

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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Federal Open Market Committee
by the Staff

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SUMMARY*

All Districts report that the economy has strengthened further in recent weeks, but inflation is a dominant concern. Consumer spending is mixed, with cold weather dampening sales of seasonal merchandise although car and hard goods sales are generally strong. Further improvement in manufacturing activity is noted, as orders and backlogs continue to rise and scattered signs surface of tightening labor and special product markets. Loan demand at banks continues strong, except in New York City, and savings and loan associations have raised mortgage rates as demand exceeds supply. Crop plantings are behind schedule and may hamper production this year.

District reports uniformly indicate that the economy continues to expand rapidly. Although there is some uncertainty over prospects for housing and some doubts about the strength of consumer spending later this year, there appears to be growing confidence that capital spending is strengthening (Chicago and Cleveland). Several Districts report officials are optimistic that the expansion will continue at least through 1978 but Chicago and Cleveland, looking further ahead, anticipate it may end in 1979. Philadelphia also reports less optimism among industrial officials than at any time during this expansion. The concern that underlies most District reports, however, is that the rate of inflation is accelerating. Practically each District notes a worsening in inflation last month, and some comment that it is their primary concern.

Indicative of the expanding economy is the continued strengthening in manufacturing activity, as reported by half the Districts. Further increases in shipments, orders, and backlogs are noted in a variety of industries,

*Prepared by the Federal Reserve Bank of Cleveland.

including steel, machine tools, food, apparel, electrical machinery, nonelectrical machinery, appliances, chemicals, and home building and construction materials (Boston, Chicago, Cleveland, New York, Philadelphia, and St. Louis). Accompanying this increased activity are reports of shortages of skilled labor (Atlanta, Chicago, Dallas, Minneapolis and St. Louis) and of castings, transportation and storage space for wheat and grain, small electrical components and cement (Dallas and Kansas City).

Retail sales present a mixed picture between and within districts. Half of the districts report strong gains in sales for April, but several others note mixed spending patterns. Generally, hard goods and automobiles are selling well, but sales of seasonal merchandise, including summer apparel and air conditioning units, have been sluggish or below expectations. Unseasonable weather apparently has hampered sales. Nevertheless, most retailers are cautiously optimistic, though they expect sales increases to moderate in coming quarters. As a result of less than expected increases in retail sales, inventories are described as at or above desired levels in several districts (Boston, Cleveland, Kansas City, New York, Richmond and St. Louis).

Credit demands are generally strong and expectations are for continued moderate strengthening during the balance of 1978. No District reports on concerns of a credit squeeze, although some look for additional firming in interest rates (Atlanta, Boston, Philadelphia). Business loan demand has been rising rapidly in some areas (Atlanta, Kansas City, San Francisco and St. Louis) but is still sluggish in New York City where alternative sources of funds tend to constrain demand (New York).

Demand for mortgage credit continues strong in all districts and mortgage rates have firmed in most districts. In response to strong demand and generally inadequate supplies of mortgage funds, savings and loans in a number of Districts have curtailed commitments or loans (Atlanta, Chicago, Cleveland, Dallas and Minneapolis). A few districts report net outflows in deposits at savings associations, (Kansas City, San Francisco and St. Louis) while others note only moderate or small increases in deposits. Uncertainty about prospects for homebuilding later this year is expressed in a number of reports that cite further increases in building costs and housing prices, higher mortgage interest rates, and a shortage of mortgage credit (Dallas, Minneapolis, San Francisco and St. Louis).

Planting is behind schedule in key agricultural regions of the country (Chicago, Kansas City, Richmond and St. Louis) because of wet spring weather and below-normal temperatures, thus raising some uncertainty over prospects for crop output in 1978. Richmond reports replanting of seeds will be necessary. While cold, wet weather has improved production prospects for winter wheat, corn planting has been delayed and initial estimates of production of corn and soybeans for 1978 are highly uncertain (Kansas City). Dallas reports drought is hampering plantings and livestock production.

FIRST DISTRICT - BOSTON

First District respondents are fairly optimistic about the economy and believe that underlying economic conditions are stronger than most published indicators suggest. In the manufacturing sector, production has picked up although some of the increase reflects the effects of severe weather in earlier months. Retailers look to somewhat slower growth this year than last but do not see any major fall-off in sales. Commercial loan demand is improving but the New England region still seems to be lagging the rest of the Nation.

Manufacturing production is recovering from the earlier effects of severe weather. New orders are rising and there has been an increase in the number of firms reporting higher backlogs. The improvement is quite general with machine tools and electronics doing particularly well. Capacity utilization has improved and order backlogs are also good for a large manufacturer of heavy capital equipment. Manufacturing inventories have increased but, while in some cases they are now higher than desired, this is not seen to be a serious problem.

Retailers expect sales to grow more slowly this year than last but they do not foresee any major slowdown. A large department store in southern New England reports that a brand new discount store is enjoying the most successful opening within its knowledge of the industry. In northern New England spring sales have stimulated activity, but consumers are showing some resistance to higher prices.

Commercial loan demand in New England is improving. Those areas which had been doing well in the past continue to report heavy demand while

other parts of the region are experiencing substantial increases. Despite this, the growth in commercial and industrial loan demand in New England seems to be significantly below that in the country as a whole. The head of one of the region's largest banks, commenting on the national banking situation, expects there to be upward pressure on interest rates throughout the year. He believes that increases in prime rates have been delayed by competition from foreign banks in the United States. This competition is felt disproportionately by the major banks in New York, so that their loan figures give a distorted picture of national loan demand. A number of large banks are reentering the real estate area. On the supply side, a large Boston bank reports that savings and NOW deposits are flat, while a representative of the region's thrift institutions observes that their deposits flows, on a seasonally adjusted basis, have been negative for several months.

