CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

October 11, 1977

TABLE OF CONTENTS

SUMMARY*

This month's REDBOOK reports suggest an economy still expanding, but at a slower pace than in the first half of the year. Various districts note a contrast between business caution and consumer confidence. Progress is uneven, with softness noted in demand for steel, nonferrous metals, farm equipment, and textiles. Capital spending continues to rise overall, but not in a manner approaching the 1973-74 boom. Except for some building materials and certain skills, few shortages are apparent. Price inflation is less commented upon, but still pervasive. Inventories are not generally excessive, but managements are keeping accumulations under close control. Retail sales are described as "strong" in most districts. Demand for housing is somewhat less intense, while commercial and industrial construction is improving gradually. The energy supply picture is surprisingly favorable. Large crops are expected, but heavy rains have slowed harvests. Demand for consumer loans and mortgages remains vigorous, in contrast to demand for business loans which remains moderate.

Most districts report some slowing in the growth of employment, output, or other measures. Exceptions are Minneapolis where "activity is quite strong," Dallas where energy exploration is booming, and San Francisco where the economy is "healthy and growing," despite some "weak spots." Strong retail sales--often contrasted with business investment--accompanied by substantial use of consumer credit are described by New York, Philadelphia, Richmond, Atlanta, Chicago, and St. Louis. The particular types of goods that were selling especially well varied by district.

*Prepared at Federal Reserve Bank of Chicago.

New York, Cleveland, and Chicago commented on recently announced cutbacks in the steel industry. Reductions in output and employment are mainly scheduled for older high-cost plants, but there is increasing concern about the viability of the whole industry and the effect on morale in other sectors. Chicago emphasizes also the competitive problems of the largest US color TV producer, and lower sales of farm equipment. San Francisco cites weakness in demand for nonferrous metals, especially copper. New York and Richmond tell of declining backlogs for textiles with output cuts expected.

Boston finds some concern about retail inventories being too high. Richmond says that one-third of manufacturers report materials inventories "excessive," but retail stocks are "in line." Philadelphia sees no change in inventories. Atlanta, St. Louis, Minneapolis, and San Francisco find inventories held in balance by careful management. In general, excessive inventories are confined to the manufacturing sector, and, except for textiles, the problems do not appear to be substantial. Stringencies of supplies of insulation and various other building materials are hindering home building in Atlanta, Chicago, and Kansas City, and probably in other regions as well.

Most districts report the capital spending picture to be mixed, but that the general trend is upward. Cleveland says machine tool orders are up sharply after a "summer sag." Demand for excavators and cranes is good, but equipment for steel mills, nonferrous metals, chemical plants, and oil refineries is slow. An engineering design firm's backlog has been "flat" for several months. Atlanta and Dallas emphasize great strength in oil and gas exploration with drilling rigs and skilled workers in short supply. Minneapolis says food industry outlays are up. Chicago comments on huge outlays required to manufacture smaller cars. San Francisco tells of substantial orders for new commercial jet aircraft.

Although markets for most industrial and consumer goods are described as highly competitive, the "underlying" 6 percent inflation rate is probably unaffected. Chicago reports 60 percent of firms paying higher prices, Richmond 50 percent, and Philadelphia 27 percent. These proportions have been higher in the past but they are still large, and very few firms are paying lower prices on average.

The supply of gas and oil for the winter appears to be shaping up much better than had been expected last spring. Cleveland and Chicago say that large gas transmission companies are taking on new industrial and residential customers, for the first time in years in the case of Ohio. New gas supplies, conservation, and shifts to alternative fuels are responsible. Atlanta also sees gas supplies as more adequate.

The iron ore strike and the dockworkers' strike are not having a significant effect, at least as yet. Cleveland says that a 45-day coal strike would have little effect because of large stocks above ground and because only a portion of total coal output would be stopped.

San Francisco says the "hot housing" market has "cooled," but with a beneficial effect. Housing markets in other regions are somewhat slower, but a large backlog of demand still exists. Apartment contracts are stronger in Dallas. Mortgage money is generally available at stable rates. Cleveland and Chicago report a gradual pickup in commercial and industrial construction. Outlays on public works are still slow in most districts.

New York, Atlanta, Chicago, St. Louis, and Minneapolis all report harvests slowed by wet weather. The effect on output probably will not be large, however. Harvests in the Midwest are ahead of schedule, because corn and soybean crops matured earlier than usual. Kansas City reports winter wheat off to a good start with soil moisture adequate, in contrast to last year. Farm income unfortunately is depressed by large crops. San Francisco says that costs of producing cotton, especially pumping of water, results in poor profits despite high prices. The Richmond region still suffers from drought.

FIRST DISTRICT - BOSTON

Directors and other Redbook respondents of the Federal Reserve Bank of Boston report some slowing of economic activity in the last month although they also express confidence in the underlying strength of the economy. Retail sales are mixed generating some concern over inventories, industrial production continues to grow although somewhat slower than anticipated and commercial loan demand continues to be fairly strong.

A major Boston retailer indicates that sales slowed somewhat in September and that despite watching them carefully inventories are somewhat higher than they would like. However in northern New England retail sales remain fairly strong. Retailers across the region are expecting strong holiday sales, in part because there will be one more shopping day between Thanksgiving and Christmas this year than last.

The industrial situation is mixed. A supplier of chemical products to tire companies reports strong performance in that industry; tire producers inventories are declining because of a rapid sales pace. On the other hand, sales of superalloy metals are weaker than expected and exports of these metals are particularly soft. A major thread producer reports that orders are beginning to fall off and that although sales are above the previous years level the increase is less than anticipated. The chairman of a large diversified conglomerate also reports a fairly widespread weakening of orders except in the machine tool area. This director does not anticipate a further softening of orders and considers the economy as a whole to be fairly strong.

According to area bankers commercial loan demand continues to be quite strong. Deposit inflows are healthy although NOW account activity makes it difficult to determine exactly what is happening. A director who runs an employment service reports that demand for workers is strong but that he has difficulty getting unskilled workers who have basic skills. No respondents reported any problems in obtaining materials nor were any anticipating difficulties with bottlenecks. Several respondents indicated that the pace of price increases had moderated significantly. Finally several directors expressed concern over the amount of uncertainty in the economy because of the energy package and the forthcoming tax reform proposals.

