

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the  
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by the Staff

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## SUMMARY\*

Business conditions in most districts continue to improve, but more signs of weakness are cropping up. Most businessmen look for a slowdown in economic activity next year. Christmas sales are slightly ahead of a year ago. Production in manufacturing continues to advance slowly; no significant shortages, excesses, or bottlenecks have developed yet. Bank lending is expected to increase at a faster rate despite higher interest rates and tighter restrictions on terms for loans. Money market certificates continue to provide substantial amounts of funds to banks and S&L's. Home building has begun to weaken. Net farm income has risen sharply with higher farm prices and bumper crops.

Most districts report the dollar volume of Christmas sales is running slightly ahead of a year ago, and much of the strength is in soft goods since purchases of big ticket items other than autos are generally slowing. The biggest sales gains are on the West Coast where California's Proposition 13 property tax cut has helped to boost consumer spending. Early holiday sales were slowed by warmer than normal weather which dampened consumer enthusiasm for shopping, but sales in some areas are expected to rebound before Christmas. Heavy promotions account for much of the strength in sales reported by New York, Atlanta, and Dallas.

Retail inventories are high, according to most districts, but remain within manageable limits. Philadelphia, however, reports stocks at national chain stores are beginning to accumulate at unplanned rates.

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\*Prepared by the Federal Reserve Bank of Dallas.

New York, Minneapolis, and San Francisco, on the other hand, indicate sales are reducing inventory levels.

New car sales are strong in the Chicago, St. Louis, Dallas, and San Francisco districts but are running below year ago levels in Atlanta. Sales of trucks and used cars are growing also. Most reports indicate new car inventories are adequate, but new trucks are in short supply.

Manufacturing output continues to rise, although the rate of increase is slowing. High levels of capacity utilization are reported in many districts, but no major bottlenecks have developed. Boston reports a slippage in the number of small firms reporting increases in new orders, and Philadelphia and Richmond indicate factory payrolls have leveled off. Manufacturers' inventories are fairly well balanced. However, Richmond and St. Louis indicate stocks are excessive, and a cutback in reorders for consumer goods in the Cleveland district has led to involuntary additions to stocks. Atlanta and Chicago, on the other hand, report a tightening in factory inventories. Shortages of materials and labor continue to be confined largely to construction, but some easing in the supply of building materials was noted by Dallas and San Francisco. Price increases for major materials should be more widespread next year according to Philadelphia, Richmond, and Kansas City.

Despite higher interest rates, bank loan demands continue to increase, and liquidity positions of most banks remain adequate to meet foreseeable requirements. However, bankers are becoming more selective in approving loan applications, and St. Louis reports a number of small outlying banks are loaned up.

Money market certificates of deposit continue to be a major source of funds for banks and S&L's, and most existing certificates are being rolled over as they mature. Deposit inflows continue weak in time and passbook accounts, and some disintermediation is noted at banks by Philadelphia and at S&L's by St. Louis.

Construction activity remains at a high level, as a weakening in home building is being offset by increases in nonresidential construction. Residential construction is slowing as a result of substantial tightening in mortgage markets. Home building in New York state remains moribund, and an increase in that state's usury ceiling is not expected to reduce a heavy backlog of mortgage applications or increase sales significantly. Condominium sales are bright spots in the housing markets in the Chicago and San Francisco districts as conversions have continued to rise.

Higher farm prices and bumper crops, except for cotton and peanuts, are raising net farm income. Improved financial conditions for farmers and ranchers have led to substantially higher land values in the Kansas City district. Shortages of railroad cars have delayed grain movements from farms according to Minneapolis.

## FIRST DISTRICT - BOSTON

Red Book interviews in the First District indicate that although overall economic trends remain very strong some softness has begun to appear in a few areas. The District's factories are operating at very high levels with occasional shortages of particular types of labor and materials appearing. After some slowdown earlier, demand for credit is increasing strongly at commercial banks across the region. While sales in general are reported to be very strong some retailers are not seeing the increases they expected.

The Chief Executive Officer of a large department store chain in Boston reports that sales in the last week of November and the first week of December were much softer than expected; up to this time sales over year-earlier figures had been very good. Furthermore, his conversations with associated retailers in other parts of the country indicate that this pattern may be duplicated elsewhere. This particular chain has had somewhat higher inventories than desirable for the last few months and thus will face an even more difficult adjustment process if sales continue to lag. However, Directors from Vermont and Connecticut report that retail sales continue to grow strongly in those states.

A manufacturer of chemical products used by the tire industry indicates that their plants are operating at record levels. However, a manufacturer of higher priced refrigerators, ovens, and other consumer durables reports some slowdown in sales from earlier in the year as well as more aggressive price competition. Similarly a survey of small businesses across New England indicates that while shipments are at very high levels there is some slippage in the number of firms reporting increases in new orders.

A large money market bank in Boston reports that commercial loan demand has resumed a strong upward trend after some slowdown earlier this fall. This bank is one of those offering a split prime rate with a discount for smaller businesses. The Chairman of the Board of the Bank reports that they decided to offer the split rate because it was very well received when they did so in 1973 and will cost them no more than 2-4¢ per share. A commercial banker in Vermont reports very strong loan demand and indicates that his bank has begun to ration credit. Other northern New England bankers also report very strong credit demand.

While there is no indication of widespread difficulties in obtaining materials some spot shortages are in evidence. A summary of New England purchasing managers indicates that delivery lead times are stretching out for electronic components, motors, valves and for some types of steel, aluminum, and paper products. No dramatic shift in price increases has been observed. However, the President of a large chemical company reported putting price increases into effect much sooner than normal because of a concern that the price guidelines may be administered more stringently later in the year. Manufacturers in almost all parts of New England report difficulty finding certain types of labor, particularly electronic technicians and machinists.

Professors Samuelson and Solow were reached for comment this month. Samuelson recommended a monetary policy that would achieve a real growth rate below that recorded in the third quarter but warned against aiming for a negative growth rate. To induce a recession intentionally would be the clearest possible example of the hubris of fine-tuning. The mild recession in the standard forecast would lower the range of probable inflation rates and reduce the chances of double-digit rates, but the magnitude of the reduction

would be very small in the short run. A slow growth path may, nevertheless, be desirable to avoid a ratcheting up of inflation.

