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CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY *

The district bank reports indicate that the economy is still expanding; however, the pattern is mixed. A few banks observed no change from the previous month. Consumer spending continues up. Inventory levels are in line with expected sales except in a few instances. Overall credit demands are rising. Some districts pointed to the high loan to deposit ratios outside the urban areas which reflects the high farm loan demand. Production generally continues up; however, a number of specific district problems were mentioned including: loss of production caused by strikes (New York, Atlanta, Minneapolis) and declining farm income or harvest problems (New York, Richmond, Atlanta, St. Louis, Minneapolis, Kansas City, and Dallas).

With few exceptions consumer spending continues up across the nation according to the district reports. For example, in the Boston and New York Districts, where little change was observed in the overall economy, some gains in sales or consumer spending were reported. Other districts reported consumer buying or retail sales as: up (Philadelphia), further improvement (Richmond), continues to advance (Atlanta), vigorous (Chicago), some gains (St. Louis), and very good (Minneapolis).

While inventories are generally at or near desired levels a few excesses were indicated. They are being watched closely and those few excesses reported are not believed to be widespread or burdensome. Also, some "shortages" continue in the building industry in a few districts.

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* Prepared by the Federal Reserve Bank of St. Louis.

Typical of the inventory reports were: being watched closely (Boston), in good shape (Philadelphia), at a desirable level (St. Louis), levels are good to adequate (Dallas), and at desired levels (San Francisco). Some inventory imbalances were reported by New York, Richmond, and Minneapolis. On the other hand, Chicago reported shortages of insulation, and shortages or poor quality of a long list of other building components and of skilled trades workers.

Credit demand continues generally upward in most of the districts. There has apparently been no letup in consumer and real estate credit demands, and a number of districts report a pickup in commercial and industrial loan demand. Richmond reported commercial and industrial loan demand to be quite strong. Indications of rising overall loan demand were also reported by Richmond, Atlanta, Chicago, St. Louis, and Kansas City. Savings inflows were reported to be slowing somewhat in a number of districts, but no serious disintermediation was indicated.

The high demand for and slow repayment of agricultural loans were alluded to in a number of District reports. Richmond reported a strong farm loan demand and further deterioration in loan repayment rates. Chicago reported significant deterioration in farm credit conditions in recent months. On the other hand, Kansas City reported some easing in the farmer's cash flow problem.

Further expansion occurred in production during recent weeks, but the overall pattern was variable. Manufacturing and industrial activity varied from no change in Boston and Richmond to a rebound in Dallas after a brief lull. Construction of homes is apparently slowing somewhat from the high levels of the summer months; however, a pickup was noted in commercial and industrial building by a few Districts. Some easing in the rate of home building was indicated by Minneapolis and Dallas, and San Francisco reported more caution by developers in putting up blocks of houses. San Francisco, however, reports a shift from single family to multiple units and non-residential construction. Gains in non-residential construction were also reported by Atlanta and Chicago.

The reports indicate that farm production will be up, gross farm income will be somewhat higher, and net farm income will be down from last year. Nevertheless, some districts reported a slight improvement in farm income expectations in recent weeks. Minneapolis reported an improved outlook for farm income, and Kansas City, while recognizing a farm commodity price squeeze, noted recent improvement in the cash flow position of farmers. Atlanta reported wider profit margins in broiler and egg production. Indicative of the lower farm income outlook, the last quarterly survey of farmland values in the Chicago District shows a decline for the first time since 1960. This followed an increase of 160 percent during the past five years.

FIRST DISTRICT - BOSTON

Most respondents in the First District observed little change in the level of economic activity in the past month. There were, however, scattered reports of reduced capacity utilization. Consumer spending was strong but has tapered off slightly during recent weeks. Industrial production is generally unchanged although several firms report that capital goods orders and foreign sales are disappointing. Inventories are being watched closely.

Retail sales in New England are up, but there seems to have been some slowing in the rate of growth during recent weeks. One major retailer reports that manufacturers are promoting their merchandise more aggressively. This is seen as a sign of a weakening sales position. There is some concern that inventories are too high. The tourist industry in northern New England did very well in the foliage season; there were more tourists and they were bigger spenders.

Most manufacturers report no significant changes in their operating levels. A few have experienced reductions. Production for all aspects of the automotive market is high. Machine tools, automotive plastics and tires are all selling briskly. Among consumer products, appliances, which are tied to housing, are doing well. One firm reports a drastic decline in shoe production; this is attributed in part to foreign competition. Sales of capital goods, especially heavy machinery, have been disappointing. This is thought to be due to slow capital spending and the weakness of foreign economies. However, one large machinery manufacturer reports that capital goods sales, including exports, are very strong. Manufacturing inventories are being watched closely; no problems are expected.

Professors Eckstein, Houthakker, Samuelson, Solow, and Tobin were available for comment this month. Houthakker remains very concerned about recent above-target money growth. He believes that the existing targets are appropriate, but if the Fed cannot attain them, he advises the FOMC to raise the targets so that "the economy will know, at least, what game they are playing." Houthakker is reassured by recent economic developments: he expects real growth to average 4.5 to 5.0 percent next year, he sees some hints that inflation is ebbing, and he believes the peak in Treasury bill rates is near.

All other respondents believe that a return to target rates of money growth is unwarranted at this time. Samuelson noted the consensus forecast of the 1978 year-over-year growth rate has been reduced by .1 percent each month. Given the wane in confidence, the Fed should compromise between increasing interest rates and returning to its money growth targets. With due regard to the long-run, overshoots in the money stock should be tolerated for the time being to avoid repetition of the experience of 1974 of jeopardizing fixed investment by sharp increases in interest rates.

Tobin believes that the days of puzzling, rapid velocity growth are over. Since early 1976, M2 velocity has generally fallen, and M1 velocity has increased only at a 3 percent annual rate. Given a realistic outlook for price inflation, the Fed can no longer rely on velocity to make the stated money targets consistent with output goals. Because the recent acceleration of money growth has occurred when output growth has slowed, it would be a mistake for policy to adhere to its money stock targets--the changing link between money and GNP mandates closer attention to interest rates as a policy guide at this time. Any further increases in short-term interest rates can be expected to spill over more strongly into mortgage and bond yields now that the prime rate is a notch below 8 percent and bills are reaching yields of 7 percent. The continuing decline in stock prices reflects this concern.

