CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Business continues to improve, if somewhat unevenly across the nation, according to District reports, and businessmen remain optimistic that economic activity will expand further in the year ahead. Respondents in every District expect at least satisfactory growth in retail sales this holiday season, although sales of new domestic cars may be below amounts projected earlier for some regions. Despite good to excellent prospects for Christmas sales, inventories at retail are still regarded as above desired levels in several Districts.

In manufacturing and other nonretail industrial activity, the overall impression is of a slight upward trend nationally, with District reports on production and sales varying from spotty and unchanged to generally expanding. Strikes are again mentioned in several reports as factors influencing business activity. And the Administration's still uncertain economic policies are said to be one of the main barriers to capital spending. Improvements in the prices of some agricultural products have helped the incomes of farmers who are now using strike and protest techniques to draw attention to their plight.

Credit demands are reported as strong in financial markets. Thrift institutions are apparently having no problems supplying mortgage funds for the booming housing industry. Demands for bank credit, business loans in particular, appear to be growing rapidly in most Districts outside the money centers of New York and San Francisco.

Everyone may not be optimistic about business conditions in 1978

*Prepared by the Federal Reserve Bank of Kansas City.

but, as Chicago puts it, no one seems to be forecasting a recession. Cleveland and Richmond report increases in business confidence this past month, and it might be inferred from some other district comments that their respondents are also more optimistic than a month ago. For example, Minneapolis finds manufacturing sales stronger than expected.

Retailers' concerns about excessive inventories were relayed by Boston, New York, Atlanta, St. Louis, and Kansas City. Philadelphia also reports relatively high retail inventories, but these stocks are expected to be worked down without difficulty by early next year. Softening in auto sales is concerning suppliers to the auto industry, according to Cleveland. Although new car sales are up in St. Louis, Atlanta, and most of San Francisco's District, inventories of new cars are described as ranging from near normal in Kansas City and Atlanta to very high in New York. Chicago, however, summarizes the story of new car sales nationwide by noting that recent adjustments in auto production schedules clearly reflect sales falling short of expectations.

Some Reserve Banks commented on special topics. San Francisco directors estimate that the average wage increase for western industries in 1978 will be between 7 and 8 per cent. Richmond expects serious consequences to its District economy from the United Mine Workers strike. Cleveland finds capital-goods producers to be more optimistic about capital spending for the first half of 1978 than indicated by the latest estimate of the Department of Commerce. Boston respondents have seen no sharp industrial price increases in recent months, and they are not concerned about shortages of materials or fuels in 1978. Dallas says petroleum refining capacity is not being expanded because of unresolved economic and political issues, but New York observes that well drilling by the oil industry is at a 16-year high.

Richmond and Atlanta report District farmers are joining in nation-wide protests against low prices of farm products. Chicago notes that some rural banks are hard-pressed to accommodate farmers who have been forced to renew loans. St. Louis, Kansas City, Dallas, and Richmond call attention to the recent improvement in prices received by farmers for some products, while Minneapolis reminds us of subsidy payments now being made to wheat farmers. San Francisco says that it is not yet clear that the drought in the western states is over. St. Louis reports farmers storing more of their crops than usual. Only about 25 per cent of the 1977 cotton crop and about 10 per cent of the soybean crop has been sold. Kansas City suggests that it is likely that wheat and corn prices may peak earlier than usual in this marketing year --if they have not already done so.

Increases in business loan demand are reported by Kansas City, Richmond St. Louis, Boston, and Philadelphia, with adjectives ranging from robust to less-than-hoped-for. Broad-based loan growth continues in the Sixth District, says Atlanta. New York and San Francisco, however, describe their demands for business loans as persistently sluggish and limping, respectively. Some softening of terms and new lending programs are reported by New York. Philadelphia bankers expect at least one round of prime rate hikes between now and June. Saving and loan associations in the Dallas District suggest mortgage demands will slow in coming months, but in the meantime, mortgage rates are expected to remain near present levels. Problems with disintermediation are not anticipated by S&L executives interviewed for the Dallas report; in Minneapolis, the disintermediation possibility that concerned directors last month has not materialized. Inflows into S&L's are reported to be increasing by St. Louis, but at a more moderate rate than earlier in the year.

FIRST DISTRICT - BOSTON

Industrialists, retailers and bankers in the First District report that economic trends have changed little in the last month. Some soft spots in the region's economy have been offset by stronger growth in other areas. Retail sales are doing well. Commercial loan demand has been strengthening and production continues to improve. Respondents have not seen any sharp price increases in recent months and there is very little concern about shortages of materials or fuels during 1978.

Retail sales continue to improve across the District. In northern New England bankers report significant increases in credit card usage as a result of very strong consumer sales. Massachusetts retailers have seen strong sales in the last two weeks, partly as a result of a change in state laws allowing stores to remain open on Sunday from Thanksgiving to Christmas. However, Connecticut, which already had Sunday sales, is also enjoying very strong demand. Some department store retailers feel that part of the increase in their business may be coming at the expense of a slowdown in auto sales.

The chief executive officer of a large soft goods chain expressed continued concern about inventories. He believes that while strong Christmas sales will enable many stores with excessive inventories to work them off, retailers will have to slow down purchases from manufacturers. As a result of the East Coast dock strike some stores will not receive goods they have already purchased in time for this Christmas rush. This could contribute to inventory problems later on.

Connecticut has been troubled by layoffs and plant closings in some areas. These reflect the difficulties of individual firms more than an overall slowdown. These job losses are also likely to be offset by strong employment increases in other industries from defense contracts and very strong demand for machine tools and fabricated metal products. Construction activity remains uniformly slow across the region. Respondents indicate that there have been increases in the number of firms bidding for new work and that the price competition is intense.

None of the Redbook respondents are experiencing any difficulty in obtaining materials, labor, or energy. Although material prices were not reported softening there was some indication that posted increases are not sticking. In part this may reflect suppliers' raising list prices because of a concern that price controls may be imposed and then discounting these increases away. While energy prices are increasing, no supply difficulties are expected and the coal strike is unlikely to affect any of the firms queried.

Several large industrial firms continued to express concern about capital formation. Uncertainty about future tax and energy policy was mentioned by one large electronics firm as having a depressive effect on investment spending. The chairman of a highly diversified conglomerate indicates that the problems of the steel industry have been a drag in the capital goods sector.