Professor Solow agreed that policy can't take the chance of an overheated economy. Nevertheless, given the importance of momentum in the economy, it is dangerous to try to engineer a "small" recession. A recession policy risks unintentionally producing a major recession which, in turn, would feed a future stop-go policy cycle. The steeper the downturn, the more politically inevitable is a sharp policy reversal in which the transitory gains are lost. Solow preferred selecting a target degree of slack or tightness which can be maintained for a long period of time. He suggested the proper degree of slack is not far from that presently experienced.



## SECOND DISTRICT--NEW YORK

Economic activity in the Second District appears to have expanded at a moderate pace in November and early December, according to the recent comments of Directors and other business leaders. Retailers profess to be more or less satisfied with the way their Christmas sales are shaping up, and they also report that their inventories are well in control. Elsewhere in the regional economy, business activity appears to be moving along without any hitches. Most businessmen continue to keep a very tight rein on their inventories in anticipation of a slowing in the national rate of economic advance. Meanwhile, no one seems very optimistic about the prospective success of the recent voluntary wage and price guidelines. Senior lending officers at the major New York City banks generally expect stronger business loan demand in the near term.

After a weak showing in early November, retail sales in the Second District apparently strengthened substantially in recent weeks. A spokesman for a leading national chain of department stores noted that catalogue sales, which are an early indication of the Christmas selling season, have been brisk. Early in the holiday season, however, retail sales were sluggish. In New York City, retailers had hoped for a rebound in consumer spending with the end of the newspaper strike in early November. Initially, however, retailing activity remained slow. One director attributed at least part of the sluggishness to warmer weather which may have dampened consumer enthusiasm for holiday-season shopping. After Thanksgiving, retail sales in the city have rebounded more than seasonally. A similar revival occurred in the upstate region, according to the Directors of the Buffalo Branch. Merchants are now looking forward to a prosperous Christmas selling season. Retailers are using heavy promotional

campaigns to bolster sales, but there is little evidence of unusual discounting. Evidently, since merchants have maintained tight controls on their inventories, there are few excess stocks of merchandise to spark sharp price reductions.

Business activity outside of retailing has lately been fairly robust. Although some businessmen are concerned about the economic outlook for next year, none of those contacted indicated they were dissatisfied with their company's current volume of business. Indeed, one large corporation in the fabricated metals industry reports that it is operating at capacity. The demand for petroleum products is also strong, and the oil industry is currently operating close to capacity. Sales have also been strong for the photographic equipment industry. Two construction firms which deal in industrial and commercial building and renovation report increases in activity, led by a revival in activity in Manhattan. In contrast, residential home building in New York State remains moribund. The upstate directors noted that there was a heavy backlog of mortgage applications in the Buffalo and Rochester areas, which were awaiting the increase in the State's usury ceiling to 9 1/2 percent. At least one banking director, however, expressed some doubt as to whether this higher mortgage rate would alter the current situation since it was still below current market rates.

On the financial scene, senior lending officers at the major New York City banks generally expect stronger business loan demand in the near term. Although the prime rate has risen considerably in recent months, almost all of the respondents report that they have not tightened either compensating balance requirements or standards of credit worthiness. Moreover, there generally has

not been less willingness to accommodate either established or new business customers. However, most of the respondents are becoming increasingly hesitant to commit themselves to fixed-rate loans.

## THIRD DISTRICT-PHILADELPHIA

Indications from the Third District are that local economic activity is mixed in December. Manufacturers say business conditions have worsened since last month and have consequently held the line on hiring. Looking ahead to the first half of 1979, executives in the industrial sector see business slipping a little further. In the retail sector, merchants report sluggish sales currently and look for more of the same over the next two quarters. Unplanned inventory accumulation is being experienced in some stores, mostly at the larger, national chains. Area bankers report strong loan demand so far in December, and look for continued growth next year. Bankers are in disagreement about the future course of interest rates.

Manufacturers responding to this month's Business Outlook Survey say business conditions have deteriorated since November. Only 10 percent of the respondents note a pickup in activity at their firms over the last month, while 28 percent report a decline. This yields a "net change" of minus 18 percentage points—the first major decline in business activity at firms in the Survey since March 1975. Supporting the claims of a drop-off in business, respondents report both new orders and shipments to be down in December. Inventories are stable after a dip last month. On the employment front, the size of factory work forces has remained more or less unchanged, while the workweek has been trimmed slightly.

For the longer term, manufacturers are generally bearish about future economic conditions. They look for a further slowing of business activity between now and June, with no change in the level of new orders and only a fractional increase in shipments. Consistent with this outlook for production is the forecast of no growth in the size of factory payrolls over the next two quarters along with further cuts in the length of the workweek.

A Director of this Bank, whose business is in the manufacturing sector, agrees that the outlook for 1979 is "shaky." In fact, his company is budgeting for a recession next year. He sees a downturn as a virtual certainty and says the only questions are when it will come and how deep it will be.

Inflation in the industrial sector continues in December. Over 60 percent of the manufacturers polled this month report higher prices for inputs, while about 30 percent are charging more for their finished products. As for the future, the executives surveyed look for price hikes to become more widespread over the next six months. Eighty-six percent of the respondents expect their costs to go up in the first half of 1979, and about 65 percent plan to raise the prices of the goods they sell in that period.

Sales at area department stores are extremely slow so far in December, but retailers are looking for a big surge to come seven to ten days before Christmas. Reports of current dollar sales range from only 3 percent above to 2 percent below December '77 levels, which means that all merchants contacted have experienced a drop in constant dollar sales. Current sales volume is generally below projected figures for this period, even though those projections were "extremely modest."

