

CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

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by the Staff

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## SUMMARY\*

The economy continues to advance but there is increasing evidence of a slowing, judging from this month's district comments. Among the positive developments, consumer buying generally remains robust, apart from the middle part of the nation where retail activity was temporarily disrupted by especially severe winter weather. Manufacturers continue to report substantial order backlogs and commercial construction appears to be strong. Business inventories are being closely watched in all sectors of the economy. On the darker side, there is apprehension over an economic downturn and the rate of inflation. Residential construction activity recently appears to have slowed perceptively. At the same time, automobile sales appear mixed with several districts noting a slackening in demand. Increasingly, there are reports of shortages of skilled labor and materials. On the financial scene, loan demand appears to have eased somewhat.

After a sluggish start, consumer spending was generally strong during the holiday and post-holiday selling seasons. Purchases of big-ticket items in particular were noted in the New York, Atlanta and Richmond districts. In the San Francisco district, several department stores are reporting record sales, some exceeding last year by as much as 25 percent. The Philadelphia district, too, reported robust holiday sales. In the middle part of the nation, however, retailing activity was unusually slow in early January. Chicago, St. Louis and Dallas attributed

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\* Prepared by the Federal Reserve Bank of New York

this to the dislocations created by heavy snows and extremely cold weather. Minneapolis felt that the severe weather conditions contributed only slightly to the normal post-holiday slowdown. In the Cleveland district, retailers see little sales improvement in real terms and there is some fear that widespread promotions and markdowns in December will dampen January sales gains. Automotive sales reports were mixed, continuing strong in the Boston, Chicago and Dallas districts, but somewhat weaker in large parts of the Atlanta, St. Louis and San Francisco districts.

Manufacturing activity and business sales continue to advance in most districts, but signs of weakness appear to be emerging. Several districts noted a lengthening of lead times for some products, citing shortages of building materials and machine parts. Cleveland reports that machine tool builders are operating at capacity and expect to continue at current production levels through most of the year. Capital goods producers in the New York and St. Louis districts report sustained activity as do Chicago and Cleveland steel producers, but some slowdowns in consumer goods are reported in Boston, Cleveland and St. Louis. In the Philadelphia district, manufacturers appear less than sanguine about the prospects for the economy, expecting a drop-off in new orders along with declining shipments. As a result, some marginal cuts in factory payrolls and further shortening of the average workweek may be in the offing. In the Richmond district, too, there is some pessimism as a result of scattered employment reductions and shortening of the workweek. Some shortages of skilled and semi-skilled labor were reported by Boston, Minneapolis, and Kansas City.

Against a background of an uncertain outlook for the national economy, businesses are closely watching inventory levels. At the retail level, inventories generally appear closely aligned with sales. In the current environment, merchants appear to be very wary about adding to their stocks. In manufacturing, the reports varied. Philadelphia reported the manufacturers continue to reduce stocks, while Cleveland noted that capital goods producers are building inventories in response to further increases in backlogs and prices.

Construction activity is mixed. Nonresidential building has remained strong in Atlanta, Chicago, Dallas, San Francisco, and Minneapolis. In contrast, residential building activity has slackened in most districts. Even in San Francisco, residential real estate activity seems to be weakening in virtually every part of the district, with inventories of unsold homes on the rise.

Much of this weakness in residential construction is being attributed to the limited availability of mortgage funds. In Richmond, tighter lending terms are having a depressing effect on residential mortgage loan demand. Similar tightening is also reported in New York. Respondents in Atlanta, St. Louis, Dallas and San Francisco blame part of the mortgage money shortage in their districts on state usury laws.

Other types of loan demand also appear mixed. Individual loan demand remains strong in Richmond but has tapered off in Philadelphia, St. Louis and Dallas. Business loan demand remained strong in several districts, but slackened in others. With respect to agricultural lending, several districts reported improved repayments from a year ago on farm loans, reflecting substantially higher crop prices.

## FIRST DISTRICT - BOSTON

Business conditions in New England remain at a high level. Most directors and businessmen see no signs of a slowdown. Manufacturers continue to have large backlogs. Retail sales are fairly strong - autos are doing particularly well. Loan demand is generally vigorous for this time of year. Lead times for some materials and components are lengthening and skilled and semi-skilled labor is in increasingly short supply.

New England's manufacturing sector has just completed a very successful year and most respondents see no signs of a slowdown. Defense has been an important factor; one large defense contractor and the government division of another large, high technology company report that 1978 was their best year ever. Order backlogs for these companies are very high. Machine tool companies also continue to have large backlogs. Several firms in the instruments category are planning major capital expansion programs. New capacity is needed because of the high level of demand and because investment projects were postponed in the past. Directors believe this is a fairly common situation. On the negative side one large machinery company reports that consumer appliances have been moving slowly. Lead times for materials and components are lengthening. Electronic components, sheet metal, and machine parts are the greatest source of concern. Skilled and semi-skilled labor continues to be in short supply. Electronics engineers, computer personnel, and machinists seem to be in particular demand.

Reports from the retail sector throughout the region are favorable. Auto dealers in particular, are doing well and in parts of the region are selling cars faster than they can be delivered. Sporting goods stores are

also experiencing very brisk sales although this is partly a seasonal phenomenon. The head of a large department store chain in southern New England thought that Christmas sales were a little less than some had expected, but they still compare well with a very strong 1977 Christmas season. It is somewhat difficult to assess the retail sector's performance in January as the weather has been much better this year than last; however, most retailers are pleased with sales thus far. There is some concern about the effects of high interest rates and the increase in the minimum wage.

Banking directors report that loan demand is good. There is usually some falling off in demand at this time of year; however, the head of one large southern New England bank reports that this seasonal decline did not occur at his institution. All categories of loan demand held up well. The director thought that other banks in his area were having similar experiences. Two northern New England bankers report that they have had a seasonal decline, particularly for mortgages, but one of the two thinks that the fall-off in the areas other than mortgages has been less than normal. Commercial demand has been strong.

Professors Houthakker, Samuelson, Solow, and Tobin were available for comment this month. All agreed that the economy showed surprising strength in last year's fourth quarter, especially in view of the relatively low rate of money growth that has occurred in the past few months. On the other hand, no clear consensus emerged on the implications of these facts for the near-term course of monetary policy, nor were the respondents unanimous in their view of the outlook for the real economy in 1979.