Professors Houthakker, Solow, Eckstein, and Samuelson were available for comment this month. Houthakker does not believe that the recent wholesale prices suggest accelerating inflation. Because unit labor costs are well-behaved, the major concern is that the domestic prices of exported goods as well as of imported goods will rise substantially due to continuing devaluation of the dollar. Houthakker is worried about the Fed's apparent inability to control money aggregates. For each aggregate, the <u>stated</u> growth target should be a single number rather than a range. The tolerance range should reflect the uncertainties of control and should not obscure the goal of policy.

Solow is also concerned about monetary targets. If the Fed is aiming for 9 percent M2 growth, then a realistic target would place 9 percent at mid-range rather than at the upper limit. Accordingly, the misunderstandings accompanying modest overshoots can be avoided. In this vein, "an attempt to mop up any excess money growth over some target which might not have been appropriate adds unnecessarily to downside risks in 1978."

Eckstein believes that there is no reason to raise interest rates at this time, a policy of watchful waiting is appropriate. With real growth of only about 4.3 percent, the unemployment rate will fall only .3 percentage points next year. Any additional restraint will sacrifice this already modest performance, and should interest rates rise as much as 75 basis points, a near recession is possible.

Samuelson believes that the outlook for next year has improved recently; nevertheless, real income will require help to reach a 5 percent growth target. If adequate growth requires higher levels of investment spending, the cost and availability of finance must improve. Accordingly, monetary policy must be prepared to be lenient should the prospects for future capital spending remain weak. Samuelson also believes that there is little virtue in maintaining capacity utilization rates as low as 83 percent. Although "it makes things easier for macro controllers by having an invalid economy," utilization rates as high as 88 percent are acceptable.

SECOND DISTRICT--NEW YORK

The pace of economic activity in the Second District continues to expand moderately, according to directors and other business leaders who were contacted recently. Retailers are optimistic about holiday merchandising as department store sales quickened in early December, after some sluggishness early in the season. Retail inventories remain on the high side, though. Containerized port activity rebounded with the settlement of the dock strike, but district employment continues to grow only slowly. On the financial front, the persistent sluggishness in business loan demand appears to have prompted some New York City banks to take aggressive measures to encourage borrowing.

Department store sales strengthened in early December and district merchants are optimistic about Christmas sales prospects. According to leading retailers, sales slowed in late November but posted sizable gains in early December. Several department store executives attributed the softening in late November to the unseasonably warm weather that followed Thanksgiving. As a result of the subsequent pickup in consumer purchases, most merchants expected a strong Christmas buying season. In New York City, retailers' assessments of the outlook ranged from "very optimistic" to "pretty good." Directors of the Buffalo branch reported that, despite the large layoffs by the steel industry, the sales experience in Western New York suggested a very strong holiday merchandising season. For the most part, retailers' reports on inventories suggested that stocks were high. Respondents emphasized that inventory positions are extremely difficult to assess at this time since so much depends on the strength of sales for the remainder of the holiday season. One respondent, nevertheless, felt that price markdowns would be required to bring stocks down to satisfactory levels. Reports on new car sales suggested that the district developments reflected national conditions. Area auto dealers reported an unexpected drop-off in new car sales in November. As a result, auto inventories were characterized as "very high."

In the industrial sector, comments of district business leaders continue to paint a mixed picture. According to the Buffalo branch directors, orders for industrial goods in upstate New York appear to be holding steady. More positively, the chief economist of a major paper firm noted a significant pickup in paper orders. For the most part, district industrialists reported ample unused capacity and had few plans to step up capital spending in 1978. Most expenditures appear to be aimed at replacing or modernizing existing plant and equipment, and few new capacity additions seem planned. One exception appears to be the petroleum industry. The economist of a major oil corporation stated that his firm planned large expenditures and that drilling activity for the industry as a whole was at a sixteen-year high.

Construction activity appears to be gaining some momentum, but continues to lag behind the nation. Several businessmen reported a pickup in residential construction activity in recent months. Nevertheless, joblessness among building trades workers remains high. Indeed, in order to encourage further construction activity, a bricklayers union in New York City has accepted more than a ten percent cut in wage rates for specific types of jobs.

Part of the general gloom of the region's sluggish employment picture has been dispelled by the settlement of the dock workers strike. In the wake of the settlement, employment and port activity rebounded as shippers attempted to move the backlog of imported merchandise to distributors and retailers. But some depressants to the district business climate remain. Cutbacks in steel production are continuing in the Western region of the district. Also, in New York State, an appeals court ruling overturned a lower court decision that had declared unconstitutional the payment of unemployment benefits to strikers.

Business loan demand continues to lag in the district. Partly as a consequence, one major New York City bank has introduced a new lending facility to accommodate commercial paper borrowers. The program involves very short-term lending at terms only slightly above the Federal funds rate. The facility is designed to provide borrowers a temporary alternative when paper financing is either relatively unattractive or not feasible. According to a senior lending officer of the bank, only a few dozen borrowers have used the facility in its initial month of operation, but other potential users appear to be interested. At least one competing bank has reportedly responded by matching this lending rate. Because of the pervasive sluggishness of lending demands, a few banks are reportedly foregoing compensating balance requirements, on a highly selective basis, on loans to prime customers or lending at somewhat below the prime rate. Outside of New York City, loan demand appears flat in Western New York, and Buffalo directors report no visible prospect for a turnaround in the near term.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that economic activity is expanding at an uneven pace. Industrial activity is unchanged from November according to the Business Outlook Survey, but retail sales are up for the third month in a row. For the future, manufacturers and retailers are both optimistic. Merchants expect to see positive real gains in sales over the next six months, and manufacturers foresee higher employment and increased spending on plant and equipment. Area bankers say that business borrowing is stronger this month, but still less than hoped for. They anticipate at least one round of interest rate hikes between now and June.

Manufacturers responding to the December Business Outlook Survey report that general business conditions are unchanged from last month, so that the slowdown reported in November appears to be continuing. New orders are also unchanged from last month, and shipments are only marginally higher. Inventories are down slightly for the second consecutive month. Consequently, employment reports are no brighter in December, and the average workweek in the industrial sector is up only fractionally. Most of the current sluggishness appears to be concentrated in the nondurable goods industries.