Professors Houthakker, Solow, Samuelson, and Tobin were available for comment this month. They all agree that the economy has not yet attained full capacity production. Tobin and Houthakker, in particular, find no indication of imminent production bottlenecks in capacity utilization data, and the comparatively low rate of investment spending predicted for 1978 only reinforces their conviction that businessmen do not expect current and prospective levels of output to strain capital resources.

No respondent believes that labor shortages are imminent. Tobin, noting the relatively high unemployment rate of prime workers which still prevails, sees no evidence of a sustained acceleration in wage inflation. Both Tobin and Solow feel that the recent growth of Public Service Employment may be "distorting" reported unemployment rates; accordingly, the Fed may have to

interpret unemployment rates cautiously. Solow is puzzled by the recent increase in employment which accompanied the first quarter's fall in real GNP. However, because employment responds mainly to confirmed trends in real growth, last quarter's slump in GNP followed by this quarter's compensating rebound may leave the unemployment rate essentially unchanged during the first half of 1978. Solow's forecast of 3 to 4 percent growth for the remainder of 1978 and the first half of 1979 suggests that the unemployment rate will remain near 6 percent at least until the summer of next year.

Houthakker and Samuelson insist that the "natural" rate of unemployment should be defined according to objective, technical criteria, and they agree with Tobin and Solow that the natural rate is not as high as 6 percent. Houthakker claims that the natural rate of unemployment is between 4.5 and 5 percent: "The economy is not now at full employment unless it is defined in an unnatural way." He believes that the economy is still recovering and that there is danger in prematurely arresting the process before full capacity is attained. According to Samuelson, there has been no change in the technical evidence in the past year or two to warrant believing that the natural rate of unemployment has been increasing. Samuelson suggests that monetary policy can do little to reduce significantly the current rate of inflation short of causing a recession. Furthermore, he is concerned that "restrictive monetary policy encourages more aggressive fiscal policy which is a recipe for a low rate of capital formation."

SECOND DISTRICT - NEW YORK

Business conditions in the Second District continue to improve according to the recent comments of directors and other business leaders. At the same time, the threat of worsening inflation remains a dominant concern. Many respondents are apprehensive that wage demands may stiffen in the wake of the coal miners' settlement. While the President's expressed concern over the deteriorating price situation was applauded, the substance of the proposed anti-inflation program was questioned by many. Among notable developments at the regional level, retail spending has been mixed lately; new orders for durable goods are expanding; and industrial inventories appear likely to grow. On the financial scene, business loan demands at large New York City banks continue to be sluggish.

The sales experience of District retailers in April and early May was thoroughly mixed, and generalizations are difficult to make. Appraisals of overall business ranged from "exceptionally strong" through "fairly satisfactory" to "disappointing" and, in one case, "disastrous." Some merchants posted large gains in sales across virtually all product lines, especially apparel, home furnishings, and appliances. District automobile dealers also reported renewed strength in new car sales. In some cases, aggressive promotional activity was credited for the brisk sales, but other merchants experienced reasonably strong demand in the absence of unusual promotional activity. Those retailers experiencing disappointing sales cited the early Easter, which had accelerated some seasonal buying into March, and unseasonably cold weather since Easter. In general, merchants were optimistic that warmer weather would stimulate sales of summer apparel. While retail inventories

appear to be a bit on the high side, they are not terribly worrisome.

Outside the retail sector, District industrialists generally reported steady strengthening in business. Although the degree of strengthening varied somewhat, several respondents noted a pickup in new orders in recent months. The chairman of a major cable manufacturer reported business was well above projections. On the other hand, the treasurer of a capital equipment producer noted that while capital spending on mining and road construction was on the rise, business spending showed little growth. Inventory stocks appears to be in good balance or perhaps even a little bit lean relative to shipments.

Inflation remains a dominant concern among respondents. Several of the directors and business leaders contacted foresaw a worsening in the underlying rate of inflation. These respondents were apprehensive that price pressures may intensify as a result of increased labor demands in the wake of the recent coal labor settlement. Other respondents saw no worsening in the fundamental rate of inflation. A distinct minority of respondents felt that the coal settlement would have no material effect on negotiations in other industries. For example, the president of a large New York City utility called the bituminous coal situation "unique", and an upstate banker characterized the settlement as a "traditional aberration."

With regard to the President's anti-inflation program, respondents generally applauded the higher priority being attached to reducing inflation. Most respondents were skeptical of the long-term effectiveness of the program, however. Indeed, several noted that the President's message could exacerbate the problem of inflation by encouraging large wage settlements and price increases in anticipation of stronger restrictions in the future. A banker noted that the anti-inflation program had been successful in defeating an inflationary farm bill.

Business loan demand at major New York City banks continues to be sluggish. Senior lending officers at three leading banks reported particular weakness in short-term lending due to underutilization of credit lines by major corporate customers. These respondents attributed this weakness to the importance of corporate liquidity at large firms due to strong cash flows and the availability and attractive cost of issuing commercial paper. One slight sign of increased demand in the future was cited by the chairman of a major bank who noted that there had been an increase in lending facilities although these facilities remained unused. With respect to the eurodollar market, respondents noted that the gradual increase in loans to nonbank foreign-based firms by overseas branches of U. S. banks may have diverted some loan demand from New York since 1973. Much of the current business lending at New York banks appears to be taking the form of floating-rate term loans or equipment and working-capital loans. Outside of New York City, business loan demand appears to be increasing, but according to some New Jersey bankers, it is not keeping pace with the increases in consumer instalment loans. Reports of below-prime lending by some New York City banks continue to circulate, and several bankers indicated that competition might soon force them to institute some type of super-prime rate structure to keep their largest corporate customers.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that the local economy is continuing its expansion in May. Retail sales are up significantly from the corresponding period in 1977. At the same time, manufacturers report another uptick in activity in their sector, along with some improvement on the employment front. With regard to the future, however, there is mixed opinion. While retailers look for further real gains in sales, optimism in the industrial sector has dropped to its lowest point in this recovery. Area bankers say business borrowing is strong this month, but don't expect any further pickup this year. Interest rates are expected to rise another 25 to 50 basis points by year-end, with the possibility of greater hikes if inflation accelerates further.