Local merchants mention several reasons for sluggish sales this month, including unseasonably warm weather which has not put shoppers in the "holiday buying mood" and the possibility that general uncertainty about the course of the economy over the next few months is causing consumers to hold on to dollars they might otherwise spend. Another reason for the poor sales performance might be that this year's sales are being compared to record levels in December '77, making it difficult to show much improvement. However, a Director of this Bank whose business is retailing sees the current sales slowdown as part of a longer-term trend that started in October. He expects consumers will continue to reduce spending and lead the economy into recession next year.

Despite slower than expected sales, inventories at department stores based in this area are reported to be in good shape. Contacts in the retail sector indicate that this is not the case in the national chains where stocks are beginning to accumulate at an unplanned pace. Merchants at the smaller, local chains say they have been insulated from unplanned inventory accumulation because they have more flexibility in buying their merchandise than do managers in the larger chains, who often make inventory commitments many months in advance.

Looking ahead to the next six months, most retailers contacted foresee little improvement in business, with the exception of the period immediately prior to Christmas. Forecasts of sales between now and June range from "flat" to 4 percent ahead of year-earlier levels. Some plans to cut inventories early in 1979 are reported.

Area bankers say that the demand for both consumer and business loans is generally strong this month. Reports of current C&I loan volume compared to December '77 levels range from "about even" to 8 1/2 percent ahead. This is generally as expected or a little ahead of plan for this period. As for the future, contacts in the banking sector foresee moderate to strong growth in loan demand over the next six months.

Future interest rates are a matter of some speculation and disagreement among local bankers. Expectations concerning the timing of a peak in rates, as well as their actual levels, vary widely. Six month projections of the prime rate, currently 11 1/2 percent at all of the banks contacted, range from a climb to 12 percent by early 1979 and then a plateau through June, to a continued rise over the next two quarters with a prime rate of 13 percent occurring in early summer.

High interest rates continue to cause some disintermediation at area banks, but the problem is apparently not serious. At least part of the outflow of funds from consumer-type time and savings deposits is being offset by new purchases of

6-month money market certificates. The certificates are being aggressively promoted currently. Moreover, a large portion of the certificates first issued in June and now coming due are reportedly being rolled over, thereby supplying the banks with a continuing source of funds.

## FOURTH DISTRICT--CLEVELAND

Economic activity in the Fourth District continues to expand in response to a high level of production of automobiles and steel and further increases in capital goods. However, manufacturing activity is being supported by some involuntary inventory buildup, especially of consumer goods. While retailers and producers of consumer goods, excluding autos, are not very optimistic over sales prospects, capital goods producers are encouraged because of sizable backlogs and a generally favorable outlook for new orders. Steel operations are expected to continue at 85 to 90 percent of capacity again next quarter. Mortgage loan demand has dropped sharply in recent weeks. Intense efforts are underway to prevent a default by the city of Cleveland on December 15.

Several key industries in the District are manufacturing at rates close to effective capacity, especially primary metals, machine tools, and industrial machinery. Although there are no widespread bottlenecks or shortages such as in 1973 and 1974, shortages of skilled labor--and even dependable labor--are constraining production, especially in machinery industries.

Auto producers and suppliers are still relatively optimistic, despite recent slippage in sales. Suppliers of steel, glass, tires, and auto components report GMC orders coincide with their publicly announced production schedules for the next few months. Also, a major appliance producer is reasonably optimistic that consumers are unlikely to sharply curtail spending for these goods because of continued gains in employment and income and the strong replacement market for major appliances.



On the other hand, other producers and retailers of consumer goods are less sanguine. A major producer of household soaps, detergents, and paper products indicates that year-over-year sales gains in recent months have slowed and are below expectations. In his judgment, high rates of inflation have caused consumers to cut back consumption of personal care products. Retailers of general merchandise also report reduced sales gains in recent weeks. They expect, at best, that this month's year-over-year sales increase will be larger than last month's but well below the increase recorded in December 1977.

Inventories of consumer goods have been built rapidly at both the retail and manufacturing level. According to one report, retailers have cut back reorders to keep stocks from building further, but manufacturers have continued to produce goods in expectation that sales would continue at last spring's high rates. Therefore, some manufacturers have involuntarily added to stocks in recent months.

A recent surge in new orders and backlogs adds support to expectations by some capital goods producers that gains in real spending next year will be in the 5- to 6-percent range, instead of 2 percent or less as indicated in latest surveys. According to some producers, the latest surge in orders reflects a growing substitution of capital for labor because of a shortage of qualified workers, favorable effects of dollar depreciation, and perhaps some double ordering because of shortages. Those firms that produce aircraft and aerospace components, freight cars and railroad equipment, and computer equipment are most optimistic. However, others have less favorable expectations because they have not experienced recent acceleration in orders or because orders have been

relatively flat with little prospect for a pickup. Major machine tool builders report strong but not accelerating order activity, and one builder pushed back his expectation of a peak in new orders from third quarter 1978 to the spring of 1979. A major producer of coal mining machinery believes many of his product lines are at cyclical peaks in orders. Still others see a relatively flat year ahead because of a lack of broadly based strength in capital goods. A major builder of basic processing plants remarked that his backlog is not large enough to sustain operations through a mild recession as has typically been the case in the past.

Steel producers are operating close to 90 percent of capacity and are growing more confident that this rate will carry at least through the first quarter of 1979. Orders have picked up strongly and those for January and February are considerably better than anticipated. Strong demand from the construction industry and capital goods produced the unexpected strength in steel. Producers have not yet had setbacks from the auto industry. Moreover, domestic steel users may be substituting some foreign for domestic steel, as higher trigger prices either reduced the price advantage of foreign steel or boost foreign above domestic prices. The strike of independent steel haulers is disrupting as much as 5 percent of total steel shipments this month, especially in the Pittsburgh producing area, although neither steel production nor employment has been affected by the strike.

Mortgage loan demand in recent weeks has weakened in response to a usual seasonal drop and further tightening in lending terms by banks and S&L's. Mortgage money generally is available, although borrowers are discouraged by rates that are as high as 11.5 percent for a 95 percent loan.

Lenders are charging 9.75 percent to 10.75 percent for a 60 percent loan. S&L's are having no difficulty in rolling over the certificates now maturing, and some report that strong deposit flows are continuing into early December because of the money market certificates. Those S&L's that acknowledge use of funds obtained from certificates for short-term investments, especially CD's, rationalize their actions on grounds they can more easily support continued issuance of certificates, while at the same time making funds available to prospective home borrowers.

