

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

June 30, 1981

TABLE OF CONTENTS

SUMMARY 1

First District - Boston 1

Second District - New York 5

Third District - Philadelphia 10

Fourth District - Cleveland 14

Fifth District - Richmond 18

Sixth District - Atlanta 21

Seventh District - Chicago 24

Eighth District - St. Louis 28

Ninth District - Minneapolis 31

Tenth District - Kansas City 34

Eleventh District - Dallas 37

Twelfth District - San Francisco 41

SUMMARY*

According to this month's district reports, economic activity in the nation remains mixed. Agriculture probably offers the most consistent observations, with most districts indicating bright prospects for crop yields and farm prices later in 1981. The construction industry is in the doldrums for the most part, with residential building still not showing any real life, and commercial construction beginning to lose its momentum. Manufacturing remains soft in many areas, but reports from Minneapolis and Dallas hold some hope for the industrial sector. Factory inventories are generally in good shape. Retail trade is one of the brightest spots on the economic horizon at this time, with sales running well ahead of the June 1980 levels in most districts, and ahead of most projections as well. Auto sales remain a blemish, though. Financial institutions continue to show very little, if any, loan growth and are experiencing deposit flow problems as well.

Agriculture. The prospects for agriculture have brightened somewhat across the nation. Excessive rains in parts of the midwest have subsided, and although plantings of corn, cotton, and soybeans are behind schedule, normal yields are projected. Other parts of the nation, suffering from drought conditions earlier this year, also got some relief in recent weeks, improving the outlook for farmers in those areas too. In particular, a record crop of winter wheat is forecast, despite previous frost and drought damage. Farm prices are generally depressed at this time. Some recent strengthening has been noted in Atlanta, though, and is expected in most other districts as well.

Construction. Every district reporting on residential construction tells the same story in July—very little activity, owing primarily to high mortgage rates. Creative financing appears to be offering very little help to the sagging homebuilding

*Prepared at the Federal Reserve Bank of Philadelphia.

industry, with many institutions offering VRMs, GPMS, VMMS, etc., but few potential homebuyers accepting the new instruments.

Commercial construction is generally stronger than residential, but it too has started to show some signs of tailing off. Commercial building continues to move at a good clip in Atlanta, Minneapolis, and Dallas, but has started to soften in Chicago, St. Louis, and San Francisco. High rates are said to be responsible in part for the dropback. Many of the projects already in progress when credit conditions were initially tightened are now reaching completion but are not being replaced with new ones, as developers are scared off by high financing charges and economic uncertainty.

Manufacturing. Industrial activity is mixed in July. While Minneapolis and Dallas report improvement in the manufacturing sector, some production cutbacks are reported in Boston and Chicago. New York, Philadelphia, Atlanta, and St. Louis all indicate little or no change in factory activity in those areas. Both Boston and New York say there has been little interest on the part of manufacturers to increase plant and equipment outlays. Manufacturers' inventories are generally "in line" to "a little tight," except in St. Louis where some curtailment of production is planned to reduce excessive stock levels.

Retail Trade. Consumer spending on general merchandise is reported to be quite strong in most districts, with sales outpacing both year-ago levels and expectations as well. The exceptions are in St. Louis, where sales are up in nominal terms but flat after adjusting for inflation, and in San Francisco where "a rather widespread and substantial weakening in consumer spending" is noted. Part of the unexpected strength is a result of heavy promotions, mentioned in a number of district reports. Growing consumer confidence, as evidenced by a pickup in recent credit sales, and the anticipation of a tax cut are also cited as explanatory factors, however. As for the

future, most retailers are projecting a strong finish for 1981, with perhaps only a temporary slackening in the third quarter.

Auto sales are almost universally very, very soft. Sales in many districts are only slightly ahead of last year's depressed levels, remaining well below the prosperous volume of 1978.

Finance. Loan demand is variously described as "flat," "sluggish," and "weak" across the country, as both consumers and businessmen appear to have trimmed borrowing to the bone. The prime rate ranges from 19 1/2 to 20 1/2 percent. Bankers have tried to bolster borrowing with a variety of floating rate schemes, as noted by New York, but apparently without much success.

Deposit flow problems are mentioned in a number of reports and seem to be especially acute in the Twelfth District where there has been an increased call for legislative action allowing thrifts and banks to more effectively compete with money market funds.

Services. A fair amount of strength in the services related to tourism is implied in the district reports from Atlanta, Chicago, St. Louis and Minneapolis. Summer tourist trade is picking up in those areas, aided by adequate gasoline supplies and some recent softening in gasoline prices, and has been giving tourist-related retail sales a boost. An exception is noted by Atlanta. In South Florida, the usual wave of foreign tourists has been checked a bit by recessionary conditions in Europe, a stronger American dollar, and some political unrest in nearby Central America.

FIRST DISTRICT - BOSTON

The overall level of economic activity in the First District has been reasonably constant for the past several months. However, manufacturing respondents with markets abroad report that business in western Europe has weakened significantly. Manufacturers also report that, although sales of routine items are slow, interest in products which increase productivity is very strong. Retail sales are keeping ahead of the rate of inflation. Loan demand is flat.

In the retail sector, general merchandise sales compare favorably with year-ago levels. High quality and discount products are selling more successfully than items in the middle of the range. Sales of home entertainment products and sporting goods are particularly strong. According to an executive of a large supermarket chain, food sales are increasing at a rate just short of inflation; for the year to date, the number of price increases for food products has been substantially below the number in the corresponding period of 1980.

Manufacturers with activities abroad have observed a pronounced slowing in sales in western Europe. This is attributed variously to recession conditions in the United Kingdom and West Germany, the strong dollar, and political uncertainties. Firms reporting such a slowdown included a chemical manufacturer, several high technology companies in the instruments field, and a manufacturer of a variety of fabricated metal products. Foreign markets other than Europe have remained quite strong. Domestic sales of capital goods which increase productivity or lower costs are very strong; however, sales of capital goods for replacement or

expansion or of products tied to the general level of industrial production are weak.

Manufacturing inventory levels are seen as satisfactory. Price increases from suppliers are more moderate than in the past. In a survey of New England purchasing agents, fifty percent reported prices the same as in the preceding month, fifty percent reported increases. In most earlier surveys two-thirds of the respondents reported increases. Expectations as to future price increases were also lower.

Banking respondents see little increase in loan demand; they continue to lose demand deposits and NOW accounts. Two large thrift institutions in Boston announced that they are withdrawing from the mortgage business; many others have dropped out unofficially. However, one banker from rural New England reports that thrift institutions in his area continue to make fixed rate mortgages at rates below anything a commercial bank would consider.