Eckstein claims that "pure monetarism now will lead to disaster." Policy must consider the state of the economy and credit markets as well as money growth. Real growth may average 4 to 4.5 percent in 1978 if nothing upsets the economy, and at this stage of the recovery credit markets are very sensitive to monetary restraint. Not only is disintermediation a real threat, but the increasing reliance of business on bank financing means that significant increases in interest rates or reduced money growth can have a pronounced, adverse effect on real growth.

Although Solow foresees no downturn in 1978, real growth will average 4 or 4.5 percent, at best. This performance is "utterly inadequate." The economy needs and could stand 5 or 6 percent growth without rekindling inflation. Since the proper role of policy is to support a healthy recovery, the announced money growth targets are "utterly destructive and inadequate." Focusing on M2 and generously presuming a 5.5 percent rate of inflation, a minimal money growth target for 1978 is at least 10.5 percent. Solow is "uncomfortable with the Fed's forcing the Administration to undertake more fiscal expansion and then complaining about the size of Federal budget deficits."

SECOND DISTRICT--NEW YORK

Activity in the Second District continues to be mixed and lagging behind that of the rest of the nation, according to recent comments of directors and other business leaders. On the national outlook, respondents were generally encouraged by prospects of continued economic expansion, although many appeared concerned that the uncertainties of prospective tax and energy legislation will inhibit capital spending. Within the district, retail activity posted a moderate gain in October, but inventory levels remained on the high side. Harvest losses caused by heavy rains in the Western region of the district are expected to exceed $150 million. Containerized port activity remains at a standstill as the dock strike enters its second month.

Department store sales in October apparently met merchants' expectations. Several leading retailers reported that sales were very strong during the first half of the month but subsequently waned. For the most part, retailing executives attributed the slackening in activity to unseasonably warm weather, which curtailed purchases of outerwear. One leading merchant suggested that part of the slowdown could be the lack of a spillover of pre-Election Day sales activity into October. Several respondents indicated that sales gains lagged the rest of the nation. Despite the softening, the department store executives looked to the approaching Christmas season with "cautious optimism."

Outside of department stores, consumer spending on new cars appeared more robust, although here too the pace appeared to lag the nation. A director of a major automobile finance company held a sanguine assessment of automobile sales, professing no concern over consumer indebtedness or delinquency rates. Several major auto dealers reported that sales in October were on target but lagging national sales. The higher prices of new models apparently met with little sales resistance.

Although some inventory imbalances were reported, they did not appear to be widespread nor unduly burdensome. In the retail sector, the slowdown in sales did apparently lead to some buildup in inventories. One retailing chain executive attributed his firm's increase in stocks to over-ordering by store managers. None of the retailers contacted felt their stocks to be seriously out of line with plans, especially in view of the approaching Christmas season. In the industrial sector, a chemical executive expected the industry's inventory excesses to be worked off by the end of the year. For the most part, respondents felt that businesses' tight inventory policies prevented any serious or widespread involuntary accumulation.

Pervasive uncertainty over government policies was frequently blamed for inhibiting capital spending by business. Several directors reported that firms were awaiting clarification of the outlook on tax legislation before framing their capital spending plans. More generally, uncertainty surrounding a broad range of government policies was cited by the chairman of a major New York City bank. One director voiced apprehension over energy and environmental policies as retarding plant and equipment outlays. The president of a major chemical firm mentioned the uncertainty associated with the proposed social security legislation. The president of a major New Jersey bank felt that local business in his area seemed to be more caught up with local environmental and tax issues than with national policies. In a similar vein, the Buffalo directors expressed concern over the high tax burdens in New York State that tend to limit spending on capital improvements of existing plants. On a positive note, one Buffalo director reported some acceleration in capital spending plans among small- to medium-sized firms due to special tax incentives offered by the State for job-creating capital infusions.

There is a good deal of concern over the farm crop in central and western New York State. Heavy rain from the middle of September through October seriously damaged the crops and left the ground too wet to harvest surviving crops by the customary mechanical means. Dairy farmers also are suffering as they are unable to harvest the feed for their herds. Crop damage in the thirty-five upstate counties is expected to exceed $150 million.

Another negative factor weighing on the regional economy is the limited dock strike, which appears to be having an increasing impact as it enters its second month. According to an executive of a leading maritime firm, there are currently 16 to 20 fully loaded ships tied up in the Port of New York. There appears little hope for an immediate settlement though there are some indications that one many be reached before Thanksgiving. The lengthy strike is expected to produce serious difficulties for retailers who offer significant quantities of imported merchandise for Christmas sale and could spark some upward price pressures. The continuation of the strike also has serious repercussions on Puerto Rico because of the commonwealth's heavy reliance on imported goods.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District are that economic activity is expanding, but at an uneven pace. Retail sales are up for the second consecutive month according to executives in that sector, but manufacturing activity is virtually unchanged from October according to the latest Business Outlook Survey. For the longer term, both retailers and manufacturers appear to be more optimistic about future economic conditions than they have been recently. Retailers expect sales in real terms to at least hold steady and manufacturers foresee increases in employment and capital spending. Commercial bankers say the demand for consumer loans is very strong, but that commercial borrowing is mixed. Interest rates are expected to increase over the next six months.

Manufacturers responding to this month's Business Outlook Survey say that general business conditions are only marginally better than they were in October. Fifteen percent of the respondents indicate an improvement, while 6 percent say conditions have worsened. Both new orders and shipments are unchanged in November, while inventories are down slightly. This represents the first inventory decline in nine months. Consistent with these reports, employment, which was up fractionally in October, and the average workweek in manufacturing are unchanged from last month.

Despite the apparent lack of economic improvement at the moment however, manufacturers seem to be getting more bullish about future business conditions. About half of those responding to the November survey say they expect business to get better over the next six months. A similar proportion anticipates increases in new orders and shipments. Inventories are expected to remain unchanged over the period. This optimism is reflected in hiring and spending plans. Twenty-four percent of the respondents plan to add to their payrolls by May, and 18 percent expect a longer workweek. Increases in capital expenditures are projected at one-third of the firms sampled.

