banks is up over year-ago levels, with most of the increase being attributed to commercial

loans. Reports of C&I loan volume range from 5 to 18 percent over levels of last March. Consumer loans are also up, but by less. Looking ahead to the next six months, loan volume projections indicate little change between now and September.

Banks in the Third District are currently quoting a prime rate of 17 3/4 percent. Projections of the prime call for an increase in the next month of about 100 basis points, provided that strict credit controls, which all bankers contacted anticipate, are not enacted, followed by large cuts leaving the rate 300 to 400 basis points below its current level by the end of the year.

Area manufacturing activity appears to have dropped another notch this month according to the most recent Business Outlook Survey, pushing the industrial sector further into the slump that began eight months ago. Recent trends in specific indicators of business activity have continued, with new orders down again substantially and shipments off to a lesser degree. Inventory liquidation seems to have slowed, at least temporarily. On the employment front, factory payrolls have been trimmed again (for only the second time since the downturn started) and working hours have been cut as well.

For the longer term, survey respondents are expecting a holding pattern for business over the next six months. Virtually no change in the overall business climate is forecast between now and late summer, nor is any change in new orders or inventory levels predicted. Only a marginal pickup in shipments is anticipated. Such a mediocre outlook doesn't mean bad news for local labor; no further net payroll cuts are planned by

respondents. Any necessary cutback in manpower will apparently be effected through a shorter workweek.

Prices are up again in the industrial sector, according to this month's survey. About three-quarters of the manufacturers polled this month report paying higher prices for raw materials than they did last month, and better than half are charging more for their finished products. Looking ahead to August, 87 percent of the respondents expect input costs to go up by late summer, while 70 percent plan price hikes for the goods they sell.

FOURTH DISTRICT -- CLEVELAND

Business activity in the Fourth District continues to show strength, although accelerated inflation and higher interest rates have caused some respondents to lower their forecasts of GNP for 1980. Consumer spending continues to expand, and most respondents expect only a gradual rise in the savings rate. The steel industry is experiencing a rebound in orders because customer attitudes about inventories have apparently been revised upward. Consumer loans are showing signs of slowing because of higher interest rates, C and I loans remain strong, especially among larger banks. Several S&Ls report a sharp decline in mortgage lending and few expect any improvement in the near future.

Economists who attended a Fourth District Economists Roundtable held at this bank on March 7 still expect a recession in 1980, but one that is more mild than they expected at a similar meeting last November. Of sixteen economists who attended the meeting, fifteen forecast a slight decline in real GNP this quarter and expected that the balance of the recession would get underway in the second quarter. The meeting forecast of this group shows a 0.2 percent annual rate of decline in real GNP in the first quarter, 2.8 percent decline in the second, 1.6 percent decline in the third, and a recovery of 0.5 percent and 2.5 percent in the fourth quarter of 1980 and first quarter of 1981, respectively. Next quarter reduction in GNP is associated largely with a substantial reduction in the rate of growth in nominal consumer spending and another decline in residential construction. Skepticism over a mild recession scenario was expressed by some of the group who felt that high inflation and high interest rates may result in a more serious recession

than indicated in immediate forecasts.

Some of the upward shift in expectations about the economy was associated with continued, though mixed, strength in consumer spending. Consumers have been cutting back usage of some goods in order to have money available for goods that are perceived to be a hedge against inflation or that are perceived as a bargain. A major producer of appliances reports a better than expected order pattern in recent weeks, after weakening in December. A producer of nondurables, however, has not experienced the increase in his business that was expected because of high inflation. An economist for a major department store chain expects a 10 percent increase in total goods sales (current dollars) in 1980, which is still below his expected inflation rate. An automotive economist reports that consumers are taking advantage of price discounting on 1979 models, but sales of 1980 models have been adversely affected. Although most respondents expect the personal savings rate to remain low in the near term, they also expect a gradual pickup to about a 4.5 percent rate by year-end. Demographic changes and inflation psychology are the most often given explanation for the low rate.

Reflecting the changes in expectations, new orders and shipments in the steel industry have shown unexpected strength since the beginning of the year. As a result, some recalls of workers have taken place. According to one steel economist, many customers had cut orders more than necessary at the end of 1979. Most of the cuts came from steel service centers in attempts to liquidate inventory. Now, however, steel inventories are judged low and some customers have begun to rebuild stock. A steel official reports a 50 percent increase in bookings during January and February, but attributes

some of that strength to hedging against an April price increase for flat-long steel. The capacity utilization rate in the industry is currently about 83 percent of capacity, but new orders, according to a steel economist, are equivalent to a 90 percent rate. However, some steel officials expect customers to be under pressure to cut inventories because of the high cost of financing inventories and because the availability of steel is no longer a serious concern.