Professors Houthakker, Eckstein, Samuelson, and Tobin were available for comment this month. Houthakker has found no good explanation of the surprisingly strong growth of real GNP in the first quarter, and he expects to see a compensating drop in the growth rate for the second quarter. He expects no recession during 1981 or 1982. There is a good chance that the inflation rate may fall to 6 or 8 percent by the end of 1981: increases in productivity should allow prices to rise more slowly than compensation. Nevertheless, high interest rates have not increased savings nor have they deterred borrowers, implying that many believe that high inflation will persist. But Houthakker is encouraged by the Fed's recent success in controlling money growth. A continuation of current policy should enable the Fed to issue a "victory bulletin" later this year.

Eckstein fears that interest rates now may be too high. While "there is a volume of business to be done at today's rates, the economy is being held back and will not go anywhere at least until the tax cut." Now that the rate of money growth has declined, "the Fed ought to play by its rules--having accomplished its goals, the Fed is pushing its luck by holding interest rates at their peak. There is plenty of time later this year to raise yields if slower money growth is required once taxes are cut."

Samuelson believes that much of the recent data indicates that real growth in the second quarter will be negligible. For the remainder of the year, the "consensus forecast" shows "no solid evidence of the economy springing back." Fiscal policy is neutral: "Reagan's tax cut is not wildly expansionary because it will be compensated for by lower spending." Monetary policy is restrictive: Reagan's five-year forecast requires an unprecedented and unlikely increase in money velocity over the next five years. The Administration's forecast contains an inconsistency: the clash between the projected nominal GNP growth rate and the money growth target implies high interest rates. "High yields may stand in the way of renewed growth--I can't see housing or autos coming back strong unless rates fall."

Tobin also believes that fiscal policy is not expansionary. The principal cause of current and projected future budget deficits is the slow growth of the economy. Reagan's forecast of income growth is overoptimistic; so the deficit will be larger than projected. This larger deficit will not "crowd out" investment; the economic weakness that increases the deficit also lowers investment demand. The current money targets can only depress the demand for housing, plant, equipment, and other durable goods and, at the same time, increase the government's deficit by

constraining the growth of income. "Hoping for rapid velocity growth due to high interest rates is not a recipe for prosperity." If, however, rapid velocity growth is achieved--implying the economy developed new money substitutes or used existing substitutes more extensively--can the Fed legitimately claim it achieved its targets once it considers the more rapid growth of the properly measured money aggregates?

SECOND DISTRICT -- NEW YORK

Economic activity in the Second District was again mixed in late May and early June. Department store sales continued to be strong, with most chains reporting sales moderately above plan. There has been a partial recovery from the post-rebate automobile sales slump, but lower-priced models remain particularly weak. Manufacturing activity was varied with strength in steel production, for example, but with further weakness in machine tool orders. Business economists still look for little real GNP growth for the next two quarters. On the financial side, the proportion of short-term commercial loans issued on a variable-rate basis is increasing.

Consumer Spending

The unexpected strength of department store sales generally continued into June. Sales gains extended to most product lines and to stores throughout the District. Apparel sales were especially strong. As in the past several months, there was a great deal of promotional activity. The outlook for the near term is optimistic, especially when a tax cut is taken into account. Although one respondent worried that the current strength might be coming at the expense of sales later in the year, some chains are adjusting their plans and inventories upward.

Automobile sales showed modest improvement over the post-rebate slump, but are still running well below 1980 levels. High loan rates and recent price rises were most commonly cited for the sluggish

performance. A dealer of less-expensive domestic cars reported the worst June for new cars in his history. A foreign car dealer reported that lower-priced lines are not selling at all, although the demand for higher-priced models remains strong. The brisk pace of used car sales was taken by one industry specialist as a harbinger of future strength of new car sales. Inventories generally are being kept as low as possible because of high interest rates.

Manufacturing Sector

Manufacturing activity remained mixed in recent weeks. Upstate, steel production rose sharply to the highest level since September 1979, but a major paper products firm reported weakness across all product lines. The respondents in the capital goods sector indicated an overall deterioration of demand, requiring a decrease in production as backlogs have begun to fall. None of the firms which were surveyed reported any curtailment of their ongoing capital spending programs. However, high interest rates were said to be discouraging some new projects at this time. There was little evidence that price pressures were abating. Firms look forward to possible tax cuts, but as yet they have not acted on their expectations.

Economic Outlook

Despite the unexpectedly large first quarter real GNP growth announced since the last survey, the consensus of business economists continues to be for little real growth for the next quarter or two. Some respondents look for improvement if and when tax cuts are

enacted, but even the most optimistic do not foresee any signs of recovery until late in the year. Forecasts for specific industries vary. A major conglomerate is projecting strength in plastics, chemicals, and energy products, while a large oil producer expects national demand for oil to continue to be weak. There have been some signs that inflation is abating. One analyst suggested that the growth in consumer spending may cool if the inflationary "buy-in-advance" psychology abates.

Financial Developments

Floating rate pricing schemes have become standard offering at large commercial banks. According to senior loan officers at major Second District banks, most short-term commercial loans are being issued on variable-rate basis. Floating rate loans are generally made at the prime rate or at a mark-up over that rate. When the prime rate is changed, the rates on these loans are automatically changed. The loans are pre-payable without penalty and usually have maturities of 60, 90, or 180 days.

Financial Panel

Comments this month are from Henry Kaufman (Salomon Brothers), Donald Riefler (Morgan Guaranty Trust), and Robert Stone (Irving Trust).*

*Their views are personal, not institutional.

Kaufman: The sluggish economic pace will continue through the summer months but will be followed by a sharp snapback in the fourth quarter. While the rate of inflation has slowed, it should be noted there are transitory aspects to this improvement, including the cyclical improvement in productivity, a good agricultural crop this year, and the tight inventory posture of business. In the financial sector business corporations are again missing the ability to fund an adequate volume of short-term indebtedness. They will be pressed with greater urgency to enter the long-term market in the next twelve months at interest rate levels that were unacceptable just a year ago. The most vulnerable sector of the fixed-income bond market during the year ahead is likely to be the municipal market. A series of developments are highly unfavorable to this market. These include tax reductions, the potential issuance of partially tax exempt certificates of deposit, the reduction of grants and aid by the Federal Government to state and local governments, the very limited buying of tax-exempts by commercial banks, and the advent of spread banking.

Riefler: Inflationary expectations have dropped. The Fed should therefore tolerate lower levels of interest rates. However, rates should not be allowed to drop so rapidly and so far that the policy would have to be reversed later in the year. It is important that this be the last peak in rates.

Stone: While the economy will experience little or no real growth in the second quarter, the prospect, in our view, is for a

resumption of moderate (4 percent or so) growth in the second half. We also anticipate further reductions in inflation rates and in inflationary expectations. Against this background, and in view of the recent behavior of the monetary aggregates, it is my opinion that the time has come for the Fed to relax slightly the grip in which it is holding the banks at the discount window. Thus I suggest provision of nonborrowed reserves such that borrowings for the next three to four weeks center around 1.5 billion or thereabouts followed, after that interval, by another slight relaxation to the 1.2 billion area should aggregates then be behaving in a satisfactory way.