Professors Eckstein, Houthakker, and Samuelson were contacted this month. Samuelson notes that a large majority of professional forecasters anticipate real growth of between 3 1/2 and 4 1/2 percent over the six-quarter period ending in 1978. The exceptions, along with most nonprofessional estimates, are lower and are presumably based on the expectation that the lack of economic vigor will ignite inventory decumulation. The anticipated economic climate is reminiscent of 1974, when several quarters of sluggish growth culminated in a collapse in demand. All forecasts fall well below the 5 percent real growth target that Samuelson finds economically and politically desirable.

Samuelson and Eckstein both eschewed the Shadow FOMC's recommendation of a one-shot $4 billion drop in M1 to return to the target path. Both are convinced this policy would result in a severe credit crunch and a recession. "It's hard to envision a worse policy," according to Eckstein. Each fears that a highly restrictive monetary policy will trigger massive tax reductions which, in combination, would be "disastrous" for capital expenditures.

Professor Houthakker finds no fault with the present long-run monetary growth targets. He urges a stronger effort to achieve the present targets. He notes that the outlook for the current account in 1978 is "not good" but believes it can be financed by the combination of higher interest rates here and lower rates abroad.

SECOND DISTRICT--NEW YORK

Business activity across the Second District is somewhat mixed according to directors and other business leaders contacted recently. While the consumer sector appears to be relatively strong, inventory levels remain on the high side, and the outlook for capital spending is mixed with little indication of a significant step-up of planned plant and equipment outlays. Concerns over the prospective rate of recovery of the District's western region due to the large cutbacks by the steel industry appear to have been intensified by sizable harvest losses caused by adverse weather. On the financial front, the sluggishness in business loan demand persists.

Retail sales increased moderately in September in the wake of an exceptionally strong August gain. Several department store executives expressed satisfaction with the sales activity in the New York and New Jersey branches. Among product lines, both household furnishings and women's apparel appear to have maintained strength, although in the latter instance, some resistance to this season's higher prices was noted by several merchants. The controller of a major chain credited Sunday store openings with helping to improve sales activity in New York. He noted that since Sunday openings were legalized a year ago, these sales have accounted for an increasing proportion of total sales. In general, merchants as well as executives of other consumer-related businesses expected favorable sales developments in coming months. Based on strong inflow of orders, the chairman of a national manufacturer of photo equipment reported that the consumer sales outlook appeared good. Brightening sales prospects were also suggested by telephone and newspaper executives who reported strong pickups in retail advertising.

Area auto dealers reported good sales in September. A rebound in the used car market led the advance, apparently as fears over prospective energy legislation dissipated. New car sales were characterized as "strong," although several respondents expressed concern over the effect the higher prices on new models will have on sales in coming months.

Inventories remained on the high side. In the retail sector, most executives professed little concern over high levels of stocks, judging them not to be unreasonably out of line with sales prospects for the fall and Christmas seasons. Outside of retailing, respondents were generally less sanguine in assessing their inventory positions. A textiles executive expressed concern that excessive inventories were accumulating in his industry. Several respondents in the chemical and petrochemical industries reported higher-than-desired stocks. The treasurer of a major nonferrous metals company reported a similar backing up of inventories, although at least part of the stockpiling had been in anticipation of aluminum price increases.

Capital spending plans for 1978 remain mixed. While responses varied among industries and firms, several directors foresaw expenditures for next year to be on a level approximately equal to that in 1977. At one extreme, plant and equipment spending by the steel industry is being curtailed sharply. Capital spending by farmers in western New York State is also likely to be reduced because of the heavy crop losses they suffered due to the past month's unusually heavy rainfall. Several machine tool manufacturers related that as a consequence of weakness in new orders and bookings, they will limit their new capital investment. The president of one large chemical company reported that due to overcapacity his firm's spending would be shifted to maintenance and conservation rather than expansion, while the chairman of another chemical company felt the instability in the economy was undermining the growth of capital spending. Several other business leaders across New York State indicated that they had no plans to expand production facilities during the coming year. In addition to uncertainty over the outlook for demand, a leading apparel executive also cited the high cost of raising funds as a reason for lagging capital investment in his industry. At the other extreme, one major nonferrous metal fabrication firm has greatly increased its capital outlays in upstate New York due in part to substantial improvement in its cash position. The chairman of a major petroleum company also expected his industry to continue its relatively high rate of capital spending.

With few exceptions, business loan demand at Second District Banks has remained sluggish. Moreover, the leading bankers contacted did not expect any substantial pickup in the near term because of the strong liquidity position of potential borrowers. Several financial analysts attributed at least some of the weakness in loan demand at commercial banks to increased competition of commercial finance companies in servicing the credit needs of small- and medium-sized businesses. In other banking developments, upstate directors noted that individual savings show steady growth and that instalment lending continues at a high level. And the president of a leading New Jersey bank reported that mortgage loan demand has risen sharply in his area.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that economic activity is expanding. Retail sales are up, and manufacturing activity in the region continues to increase according to executives polled. Industrial employment, however, is virtually unchanged. Attitudes about future economic conditions are mixed. Manufacturers are less bullish than they've been in almost three years, but most retailers look for sales growth to at least keep pace with inflation over the next six months. Commercial bankers say that consumer loan demand is satisfactory, but that business borrowing continues to be sluggish. Interest rates are expected to climb over the next two quarters.

Directors of this Bank and manufacturers responding to the October Business Outlook Survey say that business is improving this month. Twenty percent of the respondents to this month's survey report that business is better than in September, while 3 percent say it has worsened. This "margin of improvement" of 17 percentage points is unchanged from last month. New orders and shipments are higher in October, and inventories have remained unchanged for the sixth month in a row. Despite this pickup, the employment picture, after brightening somewhat last month, is showing little improvement. Work forces have grown only fractionally, and the average workweek is unchanged from September.

Directors contacted agree that business is improving. One went so far as to say that current conditions are better than at anytime so far this year. Although Directors don't seem to foresee any large obstacles to future gains, they do say that future plans depend somewhat on Federal action on taxes and energy.

