CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

September 14, 1977

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SUMMARY*

The general concensus that emerges from the August district reports is of continued moderate growth in consumer spending and little prospect of significant advances in plant and equipment investment. Retail trade, particularly automobile sales, remains strong and residential construction continues at a brisk pace. Concern over a slowdown in economic activity during the next six months has produced a cautious inventory strategy and restrained new business investment. Consumer loans remain strong, but sluggish business lending is common in most districts. The combined effects of bumper crops and drought have reduced farm income and increased agricultural indebtedness in many areas.

Consumer spending was generally strong during August. Solid gains in department store sales were achieved in Boston, New York, Atlanta, Chicago, Cleveland, Minneapolis, and Dallas, although Philadelphia merchants describe sales as below expectations and St. Louis reports only modest gains. Philadelphia and San Francisco report strong sales of durables, such as furniture and appliances, matching the growth in residential construction. Sales of 1977 model automobiles, apparently stimulated by price increases announced for next year's models, continued to be excellent in the Atlanta, Chicago, Dallas, Kansas City, St. Louis, and San Francisco districts.

Both residential and non-residential construction continued their vigorous advance in many areas, although scattered reports of labor and material shortages have appeared. Dallas reports that housing starts are down only slightly from the record June pace and that shopping center construction in Texas is triple the level of last year. The Atlanta, Chicago,

*Prepared by the Federal Reserve Bank of Boston.

Kansas City, and St. Louis housing markets remain robust. The housing boom continues on the west coast, but San Francisco reports that the rate of increase has apparently reached a plateau in most areas. While no district is experiencing a shortage of mortgage funds, Chicago, St. Louis, Atlanta, and Dallas report spot shortages of various building materials and skilled construction workers.

Manufacturing activity presents a mixed picture, with materials shortages appearing in some districts and concern over the health of the steel industry growing in others. Dallas reports a continued rise in industrial production, led by increases in the output of oil field equipment and building materials. Shortages of brick and cement are reported to be widespread, however. Record offshore oil and gas production has stimulated shipbuilding activity in Atlanta, but "serious shortages" of all types of oil handling equipment have developed. In New York, production cutbacks announced by a major steel producer will further retard the sluggish recovery of the western part of the state. Cleveland expresses concern over layoffs and salary cuts at steel plants in its district. Manufacturing output continues to increase at a moderate rate in St. Louis, particularly among consumer goods, although steel shipments are down 10 percent or more from year earlier levels and new orders for several lines of chemicals slowed in August. Reports from other districts are more optimistic. Growing manufacturing activity has provided new jobs in Minneapolis, and is expected to continue to do so. Shipments were generally up in Richmond, but new orders showed little change. In Boston, on the other hand, a slight drop in production reflecting normal seasonal influences is expected to be reversed in the near future due to an increase in new orders for defense goods.

Philadelphia reports a rise in industrial production, especially in durable goods, while Kansas City is experiencing an energy-sector led increase in business activity.

Investment in inventories and capital projects may best be described as cautious. In view of the slowdown in business activity expected in many districts over the next six months, current low inventory/sales ratios are generally regarded as satisfactory. Inventories appear to be at desired levels in Boston, Philadelphia, St. Louis and Dallas. Excessive inventories in specific industries are mentioned by New York, Chicago, and Minneapolis. Business surveys in the Richmond district suggest some unintended inventory accumulation, with an increase in the number of respondents who view their inventories as excessive. Less optimistic business expectations are also reflected in the behavior of plant and equipment expenditure. New York reports "very conservative" capital spending plans; only 37 percent of firms surveyed in Philadelphia plan increases in capital spending over the next six months; Kansas City, Cleveland, and Atlanta cite energy and tax legislation as important causes of business uncertainty; San Francisco sees capital spending as generally weak in the west, with a significant portion of new investment tied to pollution control equipment.

Loan demand continues its familiar pattern, with consumer loans, particularly for automobiles, remaining strong and business loans remaining flat in most districts. Commercial loans are up in Boston, but the funds are being used primarily for plant modernization rather than for new capacity. Atlanta and St. Louis note that a recent court decision in Tennessee upholding the 10 percent limit on consumer loan interest rates has caused a virtual halt in consumer lending in that state. Bankers in the Cleveland, Kansas City, and Philadelphia districts expressed fears of possible disintermediation due to the recent rise in short rates, although current deposit inflows have remained strong in these and other districts.

Agriculture is a particular concern in many districts. In some areas, record harvests, by driving prices down, and unprecedented drought, by driving costs up, have reduced farm income, increased agricultural indebtedness, and decreased the demand for heavy agricultural implements. This basic pattern is mentioned by Chicago, Minneapolis, Kansas City, Dallas, and San Francisco. In other areas, such as Boston, Richmond, and Atlanta, the crop-reducing effect of the drought has had the most pronounced effect on farm income. Atlanta notes that prices for Florida citrus fruits are double last year's level, however.

FIRST DISTRICT - BOSTON

Reports from First District directors and businessmen indicate that the favorable experience of recent months is continuing. However, expectations of somewhat slower growth later in the year are widespread. Retail sales have remained strong. This has been reflected in increases in consumer loan demand, particularly the automobile component. Production seems to have declined slightly but this is attributed to summer vacations. New orders and capital spending appear to be up. Inventories are being watched closely but few think that they are excessively high.

Retail sales appear to have been very satisfactory in August. One of the region's largest retailers reports a softening thus far in September, but he does not expect this weakness to continue. Reflecting the strong retail activity, several banks have seen significant increases in consumer loan demand. Autos have accounted for a large portion of the increase but all aspects have been represented. The summer tourist season in northern New England was the best within memory by a considerable margin.

Retail inventories are being watched closely. One retailer thinks that the successful summer may have caused buyers to be somewhat over-optimistic and that the inventory level for the trade as a whole may be too high. In manufacturing, inventories seem to have risen slightly but they are not seen as excessive and most purchasing agents plan to maintain current levels.

Production appears to have dropped slightly but this is attributed to normal vacation shutdowns. New orders are increasing, particularly for hardware products and capital goods. One respondent reports that the shoe companies in his area are advertising for workers for the first time in a long while. The region continues to be very successful in securing defense contracts. The latest, Sikorsky's contract for naval helicopters, will create new jobs in both Connecticut and Massachusetts. In addition to the actual jobs created, these contracts have boosted business morale considerably. One negative aspect of the industrial picture, at least for northern New England, occurs in the agricultural sector. Drought in northern parts of the region will reduce the hay and corn crops with possible adverse impacts on the dairy industry.