This course would reduce the chances of a material undershoot of M1B over the next couple of months and, by the moderate nature of the relaxation, would minimize the chances of laying the background for substantial overshoot later.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business activity is sluggish to mixed, but hold some hope for improvement by year-end. Manufacturers report no real change in overall industrial activity, with payrolls holding steady for the fifth consecutive month. They expect a sharp upturn in the industrial sector to come some time in the next two quarters. Local retail merchants say they are well ahead of last year levels, owing, at least in part, to big promotional campaigns. The balance of '81 looks good also, as retailers expect sales to continue growing. Third District bankers report sluggish to mixed loan activity. C&I loan volume is up marginally in June, but consumer loans are down sharply. Looking ahead to December, District bankers forecast slight improvement in business borrowing and expect the current decline in retail borrowing to level off. On the residential construction scene, sales have dropped off sharply as high mortgage rates have discouraged many buyers, according to area real estate contacts. Contractors and developers are holding off on new groundbreakings until they are more certain about future mortgage rates.

INDUSTRIAL

Area manufacturers responding to the June Business Outlook Survey report no change in the level of overall industrial activity from last month. Specific indicators are mixed. Factory shipments are up marginally in June, while new orders are off slightly for the first time this year. Inventories, following last month's spurt, have slipped back fractionally. As for employment, the first half of 1981 has been a period of stagnation for area factory workers and this month appears to be no exception. June survey participants report, for the fifth consecutive month, no real change in factory employment. However, a marginal increase in the average workweek is reported.

Despite the sluggishness that has beset area industry since January, local manufacturers have retained their optimism. Respondents to the June survey are confident, predicting a strong boost for business within the next six months. Over one-half of the respondents anticipate growth in new orders between now and December, while a slightly smaller portion project increased shipments by year-end. Producers' backlogs are expected to swell marginally. The upbeat outlook may be good news for area labor, as manufacturers plan to increase payrolls and lengthen working hours in the second half of 1981.

On the inflation front, industrial prices are up again in June. Over 60 percent of the survey participants report paying more for raw materials than they did a month ago and nearly 40 percent say they are charging more for the products they sell. Area manufacturers expect inflation to continue throughout the balance of 1981, as over three-quarters of the respondents expect input costs to increase by year-end and about two-thirds plan to raise their own prices.

RETAIL

According to area retailers, June sales are well ahead of last year's levels, surpassing all expectations by a good bit. Reports of sales volume in June range from 10 to 15 percent above mid-1980 figures, as big-promotional campaigns helped to boost business. Credit card sales appear to be about even with early 1980 levels, matching the volume that existed before the 1980 credit restraint program was instituted. Credit collections are fair to good. Sales of soft goods, particularly men's and women's quality sportswear, are doing well, and big ticket items are starting to pick up.

For the longer term, area merchants are optimistic, expecting sales in coming months to run 6-8 percent above year-earlier figures. According to some contacts, consumer confidence appears to be growing with the anticipation of tax cuts and further

easing of inflation. Local merchants look for a strong finish in 1981, anticipating a big fourth quarter as seasonal factors give sales an added boost.

FINANCIAL

Third District bankers report sluggish-to-mixed loan activity in June. C&I volume is up modestly, 4 to 6 percent, over year-ago figures, which is in line with area bankers' expectations for the most part. Consumer loans, on the other hand, are off as much as 15 percent from June '80 levels. In order to boost business loan demand, some below-prime lending is taking place, but bankers are shying away from making fixed-rate loans. Looking ahead to the balance of 1981, bankers expect business loans to show slight improvement by year-end, and retail loans are expected to bottom out, putting a halt, at least temporarily, to the steady decline in consumer borrowing observed since April 1980.

Deposit flows in the Third District are also mixed. Demand deposit levels are about 4 percent below year-ago figures as area bankers are still adjusting to the institution of NOW accounts. Savings and time deposits are up slightly this month, and CDs are in line with budgets.

Local bankers are currently quoting a prime rate of 20 percent. Projections of the prime indicate an anticipated turnabout from the recent trend of rising rates. Cuts in the prime are expected to leave the rate 300 to 500 basis points below its current level by December.

HOUSING

Housing sales in the Third District have dropped sharply again this month compared with year-ago levels. Residential sales are down as much as 50 percent from June '80 figures. With conventional mortgage rates at 16 1/2 percent, more and more buyers are pulling out of the market, causing a softening in residential prices. Contractors and developers are holding off on new groundbreakings until interest rates

come down. Even then, however, many builders are, as one contact put it, "sitting on the sidelines" waiting for pre-sale commitments before going back to work.

FOURTH DISTRICT - CLEVELAND

Summary. Respondents in the Fourth District generally expect very little growth in output through the third quarter, and many are beginning to lower their inflation forecast for 1981. Manufacturing activity in the District continues to expand, although signs of third quarter weakness are emerging. Consumer spending, weakened by the second quarter slump in auto sales, is expected to strengthen in the third quarter. Bank lending activity has increased in June, partly due to financing business inventories. Local housing construction has declined again in June, as saving flows into S&Ls have weakened further.

Outlook. The tone of the Fourth District Round Table meeting early in June was somewhat more optimistic with respect to output and prices in 1981 than at the March meeting. The median forecast of the 30 participants shows growth in real GNP of 3.2% between the fourth quarter of 1980 and the fourth quarter of 1981, and 4.0% in the subsequent four-quarter period. One-third of the group still expects real GNP to decline in the second quarter (-1.4%, according to the median forecast), but all 30 expect resumption of at least mild growth in the third quarter. The projected acceleration in growth of output later this year is in response to a personal tax-rate reduction and less intense inflation that will increase growth in real income. Nearly two-thirds of the group assume that growth in M-1B in 1981 will be within its long-run target range and the balance expect that growth will exceed the upper limit of the range. The bulk of the group expects a Federal deficit for fiscal year 1981 in the range of \$55-60 billion and a deficit for 1982 in the range of \$45-55 billion.

Prices. Fourth District economists scaled down their forecast of the GNP implicit price deflator a little from the March Round Table meeting. The median forecast now shows the deflator increasing by 9.1% in 1981 (fourth quarter to fourth quarter) and 8.6% in 1982. While most participants expect a gradually decelerating inflation trend to provide thrust to economic activity, many remain doubtful that the underlying inflation rate has changed much, despite recent moderation in consumer and producer prices. Some raised doubts that farm price declines will continue much longer.