Price increases in the industrial sector continue to become less prevalent. Twenty-four percent of the executives surveyed this month report paying more for inputs, while 15 percent say they are receiving higher prices for the goods they sell. For the longer term, 85 percent foresee higher prices for raw materials by May, and 59 percent expect to get more for their finished products by that time.

Department store sales in the region are up this month according to area retailers. Current dollar sales are reported to be between 5 and 15 percent above year-ago levels, and generally above anticipated levels as well. Both downtown and suburban stores are doing well this month. Favorable weather and a "willingness to buy" on the part of the consumer are cited by retailers as reasons for the strong sales. Overall, inventories are said to be in good shape, and retailers feel they are in a position to deal with any unforeseen change in economic conditions which might develop.

Looking at the future, merchants continue to gain optimism but still remain somewhat cautious. Those contacted expect to see gains of 6 to 15 percent over year-earlier levels by the end of the second quarter. Uncertainty about future effects of Federal energy policy and possible income tax changes in Pennsylvania still persists among retailers. However, they have not adjusted future plans on the basis of this uncertainty at this point.

Area bankers report that while the demand for consumer loans is quite strong, business loan demand is still mixed. Current levels of C&I

loans are reported to be between 3 percent above and 9 percent below year-ago levels. Although one contact says commercial borrowing is slightly above planned levels, most say it is substantially lower than anticipated. All of those contacted agreed that borrowing by local businesses was better than national borrowing at their banks.

For the longer term, bankers foresee little or no change from the current trend in commercial borrowing. They feel that businessmen are still very unsure about the future, and therefore will not be willing to commit themselves to projects that require large sums of borrowed cash. Most banks forecast at least one more round of interest rate hikes, pushing the prime rate to 8-8 1/2 percent by June. The prime is currently 7 3/4 percent at all of the banks contacted.

Bankers say they have experienced some outflow of savings deposits, owning to higher short-term interest rates, but that they are not concerned about the possibility of this becoming a major problem. One contact noted that higher short-term rates would have more of an effect on the demand for funds than on the supply, saying that, "if the spread between the commercial paper rate and the prime becomes much larger, we can expect to see a significant number of borrowers turning to the paper market instead of to banks."

FOURTH DISTRICT - CLEVELAND

Growth in real GNP is expected to continue to moderate throughout 1978, according to economists who met at this Bank on November 4. The economists are skeptical that gains in any major spending sector next year will exceed 1977. Steel output may be considerably improved from recent levels, if imports are curtailed as a result of Treasury rulings on dumping. Thrift institutions report no evidence of disintermediation.

Economists who attended the November 4th economic outlook session held at the Federal Reserve Bank of Cleveland shaded their forecast of real GNP growth to an annual rate of 4.6% from the fourth quarter 1977 to second quarter 1978. Moreover, they expect real GNP to increase at only a 3.2% annual rate in the second half of 1978. The economists were skeptical that any major spending sector, except for Government, would provide more thrust to overall activity in 1978 than in 1977. They anticipate consumer spending to exceed 1977 totals only slightly, but residential construction and business fixed investment are expected to show smaller gains over the period ahead than in 1977. While several members pointed out that stimulative monetary and fiscal actions should result in strong economic growth in 1978, others expressed concern that these actions would result in higher prices rather than higher output. Although the group as a whole seemed convinced over prospects for limited growth, only one of the 27 economists forecast an outright decline in real GNP, expected in fourth quarter 1978.

The group's view on fixed investment typifies its scaled-down expectations for economic growth. In contrast to last June when accelerating gains in spending in several industries were expected, a leveling out or reduced gains are now anticipated for 1978. The median forecast anticipates a 13.2% increase in fixed investment from the fourth quarter 1977 to fourth quarter 1978, a considerable slowing from the 16% rise for the comparable year earlier period. One economist pointed out that his company's orders for capital equipment this year have not been uniformly strong and that a forecast of slow growth in output, especially in the second half of 1978, would tend to dampen real gains in capital spending in 1978. Similarly, the upswing in machine tool orders in this expansion has not been broadly based and will apparently peak this year largely because next year's orders for retooling of autos have already been placed. According to one economist, capital spending by steel producers is likely to decline because of negligible growth in retained earnings, inadequate depreciation allowances, and the industry's inability to raise funds in either debt or equity markets. Weakness in capital spending by a producer of glassware and packaging reflects a low return in investment, lack of confidence about current and future economic conditions, weak prices, and uncertainty over Government tax and energy policies.

Increased October sales have encouraged retailers and producers of consumer goods, although they are still cautious over near-term sales prospects. Department store officials report a sizable sales pickup last month following September's drop, but they point out that sales levels were not much above August. Slow growth in real income should continue to cause month-to-month fluctuations in sales, according to an economist with a major department store chain. He also indicated recent sales promotions may have the effect of borrowing from sales in the fourth quarter. More than usual sales promotions this quarter will likely be needed to stimulate consumer spending, according to some officials. Auto producers are guardedly optimistic over sales for 1978. An economist for a major producer expects domestic new car sales to amount to 9.3 million units in 1978, about the same as in 1977. Although sales in October rebounded from September, this economist expressed some uncertainty because of softer-than-expected sales of Chrysler and AMC cars, which in turn led to plant shutdowns. In addition, some 1978 intermediate-size GMC cars have not sold as well as expected.

Some of the gloom that has dominated the steel industry in recent months appears to be eroding as a result of a recent Treasury ruling that affirmed dumping of steel in the U.S. by Japanese producers. An immediate effect of the ruling has been a sharp increase in steel plate orders by domestic producers. According to an economist with a major steel producer, a higher volume of orders is booked for November than at a comparable period in October, and orders for December delivery are higher than at a comparable period in November. Four large steel producers in the District have filed separate dumping complaints involving a variety of steel products. Because Treasury rulings probably will be made by the end of March 1978, some Japanese steel producers will not make commitments on steel prices after February 1978. The result of these rulings could sharply curtail steel imports, which could fall to 10-to-12 million tons in 1978 compared with an estimated 20-million-ton annual rate of imports in recent months. Should this occur, one steel economist predicts steel earnings in 1978 would improve, and steel operations would rise to close to capacity in the second half of 1978, compared with the present operating rate of about 73% of capacity. Some steel officials also seem buoyed by the recent bottoming out in steel operations this quarter, in contrast to the continued slide that occurred late last year.