Consumer loans have softened. One District banker reports installment loans have been reduced because credit terms have tightened. Although demand remains strong, loans are only being made to better customers who meet stringent requirements, including higher down payments. One bank official reports that interest rates on auto loans have been boosted to 17 percent, which is expected to dry up consumer loans and to affect auto dealers who cannot sell to commercial buyers.

Larger banks generally expect increased demand for C and I loans, while smaller banks report C and I loans to be relatively slack. One bank official reports that firms are cutting back on equipment spending and some firms postponed debt offerings. Some banks exhibit nervousness among borrowers about credit availability, but they've discouraged requests for increased lines of credit. One bank economist reports increased inquiries by utilities and expects higher loan volumes in the near future. Large firms can still pay higher interest rates and strong loan demand is expected for several months, partly because of inventory demand, hedging against further increases, and a surge in acquisition loans. On the other hand, some small businesses are cutting back because of higher interest rates.

Mortgage lending weakened substantially in February and several S&Ls are reported to have withdrawn from the market in recent weeks. Mortgage rates vary from 14 1/2 percent to 16 percent, plus two points or so. One S&L official states that current mortgage rates and credit conditions disqualify many potential buyers. A respondent reported a 50 percent decline in loans and a 60 percent decline in commitments in February from a year earlier, and expects March to be even worse. A supplier to the residential construction industry confirms that a collapse in orders has occurred. Housing, according to an S&L economist, will continue to weaken in 1980 until interest rates decline. Although prolonged high interest rates are encouraged through S&Ls, several officials expressed concern that credit controls could accelerate disintermediation. Since 35 percent of all certificates mature in July, interest rates must decline by then to prevent a total collapse of the mortgage market, according to one S&L official.

FIFTH DISTRICT -- RICHMOND

Business activity in the Fifth District remains spotty but does not show any clearly defined trends, either generally or within industries. Manufacturers' new orders continued to weaken slightly over the past month and order backlogs were further reduced, but shipments were somewhat higher and inventories were generally larger than in January. Still, fewer than a third of our respondents find current stocks excessive. Retail sales seem to have advanced in the past month despite some softening in big ticket lines. Inventories at the retail level are essentially unchanged and are generally in line with desired levels. It appears that aggregate credit demand in the District is holding steady, but its composition is changing. Business loan demand is now the primary source of overall strength. Installment loan demand is sagging while mortgage lending practices have tightened considerably. Recent snowstorms inflicted substantial and lasting damage on poultry producing operations in parts of the District.

In the manufacturing sector new orders remain soft and order backlogs continue to be worked down; on the other hand, both shipments and inventories were up somewhat in the past month. Despite the rise in stocks on hand, particularly in finished goods, there was virtually no change in inventories relative to desired levels. Employment and the length of the workweek held essentially stable over the month. An overwhelming majority of manufacturers remain satisfied with current plant and equipment capacity and with current expansion plans.

The recent softness in new orders does not appear to be concentrated in any particular area or industry. Industries such as building materials,

paper products, and electrical equipment have shown perhaps the least strength in recent weeks. Textile firms report basically stable orders, while some strength has appeared in the furniture group.

Retail sales continue firm across the District. General merchandise sales are providing much of this overall strength. Big ticket items have weakened, at least in relative terms. Inventories held by retailers were level, on balance, over the month, but apparently declined relative to desired levels. Most retail respondents are comfortable with current stocks.

Price increases remain pervasive and there is little evidence in our survey responses of any easing in this area. A large majority of our directors anticipate price increases, as measured by the CPI, to be at least as great in 1980 as in 1979. Expectations generally are less uniform than in recent months. District manufacturers, on balance, remain deeply pessimistic, although less so than in recent months. Most continue to expect a decline in national business activity over the next six months, but the number expecting declines in their respective firms and market areas is somewhat lower than a month ago. Retailers, on balance, expect little change in the level of activity over the next six months. Although our survey responses suggest that most firms are comfortable with current expansion plans, most of our directors foresee many firms cancelling or delaying previously approved investment projects.

Despite sharp increases in the prime lending rate, business loan growth at large Fifth District banks has been strong recently. Factors contributing to this strength in commercial and industrial loans have been a demand for short-term bank loans for interim financing until long-term bond rates drop and demand for tax-free industrial revenue financing. Business

loan growth would be even stronger if it were not for some prime rate loans having been paid early as borrowers shift to the commercial paper market as a source of funds. Area banks have become much less willing to make fixed-rate loans of any maturity, and loans for speculative purposes are being discouraged. The demand for and use of loan commitments has not changed to any great degree. Moreover, the consensus among District bankers seems to be that over the near-term business loan demand will continue about as is or possibly weaken moderately.

