CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Nine Redbook reports indicated weakening in activity since the last FOMC meeting, with varying degrees of emphasis. Exceptions were Dallas and Philadelphia, where activity was judged to be expanding, and St. Louis with "no marked change". Inflation appears to have moderated, but most observers fear a resurgence. Virtually all reports commented on the depressive impact of current high interest rates, especially on housing, but also on nonresidential construction, capital goods, motor vehicles, and inventory investment. Employment is sluggish, at best, in most districts. Retail trade is mixed, but with auto sales severely depressed everywhere. Labor unrest, highlighted by the air controllers' strike, is increasing. Capital goods demand is generally weaker. Energy development and defense procurement are among the few strong sectors. The higher value of the dollar has tended to slow exports and increase imports, but quantification is difficult. Consumer credit use has slowed. New residential mortgages are difficult to negotiate under current terms. The S&L crisis deepens. C&I loan demand varies, with merger-related loans a big factor in money centers. Crop prospects are "good to excellent" in most of the nation. The new fiscal package is viewed as favorable, but no substantial early impact is foreseen. Many observers anticipate a revival in activity late in the year or in 1982, but only if interest rates decline.

Exchange value of the dollar. All districts found that the higher value of the dollar was affecting imports and exports, but the picture is confused by the weak economic situation in Western Europe. Also, most

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*Prepared at Federal Reserve Bank of Chicago.

observers expect the full impact to be delayed. Boston comments on reduced exports of "high-tech" items. New York finds exporters "worrying", but with few specific examples of declines in sales. Cleveland reports increased foreign competition for machine tools and pigments. Richmond finds textiles affected. Chicago reports a drop in inquiries from abroad as to the availability of U.S. products. San Francisco finds demand for aircraft and forest products seriously affected. Various districts pointed to reduced foreign demand for agricultural products, with accompanying downward pressure on domestic prices.

Inflation. Boston, Richmond, and Kansas City reported a trend toward price stability with fewer purchasing managers reporting paying higher prices. Prices of building materials, especially cement, are generally weak. Cleveland economists still see a "core" inflation rate of about 9 percent. Chicago reports prices rising faster in July than last year, and business equipment prices up at least 10 percent this year.

Financial institutions. Most districts commented on the growing S&L crisis. A New York analyst fears "a mass failure of the thrifts", and a shock to the economy. Outflows of funds continued heavy in July, and net worth is declining. The new adjustable mortgage loans and tax exempt "small savers" certificates may be of some help. But the basic problem is high interest rates. Atlanta points out that many people could not now afford to buy the houses they live in, and Dallas warns of a wave of foreclosures when creative financing deals must be renegotiated.

Housing. The housing industry remains depressed throughout the country, even in the relatively strong economy of the Eleventh District. Mortgage rates up to 18% and high prices are preventing many potential buyers from entering the market. Some developers are cutting prices. Bankruptcies of small builders are increasing. Related industries continue to suffer, including building materials, manufacturers, forest products, and appliances. Mortgage lending activity is reported nearly nonexistent in some areas.

Manufacturing. Manufacturing production was generally reported unchanged to down in the latest month. Industries linked to the construction and auto sectors were particularly adversely affected, while those producing military hardware and oil and gas equipment benefited. In contrast with other districts, Dallas reported continued expansion of manufacturing output, and Philadelphia noted signs of improvement following a decline earlier.

Retail sales. Reports on consumer spending are mixed though indications of lower, softer, or spotty sales predominant. Autos, appliances, furniture, and building materials are particularly sluggish. Discounting and heavy advertising to boost sales are being reported. Auto sales are benefiting from the recently announced promotion programs of the automakers. Additional parts and servicing business is partially offsetting weak new car sales in some areas. But additional auto dealers were reported to have gone out of business. The air traffic controllers' strike is exacerbating the problems of the airlines. Tourism, "already anemic" in the South, has been hit hard by the strike.

Inventories. Businessmen are generally reported to be watching inventory levels closely. Nevertheless, excessive levels have developed in a number of industries. High interest rate levels are encouraging tight inventory control. Kansas City noted that inventory cutting appears to be taking place at all stages of production. Types of inventories noted as being excessive include motor vehicles, farm and construction equipment, construction supplies, steel, certain lines of retail goods, and crude petroleum.

Capital investment. The Cleveland and Chicago districts, which emphasize durable consumer and capital goods, continue to send in pessimistic reports. Nonresidential construction is now softening in most regions as a result of financial stringencies. A number of districts reported reduced demand for producer equipment, including private and commercial aircraft, freight cars, trucks and trailers, and especially farm and construction equipment. Energy development items, defense equipment, and high-tech items are relatively strong.