Loan volume is up. The increase is most marked in the southern states where demand had been weak earlier. All categories have shared in the increase: auto loans, consumer instalment credit, residential mortgages and commercial loans. Investment loans are primarily for plant modernization and equipment replacement rather than new building capacity.

Despite their own relatively favorable experience, a number of businessmen expect a slowdown in national growth in the second half of the year. Several companies with forecasting units report that projections for real GNP for the rest of this year and 1978 have been revised downward. Weak capital spending caused by business uncertainty seems to be an important consideration in this gloomier outlook. Also, although it is not directly represented in the region's economy, some New England businessmen are concerned about the long-term future of the nation's steel industry. This concern is justified according to one of our industrial consultants: large capacity reductions at one major company and delayed expansions at others could cause serious supply problems after 1980.

The outlook for prices seems somewhat less pessimistic. Several businessmen report that the rate of price increases seems to have plateaued at an annual rate of 6-7 percent. Lumber prices, which had been increasing very rapidly, are expected to rise at a much more moderate rate in the future. According to a local consulting firm recent price increases have been caused by the demand pull of very strong housing demand in conjunction with the cost push of the 1972-73 increase in stump prices on public lands in the West. The increase in stump prices did not become apparent until timber available under old contracts was depleted. However, most of the influence of both these demand and supply shifts is already reflected in today's prices.

Professors Samuelson, Tobin, Eckstein, and Houthakker were available for comment this month. Samuelson and Tobin were most concerned about the high risks of a growth recession in 1978. Samuelson believes that the strength of the world recovery is so uncertain and the prospects for more vigorous investment spending so tenuous that the Fed should err, if at all, toward excess stimulus until the outlook is more secure. Fearing that a loss of momentum will be difficult to recover, Samuelson believes that a growth recession could only contribute to the economy's lasting structural problems, perhaps worsening the prospects for controlling future inflation.

Tobin believes that increasing the federal funds rate further as the pace of growth falls may constitute a mistimed policy. Business confidence in the recovery is already fragile enough that the Fed should avoid further restraint during the current slowdown.

Noting that private demand "has not fallen apart," Eckstein believes economic growth will average just under 5 percent during the next four quarters. The major uncertainties in the outlook are that foreign demand for exports may deteriorate and that Federal expenditures may fall well short of budget entitlements. Although Eckstein believes that short-term interest rates can increase 50 to 75 basis points during the next four quarters, it is better for now to hold the federal funds rate constant until the extent of the slowdown in activity can be assessed with more certainty.

Houthakker is "mildly satisfied" with recent economic performance, and he does not believe that a major growth slump is likely in the near future. The rate of inflation appears to be falling, and there is no indication that price increases should re-accelerate in the near future. Houthakker is critical of the recent instability in the growth of M1, however; the Fed appears to be increasingly unable to meet its stated aggregate targets.

SECOND DISTRICT--NEW YORK

Business activity in the Second District continues to expand moderately, judging from recent comments of directors and other business leaders. The expansion appears to be quickening in New York City but prospects for gains in activity in the Western region of the district have been clouded by sizable planned cutbacks in steel production and employment. For the district as a whole, the pace of activity continues to lag the nation. Retail sales continue strong, but the outlook for capital spending remains unclear. Inventory levels appear to be on the "high side." On the financial front, business loan demand remains sluggish, but many bankers look for a pickup in demand in coming months.

The gains in retailing varied across the district. Department store sales in New York City continued to post solid gains in August. According to leading City retailers, the gains were bolstered by aggressive merchandising and major remodeling of several stores. Among product lines, apparel sales recorded large gains as consumers appeared to step up purchases of fall fashions and back-to-school clothing. Sales of consumer durables, most notably fans and air conditioners, were cited as remaining strong. Upstate sales appeared to be less robust. The president of a major department store in Rochester reported sales were somewhat below expectations.

The announcement of production cutbacks by a major steel producer represents a severe blow to the sluggish recovery of Western New York. Within the next few months, the firm plans to cut steel-making capacity in its Niagara frontier facility by some 40 percent, from 4.8 million tons annually to 2.8 million tons. Four blast furnaces, one basic oxygen furnace, and three rolling mills will be closed. Some 3,500 employees, accounting for 30 percent of the firm's payroll in the area, will be laid off. In addition to this direct loss, observers expect employment in related industries -- most notably trucking and railroads -- to be affected adversely.

According to a steel executive, the problems plaguing its Niagara frontier production facility were age and inefficiency. A commercial bank economist noted that these problems are not unique to steel. In this economist's view, upstate capital goods producers in general are saddled with older, less efficient plants. Given the sizable tax disadvantages of operating in New York, many firms are hesitant to reinvest and many simply transfer operations out of the state. Reflecting the continuation of these trends, several major manufacturers recently announced such actions.

Inventory stocks appear to be high. At the retail level, some executives reported little concern with the higher level of inventories because of optimistic sales prospects. Other retailers, however, were wary of the higher stocks. The chairman of a major New York City bank reported some specific situations where inventories were getting a "little out of hand" but felt there was no widespread problem. In this vein, several directors pointed out inventory excesses in the metals industries due to lower-than-anticipated orders and shipments. A chemical executive reported inventory imbalances in certain chemical and textile products and expected production curtailments in coming months to bring stocks into line with sales. The directors of the Buffalo Branch agreed that continued tight inventory policies would prevent any excesses from becoming widespread.

Notwithstanding the upward revisions in the government survey of 1977 planned investment outlays, directors of the Buffalo Branch reported that businessmen continue to make capital spending decisions in a "very conservative," even "cautious," light. On the outlook for 1978, respondents offered little hope for a quickening in the pace of spending. The economist of a major chemical producer reported that his firm had cut 1978 planned spending by 25 percent compared with 1977. Several directors reported that the slack conditions in the ferrous and nonferrous metals industries augered for cutbacks in spending in these industries. A director of the Buffalo Branch felt that the leveling off in gasoline consumption accounted for the apparent slack in investment in refinery capacity. The chief economist of a major automobile manufacturer expects his firm's 1978 spending to hold at the record level planned for this year. For the automobile industry as a whole, he felt capital outlays could be strong due to outlays required on tools and equipment associated with resizing automobile production.

Apart from a recent spurt in bankers' acceptances, the demand for business loans in the district on balance has remained sluggish, both in and outside New York City, and generally below earlier expectations. However, a number of loan officers at large commercial banks throughout the district looked for some pickup over the coming months. Several bankers noted a strengthening in automobile loans. No significant change in time and savings deposit flows at district commercial banks was evident in recent weeks. There was a moderate net outflow in August at New York State savings banks which, according to a savings bank association official, was probably seasonal as well as reflecting some runoff of "wild cards."