Comments by a director of this Bank are in line with these reports. He says that business is no better than in November at his firm, which manufactures nondurables. He notes, though, that business always tends to level off at the end of the year. With respect to the future, he expects only moderate improvement in 1978.

The slow pace of activity in the current period has not, however, put a damper on manufacturers' optimism. Over half of the respondents to the current survey say they expect business conditions to get better in the first half of 1978. A like proportion projects higher levels of new orders and shipments by June, and inventories are expected to rise fractionally by that time. Hiring and spending plans reflect this bullish attitude. About one-third of those responding anticipate adding to their work forces over the next two quarters, and 10 percent foresee a lengthening of the workweek. Capital spending increases are forecast at slightly more than one-third of the sampled firms--up from last month.

Price increases in the industrial sector are still less widespread than they were earlier this year. About 25 percent of the executives surveyed report paying more for raw materials this month, while less than 10 percent say they are getting higher prices for their finished products. For the longer term, over four-fifths expect to be paying more for inputs by June, and about three-fifths foresee higher prices for the goods they sell.

Area department store sales are higher this month according to retailers contacted. Reports of current dollar sales range from 10 to 16 percent above December '76 levels, and are generally above anticipated levels as well. Both downtown and suburban stores are doing well this month. Retailers attribute the fast pace in early December to bad weather last month, which kept a lid on sales, and better overall economic conditions from the consumer's point of view. Inventories have been built up through the fourth quarter, but most of the accumulation was voluntary, and executives think that the higher level of stock is consistent with stronger sales. They expect inventories to return to lower levels in the first part of next year.

Over the next two quarters, merchants anticipate sales to be 7 to 10 percent above year-earlier levels. Part of this projected increase, though, (about 2 percent) reflects low sales last spring, owing to a public transit strike in the area. Merchants contacted say they have not adjusted their plans to take lower inflation into consideration, despite the recent slowing in money stock growth. Nor do they expect the imminent increase of two-tenths of a percentage point in the Pennsylvania personal income tax to affect their sales significantly.

Commercial bankers in the region report that the demand for business loans is stronger. Current volume is reported to be at or above last year's levels, but most contacts say it is still below plan. Bankers say that with higher short-term interest rates, many borrowers are turning to the commercial paper and bond markets, instead of borrowing from banks. In an effort to increase business loan volume, some banks have been making special marketing efforts, such as offering fixed rate loans, and increasing offshore loans. Consumer borrowing remains strong and well ahead of year-ago levels.

For the longer term, most bankers contacted foresee some pickup in the demand for C&I loans, with June 1978 levels 8 to 10 percent above mid-1977 figures. Their general feeling is that uncertainty in the business community about tax changes, energy plans, and the dollar's position on foreign exchange markets is blocking further expansion of loans.

The prime rate at all of the banks contacted is steady at 7 3/4 percent. Most bankers forecast "moderate" increases in the prime of 50 to 100 basis points over the next six months. Although one contact says some disintermediation has occurred because of higher short-term rates, most say that any current deposit outflows are a seasonal occurrence.

FOURTH DISTRICT--CLEVELAND

Financial officers and economists in the Fourth District generally are more optimistic than a month ago, although they are reluctant to increase forecasts of output. Retailers of general merchandise are cautiously optimistic that Christmas sales will show larger gains than a year ago, but softness in auto sales concerns suppliers. Capital-goods producers believe capital spending for the first half of 1978 will exceed latest estimates by the Department of Commerce. Steel operations are picking up gradually. Although material shortages are delaying new housing completions, mortgage loan demand remains strong.

Despite the recent spate of favorable business news, economists have not revised upward their projections of output for either the first half of 1978 or the entire year. Those who look for stronger gains than 4 to 5 per cent annual rates of increase in real GNP feel that the latest data corroborate their more optimistic projections. Others, who are less optimistic, believe developments that would accelerate consumer and business spending have not improved sufficiently to justify scaling up their projections. Skepticism centers on sales prospects for the auto industry and on acceleration of fixed investment.

Retailers view Christmas sales with cautious optimism. One department store executive believes that sales gains this season will exceed last year's increase. Prior to recent heavy snowfalls, sales were strong. Unconcerned that consumer debt was burdensome, this economist indicated that the retailer will continue to encourage credit sales, which now make up about 58 per cent of total sales. An economist with a major national chain of department stores had expected November retail sales to fall from October levels because of weakness in auto and general merchandise sales. He now estimates that December sales will rise by 1 to 1.5 per cent over November and that PCE will increase at an annual rate of 8.5 per cent this quarter, not much more than last quarter's increase. Growth in real sales is being limited because consumers are saving a higher proportion of their disposable income. The strongest retail gains have been in lumber and building materials, reflecting home maintenance and remodeling.

Auto producers and auto suppliers view recent softening in auto sales differently. An economist with a major producer still forecasts a 9.3 million rate of sales for 1978. GMC officials project domestic new car sales of 9.7 million, but one supplier reported GMC recently has shaved its production schedules for the first quarter 1978 by 2½ per cent. Some suppliers, skeptical of what they consider to be unrealistic sales forecasts of producers, expect auto sales in 1978 at around 8.8 to 9.0 million units. While suppliers of flat glass, tires, steel and body frames report little or no cutbacks in orders from Ford, a major tire producer reported that GMC has cut back orders for tires for intermediate-size cars. Chrysler also has reduced tire orders as a result of production cutbacks because of excessive new car inventories.

Officials and economists associated with capital-goods industries generally believe that real capital spending during the first half of 1978 probably will increase more than the latest Department of Commerce survey indicates. Although no one expects a boom in capital spending, some contend that the Department of Commerce estimates are too conservative for even the moderate growth in output expected next year. Still others thought that the timing of the survey may have affected business expectations. One producer who earlier predicted a 6 to 7 per cent increase in real spending in 1978, now believes only a sizable business tax reduction, enacted early in the year, could bring about such increased spending. Some expect a slower rate of gain in fixed investment next year because of a moderated pace of spending by the utilities and petroleum and automotive industries. A producer of transmissions and axles for heavy-duty trucks looks for a slower rate of expansion in both output and shipments next year, in spite of record orders. Similarly, machine tool orders and shipments are not expected to rise as rapidly in 1978 as this year. Others expect gains in spending early next year to be at rates at least equal to or stronger than 1977, especially in such nondurables as food, paper, and chemicals and some nonmanufacturing, especially communication. Lack of confidence and uncertainty are hindering fixed investment and more rapid economic growth, according to one of this Bank's directors.