Agriculture. Among the districts reporting good-to-excellent agricultural conditions are Richmond (tobacco), Chicago (near ideal weather for corn and soybeans), St. Louis, Kansas City, and San Francisco. However, Atlanta finds dry weather again restricting crop growth, and Minneapolis complains that excess moisture now endangers crop yields. Farm income is depressed by low farm prices and rising costs, and farmers are restricting new investments.

FIRST DISTRICT - BOSTON

Respondents in the First District report that high interest rates are having a serious impact on interest sensitive segments of the economy. Residential construction is depressed and the repair and commercial renovation business is now beginning to fall off. Manufacturers of homebuilding materials and appliances are having a difficult year. The experience of manufacturers in other fields is highly varied; firms in similar industries have very different backlog situations and new order rates. Overall, the level of manufacturing activity appears to be about the same or a little lower than earlier in the year.

The export situation is a source of concern, particularly among high technology executives. A number of high tech firms have seen slowdowns and even declines in export sales. This weakness is attributed as much to the depressed state of the west European economies as to the effects of the strong dollar. However, even those firms which have not yet seen a deterioration in exports, or not one traceable to exchange rates, expect the strong dollar to have a depressing effect in coming months.

There is little of moment from the retail sector this month. Sales are reported to be flat to "pretty good." Inventories are being watched closely, although there are a few areas, such as small appliances and hardware, where inventories are higher than desired.

The level of manufacturing activity is largely unchanged. In a recent survey of area purchasing agents, the number of firms reporting increased production and higher orders equalled the number with lower production and order rates. This has been the pattern for some months now. The industries experiencing the greatest difficulty are tied to the housing industry or other interest sensitive sectors. A leading manufacturer of homebuilding materials reports that sales this summer are very poor; since summer is normally the busiest time of year, the entire year will be very disappointing. Sales of construction equipment, large appliances, and private aircraft are also reported to be suffering from the effects of high interest rates. While high technology overall appears to be holding up quite well, individual firms are experiencing difficulties and one chief executive officer has observed a marked softening in the demand for highly skilled personnel.

For the past two or three months First District businessmen, particularly in the high technology industries, have been reporting a slowing in export sales. The strong dollar is not seen as the primary cause of the slowdown to date; however, it is expected to be a more important factor in the second half of 1981 and beyond. In a recent survey of New England executives in the instruments and electronics industries a substantial majority responded that, while domestic business would be higher, international business in 1981 would be the same as or lower than in 1980. Looking ahead to 1982, the executives were almost unanimous in forecasting an improved year at home but only half expected an upturn abroad.

One positive development in this month's reports is evidence of further progress in bringing down the rate of inflation. Only a third of purchasing managers surveyed reported prices increased in the past month;

earlier in the year and for most of 1980, two-thirds normally reported higher prices. Commodity prices have softened and are expected to remain soft for some time. Not everyone is happy about lower prices: the building materials executive reports that although costs are up, his firm has been forced to price its products below 1980 levels.

Professors Houthakker and Samuelson were available for comment this month. Houthakker is disappointed that fiscal policy for 1982 will not reduce the budget deficit, and he sympathizes somewhat with our foreign trading partners who object to domestic policies. Nevertheless, he believes there is no need to change monetary policy at this time. Houthakker recommends a temporary shift of attention to M-2 if a conflict should arise between attaining the M-2 guideline and the M-1B guideline. Once the NOW account adjustment is complete and the M-2 and M-1B guidelines are once again mutually consistent, the Fed should return its attention to M-1B. Houthakker wonders how much of recent M-2 growth is due to the increase in money market mutual fund balances. The Fed might consider levying reserve requirements on those MMMF balances not invested in assets that already bear reserve requirements themselves--e.g., no reserve requirements would be levied on that proportion of balances invested in Eurocurrency liabilities of domestic banks or on large CDs issued by domestic banks.