Thrift institutions report no signs of disintermediation in recent weeks, despite narrowed yield spreads between rates on time deposits and money market instruments. Deposit flows in October and early November have been strong in both passbook and time accounts. Although some officials anticipated lessened growth in deposit flows next year, they have not cut back commitments. Loan demand for single-family dwellings remains strong, and revival in multi-family units, especially apartments, seems to be strengthening as a result of recent boosts in rent prices. Some S&L officials believe the higher proportion of deposits in certificates will enable them to cope with the effect of disintermediation better than they did in 1973 and 1974. Also, liquidity for some is still considerably higher than legal requirements, and several indicate ample opportunity to increase borrowings, if needed.

FIFTH DISTRICT - RICHMOND

Overall manufacturing activity in the Fifth District remains relatively stable judging from responses to our latest survey. New orders apparently firmed slightly in the past month and manufacturers' inventories remained essentially unchanged. Manufacturing employment among our respondents was also unchanged although average weekly hours declined somewhat. Prices paid and received by manufacturers, including employee compensation, continued upward. While the respondents still foresee little improvement in the overall level of business activity over the next six months, prospects for their respective firms have apparently picked up since last month. Some isolated cases of production losses due to natural gas curtailments have arisen. One of our respondents in the stone, clay, and glass group and a fertilizer plant, both in North Carolina, have reported such curtailments. Bank credit at large Fifth District banks has grown rapidly in recent weeks, with sustained real estate lending and new strength in business lending accounting for most of the growth. Our latest farm credit survey indicates that farmers, many of whom have suffered from drought damage to crops, are not finding it difficult to get needed credit.

Responses to our survey of manufacturers suggest a modest further expansion of shipments in the past month along with a pickup in the volume of new orders. Over forty percent of the manufacturers report a rise in orders. Meanwhile, backlogs of orders were essentially unchanged, as were inventories of both materials and finished goods. Nonetheless, current stocks remain above desired levels at over one-fourth of the firms reporting. Manufacturing employment was stable over the month, but nearly one respondent in five indicates a decline in weekly hours worked. Prices, particularly those paid by manufacturers continued to rise.

Current plant and equipment is viewed by most respondents as about right, but there remain several who feel it excessive in their individual cases. There are now a few manufacturers, however, who feel current expansion plans should be enlarged. Expectations for the level of business activity over the next six months continue to lack the optimistic tone of a few months ago, although nearly one-third of our respondents look for some pickup in the level of production in their respective firms over that time period.

On balance, the textile industry appears to have experienced a somewhat broader gain in new orders than the other manufacturing groups. Shipments also held up relatively well for this group in October. Also, we received the most favorable reports from the furniture industry in some months. The improvement reported by our furniture industry respondents is also consistent with information recently made available by the industry which indicates a pickup in business beginning in late summer. Responses from the chemicals industry are a mixed bag, while activity among primary metals producers is apparently less buoyant than in recent months.

Scant reports from the retail sector suggest some further improvement in sales and in the relative sales of big ticket items. Inventories at retail remain in line with desired levels. The outlook for business over the next six months remains cautious.

Demand for commercial and industrial loans appears to be quite strong, with the largest increases in such loans occurring in the retail and wholesale trade sectors. There have also been recent gains in borrowings by utilities. Real estate lending continues undiminished. Consumer installment loans, however, have weakened of late. Time and savings deposits of large District banks, net of negotiable CD's, show very little growth. At the same time, private demand deposit balances have continued to increase along the strong upward trend maintained through the year. Acquisitions of negotiable CD's have been large when measured by recent standards.

With depressed farm income levels in many areas of the District, replies to our third quarter farm credit survey reveal that bankers are experiencing a fairly strong demand for farm loans, further deterioration in loan repayment rates, and increased renewals and extensions of existing loans. Supplies of loanable funds at commercial banks are generally ample, however, and regular farm customers apparently are not finding it difficult to get needed credit. Reportedly, numbers of farmers in some areas have qualified for drought disaster loans from the SBA and/or the FmHA, thereby reducing the demand for farm loans at banks.

Also in the agriculture sector, marketings of flue-cured tobacco have been 12 percent under a year ago. Thus, despite higher prices, the value of gross sales for the season has so far been some $65.6 million, or about 6 percent, below last year.

SIXTH DISTRICT - ATLANTA

The District economy appears to be on pretty solid footing despite a preponderance of strikes and continuing weakness in the farm sector. Consumer spending continues to advance. Lending activity is heavy; and deposit inflows have been moderate but slowing. Nonresidential construction shows spotty strength but the promise of strong gains. The tourist industry is flourishing in some unexpected areas.

At least 13,500 workers (in addition to the longshoremen) have been striking major District employers, keeping hundreds of other employees off the job as plants ceased operations. Lockheed-Georgia's 5,000 machinists joined California counterparts in a walkout that closed the Marietta plant. A dispute over production standards evolved into a 4,500-man strike at GM's Doraville, Georgia, facility. The Port of New Orleans reopened in mid-October as the general strike ended. Longshoremen are now working conventional cargoes but still striking containerized vessels. Grain exports have been caught in the bottleneck. The Savannah port, where shipments were already sluggish, is operating at 40 percent of capacity. Most Florida ports have been only slightly affected by the strike because of the low proportion of containerized shipping. The Tampa port, however, has been badly congested, largely because of increased phosphate exports.

As yet, disintermediation has not been significant at District financial institutions. Savings and loans' net savings inflows are off only slightly from near-record levels. Nonpassbook time deposit inflows have slipped at member banks, but total deposits maintain moderate growth. However, our Fiscal Agency Department notes increasing security sales, a rising proportion of tenders of checks drawn on savings and loans, and a jump in telephone inquiries about rates.

Loan demand continues brisk. One Atlanta bank attributes rapid growth of credit card loans to a voluntary willingness of consumers to carry more credit card debt. In Tennessee, the most recent reports from large commercial banks indicate that uncertainty over usury enforcement has sharply reduced extensions of consumer instalment credit, particularly direct auto loans. But a heavier volume of single-payment loans may be offsetting reduced instalment credit. An economist from the Atlanta Federal Home Loan Bank expresses concern that high mortgage demand has caused associations to overcommit, even on the basis of current inflows. A director reports that some S&L's in southwest Florida have extended their maximum allocations of commercial loans.