Manufacturers' optimism about general business conditions six months out continues to diminish. In the current survey, only one-third of the respondents look for improvement in economic conditions by April. This is the lowest proportion reporting such expectations in almost three years. Increases in new orders and shipments are anticipated, but again by the smallest fraction of sampled firms since late 1974. At the same time, inventories are projected to remain unchanged over the next six months, and only marginal growth in employment is anticipated. One-third of the executives surveyed plan to increase capital spending over the next two quarters--about the same as last month.

The pace of inflation in the District's industrial sector continues to slow. Twenty-seven percent of those polled this month report paying more for raw materials, while 20 percent say they are receiving higher prices for their finished products. For the longer term, manufacturers continue to foresee widespread price increases. Four out of 5 foresee higher prices for inputs by April, while about half project higher prices for the products they sell.

Retailers report that department store sales in the area are up. Current dollar sales are reported to be between 7 and 20 percent over year-ago levels. While one merchant says that sales are slightly less than anticipated, sales are generally at or above expected levels. Both center-city Philadelphia and suburban stores are doing well this month. Energy-related products, such as insulation and storm windows, are said to be moving extremely well. Retailers say their inventories are in good condition. While some report more rapid than anticipated inventory accumulation, they say this higher level of stocks is consistent with higher sales.

Most merchants are approaching the next two quarters with a slightly more bullish attitude than they have in recent months, and look for April '78 sales to be between 4 and 15 percent above year-earlier levels. Retailers are not worried, for the most part, that Federal tax and energy policies or inflation will put a damper on consumer buying, and they have not built such contingencies into their plans.

Commercial bankers in the area report that loan demand is mixed. Although the demand for consumer loans has softened recently, it is expected to pick up again with the introduction of 1978 autos. Business borrowing, however, is still generally sluggish. Reports of current levels of commercial borrowing range from 8 percent below to 6 percent above October '76 levels. Most bankers say that current loan levels are below expectations. All of the bankers contacted feel that at least part of the problem is the availability of alternative sources of funds to large borrowers. Consequently, smaller institutions, catering to smaller, local customers, aren't generally feeling the effects that larger banks are.

For the longer term, bankers anticipate little change from the current trend in business borrowing. Interest rates are expected to continue climbing, with the prime rate (currently at 7 1/2 percent at all of the banks contacted) going to 7 3/4 - 8 percent by the end of the first quarter.

Bankers are showing mild concern over the possibility that rising short-term interest rates will cut off deposit inflows. They are also "somewhat worried" that uncertainty, generated by the possibility of renewed inflation next year, will have a detrimental effect on economic expansion. However, they do not yet consider this threat serious enough to alter future planning.

FOURTH DISTRICT--CLEVELAND

Depressed steel operations and a slowdown in inventory investment have hindered economic expansion in the Fourth District. Retailers are more optimistic for this quarter's sales prospects as a result of a recent strengthening in sales. Capital spending continues to expand, although industrial and public works construction are still weak. Early indications are that natural gas and coal supplies will be adequate for this winter.

Perhaps the major District development in the past month concerns the well-publicized projected closing of a steel plant and the layoff of about 5,000 workers in the Youngstown area. This layoff would lower total non-agricultural employment by less than 0.5 percent, but would account for about 2.5 percent of total employment in the Youngstown-Warren metropolitan area and an umemployment rate by year-end of about 9.3 percent.

Short-term prospects for steel again have been scaled downward by steel economists with the nation's largest producers. They expect an operating rate of between 75 percent and 80 percent of capacity, which is similar to last quarter. However, this is difficult to pinpoint because as much as 3-to-5 million tons of an estimated 160 tons of capacity have been or are scheduled to become permanently retired. These economists expect cash flow, and especially profits, will be badly depressed again this quarter. One economist expressed the view that the break-even point in steel is even higher than 80 percent of capacity because energy costs to produce a ton of steel have risen from $18 to $80 and have not been recovered in prices. Therefore, the industry could face further layoffs, closing of marginal facilities, dropping of unprofitable products, and perhaps shutdowns of some middle-sized producers.

These steel economists have mixed views about the future for domestic steel producers. One believes that the domestic industry will continue to shrink because of its inability to operate profitably against Japanese competition, to finance new capacity, or to meet pollution abatement standards. He predicts that domestic producers will specialize in a few product lines and will diversify into non-steel products. Another economist contends that domestic producers are competitive with European steel but Japanese mills can produce steel for about $25 to $65 per ton below U.S. costs. When transportation, duties, and other charges are added to production costs, the cost of Japanese steel is higher than domestically produced steel. The current problem is triggered by a surge of imports that reflects a worldwide surplus of steel supply. Imports in the last few months have risen to about a 20-million-ton annual rate which amounts to about 22 percent of domestic shipments. The increase in imports was widespread, including not only EEC countries but Finland, South Africa, Canada, Korea, Mexico, Spain, and India.

Strong September sales have prompted optimism about near-term sales among some retailers. However, executives and economists who were contacted suggest a mixed pattern of spending. Recent strength has been broadly based but especially marked in apparel. Retailers acknowledge that a step-up in sales promotions has been an important factor in the revival of sales. But some economists take a less sanguine view of consumer spending prospects. One associated with a major retail chain emphasizes that consumers have shifted from purchases of durable goods, especially automobiles, to nondurable ones.

Recent sales gains have been registered mostly in general merchandise, especially apparel, which was soft earlier in the year. After seasonal adjustment, retail sales, excluding autos, probably were not much stronger in September than in August. He cautions that gains in October would not be as large as in recent months and that sales will continue to show monthly swings. Another economist with a major producer of personal and home-care products indicated a flattening in grocery store sales of their products in recent months, perhaps in response to unexpectedly rapid growth rates in late 1976 and early 1977. He expects consumer outlays for those products will be stepped up in line with historical growth rates.