Professor Houthakker feels that the Fed may be "overdoing" its tight money policy and is concerned about the consequences for the real economy of

two or three more months with low rates of money growth. He believes that growth within the target ranges is compatible with further increases in real GNP, albeit at a slower rate than currently, but that the present restrictive policy probably makes a recession inevitable. More optimistically, Houthakker expects the current account to show a surplus by the end of the year whether or not there is a recession; thus, he believes that tight monetary policy can no longer be justified on balance of payments grounds.

According to Professor Samuelson, the combination of strong real growth with weak money growth merely reflects the effect of high interest rates on velocity. For this reason, he sees no cause to worry if the aggregates remain below their target growth ranges for a prolonged period. Although he is not happy to make the recommendation, Samuelson argues that since the real economy is stronger than expected, another round of credit tightening is probably necessary to fulfill the promise of a policy-induced recession made implicitly last November 1.

In the opinion of Professor Solow, the recent data provide no reason to change one's "expected value" for the size, length, and timing of the 1979 recession. He thinks that the outlook for the year depends crucially on the economy's performance in the first quarter: if it's too strong, then the ensuing downturn will be sharp; if the fourth quarter represented only a "last gasp," then a mild "concensus-shaped" slowdown will occur, probably beginning late in the third quarter. Solow cautions, however, that the economy cannot be fine-tuned--that there is always a non-negligible probability that a mild downturn will cumulate into a severe one--so he advises the Fed to follow Brainard's dictum: "If you don't know what you are doing, then do it gently."

Professor Tobin reluctantly agrees with Samuelson that if the actions of November 1 are to retain credibility, that is, if the "irrevocably decided" policy is to produce a recession, then further credit restraint would be called for. Tobin is not particularly pleased with this policy, though, because he would expect inflation to decelerate this year as long as real growth is below the pace in 1978. Noting that what used to be considered a normal cyclical increase in the price level is now being interpreted as a permanent increase in the inflation rate, Tobin argues that 3 percent real growth would probably produce about the same inflation outcome in 1979 as a full fledged recession.

## SECOND DISTRICT--NEW YORK

Economic activity in the Second District appears to have expanded at a fairly brisk pace in December and January, according to the recent comments of directors and other business leaders. Retailers recorded much stronger sales during the Christmas season than they had expected, and their inventories are running on the lean side. In other sectors of the regional economy, business also appears to have picked up. New orders were booked at a vigorous pace, order backlogs lengthened a bit, and inventories remained well under control. Although there are presently no signs of an impending slowdown in U.S. economic activity, businessmen remain cautious with many looking for a recession later in the year. For all of the respondents, inflation remains a major concern.

The strength of retail sales in the Second District during the holiday season spilled over into the new year. Since consumer buying had been rather sluggish at the beginning of the Christmas season, the vigorous overall performance reflected consumers' unrestrained binge in spending toward the end of the season. While this spending spurt has extended into the new year in the downstate region, upstate merchants report a much more mixed experience. In any event, retail inventories are "well under control" and indeed appear to be a bit on the lean side. While these lean inventories are partly the result of the unexpectedly strong holiday sales, the retailers themselves do appear to be trying very deliberately to keep a tight lid on their inventories. Meanwhile, there is also some evidence that consumers have stepped up their purchases of bigger-ticket items. Auto dealers in the New York City area report sharply

improved sales activity, and they claim that they could have chalked up even larger sales had it not been for shortages of particular models. One dealer in foreign cars thought that the exceptionally strong sales he was experiencing for his small cars might be related to the shortage of unleaded gasoline which many new American-made cars require.

In addition to retailing, overall business conditions also appear to have lately taken a turn for the better. Businesses report that their new orders have either risen modestly or else are "holding up well"; some businesses have revised their capital spending plans upward a bit; and everyone claims that his or her company is adhering to a very parsimonious inventory policy. One director remarked that business was booming for a heavy industrial manufacturer with which he was familiar. This company produces heavy-duty equipment such as railroad cars and oil gear, and it was already totally booked up for 1979. Similarly robust conditions were also reported for such diverse industries as aerospace, photographic equipment, automotive supplies, building materials, machine tools, petroleum, paper products, and aluminum. Only in the fabricated metals industry was there any evidence of a softening in demand. While businessmen still say that they are "nervous concerning the economy," it seems that fewer of them now believe that a national recession is imminent than was the case a few months ago.

On the financial scene, there was a consensus among respondents that lenders had recently tightened credit standards. The directors at the Buffalo branch, for example, generally agreed that lenders had either tightened their standards outright or were more closely monitoring

borrowers' financial conditions, especially small and medium-sized businesses. A leading labor union official indicated that mortgage money in New York State remained very tight. Downstate bankers indicated that they had raised credit standards in response to strong loan demand and constraints on their ability to obtain new sources of funds at profitable rates. On the outlook for mortgage demand, one New Jersey banker noted that home sales and mortgage demand appeared to be turning sluggish. In contrast, another New Jersey banker reported that a large industrial developer and builder whom he knew was looking forward to a "very busy" year that would exceed the sales records he had set in 1978.

## THIRD DISTRICT-PHILADELPHIA

Reports from the Third District indicate that economic conditions are mixed this month. Although executives in the industrial sector say there has been no expansion in manufacturing in January, retailers report boom conditions. For the longer term, manufacturers generally look for a slowdown to come by late summer, while retailers in the area have mixed views about near-future business conditions. Local bankers report sluggish business loan demand presently but see it as a temporary condition and look for a pickup within a few months. Interest rates are projected to peak after midyear, but forecasts of what that peak will be vary widely.

The pace of industrial activity in the Third District is unchanged from last month according to manufacturers responding to the January Business Outlook Survey. Although shipments are up at area factories, new orders are no higher than they were in December. Consequently, inventory levels have tumbled for the third consecutive month, and employment levels are reported to be unchanged from December.