A regional commercial developer points to backlogged demand as the stimulus for heavy current and near-term leasing activity, particularly of warehouses and offices. He notes keen competition for rather scarce high-quality, developed, income-producing properties, but expects only moderate commercial construction until rents rise enough to produce adequate investment returns. An increasing number of his customers for new developments are local governments or private coalitions of investors interested in the renewal of downtown areas. Office space is becoming scarcer in Atlanta and Miami, two cities previously plagued with extensive vacancies.

As for industrial investment, opinions of directors and other business leaders about current activity and prospects are widely mixed. A Tennessee director surmises that low stock price/earnings multiples have made acquisition of small existing companies a more economical means of expansion than investment in new facilities. One large construction firm which specializes in pulp, paper, and energy boasts a record backlog of contract work. The Southern Company, which supplies about half of the District's electrical power, complains of a lack of new industries but (reluctantly) plans capital expansion of its own to help meet surging residential demand and the more moderate additional requirements of expanded existing industrial facilities. One director notes that small projects are keeping many contractors busy in the Jacksonville area, but the paucity of large projects threatens the existence of large-project construction firms. In central Florida and Louisiana, announcements for both new industries and expansions of current operations continue very heavy. Plans for several huge electric-generating plants have boosted District nonresidential construction contracts to record levels three times this year.

Most areas continue to enjoy strong retail sales, with auto sales showing substantial year-ago increases and many dealers still complaining of low inventories. Clothing sales have been quite good in places. One director contrasts recent local increases in television advertising volume with the apparent hesitance to make ad commitments at the national level. Though we have seen no evidence as yet of a slowing of the overall sales pace in Tennessee, the credit slowdown has cut into used car sales rather sharply and swelled dealer inventories.

Harvests have been nearly completed despite unfavorable damp weather. Field losses have been large. Cotton quality has been reduced and yields disappointing. But the tobacco marketing season closed with huge volume and record price. Citrus processors have bid up the price of the scanty Florida orange crop sharply in "panic buying." Gains in the hog market continue to surpass expectations. Wider profit margins are stimulating broiler and egg production.

Tourist traffic has been lighter than usual in the off season of Atlantic Coast beaches and only slightly heavier at central Florida attractions, with little extra-seasonal gains expected this fall. However, a rising stream of Latin American visitors has shored up tourism and trade in some parts of the state, particularly downtown Miami. On the Gulf Coast beaches, especially in Mississippi, and in the inland areas of Georgia, Alabama, and Tennessee, solid gains in tourism have been reported. Upcoming conventions should boost this industry's revenues in Miami, New Orleans, and Biloxi.

SEVENTH DISTRICT - CHICAGO

With the agricultural sector a notable exception, the economic outlook in the Seventh District appears to be generally healthy. Retail sales are reported to be vigorous in virtually all categories. Capital outlays are still increasing, and perhaps at a somewhat faster pace, but the picture varies greatly by product. Except for continued stringency in residential building materials, supplies of goods are ample. Agricultural credit conditions have deteriorated significantly in recent months. Demand for credit is generally strong except for large business loans. Interest rates have strengthened moderately.

Concern expressed in the third quarter that the expansion might be at or near a peak has largely dissipated. Most executives and analysts share the opinion that activity will continue to grow, at least through the first half of 1978. Ready availability of virtually all purchased materials is encouraging business firms to closely control, even reduce, inventories. However, holdings of fuel oil and propane are very large, and will be maintained at high levels.

Major retailers report sales to be at good levels, and they plan on a strong Christmas season. Hard goods continue to lead, while fashion-type apparel is relatively weak. Home improvement items, automobile supplies, refrigerators, electric ranges, microwave ovens (many from Japan), dryers, and disposers are doing especially well. Instalment credit is being used freely, indicating consumer confidence, and delinquency experience is excellent.

The slowdown in auto deliveries in September partly reflected the delayed availability of some new models. These were introduced in early October, and apparently were well received. The strength of the auto market varies greatly by model. Periodic shutdowns of various district plants have been required to control stocks of less popular cars, while other models are in short supply. Inventories of popular imports are down sharply, which may be holding back sales.

The uptrend in sales of heavy trucks and trailers leveled in September and October. Opinions differ as to whether this lull is only temporary. Sales of light trucks, many to consumers, continue strong.

The auto industry, at least the two largest producers, are in the midst of massive programs to downsize cars. Orders from the auto companies are largely responsible for strength reported in machine tool orders, especially presses and transfer machines. Originally concentrated in equipment, auto industry capital spending programs now include a substantial commitment to new structures and expansions of existing buildings to be ready in 1978, 1979, or later. There are fears that the third and fourth ranking auto producers cannot finance the capital outlays required to produce the mix of cars that will meet federal rules.

Most producers of capital equipment report orders to be "good but unspectacular." Our impression is that the general picture is somewhat better than a few months ago. Among the strongest types are machine tools, construction equipment, freight cars, well-drilling apparatus, fluid power, and electric motors. Farm equipment and heavy mining equipment are very weak. Orders for mining equipment and replacement parts have been hurt by the iron miners' strike.

Many homebuilders complain that shortages of insulation have delayed completions by a month or more. Some have been unable to provide the extra heavy insulation they had promised home buyers. Housing analysts expect that starts in 1978 will be about the same as this year with apartments somewhat higher and one-family units somewhat lower. Aside from insulation, there are complaints of shortages, or poor quality, covering a long list of components. Substitutions often have been necessary. There is a general shortage of <u>really</u> skilled building trades workers, with consequent reports of "shoddy" construction.

Real estate transfers continue at a high level, about 30 percent above last year. A wave of condominium conversions of rental units in buildings large and small, new and old, is in progress with a substantial volume of funds required to finance purchases by (often reluctant) renters. Meanwhile, rents are gradually rising to a point that is encouraging promoters of new apartment buildings. Mortgages funds continue to be generally available, but some S&Ls have raised their basic rate from 8.75 to 9 percent. Usury ceilings are no longer a threat in Illinois because a flexible formula is used now.