Manufacturing Activity. The latest monthly Survey of Fourth District Manufacturing indicates continued expansion in shipments and orders in June, although some easing in the pace is occurring. A steel economist reports a letup in steel orders in recent weeks, apparently because of a sharp rise in imports and hedging prior to the price increase in June. Aluminum orders for the second half of 1981 are weak virtually across the board, according to an aluminum industry economist, and some cutback in production is anticipated in the third quarter. Also, two regional crude-oil refineries in the District are still operating at about 70% of capacity. Backlogs of machine tool orders have been steadily cut to 12 months from 18 months a year-ago, according to an industry economist. The long slide in machine tool orders is unlikely to be reversed for another quarter or two. The spending surge for machine tools by the auto industry has peaked, judging from recent cancellations and deferrals of spending by GMC, especially for production of additional four-cylinder engine capacity. In view of the letup in capital spending by the auto industry, some machine tool producers believe they have sufficient capacity to accommodate an upswing in defense orders before reaching supply constraints, perhaps in 1983.

Consumer Goods. Despite a second-quarter decline attributed largely to weakened auto sales, consumer spending should increase by about 3% in 1981, according to an economist for a major department store chain. Retail sales of food items are expected to be flat over the year, but real growth in department store sales should reach 4%. A packaging producer for nondurable consumer goods reports that shipments of corrugated boxes, usually a reliable coincident indicator, have been dropping slowly. Several producers of durable consumer goods report that inventories continue to be tight at plant and retail levels, with some seasonally volatile items (such as air conditioners) experiencing slow deliveries as a result of low stocks. Auto producers have been trying to influence dealers to step up orders for the remainder of this model year, but dealers are reluctant to order because of high interest rates on floor plans and an uncertain consumer market. An auto industry economist states that May and June should be a post-rebate low point in auto sales, and summer months are expected to show increases, on a seasonally adjusted basis. This assumes, however, continued moderation in consumer prices, further declines in gasoline prices, and lower interest rates. The economist asserts that availability of instalment credit, hindered by usury ceilings in many states, is depressing auto sales rather than higher interest rates.

Banking. Loan demand by businesses has increased in recent months, but consumer loan demand remains weak. A bank economist reports that C&I loans recorded a strong increase in June. Inventory financing and a need for working capital appear to be significant factors for the step-up in borrowing from small and middle-sized corporations. Continuation of interest rates at current levels could have a crippling effect on smaller businesses over the next three to six months, according to several bank economists. Consumer instalment lending

continues to decline, according to a local bank official, but at a slower rate than during the first quarter. However, an area banker expects installment lending to receive a boost from new car buying in the fall. Credit card usage is showing signs of bottoming out.

Housing. Mortgage loan demand remains very weak in the District, with mortgage rates rising to as high as 18% on conventional 80% mortgages. A 100-basis-point advantage on renegotiable-rate-mortgages has not overcome consumer reluctance to buy homes under current market conditions, according to an S&L official. An official for a major builder reports that orders for new houses in the second quarter are 30% below normal, with each month showing progressive weakness. The current order pattern, along with rising mortgage rates, does not suggest a revival in housing starts similar to that which occurred last summer.

Savings flows into S&Ls may fall as sharply in June as in April, according to an economist for a regional FHLB in the District. An S&L that has benefited from a promotion to attract funds to their six-month money-market certificate in May reports that competition from other S&Ls and higher rates offered by commercial banks have reduced savings flows in June. Several S&L officials see little relief from their earnings problem this quarter or next. Losses this quarter will apparently be even more widespread than last, which will aggravate those associations that have already been operating with relatively low liquidity. An S&L official asserts that the proposed tax-free savings certificate would promptly improve the supply of and demand for mortgages, although several others feel such an instrument would be too late to benefit this selling season.

FIFTH DISTRICT - Richmond

Overview

Responses to our latest survey of Fifth District business conditions suggest a modest downturn has occurred over the past month. On balance, manufacturers contacted report slight declines in shipments, new orders, and order backlogs. For many, however, shipments and new orders seem to have held their own and there remain isolated areas of moderate strength. Retailers report little change in total sales, but sales of big-ticket items have slowed in recent weeks. Employment appears to have fallen in both the manufacturing and retail sectors. The inventory situation is mixed. Retailers experienced some buildup over the month. Manufacturers report significant accumulation of materials while stocks of finished goods are down sharply from a month ago. In general, loan demand across the District has been moderate, but residential mortgage activity continues weak. Recent severe weather conditions have attenuated earlier optimism concerning crop and livestock production prospects. Crop conditions remain generally favorable, but have declined in some areas over the past two weeks.

Consumer Spending

It is difficult to discern any clear pattern in consumer activity. Significant disparities exist among localities and sectors. Our survey suggests little change in total retail sales from a month ago, but some weakness in big-ticket items, particularly automobiles. Overall, however, demand for consumer installment loans is seen as moderate with significant strength appearing in some areas. Among general merchandise lines, those of

better quality continue to be the better performers. Those retailers surveyed report inventories unchanged to slightly higher and employment unchanged to slightly lower. Richmond directors also found little change in retail inventories other than automobiles. Automobile dealers have experienced rising inventories, but this has been attributed to seasonal factors.

The Manufacturing Sector

In the manufacturing sector activity declined modestly over the latest survey period. This decline was most noticeable in new orders and order backlogs, but shipments were also off slightly. The textile, building materials, furniture, and electrical equipment industries held their own over the month, but most other groups seem to have experienced some relative weakness. According to our survey respondents, materials inventories have risen lately while stocks of finished goods were down sharply. Our directors, for the most part characterized manufacturing inventories as steady. Nonetheless, over half of manufacturers surveyed feel current inventory levels are higher than desired. Employment was off slightly among those surveyed, but the average workweek was unchanged.

The Financial Sector

Loan demand has generally been steady in recent weeks but does seem to vary by type of loan and locality. Commercial and industrial loans have been weak to moderate with only isolated areas of significant strength. Demand for consumer installment loans has been steady and moderate in most areas, but, once again, areas of strength have emerged. Demand for non-residential and, particularly, residential mortgages continues to be weak.

The Outlook and Prices

Manufacturers and retailers surveyed report a continued abatement of price increases. Over 40 percent of the manufacturers surveyed paid no higher prices than a month ago, and over two-thirds held the line on prices received. Nearly half of the retail respondents reported no change in prices paid and received over the month. Manufacturers are somewhat less optimistic than a month ago about the business outlook, but retailers are decidedly so. Fewer than half of the retailers expect business activity nationally, locally, and in their respective firms to improve over the next six months. Nearly one respondent out of eight, from both sectors, expects business to deteriorate over that period.