Steel sources remain more optimistic than just a few months ago. Orders continue to strengthen, as indicated by a higher volume for December deliveries than received for a comparable period in November. January orders are also somewhat stronger than for a comparable period in December. This quarter's steel shipments will approximately match last quarter's, and shipments next quarter should rise about 5 to 10 per cent from the fourth quarter, according to one steel economist. Steel sources attribute strengthening primarily to termination of steel inventory liquidation and to a drop in imports, one that is partly seasonal and partly because of the problems relating to recent charges of dumping. One steel economist projects that production could rise to as much as 85 per cent of capacity next quarter, compared with about a 75 per cent operating rate this quarter. Some economists suggest that domestic industry is being forced to accept the reference pricing of steel as an alternative to enforcement of anti-dumping laws.

Inventories are not judged to be excessive, but excess stocks of some types of automobiles, chemical products and petroleum products will likely restrain gain in output. One retailer estimates that stocks of consumer goods are about 5 per cent higher than warranted by sales, but he expects that aggressive pre-Christmas sales promotions will help bring stocks into line with actual and projected sales.

Some coal producers appear less certain about the duration of the coal strike than they did a month ago. One director of this Bank expects a strike of at least two but not more than three months, at which time union funds will be exhausted. The work stoppage is not expected to affect users for at least two months, since half the industry is unaffected by the strike and coal inventories are adequate.

Bankers note continued strength in deposits, while S&L's still are experiencing a reduced flow of deposits, especially for savings accounts. Mortgage loan demand remains strong and has contributed to firming in mortgage rates in some areas, according to one director. Building materials shortages have hampered completion of new housing starts, and one mortgage lender reported that builders have noted easing in lumber prices from last summer's highs.

FIFTH DISTRICT - RICHMOND

Advances in Fifth District manufacturing activity continued spotty in November. Responses to our survey of manufacturers were nearly evenly divided between gains and losses in shipments, new orders, and backlogs of orders. This essentially sideways movement apparently prevailed for most individual industries as well as for the entire sample. Initial indications are that the retail sector is experiencing a strong Christmas selling season. The UMW strike, should it persist, looms as a major factor in Fifth District economic performance. Coal mining is virtually shut down in the District, even in such non-union areas as Maryland. In addition to the coal industry, the effects are already being felt by District railroads, where layoffs began before the strike. Fifth District bank credit expansion continues strong, with robust business lending compensating for weaker expansion in consumer and real estate loans. Despite problems in the coal industry and the lackluster results of our latest survey of manufacturers, business psychology in the District appears to have improved substantially in recent weeks.

In the manufacturing sector the overall level of activity appears little changed over the past month. Shipments, new orders, and backlogs of orders were higher in some firms, lower in others. This pattern was apparent within individual industries as well as across the manufacturing group as a whole. Inventories of finished goods are somewhat higher than a month ago while stocks of materials are essentially unchanged. Approximately one-third of our respondents now view current inventory levels as excessive. The diffusion of manufacturers' responses suggests a decline in employment as well as a reduction in weekly hours worked. Employee compensation and other prices paid by manufacturers rose widely in November while prices received were stable. Current plant and equipment capacity remains in excess of desired levels and there appears to be little sentiment for enlarging current expansion plans.

Among District retailers the situation has brightened significantly in the past month. All respondents indicated a pick up in sales and in relative sales of big ticket items from a month ago. Inventories, employment, and prices all rose over the month for these retailers. Christmas related sales are apparently running ahead of last year's heady pace. Sales are also substantial in a broad market for items to keep warm and to conserve energy, including such varied items as warm clothing, fireplace equipment and chain saws. Expectations of retailers are more buoyant than at any time in recent months, with respondents unanimous in expecting further improvement nationally, locally, and in their firms over the next six months.

Optimism among our manufacturing respondents also appears to have increased significantly after lagging for two months. A third of these respondents now expect the level of activity nationally and in their respective firms to improve over the next six months. Also, at their latest meeting, both head office and branch directors of this Bank expressed more bullishness about business in general than at any time since early in the year.

The UMW strike represents the largest uncertainty in the Fifth District. From preliminary figures, it appears that the strike is directly affecting approximately 80,000 miners in the District. This figure includes non-union miners in Maryland but not in Virginia. A non-union walkout in Virginia could add 10,000 to the figure. In addition, more than 1500 railroad workers have been laid off as a direct result of the strike, and this figure could run as high as 3500-4000 by mid-December. Beyond these effects, the impact on other activity in the District will depend on the duration of the strike. Most manufacturers and utilities have stockpiled up to 90-day supplies of coal. The most optimistic estimates of the length of the strike are in the 2-3 week range. Other estimates run as high as three or four months.

Business credit at large District Banks expanded at an annual rate of 20 percent in the last month. Some of this expansion, estimated at 15-20 percent of the total, is attributable to the dock strike, as exporters have sought credit to finance unexpected inventories. The greatest part, however, appears to be accounted for by middle-sized corporations representing a broad spectrum of activities. Consumer credit is recovering from an early fourth quarter lull, with some reports of special strength in the bank card area. Although real estate lending has shown some recent weakening, bankers feel that it will be strong in future months. The demand for single family mortgage loans is seen as a primary source of strength, with apartment lending increasing too.

Marketings of the 1977 crop of flue-cured tobacco were characterized by smaller volume and lower quality tobacco, particularly the leaf usually bought by exporters. The shortage of export grades resulted in record prices for the better grades usually purchased for export, bringing the season average to a record high $1.18 per pound, some 7 percent above the 1976 figure. Total value of sales was down $133.8 million or 10 percent below a year ago, however. The nation's farmers apparently face another year of relatively low prices and incomes in 1978. Consumers, however, seem assured of abundant supplies of food at prices only moderately higher--4 to 6 percent--than in 1977. The November crop report revealed further declines in the District cotton crop but slight gains in the tobacco, soybean, and peanut crops. The District farmers are joining in nationwide demonstrations against the cost-price-income squeeze in agriculture.