Nonresidential construction activity is improving. Office buildings lead the uptrend, but industrial building also is picking up. Virtually all new plants or plant expansions are located in outlying areas or smaller towns. Outlays to build or repair highways and highway structures, and to build sewer and water systems, are rather strong, but the rest of the public sector, especially school buildings, is weak.

Our latest quarterly survey shows a decline in farmland values for the first time since 1960. In the past five years these values had increased by 160 percent. The overall decline for the district for the third quarter was 1 percent, but reports by states range from an 8 percent decline for Illinois to a 4 percent rise for Wisconsin.

Farm credit conditions have deteriorated markedly in recent months with rapid loan growth, slower loan repayments, increased loan renewals, and reduced bank liquidity. Almost half of the rural banks view their loan-deposit ratios (now averaging 64 percent) as "excessive." This is about double the normal proportion expressing this view.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth Federal Reserve District continues upward, although the rate of increase has slowed from the rapid advances early this year. Some gains in consumer spending have occurred since last summer. Manufacturing activity continues at a high rate, but with only modest gains in recent weeks. Businessmen are generally satisfied with the current level of inventories. In some cases inventories have been increased to reflect anticipated increases in sales, but reports indicate that cautious inventory policies are being followed. In the financial sector, demand has been brisk for all types of loans. Crop yields in the District are generally excellent and, on the whole, harvesting has proceeded ahead of schedule.

Consumer spending continues to increase relative to year ago levels. Gains in sales since the summer months have been primarily in softgood items, but big-ticket items, such as furniture, appliances, home improvement items, and automobiles, have continued to sell at the relatively high midsummer rates. Strong Christmas holiday sales are anticipated by department store representatives, and gains over a year ago are expected to be at least as large as those posted in recent months.

Inventories at both the retail and manufacturing levels are reported to be at a desirable level, given current sales expectations. Retailers note inventories are sufficient to accommodate some increases in sales, but they believe overstocking for the Christmas season has been avoided. A manufacturing representative of a capital goods firm noted that inventories have been built up for certain items in anticipation of future increases in sales. While these inventories are now considered to be at a healthy level, it was noted that a decline in sales from expected levels could substantially alter this appraisal. One clothing manufacturer reported a greater than preferred level of finished goods at the manufacturing level, but this situation was improving rather than worsening. In home construction, inventories of unsold homes are quite low and some backlogs of buyers still exist.

A recent slowing in savings inflows has been detected by financial institutions. Savings and loan association representatives report that recent slower gains in savings deposits may be the result of rising market rates relative to rates offered by financial intermediaries. Commercial banks have experienced increases in total savings deposits, but most of the increases were in higher-yielding time deposits and large certificates of deposits.

Demand remains strong for most types of loans. Home mortgage loan demand is still quite strong for this time of year. Earlier this year mortgage lenders had difficulties in keeping up with the incoming applications for loans, but the rush has subsided. Instead, lenders are now actively seeking loans. Business loans at larger commercial banks have picked up after several months of sluggishness. A representative of a large commercial bank noted that demand for loans by large corporations was greater than it had been for some time. Also, further gains in consumer, real estate, and agricultural loans were registered in recent weeks.

Manufacturing activity continues at a high level. Strength eminating from the housing sector is noted by several manufacturers. A major appliance manufacturer, for example, noted that contract sales to the housing industry have continued brisk, and that appliance sales at the retail level have held up better than anticipated. Suppliers of building materials, such as heating equipment and connector plates, report sales on a seasonally adjusted basis are still quite vigorous. A representative of a capital goods firm pointed to substantial increases in orders from a year ago, and further gains are anticipated next year. On the other hand, an apparel manufacturer, serving mostly rural areas, reports little change in sales in recent months as a result of lower farm incomes. Also, despite generally good sales of chemicals, sales of some fibers and plastics have been less than expected, partly reflecting sluggish export markets.

Crop yields are reported to be excellent and harvesting of crops has continued at a generally satisfactory pace in the District. Cotton picking is well ahead of normal and rice harvesting is virtually complete. On the other hand, soybean harvesting has been held up by rainy weather and in some areas of the District fall planting of wheat has been halted. Harvesting of some crops is not likely to be resumed until freezes permit farm equipment to be moved into the fields.

NINTH DISTRICT--MINNEAPOLIS

While still fairly strong, economic activity here shows some signs of slowing. Consumers are still spending well in areas not hurt by the iron ore strike or agriculture's problems. And farmers' income outlook has actually improved somewhat recently. But some directors are now concerned about excessive business inventories and an apparent slowdown in homebuilding.

Consumer spending still strong

The district's strength and its two major weaknesses are still reflected in reports about consumer spending. Overall, retail sales have been very good and are expected to remain so through the holiday season. But the three-month-old iron ore workers' strike is depressing income and spending in northeastern Minnesota and the Upper Peninsula of Michigan. People in areas dependent on agriculture have not had much to spend either: directors from North and South Dakota say farm-related retail sales there have been only fair or "spotty," and about half of the rural bankers responding to our October survey of ag credit conditions said farmers were spending less than last year.

Ag outlook improved

Spending in rural areas may increase somewhat because farmers' income prospects improved recently. Rain and insects did not hurt crops as much as expected so farmers have more to sell than they thought. They are getting more for their crops too: because of rumors of better demand here and abroad, grain prices have stopped falling and some have actually turned up. Further price improvement is likely since the Russians' poorer-than-expected wheat harvest has been officially confirmed. More money will also be available from the government; the new farm bill's target price on wheat could bring district farmers as much as $300-350 million in subsidies this December. Including government payments, farm receipts from crops this year are now expected to at least match last year's level.

Directors see these developments--especially the subsidies--as helping rural banks' current liquidity problems. Because farmers have so far had little money to repay loans or save, rural bank liquidity is tighter than usual. In our October survey of rural bankers, 35 percent called their loan-to-deposit ratio "high," more than the 29 percent in July. The share with 70 percent or more of their deposits loaned out increased from 36 to 42 percent. And in October a quarter of the bankers were referring more than the usual number of loans to nonbank credit agencies.

Concern about inventories and homebuilding

The weak ag sector looks a little better this month, but some directors see signs of slowing in the district's relatively strong business activity.