Manufacturers responding to the latest Business Outlook Survey give a clear indication that the upswing that started in March is continuing. Over 40 percent of the respondents this month say business has improved since April. A Director of this Bank in a nondurables industry confirms that May has been a strong month so far. In terms of specific indicators, new orders and shipments are higher in May, while inventories are down significantly for the first time since the beginning of 1977. The current surge has given a boost to manufacturing employment also. Larger work forces are reported at one-fourth of the firms sampled, while the average workweek is longer at a slightly smaller proportion.

Although manufacturing executives are still generally bullish for the longer term, optimism is, on average, less widespread now than at any time during the current expansion. Reflecting this, the proportion of

respondents anticipating growth in new orders and shipments over the next six months is shrinking. Inventories are expected to remain unchanged between now and November. Despite this gloomier forecast though, respondents still anticipate an increase in factory payrolls six months down the road, and project higher expenditures for plant and equipment.

On the price front, inflation appears to have worsened slightly in May. Fifty-six percent of those polled report higher prices for raw materials this month, and 38 percent say they are charging more for their finished products. Comments by a Bank Director in the food industry agree with these reports. He says that all costs of production, including labor, are rising and that he will have to raise the prices of his products to maintain current profit margins. Looking ahead, about 9 out of 10 Survey respondents anticipate paying more for inputs by November, and about 2 out of 3 expect to be charging more by then for the goods they sell.

Third District retail sales are strong in May. Reports of current dollar sales range from 6 to 20 percent over year-ago levels, and would probably be higher were it not for unseasonably cool weather. These figures may be slightly inflated though, because sales at this time last year were depressed in the Philadelphia area by a public transit strike. Nevertheless, sales are outpacing expectations by 1 to 4 percent at the stores contacted. Inventories are at desired levels, on average.

Looking ahead to the rest of the year, most area merchants are optimistic. Although one contact anticipates sales growth of only 5 to 6 percent over year-earlier levels, most look for larger gains of 10 to 16 percent. One dark spot in sales projections, however, is inflation. Several retailers contacted feel that the current upswing in sales is the result of

consumers trying to hedge against future price increases. If this is true, they point out, sales will slow in the coming months, as buyers start to pay for merchandise bought now.

Commercial bankers in the region say business loan demand is stronger in May. Current levels of C&I loans are reported to be between 4 and 10 percent above year-end '77 levels, and as much as 7 percent over planned volume. Contacts say the bulk of the demand is from larger companies outside of the immediate area.

As for the future, bankers forecast generally flat loan demand and gradually rising interest rates throughout the remainder of 1978. The prime rate (currently 8 1/4 percent at all of the banks contacted) is projected to be in the 8 1/2 to 8 3/4 percent range by year-end. One banker puts a caveat on the prediction, however, saying that if inflation worsens, the prime could go to 9 percent.

FOURTH DISTRICT - CLEVELAND

Officials and economists in the Fourth District have expected a surge in income, production and sales this quarter, but recent high rates of inflation have raised uncertainty over continued expansion for another year. Auto producers and suppliers anticipate some letup in sales from recent high rates, and retailers see little prospect for improvement in sales of nondurable goods. Steel production is expected to rise to about 90 percent of capacity this quarter; coal production has rebounded virtually to capacity. Mortgage loan demand continues strong, and mortgage rates have firmed in response to weak growth in deposits.

A vigorous recovery in output is widely expected this quarter, with some economists forecasting real GNP gains as high as a 9 percent annual rate. Even at this higher rate, however, real GNP for the first half would fall short of expectations held earlier this year. One frequently cited reason for this anticipated shortfall is a higher than expected rate of inflation. Some economists believe the sharpness of the recovery is conducive to price increases in those industries that have not been able to raise prices because of relatively weak markets. Also mentioned as an additional factor in inflation is the increasing use of marginal labor that has added to costs.

The recent sharp pickup in consumer spending has not been uniform. While auto sales surged, consumer spending for nondurable goods has been relatively flat. The March-April surge in new car sales is explained as a make-up from the poor economy and severe winter weather. Although pleased by the comeback in sales, economists with major auto suppliers expect some letup from the recent 12 million annual rate to about 10.8 million units for the year.

An economist with a major producer expects that sales this quarter will range between 11.4 to 11.7 million units (2.0 million imports) and average at least 11.1 million sales for the year.

Strength in auto sales has not been matched by increased sales for some other types of consumer goods. An economist with a national retail chain states that despite recent impressive gains, sales increases only equalled their earlier expectations for an 8 percent year-over-year gain for the February-April period. There was little recouping of earlier sales losses. Apparel and soft goods sales have been sluggish for the past several months and inventories are more than ample. In his view, retailers face a sharp reduction in profits for the next few quarters with general merchandise sales increases of about 3.5 percent in real terms from the fourth quarter of 1977 to fourth quarter of 1978. Similarly, retail sales of personal care products and packaged foods have shown little if any gain in real terms compared with a year earlier.

Steel industry economists expect production to increase to about 90 percent of effective capacity this quarter from last quarter's 80 percent rate. Order cutbacks are not evident yet, but one economist expects a usual seasonal slump in orders and production next quarter as steel consumers realize that inventories are ample and supplies are readily available. Imports last quarter were at a record high level for that quarter, and it is unlikely that the full impact of trigger pricing of steel will be felt until the third quarter, according to one steel economist. Profits are expected to improve sharply this quarter following another weak performance last quarter. Still, higher profits will not result in increased capital spending.