SIXTH DISTRICT - ATLANTA

Optimistic reports of consumer activity highlight economic news in the Southeast. The employment situation is still troubled by strikes, and crop farmers' revenue losses have been brought to the nation's attention. Inventories appear generally in balance. Housing continues to set post-recession records, while commercial and industrial development shows moderate gains. There's been no slackening of loan growth, but deposit inflows have tapered.

Reports of day-after-Thanksgiving retail sales have been almost universally glowing, fueling merchants' expectations of an excellent holiday season and extra-seasonal sales gains. Heavy advertising, special sales, and the recent opening of new shopping centers in many areas have helped stimulate sales. One director notes that the dock strike has created shortages of electronic products, such as TVs, radios, and stereos, and of some soft goods from the Far East in his area. Despite their optimism, retailers in several cities have expressed concern that their large pre-season stock build-ups won't be entirely worked off.

Sales of new and used cars and trucks have varied widely in strength, by location and by make. Though December is typically a slow month for them, many dealers expect sales tallies to surpass last December's. Inventories of 1978 models seem short to adequate, with deliveries quickening. However, a few scattered dealers have substantial supplies of slow-moving 1977 models.

Indications are that producers' inventories are generally stable and under control, with finished goods stocks in a slight downtrend and raw material supplies holding. However, cold, wet weather has delayed fertilizer applications and driven up stocks of phosphate products. Producers (mainly in central Florida) had been working down excess stocks for several months, and the latest setback prompted them to cutback production, close several small plants, and lay off some workers.

The biggest inventory story is coal. Electric utilities have been stockpiling for weeks in anticipation of the U.M.W. strike and are carrying supplies adequate for roughly four months of normal winter service.

Gas utilities and fuel dealers continue measures to ensure supplies through the winter. Gulf States Utilities has announced a three-year, $750 million investment program to convert its gas-burning plants to coal or nuclear power.

Settlement of several large strikes has sent thousands of workers back to their jobs. But 5,000 Lockheed workers in Atlanta and 2,000 Pullman-Standard employees in Birmingham were still striking when the U.M.W. pulled coal miners off the job.

Abnormally heavy November rains put harvests even further behind schedule and damaged crop quality in many areas. Cattle prices have risen slightly; one director remarks that a spring swell in beef cattle herds is in the making. Orange and concentrate prices remain at an all-time high, with excellent harvest conditions, unusually strong post-Thanksgiving demand, and heavy out-of-state shipments.

An estimated 5,000-8,000 farmers from Georgia and neighboring states tractored to the State Capitol in Atlanta this weekend, peacefully protesting low prices of farm products and income losses (particularly pronounced in the Southeast because of production shortfalls) and demanding

100 percent parity. They say they will join a nationwide strike to begin Wednesday. More ominous than this threat has been the rumor that the Teamsters may support them with a boycott of farm products; at least one importer of feed from the Midwest has arranged for advance deliveries.

Residential construction and housing sales show no signs of letting up, other than or in spite of the usual seasonal slackening. Nonresidential gains continue to be less spectacular but moderate. Recent building plans announcements have included sizable portions of medical facilities and public construction. Private investment plans are by-and-large for smaller, less costly additions and short-lived equipment, though several major investments are on the horizon.

Strong, broad-based loan growth has continued. Bank investments have been virtually flat. While savings deposit growth has diminished at member banks, demand deposits have expanded notably and large banks' outstanding large-denomination CD's have risen. At savings and loan associations, deposit inflows have moderated; though rates are generally stable, some increases in rates on mortgages and certificates have been reported in Atlanta and Birmingham.

SEVENTH DISTRICT - CHICAGO

As the year draws to a close, virtually all informed observers in the Seventh District are confident that the expansion will continue well into 1978, perhaps through the year. Retail sales have been at satisfactory levels, and inventories are generally well balanced. Price increases in many industrial markets have been restrained by competition, but the underlying trend is still strongly upward. Orders for steel have improved. The capital goods sector continues to improve with a bigger boost from nonresidential construction. The agricultural sector remains weak with some optimism generated by the recent rise in grain prices. Credit is generally available, but some rural banks are hard-pressed to accommodate farmers who have been forced to renew loans.

Professional forecasters in the district have predicted increases in real GNP for next year ranging from 3.5 to 5.5 percent. No one seems to be forecasting a recession. Most expect price inflation to accelerate somewhat next year for various reasons including: a bottoming out of farm prices, moves for protection, the higher minimum wage, increased social insurance taxes, rising wages, and higher income supplements--both private and public. Views differ on the desirability of a large reduction in federal taxes. Some professional forecasters believe that a substantial tax cut is necessary to sustain the expansion, while others, probably more numerous, believe that a cut of $20 to $25 billion is not large enough to make a significant difference in a $2 trillion economy.

Sales of general merchandise were adversely affected by extremely cold weather in the first third of December, but prospects for the Christmas season remain excellent. Sales of soft goods had begun to improve relative to hard goods in October and November, but hard goods--especially appliances, home improvement items, and auto parts--continue to show the largest gains. Some retail executives believe that recent heavy use of instalment credit will moderate. Nevertheless, delinquency experience continues to be excellent. The use of bank cards continues to expand with another department store chain added to the list of users.

The airlines have been pleased with larger than expected (10 to 12 percent) increases in traffic over year ago starting in October. Only part of the gain can be attributed to cut-rate fares on certain routes.

Recent adjustments in auto production schedules clearly reflect sales falling short of expectations. Success of the new smaller models, in doubt at present, is necessary if 1978 sales are to equal or exceed 1977 as auto executives have predicted. There is greater confidence that sales of light trucks will continue at high levels. All makes have expanded capacity to produce vans, which have been in short supply. Sales of heavy-duty trucks and trailers continue on a plateau, and at least one maker has cut production.

Orders for capital goods continue to expand overall. Sales of virtually all types of farm equipment have been far below year ago levels, however. Among the strongest capital goods sectors have been components: castings, fluid power, mechanical and electrical drives and controls, bearings, and electric motors. Some producers of these items report that inquiries suggest a shift toward larger projects for expansion and modernization, as opposed to orders for off-the-shelf items for replacement and maintenance. Manufacturers of capital equipment, except for some specialties, have expanded capacity substantially since 1974, and could accommodate additional orders.