Although not yet indicating a widespread sales slowdown, directors report some unexpected business inventory buildup. Directors say the demand for pulp and paper in eastern Montana has weakened enough to put inventories 25 percent above a year ago. And excess copper inventories are depressing activity in Upper Michigan. Several other directors report inventories somewhat high but not yet a problem. One says customers of his major manufacturing firm are cutting orders at the slightest sign of weaker sales.

Housing activity appears to be slowing here too. Total residential building permits in the district are still far above last year and the 1972 record level. And directors see strong homebuilding in Montana, South Dakota, southwestern Wisconsin, and Minneapolis-St. Paul. But Minneapolis-St. Paul realtors say the demand for housing there has weakened recently. And directors note less building in North Dakota, parts of Upper Michigan, and central Minnesota.

Some directors think homebuilding will slow further because less mortgage money will be available. Though right now funds are still generally adequate throughout the district, directors in Montana and South Dakota are concerned about high short-term interest rates drying up funds in their states. A Minnesota director associated with the housing industry actually expects disintermediation to cut this region's residential construction 15 percent next year.

TENTH DISTRICT--KANSAS CITY

Economic conditions are generally good in the Tenth District, except in agriculture, and even there some improvement is observed. Directors and business economists believe the expansion will continue at a slow-to-moderate rate, held back largely by business reluctance to invest when there is so much uncertainty. A combination of price increases and government payments has increased cash flow to farmers, although the squeeze continues. Loan demand is up sharply in most banks, and expected to rise more rapidly than deposits in the month ahead.

According to Directors contacted, the major stumbling block to business fixed investment continues to be uncertainty about Federal Government policies and regulations. This is also the refrain of economists employed by businesses in the District. For the most part, Directors and business economists do not believe that developments in recent weeks have jeopardized the outlook for moderately slow growth in the economy in the year ahead. Of those who offered comments on the rise in short-term interest rates, all but one economist felt the increases were necessary to fight inflation.

With only a couple of exceptions, businesses intend to go through with the purchases of plant and equipment that they had planned earlier. General business conditions are observed to be good throughout the District, except in areas especially dependent upon sales to grain farmers. "They aren't buying anything," says one Director, who also notes, "This credit thing isn't getting any better out here (Kansas). The banks say they have gone as far as they can go, and some have told the farmers to consider selling some land."

Some signs of an easing in Tenth District farmers' cash flow problems are beginning to be observed. For the first 7 months of 1977, cash receipts from farm marketings increased 1.5 per cent over year-earlier levels for District farmers. Wheat and corn prices have slowly increased above summer lows, although they are still quite depressed. Additionally, in the District states, 222.4 million bushels of the 1977 wheat crop have already been placed under Commodity Credit Corporation (CCC) loans. In most instances, the net proceeds to farmers of these loans have exceeded the market price of the wheat. Substantial quantities of 1977 corn are also expected to go under CCC loans, again with net loan proceeds for many of the loans likely to exceed cash corn prices. Of the $1.2 billion in deficiency payments the Nation's wheat farmers will receive late this year under the target-price program, an estimated $501 million (42 per cent of the total) will be paid to wheat farmers in the Tenth District states. Payments will average almost $19 for each acre of wheat harvested in these states during 1977. Finally, fat cattle and feeder cattle prices are presently almost 13 per cent above year-earlier levels, while hog prices are currently 33 per cent above year-earlier levels. Thus, although the farm-price squeeze continues, District farmers are experiencing some modest improvement in cash flow.

The monthly survey of Tenth District bankers indicates that, for most respondents, loan demand is up sharply. Strength of the individual bank's loan portfolio reflects the economic diversity of the District. Construction loans for residential building, especially one-family homes, are reported strong in the Denver and Lincoln areas, while energy-related loan demand is reported strong in Oklahoma and in Denver. Other respondents indicate that inventory loans and correspondent bank loans are contributory factors in the strength of loan demand.

Most respondents dealing in agricultural loans say that, in general, new agricultural loans are simply extensions of old loans. One Denver banker feels that some of these loans have become illiquid, especially in over-lines from rural banks to large banks. One respondent mentions that the agricultural loan market was very tight in September, but has since eased due to the harvest being near completion and to the sale of grain inventories.

A majority of respondents expect loan demand to increase more rapidly than usual during the next month, although none expect strong agricultural loan demand. The expectation of strong loan demand in the future is reflected by the raising of prime rates to 7 3/4 per cent, an action taken by all but one banker surveyed. Almost all bankers expect future loan demand to outstrip deposit inflows, requiring them to use CD's as well as nondeposit sources of funds such as Fed funds.

Most bankers report that time and savings inflows had slowed or stopped in October. Only a very few report any evidence of disintermediation.

ELEVENTH DISTRICT--DALLAS

Economic indicators suggest that business conditions in the Eleventh District are continuing to strengthen, and Directors, businessmen, and bankers contacted this month remain generally optimistic. Industrial output has rebounded after a brief lull. The rate of unemployment declined slightly in September, and Directors report that skilled labor remains in short supply in most urban areas. Housing starts eased some recently but still remain at a high level. Automobile dealers report that new cars are selling especially well, and retailers are very optimistic concerning Christmas sales this year. Most businesses indicate that inventory levels are good. Total bank loans continue to show good growth, although bankers generally indicate continuing disappointment over the strength in commercial and industrial loans. Farm incomes are down somewhat due to lower prices for crops.

The 1978 model automobiles are being well received. All auto dealers interviewed report higher sales of both fleet and consumer cars this year, and several dealers indicate they have experienced record sales during this introductory period. Price increases seem to have had little impact on purchases. All dealers report a strong demand for intermediate- and large-size cars with optional equipment. Many dealers report an exceptionally high volume of large luxury car sales, and Ford dealers indicate they could sell twice as many Thunderbirds as they can get. Nevertheless, smaller cars, such as Ford's Fiesta and GM's Chevette subcompacts, are selling extremely well. Most of the dealers have very low stocks of 1977 models, and inventories of 1978 models are down, especially on some of the hottest selling models.

A "good" volume of orders was placed at a recent showing of women's spring apparel at the Dallas Apparel Mart. Most buyers--largely from small retail outlets--are cautiously optimistic about the prospects for future sales. Some bookings resulted because retailers feel that apparel costs may rise significantly next year when wage adjustments, stemming from the increased minimum wage, work into production costs. Retailers report consumers continue to be highly sensitive to price increases. Sales in rural communities are off because of depressed farm incomes, but sales are expected to strengthen somewhat when the government begins to disburse deficiency payments. Another factor that is affecting current sales is the unseasonably warm weather for this time of year. Inventories of winter merchandise are high. And if unseasonal temperatures persist, retailers may be forced to cut prices before Christmas to reduce stocks.