Looking ahead to the next six months, responding manufacturers' confidence about the strength of the economy continues to diminish. Nearly three-quarters of the Survey participants are anticipating either a further slowdown in business activity or, at best, a continuation of present conditions. A drop-off in new orders is projected along with declining shipments. Further trimming of inventories is also planned. As a result of these projections, a marginal cut in factory payrolls and further shortening of the average workweek also appear to be likely.

On the inflation front, prices continue to rise in the region's industrial sector. Almost three-quarters of the manufacturers polled report paying higher prices for raw materials this month, while one-third are charging more for their finished

goods. For the longer term, about 9 out of 10 of the executives look for further increases in the cost of inputs and 3 out of 4 plan to raise the prices of the goods they sell.

Retailers in the area say sluggish sales experienced in mid-December picked up steam a few days before Christmas and have been rolling along quite well since that time. Current dollar sales at area department stores are running as much as 15 to 20 percent ahead of year-ago sales and well ahead of plan. Local merchants say that even after accounting for inflation and the fact that last January's business was depressed by record bad weather, sales are still 5 to 10 percent ahead of year-ago levels.

As for the future, retailers have varied outlooks. While some look for continued strength, others feel that increased social security taxes, the possibility of local property tax hikes, and fear of rising inflation could cause consumers to hold on to dollars they might otherwise spend.

The late Christmas sales rush saved most merchants from getting caught with heavy stocks in January. Inventories are reported to be in good shape now, but retail executives have adopted an extremely cautious position with regard to stock levels over the next few months.

Area bankers say business loan demand is very slow at this time and that consumer loan volume, while still rising, is starting to taper off. According to bankers contacted, some of the reasons for sluggish business borrowing are relatively strong corporate profits recently and a run-off in inventories, both of which reduce the need for businesses to borrow. Some of the slowdown could also be seasonal. Looking ahead to the next six months, bankers are moderately optimistic in general. Projected strong capital spending and both voluntary and involuntary inventory building will provide a source of loan demand over the next several months.

All of the bankers contacted project rising interest rates throughout the first half of 1979 and into the third quarter. Six-month forecasts of the prime rate (currently 11 3/4 percent) range from 12 1/2 percent to 14 percent, with a cyclical peak generally anticipated around August.

Money market certificates are still very much in demand in the Third District, but they are not attracting as much "new money" to banks as they had been. Bankers note that a rapidly rising percentage of the certificates is being bought with proceeds from maturing CDs issued by the same bank or with withdrawals from savings accounts.

## FOURTH DISTRICT--CLEVELAND

The unexpectedly strong pace of economic activity last quarter has led some District observers to postpone the timing of a recession, now expected to occur later this year. Retailers and producers of consumer goods are cautious in their appraisal of near-term sale prospects. On the other hand, manufacturers expect to operate at or near capacity at least this quarter. S&Ls are concerned that supplies of mortgage funds may be sharply reduced if latest deposit experience continues. Financial prospects for the City of Cleveland remain uncertain.

Several economists who had forecast a recession in early or mid-1979 have pushed back their expectations to late 1979 in response to the better-than-expected pace of activity last quarter. Some raised estimates of the level of output for the year, but still expect a recession late in 1979. A few economists indicated unwillingness to change their recession forecast because of uncertainty over how long the recent sluggish behavior in monetary aggregates will last. Also, a few others do not expect a recession this year. They point out that consumer spending may not be as weak as perceived and that fixed investment will likely be stronger than indicated in latest surveys.

Retailers and producers of consumer goods are still cautious in comments on short-term sales prospects. They explained that department store sales in December and the fourth quarter showed little improvement in real terms. An economist with a major national department store chain remarked that year-over-year sales gains amounted to about 8 percent last quarter, considerably less than indicated in preliminary estimates of

national product accounts. Widespread markdowns and extensive sales promotions in major metropolitan centers of the District during December are expected to dampen sales gains in January, although retailers report sales have been running well ahead of a year-ago, when sales were depressed by frigid weather throughout the District. Some retailers expect modest, if any, sales gains this quarter and have held tight control over orders to their suppliers. An apparel producer, for example, notes that sales to large retailers continue to run behind a year-earlier volume. A major auto producer, which late last fall projected total new car sales for 1979 at 11.1 million cars, recently reduced its forecast to 10.8 million units.

Manufacturing activity in the District has been sustained by high operating rates, at or near effective capacity, in capital goods, primary metals, automotive products, rubber, plastics and glass industries. Machine tool builders are operating at capacity and expect to continue at capacity through most of this year as backlogs are still expanding. Orders in January have apparently rebounded from a drop in December. In steel, expectations are that the industry will be operating at or near effective capacity this quarter and perhaps next. Millers are generally booked this quarter and orders for second quarter are reported to be heavy. Steel orders from appliance producers have been sluggish but more than offset by sizable demand from the automotive industry and increasing demand from capital goods producers, including machinery and construction. The January 1st increase in trigger prices for steel is not expected to result in any meaningful reduction in steel imports until March at the earliest. One economist attributes the unexpectedly high level of demand to a fear of shortages and believes inventories are being built rapidly. Another believes

that a rapid buildup of steel inventories is occurring only at the distributor level.

Retailers and manufacturers generally are still cautious over inventory policies. Retailers of general merchandise have managed to trim stocks through aggressive promotion last month but apparently some still have higher than desired inventories. Stocks of major appliances, which were trimmed by recent production cutbacks by some large producers, have been reduced to a more normal range. According to one producer, last quarter's adjustment reflects expectations of little or no sales gain this year. Relatively low profit margins, lack of growth over the next few years, the need to revamp appliances for energy conservation, and continuous labor strife are said to be among the reasons for an impending March 1st shutdown of a major appliance producer in the District that employs about 7,500 workers. A few manufacturers, especially in capital goods industries, plan to step up inventory building in response to further increases in backlogs and rising prices. Tire producers are finding it difficult to build inventories of radial tires because of high demand. One cautionary note is that inventories are actually higher than suggested in customary inventory-sales ratios because many businesses switched from fifo to lifo. Housing demand has been slowing, probably more than seasonally, although causes are uncertain. One source suggests a problem that might be shaping up is the lack of availability of mortgage funds. Some S&Ls have not been offering money market certificates and others have a capped rate below the maximum because of a profit squeeze. Also, S&Ls are investing a sizable proportion of money market certificates, especially in bank CDs. Consequently, mortgage commitments are being held back. One of the largest S&Ls in the District reports a sizable runoff

in deposits during January, the second successive month deposit flows have been below expectations. The association attributed outflows to the 2-year Treasury bill they believe has attracted interest because of the longer maturity than savings certificates. Home builders in most parts of the District are said to be cautious in their building plans in order to avoid repetition of the 1972-1973 housing boom.