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District is expanding at an uneven pace. Department store sales are mixed, while activity in the region's manufacturing sector continues to increase. New orders and shipments are higher in September, and factory employment and the workweek also show signs of improvement. Manufacturer's inventories are down somewhat this month. For the longer term, retailers and manufacturers are less than optimistic. Most merchants expect a continuation of the recent trend of weak sales growth. In addition, the proportion of sampled manufacturers anticipating better business conditions six months out is the lowest in over two and a half years. Commercial bankers say that consumer borrowing remains strong, but business loan demand, although better of late, is still weak.

Manufacturers responding to the latest Business Outlook Survey report that business is improving in September. Of the executives surveyed, 26 percent say that business is better than last month, while 9 percent say it is worse. New orders and shipments are higher in September, and moderate gains in employment are reported as well. Both work forces and the average workweek are increasing for the first time since June. Inventories, however, are reported to be down somewhat after holding steady for the past four months.

Overall, the pickup in manufacturing activity in the District appears to be more widespead in durables than in nondurables. Comments by Directors of this Bank support this observation. Two Directors, whose companies manufacture nondurables, report that business has been slow over the last six months. While one is unsure about the future, the other expects a recent pick-up to gain strength. Another Director, a manufacturer of durables, says business is better than anticipated, and looks for additional expansion next year.

Despite the improvement in general business conditions in the current period, manufacturers are not very optimistic for the longer term. In the latest survey, 43 percent of the respondents anticipate improvement in economic conditions over the next two quarters. Expectations of gains six months out are now less widespread than they've been in over two and a half years. Increases in new orders and shipments are anticipated at about half the sampled firms. These are the lowest proportions projecting increases in these categories in a year. At the same time, inventories are expected to be unchanged over the period, and little growth is anticipated in employment. Thirty-seven percent of the sampled firms project increases in capital spending over the next six months. This proportion is roughly unchanged from last month.

Prices in the industrial sector continue to increase, although prices received by manufacturers are climbing at a slightly slower pace than in August. Forty-six percent of those surveyed report paying more for inputs, while 23 percent say they are receiving higher prices for the products they sell. For the longer term, 4 out of 5 project higher prices for raw materials by March, while 3 out of 5 look for higher prices for their finished products. This latter proportion is down somewhat from August.

Reports from retailers indicate that department store sales in the area are mixed. Current dollar sales are reported to be between 2 and 22 percent above September '76 levels. Hard goods, specifically furniture, are selling extremely well. However, while one merchant says sales are better than anticipated, most say they are below expectations. In general, suburban stores are doing better than those located in downtown Philadelphia. Retailers say their inventories are in good shape overall, and feel they would not be overstocked if a period of extreme softness developed.

As for the outlook, most merchants contacted are "cautiously optimistic" about economic conditions between now and March. While one expects to see March sales 15 percent above year-earlier levels, others look for gains in the 5 to 7 percent range. Retailers do not seem to be concerned either that high levels of consumer installment debt will be putting a damper on sales in the latter part of the year, or about the possibility of a downturn in the economy next year.

Bankers in the region report that consumer loan demand continues to be strong, but that business loan activity, while better in recent weeks, is still below expectations. Reports of current levels of C&I loans range from 3 percent below to 8 percent above year-ago levels. Most of the bankers contacted say that although borrowing by local business is at or above expected levels, the national market continues to be depressed. They feel that the national sluggishness results, in part, from the availability of alternative sources of funds to larger firms.

For the longer term, most of the bankers contacted anticipate expansion of business borrowing through the first quarter of 1978, with business loans at that time 6 to 7 percent above March '77 levels. Interest rates are projected to climb, with the prime rate, currently at 7 percent at all of the banks contacted, expected to rise to 7 1/4 - 7 1/2 percent by March.

Bankers appear to be only "mildly worried" that the rising short-term rates will cut off savings inflows. They anticipate real growth in the 3 to 5 percent range next year, and do not expect that higher short-term interest rates will lower this rate of growth.

FOURTH DISTRICT - CLEVELAND

Weakness in the steel industry and more cautious inventory policies by manufacturers and retailers have slowed the pace of eocnomic activity in the Fourth District this quarter. Despite strong sales gains again in August, retailers remain cautious about prospects for the balance of 1977. Capital goods producers report continued strong demand for machinery and equipment, but heavy construction remains weak. Residential construction and mortgage loan demand continue strong.

An atmosphere of gloom seems to have marked the steel industry in recent weeks. Steel orders have not rebounded as much as was generally expected. Although several producers are operating at about 75-to-80% of effective capacity, they expect another quarter of little or no profits. A recent surge in steel imports and further mild runoff of inventories have led directors and steel economists to scale down forecasts for the balance of this year. Consumption has remained relatively strong except for structural steel. Still, one economist noted orders from the automotive industry have not been as strong as previously expected when production schedules for 1978 model cars were announced. The industry, therefore, is marked by discounting of prices, layoffs of salary and production workers, suspension of cost-of-living adjustments for white-collar workers, numerous closings of marginal facilities, and halting or stretching out of capital-spending plans. A producer, for example, cut the price of structural steel products $50 a ton below published price to keep its mill in operation. Another producer hopes to improve cash flow by selling its interest in iron ore properties in Labrador, valued at about $75 million. While steel economists anticipate that next quarter's production levels will increase to at least 80% of capacity, they acknowledge little sign of improvement in orders to support their expectations. Furthermore, the industry would not generate much profit even at a higher operating rate.

Retailers and producers generally feel inventories have been built sufficiently earlier this year and approach inventory policies with caution for the rest of 1977. Inventories are not judged to be excessive, although some adjustment is now occurring. Still it is not of the magnitude experienced late last year. A large automotive and truck parts supplier expresses the view typical of cautious inventory policies; keep inventories as low as possible regardless of past inventory-sales ratios. Similarly, a director associated with a retail chain commented that retail stocks are more balanced since the July-August pick-up in sales and that should sales soften later this year, orders would likely be cut back promptly to avoid another inventory buildup. Steel inventories at both consumer and producer levels are not judged to be high. One large producer, however, will trim stocks to reduce costs. Steel consumers have been cutting inventories but steel economists expect a reduction to be brief and mild in contrast to that of late last year. One economist estimates that steel inventories currently are only slightly above those during troughs in 1970-1971 and late 1976, in spite of the fact that consumption is considerably hgiher than in those periods. Copper and scrap inventories held by one firm are reported to be at an all-time high and will likely be cut. Crude oil and gasoline stocks continue at levels well above a year ago, although one refinery reported a rather sizable reduction in gasoline stocks during August. On the other hand, distillate and residual fuel stocks are only slightly above last year's levels and as some producers will apparently aim to increase those stocks.