The Agriculture Sector

Fifth District crop production prospects for 1981 were fairly optimistic as of mid-June. With the exception of soybeans, virtually all spring and summer crop plantings were complete. Conditions of the major crops were reportedly as follows: tobacco, good to excellent; peanuts, fair to excellent; cotton, fair to good; corn, fair to excellent but mostly good; and early-planted soybeans, peaches, and apples, mostly good. High temperatures caused crop conditions to decline in South Carolina during the third week of June however, and resulted in the loss of more than 75,000 broilers and breeder hens in North Carolina.

SIXTH DISTRICT-ATLANTA

Economic activity in the Sixth District remains mixed. Indicators continue to send out diverse signals as they have since April. Consumer retail spending has improved, but auto sales remain depressed. Residential builders continue to be plagued with high interest rates. Commercial construction appears strong, with numerous large projects underway. Inflation has moderated somewhat recently but is still in the double-digit area. The prospects for agriculture have improved due to recent rainfall that has brought some relief to the Southeast.

Consumer Spending and Inventories. Retail sales have been holding their own. A few merchants, who directors characterize as innovative and particularly aggressive, are doing better than expected. Demand has been strong for seasonal fashions and home furnishings. Credit sales have picked up recently—a pattern that one retailer interpreted as a display of consumer confidence in the economy. Inventories continue to be closely monitored. Businessmen are active in development of mechanized information systems where point-of-sale terminals are tied directly to the computer to facilitate the maintenance of proper inventory levels.

Used car sales continue to be the mainstay of new car dealerships as a result of high interest rates. Dealers say many people are looking and comparing but not buying. Chevrolet and Pontiac dealers complain about the unavailability of J-cars. Auto dealers seemed pessimistic and, as a group, do not expect to see their position improving significantly in the near-term.

Inflation evidently is slowing in the Deep South as in the rest of the country. From May 1980 to May 1981, the all-item consumer price index for Miami rose 10.6%. While this inflation is still unacceptably high, it represents a marked improvement over previous months. This same index had risen 14.8% from March 1980 to March 1981

and 13.2% from January 1980 to January 1981. Although transportation costs were primarily responsible for the slowing, housing costs rose by much less than in previous periods.

Financial and Construction. Housing starts slowed to a trickle in May and early June following two months of increasing activity. The spring surge in building permits also subsided. In Atlanta, permits for single-family houses fell by 34% from April. With soaring interest rates, prospective buyers are unable to qualify for financing—even with an ever-lengthening menu of options, such as buydowns, wraparounds, and renegotiable mortgages. Savings and loans are being crippled as the cost of funds is exceeding their loan portfolio income. The average price for a single-family home reached \$93,000 in south Florida recently. High home prices and condominium conversions are putting pressure on rental units. Demand for low-cost rentals is outstripping supply in most areas of the District.

Commercial construction appears strong. Contracts at military installations have boosted construction in central Louisiana. In south Florida, foreign investors continue to buy up properties, and in Tennessee, much construction activity has been generated by preparations for the World's Fair.

Employment and Industry. The employment situation has shown moderate improvement. Expansion of military weapon systems has added to employment rolls; still, youth unemployment remains high. High school students have staged two marches in Atlanta to protest lack of summer jobs.

Port tonnage is up over last year throughout the District with the exception of the Port of Mobile, where the United Mine Workers strike curtailed coal exports. The Port of Miami continues to expand into one of the world's most active specialized ports as growth prospects have led port executives to finalize a long range 20-year expansion program. The quarter-billion-dollar expansion has been approved and

environmentally endorsed. Business is also brisk at the Tampa Port, with the largest dockside cold storage facility in the country.

According to travel experts, business has improved in recent weeks in north and central Florida. A successful spring season and the availability of gasoline have heightened expectations for continued improvement in that region. A less optimistic outlook is expressed for south Florida, however, where tourism (Florida's largest industry) is heavily dependent on foreign visitors. This year, economic problems in Europe, political unrest in Central America, and the sudden strength of the U. S. dollar are discouraging foreign visitors. Merchants are predicting that some shops will not last through the summer. Tourist trade from Venezuela, which sends more tourists to south Florida than any other Latin nation, has slowed this year because the country's oil-driven economy has been stagnating after years of fast growth. State tourism figures show that foreign tourists traditionally spend about \$500 more per person on visits to Florida than do domestic tourists. Tourist-generated business receipts of \$16.1 billion in 1980 will be hard to match in 1981.

Agriculture. Recent rains have provided some relief from the drought and curtailed impending water restriction plans in Florida. Prospects for high yields for crops look promising in most District states, and the wheat crop is expected to be two-thirds larger than 1980's harvest. Prices for hogs and beef cattle have begun to show strength in recent weeks in response to the long-awaited reductions in hog marketings.

SEVENTH DISTRICT--CHICAGO

Summary. Seventh District business activity, overall, is unlikely to show significant improvement in the second and third quarters, although many firms will report good gains from the depressed periods of 1980. This prospect suggests continued adverse comparisons with the national economy. Most business firms now anticipate lower sales in the near-term than they had expected a few months ago. Moreover, a smaller rise in farm income is projected. Construction plans, both residential and nonresidential, have been scaled down. Loans are available in virtually all credit markets, but high interest rates deter borrowing. With rising personal income, retail sales have held up well. There is a widespread view that an acceleration in general activity will begin late in 1981, and continue into 1982. Such forecasts assume lower interest rates, tax rate reductions, a boost from defense spending, and further easing of inflationary pressures.

Employment. Demand for workers is weak. New layoffs or extended vacations have been announced recently for farm equipment, meat packing, and electrical products. However, claims for unemployment compensation are running well below last year's level. Indefinite layoffs reported by auto producers are down to 160,000 from 240,000 last year. Summer jobs for youth are hard to find, partly because of cutbacks in CETA programs. Various state and local governments have frozen hirings. Many help-wanted ads in district newspapers attempt to lure skilled workers to the South and West.

Personal income and labor negotiations. Worker compensation continues to rise at a rate of about 9 percent in the district, despite a surplus of workers.

Efforts of employers to get organized labor to moderate new demands, or to renegotiate existing contracts, have been successful only under a threat to shut down the operation. Mass transit workers of the financially-strapped Chicago-area RTA system threaten walkouts over any move to adjust their liberal compensation and work rules. Building trades have negotiated 8.5 to 11 percent increases this year.

Retail sales. Some very large retail chains have been pleased by double-digit increases in sales in recent weeks. They are using heavy promotions and aggressive pricing. Consumer credit delinquencies remain high. Most big ticket items often bought on credit are not selling well. Most general merchandise chains are losing money. An old chain has filed for bankruptcy under Chapter 11. Vacation travel and sales of recreational vehicles are being aided by ready availability of gasoline.