In the city of Cleveland, serious proposals have emerged in a last-minute effort to avoid default on \$15.5 million in bond anticipation notes that mature December 15. A plan developed by an outside consultant calls for resolution of the sale of the municipal light plant and the passage of a state law establishing a fiscal control board with power to raise the income tax rate by 0.5 percent to 1.5 percent. The rate increase would make Cleveland's rate comparable to other Ohio cities and add about \$30 million in annual revenues. The city administration plans a layoff of 600 fire, police, and service workers starting next year which would save about \$6 million. It also has scheduled bill payments for December 31 so that checks will not clear the banks until 1979. Even with a rollover, the city would still face the possibility of default when an additional \$25 million in notes begins maturing next summer.

## FIFTH DISTRICT - RICHMOND

Business activity in the Fifth District in November seems to have held on to most of the gains of recent months, but apparently made only meager further advances. In the manufacturing sector new orders continued to move ahead but gains were spotty. Backlogs of orders and inventories were down slightly from a month ago. Retailers report little change in total sales over the month, but suggest that relative sales of big ticket items weakened. Price increases continue widespread in all sectors and the business outlook remains largely negative. Year-end credit conditions in the District appear to be moderately tight, with rates on loans rising and nonprice lending terms tightening. Liquidity is good at regional banks, and thrift institutions continue to rely heavily on funds raised through 6-month money market certificates. Loans at District banks are off seasonally but bankers consider loan demand generally to be moderately strong.

Our latest survey of District manufacturers indicates continued expansion of activity during November although this expansion narrowed markedly from recent months' experience. On balance, shipments and new orders rose, but the incidence of declining activity at individual firms or establishments also increased. Backlogs of orders were unchanged to slightly lower overall. Inventories, despite scattered reductions, apparently rose relative to desired levels. Employment and weekly hours worked were basically unchanged at those manufacturers surveyed. Over 25 percent of our respondents now view current inventory levels as excessive. Current plant and equipment capacity is essentially in line with desired levels, and there is almost no sentiment among respondents for altering current expansion plans.

Much the same picture emerges from the results of our survey of retailers. District retailers surveyed report little or no change in total sales during the month, but some noted a decline in relative sales of big ticket items. Retail inventories rose somewhat from October, but remain essentially in line with desired levels. Retail employment also rose in our latest survey period.

Retailers and manufacturers continue to report widespread price increases. Respondents' expectations remain broadly pessimistic. A majority of manufacturers surveyed expect the level of business activity nationally and in their respective market areas to decline over the next six months. In addition, 40 percent expect the level of production in their own firms to worsen over that period. Retailers generally share these expectations, but as a group are somewhat less negative about the outlook for their respective market areas and firms. A large majority of the Richmond Directors feels that there is at least a 50-50 chance of a recession developing in 1979.

Business lending in the District is seasonally depressed with substantial rundowns in loans to commodity dealers and the wholesale trade sector. Nonetheless, there is a general expectation that demand for commercial and industrial loans over the next three months will equal or possibly exceed its recent cyclical strength. Nonprice terms on loans to businesses have tightened of late, taking the form of firmer compensating balance requirements and limits on approvals of lines of credit to new customers. Also, fixed rate loans are harder to come by. Uncertainty about the real estate outlook has made banks less willing to make construction loans to builders, especially for multi-family projects. Instalment lending to consumers is healthy, although not as strong as in previous months.

Liquidity at most District banks seems ample. Regional banks are experiencing strong trend growth in private demand deposits and growth in small time deposits seems to be holding up fairly well. Deposit growth at regional thrifts has virtually halted except for 6-month money market deposits. It does not appear that ATS services offered by regional commercial banks are drawing funds away from thrift institutions.

Bumper harvests are in prospect for most District field crops except cotton and peanuts. Farmers' cash income from farm marketings continued to improve through August, with some improvement over a year ago beginning to show up in crop receipts as well as in receipts from livestock. Further gains in cash receipts appear likely as the large crops are harvested and sold. Farmers' gross returns from the 1978 flue-cured tobacco crop, most of which was sold after the month of August, were at a record level some 26 percent above a year ago.

## SIXTH DISTRICT - ATLANTA

Business activity has slowed in the Southeast, with hesitation generated by pessimistic attitudes and concern with high interest rates. Consumer spending for apparel and new automobiles has been weak; retailers will depend on heavy promotions and markdowns to help clear inventories in what they expect to be an unspectacular holiday season. Producers, too, are aiming at tighter control of stocks. Commercial construction continues to advance, but home building is waning. Many S&Ls have shown reluctance in mortgage lending. Demand for all types of loans remains strong; money market certificates have been an important source of funds at both banks and thrifts. Crop harvests have been very good, but problems linger from the recently ended drought.

Branch directors and their business contacts almost unanimously foresee a slowdown or recession in 1979, a sharp contrast to the expectations prevailing two months ago. High interest rates are now the scapegoat for current and prospective economic ills, replacing inflation as the most frequently mentioned problem. Recession talk appears to have been a major influence on attitudes; many fear that it will become a self-fulfilling prophecy. Still, most contacts anticipate only a mild downturn, if any, and expect their areas to weather it well.

Contacts generally characterize November retail sales as good, especially of luxury and "better" goods, but nearly all noted some weakness in apparel sales due to unseasonably warm weather. Reports are mixed on Christmas sales thus far; expectations are that holiday sales will be even to slightly ahead of last year. Heavy promotions and discounts are expected to continue, evidencing retailers' fears that stocks are on the high side and their pessimism for early 1979 prospects.

New car sales are reported to be down, sharply in some areas, or even with last year at best. Inventories appear to be adequate; dealers blame the slowness on high prices, shrinking sizes, and consumers' uncertainty about the economic outlook. Commercial sales of trucks and cars for rental, however, have been strong, as are sales of late-model used cars.