Cleveland's financial prospects for 1979 remain uncertain as the campaign on a referendum to raise taxes and to sell the municipal light and power gets underway. Recent polls show for the first time voter approval for both the 0.5 percent tax increase and the sale of municipal light. However, growing fears that revenues will not be sufficient to balance the budget or to deal with over \$90 million in accumulated debt has prompted State legislation that could lead to a Yonkers-style plan to control the City's financial management. While fighting off attempts at State controls, the City administration continues to defer payment on employee pension funds and has stopped construction projects because of a shortage of funds.

## FIFTH DISTRICT - RICHMOND .

Our latest survey of Fifth District business conditions turns up several signs of a softening of activity over the past few weeks. Manufacturers report weakness in new orders and reductions in backlogs of orders along with some further inventory accumulation. Shipments continue at former levels, however, and inventories, in general, remain at or near desired levels. Increases in prices other than employee compensation have been somewhat less widespread recently than in previous months. Credit conditions in the District seem to reflect generally comfortable liquidity positions at commercial banks and an overall easing in the demand for loans due mainly to weakness in business credit demand. Demand in the consumer and construction areas remains firm.

Manufacturers responding to this month's survey indicated little or no change in total shipments, but noted some weakness in new orders. Nearly one-third of the respondents noted month-to-month declines in the volume of new orders. There was also some working down of backlogs of orders over the month. Further accumulation of inventories occurred during January, but the breadth of this development was limited, particularly as to stocks of finished goods, and concern over excessive inventories diminished somewhat. Our survey results further suggest that there were some scattered reductions in employment and in length of workweek during the past few weeks. A substantial majority of all respondents continue to view both current plant and equipment capacity and current expansion plans as appropriate.

Despite the apparent weakening in the level of activity in recent weeks, the broadly based pessimism we have discerned lately seems to have

diminished somewhat since our last survey. The consensus outlook for the level of activity at the national and local levels remains basically negative. Nonetheless, pessimism is now less widespread than formerly and the outlook with regard to individual firms has turned positive. On the inflation front, price increases continue to dominate the picture but to a much lesser extent than in other recent survey periods.

In the financial sector, commercial and industrial loans have not been as strong as expected, even after taking normal seasonal weakness into account. This pause in lending appears to be widely distributed across type of industry and size of firm and also cuts across regional lines. Bankers interpret the weakness as being due to conservative inventory policies, especially among retailers, and to strong fourth quarter profits. Bankers also suggest that their customers are becoming more cautious about capital spending. Growth of loans to individuals for personal expenditures has been robust. There is a noticeable change in emphasis on the part of consumers away from instalment contracts and toward revolving credits, and big ticket items are being charged on credit cards to an increasing degree.

Construction loan demand is strong, and banks are generally willing to continue providing funds for building projects. There is no sign of weakness in the construction industry when viewed from the lenders' perspective. Contacts with District S&L's, however, indicate tighter lending terms are having a depressing effect on residential mortgage loan demand. Nonetheless, pockets of undiminished strength in mortgage loan demand do exist.

With a generally good crop year and higher farm product prices--especially for livestock--in 1978, farm income levels rose and the financial position of Fifth District farmers in general improved. With this improvement, bankers responding to our fourth quarter survey of farm credit conditions noted

that loan repayment rates were much better than a year earlier and requests for renewals or extensions of existing loans were down sharply. Farmers' demand for bank credit remained fairly strong but showed less strength than a year ago. Bank supplies of farm loan funds continued at the reduced levels of the second and third quarters and were considerably lower than in the fourth quarter of 1977. Bank interest rates on farm loans rose sharply. Moreover, better than one-tenth of the respondents, the same as in the two immediately preceding quarters, indicated that they had been forced to refuse or reduce a farm loan because of a shortage of funds.

## SIXTH DISTRICT--ATLANTA

A surge in consumer spending seems to have improved businessmen's attitudes and brought retail inventories under better control, but activity in most other sectors has been waning. Both loans and deposits have grown slowly. The easing of housing markets continues, and recent nonresidential construction news has been less upbeat. Current and prospective job growth is lackluster. Industrial output levels are generally holding strong, with perhaps some increase in stocks. Agricultural prices remain on an uptrend.

A late December spurt in consumer spending allowed merchants throughout the District to equal or exceed 1977's sales records and reduced their inventories almost to desired levels. Since Christmas, markdowns and promotions have been only slightly heavier than usual and sales have continued good. Big-ticket expenditures have been described as growing slowly in some areas; brisk demands for luxury items, home furnishings, and small appliances have been noted in others. Some banks, but few retailers, have noted an upward drift in consumer loan delinquencies, although these have largely proved collectible. One Birmingham banker reported that local credit card sales have fallen below the year-earlier level.

Auto sales reports have been mixed but generally point to weakness in the new car market. Sales of trucks and used cars remain very strong. Auto stocks appear to be relatively light, with dealers complaining loudly about the high cost of inventory financing and floor planning. A few are offering discounts to customers who order from the factory.

The recent unexpected strength in the national economy and the pickup in southeastern consumer spending appear to have ameliorated businessmen's expectations. Many still look for recession later this year but

anticipate it to be mild and consider the economy in good shape to weather it. Most believe that their own areas or businesses will fare better through any slowdown than will the nation as a whole. Retailers are less anxious about prospects than they were in early December but remain among the most pessimistic respondents. Bankers, too, look to 1979 with caution; the fast food industry is expecting real trouble from rising beef prices, wages and utility costs, and higher unemployment among their teen-aged customers. Contractors hope that home repair business can take up the slack left by a housing slowdown.