Directors and officials associated with consumer goods are mixed in their views about prospects for consumer spending. Even though sales gains in August were large relative to a year earlier, some retailers remain cautious. A director of a department store chain cautions that slower gains in income and an unsustainably high proportion of expenditures for automotive and luxury-type goods would likely hold down future consumer spending. An economist in retail trade expects slower growth in disposable income and increased personal saving rates will hold overall gains in real consumer expenditures to about a 3% annual rate of increase this half. He does not believe that the rapid rate of increase in retail sales last month can be sustained, nor is it consistent with forecasts of only 4-to-5% quarterly gains in real GNP during the second half of 1977. A director associated with a producer of household products, whose sales surged in August following two months of reduced order activity, took a more optimistic view. He reports his firm plans to step up its capacity expansion program.

Recovery in capital goods industries is still not broadly based. Although producers contacted expressed growing confidence that the 13% gain projected in the latest Commerce Department survey will be realized, they see few indications that suggest an accelerated pace over the next few quarters. One official with a large producer of parts and equipment for industrial and agricultural machinery suggests the atypical lag in the recovery can be attributed to concern over the next recession, lack of strength in export markets, and ample capacity. His firm experienced a substantial decline in sales of components for farm implements, a trend he expects will extend into 1978. Orders for medium trucks used for inner-city transit are slowly increasing. On the other hand, the firm's heavy-duty truck production has rebounded rather strongly, and 1977 output is expected to be 45-50% higher than last year.

Similarly, orders for industrial lift trucks accelerated sharply since spring and shipments for the year are expected to be about 35% higher than in 1976, but well below 1973-1974 peak levels.

The contrast in capital goods industries is perhaps best illustrated by the rising demand for machinery and equipment--including machine tools, materials and handling equipment, forgings and communication equipment for which backlogs have been rising steadily--while construction of new plants and public works projects remains weak. Continued weakness in public construction has prevented recovery in production of off-highway equipment, structural frames for bridges and highways, and structural steel. Financial officers with two large international firms that design, engineer and construct plants report that interest in new construction projects has either been flat or weakened recently. One noted a tendency for shelving projects until an energy program and tax legislation are enacted. One of these officials also expects that it may be at least a year or more before construction of new plants begins to accelerate.

Residential construction remains strong and demand for mortgage loans is at or near record levels, according to officials of several large S&Ls. A major northeastern Ohio utility increased its forecast of 1977 housing starts by 10% because sales have kept pace with completions. Several S&Ls continue to report very strong demand for mortgage loans. None report disintermediation but an official with a $360 million deposit association reported a recent runoff in deposits because maturing 4-year certificates were not redeposited. In fact, some associations have had to step up borrowings from Federal Home Loan banks. While still above the 7% requirement, liquidity at S&Ls has generally been reduced.

FIFTH DISTRICT-RICHMOND

District manufacturers responding to our latest survey are developing some uncertainty about business prospects,and this uncertainty is apparently being fed by recent developments in business activity. New orders at these manufacturers were nearly flat in August, with the only really bright spots occurring in the apparel and furniture industries. Coincident with this performance in new orders, there appears to be some growing sentiment that inventories and plant and equipment capacity are excessive for current needs. Additionally, a majority of manufacturers surveyed anticipate little or no change in the level of activity over the next six months. This Bank's Directors, addressing a question on the outlook for business capital spending, were in general agreement that there is little evidence of a recent change in prospective outlays.

Among District manufacturers surveyed this month shipments were generally up while new orders and backlogs of orders showed little change. What strength there was in the new orders picture seems to have been largely a somewhat tardy advance in the apparel and furniture industries. Manufacturers' inventories continued to expand as did the number of respondents viewing current levels as excessive. Twenty-five percent of all respondents also now view current plant and equipment capacity as excessive. One representative of the furniture industry cited the intention of his firm to cut back on output over the next six months in order to reduce their stock of finished goods. The diffusion of survey responses further suggests little change in manufacturing employment and weekly hours from last month. Prices continued to rise across a broad front with over one-third of all manufacturers surveyed paying higher prices in August.

Our survey of retailers presents a somewhat brighter picture of current conditions. Total sales were up in August although relative sales of big ticket items showed little change. Retail inventories were reduced and brought into line with desired levels.

Perhaps the most conspicious feature of the survey responses of manufacturers and retailers is the sharp differences between their respective expectations, or more precisely the recent change in their respective expectations. Retailers as a group, while still anticipating little change in the level of activity over the next six months, are more optimistic now than a month ago. Manufacturers' expectations, on the other hand, are decidedly less positive than in recent months and there was even a significant deterioration in the outlook during the most recent survey period. Fewer than one-fifth of all manufacturers surveyed expect business conditions, nationally or for their respective firms, to improve over the next two quarters. Only slightly more foresee improvement in their immediate market areas.

Some support is found among the Directors of the Richmond Bank and its' Branches for the view that state and local government expenditures will help sustain business expansion in the near future. Nearly half of the Directors commenting on this question foresee at least a moderate increase in state and local government spending in their respective areas in coming months. Some of the Directors believe that businessmen and investors now foresee some moderation in the rate of price increases. However, inflation remains a major concern, and the expectation of some moderation is by no means universally held.

Data for Fifth District weekly reporting banks suggest that loan demand has faltered somewhat in recent weeks, although bankers do not seem to think this will continue. Our mid-August survey of changes in bank lending practices shows no banks expecting weaker business loan demand in the months ahead. Recent data on consumer loans show a tapering off of growth, as do data on real estate loans. Advances in the consumer loan and real estate loan areas, however, are also expected.

The commercial and industrial lending picture is somewhat mixed, the net result being a recent flattening out in this category. Most of the weakness in business loan demand seems centered on the nondurable goods industrial sector, although declines in the volatile public utility classification have also been a depressing factor.

District cash farm income during the first half of 1977 was 8 percent above a year ago, but the outlook for the second half is not as encouraging. Sagging grain, soybean, and cotton prices weaken the farm income picture. Moreover, District farmers generally face prospects that 1977 crop output will be the poorest in many years. Because of the prolonged drought, prospective yields per acre are down sharply. And acreages for harvest in general are smaller. Recent rains will boost pasture conditions and may improve the yields of tobacco, soybeans, and peanuts but came too late to help the corn crop--now expected to be 35 percent under a year ago. Indications also point to a 25 percent drop in flue-cured tobacco production. On the bright side, however, quality of flue-cured marketings has improved in recent weeks, demand has been strong, and prices have risen sharply, averaging 12 percent above a year earlier and hitting record levels in two of the three flue-cured belts.