Inventories. Most firms are holding inventories at low levels to reduce heavy finance charges. Expected price increases no longer spur anticipatory advance buying. In some cases product lines have been narrowed and delivery times have been allowed to stretch out in order to economize on working capital. Low inventories act as a buffer against any possible recession, but they also provide a springboard for faster inflation if final demand accelerates.

Steel. Orders for steel slowed somewhat in the past month, partly for seasonal reasons. Steel demand is very strong for "oil country goods", and is above last year for vehicles and appliances. Orders for structural steel have softened. More steel users are buying from service centers in order to keep their own inventories low. Total steel shipments from U.S. mills are now projected at 93 million tons for 1981, up from 84 million in 1980, but well below 100 million in 1979.

Capital goods. Most district producers of capital goods report new orders well below their capacity and below expectations expressed earlier. The weakest sectors are equipment for construction, mining, and railroads. Demand for farm equipment and heavy trucks has been disappointing. Equipment for oil and gas exploration is booked to capacity, but this sector is relatively unimportant here.

Autos and trucks. Sales of autos and trucks have remained at low levels. Output of cars and trucks in the second and third quarters will substantially exceed last year's reduced levels, but will remain far below the prosperous levels of 1978. Inventories may rise in the months ahead partly to encourage concessions by the UAW.

Residential construction. Housing starts are running somewhat above last year's very depressed level in district centers. Home mortgages are offered at 16.5 to 17.5 percent or more, but with few takers. "Creative financing" is not helping much. Many S&Ls and banks are not making any mortgage loans. It is already too late in the season for lower interest rates to help housing construction in the district this year.

Nonresidential construction. A large number of smaller shopping centers, office buildings, warehouses, and other nonresidential construction projects were postponed in May and June. Interest rates of 14 percent or more, often with equity participations, are too high to attract developers. Most life insurance companies and pension funds have halted all commitments on commercial mortgages. Public construction is very weak, especially road work.

Agriculture. Recent rains eased remaining drought concerns in parts of Iowa. However, plantings, already unusually late in the Eastern cornbelt, were further delayed. These developments are dampening hopes for good crop

yields in the Midwest. Farm income in the Midwest was especially suppressed in the first half because of low livestock prices. These prices have risen in the past two months, and are approaching breakeven levels after a prolonged period of losses. High interest rates and low farm earnings are blamed for sluggish capital spending by farmers. Revised industry projections put 1981 sales of farm equipment only modestly above the depressed level of 1980 instead of the strong rebound expected earlier.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth District has been generally sluggish in recent weeks according to reports from area businessmen. Retailers report that unit sales of general merchandise and automobiles have shown no improvement in the past two months, although dollar sales are above the depressed levels of a year ago. Appliance, chemical, paper, and building materials firms report a slowing in activity and plan to adjust their production schedules to reduce their inventories. Homebuilding activity remains quite sluggish, although nonresidential building remains fairly strong. Bank lending activity is flat and savings and loan associations continue to curtail lending. In agricultural areas, the planting of crops was delayed by excessive rainfall, but corn and cotton planting is now complete. However, some crops, particularly cotton, have been damaged in some areas by excessive rainfall.

Consumer spending in dollar amount has been rising, but in real terms has been flat or declining in recent weeks according to area retailers. Department store representatives reported that dollar sales are well above last year's level, but noted that year-ago sales at this time were extremely low. Automobile dealers report their sales have changed little during the past two months, but are above year-ago levels.

Manufacturing industries have shown some weakness. Representatives of two major appliance firms reported that recent sales have been sluggish and that appliance inventories are high. One firm plans to curtail production for several days in order to reduce inventories. Manufacturers of chemical and paper products, which reported some strength earlier in the

year, noted a recent slowing in sales. Also, with weakening homebuilding activity, producers of wood and wood products, connector plates, and other building products report that sales are very sluggish. A manufacturer of uniforms and other apparel noted that sales were essentially flat in the first half of this year. On the other hand, firms producing energy-efficient equipment, oil and gas equipment, and military hardware continue to experience strong demand.

Some service industries report relatively strong activity. For example, a representative of a firm that owns and operates hospitals nationwide, stated that his business is very strong. Tourism in the district is also expected to make gains this summer, aided by lower gasoline prices.

Residential and nonresidential building activity are reported to be slowing. Homebuilding continues at a particularly slow rate. St. Louis area housing permits rose somewhat in the first half of 1981 compared to a year ago, but activity is now falling off again. Traffic levels at building sites are estimated to be less than one-half that of early this year. Nonresidential building activity in the St. Louis area remains fairly strong based on a sizable number of projects underway. With the fewer new projects, however, there is some indication that such activity is slowing. One large construction and engineering firm reported fewer new projects for industrial plants and highways, and that in the past 60 days three large construction projects had been postponed at a very late stage of development.

Overall, loan activity at district banks is reported to be flat. Business loans have been unchanged in recent weeks while installment loans have increased only slightly. Officials of area savings and loan associations report that few mortgage loans have been made at the 16 to 16-3/4 percent rates now prevailing. So far the new variable rate mortgages have not been offered, although most associations are considering them. S and L officials report some success in building liquidity by reducing mortgage lending and investing in short-term assets.

In the agricultural sector, most crop plantings were later than usual because of excessive rainfall. Nevertheless the intended amounts of corn and cotton have generally been planted. An estimated 10 to 20 percent of the cotton acreage in the upper Mississippi Valley, however, has been damaged by excessive rainfall and will be abandoned. Soybean planting is only 80 to 90 percent complete, but the planting can be continued until about July 4th and still produce a normal yield. The wheat crop has been harvested over most of the District.

NINTH DISTRICT - MINNEAPOLIS

Although sluggishness persists in the Ninth District, signs of improvement occurred in May and early June. The signs of improvement were many:

- . Consumer spending, particularly for merchandise, continued the improvement it began in April.
- . Industrial activity improved as suggested by an increase in manufacturing firms' new orders and by the settlement of construction strikes.
- . Late spring rains have improved growing conditions, and crops are off to a good start.

Despite these improvements, farm prices and auto sales in May and early June were disappointing after showing signs of improvement in April, and mining and lumbering remain weak. These weaknesses continue to be reflected in sluggish bank lending.

Consumer Spending

The district's consumers continue to be less hesitant to spend than they were in March. Our last report indicated that general merchandise sales increased somewhat more than seasonally in April, and this improvement has continued. Two major district retailers reported sales gains in May and early June and indicated that sales exceeded expectations. Directors from Minnesota and Montana also reported that general merchandise sales have continued to improve. Not only are consumers spending more in stores, but they are traveling more, for reports from Minnesota and the Upper Peninsula of Michigan indicate a more-than-seasonal pickup in tourist spending in May and early June.

This pickup in spending, however, does not extend to autos and homes. A regional sales manager for a domestic automobile manufacturer indicated that in May and early June, car sales returned to their depressed pre-rebate levels after improving in April. Home sales did not drop, but did not improve; mortgage loan applications at Minneapolis-St. Paul S&Ls in May and early June were unchanged from April's depressed level.