In the past few weeks personal loans made by large banks have shown almost no growth. This appears to be due to slackening demand rather than limited supply. By and large, District banks remain active in the retail credit area. A number of reports have indicated that credit unions, however, are short of loanable funds. Instalment loan rates are up sharply since the most recent discount rate increases and indications are that the increased cost of credit is discouraging consumer borrowing. The rate on home mortgages is also up sharply for those potential borrowers who can find funds. Our recent survey of lending practices at large banks shows half of the respondents less willing to make single-family mortgage loans. Two-thirds are now less willing to lend funds for multi-family properties. Thrift institutions are much less active in the mortgage market, and our directors report that funds availability is tight around the District.

Recent winter storms resulted in severe losses to poultry producers in parts of the District, particularly eastern North Carolina. In one county more than 100 poultry raising operations were destroyed. Stock losses in that area may amount to one-half million broilers and 200,000 turkeys.

## SIXTH DISTRICT — ATLANTA

Retail sales continued to expand, especially for energy-saving items. Small car purchases led the advance in automobile sales. Soaring mortgage interest rates hampered home sales. The recent surge in interest rates further crimped consumer and commercial loan demand. An increasingly comprehensive ban on exports to Russia will have significant repercussions on Florida's phosphate industry. Overall, the freeze damage to fruit and vegetable crops appeared to be moderate.

Retail sales persisted at high levels on the strength of both durables and nondurables. Executives of two Atlanta area department stores observed brisk sales. And an official of a retailing chain said that, since the beginning of the year, business has been good throughout the District. Large department stores appear to be doing well, while smaller stores and specialty shops are holding their own. Several contacts noted a drop in impulse buying as evidence by a sizable reduction in returned items.

An Atlanta-based conglomerate involved in the manufacture and sale of various consumer goods noticed abrupt gains for some energy-saving items. Bicycle and motorcycle sales jumped dramatically. Also, sales of billiard tables and bowling balls were up sharply as people looked closer to home for entertainment.

Automobile sales turned up, largely on the strength of small car purchases. Foreign car dealers experienced excellent sales; however, slow deliveries held these sales below potential. Sales advanced for the Chevrolet and Ford dealers contacted in Knoxville. In the Atlanta area, an AMC dealer reported very good volume and a Chevrolet dealer reported steady

sales, while Ford dealers said business improved due to rebates. Inventories of domestic automobiles were considered adequate, but some dealers expressed concern about the availability of enough compact cars to compete with foreign imports. Most dealers do not view high interest rates as significantly hampering automobile sales.

The outlook for production at Atlanta's two GM assembly plants is mixed. After a three-month layoff, about 2,200 second shift employees at the Doraville plant returned to work in late February. The recall was primarily attributable to brisk sales of the Oldsmobile Cutlass, one of several intermediate models assembled there. On the other hand, 900 truck assembly workers at the Lakewood plant will be furloughed during the middle of March, ending that plant's production of pickup trucks for the remainder of the 1980 model year. The second shift of truck assembly workers was placed on indefinite layoff in early December.

Despite high interest rates, demand for homes remained relatively steady, supported in some areas by employment transfers. Nonetheless, overall sales of new and existing homes were soft. Soaring interest costs are expected to preclude all but upper income families from qualifying for even moderate mortgage loans. A survey of eight building supply firms in eastern Tennessee found inventories about the same as year-ago levels, with cutbacks in residential sales balanced by advances in nonresidential sales and home improvements. Mortgage loan applications in the same area were down 75 percent from a year ago. An FHLB official in Atlanta observed that commitments fell markedly, savings inflows contracted, and S&Ls borrowed heavily from the FHLB.

Accelerating interest rates dampened consumer and business loan demand. An economist for one large Georgia bank reported that loan demand was slack. Also, banking contacts in several parts of the District observed a recent downturn in loan requests. One reported nearly all loan requests coming before the committee were for smaller size credit renewals up to \$50,000. Many customers incurred penalties on long-term certificates to purchase money market instruments. More emphasis is being placed on variable rate loans by bankers at numerous institutions.

The U.S. Government's recent ban, for an indefinite period, on phosphate exports to the Soviet Union is expected to significantly disrupt Florida's phosphate industry. A \$1 billion per year contract between Occidental Petroleum and the Soviet Union was canceled. This agreement involved the shipment of phosphate, mostly from Florida, to Russia in exchange for other fertilizer products. A temporary glut is anticipated, but eventually the surplus will be eliminated because world phosphate demand exceeds available supply.