SIXTH DISTRICT - ATLANTA

Directors' and other business reports from around the District are generally optimistic and indicate solid growth. Retail sales are strong. The housing boom continues to spread and gather momentum, straining supplies of some building materials. Energy development activities are at record levels. But the agricultural outlook remains dim despite small improvements in production prospects. A recent Tennessee court decision, strictly enforcing the Constitution's 10-percent interest rate ceiling, has cut off funds from finance companies and reduced bank lending, threatening consumer spending. Directors cite uncertainties about the direction of government policy, particularly the possible elimination of investment tax incentives, as the main cloud on the horizon.

Consumer spending is strong in most areas, with record retail sales reported in southeast Florida and along the Gulf Coast. August auto sales were excellent following announcements of price increases on 1978 models; many dealers expect healthy demand to carry over to the new models. Some softness is evident in sales of higher-priced fall apparel, notably menswear, and is causing inventories to back up at Georgia textile mills.

Tennessee banks, finance companies, and credit unions are in a lending quandary since an August 22 State Supreme Court decision invalidated a statute which allowed lenders to skirt the Constitution's 10-percent interest rate ceiling by using add-ons or discounts. A pending class action suit on behalf of all borrowers demands repayment of all interest in excess of 10 percent collected on loans made by the state's lending institutions in the past five years. A constitutional convention is currently considering proposals to modify or remove the usury provision but will not be able to get the issue before the voters until May or August of 1978.

The state's finance companies (there are nearly 500 with 450,000-500,000 borrowers), specifically affected by the decision, have virtually ceased all cash lending and have laid off about 1,000 employees. Bank reactions indicate confusion as to interpretation of the decision and fears that future challenges may extend strict interpretation of the interest limitation. Interest charged by stores and car dealers or on bank credit cards in financing specific purchases has been exempted from the ceiling by an earlier court decision, but the more recent ruling has been construed to apply to bank loans for such purposes. Banks generally are making such loans only to those established low-risk customers to whom they can profitably lend at 10 percent or are offering 12-month, 10-percent loans with final "balloon" payments, hoping the Constitution can be amended in time to refinance. Some have cut off all small loans. Most are still buying auto dealer paper. A few are escrowing interest collected in excess of 10 percent.

State retail sales figures are not yet available to show the impact of the credit dam. There have been some reports of lighter sales of big-ticket durable goods; one director remarked on increased auto sales by dealers just inside Kentucky. Displaced borrowers are expected, wherever possible, to go out of state for financing; loan activity has reportedly already risen at Mississippi banks in the Memphis area.

Residential real estate sales and housing construction have accelerated to an extremely rapid pace in Florida's coastal areas. New apartments and condos account for much of the latest surge on the "Space Coast." Vacant land has grown scarce in the Miami area, encouraging speculation. A Florida director notes continuing moderate real estate speculation along the north Gulf Coast. Mortgage money is plentiful throughout the District, and loan closings at savings and loans are up sharply. Farm real estate activity has risen in Tennessee.

Plans to construct new hotels and expand tourist attractions highlight moderate advances in nonresidential construction. Announcements of plans to build shopping centers and large industrial facilities have become more numerous in the Gulf states. The latest round of announcements included a phosphate mine expansion in central Florida, a headquarters relocation and new industrial complex for the Melbourne area, and large army construction projects in Mississippi. Commercial and industrial growth in the Atlanta area has not kept pace with other District cities. A foundry owner finds encouragement for business spending in rising orders from capital goods producers.

Intense construction activity has resulted in delayed deliveries and climbing prices of building materials, particularly in Florida. Lumber supplies are low, and prices have risen as much as 20 percent in the past three months; one Tennessee producer has been turning down orders. Atlanta and Florida builders report shortages of insulation materials.

August rainfall has improved crop production prospects, but harvests of most crops will be considerably lighter this year than last. Pest damage is unusually heavy; some pesticides are in short supply. Despite extensive losses in some areas, the District's cotton and soybean output should be abundant this fall, but sluggish demand and soft prices for these and several other major cash crops will restrain farm revenues. However, rising demand and expectations of low supplies are allowing citrus growers to sell production in advance of the season for the first time in years, at prices nearly double last year's. Livestock liquidation has slowed as pastures revived. Purchased feed costs have fallen, enlarging profit margins of poultry and hog producers, but depressed local corn and hay production will make beef cattle herds difficult to maintain through the winter.

Oil and gas industry activity, both onshore and in the Gulf, is at an all-time high. Some shipbuilders, benefiting from larger volumes of oil-related jobs and preparations for East Coast drilling to begin soon, are experiencing serious shortages of all types of oil-handling equipment. Others remain concerned about maintaining sufficient work levels despite improvements; layoffs by New Orleans and Pascagoula shipyards probably won't be as severe as originally announced but will be substantial at best.

SEVENTH DISTRICT - CHICAGO

The business upswing appears somewhat less vigorous to observers in the Seventh District than a few months ago. Few, if any, believe that a general letdown is in prospect over the next several months, but most corporate managements are not in a mood to take on substantial new risks. The capital expenditure picture continues mixed, with lighter products and components appreciably stronger than heavier items in most categories. Building materials are hampering completion of housing units in some areas. Most other goods appear to be in ample supply and inventory buying policies are under close rein. However, oil product inventories are above desired levels. The general energy picture, including natural gas, appears favorable for next winter. Farm crops appear excellent, but concern over the impact of low prices on farmers is growing.

Large retailers continue to report good increases in sales. Stock-sales ratios are relatively low, but virtually all goods are readily attainable. Sales of home improvement items, insulation, paint, etc.--are excellent.

Sales of both domestic and imported cars are at least matching expectations for most models. Michigan's economic health is much improved. However, the smallest car producer closed one of two assembly lines in Racine only three weeks after output of new models was begun. In addition, a large assembly plant in the Rockford area will be closed for several weeks as lines are converted to smaller cars.

Sales of heavy-duty trucks and trailers continue at high levels. Other relatively strong capital goods sectors include railroad equipment, small construction and earth-moving machines, machine tools, lift trucks, ore processing equipment, diesel engines, well-drilling apparatus, and electrical and mechanical switches and controls. In contrast, farm equipment sales are down sharply. Shipments of large mining shovels, at capacity for several years, are 20 percent below last year and backlogs are much reduced.