Steel orders began to improve in November and order books are filling up for early 1978. Pressure to curb imports and possible shortages resulting from extended coal/ore strikes may be temporary factors. A major district producer, however, cited an improvement in orders for plates, bars, and structurals, which are associated with a rise in capital goods production.

Prospects for nonresidential construction continue to improve. Except for the auto industry, planned industrial projects are relatively small, e.g., light manufacturing and distribution centers. Plans for new office buildings and hotels are significantly stronger in the Chicago area, both in the Loop and in favored suburbs. Retail store construction also is picking up in the district, but only for smaller "community" shopping centers. No large "regional" centers are needed in the near future. Some huge "closed mall" type shopping centers still are not operating at planned levels.

Residential construction should be at a high level again in 1978. Sales of new and existing units continue strong with prices 10 to 12 percent above year ago. More and more existing apartment buildings are being converted to condominiums. Apartment construction is picking up, but on a highly selective basis. Rents will have to rise substantially further to justify major rental projects because rising costs of construction and operation are outpacing rents. The rise in construction labor costs has moderated, but prices of lumber, insulation, and other materials are up 20 to 50 percent from year ago.

Although incomes of grain and livestock farmers have been sharply reduced, to the point of bankruptcy in some cases, the agricultural picture is not all bad. Fruit and dairy farmers have had good to excellent results this year.

EIGHTH DISTRICT - ST. LOUIS

Business activity in the Eighth Federal Reserve District continued to expand at a moderate rate in recent weeks. Consumer spending has advanced in line with expectations of most retailers, but few inventory excesses have developed. In the financial sector, credit demands remain strong. Time deposits at commercial banks have increased substantially, largely reflecting sales of large CDs. Savings inflows at savings and loan associations continue to increase, but at a more moderate rate than earlier in the year. In the manufacturing sector some gains continue to be made in most industries. Home building remains at a high level for this season of the year. In the farm sector, the income picture has shown some promise for improvement as a result of recent increases in farm commodity prices. Farmers are reported to be holding and storing a larger proportion of their 1977 crops than usual.

Consumer spending has continued above year ago levels according to area retailers. Major department store representatives report that recent sales have been in line with their expectations. Appliance sales at department stores have been especially large in recent weeks. Automobile sales are also reported to be up from year ago levels. Some weakness was noted in women's apparel items, but this was believed to be the result of some unfavorable weather and was viewed as temporary.

Most retailing and manufacturing firms report inventories are at desired levels. However, some product lines -- including some chemicals, paints and coatings, and furniture -- were reported to be larger than desired. On the other hand, a manufacturer of connector plates used in construction experienced greater than expected sales in recent weeks and some rundown in inventories. Also, inventories of some building materials, principally insulation and storm doors and windows, are well below desired levels.

In the financial sector, commercial banks report that demand remains quite strong for real estate, consumer, and agricultural loans. Demand for commercial and industrial loans has also increased in the past two months. Savings and loan institutions, however, report that home mortgage loan demand has leveled off since last summer.

Total time and savings deposits at commercial banks have increased rapidly in recent months. Time deposits, primarily large certificates of deposits, have increased quite rapidly, more than offsetting a decline in small consumer-type savings deposits. Savings inflows at savings and loan associations have continued to advance, but at a more moderate rate than earlier in the year.

Production of manufactured goods generally continues to advance. Production of capital goods — such as motors, railroad cars, and welding and cutting equipment — were reported to have made further advances. A manufacturer of capital goods reported, however, that although appropriations for capital goods are quite strong, orders had not been as good as expected.

A sizable backlog of orders continues in the home construction industry in parts of the District. In some cases, new home buyers are waiting two months or more beyond original scheduled dates for completion. Unfavorable weather is hampering efforts to get back on schedule.

Reports indicate that farmers are holding a larger proportion of their fall crop off the market than in recent years as a result of the relatively low farm commodity prices. It is estimated that only about 25 percent of the 1977 cotton crop and about 10 percent of the soybean crop has been sold. As a result, farm storage facilities for crops have increased very rapidly this year. Farm income prospects have improved somewhat in recent weeks, reflecting the recent rise in farm commodity prices.

In early December an electrical power emergency developed in the TVA service area and customers were asked to cut back electrical consumption. The situation developed as seven large generating units required repairs (five unexpectedly) at the same time and a substantial rise in electrical power demands occurred due to sharply lower temperatures. Repairs for most of the units are expected to be completed by the second week of December.

NINTH DISTRICT - MINNEAPOLIS

Despite some business uncertainty, the Ninth District economy is quite healthy in late 1977. Both retail and manufacturing sales are expanding briskly. Mortgage funds are available to support the district's current high level of homebuilding. And the region's two weak areas, iron ore mining and agriculture, are slightly improved. However, directors' comments indicate that uncertainty about the Administration's economic policies is holding back some investment spending.

Strong retail and manufacturing sales . . .

Consumer spending is strong in most of the district. Two major Minneapolis/St. Paul area retailers report that recent sales either have met or exceeded their fairly optimistic expectations, and another says business is currently "pretty good." Directors also report strong retail sales outside Minneapolis/St. Paul, except in areas affected by the iron ore workers' strike and in smaller communities where farm income is down considerably.

District manufacturing sales are strong too; overall they are stronger than expected. During the first nine months of this year, manufacturing sales were up about 14 percent from a year ago, but in August manufacturers expected only a 10 percent increase in the fourth quarter. In November, however, manufacturers reported a fourth-quarter sales gain about the same size as the rest of the year (with durable goods sales up 17 percent; nondurable goods sales, 11 percent). This pickup in business has not resulted in any inventory shortages or capacity problems. It has, though, increased manufacturing employment about 4 percent over a year ago.

. . . and homebuilding

Homebuilding is another important source of strength for the district economy. A record number of building permits has been issued this year for residential dwellings. Also, last month's concerns about disintermediation have not materialized, so funds are still available to accommodate a high level of homebuilding. Although some sophisticated investors have shifted funds from savings deposits to higher yielding money market instruments, this Bank's directors report that higher interest rates on U.S. government securities have had little effect on the growth of time and savings deposits in their communities.