Bank lending has turned unexpectedly sluggish; tightening of loan terms and credit standards has been widespread across loan types, lenders, and locations. Deposit growth has been largely confined to money market certificates; at both banks and thrifts, passbook savings inflows have been weak or negative. One director commented on the "amazing speed" of shifts from passbook accounts to six-month certificates. Most S&Ls have felt obliged to continue to offer these at ceiling rates, but a significant amount of these funds are being channeled into the money, rather than housing, markets. Tennessee's financial institutions are facing rather dismal prospects, possibly a state credit crunch, if the legislature fails to liberalize the usury ceiling this year. The majority of our contacts in that state expect the pending bill to pass, however.

With the exceptions of south Florida, northeast Tennessee, and some spots along the Gulf coast, all areas of the District have now noted some slowdown in residential construction and real estate sales. While some sources indicate that rising prices and financing costs have reduced housing demand, others claim that the availability of money is the effective

restraint, with mortgage applications still rising. Unsold stocks are reported to be low, albeit increasing in some places. Expectations of a substantial slowdown in 1979 are widespread but not universal--some Florida analysts are counting on continued in-migration to keep residential markets at near-boom activity levels in that state.

Given the heavy backlog of contract work and reports that businesses intend to go ahead with planned capital spending, nonresidential construction should continue to grow moderately through 1979. But the plant announcements of the last few weeks, though steady in number, have been primarily for small- to medium-sized projects. The potential for expansion of office and warehouse facilities may not be realized because of zoning restrictions, stringent financial market conditions, or the failure of rents to keep pace with operating expenses, say realtors in two major cities.

We've seen signs of slower job growth in the latest weeks, including a sizable round of layoffs. In response to a denial of a requested rate increase, Alabama Power has cut its work force but not by as much as it threatened. Ingalls Shipyard continues its gradual, large-scale staff reductions. Retailers anticipate some clerical layoffs with the raising of the minimum wage. However, labor supplies are still characterized as tight in some industries, notably paper and shipping.

Production levels remain high in most nonautomotive manufacturing plants. Steel output is brisk, with a heavy backlog of orders, though there appears to be some inventory overhang in the industry and Jacksonville Port's steel import volume has been strong. A paper plant has announced its closing, but generally, production volume is good; transactions prices

are rising but not as rapidly as list. Phosphate producers are reported to stockpiling their products in anticipation of higher prices.

Farm product prices continue to advance, led by beef. Damage to Florida's citrus crops from an early January freeze was mainly confined to leaf burn. Harvesting has been stepped up; the earlier California freeze has boosted demand for the Florida fruit. Support for and participation in the recent tractorcade was rather thin.

## SEVENTH DISTRICT - CHICAGO

The big story from the Seventh District is the weather, severe cold and unprecedented heavy snow concentrated in the Chicago area. Through December and early January business activity continued vigorous in the district. Businesses trying to comply with the wage/price guidelines find the rules confusing.

Although Wisconsin and Iowa have been afflicted, the focal point for bad weather has been the Chicago area with about 8 million people. Major roads leading to Chicago have been impassable for varying periods.

Temperatures far below zero put many trains and motor vehicles out of commission. Worse than the cold, Chicago has had over 60 inches of snow, 50 percent more than the normal average for an entire year.

O'Hare field with its heavy traffic of direct and connecting flights has been closed or operating on limited schedules. Travel and freight movements by road and rail also have been seriously impeded. A large steel company has been particularly hard hit. Chicago's mass transit system has been called a "rolling disaster" with many riders taking hours to reach their destinations or failing to arrive at all. A major trucking firm reports that freight movements to and from Chicago have been cut in half in the past two weeks. Absenteeism has ranged up to 50 percent on some days at some firms.

The Chicago area produces a wide variety of services, finished goods, and components. Also, components move through Chicago on their way to their destinations. These components are vital to other regions. The area has only one auto assembly plant, for example, but it makes many stampings and other components used elsewhere. We have heard reports that output in other regions has already been affected by reduced shipments from Chicago.

Retail stores, especially in the Loop, say business is down sharply. However, there has been a run on four-wheel drive vehicles, snow tires, batteries and other accessories. Attendance at sports events and trade fairs has been poor. Schools have been closed or have delayed reopenings.

Many roofs have collapsed, mainly lumber yards, stables, and retail stores--some of modern construction. Water damage in residential structures has been severe. Insurance companies have been swamped with claims. Many lawsuits doubtless will be filed. A booming business has developed in roof clearing and emergency repairs. No doubt the Chicago area will snap back rapidly once weather improves, and many will profit from the troubles of others. However, incomes of many individuals and firms will have been reduced while inflationary pressures will have received added impetus.

Reports from purchasing managers, trade associations, and business executives indicate that output, employment, and new orders continued to rise through December and into early January. Order backlogs suggest the expansion will continue at least through mid-year. Producers of railroad equipment and machine tools believe they will be operating at capacity for a year or more. Heavy trucks, construction equipment, and related components are backordered. Demand for autos and trucks remains vigorous, but output of less popular models has been cut back to reduce excess stocks. Inventories of most goods are moderate, and inadequate in some cases where cautious schedules of output have been followed. High carrying costs at present interest rate levels are often cited as a reason for keeping stocks lean.

Steel shipments from U.S. mills and abroad have been exceeding expectations. A large share of the imports are required to meet demand because domestic capacity is inadequate. One steel company is booking orders for April and May.

Auto companies are ordering steel in line with announced production schedules.

Nonresidential construction activity is certain to rise this year, with large office buildings and auto factory buildings leading. Builders and lenders expect a decline in housing starts ranging from 10 to 25 percent. Shortages of building materials, especially cement, are expected to continue to hamper activity throughout the year.

Many non-union employers, including banks, say they are following the seven percent guideline on wage increases. Some say they will review the matter at mid-year and grant further increases if the guideline is relaxed. Union bargaining is another story. A union leader says "it will be a turbulent year".

Increases in construction worker wages may be held to seven percent but there will be great pressure for more generous fringes, especially pensions and welfare. Construction bargaining deadlines are likely to be delayed as long as possible to see what's happening elsewhere. A trucking executive says flatly that the Teamsters will not settle for seven percent, but may get nine percent or more. Most unions are able to find some "tandem" relationship with another group that obtained a favorable settlement recently.