Capital goods producers comment that demand continues to expand. Still, the pace is not accelerating nor is demand more broadly based than previously reported. Major machine tool builders report orders in August and September picked up sharply following a midsummer sag. Demand for business equipment, especially computer terminals and communications equipment, continued strong throughout the summer, in contrast to a usual slowing. Demand for overhead cranes and excavation machinery has been increasing steadily from a trough earlier this year. But one producer does not expect a strong pickup until accelerations of public works programs, such as construction of highways, bridges, sewers, and waterworks. Industrial construction is also recovering slowly. A major design and engineering firm reports its backlog has been flat for the last several months because of little demand from steel, nonferrous metals, chemicals, and oil refineries.

Supplies of natural gas are not expected to be as tight this winter as in 1976-77. The largest natural gas utility in northeast Ohio lifted all curtailments last June and expects to be able to take on new industrial and residential users for the first time in several years. The utility is prepared for a colder-than-normal winter but not one as severe as last year. The encouraging forecast is based on reduced demand--stemming from the partial closing of a steel plant and conservation programs of industrial and residential users--and increased supplies as a result of self-help programs, imported natural gas, and an increase in the number of wells drilled.

Officials with a major coal producer believe supplies should be adequate even if there is a coal strike which lasts as long as 45 days. Nearly an 80-day supply of coal should be in inventory by the end of November. However, these officials hold that chances for a lengthy strike have diminished considerably because of a shift in key issues from the right of local unions to strike to a larger package of benefits for miners. It is unlikely that the entire industry would be affected by a strike since only 60 percent of Eastern mines are unionized and an even smaller percentage in the West. These officials maintain that the industry can produce 1.0 to 1.2 billion tons of coal by 1985 even with existing environmental constraints. Still, producers are not stepping up expansion programs until an energy program is legislated.

Residential and consumer loans continue strong, but business loan demand is still somewhat sluggish and below expectations. S&Ls also indicate continued strong demand for mortgage loans, and some expect a record year for mortgage loans and commitments. There is also some softening in prices of existing homes, although an official with a large builders' association in Ohio expects that prices for new houses will continue to rise because of higher costs of insulation and shortages of skilled construction workers.

FIFTH DISTRICT - RICHMOND

Responses to our latest survey suggest that Fifth District manufacturing activity made few advances in September. Shipments by District manufacturers increased, but by less than during the previous month. New orders have weakened slightly and backlogs of orders have been worked down somewhat since August. Inventories continued to expand, albeit rather slowly, and remain above desired levels. The optimism which prevailed among District manufacturers until recently has now been entirely dissipated. The retail sector apparently did better last month as both total sales and relative sales of big ticket items picked up. Credit extended by large District banks surged ahead in the past few weeks, led by substantial gains in commercial and industrial loans. Much of the increase, however, appears to be of a seasonal nature as banks meet the credit needs of tobacco leaf dealers.

Survey results suggest continued slow growth in manufacturing employment, although an increase in weekly hours worked was indicated this month. Manufacturers' shipments continued to make some gains in September, but apparently demonstrated less overall strength than in August. New orders were virtually flat for the third consecutive month and, as a result, backlogs of orders are now somewhat below last month's levels. Manufacturers' inventories, particularly of materials, continued to expand and more than one in three respondents view current levels as excessive. Prices paid, other than employee compensation, continued to advance with nearly one-half of the manufacturing respondents reporting further increases. Increases in average hourly earnings were less common than those of other prices paid. On the other hand, respondents reported virtually no change, on balance, in prices received.

These recent developments have been rather general, not restricted to any one sector. The only exception to this is a noticeable slowing in the textile industry. Of textile manufacturers responding to our survey, one-half reported a decline in the volume of new orders in September, while 60 percent experienced a reduction in backlogs of orders. At the same time, the outlook among textile producers has deteriorated to the point where one-third of those respondents anticipate further reductions in their production over the next six months.

Among all manufacturing respondents, the outlook is clearly less bright than in recent months. Concerning the level of business activity nationally, sixty percent foresee no change over the next six months while the remainder are evenly divided between expecting further improvement and expecting a worsening trend. Much the same pattern exists in their views concerning the outlook for their immediate market areas as well as for their respective firms. Among retailers surveyed, there seems to be little indication that conditions are expected to change over the next six months.

The retailers reported some improvement in September as total sales and relative sales of big ticket items both rose somewhat. Inventories were also higher than in August, but are generally in line with desired levels. In addition, there were no reports from retailers that indicated any change in prices from a month ago.

Banks' experiences have been mixed regarding the sources of strength in credit demand. While there continues to be overall strong demand for consumer loans, some isolated weakness has nevertheless arisen. This weakness, however, is seen to be temporary, arising mainly from an extended model changeover period in the automobile market. In addition to the recent increase in loans to tobacco leaf dealers, a smaller part of the overall increase in loan demand is broadlv based across industrial sectors, continuing the modest cyclical rise that has been underway for some months now. There has been a definite slowing in growth of consumer time deposits. Rising short-term market rates of interest are seen as contributing to this slowing. Many District banks see short-term rates rising in the future, and consequently there is growing interest in issuing longer term CD's.

Widespread drought and a tightening cost-price squeeze combined to weaken the financial condition of many Fifth District farmers during 1977. Some have been hard hit. Large numbers of farm operators are reported to be in reasonably good shape, however. Similarly, the overall quality of farm loan portfolios deteriorated at quite a number of banks. But all bankers reported they would be able to deal successfully with most cases of problem farm loans. Moreover, none were expecting to have to absorb any losses from their farm loans.

Year-to-date cash income from farm marketings was below the year ago level for the January-July period. The District decrease, all of which occurred in the Carolinas, amounted to less than 1 percent. With weaker demand and lower quality offerings, flue-cured tobacco prices have begun to trend downward after holding at record levels for about six weeks. The season's average price is 10 percent above a year ago and at an all-time high, however.

SIXTH DISTRICT - ATLANTA

The employment situation is the only real weak spot in the current status or fourth quarter outlook of the District economy. There's little to look forward to in the way of job growth this year. Louisiana energy industry activity is really boiling, but, paradoxically, that state may be the only one in the District to suffer serious natural gas shortages this winter. Consumers have maintained high spending levels; loan demand continues brisk at District banks while deposit growth has picked up. Residential construction has begun to encounter inhibiting factors, but nonresidential construction is coming on-stream.