Florida's citrus crop escaped major damage from freezing temperatures during the first days of March. However, a reduction in next year's crop is likely due to the blackening of blooms that had already emerged. Damage to the peach crop was estimated as high as 30 percent of this season's crop. The frozen blooms on earlier varieties cannot bear fruit. Cold weather extended into Southern Florida and, therefore, affected vegetable growers throughout the state. Although some individual growers incurred sizeable losses, the overall impact was not considerable.

SEVENTH DISTRICT -- CHICAGO

Although the long awaited general recession still has not developed in the Seventh District, the automotive and housing industries remain seriously depressed with no promise of an early revival. Output of most types of capital goods is holding at high rates. Inventories are at very conservative levels, and a high level of new orders is necessary to maintain output and deliveries. Demand for workers has eased in most areas. Consumers have not reduced purchases of most types of goods and services. Price inflation has not moderated, and businesses have taken steps to protect their profit margins in anticipation of price controls. Credit markets are very tight with many smaller businesses complaining of the heavy burden of interest rates.

A sharp contrast exists among the industries of the Seventh District. Autos, trucks, recreational equipment, the airlines, and housing all suffer from severely depressed demand. And there is no sign that the situation will improve in the near future. Most other types of capital equipment and consumer goods and services, however, remain relatively prosperous.

The Chicago Purchasing Managers Survey for February, which covers 200 companies, shows 45 percent reporting higher output in February, compared to 15 percent reporting a decline. This reverses the downward drift reported in recent months. Overall, the report suggests stability in employment, output, and inventories. The Milwaukee report is similar.

Throughout the past year our contacts in manufacturing and retailing were telling us that their inventories were generally lean. These evaluations have been borne out by events. With final demand holding up for most items, there has been no room for substantial cutbacks in orders.

Household appliances provide a dramatic example. Shipments had slowed in late 1979, but January showed a rebound with total unit shipments 11 percent above last year and close to an alltime record. Washers, refrigerators, freezers, and microwave ovens were especially strong.

Steel orders had declined in late 1979 and early 1980, but recent months brought a revival. A major Chicago producer will be operating at capacity again in March and April. Demand for steel is vigorous from virtually all customer groups, except for autos and trucks. Strength in steel orders is not believed to be related to scheduled price increases. Customers are buying steel on a hand-to-mouth basis, and they "admit" their inventories are low -- an unusual situation.

Rebates are helping sales of less economical cars and light trucks somewhat, a temporary expedient that cannot be continued indefinitely. Even so, many 1979 models remain unsold. The market is extremely depressed for large cars, vans, pick-ups, four-wheel drives, and self-propelled recreational vehicles. Major parts' manufacturers have been notified of shifts in plans that will permanently reduce the use of frames, high horsepower engines, and related components. Sharply rising gasoline prices are influencing the pattern of demand for motor vehicles to a degree unforeseen only a few months ago. Because of a better product mix, General Motors has achieved a dominant position unparalleled in the past.

The capital goods picture is mixed. Demand for heavy trucks and trailers and most types of construction equipment is weak, while orders for machine tools, electronics, and energy-related items are very strong. Orders for castings are "erratic," but one analyst believes that the pattern suggests that capital goods, in general, have passed a cyclical peak. Freight car

order backlogs are large, but a wave of cancellations may have started.

Nonresidential construction is threatened by a virtual drying up of new loan commitments. The office building boom is in high gear, and there is optimism that the new space will be absorbed rapidly. Important nuclear power projects in the district are moving ahead, but at a reduced pace. New regulations have drastically increased construction costs.

Home mortgage lending had begun to revive in February, but the recent jump in rates dealt a severe blow. With quoted rates now passing 15 percent major lenders report that loan applications, both for new and used homes, have slowed to a trickle. Some home builders and mortgage bankers have decided to cease operations in the Chicago area. Very few new rental units are planned. Given current construction costs and interest rates, a one-room apartment would require a monthly rent in excess of \$600.

Consumer spending has held up well except for autos and tourism. Consumers respond well to sales and promotions. Credit delinquencies have increased significantly, but not, as yet, to an alarming degree.

The International Harvester strike that started November 1 is still unresolved. Allis-Chalmers was struck last week. Chicago firemen returned to work after a three-week strike, in which the issues were the right to strike and inclusion of chiefs in the union. Building trades workers in the Chicago area plan to demand wage costs of at least 15 percent to "catch up."

Employers are increasingly concerned about the effect of COLAs, both for union and non-union workers. COLAs often use local CPIs. While the national CPI was 13.9 percent above last year in January, the index was up 15.3 percent for Chicago, 15.7 percent for Detroit, and 17.8 percent for Milwaukee -- 19.4 percent on the CPI-W!