Coal production is rebounding rapidly from the strike. Output recently has been boosted to more than 15 million tons weekly, compared with a low of 5 million tons during the strike. An economist with a major coal producer expects production will soon reach pre-strike levels of 16 million tons weekly and may rise to 17 million tons by yearend. Coal stocks at the end of April were at a 67-day supply but should be much higher to meet seasonal demand in July and August. Consequently, a shortfall in stocks would concern utilities which may be forced to purchase coal at higher prices in the spot market.

Capital goods producers are growing more confident over prospects for 1978 and early 1979 than they were at any time in this expansion. Expectation of at least a 7.5 percent real gain seems common. Orders for electrical equipment, communication and printing equipment have been rising more rapidly than shipments for the past several months, although the rate of increase in new orders has not accelerated. Machine tool orders revived strongly and set new highs last quarter, according to machine tool builders.

Mortgage terms continue to firm in response to softness in deposit flows and strong level of demand. S&Ls raised rates at the beginning of May by $\frac{1}{4}$ percent to $9\frac{1}{2}$ percent for an 80 percent loan, and some are charging $10\frac{1}{4}$ percent for a 95 percent loan. Some associations no longer are making 95 percent loans and also are cutting back lending in national markets. While a number of officials state it is too early to determine whether double-digit mortgage rates will curtail demand, some feel prospective homeowners are willing to pay high rates because of inflationary expectations. Deposit flows continue to fall short of projections, but some S&Ls have been aggressively attracting deposits by raising interest rates to maximum levels on all types of deposit

accounts. A major S&L reported that deposit flows in April exceeded their projection and so far in May deposits have equaled projections. S&Ls have hesitated to issue mortgage-backed securities because of the high costs relative to lending rates in this region.

FIFTH DISTRICT - RICHMOND

Business activity in the Fifth District continued to expand in April at about the same pace as in March. Responses to our survey of manufacturers suggest continued strength in new orders, with further increases in backlogs and some slowing in the rate of inventory accumulation. Retail activity apparently settled back somewhat after several months of brisk expansion, but continues firm, especially in big ticket items. Manufacturers' expectations also improved over the last month marking the end of the psychologically dampening effects of foul weather and the miners' strike. Credit demands at Fifth District banks have strengthened somewhat in recent weeks, with business leading the way. There is some indication that a slowing of deposit inflows at District S&L's over the past month is beginning to impact on terms of lending.

Of manufacturers responding to our survey, over one-third report increases in shipments, new orders, and backlogs in the past month. The growth of inventories, finished goods and materials, has slowed considerably in the last two months, but stocks generally remain at higher than desired levels. Manufacturing employment also picked up in April after declining in the two previous months. The gains, however, were scattered rather than pervasive. Areas of current strength in manufacturing include food and kindred products, apparel, non-electrical machinery and equipment, and chemicals. Some weakness was reported by manufacturers of electrical equipment, while the furniture and primary metals producers have apparently experienced little or no change in the level of activity.

Retail respondents report some slippage in total sales during April following several months of vigorous expansion. Big ticket items continue to

move well, however, Retail employment was down slightly over the month. Inventories were up a bit and remain somewhat above desired levels.

Reports from both manufacturers and retailers continue to indicate widespread price increases. Both groups report further increases in prices paid, including employee compensation, and prices received. Nevertheless, respondents remain basically optimistic, expecting continued improvement in business activity nationally, locally, and in their respective firms over the next six months.

Credit demands at Fifth District banks have strengthened somewhat in recent weeks, with businesses leading the way. Both consumer and real estate loans have started to increase from the essentially flat patterns established over the first few months of the year, but the rates of increase in these categories do not match those of a year ago. Commercial and industrial loans at both large and smaller banks, however, are stronger than at the same time a year ago. The smaller banks especially are experiencing robust demand for business loans. Loan proceeds are being used for working capital and fixed investment, with smaller sized businesses accounting for the greatest share of loan volume. Usage of credit lines by national firms is still quite low. Bank time and savings deposits net of large negotiable CD's are increasing at a healthy rate, while negotiable CD's are being allowed to run off.

Soil moisture supplies are rated adequate to surplus throughout most of the District. Because of the wet soil conditions and below-normal temperatures, spring planting is running behind schedule and prospects for good germination of earlier planted seed are in question. Some replanting will undoubtedly be necessary. Fruit crops generally remain in good condition, except for some recent scattered hail and frost damage in South Carolina.

Despite the threatened farm strike last winter, the District's farmers as of April 1 reported intentions to reduce 1978's total planted acreage by only 1 percent from that in 1977. Some significant shifts among the various crops are in the works, however. Major acreage cuts are planned for cotton, wheat (seeded last fall), and corn, while sizable increases are intended for soybeans, other small grains, hay, and sweet potatoes.

Our farm credit survey for the first quarter of 1978 revealed that the farm loan repayment experience of District banks has improved significantly, while requests for renewals and extensions have dropped sharply, since the final quarter of 1977. Much of this improvement results from farmers' receipts of funds from the Federal drought disaster loans. Demand for farm loans from banks is unusually strong. Reportedly, bank supplies of loanable funds are at the lowest level since this survey began in September 1975. Few bankers, however, have been forced to refuse a farm loan because of a shortage of funds.

SIXTH DISTRICT - ATLANTA

Business activity has been quite strong since last report. The pace of retail sales has remained healthy, though perhaps a shade less robust than in March. A continuation of exceptional business loan growth has encouraged a rise in local prime rates. S&Ls in a few cities have cut back on new mortgage commitments. Capital spending decisions have broadened the nonresidential construction base. Transportation costs have been pegged as sources of price pressures. The employment outlook is good, and port business is excellent.

Consumer spending continued to show strong year-to-year gains in April, although there are indications that buying activity moderated from the hectic March pace. A slight loss of sales momentum noted by Florida department stores in late April probably reflects the beginning of a seasonal lull after record levels of tourist inflows. Jewelry and hard goods sales have been described as brisk. Auto sales edged down during the month, but dealers are generally quite pleased with the improvement from the April 1977 pace.