The guidelines for prices are even more confusing. Determining average prices and profit margins for large, complex corporations leaves much room for judgement. Accounting firms are pushing programs which they believe will help clients comply.

Most, but not all, professional forecasts for the general economy call for a moderate recession to begin in the third or fourth quarters. However, the typical executive expects his own business to avoid a slump. Conflicting views between forecasts of economists and executives have been noted in the past with no clear pattern as to which group was more accurate.

## EIGHTH DISTRICT -- ST. LOUIS

Overall, the Eighth District economy continues to advance at a modest rate. While retail sales through the Christmas season were generally strong, January sales are reported to be sluggish, possibly reflecting unfavorable weather conditions. Manufacturing activity continues to make advances in a number of industries, such as capital goods and chemicals, but has leveled off for some consumer goods, particularly those closely related to housing. Inventories throughout the marketing sector are reported to be "lean". Overall loan demand continues to increase, but some bankers commented on some recent weakness in business loan demand, and some savings and loan associations noted greater-than-seasonal declines in mortgage demand in recent weeks.

Retail sales during the Christmas and post-Christmas season were reported to be quite good and, in some cases, gains were greater than had been expected by retailers. This optimistic picture changed in January to one termed as "sluggish" by representatives of department stores and automobile dealers. Retailers, however, are generally attributing slower January sales to bad weather.

Many businessmen expect a slowing down in economic activity sometime this year, although opinions differ about its severity and timing of the slowdown. Consequently, businessmen continue to closely watch their inventories, and, in general, to maintain them at low levels relative to current sales. Automobile dealers in the northern portion of the District, however, report that inventories are somewhat "heavy" because of the January slowdown in sales.

Manufacturing activity has been mixed in recent weeks. The capital goods sector continues to register gains in orders, but a weakening in sales has occurred in consumer products, particularly those related to the housing industry. Producers of such capital goods as industrial motors, aircraft, metal products, welding and cutting equipment, and lubrication equipment report continued increases in orders and, in some cases, large backlogs of orders. A representative of the aircraft and defense industry in the St. Louis area reported a surge of new orders for commercial aircraft last year as well as prospects for increased military spending.

Among industries producing consumer products, appliance manufacturing activity is reported to have leveled off in late 1978 and is continuing unchanged in early 1979. Representatives of two major appliance manufacturers noted larger unit sales in 1978 than in 1977, but expect consumer spending to decline this year. One noted that his firm had already begun to prepare for a decline by reducing both the work force and inventories.

Homebuilders report a sharp decline in buyers actively looking for homes and in sales volume since mid-December. Although home sales normally decline during this time of year, the current decline is more severe than in the previous two years. Several builders and mortgage lenders anticipate a sizable decline in the demand for new homes based on higher interest rates, continued sharp increases in home prices, and difficulties in obtaining credit in some states due to usury ceilings. Builders report that backlogs of orders have been substantially reduced from a year ago. Hence, if home sales do not resume a strong upward pace this spring, cuts in construction will be necessary. Construction of apartments is reported to be quite low

except for government-subsidized projects. Although apartment rents are reported to be rising substantially, the increases in rent have not been enough to encourage greater building of multi-family rental properties due to rapidly rising construction costs.

Overall, loan demand at commercial banks continues to advance. Consumer demand for credit continues to increase, but demand for commercial and industrial loans is reported to have slackened in recent weeks. Agricultural loan demand is at a seasonal low and repayments have improved from a year ago, reflecting substantially higher farm income last year. Interest rate ceilings in several District states are having some impact on credit markets. For example, lending institutions have virtually stopped making low down payment mortgage loans, and loan applications are screened with greater care. In Missouri, which has a 10 percent usury ceiling on mortgage rates, several laws have been introduced in the legislature to increase the usury ceilings. One official at a large St. Louis savings and loan association warned that they would be forced to quit making new mortgage loans by this summer if the usury ceiling was not increased.

## NINTH DISTRICT - MINNEAPOLIS

The district economy is holding up pretty well under unusually harsh winter conditions, but government economic policy may prove to be tougher to handle than the elements. The weather has had a substantial impact on the agricultural sector, and it isn't all for the worse. Other sectors have been affected less by the weather. Most retailers have seen just a bit more than the normal post-holiday sales slowdown. Homebuilders aren't too busy either, but again that's normal for this time of year. In contrast, commercial builders, manufacturers, and bankers remain quite active despite the season. Directors were concerned that wage and price guidelines and Congress's treatment of Carter's budget could be much harder to handle than the bad weather.

Severe winter weather has had its most pronounced impact on the agricultural sector. Directors report that cattle producers have had particular difficulty dealing with the elements. Range conditions have forced ranchers to deplete their feed supplies at an unexpectedly rapid rate in the Dakotas and Montana. Fortunately, those supplies were at abundant levels last year, and they should be sufficient for the rest of the winter. Nevertheless, some stock loss has been suffered, and ranchers are concerned that continued bad weather might take a large toll during the calving season, which is just now getting underway.

Continued bad weather could actually be good for many grain producers, though. Heavy snow has two beneficial effects for farmers. It provides needed cover for the winter wheat crop. And it provides soil moisture, which is essential for good crops throughout the year. The main negative impact of the severe winter for grain farmers is related to the scarcity of rail cars for grain hauling mentioned last month. A couple of bank directors noted that this situation has been exacerbated by recent weather conditions.

The normal post-holiday retail sales slowdown was made only slightly slower by these weather conditions. Directors from Michigan, South Dakota, and Montana mentioned that some shoppers were reluctant to venture into the cold and snow. But other directors from Montana and Minnesota indicated that sales were about at or slightly higher than expected levels for this time of year.

Like retail sales, district homebuilding activity is typically slow in January relative to the rest of the year. And this January some parts of the district have seen homebuilding come to a near complete halt. But in some other parts of the district, for instance, a few large Minnesota communities, homebuilders have been busier than expected. For the district as a whole, then, this month's building lull does not appear exceptionally quiet.