Manufacturers, influenced by prospects of slower shipments and the rising cost of inventory financing, seem to have tightened their rein on stocks. Although plant utilization is generally high, materials shortages are minor. Complaints of slow deliveries or tight supplies are less frequent than they were two months ago.

Commercial and industrial construction generally remains strong, with more on tap. In-migration of industry from outside the region continues at a steady pace; Georgia-Pacific's relocation of headquarters to Atlanta was noteworthy among last month's announcements. Several areas, however, report that rising costs, particularly of power and money, have resulted in some slowdown.

While final demand for new homes continues fairly strong in all but the highest price ranges, housing construction is suffering the impact of high interest rates, tight money, and wariness of prospects. Speculative building has virtually ceased in all but the most active markets (south Florida); S&Ls have moved to restrict construction loans; lot sales are meeting resistance in some areas; and planned projects are being delayed.

Supplies of mortgage money appear somewhat strained. S&Ls' sales of money market certificates have been strong, but, overall, net inflows have been weak to moderate. From throughout the District, we hear reports of S&Ls, both large and small, suspending or limiting commitments. However,



many of these are rebuilding liquidity by investing in banks' large CDs, anticipating higher mortgage rates (especially in states where the legislature is expected to consider raising the usury ceiling next month). Some are requiring larger downpayments; others are pushing up interest rates and/or points as usury ceilings permit. Conventional rates range from 9 5/8 to 10 3/4 percent, points from 2 to 4 1/2 percent. In states where rates have reached usury ceilings, there is some evidence that borrowers are switching from conventional to government-insured loans. Still, several directors report no problems with availability of mortgage funds in their areas; in fact, many of the District's large associations have been aggressively seeking new commitments.

Bank lending has accelerated in recent weeks. Except in Tennessee, where national and state banks' rates are limited to one point above the discount rate, most of the District's larger banks are posting an 11 1/2-percent prime rate. One director noted that banks in his area had become more selective and had raised interest rates in their consumer instalment lending. At banks as at S&Ls, sales of money market certificates have been heavy despite their costs and there have been substantial outflows from passbook savings. ATS has found few takers, and those are largely customers who normally maintain high deposit balances.

Rains have improved pasture conditions somewhat, but pasture growth is likely to be slow enough to delay feeding of stocker cattle to full weight; one agricultural expert sees temperatures as the key to cattle prices in the next few weeks. The recent downtrend in milk production should continue, as hold-over effects of the summer weather depress output per cow and high cattle prices promote extensive culling of dairy herds. Florida's citrus

growers are disturbed by competition from Brazilian imports; year-end carry-over is likely to be large enough to press prices down from recent near-record levels. However, the lengthy drought has made citrus crops more susceptible to freeze damage.

## SEVENTH DISTRICT - CHICAGO

Despite fears of a recession next year the Seventh District appears to be approaching 1979 with a good head of steam. Order backlogs of capital goods producers continue to rise. Inventories remain generally adequate, but not excessive. Supplies of some items are tight. Employment is still rising. Scattered reports indicate a vigorous Christmas season. Residential construction is almost certain to decline next year, but nonresidential building should rise. Price inflation has not moderated for goods and services, but prices of existing homes are softening. The farm sector is much happier than last year with good crops and higher prices. Lenders say they are increasingly cautious in granting new loans in all major classes.

Business executives, especially in the business equipment fields, seem optimistic about prospects for 1979. There is some concern that predictions of a recession will help bring about such a development. Professional forecasters vary with some predicting a mild recession starting about mid-1979. The more common view is that growth will slow further in 1979, but that a two quarter decline in real GNP can be avoided--at least that it is not inevitable. Chances of slowing the rate of inflation are deemed poor by virtually everyone.

Reports of purchasing managers in the Chicago and Milwaukee areas showed further strength in November with new orders, backlogs, output, and employment all rising. Order lead times lengthened again. The Milwaukee report was even stronger for November than October. Milwaukee is heavily dependent on capital goods production.

Auto sales were somewhat above expectations in late November. Truck sales are generally limited by supplies. General Motors sticks to the prediction

that auto and truck sales next year will match 1978. Ford agrees on trucks but thinks auto sales will be down by 300 to 500,000 units. Some GM and Ford cars are in short supply. The other producers have had to cut production schedules in line with disappointing sales.

We are unable to find evidence of an excessive buildup of inventories, except for some types of clothing. A large retailer whose sales have lagged year ago insists it has held orders to a level which has kept inventories in good balance. Output has been adjusted promptly, for example in appliances, when a buildup of inventories was threatened. Large companies are said to have pushed their inventory problems back on suppliers to a greater extent than usual.

Short supplies of cement, castings, and some motors are limiting activity. Steel users say that the steel haulers' strike will hamper their operations if it is not settled soon. West Coast paper strikes continue to pinch supplies in this region.

No final reading on consumer buying during the Christmas season will be possible until the second week of January. Scattered reports indicate that people are spending freely. Air traffic continues to show substantial gains.

Some bankers are screening consumer credit applicants more closely, restricting loans to regular customers in some cases. Despite vague reports of increased delinquencies, a major auto company says delinquencies have been at last year's moderate level. Half of these auto loans are for 48 months. Michigan utilities say delinquencies are rising, but this is attributed to regulations which drastically curb service cutoffs.

Consumers had been cleaning out dealer stocks of snow blowers, selling in the \$250 to \$500 range, even before recent heavy snows. District producers of snow blowers and components who are operating all out for three shifts per

day cannot satisfy demand. Shipments of over 800,000 units this year will be about double last year's total. Some types and sizes of snow tires are available only after a long wait. Sales have exceeded manufacturers' expectations.

Evidence that labor markets remain tight is offered by reduced unemployment compensation claims, more applications on file at state agencies, a heavy volume of help-wanted ads, and reports of shortages of skilled workers both in industry and construction. Shoppers have complained about inadequate staffing of stores in suburban areas, especially where individual transportation is required. In the Chicago area \$4 per hour to start for low skilled help is not uncommon.