Improving iron ore mining and agriculture

Not only are the district's strong sectors still expanding, but the two weak sectors look better than they did last month. The striking iron ore workers appear to be closer to reaching a settlement; several locals have already signed contracts. Ending these disputes would do much to boost economic activity in northeastern Minnesota and the Upper Peninsula of Michigan. In the other trouble spot, agriculture, the subsidy payments to farmers under the recent farm legislation are being made this month. They should help offset some of the current weakness in district farm receipts. In fact, a Montana director thinks December wheat subsidy payments in his county will total about $8 million. This would be about $20,000 for a farmer with an average-sized farm.

Business uncertainty

Even though the district's economy is currently quite strong, uncertainty about the Administration's economic policies is dampening plant and equipment spending. Two directors associated with large manufacturing firms say uncertainty about the tax and energy programs is holding back some investment outlays. And a regional economic survey by a director's large Minneapolis bank found that a lack of confidence was limiting investment spending in the Minneapolis/St. Paul area.

TENTH DISTRICT--KANSAS CITY

Tenth District retailers report moderately good fourth quarter sales, continuing the improvement seen in the first 9 months of the year. Several merchants, however, mention the possibility of a need for inventory cutting in the period ahead. Auto dealers, on the other hand, have relatively low inventories of 1977 cars and also report good sales for the 1978 model year. On the agricultural front, wheat and corn prices have exhibited unexpected price strength, despite the large production of these grains. Tenth District bankers report unseasonably strong loan demand, especially for commercial, industrial, and consumer instalment loans, although agricultural loan demand is relatively unchanged.

Larger retailers in the Tenth District appear to be cautiously optimistic about both expected total sales for 1977 and prospects for 1978. In almost all cases, results for the final 3 months of the year are expected to exceed the same period last year by about the same percentage recorded for the first 9 months of 1977. In the Denver area, however, a few merchants report slower than expected December sales.

Reports on the actual magnitude of sales improvement and on the inventory situation are varied. Projected sales increases for all of 1977 range from a low of 6-7 per cent to a high of 20 per cent over 1976. No store reported any unusual problems in getting goods from suppliers, but several indicated that their inventories might be too high. Several respondents had difficulty making comparisons with 1976 because one or more new branch stores have been opened in the past year.

Domestic automobile dealers in major cities of the Tenth District report normal or somewhat lower than normal inventory levels for 1977 model cars. The 1978 model cars appear to be selling quite well, with midsize and small car sales outpacing large car sales. Generally, cars are being sold with many accessories, with this especially true for larger cars. Used cars are selling very well, possibly due to the price increases on new cars. It also appears that the demand for smaller used cars is particularly high. Foreign car dealers seem to be having difficulty in getting cars from manufacturers, and most have very low inventories of 1978 models. Generally, the 1978 model year is expected to be better than 1977, although about a third of the dealers, especially those in Denver, indicated it was too early to tell and felt that sales might be off somewhat.

Prices received by farmers for wheat and corn exhibited counter-seasonal increases during late summer and fall this year. Despite the prospects for large U.S. production, wheat and corn futures prices trended upward from late August to mid-November. Since then, futures prices have declined somewhat.

Rumors in the grain trade of increased Russian purchases no doubt account for part of the price strength. Continued strength will be dependent upon larger placements of grain under Commodity Credit loan--thus reducing free market supplies--and continued favorable export news. Given the large supplies of grain on hand, it is likely that wheat and corn prices may peak earlier than usual in this marketing year--if they have not already done so.

Tenth District bankers report that loan demand in November was moderately to significantly stronger than usual for this time of the year, with areas of strength being commercial and industrial loans, and consumer instalment loans. The strength in commercial and industrial loans is related primarily to construction of commercial and residential property, with single-family homes and condominiums in ski resort areas being of major importance. Mortgage loans, either placed directly or through mortgage brokers, are, nonetheless, reported as normal or somewhat weaker than normal for this time of the year. The strength in consumer instalment loans appears to be concentrated primarily in the areas of new auto loans and revolving credit for bank charge cards.

Agricultural loans are reported as relatively unchanged in November, although most bankers consider this normal as crops are brought to market. Several bankers indicate that the liquidity position of their smaller respondents has so improved that these respondents are repurchasing agricultural loans from them.

Time and savings deposits as well as small CD's at most banks were either unchanged or declining in November. A few bankers attribute the decline in small CD's to stiffening competition with savings and loan institutions. Large negotiable CD's, on the other hand, are reported by most bankers as either steady or increasing.

Several bankers expect that, as a consequence of insufficient overall deposit growth, their banks will have to purchase funds (either negotiable CD's or Fed funds) in order to keep pace with loan demand. Some of the bankers note, however, that the purchase of funds is normal for their bank at this time of the year.

ELEVENTH DISTRICT--DALLAS

According to the Directors and businessmen surveyed this month, the economy of the Eleventh District continues to expand nicely. The unemployment rate fell to 5.3 percent in October--the lowest rate for the year. Preliminary indications suggest Christmas sales this year will be up sharply from a year ago. Residential construction remains strong, while nonresidential construction activity is making a year-end surge. But industry spokesmen predict a slowing in construction activity by mid-1978. The demand for home mortgages remains very active, but savings and loan associations suggest market demands will slow in coming months. Most petroleum refiners continue to put aside plans for plant and equipment spending until a national energy policy is established. Because profit margins have improved, the number of cattle on feed in Texas is up sharply from the level a year ago.

Department store executives indicate Christmas sales should be excellent this year. Thanksgiving sales were 14 percent above a year ago, and December sales may well top that rate of increase. Although consumers continue to be price and quality conscious and are making "practical" gift selections, many show a ready willingness to buy expensive gifts. The more popular selling items include major appliances and electronic television games. Although dresses and young men's apparel are selling well, sales of coats and sweaters have been slow because of mild weather. Inventories are at planned levels, and there appears to be little need for price cutting to move merchandise.

Residential construction remains strong in the Dallas-Fort Worth and Houston areas. A major home builder in Dallas reports his company has all the contracts it can handle through March. In Houston, about 5 percent of all single-family homes are vacant, and the vacancy rate for multifamily units is a thin 1 percent. In other areas of the District, reports are mixed. Construction of single-family homes in El Paso has slowed because of a rise in the inventory of new unsold homes. However, housing sales remain good, and the current lull in home building should be short lived. In San Antonio, construction of single-family units remains active while multifamily unit construction remains weak.