The housing market is somewhat less frenzied but still vigorous nonetheless. Completions of housing units are being slowed by shortages or slow deliveries of insulation, bricks, windows, and other components. Many additional skilled workers could be used currently. Mortgage funds are readily available and mortgage rates are not expected to rise, even if market rates do so. Apartment building is continuing to rebound with greatest strength in smaller projects of 10 to 12 units, rather than high-rise units. The Chicago area is experiencing a surge of conversions of rental buildings, some very large, to condominiums.

Sheet and other lighter steel products are in good demand. Heavy structurals, large castings, and other products for capital goods continue to lag. Imported steel is penetrating the Midwest to an unprecedented degree. With lead times short steel buyers are not interested in rebuilding inventories. Short runs on particular steel products are hurting mill profits. Some steel companies have undertaken drastic cost-cutting programs. Such actions created rumors, since denied, that the South Works in Chicago (one of the city's largest industrial employers) would be closed.

The iron ore strike in Minnesota will have a serious impact if it lasts another month or two. Steel companies will attempt to move more ore through Lake Superior during the winter than in the past. Rail transport capacity is quite limited. Recent and prospective coal strikes are also a threat to steel output. Experts are puzzled that possible cutoffs of steel supplies do not encourage inventory building by users.

Industrial and commercial companies are continuing their efforts to protect their operations in case of another severe winter. Among steps taken are conservation, increased storage for oil and propane, new proprietary gas wells, realignment of processes to reduce dependence on natural gas, and detailed contingency plans to implement in case of a cutoff.

The natural gas outlook is much better than expected. All storage fields are rapidly being filled to capacity--including some new fields. District utilities have contracted for additional gas and some have participated in successful new finds. Short of a diversion elsewhere, there should be no problems in the district except perhaps in Indiana. Even in Indiana the major utility has assured customers that it has additional supplies and that it will monitor and manage its send-out more carefully to avoid "surprises." A Michigan utility is accepting new small industrial and commercial customers for the first time since April 1975.

Heavy rainfalls in recent weeks have substantially replenished subsoil moisture in most areas of the district. Generally excellent crops are well ahead of normal development. Corn harvesting has begun, ahead of schedule, in scattered areas. Lowered feed costs are expected to trigger increases in production of hogs and fed cattle. While favorable for general inflation prospects, lower crop prices are causing enhanced concern among farm lenders and those who sell products to farmers. Sales of farm equipment, for example, are down sharply. However, expenditures on crop storage facilities are strong.

EIGHTH DISTRICT - ST. LOUIS

The Eighth District economy continues to advance at a moderate rate, although growth has slowed from the very rapid rate of the first half of the year. Consumer spending continues on an upward course, but at a reduced rate from last spring, and a number of manufacturing industries indicate continuing increases in orders. Retail and manufacturing inventories are generally at desired levels, except in a few industries where demand has been weak recently. Homebuilding continues at a rapid pace. In the financial sector, demand is generally strong for most types of loans, particularly real estate. Crop prospects are excellent for several major crops.

Consumer spending continues to increase, but at a slower pace than earlier this year. Representatives of major department stores report back-to-school and early fall sales are up from a year ago. Some of the respondents, however, noted that competition for the consumer dollar is increasing, and sales are becoming more difficult to obtain. Passenger car and truck sales are reported to be strong.

Retail and manufacturing inventories are generally in line with the expected moderation in sales. Retailers report that they have been cautious about inventory building and have adjusted quickly to changing demand conditions. However, one retailer of ladies apparel noted some softening in sales and somewhat higher inventories than desired. In manufacturing, steel inventories are being reduced in the third quarter, and the chemical industry reported excessive inventories of fibers due to softening demand.

Savings continue to flow into thrift institutions at a strong and steady pace. Representatives of these firms report a continued high level demand for mortgages, and some firms report a great deal of overtime by their staff to keep up with the workload. Commercial bank loan demand is reported to be quite strong in smaller cities and rural areas, while business loan demand in the larger cities remains sluggish. Interest rates on mortgages are predominantly in the 8-3/4 to 9 percent range and are expected to remain at this level for the next few months. Bankers in the area expect the prime lending rate to increase to about 7-1/2 percent before the end of the year.

A ruling by the Tennessee Supreme Court on a statute, which circumvented the 10 percent usury law written into the State constitution, has thrown consumer lending in that state into confusion. Some banks have decided to operate on a 10 percent simple rate until the banking law on interest rates has been clarified. These bankers say that the quality of their consumer loans will be upgraded, thereby reducing collection and loss expense. Other banks have not changed their loan policies. Small loan companies in the state have generally stopped making loans.

Manufacturing activity continues to make moderate gains. Manufacturers of electrical motors, appliances, furniture, paints and coatings, barges, hotel supply equipment, footwear, plywood, and certain apparel items all reported sales gains. However, a representative of the steel industry reported depressed conditions. Steel shipments are currently running 10 percent or more below levels of earlier this year. A chemical industry representative reported a slowing in orders among several product lines in August. Demand for textile fibers and plastics has slowed, partly due to weak foreign demand. Industrial chemical sales have been flat recently, while agricultural chemicals, after a period of weak demand, have picked up.

Home construction remains one of the healthiest segments of the District economy. Most areas report large increases in construction of both the single-family and apartment units over a year ago, and recent sales have continued relatively brisk. Current construction of single-family homes continues to reflect homes already sold, and very little speculative building is reported. Material and labor availability has been of some concern, although some observers of the homebuilding industry believe that such shortages are overemphasized.

Prospects for the fall harvest of most District crops are quite good. Yields for corn, soybean, and cotton are expected to be generally good. However, reports from the southern portion of the District indicate that the cotton and, to a lesser extent, the bean crops are being damaged somewhat by army worm infestations. The tobacco crop in Kentucky is reported to be good, and somewhat higher prices than a year ago are expected for this crop.

NINTH DISTRICT - MINNEAPOLIS

Despite some trouble spots, the Ninth District's economy is currently quite strong, and directors seem generally optimistic. Several regions are suffering from strikes and layoffs, but employment is up in large urban areas, and more gains are expected. Manufacturing sales gains have been sizeable all year, and although they are expected to moderate somewhat, most manufacturers are satisfied with current inventories and plant and equipment. For most farmers, low grain prices are still taking the luster off the expected large harvest, but income prospects have improved for some. As a result, many district consumers have increased their spending recently, and retailers expect good sales this fall. Borrowing has increased too, both to support the expanding industries and the spending consumers and to refinance farm debt.