Natural gas supplies were adequate in the district last year. This year district experts say the whole nation is in similar shape. One large gas pipeline system has canceled a contract for deliveries from producers because the market is soft. New commercial and industrial customers are being accepted after a lapse of years.

Oil companies are somewhat edgy about supplies of heating oil and gasoline, especially no-lead gasoline. Refineries are operating at capacity. Big companies no longer are able to help out competitors with temporary production problems. A continued flow of oil from Iran, which supplies about 10 percent of US imports, is crucial. It is not considered desirable to publicize tight supply conditions for fear a large proportion of users will fill their tanks and create temporary supply problems. Supplies are deemed adequate, but margins of safety are narrow.

Realtors say that home sales have declined more than seasonally in the last several weeks. Only sales of condos are up because of conversions. High interest rates are expected to cut new residential developments next year.

## EIGHTH DISTRICT — ST. LOUIS

Business expansion in the Eighth District continues, but at a more moderate rate than in the first half of the year. According to reports from retail representatives, consumer spending has slackened somewhat on the "big ticket" items, while automobile and soft goods sales continue to register moderate gains. Business inventories have begun to increase slightly in some sectors, and business loan demand continues strong. Farmers in the District are enjoying a relatively profitable year, having produced large crops and receiving higher average prices than a year ago for commodities sold.

While most retailers remain optimistic about pre-Christmas and early 1979 sales prospects, they report some slowing in sales of home appliances and other major expenditure items. One major retailer reported that sales of clothing and other soft goods are "coming along great", but sales of large home furnishing items were softening. This trend was also noted at the manufacturing level where a major manufacturer of small electric motors reported that sales of such motors to appliance manufacturers had declined. One major manufacturer of home appliances reported layoffs of some employees. Nevertheless, sales of automobiles and other consumer items continue up. One automobile dealer reported that overall sales in November were above the year-ago level, but that buyers were more selective than last year as indicated by a larger percent of customer orders rather than sales off the lot.

Inventories at all levels have apparently increased somewhat. A representative of a furniture manufacturing plant reported an eight percent increase in inventories from a year ago; a shoe company reported some buildup

in inventories; and an automobile dealer reported some excess in inventories, reflecting the larger than usual special orders from the factory by customers. Nevertheless, no one contacted expressed a great deal of concern about excessive inventories. On the other hand, one building contractor reported some shortages of materials, tools, architects, subcontractors, and other skilled workers.

Reflecting the continued upswing in business activity, loan demand at District banks is increasing, furthering upward pressure on interest rates. A major St. Louis banker reported a strong business loan demand and rising interest rates; some Little Rock banks are selling loans to improve liquidity; and some Louisville bankers have instituted stricter credit standards. A number of smaller banks in outlying sectors report that they are loaned up.

Interest rates have continued up in the District where usury laws permit them to rise. Usury laws in Arkansas, Missouri, and Tennessee were reported to be having adverse impacts on lending activity in these states. Some disintermediation has occurred in Tennessee savings and loan associations and St. Louis associations report that virtually all the increases in their deposits are from the new money market certificates. Those S & Ls in St. Louis which are advertising extensively and offering premiums to attract the new CDs report that they have gained sizable amounts of these funds, whereas those choosing to limit promotional efforts are experiencing some net withdrawals of savings capital. Some savings and loan institutions actively seeking more CD deposits, however, are purchasing higher-yielding large CDs at commercial banks rather than making permanent mortgage loans.

In the agricultural sector conditions are generally good. Farm commodity prices are higher than expected, and relatively large crops were harvested. One representative in Kentucky reported the tobacco crop to be the best in many years. The soybean and corn crops were generally good throughout most of the District, and the harvesting weather was favorable. Prices received for both crops and livestock products are above those of a year ago, and net incomes of most farmers are up.



## NINTH DISTRICT - MINNEAPOLIS

Economic activity in the Ninth District remains strong as 1978 draws to a close, but prospects for 1979 are uncertain. Retail sales are up. Inventories are about right. Industrial activity is hectic. Builders are busy. Farm receipts are high. And financial institutions still have lots of customers. However, uncertainties regarding government policies loom large in most scenarios of likely economic developments in 1979.

Retail sales have rebounded after a fairly slow start in holiday spending. Retailers across the district were concerned about the low level of sales activity over the Thanksgiving weekend. But reports indicate a substantial acceleration in consumer spending has been realized during the last couple of weeks. Directors from every district state remarked that the recent strength in buying should push this year's holiday sales well above last year's.

This sales increase is draining off some of the inventories that a few district retailers, especially soft goods dealers, had seen building up in November. In fact, one Minnesota director expected fewer post-Christmas sales than usual because of low inventory levels.

Manufacturers have kept inventories under control too. Our Bank's latest Quarterly Industrial Expectations Survey reveals that most manufacturers consider their inventory levels "about right."

Brisk sales have held down those inventories. Based on our survey, we estimate manufacturing sales are currently running about 13 percent above last year's fourth quarter. Since producers' prices have climbed only 8 percent during the past year, these sales represent substantial real gains in manufacturing activity.

The construction sector is substantially busier than last year, but some slowing has been observed around the district. Construction employment is way up, and the market for building trades people is very tight. Commercial and industrial construction has shown almost no signs of slackening. That isn't true of residential building though. While it is difficult to disentangle seasonal elements, most directors detect signs of a slowdown in the homebuilding sector.

Some things are moving slowly in the agricultural sector, but not cash receipts. Railroad cars have been in short supply relative to demand, so that many farmers have encountered difficulty in getting their grain off the farm. A Montana director reported that about 10 percent of the grain produced in one county was sold, but could not be transported. A South Dakota director attributed the severity of the transportation problems to the extremely good harvests. Because of those bumper harvests, grain farmers are in good shape financially despite the slowdown. And cattle ranchers, poultry producers, and dairy men are benefitting from abundant feed and relatively high output prices.

The price of credit is also high, but financial institutions continue to have customers. There has been a shift in the type of customers, though, as commercial borrowing has declined substantially, while installment borrowing is way up. There were even several customers for the new automatic transfer service in one of Minnesota's larger communities, but that was in contrast to a lack of demand for ATS in most locations.