A general strike by New Orleans longshoremen has shut down that port (while selective strikes against containerized ships are slowing trade at other ports), costing the city about $2 million a day and forcing some ships into other ports. But in Atlanta, Lockheed workers stayed on the job despite a walkout at that company's California plant. In general, District job growth has been stalled, and there are indications that no significant extra-seasonal gains will occur during the remainder of the year. A number of recently announced plant closings or layoffs (outside the steel industry) will offset expected increased hiring by some manufacturers.

Barring abnormally severe weather, natural gas supplies will be more adequate this winter than last in most areas. Due to expanded underground reserves and new pipelines, Southern Natural Gas expects to meet demands of all first-priority users. The FEA lists Alabama, Georgia, and Tennessee among 18 states where milder weather, fuel switching, and conservation effects will reduce curtailments. But an FPC recommendation that would divert supplies from Louisiana consumers to northeastern states could result in losses of as much as $500 million and 40,000 jobs from plant closings and setbacks to the sugar industry.

A recent discovery of a large gas field in central Louisiana added impetus to already booming energy industry activities. One oil company's plans to produce 21 rigs and supply the required crew and supply vessels for Gulf drilling should ease the severe strain on the supply of rigs. Otherwise, the industry expects no shortages of materials; operators foresee at least five years of uninterrupted activity.

Rapid inflows of time and savings deposits have boosted deposit growth at District banks. Lending continues strong, but slightly off the earlier pace, with good gains in all loan types. Tennessee banks appear relatively unaffected by last month's usury enforcement; the instalment loans of seven weekly reporters rose about half as much in September as they had in August. Louisiana banks are enjoying heavy loan demand from oil-related firms.

Retailers seem generally satisfied with the sales pace and consider holiday season prospects excellent. Durable goods and home furnishings continue to dominate spending. Nineteen Hundred and Seventy-Eight model autos have been well accepted in most areas. Directors' reports on soft goods sales have been mixed.

Uncertain about the outlook, producers continue to manage inventories carefully. There have been some slight accumulations in raw material stocks, while finished goods inventories tend toward some liquidations. Export demand has allowed Florida phosphate producers to whittle excess stocks. Retailers are beginning preholiday stock building. Auto stocks were nearly negligible as 1977 models cleared and dealers expect to hold rather short supplies through the fall.

Wet weather has slowed harvests, and floods have damaged some crops in the western range of the District. Louisiana's sugar and cotton crops sustained some hurricane damage. Profit margins are improving for livestock, poultry, egg, dairy, and hog producers as prices are stable to slightly higher and feed costs are declining. Gains in fed cattle prices may be restrained by rising pork supplies; heavy marketings of stocker calves continue to depress prices.

A steady stream of announcements of new plant and commercial buildings promises solid gains in nonresidential construction. The mixed current situation is illustrated by two comments from the Birmingham area. A materials producer, who supplies the Chicago and Texas areas as well as the Southeast, attributes recent demand strength to nonresidential construction (whereas housing and highways boosted revenues earlier in the year) and notes particularly heavy purchases by District customers. But a producer of welding equipment sees in his sales mix an indication that producers are trying to make do with current capacity rather than investing in new plants.

Though high activity levels should prevail until early next year at least, the rosiness of the residential construction outlook has started to fade. Shortages of an expanding variety of materials are delaying building in some areas; some South Florida builders are protecting themselves from climbing costs by refusing to take contracts that cannot be completed in six months or less. One director suspects overbuilding of more expensive homes in the Jacksonville area, where builders are holding off on options to purchase land. It appears that multifamily projects will account for a growing share of new housing as single-family home prices soar, especially in Southeast Florida where population growth is accelerating, single-family lots are growing scarce, and a 40-year supply of multifamily zoned land remains.

SEVENTH DISTRICT--CHICAGO

Although conditions vary, sector by sector, activity in the Seventh District appears to continue to advance at a modest pace. Consumer sentiment is stronger generally than business confidence. Some forecasts have been lowered moderately, both for the economy and particular products. Retail sales continue vigorous, with credit use increasing. Shortages are largely confined to residential building materials. A serious morale problem has developed in the television and steel industries. Capital equipment demand is quite mixed. Reports on price inflation also vary, but the underlying rate of rise is probably unchanged. Home sales are still strong. Nonresidential construction prospects have picked up. The fall harvests have been slowed throughout the district by heavy rains, but large crops are still probable.

Large retailers are pleased with recent sales. The largest retailer is said to be leading the field with heavy promotions and price cuts on selected items. Not all competitors are able to counter this competition effectively.

Auto dealers are said to be enthusiastic about the new cars. Auto inventories are short for some models and excessive for others. Auto companies are forced to push small cars to meet mileage requirements, although these models are "not profitable." Captive imports can be averaged into a company's mix to a limited degree. Captive finance companies are leading the trend toward 42- and 48-month loans, and say the credit experience has been excellent.

Business executives are concerned about energy, regulations, possible tax changes, foreign imports, inflation, the depressed state of the stock market, and prospects for higher interest rates. This causes them to pursue cautious policies on inventories and major capital outlays. Recent announcements of planned cutbacks by a major Chicago-area TV producer and cost-cutting efforts of various steel companies have no clear counterparts elsewhere as yet, but the effect on morale has been widespread. A year ago, even six months ago, these industries foresaw high level operations and good profit margins for this time.

Purchasing managers in the Chicago area reported a somewhat faster rate of rise in output, orders, and employment in September. Delivery lead times increased slightly, but, except for building materials, there are no exceptional procurement problems. About 60 percent report paying higher prices each month, compared to 2 percent paying lower prices.

Although all steel companies are worried about steel imports, the impact varies by product line and by company. Some of Chicago-area plants are modern and well-maintained, while others are not. The recent announcement of the shift of a steel company headquarters from Youngstown to Chicago will not increase steel employment or output here.

Most observers here accept the view that the underlying rate of inflation is about 6 percent. A general merchandise firm estimates that its prices average 4.2 percent above last year, with imported goods accounting for 15 percent of all sales. Costs of services such as insurance, professional fees, medical care, and taxes continue to advance at a rapid pace. A recent survey shows that the average cost of a hospital stay in the Chicago area ranges from $200 to $400 per day (excluding doctors' services), double the level of four years ago. A large share of this rise reflects more elaborate treatments.