Rumors abound that price/wage controls, and/or selective credit controls, will be imposed, perhaps without advance notice. Anticipatory price increases are reported. Various steps are being taken to adjust pricing policies to protect profit margins if and when price controls are imposed. List prices may be raised and then discounted for the time being. Prices may be raised with temporary rebates. Coupons may be offered on food items, and then withdrawn at a later time.

High interest rates and reduced availability of credit are beginning to "bite" to a degree unprecedented in this cycle. Usury is no longer a major factor in mortgage loans, because high rates eliminated many potential borrowers. Auto loan ceilings are cited as a factor reducing the availability of loans in some states. In Michigan, hearings are being held on a bill to raise the 12 percent ceiling on indirect auto loans, which has virtually cut off this type of lending. The UAQ is actively opposing the legislation. We are receiving numerous complaints from smaller businesses that loan rates of 18 percent or more are driving them to the wall. Vehicle dealers are among the most vociferous.

EIGHTH DISTRICT -- ST. LOUIS

Economic activity in the Eighth District remains at about the same level as in January. Retail spending has remained about constant in real terms, and sales have been somewhat better than expected. Automobile manufacturing, which declined substantially in the District during 1979, has apparently stabilized in recent weeks. Nonresidential construction remains at a high level and aerospace manufacturing is reported to be gaining strength due to increased defense spending. Homebuilding, however, remains at a very low level as sharp increases in mortgage rates have discouraged home buying. Savings and loan association officials report a sharp decline in small savings deposits and time certificates, although total net inflows of savings are still positive.

Consumer spending has been mixed recently. On the whole, retail sales have apparently increased at about the rate of inflation. One department store representative noted that sales of nondurable goods have offset losses from the sales decline in durable goods to the housing industry. Automobile sales have been surprisingly strong at some dealers in recent weeks, especially for energy-efficient intermediate and small-sized cars. Total car sales, however, have remained substantially below year-ago levels.

In general, inventories were reported to be at desired levels both in the retail and manufacturing sectors. Retailers report that they are keeping inventories to a minimum, and complained that high interest costs have substantially reduced profit margins.

Manufacturing activity in the District continues at about the same level as in recent months. During 1979 the District fared somewhat worse

than the nation as a whole, partly because of a sharp decline in the manufacture of transportation equipment. In addition, a slowing occurred in chemicals, furniture, lumber, and apparel production. Production in most of these industries has apparently continued at about the same level as late last year. On the positive side, the aerospace industry has experienced increasing demand for its products, reflecting increased defense spending and continued strong demand from commercial airlines.

Homebuilding has been very sluggish in the District in recent months and is now expected to decline further. As a result of significantly higher mortgage interest rates, monthly payments for new homes have risen beyond the reach of many prospective home buyers, and lenders report that a sizable proportion of mortgage loan applicants are being turned down.

Nonresidential construction remains at a high level in the District. Construction representatives still report backlogs of projects and most expect to be busy throughout the year. Many projects underway, however, are reported to be financed through municipal, state, and federal funding.

Credit demands in the District remain strong, particularly demand for business loans. Banks report strong demand from their business customers for credit line extensions as businessmen are apparently shying away from long-term credit. Requests for mortgage loans have fallen off with the higher rates, and some savings and loan officials report that they have quit taking applications. Net money inflows continue positive at most financial institutions. Savings and loans are offering the maximum rates on money market certificates, but recent sharp increases in rates are causing some associations to review their policies with respect to rates that can be offered. Withdrawals from passbooks and other time deposits

continue at a rapid pace, as conversions into higher yielding money market certificates become more attractive. Consequently, some savings and loan associations are reported to be in a liquidity bind, and in a few cases mergers may be required to save some weaker associations.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District is not in a recession yet, but district business activity seems to be softening further. Manufacturing shipments and employment continue to expand, and agricultural conditions remain quite good. However, interest rates have been increasing lately and cutting back loan requests. Lending has also been restricted where interest rates have not been allowed to rise.

The district is not yet in a recession . . .

Industrial output and employment are still expanding in the district. Manufacturers responding to our latest survey expect their first-quarter shipments to be up 15 percent from a year earlier. Rising prices undoubtedly account for much of this gain. But manufacturers do still seem to be adding to their work forces: Minnesota manufacturing employment is up about 4 percent from a year ago. And directors say hiring and industrial activity generally are growing in their areas.

Agricultural conditions also continue to help keep the district out of a recession. Our last Redbook report indicated that despite the embargo on grain sales to the Soviet Union, crops and prices were quite high in the district, so farm income prospects were pretty good. This assessment hasn't changed, as recent grain prices continue to approximate their preembargo levels.