Future prospects for the economy are clouded by uncertainty over government actions. Two directors were concerned that price guidelines would have the same stifling effect on the economy as price controls typically have.

A South Dakota director noted concern among cattle producers that the President would allow expanded beef imports in response to continuing high beef prices. And a couple of directors were apprehensive regarding the impact of the imminent boost in the minimum wage.

## TENTH DISTRICT—KANSAS CITY

Tenth District economic activity continues strong, but with some signs of less support from consumers and from nonfarm businesses. Manufacturers are finding supplies adequate to operate at near capacity levels in most cases. Retailers detect some softening in sales, but see no cause for alarm. Inventories at retail as well as at the producer level are considered to be in good shape. Farm real estate values are rising rapidly with the recovery of farm income and the prospects for favorable farm product prices. Agricultural loan demand is strong, but commercial loan demand is weakening. Bankers expect prime rates to rise further.

Tenth District purchasing agents expect prices of most major inputs to continue to rise, perhaps at an accelerated rate, in the year ahead. In recent months, the prices of steel, wood materials, and jet fuel have increased particularly rapidly. However, buyers in most industries are not having much trouble obtaining materials. Some problems with suppliers are being experienced by the machinery and nonfarm transportation equipment industries. All industries contacted, except the machinery industry, are operating at close to full capacity. The furniture industry is having difficulty finding skilled labor.

Material inventories are at satisfactory levels, except in the electrical goods industry where they are reported to be excessive. The airline industry expects to be cutting fuel stocks because of cash-flow problems arising from increasing fuel costs. Other industries plan to maintain current inventory levels through the first quarter of 1979.

Sales by District department stores are reported to be ahead of last year at this time, but some respondents detect a softening in the last

three months. Sales of fashions, fabrics, and other "wearables" have been quite good recently while hardlines, appliances, and major ticket items have slowed down. Good weather probably has delayed the usual winter buying of some seasonal items, say store executives. While some retailers expect strong sales in the first quarter, others are less optimistic.

Retailers say their inventory levels may be a shade high, and they plan some cutbacks in purchases and some increase in promotions. Still, inventories are said to be in better shape than a year ago, and stocks are expected to be back into balance by April 1.

Farm real estate values are continuing to rise at a brisk pace in both the District and the nation as a whole. As of October 1, 1978, District land values were—depending on the type of farmland in question—11 to 13 per cent above year-earlier levels, with about half of this increase occurring during the third quarter. These increases are very much in line with recent USDA figures on farm real estate values which, for the year ending November 1, 1978, show an annual gain of 12 per cent for District states as well as for all U.S. farmland.

Higher farm incomes, reflecting stronger commodity prices and increased Government benefits, account for most of the strength in the farm real estate market. For the nation, net farm income in 1978 is expected to run about 30 per cent above the 1977 level, and it is clear that net income within the Tenth District will also be up rather significantly this year. Given the favorable price prospects for most farm commodities in 1979, together with the outlook for net farm income, which promises to remain fairly steady, further increases in land values are likely to occur in 1979. If the land transfer rate holds up or increases in the period ahead, the

demand for farm real estate loans will remain strong, notwithstanding the possibility of higher interest rates.

Most bankers in the Tenth District report that loan demand remains strong. However, some bankers in metropolitan areas—Kansas City, Denver, and Lincoln—report some softening. Agricultural loans are particularly strong, according to those banks making them either directly or through correspondents. Construction loans are generally up, also. Commercial loans at the larger banks show the most weakness. Nearly all bankers contacted have prime rates of 11 1/2 per cent, following the lead of the large money center banks. All expect further increases in the near future. Most bankers do not expect to have problems meeting future loan demand. However, some mentioned having higher-than-desired loan-asset ratios, cutting back on real estate loans, and being more selective in general.

Deposit growth is moderate or down slightly at most banks contacted. Demand deposits are flat or down slightly at all but a few country banks. Savings deposits are generally down due to higher interest rates and shifts into money market CD's. One banker notes, however, that his savings deposits are up slightly due to automatic transfers. Time deposits are generally flat or up slightly over a year ago. Several bankers, who say that they have recently become more aggressive, report increases in large CD's and money market CD's. Most bankers believe their demand, time, and savings deposits will grow no more than moderately in the near future due to rising interest rates and stiff competition for funds. Bankers who are aggressively seeking interest-sensitive funds expect continued inflows of these funds.

## ELEVENTH DISTRICT--DALLAS

Although rapid inflation and high interest rates are worrying many, retail sales, construction, and manufacturing activity are running at brisk rates in the Eleventh District, according to the Directors and businessmen surveyed this month. Department store executives predict moderate sales gains over last Christmas' very successful season. The increase in new car sales reflects mainly foreign cars. Although borrowing by consumers is softening, deposit inflows and commercial lending activities remain strong at banks. Mortgage demand is slowing under the weight of tighter mortgage requirements, while savings and loan associations are increasing their investments in commercial paper, bank CD's, and out-of-state mortgages. Total construction activity remains strong, but residential construction is slowing, especially multifamily housing starts. Shortages of building materials have eased slightly.

Department store sales are stronger than forecast earlier and are expected to top the record level of Christmas sales last year by a margin comparable to the average rise in prices. Much of the current strength in sales may be due to price markdowns and promotions to run off heavy inventory levels at many stores. Department store executives warn that consumer spending may weaken considerably with continued erosion in purchasing power and mounting burden of consumer debt. Slower year-over-year sales gains are expected in 1979.

Domestic auto sales are running at the same level as a year ago, and inventories are tight. Sales of recreational vehicles are particularly strong, and according to one AMC dealer, some dealers are haggling for the available supply of Jeeps. Foreign car dealers report inventories have

expanded to desired levels, and sales are running well ahead of a year earlier. Most auto dealers note price resistance from buyers, and sales of used cars and parts have been growing since the new model year began.