Sales of most types of business equipment and components continue to increase at a good, but "unexciting," rate. Among the stronger sectors are earth-moving equipment and well-drilling equipment. Sales of trucks and trailers have softened recently, but the outlook is still good. Orders for freight cars and locomotives are much improved. Among the weakest types are equipment for steel mills and for farmers. Farm equipment sales have been hurt by reduced net farm income, large sales in previous years, larger farmer debts, and prospects for acreage curtailments. Nevertheless, a huge tractor plant in Iowa will be substantially expanded. Auto companies are spending huge sums on plant and equipment to produce cars with better gas mileage, far more than would be the case if mileage standards had not been mandated.

The energy outlook continues to be favorable. A major gas transmission company headquartered in Michigan is prepared to take on additional large industrial customers, but gas must be for "essential processing" rather than boiler fuel. Many interruptible industrial gas customers in other regions have turned to alternative fuels, thereby releasing supplies for priority users.

Completion of housing units is being delayed by shortages of various materials (especially insulation) and skilled workers. Contracts for office and apartment buildings have picked up, including some major projects that were "shelved" in 1975.

Although rains have slowed agricultural field work, the harvesting is ahead of normal because of an earlier start. Virtually all corn and soybean crops are mature. An early killing frost would have only minimal effect. Wet weather has increased pest infestations. As yet, conditions do not appear serious.

EIGHTH DISTRICT - ST. LOUIS

Slowing in the rate of growth of some aspects of economic activity in the Eighth Federal Reserve District has occurred since the first half of the year. Businessmen generally remain optimistic, however, and few expect a further decline in the rate of expansion. Growth of consumer spending continues unabated. Business inventories are reported to be in line with sales. While growth of business loans at large banks remains slow, overall demand for credit continues to expand. Manufacturing and construction activities continue to expand moderately. Wet weather during the past week has slowed crop harvesting in parts of the District, but harvesting is still ahead of a year ago, and most crops are expected to be larger.

Consumer spending has increased somewhat in recent weeks from a mid-summer slump according to major retail store representatives. One representative in the St. Louis area reported rising sales for big ticket items, such as furniture and appliances. Retail sales were reported to be excellent in Little Rock as well as other parts of the District. Furthermore, most of the retail respondents remain cautiously optimistic as to sales in the fourth quarter.

All respondents report that inventories are being watched closely and that no excesses are present. The department stores reported some excesses in soft goods during the summer months as a result of smaller-than-expected sales, but in recent weeks these excesses have been worked off to desired levels. Builders generally report that no homes are being built except on order. Also, in the Memphis area the excesses of condominiums built up in the previous recession have been largely worked off.

Loan demand generally continues moderately upward. Outside the major cities loan demand is reported to be strong in all sectors of the economy. In the larger cities, however, the rising demand is generally limited to real estate and consumer loans, with commercial and industrial loan demand remaining weak. Savings and loan associations report continued strong savings inflows; however, savings deposits at the large commercial banks in the District have declined. Interest rates on real estate loans remain stable at about 8-3/4 percent. Rates on most other loans, however, have inched up along with the rates on other market instruments.

Production in the major industries of the District continues to expand but generally at a slower rate than in the first half of the year. In the manufacturing sector, major chemical firms reported slower growth in August and September than earlier in the year but did not consider this as a serious weakness. Manufacturers of textiles, fibers, boxboards, automobiles, apparel and construction materials generally report a more moderate uptrend in orders and production.

Construction of single-family homes remains at a high level throughout the District. Such construction in the St. Louis area is reported to be at the highest level in twenty years. The occupancy rate is relatively high in multi-family units, but construction remains relatively weak, especially in the St. Louis area. Commercial construction remains weak, but an increasing number of small projects is reported.

Crop harvesting is well underway in the District and large crops of most commodities are expected. Weather conditions were favorable for crop growth, but recent rainfall has slowed harvesting in some parts of the District. Despite the large crops, gross farm incomes in the area may not exceed year-ago levels as the increased production will likely be offset by lower prices.

NINTH DISTRICT - MINNEAPOLIS

Economic activity here is generally quite strong and is expected to remain so. Directors report widespread business expansion and are optimistic: they see few capacity or materials problems, wage increases have not been large enough to lead to production adjustments, and firms have increased capital spending. As a result of this business strength, consumers have been spending more, and retailers expect good sales to continue. The district's two major weak spots are still the iron ore workers' strike and farmers' poor income prospects. Loans to farmers, consumers, and businesses have increased faster than deposits at district banks, thus tightening their liquidity positions.

Business activity

Several directors say business activity is now strong in their industries and areas. One director reports heavy incoming orders and a high backlog at his large national manufacturing firm. A director associated with the food and apparel industries says sales of those items picked up recently. Energy development is boosting economic activity in Montana and North Dakota. And business generally is strong in South Dakota and southwestern Wisconsin.

Directors see signs that this current strength will continue. They see few capacity constraints or material shortages which could limit business activity, and they don't think any recent wage increases have been large enough to reduce it. They also report that district manufacturers are still increasing their plant and equipment spending, which indicates planned expansion. A director who sells control devices for industrial plants says his firm's orders have been rising steadily. Another reports increased capital outlays in the food industry. Spending for energy development in Montana and North Dakota is expected to be substantial too.

Consumer Spending

The current business strength is allowing district consumers to increase their own spending. Regional auto managers say car sales have been quite good recently. And major Minneapolis/St. Paul department and discount stores report excellent business since summer. Their fastest selling items have been appliances and home improvement and energy-saving materials and devices.

Most retailers expect consumer spending to remain strong. Some are concerned about shortages--of insulation, for example--resulting from the recent good sales. But they are generally satisfied with current inventory levels.

Iron Ore and Agriculture

The district has two industries with big problems and little optimism: iron ore and agriculture.

The strike of about 18,000 iron ore workers has been depressing economic activity in northeastern Minnesota and Upper Michigan since August 1. According to recent press reports, the chance of a settlement soon are small.