Commercial builders, manufacturers, and bankers have seemed nearly immune to the bad weather. Commercial construction activity, especially in Minnesota, is reported to be quite hectic for this time of the year. Manufacturers throughout most of the district are straining to work down large backlogs, and shortages of skilled labor were mentioned by a few directors. Financial institutions continued to face strong loan demand and were actively competing for expensive funds to augment rather slow growth in demand and savings deposits.

Several of the bank's directors were more concerned about the impact of government economic policies than they were about the weather. They and other observers around the region remarked on problems with wage/price guidelines. Area businesses are expending a considerable amount of resources trying to understand the implications of the guidelines for their pricing and wage setting behavior. Furthermore, directors commented on the inefficiencies which would arise from strict adherence to guidelines. One director noted that controls on oil and gas prices and less stringent control on exploration and drilling

expense was likely to reduce oil and gas output, meaning higher prices for consumers in the end. Another director remarked on the difficulty of holding health care prices within the guidelines in the face of the increasingly complex maze of regulations affecting the provision of those services.

Most directors looked for government austerity as the best way to fight inflation and were concerned that Carter's budget might not be austere enough when Congress finishes with it. Several directors speculated that Congress would substantially increase budgeted nondefense spending. On the other hand, a couple of directors thought the spirit of Proposition 13 might keep Congress's hands off the budget.

## TENTH DISTRICT—KANSAS CITY

Business activity and inflation remain strong in the Kansas City District. Purchasing agents report that input prices are rising at a 7 to 10 per cent rate and that they are beginning to encounter some input availability problems. Fourth quarter retail sales were very strong, but retailers expect some softening in upcoming months. Financial conditions in the agricultural sector continue to improve with the uptrend in farm prices, especially for livestock. The recent improvement in farm cash flows has been reflected in better liquidity positions at rural banks. Loan demand is reported to be fairly strong throughout the District, and bankers are not expecting any decline in interest rates before mid-1979.

Tenth District purchasing agents expect the prices of most major inputs to continue rising in 1979 at approximately the same 7 to 10 per cent rate experienced during 1978. The prices of steel and plastics have grown particularly rapidly during the past three months. Lead times have been lengthening in nearly all industries contacted, creating availability problems for some inputs. For example, tools for the small aircraft industry are reported in extremely short supply and the agricultural machinery industry is finding steel difficult to obtain. No labor supply problems are reported, except in the small aircraft industry where there is a serious shortage of skilled workers. The agricultural equipment, machinery and rubber products industries are operating at nearly full capacity. Present levels of input inventories are satisfactory for nearly all industries.

Retailers report that sales have been strong in recent months, and

extremely good in December. Clothing, toys, and electronic games have been big sellers while fabrics and home decorations have been unusually weak. Despite strong fourth quarter performance, business activity is expected to slacken in 1979. Most retailers contacted predict that sales in the first half of 1979 will be but 7 to 10 per cent above those in the first half of 1978, before adjustment for inflation. Though inventories are currently viewed as being at satisfactory levels, many retailers plan some reductions by spring in anticipation of the slowdown in sales growth.

Recent reports from the U.S. Department of Agriculture confirm that meat supplies for 1979 will probably exceed 1978 levels by a small margin, with beef production declining and pork and poultry production rising. The prospects for larger pork supplies—particularly during the second half of 1979—may dampen some of the upward price pressures in the cattle industry. Production levels for corn and soybeans in 1978 were recently revised upward, adding further to the abundant supplies available for 1978-79. Unless 1979 production levels are greatly reduced—an unlikely event based on the planting intentions report—crop prices could weaken substantially during the second half of the year.

One Bank director, who has consistently expressed concern about the agricultural situation over the last two years, now feels that most farmers are satisfying their cash-flow requirements. He observes that consumers do not now seem to be resisting rising meat prices, but wonders how much longer this situation will last. He believes that the credit needs of farmers are generally being met by the banking community, although the impact of rising interest rates on farm cash flows is causing some concern. Money is now readily available for livestock loans, but bankers are scrutinizing their

other agricultural loan requests quite closely.

Agricultural credit conditions in the District continue to show improvement. Relative to a year ago, loan demand seems to have tapered off, fund availability has increased, and farmers have improved their repayment performance. Moreover, loan-deposit ratios at rural banks declined slightly in the fourth quarter—but they are still somewhat above year-earlier levels. The average ratio as of January 1, 1979, was 62.2 per cent.

Tenth District bankers report widely varying experience in deposit growth since mid-December, with the most common response being that deposit growth has been lower than during most of 1978. Money market CD's have continued to grow strongly, but there has been some weakness in both savings deposits and IPC demand deposits. Bankers express the view that ATS accounts will continue to grow in 1979, although the initial growth spurt in these accounts is over. With the exception of one Omaha bank, there are no plans to extensively promote ATS accounts in the early part of 1979.

Loan demand is reported to be moderately strong, although several bankers suggest that it has been slightly weaker than a year earlier. Most banks report that loan-deposit ratios are about at the desired level, but several banks that have recently experienced weak deposit growth find themselves with slightly higher ratios than would be preferred. One Kansas City bank reports that it is planning to tighten nonprice terms on consumer loans, and several banks report slightly more restrictive lending policies.

Bankers' expectations as to interest rates are fairly evenly divided between those who think that interest rates are now at or near their peak and those who expect some additional increases in short-term rates. There is general agreement that rates will show little decline before mid-1979.

## ELEVENTH DISTRICT--DALLAS

The District economy is expected to continue to grow moderately, at least through midyear, according to the Directors and businessmen interviewed this month. Both department stores and auto dealers report strong sales although severe weather hampered sales in early January. Liquidity positions of banks and savings and loan associations are tightening. Home sales are expected to decline sharply after midyear once current mortgage commitments are taken down. Some slowing of nondurable goods production is noted, but manufacturing activity generally continues to make moderate gains.

Severe winter weather temporarily played havoc with department store sales in early January, but sales volumes have since recovered. Anticipations of continued high inflation are spurring sales of such items as jewelry, furniture, and appliances. Store executives are cautious in their sales forecasts and are maintaining a close watch on inventories. In-store inventories are near desired levels, but some large department stores remain concerned that the volume of goods on order may be excessive. Some deliveries are unusually fast, possibly indicating an excess of goods in the distribution channels.