. . . but higher interest rates have further softened business activity

Real interest rates have risen further since the last Redbook, though. After being adjusted for inflation, interest rates rose in late 1979. They have

risen even higher lately, as nominal rates have been accelerating much faster than inflation.

This rise in real interest rates appears to be causing further cutbacks in lending. Our last Redbook report said that lending was softening. According to Minneapolis/St. Paul banks, the recent rise in real interest rates has resulted in another drop in loan requests from all types of small businesses. Bank directors also report a further letup in mortgage loan requests in their areas.

Where some nominal interest rates haven't been allowed to rise, lending activity has been further reduced too. Usury ceilings have for some time been curtailing private borrowing and now are also curtailing government borrowing. Municipal bond yields recently have exceeded the 7 percent limit that Minnesota has imposed on local government borrowing costs, and in late February the Minneapolis School District and the city of St. Paul cancelled two bond offerings.

This recent letup in lending is another blow to home sales. Our last Redbook report indicated that district home sales were down. A large Minneapolis/St. Paul homebuilding supplier reports that less mortgage lending is further depressing home sales.

Not only are district consumers now more reluctant to buy homes, but they continue to be hesitant to buy other goods. Last month directors used words like "spotty," "steady," or "down" to characterize their areas' general merchandise sales, and they haven't changed that assessment. District consumers also remain reluctant to purchase autos; in January and February new domestic auto sales in the district were down 15 percent from a year ago.

With consumers still hesitant to spend and higher interest costs discouraging borrowing, businesses continue to be reluctant to order merchandise. Directors report, as they did last month, that district businesses are striving to hold down their inventories. And new manufacturers orders continue to slacken. For example, one large Minneapolis/St. Paul manufacturer reports that its new orders are now just even with those a year earlier, whereas several months ago they were substantially above last year's level.

TENTH DISTRICT—KANSAS CITY

Some softening in economic activity is reported by businessmen in the Tenth District, along with continuing increases in both costs and prices. Housing starts are down substantially, and savings and loan associations are pessimistic about savings inflows for the rest of the year. Cattle feeders in the District have been experiencing some losses, and many farmers are having difficulty repaying loans. Loan demand is variable across the District, and total deposit growth appears to be stable.

The majority of Tenth District retailers questioned this month report mostly moderate gains in current dollar sales through February 1980 compared to February 1979, but sales have apparently softened since the last quarter of 1979. Most retailers remain optimistic about total dollar sales for the remainder of 1980, with expected gains ranging from 5 per cent to 20 per cent.

Most retailers report moderate price increases. Most increases have resulted from increased cost of petroleum-based products and increased cost for metal products such as jewelry and tableware, with costs of merchandise and transportation slowing somewhat. All retailers report that they are trying to maintain inventory markups and profit margins. Tight inventory control has become standard policy for all retailers. While some retailers report higher levels than desirable, no serious problems were noted.

Nearly all the purchasing agents contacted report substantial input price increases over the past year. Major suppliers have raised prices during the past three months, and further increases are expected before summer. Input availability is not a current problem in the District. Continued high interest rates and pessimistic outlooks for the economy lead most purchasing

agents to desire low materials inventory levels. While over half of the purchasing agents still plan to trim their inventories further, a few report plans of inventory expansions to prepare for future delivery problems, as well as to compensate for earlier reductions that were too drastic.

Tenth District home builders' associations indicate that housing starts in the area are down at least 20 per cent compared to last year, with single-family housing starts doing considerably worse than that. There is some hope for a rebound later in the year if more prospective buyers are able to qualify for loans. Association spokesmen report that sales of new homes are mixed, and many new home prices are easing off.

Savings and loan associations in the Tenth District are decidedly pessimistic about the future of their savings inflows as the year progresses. There seems to be considerably less demand for mortgage funds so far this year, and commitments are being held down. Mortgage rates have been steadily rising and are currently around 14 per cent, but some savings and loan association spokesmen feel that mortgage rates will not rise much further.

Grain prices throughout most of the Tenth District have stabilized after the fluctuations caused by the grain embargo to the Soviet Union. Despite lower than desired prices, farmers in many areas are selling grain to meet current financial obligations or because the cost of carrying the grain for any longer period offsets any expected gain in price. Farmers in many areas are having difficulties repaying loans as they come due, especially farmers attempting to service large real estate debts. Higher interest rates are expected to cut loan demand somewhat. Continuing higher costs associated with irrigation of corn are forcing some farmers to reconsider spring planting options.

Cattle feeders within the District have experienced some losses in recent months due to the high price of feeder cattle and the increased interest costs associated with their purchase. Many smaller feedlot operators are not refilling the lots as the fed cattle are sold. While large feeding operations have also experienced losses, excellent rates of gain due to the mild winter weather in many areas have helped to limit those losses.