Employment

Large strikes and layoffs are currently depressing employment in several district areas. The iron ore workers' strike has cut job growth in the Upper Peninsula of Michigan and northeastern Minnesota. And a large copper producer in Upper Michigan has laid off a substantial number of workers.

But labor market conditions are strong in the large urban areas, according to directors. Employment has grown considerably over last year, and unemployment is down. The Minneapolis/St. Paul area unemployment rate, for example, is currently 5.1 percent compared to 6.5 percent a year ago. Most of the new jobs are reportedly in construction, trade, and service industries. And the prospects for further job growth are considered good.

Manufacturing

Strong manufacturing activity has been providing new jobs too and will probably continue to, though some easing is expected. After sales gains of 14 percent over a year ago during the first half, district manufacturers responding to our latest quarterly survey think their sales will increase 13 percent in the current quarter, 10 percent in the fourth quarter, and 8 percent in the first quarter of 1978. Gains in durable goods sales are expected to slow from 16 percent in the third quarter to 10 percent and 8 percent in the next two quarters. Sales of nondurable goods, meanwhile, should increase a fairly steady 8 percent.

Despite the overall slowing in sales growth, most manufacturers don't seem to expect any sharp drop in activity: Only electric machinery manufacturers consider their current inventories and plant and equipment capacities excessive through early 1978.

Agriculture

Directors still consider agricultural conditions generally troubling. Although harvests are expected to be excellent this fall--"spectacular" in some places--prices are very low, so most farmers' income probably won't match last year's. Recent rains may have set back North Dakota farmers even further; they have delayed wheat harvesting and so could substantially cut yields there. The Administration's plan to cut back wheat production is worrying some directors, particularly in Montana where farmers have few production alternatives. And the impact of low grain prices on cattle producers is still unclear.

Directors do see signs of possible improvement for some farmers, however. Good crops are expected in last year's drought areas, so despite the low prices farmers there could have more cash to spend this year than last. The low grain prices will probably improve the profitability of those who feed grain to dairy cattle, poultry, and hogs. And the pending farm legislation's price supports should help bolster farm income generally.

Spending and Borrowing

Because of the somewhat brighter ag outlook and the strength in other industries, directors say many district consumers have increased their spending recently. The labor strikes and layoffs are depressing spending in Upper Michigan and northeastern Minnesota. But otherwise both large urban areas and rural communities report stronger retail sales. And most of the district expects this strength to continue into the fall.

Bank lending has been quite strong recently too. District consumers and businesses have increased their borrowing, and farmers have gone further into debt.

TENTH DISTRICT--KANSAS CITY

Tenth District directors report continued strength in the area economy and a general mood of optimism among area businessmen. Retail sales are only moderately good, but construction is booming. The most negative factor mentioned is the continued uncertainty generated by a "garbled" energy program and an as yet unspecified tax reform package. On the agricultural front, bumper crops should provide stability to retail food prices, but they continue to depress farm incomes. As a result of these lower incomes, agricultural credit needs are particularly heavy--contributing to an overall strong demand for loans.

Nonbank directors report that business conditions are generally good in the regional economy. The strongest sector, mentioned by several directors, appears to be construction. In Denver, especially, office construction is booming. In Omaha, homebuilding is reported as the best in 4-5 years, with apartmentbuilding contributing strongly to this growth. Unemployment is down across the area and employment is up. Retail sales were mentioned by several directors as doing "reasonably well," with dollar gains most marked in the suburban areas. Auto sales, in particular, were very strong, and Oklahoma directors reported greater retail strength than did other directors. In general, noted one director, "It's hard to get a controversy going; everything is doing well."

Directors from both Oklahoma and Colorado noted a positive influence of the energy situation on the economy of their respective states. In Oklahoma, "There is much activity in the energy sector, which is causing a pickup in general business." In Colorado, there is the "feeling of the powerful influence of coal and especially oil shale. In addition, much solar energy research is also taking place."

While attitudes of businessmen are generally bullish, two important negative themes were mentioned by most of the directors. First, the business community remains skeptical of the Administration's tax and energy programs. As a result, capital expenditures are being delayed awaiting clarification. "The energy thing is just chaotic, expressed one director." Second, although the weather has been excellent, farm income is suffering badly due to low product prices, and farm implement dealers, especially, are feeling the impact. As to the national economy, however, the consensus still expects continued strength at least through mid-1978.

Livestock and major crop supplies will likely be large enough to effectively preclude a significant rise in the prices received by farmers in the coming months. Although the fall harvest has just begun, there is clear evidence that the size of the feed grain and soybean crops will be of bumper proportion, pushing total supplies for the new marketing year well above year-ago levels. Moreover, grain stocks a year from now will probably show substantial gains over current levels. Although grain prices may show some seasonal strength in the post-harvest period, they are not expected to average much above government loan rates in the foreseeable future.

The sharp reduction in grain prices has significantly lowered feed costs in the livestock industry. As a result, producers have been encouraged to expand their breeding and production programs. Therefore, meat supplies through mid-1978 promise to run larger than originally anticipated, which suggests that prices at the farm level are not likely to rise significantly. The Index of Prices Received by Farmers dipped for the third consecutive time in the month ended August 15 to a level 6 per cent below a year ago. Given the outlook for commodity supplies, farm prices will probably show only modest strength at best for the next several months, and this development should provide some degree of stability to retail food prices.

Most Tenth District bankers contacted for the September Red Book survey reported strong demand for loans. Agricultural credit needs are particularly heavy--necessitating increased sales of loans by smaller country banks to their correspondents. Some bankers reported an increase in business loans--particularly in the construction area--although others reported a softening in business loan demand.

Total deposits have increased at most banks contacted, but time and savings deposit inflows have moderated. Many bankers felt that the rise in short-term rates could affect savings flows in the near future. Most bankers expect strong loan demand in the near term, and many said that deposit growth would not keep pace with the need for funds. These bankers anticipate that they will have to further reduce their securities and sell loans to larger banks.

ELEVENTH DISTRICT--DALLAS

The major regional economic indicators suggest that business conditions in the Southwest remain strong, and the Directors and businessmen contacted this month are basically optimistic about the future. Total employment has declined slightly, but shortages of labor in some job categories continue to persist. Department store sales remain moderate, but automobile sales continue strong. Total loan demand is showing further signs of improvement. Drilling activity in Texas is at an 18-year high, while manufacturing output continues to rise with increased production in durable goods industries. Farm machinery output is down as a result of depressed farm prices and incomes. The boom in construction continues with few signs of any slackening.