Automobile sales, despite bad weather, are running slightly ahead of the strong pace a year ago. Recent price increases are having only a moderate effect on new car sales, and popular selling models remain in short supply.

Liquidity positions have tightened at many banks with a slowdown in deposit growth. Although most banks report no unusual

difficulty in meeting loan demand at this time, they are more selective in granting loan applications. Commercial lending remains active, while real estate and consumer lending is slowing from the rapid pace of a few months ago. Most banks report depositors are shifting funds from demand accounts to time deposits, especially money market certificates, and overall deposit growth is moderating. Large-denominated CD's remain a major source of deposit growth.

Our January 1 survey of agricultural credit conditions indicates that funds for agricultural loans are adequate at most country banks in the District. Credit conditions appear tightest in southeastern New Mexico and the High Plains of Texas where a late cotton harvest and delayed crop sales have slowed deposit inflows. Some banks in those areas are particularly tight because seasonal demands for loans are on the rise. Rural bankers also report that the number of referrals to nonbank credit agencies is rising. Most correspondent banks in Texas are not willing to accommodate country banks' requests for participations in loans to farmers at interest rates below the state's 10-percent usury ceiling. Because corporations in Texas may be charged higher rates than individuals, a few farmers have incorporated in order to obtain funds.

Terms on mortgage loans continue to be tightened by S&L's as mortgage rates have reached the usury ceiling in Texas. Some S&L's have recently stopped making conventional mortgages. Bills to raise the usury ceiling have been introduced in the Texas legislature, but no action is expected until the last half of the year. Government insured or guaranteed loans remain relatively abundant. Contributing

to the tight mortgage situation is an apparent reversal of the savings gains of the last half of 1978. A few S&L's report being in the red, while nearly all report little new money coming in. Most money market certificates are being rolled over automatically.

Home builders still have plenty of mortgage commitments from S&L's, and new home sales are not expected to fall off significantly during the first half of the year. New housing starts, however, are slowing as builders anticipate a drying up of new mortgage commitments for the second half of the year. Builders have already begun to work down inventories of unsold homes. New orders for lumber, concrete, and other building materials are reported to be softening at the current high level of demand, according to brokers and dealers.

Tight credit may also slow commercial building late this year. For now, however, office building construction in major cities continues very active, and office space remains tight. Construction of new hotels is booming in several District cities.

Manufacturing production continues at a brisk pace although gains in many industries are coming more slowly. Output of apparel, textiles, paper and allied products, and chemicals has tapered off in recent months. No new materials shortages have developed, but skilled and unskilled labor remains in tight supply.

## TWELFTH DISTRICT -- SAN FRANCISCO

The Western economy continues to grow, but several weak spots have begun to develop. While department store sales continue strong, auto sales have declined in most areas of the District. A decline in residential construction is being partially offset by an increase in commercial construction. Labor shortages have emerged in a number of areas. Loan demand is weakening in some areas, though non-real estate loan demand appears to continue strong in many parts of the District.

While there is little information available on post-Christmas sales, the Christmas season itself was characterized by strong and sometimes unexpectedly strong growth in department store sales. One Oregon department store noted a 15-20 percent increase in December sales over last year. Merchants in two Washington counties reported record Christmas sales, some exceeding last year by 25 percent. While other areas reported similiarly strong sales, at least one observer noted that merchants were approaching 1979 with caution and keeping a sharp eye on inventories.

Auto sales, on the other hand, have slowed considerably throughout the District. In Salt Lake City, dealers reported a significant drop in new car sales in December. In Oregon, dealers reported special resistance to "new models which are higher in price and smaller in appearance." Central Washington reports a slight falling off in auto sales and while booming Seattle reports continued excellent auto sales, this is composed of very strong demand for large cars and a weaker demand for small, particularly imported, cars.

Residential real estate activity seems to be weakening in virtually every part of the District. One of the largest banks in California has noticed

a significant decline in applications for real estate loans over recent weeks -- the first such decline observed by this bank during the current cycle. One California construction firm expects to see a 25 percent decline in housing starts in 1979. The current inventory of unsold homes in Utah is estimated to be 50 percent above a year ago. Real estate activity in central Oregon was said to be "slowing down rather markedly." One Idaho banker noted that the state's 10 percent usury law has put a stop to all his mortgage lending, save FHA and VA loans. Even in Seattle, which is still riding high on a Boeing-led boom, consumers are said to be resisting high mortgage interest rates and high home prices. The inventory of Seattle homes over \$75,000 has increased markedly.

In sharp contrast to the decline in residential real estate activity is strong growth in commercial activity. In Seattle, the number of major downtown buildings announced or under construction is the greatest in history. A California construction company notes that the demand for space in industrial parks is high and expected to remain so throughout 1979. A report from central California also described commercial construction as being strong.

Labor shortages are appearing in various parts of the District. In southern California, an airplane was seen flying along the beach pulling a sign which pleaded "Hughes needs engineers." There are reportedly a hundred pages of help wanted ads in the Los Angeles Times. A major electronic firm which had been planning to relocate in Salt Lake has grown so tight as a result of new industry moving in in record numbers, that business leaders have asked the Chamber of Commerce to cease promotional activities. While Boeing expects to increase its employment in Seattle by 10,000 over the next year, some observers wonder where those workers will come from. Still, even in booming Seattle,

the unemployment of black youths continues to be a problem.

The financial picture is quite mixed in the District. Banks and savings and loans in Utah are said to be "heavily loaned up," given the strong loan demand coupled with no growth in consumer savings. In both Washington and central Oregon, however, loan demand is said to be dropping with the rising interest rates. A large California bank reported strong consumer, commercial and real estate loans through the first week in January. One Seattle banker who was very concerned about the continued expansion of consumer debt noted, "in my thirty years of observing consumer credit, I have never seen such a long, sustained period of expansion of consumer credit as we have seen over the past four years."

Part of the continued business loan demand appears to be due to firms borrowing short term in anticipation of a decline in long term rates. This shift in financing was reported by a natural gas firm, a wood-products firm, a university, a chain saw and power tool manufacturer and a truck manufacturer. Most Western bankers, however, do not feel this trend is significant.