Industrial Activity and Inventories

Like consumer spending, industrial activity showed signs of improving in May and early June. Manufacturing orders have increased. Our last report indicated that gains in some manufacturing firms' new orders were being offset by declines at other firms. But 46 percent of the respondents to a recent University of Minnesota survey of Minnesota manufacturers reported increases in new orders in May, 35 percent reported declines, and 19 percent reported no changes. Most of these firms also said that they had no buildup of unwanted inventory, and several reported that the prices they paid for inventories had either stopped rising or had declined. Construction activity has also picked up as the strikes, which had shut down many Minneapolis-St. Paul area construction projects since early May, were settled in mid-June.

In contrast to the improvement in manufacturing and construction, mining and lumbering remain in the doldrums. A Montana director indicated that the forest products industry in western Montana continues to operate at 60 percent of capacity. Similarly, in northeastern Minnesota and the Upper Peninsula of Michigan, some iron ore mines remain closed and others are operating only part of the time.

Agricultural Conditions

Improved growing conditions have coincided with the improvements elsewhere in the district, but farm prices remain a concern. At the time of our last report, substantial portions of the district were still experiencing drought. Rains came to most of these areas in late May and early June, and crops throughout the district now are off to a good start. Although crop prospects have improved, farm prices haven't. After increasing in April, cash grain and livestock prices in Minneapolis and South St. Paul, except for slaughter cattle and hogs, either remained the same or declined between April and May. All these prices remain well below the highs attained late last year. The continuing weakness in grain prices stems from export sales being low; for example, an economist for a major Upper Midwest railroad indicated that his firm's grain shipments to West Coast ports have been less than anticipated.

Financial Developments

Although there are signs that the district's business activity may see some improvement, it remains sluggish at the moment. Recent loan growth is consistent with this overall assessment. Loans at Minneapolis-St. Paul area banks in May and early June remained at April's lackluster level, and outside the Twin Cities, bank directors reported no pickup in bank lending.

TENTH DISTRICT—KANSAS CITY

Overview. The Tenth District's economy is showing little real growth. Over the last year, current dollar retail sales increased only slightly faster than retail prices. Purchasing agents report input prices up about 10 per cent above June 1980 and expect price increases to accelerate by year-end. Housing starts have increased very little over last year's depressed levels, due to high mortgage rates. Although the national winter wheat crop is expected to set a new record, Tenth District crops have been substantially reduced by frost and drought damage. Growth in loans and deposits at commercial banks is slow. Prime lending rates are unchanged from last month and range from 19 1/2 to 20 1/2 per cent.

Retail Trade. All Tenth District retailers report their current dollar sales during January-May 1981 were in excess of 10 per cent above those of January-May 1980. Double digit sales increases have been reported throughout the District since March of this year. Most Tenth District retailers indicate that merchandise cost increases remain in the 6-8 per cent range. Retailers are maintaining full inventory markups and gross profit margins by passing these cost increases on to consumers.

Current stocks of merchandise at District retail stores are satisfactory relative to recent sales growth. However, most retailers expect sales to level off in the third quarter of this year. Inventory levels will, therefore, be watched closely in coming months. A majority of Tenth District retailers expect sales to pick up in the fourth quarter of 1981. Any build-up of inventories in the third quarter will then be used to ensure merchandise availability later in the year.

Purchasing Agents. Most purchasing agents report that input prices are more than 10 per cent above year-ago levels. Although they report a stabilizing trend in recent months, most agents feel that price increases will accelerate before year-end. Lead times are generally low throughout the District, and materials inventories have been reduced to satisfactory levels. Overall, companies are buying slightly more inputs than last year. About one-third report laid-off workers and excess operating capacity.

Homebuilders. Homebuilders' Associations indicate that housing starts are currently only slightly above last year's depressed levels. Most builders expect starts to remain low until Autumn. Some improvement is expected during the last quarter of 1981, depending on the level of mortgage rates. There are no reports of excess inventories of unsold homes in the District. Yet, home prices appear to have risen very little, as high mortgage rates have restrained demand. No problems with material availability currently exist. But most builders note that if starts increase, some shortages will occur as suppliers of materials incur start-up lags while bringing idle capacity back into production.

Agriculture. A record U.S. winter wheat crop is projected for 1981 because of an increase in acres planted, despite frost and drought damage during the growing season. Frost damage was worst in northwestern and west central Kansas. Some areas of the Tenth District report hard red winter wheat production to be as much as 40 per cent below average levels. The Kansas wheat crop may be reduced as much as 56 million bushels. Colorado and Nebraska crops will probably be reduced by 10 million bushels and 22 million bushels, respectively.

Winter wheat production in areas of Oklahoma may also be lower than anticipated because of hail damage and drought conditions during the growing season. The shortfalls in hard red winter wheat yields are expected to be offset by improved prospects for other portions of the wheat crop. Due to low prices, many farmers are holding much of their wheat crop off the market, anticipating higher prices later this year.

Range and pasture conditions throughout the District have improved due to recent rainfall, but additional moisture is necessary to maintain the rangeland in good condition.

Financial. Loan demand at commercial banks in the Tenth District is weak to moderate in most categories. However, growth of commercial and industrial loans continues strong in those regions experiencing a boom in energy-related activities. Lending rates for prime business customers are predominantly within a range of 19 1/2 to 20 1/2 per cent, with no appreciable change in the past month. Some of the larger banks have adopted or are thinking of adopting a change in the method for establishing lending rates that more nearly reflects their marginal cost of funds.

Growth of deposits at most Tenth District banks is weak or moderate and concentrated in 6-month money market certificates. A number of banks are offering retail RP's to attract funds, due in part to intense competition from money market mutual funds. Several other banks are considering offering retail RP's in the near future.

ELEVENTH DISTRICT--DALLAS

The expansion of the Eleventh District economy continues at a moderate pace. Mining, equipment manufacturing, and commercial construction are spearheading the District's growth. Some manufacturing firms have laid off employees, but overall employment is up. The growth in department store sales is down slightly from pre-Easter levels, and auto sales are weak. Housing starts are declining. Total loans and deposits at commercial banks show little growth. S&Ls report lower deposit outflows, but they are making few loans. Heavy rains have reduced some crop yields in the District.

Total employment in Texas has increased steadily throughout the year and is up 6 percent from year-ago levels, despite layoffs in electronics, commercial aircraft, and residential construction. The unemployment rate increased 1.1 percentage points from April to 5.3 percent, comparable to the May 1980 level. Much of the growth in manufacturing employment is associated with the increase in production of oil field equipment.