Prospects for retail sales for the remainder of the year are very good. Most retailers contacted indicate that Christmas sales this year are well ahead of last season, and in some stores, sales have already exceeded even their optimistic forecasts. Price increases have not averaged more than the general rate of inflation. Inventory levels are good to adequate at most establishments.

Interviews with District bankers and Directors reflect that total loan demand is continuing to strengthen but more slowly than expected. Real estate and consumer loans appear to be the main areas of strength at most banks, although some banks in Dallas and Houston report some further growth in loan demand from energy-related industries. Bankers note that there still is no evidence of a rising volume of machinery purchases, oil field equipment excluded. Machinery manufacturers are holding inventories at low levels.

All bankers contacted indicate that disintermediation as a result of recent increases in short-term interest rates probably has been small or non-existent thus far. Some shifting of funds from savings deposits to large CD's was noted, however, and most of the contacts feel that disintermediation would occur as time deposits mature and short-term rates continue to rise.

Cash receipts from farm and ranch marketings for the District states in the first eight months of this year were 2 percent above the same period a year earlier. Although showing a cumulative gain of 6 percent, receipts from crop sales have slowed considerably as prices for cotton, soybeans, and corn have fallen sharply. Prices for wheat, oats, barley, and grain sorghum have strengthened somewhat in the past two months but remain well below levels a year ago. As a result, crop sales are also likely to decline further in coming months despite a bumper cotton crop. Because of low market prices, a significant portion of the 1977 cotton and grain crops will likely be placed under the nonrecourse loan program of the Commodity Credit Corporation. Livestock sales this year have lagged year-earlier levels, but receipts probably will increase during the remainder of 1977 with a small rise in fed cattle marketings and strengthening cattle prices. Altogether, cash receipts for 1977 may only match last year's level.

TWELFTH DISTRICT - SAN FRANCISCO

The Western economy is still growing, but with a few weak spots. Retail sales are mixed - strong in some places, sluggish in others. Inventories are generally at desired levels. The industrial picture is also mixed-- many industries growing nicely but problems in pulp and paper, aerospace and steel. The current kingpin of the Western economy is construction, where single family building continues strong, but multiple unit and commercial appear even stronger. Demand continues strong for both construction and mortgage lending. While there is concern about disintermediation, little has been observed.

Retail sales appear uneven in the West. Some areas report strong sales, particularly in small cars, while others report sluggish sales. Third quarter retail sales were up 14.5 percent in Utah and 14.0 percent in Idaho over a year ago. Food sales in Seattle are a bit weak, due partly to the fact that the Boeing strike involves some 2 1/2 percent of the total Seattle work force. Also, a national clothing manufacturer located in the district reports mediocre sales. Inventories appear to be generally at desired levels.

The Western industrial picture is mixed. The forest products industry is generally in good health, except for the pulp and paper portion which was declared by one director to be a "disaster area." Alumimum orders have leveled off temporarily, but there is said to be fundamental growth in the demand for aluminum from the food and transportation sectors, so that output next year is expected to increase beyond a rather good 1977. Aerospace is hampered by strikes at both Boeing and Lockheed. Steel production in Oregon is said to be depressed by foreign imports, but overall, Oregon manufacturing continues strong as indicated in the rising employment figures. Two new food export ventures were noted in the Pacific Northwest. One is an operation which has begun to ship a planeload of live beef to Japan each week and the other is a project by a large Seattle food distributor to fly fresh meat and produce to a new supermarket in the Middle East.

Directors from Utah and Idaho claim not to be experiencing a pause in their economies. Most firms are said to be far out-stripping their level of output of the previous year. Significant employment gains in construction, mining and manufacturing are cited for Utah.

Construction appears to be the sector of strength in the Western economy. While average unemployment rates remain high, there is virtually no unemployment in construction. Some areas are actually reporting shortages of such skilled workers as electricians, carpenters and plumbers. However, there have been two shifts taking place; one is the diffusion of the construction boom from California to other Western states and the other is a shift from single family units to multiple units and non-residential construction.

Southern California reports an end to the lotteries and overnight sellouts of subdivisions, and developers are becoming a bit more cautious by putting up smaller blocks of houses at a time. Homes are remaining on the market longer and there is more price bargaining. While the level of single family construction continues high, the real growth in Southern California has been in commercial and industrial construction, which for the first 9 months of this year was up 110 percent over the same period last year. Even this rapid growth has apparently not kept pace with demand, for a shortage of prime, new office space is said to be developing. Construction of multiple family units is experiencing growth through California -- 100,400 multiple unit permits were taken out in September, the largest number since February.

In Utah, 1977 home building is estimated to be up 47 perment over last year. There, as in several other areas, shortages of such building materials as insulation, cement and sheetrock have been reported. In Oregon, residential construction continues strong and the previously sluggish non-residential sector took off in August at a level 300 percent higher than a year ago. Portland, in particular, is said to have experienced more rapid expansion of commercial construction in the past three months than ever before in history. One observer listed over $300 million worth of hotel, office and hospital projects currently underway in the Portland area.

Consistent with the strong pace of construction and real estate sales, the demand for both mortgage and construction is described as "high," "brisk" and "strong" all over the district, though some areas report a leveling off in demand. Reports from Southern California, in particular, note that while mortgage demand is still strong, it is less than in the first half of the year when real estate speculation was at its peak. It is explained that most of the pent-up demand for homes has run its course and consumers have become slightly more cautious about incuring additional debt.

A number of directors addressed the question of disintermediation, but only one felt he had observed any signs of the phenomenon having actually begun. While banks in smaller towns felt there would be no problem until 90-day Treasury bill rates hit 7 1/2 to 8 percent, large California banks felt 6 1/2 percent would be enough to trigger a mild degree of disintermediation. Still, even one of these larger bankers observed that a prolonged or extensive shortage of mortgage credit similar to 1969 and 1974 is not expected because financial institutions are more liquid now and interest rates are not expected to reach double-digit levels.