Consumer spending is strong in the District. Department store sales are up 13 percent above a year earlier, and according to one Director, sales are anticipated to continue to rise at the current pace for the remainder of the year. Retailers remain cautiously optimistic about their overall inventory condition. Inventories are in line with the current level of sales. However, some indicate merchandise on order is heavy, and a buildup of inventories may occur if sales should fall off. Auto sales continue to do well across all model lines. Dealers report that some consumers are buying now in order to avoid announced price increases on 1978 models. As a result, inventory carry-overs of 1977 models should be quite small.

District member banks in urban centers are very liquid because of strong inflows of deposits, and loanable funds are readily available. Most commercial banks are currently investing their excess funds in municipal bonds. However, several Dallas banks report that as securities in their investment portfolios mature, they intend to aggressively seek loans for these funds rather than roll the investments over.

Total loan demand is showing further signs of improvement. Consumer, real estate, construction, and mining loans continue to be areas of strong lending activity. Loans to the nondurable goods industries, with the exception of petroleum refining, remain sluggish. However, bankers expect business loan demand to continue to pick up slowly through yearend.

Drilling activity in Texas remains strong, while production of oil and gas continues to trend downward. The number of active rigs in Texas is up 19 percent from a year ago to the highest level in over 18 years. Drilling contractors report a comfortable backlog of development contracts for onshore work. And while drilling activity is expected to slow slightly during the last half of the year from that in the first half of the year, industry forecasts indicate that the total number of new wells and footage drilled this year will be 21 percent and 25 percent, respectively, ahead of last year. Many contractors are ordering new equipment--especially rigs and drill pipe. Shortages of materials have not yet hampered operations, but the shortage of skilled labor is becoming more troublesome.

Industrial production in Texas continues to rise on the strength of durable goods manufacturing. Oil field equipment and building materials output is beginning to press current productive capacity. Spot shortages of many building materials persist in most areas. Builders report delays of up to five months for clay brick, and as a result, shipments of brick from outside the state have increased sharply. Shortages of cement are also reported to be widespread. Production of construction machinery is strengthening, while steel output continues relatively unchanged. Aluminum output is rising on strong demand from the building, container, and transportation industries. Fabricated metals production is improving as orders for farm storage bins pick up.

Production of farm machinery in the District is down, and producers are experiencing a buildup in inventories. Farm machinery and equipment sales have slowed somewhat in recent months because of low farm prices and incomes. Sales are also sluggish, according to one dealer in Central Texas, because farm inventories of machinery and equipment were built up to high levels in the past three to four years. Dealer inventories, on average, have been building with lackluster sales. Farmers have reduced purchases of new machinery and are generally trying to make do with existing tractors, combines, and equipment. Another dealer said parts and repair work are up somewhat, indicating farmers will be trying to make do with existing machinery and equipment for the coming year. In contrast, sales of cotton strippers have been strong, and farmers are expected to increase purchases of hay equipment because of improved moisture conditions and the improved outlook for cattle prices.

The boom in construction activity rolls on. Housing starts remain strong, although they are down slightly from a record high set in June. Construction of shopping centers in Texas more than tripled in the first half of this year compared to the same period in 1976. Much of the increase in commercial building is centered in Houston where rapid population growth and liberal zoning laws have spurred strong development. Some delays in construction activity continue to occur because of both material and labor shortages.

TWELFTH DISTRICT -- SAN FRANCISCO

Retail sales continue strong in the west, with an emphasis on autos and appliances. Capital spending, on the other hand, continues generally weak, with a quite visible portion of this spending being used for pollution control. Residential construction remains strong, though the rate of increase has plateaued in most areas. Because of low grain prices and high drought-induced production costs, many Western farmers are experiencing serious cash-flow problems and rural economies are somewhat depressed. The much-noted forest fires of the west have been mainly confined to wilderness and park areas and are unlikely to have any noticeable impact on the timber supply.

Retail sales continue strong throughout the district. In Salt Lake City, sales of appliances and other big ticket items are matching the rapid pace of residential construction. The largest gains of the year are currently being experienced by Portland's largest department store. A northwestern distributor of foreign cars reported the best August since 1973, with sales up 42% from July. Several areas in both southern California and Idaho reported that retail sales continue to increase at 15 percent over 1976.

Capital spending still appears generally weak in the West. One Oregon bank reported that most of its commercial loans were for debt restructuring or acquisition of other companies. Another Oregon bank observed that much investment was for transportation items. An independent Idaho oil producer claims that his company is making no oil-related investments. Several industries noted that a significant portion of capital spending was for pollution control equipment. A large aluminum producer reported that it had been devoting some 25 to 35 percent of its new investment to pollution control and that this share was expected to remain constant over the next several years. A large forest products firm, which had also been directing about 25 to 35 percent of its capital budget to pollution control over the past five years, claimed to have reduced this share to roughly 10 to 12 percent. The aerospace industry, not being a noticeable polluter, is devoting practically all of its modest capital spending to such productivity-improving equipment as new computer technology and new machine tools.

Residential construction still continues strong in most Western cities, though the rate of increase has stopped moving up. Salt Lake City, for example, reports record-breaking levels of new housing starts but notes that the rate has apparently peaked. In Idaho, construction of single family homes continues 28 percent ahead of 1976 though this rate has been steady and not increasing. In California, construction continues above its long-term growth in demand but the rate of increase is falling. On the other hand, the peak has not yet arrived in the cities of the Pacific Northwest. Due to falling net farm income rural construction is slow, and one Washington reporter notes that most new rural units are mobile homes.

Western farmers are being squeezed between low grain prices on the one hand and higher unit costs (induced by drought) on the other. This results in serious cash-flow problems for farmers and thus a serious weakening in the rural economy, since farmers are buying very little. In Oregon, the winter wheat crop is reported to be down 27 percent from last year. One Oregon banker noted that virtually all retail and service firms in rural communities on the east side of the state have been adversely affected. Similar reports have arrived from the east side of Washington. In California, the estimate of drought-induced agricultural losses was recently reduced by 40 percent to only $800 million, about two-thirds of which are borne by the livestock industry. Still, the decline in net income and extreme uncertainty over water supplies for next year has seriously depressed sales of farm implements and equipment.

During the past month there has been much press coverage of forest fires plaguing the West in general and California in particular. While California's forests have suffered considerable fire damage, the impact upon the timber supply should be negligible. This is because most of the fires have been confined to wilderness and parklands unavailable for logging. Other western states report that fire damage is running about normal for this time of year.