Income prospects remain small too, for both livestock and crop farmers in the district. Although cattle prices have increased some recently, they are still not high enough to make cow/calf operations profitable. Cattle feeders may be somewhat better off because of the very low costs of grain. But grain farmers' income is likely to suffer from those low prices plus lower yields than previously expected. Insects have been infesting corn crops and rains have been delaying harvesting recently, especially in North Dakota.

One director sees rain as a source of possible relief for ag income, though. Since Canada's wheat yields have also been reduced by rain, and since Russia may need to import more wheat than expected, our grain exports and prices may increase modestly.

Banking

The current strengths and weaknesses of the rest of the economy are apparent in district banking activity. Loan and deposit growth has been strong at urban banks, reflecting the strength in the business and consumer sectors. Because of farmers' income problems, lending has been strong at rural banks too, but deposit growth there has slowed. Total loans therefore have grown more than total deposits, raising the loan-to-deposit ratio of all district member banks from 70 to 73 percent in the last year.

TENTH DISTRICT--KANSAS CITY

The performance of the residential construction sector in the Tenth District continues to be strong over all, despite some hints of a slight softening. Industry representatives suggest that further rapid increases in construction costs and rising interest rates are the factors most likely to reverse the current favorable situation. The new wheat crop is off to a good start, and crop prospects are very good compared with this time last year. Commercial bankers report both strong loan demand and signs of a slowdown in time deposit growth.

Conversations concerning residential construction activity and its financing were held with representatives of savings and loan associations and home builders associations in the District's metropolitan areas and in some additional urban locations. Over all, the situation is one of continuing strength in savings inflows and mortgage activity at the thrift institutions and in the construction and sale of new housing units. In virtually every reporting area, sales of new homes continue to be very strong. Inventories of unsold homes range from "zero" in most places to "manageable" in other locations. Housing starts are also almost uniformly described as especially strong, particularly in single-family units. Exceptions to this generally bullish picture are found in reports of a slight softening in activity in Nebraska and Oklahoma.

Scattered shortages of construction materials, along with sharply rising prices and dealer rationing, are common across the District. Prices of lumber and insulation are of special concern, as is the availability of insulation, sheetrock, cement, and brick in some areas. According to most respondents, furthur rapid increases in the cost of new construction and rising interest rates are feared as the factors most likely to reverse the industry's favorable situation.

Responses from Tenth District savings and loan institutions suggest that they are watching savings inflows carefully to see whether the recent easing is only seasonal and whether market interest rates are beginning to influence inflows. Inflows are variously described as satisfactory although erratic; not what they have been; holding up, but a little lighter; and a little below projections. Comments about demand for mortgage funds and about mortgage commitments, together with the comments on savings inflows, leave a feeling that these respondents believe that an easing away from boom conditions is occurring. Mortgage interest rates are reported to be steady-to-firming. Nearly all respondents report no recent change in rates, but a majority say they expect a moderate rise in the months ahead.

The new wheat crop is off to an excellent start throughout the District. In contrast to last year, when farmers were quite concerned about drought, soil moisture levels this year are generally very good. In fact, a few localities have encountered planting difficulties because of too much rain. For the most part, however, wheat planting is running on or ahead of schedule, and in the southern part of the District the wheat has germinated and is beginning to grow. According to one director from an agricultural area, the quality of the wheat stand is excellent and the crop prospects for the coming year are "very good when compared with this time last year."

If the new crop continues to receive rain, wheat pasture will be available for grazing and some ranchers will probably take advantage of this cheap source of feed. Thus, prices for light cattle may strengthen as a result of this activity. Because most farmers were uncertain about the details of the new farm program when they started planting their wheat, acreage in the District's major producing states is expected to be about equal to 1977 levels. However, as farmers become more familiar with the program, some of the crop will probably be destroyed so that their eligibility for full Government benefits will not be jeopardized. This strategy may be employed because, with the huge stocks of wheat now on hand, the price outlook for the coming year is not bright for producers.

Most Tenth District bankers contacted report strong loan demand, especially in energy-related businesses and in real estate loans, both residential and commercial. Consumer instalment lending is also increasing rapidly, with credit card use and auto loans responsible for most of the gains. A Denver banker reports that his bank's overlines to correspondent bankers are being reduced as the smaller bankers succeed in obtaining repayments of some agricultural loans. Bankers also expect that during the next month the demand for loans will continue to strengthen, as businesses try to borrow before lending rates go up further.

There are more definite signs of a slowdown in time deposits. Only the smallest banks surveyed indicate continued strong growth, while larger banks report either slower growth or declines. Most bankers have increased their use of CD's to meet loan demand, and expect that further increases in their CD portfolio will be necessary as loan demand increases.

ELEVENTH DISTRICT--DALLAS

Discussions with Directors, businessmen, and financial executives indicate the economy of the Eleventh District continues to expand. Department store sales have quickened recently. Skilled labor is in tight supply in the major District centers, and labor markets are tight generally in Houston, Austin, and oil and gas drilling areas. With the demand for workers already high, the increase in the minimum wage will impact primarily in retailing and food service activities. Deliveries of oil field equipment can't keep up with the boom in drilling activity. The increase in planned capital spending by petroleum processors appears to be leveling off, and construction of apartment buildings is increasing sharply. The rapid pace of home buying is providing District S&L's with all the business they care to handle, while agribankers plan an 8-percent cutback in number of farm borrowers serviced. The impact of the longshoremen's strike at Texas ports is minor.

September department store sales in the District rose faster than the fairly strong rate of sales established in the first eight months of the year. Retailers report inventories are balanced and expect sales to remain strong for the rest of the year. Sales gains are fairly broad-based although some weakness is evident in shoes and men's clothing. Retailers in El Paso report that sales to Mexican nationals have returned to near the rate that prevailed prior to the devaluation of the peso.

Total employment in the District states continues to expand. But a survey of area offices of the Texas Employment Commission indicates skilled labor remains in short supply. In such isolated areas as Midland and Odessa, the problem of attracting workers is exacerbated by shortages of housing. In the large urban centers there is an increasing need for executive secretarial and skilled clerical help in all industries. Because the demand for workers is so high, the increase in the minimum wage at the beginning of the year is not expected to affect most pay scales. Important exceptions, however, are the retail trade and food service industries. A higher minimum wage will cause some retailers to trim their sales staffs.