A survey of bankers in the Tenth District shows decidedly mixed results for loan demand. Total loan demand appears to be strongest at Colorado banks, with areas of weakness reported in Nebraska, Oklahoma, and Kansas City. Consumer loans, except autos, and energy-related loans show the greatest strength. Some banks report unexpectedly weak demand for agricultural loans, particularly in the livestock area. District banks continue to make few, if any, real estate loans. Several banks feel that strength in commercial and industrial loans may be coming from short-term financing of inventories and slower collection activity. Larger banks continue to raise their prime rate in line with increases at money center banks. Most banks surveyed report tightening their nonprice terms of lending.

Total deposit growth is reported to be stable by most banks. Some banks report a decline in demand deposits as customers continue to shift into interest-bearing accounts. While passbook savings deposits are down substantially, growth in money market certificates is quite strong. All banks surveyed offer 30-month certificates, with mixed success. In those cases where the certificates have proved popular, most of the funds shifted appeared to come from existing deposits at the bank rather than from new deposits. Recent ceilings on these certificates have not yet had an impact.

ELEVENTH DISTRICT -- DALLAS

Economic activity in the Eleventh District continues to expand moderately, although the full impact of the recent increase in interest rates is yet to be felt. Labor markets remain tight. The only areas of significant weakness are related to residential construction and sales of large cars. High interest rates have virtually shut down conventional mortgage lending and interim construction financing. Sales of large cars remain lackluster and department store sales show no improvement after adjusting for inflation. Bank loan demand remains strong, but higher interest rates are expected to squeeze more marginal customers out of credit markets. Manufacturing output continues to trend upward, and oil field activity is especially strong for this time of year. Early spring planting is underway over most of the District.

The impact of the recent hike in interest rates is not yet reflected in the weekly banking statistics, but most survey respondents expect a significant slowdown in borrowing as marginal customers are squeezed out of the market. On balance, commercial loan demand has been strong at District banks, particularly for energy and real estate financing. The strength of the latter is due to prior commitments, and is expected to decline in light of higher interest rates. Although interest rates on most variable rate loans have hit the 18 percent Texas usury ceiling on loans to corporations, most bankers expect to continue to supply working capital to financially sound customers. Total consumer loan demand remains high in spite of decreased availability of funds.

Mortgage loan demand is off sharply due to the prevailing 15 percent conventional mortgage rate and the declining availability of funds. Savings and loan associations are experiencing both disintermediation and transmediation (outflow of passbook savings funds for reinvestment in money market instruments within the same association). Savings balances at credit unions and other financial institutions are declining steadily. Bank customers are foregoing accumulated interest and actively cashing in 6-month CD's prior to maturity and reinvesting in new 6-month CD's at higher rates.

Nonresidential construction continues to be a major source of strength in the Southwest economy, although a few proposed projects have been canceled because of interest costs. Labor and material supplies remain tight due to heavy demand. Residential construction activity has slowed as many small custom builders are unable to secure interim financing, but high-volume builders in Dallas report sales exceeding their expectations.

Current dollar sales at District department stores continue to exceed last year's levels, but show no real increase after adjustment for inflation. Sales are expected to decline through the summer, and department store executives plan to continue their trim inventory levels.

New auto sales are mixed. Demand for foreign and small domestic cars continues strong, while larger car sales drag. Tighter credit policies, such as lower loan limits and shorter repayment periods, continue to eliminate potential customers. Dealers' attempts to hold down inventory costs by limiting the selection of models are reported to be contributing to some loss in sales.

Factory output in the District continues to trend upward, although at a reduced rate. Production in many building-related industries has begun to decline, but output in other industries continues to expand. The District's only auto assembly plant will resume a double shift at the end of March. The second shift was laid off after last Christmas because of the slump in sales. Profit margins for all manufacturers are being squeezed by rising costs and declining productivity.

Favorable weather conditions continue to boost drilling activity, and the demand for inputs remains strong. Refinery shipments continue despite the Oil, Chemical, and Atomic Workers strike, which by all indications will be lengthy. Some settlements have been made with small refiners, but gaining new agreements with major refiners is proving to be much more difficult. The mild winter has left fuel oil suppliers with high inventory levels of heating oil. As a result, heating oil prices are expected to drop as inventory levels are reduced to make room for the increase in production of summer gasoline stocks.

Warm weather has encouraged early spring planting. Export demand for cotton is greater than previously anticipated since China expects to purchase up to 3 million bales this season. Contracting with growers for 1980 cotton is well advanced.