Nonresidential construction in Texas has picked up substantially since midyear. The growth is broad based in the construction of shopping centers, office buildings, warehouses, and manufacturing facilities. Construction of shopping centers is increasing at a fast pace in most urban areas within the District. The demand for new office space in downtown Houston continues strong. The construction of that city's tallest building is to begin this month. Construction of warehouses is also active, and the manufacturing industry that currently appears to be building new production facilities at the fastest rate is the electronics industry.

Shortages of labor and materials continue to hamper overall activity in the construction industry. The supply of labor remains especially tight. Material shortages are being managed by careful planning and by placing orders well in advance of project startup dates. Prices of most materials continue to climb. The price of cement, for example, has increased 15 to 20 percent during the last few months. Lumber prices, however, have declined to the level that prevailed in late summer.

Savings and loan associations report continued strong demand for mortgages for new homes and renovation of old homes. However, an easing of mortgage demand is likely to develop in the spring if the anticipated slowness in the current construction boom materializes. In the meantime, mortgage rates are expected to remain near present levels. Some S&L's report a substantial slowing in savings inflows, but most indicate that sufficient mortgage funds are available to meet demand. Savings and loan executives still do not anticipate having problems with disintermediation. S&L's have approximately 75 percent of their savings capital in long-term certificates of deposit. And if there is going to be disintermediation, it will affect the short-term savings accounts and not the long-term certificates of deposit.

Demand for petroleum and other refined products continues to increase, but production is only slightly higher than a year ago. Refining capacity shows few signs of growth. Refiners point to unresolved economic and political issues, especially the Administration's announced energy program, as creating uncertainties that make current expansion plans more speculative. The only plant expansions that are currently underway are by small specialty refiners.

Cattle feeding in Texas has increased sharply in recent months in response to improved profit margins. The number of cattle on feed in November was up 11 percent from a year earlier. Placements have considerably outpaced marketings, and feedlots, on average, are currently at about 85 to 90 percent of capacity. Current costs of gain are 36 to 38 cents per pound. And with slaughter cattle prices at 41 to 42 cents per pound, profits are averaging $35 to $40 a head. As a result, banks in the cattle feeding areas are experiencing strong loan demand. Placements in the next few months are likely to remain high as feeding costs should continue to be favorable. In addition, poor winter grazing could move more cattle to feedlots, and cattle prices are expected to increase further by spring.

TWELFTH DISTRICT--SAN FRANCISCO

The Twelfth District remains in relatively good health. Retail sales exceed year-ago levels by double digits in many parts of the district and only in the depressed agricultural machinery sector do inventories exceed desired levels. Among district industries agriculture remains weak but struggling and construction remains strong but moderating. A survey of wage increases reveals the average rise in labor costs is running at about 7 to 8 per cent. In the banking sector, consumer lending keeps pace with strong retail sales while commercial lending limps behind.

Retail sales appear strong in all areas of the district. In the Seattle area, the settlement of the Boeing strike has perked up sales to 10 per cent above year-ago levels. The greatest strength there is said to be among costlier items such as stereos, cameras, microwave ovens, video-games, TV's, washers and dryers. Oregon retailers use mainly superlatives when discussing their Christmas season sales, and double digit increases over last year's levels appear to be the rule. One area of Utah reported retail sales running about 14 per cent above a year ago. Reports from Southern California peg retail sales at 10 to 15 per cent above last year. The only specific weaknesses reported were in auto and truck sales in Washington, Idaho, and parts of Southern California. Truck sales were said to be down because of depressed farm incomes, and auto sales down because of consumer resistance to higher prices. However, this latter phenomenon was spotty since several areas reported auto sales to be strong. The only less-than-optimistic reports on general retail sales came from bankers in rural areas, where farm incomes have been squeezed between drought related costs and low crop prices.

The only reports of undesired inventory buildups come from the agricultural sector where sales of new farm machinery are very slow and dealer inventories have grown quite large.

The health of district industries remains generally strong and even agriculture is doing its best to adapt to a difficult situation. It is uncertain whether the California drought has ended -- one very good storm has generated some hope, but rainfall for the rainy season (which began October 1) is still below normal. Farmers have taken a number of measures, such as changing crop spacing and shifting from spray or flow to drip irrigation, to significantly reduce the water input to crop production.

Construction remains strong in many areas, but the rate of increase is beginning to moderate in some. Kern County, California reports very strong growth in both residential and non-residential construction, while requests for building permits have slowed in five southern California counties. At the other end of the west coast in Washington, the real estate market is reported to still be booming. One other economic bright spot lies in the Sierras where that November storm allowed the ski resorts to open on Thanksgiving for the first time in three drought-ridden years.

When asked about wage increases for the coming year, our directors' estimates seemed to converge in the area of 7 to 8 percent. On the high side are: the Boeing settlement with a first year increase of 9 to 12 percent, the aluminum settlement with a first year increase of 14 percent, and the Oregon forest-products agreement where the second year increase beginning June '78 is 11 percent. Northwest steel workers have been on strike for four months and are holding out for an 8.7 percent increase. On the low side is the Oregon construction sector with a June 1978 wage gain between 3.6 percent and the change in the CPI, the Northwest metal industry which just negotiated a first-year increase of 7 percent, and the Southern California natural gas industry which expects its March negotiations to yield a 7 to 8 percent wage gain.

In the banking sector consumer lending continues strong while commercial lending limps behind. In Salt Lake City, consumer lending is said to be keeping pace with retail sales -- i.e., about 14 percent above year-earlier levels. One Washington bank reported installment loans to be running almost 70 percent above year-ago levels, while an Idaho bank noted consumer lending was proceeding at a seasonally normal pace. Banks in both Oregon and Southern California report consumer lending to be growing more rapidly than the normal seasonal pattern. Installment lending at one large California bank increased at the following annualized rates: 34 percent during the first 9 months of the year, 21 percent October over September and 13 percent November over October. Its president inferred from this that consumers were becoming more cautious after their debt levels had risen to such high proportions of their incomes.

In commercial lending, only one Oregon and one Utah bank reported real strength. The more typical report was one in which there was a seasonal pickup in commercial lending to finance Christmas inventories. However, one Oregon and one large California bank claimed not to even be experiencing the usual December bulge in such lending.