Business loans continue to surge at District banks, with trade and manufacturing firms borrowing especially heavily in the latest weeks. Several of the larger banks raised their prime rates to 8 1/4 percent within the past week. Inflows of household time deposits have been moderate.

With lower levels of savings inflows and higher borrowing costs, S&Ls in Jacksonville, Nashville, and Knoxville have shown signs of backing off from new mortgage commitments. In Jacksonville, the cutbacks are being accomplished via selection rather than rate increases, but some associations

in the Tennessee cities have raised rates another quarter point to 9 3/4 percent (for 80-percent mortgages). The higher rates have increased the points that must be given up in selling VA and FHA loans. One director says that Nashville lenders have virtually stopped making such loans, while in Knoxville, homeowners are reluctant to sell to applicants for guaranteed loans. Builders in that city are either not building to FHA specifications or are raising prices to cover the point gap.

Recent plant announcements add variety to the industries and locations included in the Southeast's capital spending gains. Within the past year, announcements of large goods-producing facilities have been largely confined to the electronics and phosphate industries in central Florida, chemical or paper operations, mainly in Louisiana, and tire plants in Alabama. Georgia took the honors last month, as CBS, Oscar-Mayer, and Miller all committed to substantial investments in that state. Trade and distributive industries will provide more of a push to commercial investment (which has been dominated for the last year or so by tourism-related ventures), with a large chunk of speculative office space in the planning stage in Tampa and public and private improvements to ports and airports under way in several cities.

In Florida, rising prices of tires and equipment are squeezing profits in truck leasing and transport, but demand is strong. One director remarked that a truck shortage has driven up the cost of transporting perishables out of state. Truck hauling rates were listed among the major contributors to inflation of construction materials prices by another director; other items were cement, stone, spare parts, rail freight rates, fuel, electricity, insurance, and wages. TVA estimates that coal workers'

wage increases will add 6 percent to the cost of its services over the next three years.

Wages won't put much pressure on overall construction costs in North Florida, where contractors have negotiated a 3 1/2-percent increase for each of the next two years with five of seven major construction workers' unions. Ample supplies of nonunion labor allowed the low settlement. Heavy in-migration of semiskilled nonfarm workers is reported to be holding up Florida's jobless rate. There, and throughout the District, skilled labor seems in short supply. Surveys of hiring plans and the labor requirements of new investments indicate that the outlook for District job growth is very good.

The District's ports have been extremely busy. Auto imports generate much of the activity at Jacksonville and are expected to advance 25 percent during 1978. Recent agreements suggest that substantial exports of oranges to Japan will continue; a new ship, built expressly to carry the fruit to Japan and return with Toyotas, is now operating out of Jacksonville. Other developments at the Jacksonville Port include a decline in steel imports, stable coffee imports, and "good" wood pulp exports but virtually no paper exports. The booming phosphate industry accounts for a sizable share of export growth at the Tampa Port and, to a lesser extent, at Jacksonville.

SEVENTH DISTRICT - CHICAGO

The business expansion in the Seventh District continues on a broad front, and with a minimum of disruptive influences. Concern is growing that price inflation is proceeding at a faster pace. Consumer spending is strong overall, but cold, damp weather has held back sales of seasonal merchandise. Capital expenditure prospects have strengthened, with a growing boost from non-residential construction. Demand for mortgage credit is "intense." The financial position of the farm sector has improved.

Business and financial executives are worried over inflation (apparently accelerating), increasingly onerous government regulations, the federal deficit, the trade deficit, and other national and international problems. Somewhat surprisingly, virtually all executives expect improvement in the sales and profits of their own enterprises. Many expect the expansion to level off or turn down in 1979, but the signs are not yet evident, except perhaps in the residential mortgage sector.

New hiring continues at a good pace in most centers. Complaints are increasing, however, over the quality of job applicants, especially for jobs requiring acquired skills.

A number of large general merchandise chains in the District report that sales of seasonal merchandise have fallen short of expectations in the past several weeks. This is attributed partly to bad weather and partly to the aggressive pricing and promotions of a very large national chain. Big ticket items are generally selling well, including appliances, furniture, autos, and light trucks. Demand for instalment credit is very strong, and availability appears ample. Telephone utilities report a large rise in new

installations and toll calls. Airline traffic continues to exceed forecasts made early in the year, for full fare as well as discount traffic.

Orders for capital goods have improved fairly steadily since the start of the year, and backlogs have been building--to record highs for some firms. Among the strongest sectors are heavy trucks, freight cars, machine tools and equipment for construction, materials handling, lumbering, and communications. Among the weaker sectors are farm equipment, large mining shovels, draglines, and environmental systems--the latter affected by a lag in availability of federal grants.

Nonresidential construction activity is picking up, mainly for commercial but also for industrial buildings. Leasing of vacant commercial structures has been picking up rapidly "throughout the country." Ten large office buildings in Chicago's Loop are now underway or will be started this year. Activity is also very strong in some far-out suburban areas. Other large district centers do not match Chicago's performance.

Inflows of savings to S&Ls improved in March, but were down 60 percent from a year ago in April. The standard mortgage rate in the Chicago area is now 9.75 percent, plus 2 to 3 points, with some S&Ls at 10 percent. The mortgage terms picture has changed rapidly in the past several weeks. Some S&Ls have adopted a "customers only" policy. With the help of FHLB loans and sales in the secondary markets, mortgage volume on both new and used homes may be as large as last year. This would mean fewer units, however. The market for single-family homes is called "phenomenal," and availability of rental units is low, partly because of condominium conversions.

Farmers made considerable headway in spring field work last week, but overall progress-to-date is about three weeks behind normal. Heavy rains this

weekend point to further delays.

District farmland values rose nearly 4 percent in the first quarter. Very few agricultural banks note an increase in land purchases by foreign investors.