Manufacturing output is rising. Makers of oil field equipment report increasing sales and are operating at full capacity. Delivery schedules continue to lengthen--especially for high-technology items. Respondents expect current conditions to continue at least through 1982. The high level of steel production is stable, and sales in the apparel and furniture industries are increasing. Weak sales in consumer electronics have led to layoffs by a few large electronics manufacturers. Texas Instruments reduced the work force

in its consumer products division by 2,800 in May. Most manufacturers reported a moderation in the increase of materials prices.

The number of drilling rigs operating in the District is at a record high. Additions to the fleet of rigs in Texas have exceeded a rate of one per day since the end of April. Shortages of well casings, drill pipe, and experienced drilling crews persist.

Construction in the District remains active due to the number of large office projects under construction. Residential construction is falling, and the pace of highway, municipal, and utility construction is unchanged.

Total loans and deposits at commercial banks show little increase since April, but business loans and large certificates of deposit at large District banks are significantly higher. Mining is the fastest growing C&I loan category. Bankers report a rise in the number of small firms on their "concern" list. The volume of the consumer loans dropped sharply after the Texas usury ceiling rose to 24 percent. Consumer loan rates are currently 18 to 19 percent. The decline in demand deposits is offsetting the growth in time deposits (NOW accounts and large CDs). Large certificates of deposit are the major source of funds at commercial banks at this time.

S&Ls report their deposits outflows slowed in early June, and they are maintaining their restrictive lending policies. The decline in outflows is attributed to the narrowing in the difference between yields of money market funds and money market CDs and a savings

buildup following tax refunds. The number of NOW accounts are described as increasing steadily. S&Ls are investing in money market instruments and in commercial projects. Liquidity levels are down from the first quarter.

The growth of department store sales in nominal dollars has slowed since April, and the level of sales is 11 percent over a year ago. Strong sales were reported in the week before Father's Day, and retailers expect sales to increase through the fall and Christmas seasons. Apparel continues to sell well, and furniture sales are recovering from their low levels earlier in the year. Inventories are slightly over plan, but are not a source of concern. Price discounts are greater than originally planned, but promotional activity is otherwise normal for this season. Retailers have not altered their credit card policies following the change in the state usury ceiling, but they anticipate changes within a year. The proportion of sales purchased on credit is stable and below last year's percentage in the months before the credit constraint program was put into effect.

Automobile sales are up slightly from April but remain below seasonal levels. Dealers attribute some of the current weakness to advanced purchases made during the rebate programs and a rise in new car loan rates to 18 to 19 percent. Traffic is described as good at dealerships, and sales are expected to improve. Domestic models are selling slightly better than imports. Used cars are selling

extremely well even though loan rates on used cars are about 21 percent. Dealers are building inventory for sales through fall.

Heavy rains have reduced wheat yields by as much as 10 percent across much of the District. However, total wheat output will still be relatively large because more acres were devoted to wheat this year. The increase in soil moisture has improved the outlook for most spring-planted crops. Southern New Mexico is the only major area of the District that remains abnormally dry. The added moisture has not improved the financial condition of farmers and ranchers, however. The ability of many to repay their loans remains a source of concern.

TWELFTH DISTRICT - SAN FRANCISCO

The consensus in the Twelfth District is for a weakening in the economy. Most are forecasting a continued decline in consumer spending. Consumers are especially hesitant to buy large items. The unemployment and inflation picture in the region is following the national trend. Unemployment rates have edged upward, while the inflation rate has slowed. With housing, energy, and food prices leading the way, very optimistic short-run inflation expectations are being expressed. Little activity is occurring in the housing market. Mortgage rates are still high, up to 18 percent, and consumers are hesitant to obtain adjustable rate mortgages. Agriculture continues strong and many areas are reporting good harvests. Financial institutions are increasingly troubled by the outflow of deposits to money market funds. It is felt that the current regulations are inequitable and that the restrictions need to be immediately loosened so that banks and thrifts can better compete with other institutions offering financial services.

CONSUMER SPENDING

Indications were given to suggest a rather widespread and substantial weakening in consumer spending. Sales of durable goods, especially automobiles and appliances, are said to be extremely sluggish. It was suggested that with the ending of the rebate programs, car sales will continue to be slow. In many areas, department stores are engaging in large promotional campaigns in an attempt to attract buyers. However, it was felt that consumers are reluctant to spend due to fears over the weakening state of the economy.

EMPLOYMENT

Most areas in the region are reporting a slight upswing in unemployment. The construction-related industries are still in a major recession. Little improvement is expected until interest rates fall. The Pacific Northwest continues to be especially hard hit as its economy is highly dependent on the forest products industry. Employment in the electronics and computer industries continues to benefit from increased demand. Plant expansions continue to create new employment opportunities. Aerospace employment has leveled off as orders, especially for older craft, have declined.

REAL ESTATE

Little activity in the housing market is being reported. With mortgage rates as high as 18 percent, few potential buyers are able or willing to obtain mortgage loans. Home buyers are very reluctant to obtain adjustable rate mortgages even though they are being offered at lower interest rates than other mortgage instruments. Commercial construction appears to be tailing off. Vacancy rates are on the rise and builders are hesitant to engage in any new activity. In some cases these rates have doubled from last year's level.

PRICES

An optimistic outlook is being expressed over the short-run inflation picture. Housing, energy, and food prices appear to be significantly holding down inflation. With high interest rates discouraging home buyers, housing prices appear to be leveling off. The oil glut has helped to lower gasoline prices. Food prices have also dropped slightly. It was indicated that consumers appear to be staying away from high priced items and this, too, has helped to keep prices down. However, most are dubious that the improved

inflation picture will remain past the summer. If the economy begins to expand, prices, especially for raw materials, are expected to accelerate.

AGRICULTURE

Agricultural prospects remain bright. For the most part, recent rains have eased concerns over a potential water shortage. The rains delayed the cotton planting, but a good crop is projected. Despite a freeze in the Pacific Northwest, the apple crop may be as large as last year's record harvest. Wheat farmers are expecting high prices for their product, and farmers in general are said to be in as good a financial position as they have been in five years.

FINANCIAL INSTITUTIONS

The outflow of funds from savings and loan associations is said to be reaching record levels. This outflow is adversely affecting both the profitability of these institutions and the availability of funds for residential housing. Consumers are better informed and are less willing to be satisfied with below market rates. There seems to be an increased call for legislative action that would aid thrifts and banks. Most desire an easing of restrictions so that these institutions could compete on a more equal footing with money market funds. Many argue that thrift institutions, with their aging portfolios of mortgage loans, can be in serious trouble in the very near term if interest rates do not go down and legislative action is not taken. The FSLIC insurance reserves are deemed insufficient to withstand the demands that are likely to be imposed. Banking activity is relatively slow. Lending activity has slowed for both commercial and consumer loans.