The number of active drilling rigs continues to grow. In Texas, for example, 801 rigs are operating, compared to 693 a year ago. As a result, drill pipe and tool joint attachments are in tight supply. Forty percent of the state's drilling contractors have new rigs on order, as compared to 10 percent two years ago, and another 40 percent plans to order new rigs in the near future. The lead time required for a manufacturer to deliver a new rig has stretched to six to eight months from four to six months last spring.

The announced increases in planned capital expenditures by the petroleum processing industry appear to be leveling off. Plans for a billion dollar ethylene plant to be constructed and operating by 1982 were shelved recently, although one of the two partners in the venture is willing to revive the project if another partner can be found. A survey of the refining industry suggests that there are no plans to build large refineries in the foreseeable future. The only exception to that view is if and when offshore production is developed on the Atlantic seaboard, a few large refineries may be built on the East Coast. Future additions to capacity in the industry will come from small specialty refineries, and existing refineries will be modified to increase the output of no-lead gasoline.

Construction of apartment buildings is increasing at a rapid rate in Texas. Almost 8,000 multifamily starts were recorded in August, while single-family starts are increasing at about 6,000 units a month. A growing number of observers and participants in this business express concern that overbuilding could exist in the large urban centers by next summer. In that case, rents would level off and even decline in some areas.

Mortgage loan demand at District S&L's remains strong, and most associations report that they have all the business they care to handle. Savings inflows continue at a fast clip, but a seasonal slowdown from the strong inflows experienced earlier in the year was noted by several respondents. Rates range from 8 3/4 percent to 9 percent on conventional mortgages. Most respondents expect rates to generally hold steady into next year. Moreover, the current runup in money market rates has not triggered disintermediation, nor is it anticipated in the near term.

According to preliminary results of our latest survey of agribankers, farm borrowers from banks are going to be cut back about 8 percent. Inadequate farm income, insufficient equity, and poor management were cited as reasons borrowers will fail to qualify for further financing. It is reported many agricultural loan repayments are being made from outside income--minerals, business, savings, or sales of assets. Participations in the guaranteed loan programs of the Farmers Home Administration and Small Business Administration are up, and a few additional banks are utilizing the seasonal borrowing privilege at this Bank.

The longshoremen's strike is having a minor impact at Texas ports. All conventional break-bulk and mixed cargoes are being handled as usual, and only container ships are being picketed. Most exporters halted foreign sales in mid-September in anticipation of a general strike, but sales resumed once it was clear that the strike would not affect break-bulk carriers.

Twelfth District -- San Francisco

The Twelfth District economy can be generally characterized as healthy and growing, though with several weak spots that bear watching. Retail sales continue strong in all urban areas of the district, though depressed farm incomes have led to depressed retail sales and economic activity in a number of rural areas. Previously hot housing markets have cooled considerably. Most District industries maintain moderate to rapid growth and desired levels of inventories. Exceptions are metals and agriculture, each of which faces its own unique problems. Consumer credit continues to expand at a rapid pace and the rise in short term rates has raised fears of disintermediation.

Retail sales in all urban parts of the District continue strong. Major department stores in southern California report August sales up 12 percent and September sales up 11 percent over a year ago. A report from southwest Washington notes the unusual phenomenon that (unadjusted) August retail receipts topped those of last December. This pattern does not hold true in rural areas where falling farm incomes and farmworker layoffs have weakened all types of spending in the local rural economy.

One banker from southern California notes with relief that the extreme pressures of the recent past are moderating in the housing market. Whereas housing prices were rising at a 30 percent annual rate a year ago, today the increase is down around 10 percent. The resale of single family dwellings is said to be moving from a sellers to a buyers market in some areas, with "for sale" signs remaining up much longer today than only a few months ago. There are exceptions to this in such areas as southwest

Washington where the housing market had been rather quiet and has recently begun to heat up.

Most District industries appear to be growing at a healthy rate. In the aluminum sector, output remains high and demand is expected to remain strong through 1978. The aerospace industry is operating at high levels of output. Demand should continue strong since a large number of 20-year-old jets are due for replacement. In the forest products industry, pulp and paper markets are rather soft, though the housing-led lumber market is very strong. The pace of construction activity continues at record levels in many areas of the west.

Other positive reports come from a large electronics firm (the largest employer in Oregon) whose sales are running 27 percent above a year ago, a national power tool and chain saw producer who is currently recording record profits and expects future demand to be "very, very strong," and a truck and a truck lift firm who both report strong growth.

Sectors currently experiencing problems include metals, higher education and agriculture. Copper prices have fallen so low that our major producer of copper has begun laying off workers. Steel producers report difficult times as the steel market is characterized by widespread discounting.

While isolated producers of a few specialty crops are maintaining reasonable income profiles, farm income is generally depressed in the west. For example, even though cotton prices are at historic highs, they still fall short of production costs. Production costs in California have risen much more rapidly than elsewhere due to the prolonged drought. Wells have had to be deepened to accommodate the falling water table, and each

10 percent increase in depth results in a 10 percent increase in pumping costs, on top of which farmers have had to add rapidly rising electricity rates. One banker in the San Joaquin Valley notes that even with normal rains it will take a number of years to replenish both reservoirs and underground water. The bright spot on the farm scene is that the drought has ended in both the Pacific Northwest and Utah.

Inventories are reported to be at desired levels in aerospace, electronics, trucks and lift trucks, chain saws and power tools, a planned higher than normal in aluminum and lower than desired in clothing.

The rapid growth in consumer lending experienced in the Twelfth District during the first half of the year (an annually adjusted 48 percent between January and July) appears to continue, though at a slightly more moderate pace. Growth continues especially in the big ticket items such as autos and mobile homes, and in household appliances and furnishings. While most banks felt that consumer loan demand would continue strong, one Utah bank saw an increase in repossessions as indicating consumers may be reaching the limit of their ability to repay.

A number of people expressed fears of disintermediation, given the current high and rising level of short term rates, and one banker reported already having observed limited disintermediation at his own bank. Concern was expressed over the implications of this for thrift institutions and ultimately the housing industry.