Incomes of district farmers have been boosted by the 7-month rise in prices of feed grains and livestock. Farm loan repayments improved further in the first quarter, although the rate is still somewhat slow. Loan-to-deposit ratios at rural banks rose to a new high. An unusually high proportion (44 percent) of the banks are operating with higher-than-desired ratios.

Steel demand is the strongest since the expansion began. One producer expects to operate at capacity through June. A larger share of steel shipments is for capital equipment and nonresidential construction. Steel warehouses appear to be turning away from imports, apparently expecting higher prices and/or problems of availability.

EIGHTH DISTRICT -- ST. LOUIS

Business activity in the Eighth District has continued to register gains in recent weeks. While consumer spending on many summer-related items has been retarded by unfavorable weather, automobile sales have shown considerable strength. Inventories of some items are reported to be higher than desired, but this situation is not viewed with alarm, and retailers generally remain optimistic about future sales gains. Manufacturing activity continues to advance in several key industries, including suppliers of homebuilding products, transportation equipment, and chemicals. Demand for single-family homes continues to be strong, but concerns were expressed by homebuilders about their prospects next year. Some savings and loan associations, as well as commercial banks, registered either declines or no change in time and savings deposits in April. With strong demand for mortgage credit, mortgage interest rates have continued to increase. In the farming sector, crop planting is behind schedule, although the situation is not critical at this time.

The movements in retail sales were mixed in April as department store sales were reported to be somewhat sluggish, but automobile sales registered further gains. The sluggish performance of department store sales was largely blamed by retailers on the colder-than-normal spring weather which hampered sales of such items as summer clothing and air-conditioning equipment. Inventories were reported to be somewhat excessive for these items, but the sales slump is not expected to be permanent and the inventory buildup is not considered to be a serious problem at this time. Retail passenger car and truck sales in April registered gains relative to a year

ago and dealer inventories are at desired levels for most models.

Manufacturing activity continues to expand. Firms supplying the homebuilding industry are among those experiencing continued strong demand. A representative of a major appliance manufacturing firm reported sizable increases in orders, particularly from the contract business, but felt that the current growth rate was not sustainable over the longer term. Firms manufacturing such building products as connector plates, electrical fixtures, tools, other hardware, paints, and coatings reported strong demand. In general, however, the gains in 1978 are expected to be less than in 1977. The transportation equipment industry is another sector showing strong performance in the District. A representative of the automobile industry reported automobile orders are running above a year ago and assembly lines are operating at a high level. Aircraft, railroad car, and barge manufacturing firms are also experiencing high levels of demand for their products. The chemical industry, a major industry in the District, has also made some gains recently. A representative of a major chemical firm reported strong demand for agricultural and industrial chemicals and some pickup in demand for fibers after a poor first quarter.

The District housing industry continues to "boom" with the gains concentrated in the single-family market. The large order backlog of new homes in the St. Louis area has not yet dissipated, reflecting continued strong home sales. As construction activity has gained some momentum this spring, shortages of skilled workers and bricklayers are beginning to show up. However, such shortages are not viewed by homebuilders as an insurmountable problem and apprentice programs are bulging. Homebuilders are beginning to express some fear about a sharp decline in home demand in the future. Their

special concerns are the possibility of disintermediation, rising mortgage rates, and the continuation of sharply rising costs of building supplies. Builders report that the cost of building materials rose about 15 percent last year.

Representatives of some savings and loan associations reported a net outflow of deposits in April. This was said to reflect improved yields on short- and medium-term securities as well as renewed interest in the stock market. Representatives of the savings and loan industry report increased advertising budgets and more offerings of premiums in an attempt to maintain or advance their market share of savings. With strong demand for mortgages, considerable upward pressure has been placed on mortgage interest rates. Rates have advanced about 1/4 of one percentage point in the St. Louis and Memphis areas since last month. Considerable concern was also expressed by savings and loan representatives about the recent action of the Federal Reserve which allows automatic transfers between savings and demand accounts at commercial banks. These officials fear that interest-sensitive funds would be withdrawn from their institutions and thus reduce the supply of credit to the housing industry.

Similar to the savings and loan associations, small consumer time and savings deposits at large commercial banks registered little or no increase in April from a month earlier, although sizable increases in the volume of large CDs occurred. Loan demand at commercial banks showed considerable strength in April in both commercial and industrial loans and consumer installment loans.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District's economy is showing general improvement midway through the second quarter, according to most indicators. Retail sales, which were somewhat disappointing earlier this year, are picking up. Farm receipts are improving, and livestock producers in particular are expecting better cash flows this year. As a result, agricultural bankers are noticing fewer farm debt repayment problems and are actively seeking new loan accounts. Labor markets have tightened as district economic activity has advanced, but no serious labor shortages have emerged. Homebuilding has been strong in most areas, though increasing costs and mortgage rates have raised some concerns that housing activity may slow later this year.

Retail sales pick up

Although retailers probably will not make up all the sales postponed due to poor weather in the first quarter, directors now report that sales are good to normal in most areas. Auto sales are said to be increasing at about the normal seasonal rate after fears that even this increase would not materialize. The good demand for used cars provides some evidence of consumer resistance to high new car prices, however.

With the advent of warmer weather and improving farm income, our directors unanimously report that retailers are optimistic about the coming months. One director expects summer tourist spending to be especially good in his area.

Directors also report that most district retailers are satisfied with their inventory positions. Only auto dealers appear to be somewhat overstocked.

Farm earnings improve

District farm cash receipts came in 10 percent above a year ago in the early months of 1978 because of subsidy payments and improved commodity prices. Hog, beef, and dairy operations have become profitable, and farmers who had been holding personal and operating expenditures to a minimum now seem to be spending more as a result.

Parenthetically, the government set-aside program will probably not have a significant impact on crop production in the district. According to directors, the percentage of farmers signing up for set-asides varies from 25 percent in some areas to 80 percent in others. However, directors note that farmers can still withdraw from the program and are likely to do so if market prices continue to rise.