TWELFTH DISTRICT -- SAN FRANCISCO

The economy of the Twelfth District exhibits few signs of a recession, but the influence of high interest rates has been widely felt in the housing industry and rapidly rising prices are a universal phenomenon. Consumer spending is continuing at a strong pace despite high prices; this behavior is believed by many to reflect a pessimistic inflation psychology. Labor demand in defense-related industries and in high-technology industries is contributing continued strength to employment figures. Loan demand remained strong at most banks and S&L's last month, but there is widespread concern about the conversion of savings deposits into money market accounts and the consequent effects on the cost of funds. With the exception of activities affected by the recent flooding in California, the agricultural sector is reported to be in good shape.

The housing sector in the District has been affected significantly by the recent runup in market interest rates. With the exception of Southern California, most residential real estate markets are reported to be very slow, with considerably reduced resale and construction activity. The level of activity is very sensitive to the prevailing mortgage rate; several builders in California were reported to have started up again in early January as mortgage rates began to moderate. As rates resumed their rise, however, housing starts were depressed once again. Resales and construction in Southern California (particularly the San Fernando Valley and Orange County areas) appear to have suffered somewhat less than the district as a whole. In Salt Lake City, where the inventory of unsold homes has fallen about 25 percent, some anticipate a housing shortage in the spring.

Consumer spending continues to buoy the economy of the western region. Although sales of American cars in January were down about 15 percent over last year, there are waiting lists in many areas for the smaller domestic and foreign models. In Southern California, the aggregate volume of retail sales is up about 20 percent with certain submarkets posting even larger gains. The demand for durable goods is mixed, with strong demand reported in Central California, but weak demand in Oregon and Idaho, for example. There is widespread agreement that a "spend it now" attitude is responsible for the pattern of high levels of consumption spending and low savings rates.

The special mix of industry in the District is largely insulating the region's economy from the deleterious impact of the weak residential construction sector. Portland's economy, for example, has experienced a 900 percent increase in personal income attributed to electronics and light manufacturing firms since 1973 and these sectors remain strong today. The demand for the region's products in the Pacific Rim markets is also quite strong. Strength in the foreign demand for lumber, for example, has helped to offset weakened demand from the residential construction sector. Predictions of increased demand for defense-related products have made the markets for skilled labor (such as sheet-metal workers and computer processing personnel) very tight. In fact, there is some concern that the West Coast aerospace industry may have too little excess capacity to be utilized for additional production. A major aircraft manufacturer, however, argues that it has the ability to considerably expand defense-related production. Moreover, weak profits in the commercial airline industry have caused some carriers to not exercise their option to buy new aircraft and this

may create some spare capacity in the aerospace industry.

High interest rates are causing concern in several sectors of the economy. Financial institutions continue to experience conversion of traditional consumer accounts into money market certificates, raising concerns over the cost of funds. Loan demand generally remains strong, however, in most categories including consumer credit except where loan qualification is a problem and in those areas where usury limits have curtailed the flow of credit. A bank in Washington, for example, reports that credit card lending is only about 25 percent of its normal level because of institutions' reaction to the 12 percent usury limit that prevails in that state. The severe price declines in the bond market may have encouraged the increased use of banks as a source of corporate credit. Commercial and industrial loan quality is reported to be deteriorating, however. High interest rates are causing particular problems for frozen food processors, automobile dealers, and others for whom inventories are an important factor in their marketing. Bankruptcies in the frozen fish industry, for example, are reported to be increasing at a rapid rate.

The agricultural sector is reported to be in a relatively healthy position. The prices and production of most crops appear to be sufficient to maintain farm incomes and carry the farmers to the next planting season: beet farmers are benefitting from the recent runup in sugar prices; the citrus crops appear to be in good shape due to milder winter conditions; and the type of wheat grown in the Northwest has not been adversely affected by the recent developments in the Russian and Iranian markets. February wheat prices of \$4.24 per bushel, for example, are near the October highs of \$4.35 per bushel. Vegetable markets have been weak (particularly

onions and potatoes), however, and several planting areas in the San Joaquin and Sacramento deltas were lost to flooding.

Evidence of a rapid inflation rate is apparent throughout the District. A dairy firm involved in labor negotiations anticipates that the Teamster's national Master Freight Agreement will be the reference point for many industries. That settlement is tantamount to a 35.5 percent increase in wages over a three-year period. Seattle University expects a 12 to 14 percent increase in compensation costs this year. Natural gas prices have risen 35 to 70 percent in the last year. Newsprint prices are at an all-time high of \$375 per ton, causing severe cost pressures for publishers. A regional producer of aluminum reports that aluminum ingots, which normally trade for 66¢ per pound, recently traded on the London metal exchange for \$1.01 per pound.