A slowing of auto loans and other types of consumer credit is reported by District bankers. Commercial lending remains strong, however, and apparently reflects a "better to expand now than wait" attitude among businessmen. A major Dallas bank recently adopted a lower-than-prime rate for small businesses. Deposits continue to rise with much of the strength coming from money market certificates at small banks and large CD's at larger banks. Liquidity generally remains adequate, but a few small banks report shortages of loanable funds. Weather-induced delays in the harvesting of cotton have delayed payoffs at many country banks.

Terms on mortgage loans have been tightened recently by District S&L's. Typically, 25-percent down payments and loan limits have been imposed. Savings inflows have not slowed appreciably, but the cost of funds continues to rise relative to the prevailing 9 7/8-percent mortgage rate, plus three to five points (one to the buyer and the remainder to the seller). Mortgage demand is slowing under the current mortgage terms, and additional funds are becoming available for alternative investments such as commercial paper, bank CD's, and out-of-state mortgages, particularly California. As long as alternative investments remain profitable, S&L's are expected to continue issuing money market certificates. A few small S&L's, however, are placing restrictions on their money market certificates, such as eliminating the .25-percent premium over the six-month Treasury bill rate. S&L's anticipate no problem in rolling over money market certificates as they mature and estimate 85 percent will be rolled over.



The tight mortgage market and expensive interim construction financing are slowing housing starts. Weakness is already noted in the higher-priced homes in Houston, and the multifamily housing market in that city is said to be overbuilt as evidenced by a recent decline in starts. Similar conditions exist throughout most of the District, with most industry spokesmen predicting a continued decline in starts through mid-1979. Because of the slowing in sales, inventories of new houses have risen but remain at levels that builders consider manageable.

A major Southwest cement producer, while predicting a recession for the national economy, sees his business next year little changed from this year. What loss there may be from the residential sector is expected to be made up by gains in nonresidential construction. Cement, sheet rock, and brick continue in short supply, although the slowdown in construction activity is temporarily easing the shortages.

Most apparel firms report only moderate gains in new orders. One area of significant strength is among uniform manufacturers. The new minimum wage is expected to add 6 to 8 percent to the cost of production according to some estimates. Weak product demand, however, will keep the manufacturers from passing on the full wage increase, and price increases are expected to meet Carter's anti-inflation guidelines.

The current pinch in the supply of unleaded gasoline was caused largely by higher than expected demand and refinery outages due to maintenance and fire. Prices of all grades of gasoline, however, are headed up. Refiners are well along on their winter heating oil runs but will begin shifting their product mix for next summer's gasoline demand next month.

## TWELFTH DISTRICT--SAN FRANCISCO

The health of the western economy remains robust, though there are a few signs of possible weakening. Retail sales continue strong throughout the District, and the inventory-to-sales ratio continues lean. While there are still shortages of some construction materials, the situation has improved with weakening real estate demand. Declines in orders for heavy equipment and men's clothing may foreshadow a weakening in economic activity, though no actual weakening is yet apparent, save in real estate. The money market certificates have apparently prevented savings outflows, and early reports indicate a substantial rolling over of these certificates.

Retail sales continue brisk throughout the District. Reports from Los Angeles note that some department store chains are experiencing sales close to 20 percent above last year's levels, with particular strength being seen in soft goods. Some observers attribute this to consumers spending the money they have saved through the property tax cut associated with Proposition 13. Southern California is also experiencing very strong demand for both cars and trucks.

The other side of the brisk sales coin is a continued lean inventory-to-sales ratio. In California, reports generally suggest that sales have been a bit more rapid than expected, leaving inventories a bit smaller than planned. In southern California, in particular, shortages of both trucks and some imported cars have been reported. In Washington, one banker noted that "sales are so brisk, there has been little opportunity for inventories to rise in relation to sales."

Indeed, some manufacturers have reported difficulty in keeping production rates high enough to meet demand. A large electronics manufacturer in Oregon reported orders running 32 percent above a year ago and noted that it was hard to keep up with this level of sales. One independent oil producer noted that inventories in the oil industry are considerably below a year ago.

The chief focus for actual shortages continues to be the construction industry though the supply situation has improved somewhat since last month. Cement and drywall materials were noted to be in particularly short supply. However, as construction activity slows down, demand for construction materials seems to be moving much more into balance with supply capacity. Thus, the previously reported shortages in insulation appear no longer to be a problem. A food processor did note that there were spot shortages of corrugated boxes, paper, aluminum foil, and vanilla beans but attributed them to strikes, poor harvests, and "the like which occur at intervals in the normal course of business." Still he cited inflation in materials costs as "incredible and universal."

While the general pace of the western economy continues strong, save real estate, there were two comments that were suggestive of a slowdown. First, a distributor of heavy equipment reported an unexpected slowdown in sales and an associated rise in inventories to a level 32 percent above a year ago. Action is being taken to reduce these inventories. Second, a large clothing manufacturer noted that orders for men's clothing are down and that men's clothing is traditionally the first to feel a slowdown.

There continues to be a slowing in real estate and construction activity in the West. Only in one area of southern California are housing sales and residential construction still reported very strong. One source of continued sales in both San Francisco and Los Angeles is the conversion of apartment complexes to condominiums. In most areas, homes are staying on the market much longer than earlier in the year with particular buyer resistance to homes in the \$100,000 plus range.

Almost all reports suggest a reduced supply of funds available to the housing market. Three of the largest S&L's in California have stopped making new loans and have restricted themselves to refinancing their own existing loans. A major California bank has not restricted funds to either builders or home buyers but has increased rates and tightened terms on mortgage and construction loans. Eleven percent is now the going prime mortgage rate. Another large California bank has increased rates to 11 1/4 percent and reduced maturities from 25 to 15 years. Several small builders in southern California are reported to have gone out of business due to this tightening. Construction activity has fallen off considerably in Idaho, where a 10-percent usury law restricts the flow of funds to housing.

There appears to be a general consensus in the District that the money market certificates have helped to prevent savings outflows from banks and S&L's. There was some concern expressed that when the first generation of these certificates mature, savers may move their money into longer-term Government securities. However, one large California bank which is monitoring the situation closely, feels that reinvestment

in new certificates will be substantial. Also, several large S&L's in California have ceased offering new certificates, though they are rolling over existing certificates.