Ag bankers optimistic

Rural bankers responding to our April survey report that due to better farm earnings farm debt repayments have picked up. Consequently, loan-to-deposit ratios at these banks have not increased in the last two quarters, and most are making fewer loan referrals to their correspondents or to nonbank credit agencies. Few bankers currently expect problems meeting loan demands, and most are actively seeking good loan accounts.

Labor markets tighten

As the regional economy has improved, labor markets have tightened. The district's seasonally adjusted unemployment rate has declined each month this year, averaging 4.4 percent in the first quarter. Directors report that the demand for skilled workers is

particularly strong relative to supply throughout the district, but most areas have not yet had serious hiring problems.

Housing remains strong despite uncertainties

Homebuilding has been quite good so far this year. Housing permit activity seems to have picked up again from the January lull, and loan commitments at S&Ls are running at a seasonally adjusted annual rate of 17 percent above the fourth quarter.

Directors disagree about whether this pace will continue the rest of the year.

Several directors are very concerned that increased home prices, rising mortgage interest rates, and funds shortages will temper homebuilding activity. For example, several financial institutions in the Duluth area claim to have stopped accepting mortgage applications due to reduced deposit inflows. A few directors expect a slowdown in homebuilding in their areas because the current supply of new housing is somewhat excessive.

But other directors are confident that homebuilding will continue at a relatively high pace. One director cites the example of a modular homebuilder in his area who is experiencing very strong demand. A metro area banker thinks high lumber costs and rising mortgage rates will affect homebuilding later this year but not seriously because many builders have already obtained the necessary financing to get through 1978.

TENTH DISTRICT—KANSAS CITY

The Tenth District economy seems to be in good shape after a weather-depressed first quarter. Spring has been cold and rainy, but retail sales have shown a strong seasonal increase. Department store executives believe their inventory levels to be excessive, although they expect rising sales will take care of the problem. Purchasing agents drawn from a cross section of businesses report lengthening lead times for some items, and continually rising prices for almost all inputs. Inventories of materials are generally considered to be at satisfactory levels. The wet spring has been good for the winter wheat crop, but it has delayed corn planting. Looking ahead toward the grain harvest season, transportation and storage problems can be anticipated. In banking, loan demand continues strong, although farm loans have declined, and total deposits are growing well despite flat-to-declining levels in time and savings deposits.

Retail sales this spring at District department stores are up healthily over last year, and store executives are optimistic that consumer demand will continue to rise at least modestly in coming months. Inventories at retail, however, are reported to be "too high", largely because of sales that did not materialize during the unseasonably cold winter weather. Price increases at wholesale, the retailers report, are routinely passed on to the consumer by maintaining a customary percentage markup over cost.

The prices of raw materials and intermediate goods are generally 6 to 10 per cent above those of last year, according to purchasing agents in the District. While the prices of certain inputs are up even more (e.g., lumber and pulpboard), the prices of a few others are actually lower than those of a year ago (e.g., denim fabric). Lead times on orders of capital goods are

lengthening, say purchasing agents, naming castings as an item in especially short supply. Most buyers say their inventories of materials are at satisfactory levels, although a majority of those who are not satisfied are trying to reduce stocks.

Although the cold, wet spring across the Great Plains and Middle West has improved production prospects for wheat, it has created some problems for corn and soybean producers. After a late start, corn planting is now under way. However, additional delays much past the middle of May could well result in lower total U.S. corn acreage than presently anticipated. At this time, it is uncertain whether producers would then switch acres from corn to soybeans or increase their participation in the Government's feed grain diversion program. Thus, initial corn and soybean production estimates for 1978 incorporate a high degree of uncertainty.

Although initial projections for 1978 U.S. wheat and feed grain production are down from 1977 levels, storage space for the new crop will likely be tighter than at any time in recent years. Transportation delays and the loss of storage capacity (principally at export elevators) because of elevator explosions have compounded the space problems in many rural areas. These transportation problems are unlikely to be resolved before the 1978 wheat harvest begins. Consequently, farmers may experience some short-term cash flow disruptions as a result of their inability to market 1977 and 1978 crop production as quickly as they might like.

Tenth District bankers report that loan demand continues to grow at a rapid pace. Business loan demand is particularly brisk, with large increases in both loans to businesses supplying firms active in the oil fields and in term loans for petroleum and mineral production. Construction lending has

increased sharply, and loans to mortgage bankers are up. Borrowing by agribusiness firms, especially grain elevator companies, is strong. However, farm loans have declined, due in part to funds being available from Government support programs. This decline in farm loans has increased the liquidity of country banks, and the loan demand of country banks has, consequently, been slack. Demand for real estate loans is strong. Consumer loan demand is moderate.

All of the bankers surveyed report strong deposit growth. Demand deposits are up sharply, but time and savings deposits have leveled off or are declining. Further increases in interest rates are expected to result in additional savings outflows, especially at thrift institutions. Bankers expect to have sufficient funds to meet loan demand over the next few months.

ELEVENTH DISTRICT - DALLAS

Directors and businessmen interviewed this month report few changes in the strong pace of economic activity in the Eleventh District. Most respondents expect the regional economy to expand at the current rate of increase through the summer and then slow gradually the remainder of the year. Department store and new car sales continue strong despite recent runups in retail prices. Banks report further growth of time deposits, but passbook savings continue to decline at both banks and savings and loan associations. With home buyers anticipating a sharper tightening of the mortgage market in coming months, prospective borrowers are now more actively seeking mortgage commitments before rates and nonrate terms are raised further. Home builders are experiencing a modest "boom" in activity as work delayed by bad weather is being resumed. Manufacturers report only moderate additional gains in their already high level of output. Drought conditions continue to hold down livestock and crop production over a wide area of the District.

Department store sales for the year to date are 15 percent ahead of the comparable period last year, but month-to-month gains are slowing. Inventories are generally in line with current sales levels. Some stores report that price increases on many goods are beginning to accelerate and that retail prices next fall may be 8 percent higher than the year-earlier level. Aside from hedge-buying of jewelry, there is no evidence of a ground swell of advanced purchases by consumers to avoid further price increases.

Continued price markups for imported cars are having little visible effect on sales. The major constraint on overall sales appears to be low inventories of current models at most dealerships.

Bankers report that total deposits continue to show moderate growth on the strength of time deposits--especially issues of large certificates of deposits. Passbook savings, however, continue to post declines. Loan demand remains robust across the board. Petroleum-related and real estate loans are particularly strong. The growing number of energy-related construction projects and the strengthening of the multifamily residential market are providing much of the demand for real estate loans.

Savings and loan association executives are growing increasingly concerned as net savings inflows have dropped well below the level a year ago. Executives believe that consumers prefer to spend their money now rather than having savings reduced by inflation. Despite the slowdown in passbook savings, maturing CD's are generally being renewed. But competition for large-denominated CD's is particularly stiff as rates on some issues have reached 9 percent.

Conventional mortgage rates on 80-percent loans have now risen to 9 3/4 percent in Dallas and 9 1/2 percent in most other major metropolitan areas. A recent increase in mortgage demand was apparently due to borrowers' fears that rate and nonrate terms will be tightened further in the near future. Dallas area S&L's have begun to shorten their commitment periods.

Residential construction activity remains strong. Much of the recent activity appears to be a catchup in weather-delayed work earlier this year. Home builders are optimistic that starts will remain near last year's level and are expecting slowdowns in other parts of the country to free materials and funds to support local construction activity. However, many industry observers are forecasting a slowdown in demand and an excess supply of homes by yearend.

Because of the boom in construction, cement is increasingly in short supply. Cement was unavailable for delivery on one recent day, and construction delays of up to four months have been reported on some projects because of ongoing shortages. Texas, for the first time, has become a net importer of cement, and a growing share of imports is coming from Mexico.

Manufacturers report no major changes in industrial output during the past month. Skilled labor remains in tight supply. There are shortages of small electrical components, and a paper manufacturer notes occasional shortages of rail cars. An aluminum smelter was forced to close recently because of the rising cost of electricity produced by gas-fired generators, but the company reported that its other plants, which depend on lignite-fueled electric generators, are operating at 100 percent of capacity.

Dry weather continues to take a toll of livestock production, while dryland farmers in western areas of the District await more rain to complete plantings. Because of drought conditions, ranchers in South Texas are reculling and reducing the size of herds. One rancher, for example, was forced to sell 400 head of breeding stock to avoid losing them. The lambing rate in the Edwards Plateau area is running half the normal rate. Cotton and grain sorghum plantings are being held up in areas of West Texas until more rainfall improves dryland conditions. Irrigated crops are faring well now, but they, too, will require more rainfall to hold down the high costs of running irrigation pumps and to supplement underground water supplies.

TWELFTH DISTRICT - SAN FRANCISCO

The western economy continues strong, though a few trouble spots are beginning to emerge. While retail sales and industrial production continue to grow, two industries are at or near full capacity. Inflation expectations of our Directors average about a point above the most recent Board of Governors' forecast. And while mortgage loan demand continues strong even in the face of rising rates, some thrifts worry about running out of money.

Retail sales continue strong in the West. The largest department store chain in the Los Angeles area reports sales to be up considerably during the past month. An expected weakness in sales around income tax time was reported in one area. Auto sales were said to be booming in Seattle. Auto sales and auto dealer profits were reported brisk in Utah. Both auto and truck sales were reported strong in Oregon.

Two western industries are reported to be at full capacity. The rolled aluminum industry (which represents 50 percent of all U. S. aluminum production) is running at capacity, and shortages accompanied by higher prices are expected over the next few years. Reports from the forest products industry indicate that full capacity has either been reached or will be by mid-summer.

Our Directors expect inflation over this year to be about 8 percent, with individual forecasts ranging from 7 to 11 percent. Most see increases in the price of supplies to their firms and consequently increases in their product prices. One university reported an average 8 to 10 percent increase in faculty and staff compensation, and an associated 9 to 10 percent tuition hike in the fall. Reports from both agriculture and aluminum industry observers noted sharp increases in energy prices. A forest products

representative argued that environmental pressures and government timber policy were generating higher raw material costs for his industry.

Western cattlemen are enjoying the best prices in five years, but most are operating with sharply smaller herds so that total revenue gains are not yet sufficient to offset the losses of the past few years. Even though many crop prices are still considered very low, this does not appear to have dampened spring planting intentions.

Demand for housing in the West remains generally strong despite the recent increase of home mortgage rates to 10 percent by some California S&L's. In the Seattle area it is reported that a "vigorous housing market is being fueled by young adults at the family forming age." In southwest Washington, the housing demand is so strong that "people no longer ask what rates are being charged for home loans." In northern California there are still overnight queues when moderately priced housing tracts open up for sale. However, in southern California, housing prices have begun to stabilize and the issuance of permits is now running under a year ago. Only in Anchorage, Alaska is there said to be any overbuilding -- apartment vacancies there are currently running about 15 percent.

Real estate loan demand continues brisk in most parts of the District, despite rising mortgage rates. Many thrifts, as well as some banks, are reported to be experiencing net savings outflows. Several Oregon S&L's are said to be "very close to being out of money." Another S&L claimed to be accepting only 3 out of each 5 requests for mortgages and all mortgage requests granted were to dual-income families.

Business loan demand in the West has been growing more rapidly than the seasonal norm of the past few years. Only a small portion of

this, however, is being used for purchase of plant and equipment. Inventory financing, restructuring of corporate debt and smoothing out internal cash flow problems were cited as major uses for these funds. Large national corporations are still not a part of business loan demand as they are reported to be using the commercial paper market, long-term bonds and Eurodollars as sources of funds. Local firms and some mid-sized national firms are said to be doing most of the borrowing.