Samuelson believes that "we've got the whirlwind that we sowed." He notes that many forecasters expect GNP to decline in the current quarter. The high interest rates produced by our tight money growth guidelines have undermined housing and contributed to the weakness in auto sales. During business slumps, "interest rates decline for natural reasons, no purpose is served by delaying that decline when the turn comes unless we want to make an investment in blood letting." Samuelson is not surprised there is currently a conflict between attaining the M-1B guideline and attaining the M-2 guideline; the M-2 guideline was too low to be consistent with the M-1B guideline from the beginning. If the Fed shifts its attention from M-1B to M2, it is adopting a more restrictive policy. By attempting to achieve a path of M-2 near the middle of its current band, real growth will average 1 to 1.5 percent from 1981 to 1983. Samuelson believes this outcome conflicts with the voters' mandate to the current Administration; "a generally anemic economy (with growth averaging about 1 percent between 1978 and 1983) is too high a price to pay."

SECOND DISTRICT--NEW YORK

Economic activity in the Second District weakened a bit in July. Retail sales slowed from the brisk pace of previous months, and automobile demand remained fairly lackluster. New orders for capital goods continued to taper off. The strength of the dollar is worrying exporters, but so far few specific comments on export sales losses have been picked up. The overall economic outlook is mixed. While personal tax cuts are expected to boost department store sales by the end of 1981, automobile sales and capital spending are expected to remain weak until interest rates fall significantly. On the financial side, major banks reported substantial increases in levels of credit lines intended for merger activity.

Consumer Spending. In July, retail activity in the Second District fell from the generally high levels of May and June. While several department store chains indicated that sales were at or above plan, performances at all retail stores were weaker than those of last month. Sales in the New York City stores were slower than in their suburban counterparts, in contrast to previous months when no geographic pattern emerged. The slackening in the overall sales pace has caused no change in plans, as respondents speculated that seasonal factors and the timing of holiday promotions were partly responsible.

The demand for automobiles showed little change in July. Domestic cars sold at slightly above last year's lackluster pace, and foreign cars again sold poorly. Lower-priced lines continued to be weaker than more-expensive models. High prices and high interest rates were blamed for the poor performance of auto sales. While hope was expressed that manufacturers' rebate and finance-charge promotions would stimulate demand, the tax cuts were not expected to provide much help.

Manufacturing Activity. Weakness of capital spending persisted in July. All capital goods producers in the survey reported that new orders fell below June's depressed levels, although the backlogs at some firms have been used to shore up production levels. One machine-tool manufacturer remarked that the firm's current three-month slowdown is the first in two years. A steel plant, much of whose output normally goes to the automobile industry, was said to be operating "at a pretty good rate." Nevertheless, capital allocations to this plant are being reduced because it is not as profitable as others located outside the District.

Exchange Rate Effects on Exports. For some time now we have been hearing general comments from business leaders to the effect that the strong dollar poses a threat to exports. The only specifics, however, have been on the one hand that most U.S. industries do not really feel the impact of exchange rate changes for two or three years, but on the other that export orders for chemicals are already being unfavorably affected.

An informal survey of 10 large manufacturing firms conducted for this meeting brought out that so far there has been only a small adverse effect on export sales from the higher foreign currency exchange value of the dollar. The preponderant view was that it was still too early to assess the full impact of the dollar's appreciation. Although several companies have lost export sales especially in Europe, most believe that the export losses stem from a slowdown in economic activity abroad rather than the dollar's appreciation.

However, two indicated that higher foreign currency prices for their exports have resulted in lower sales to Europe, and they seemed concerned about greater losses in the near future.

Economic Outlook. The outlook for the next twelve months is mixed. Some retailers look forward to continued strength, while others anticipate further weakness until the end of the year. The majority of business economists see a flat-to-weak third quarter, although one is predicting 1.8 percent real GNP growth. While economists and retailers in our survey expect the tax cuts to stimulate consumer spending by the first quarter of 1982, auto industry respondents anticipate little help. One corporate economist, however, sees the tax cut helping car sales late in the year. None of the respondents foresee business tax cuts boosting capital spending soon; the prospective strengthening in capital spending is seen as beginning as early as mid-1982 or as late as 1984. GNP forecasts for 1982 indicate about 3 percent real growth.

Financial Developments. Officials at six major New York City banks reported substantial increases in the volume of credit lines intended for merger activity. Most of these commitments are for unsecured loans with maturities ranging from three to twelve years. A majority of the banks interviewed offer various pricing options on the loans while the others charge the prime rate. It is not uncommon for about forty to fifty banks to be involved in the syndications, with a significant portion of the total dollar commitment (twenty-five to fifty-five percent) provided by foreign banks. Some officials said that restrictions on the amount of money that may be lent to a single entity had limited the participation of U.S. banks in these syndicates. None of the officials interviewed anticipated any difficulty in funding these loans if and when they are taken down, and for this reason they did not expect to have to reduce credit availability elsewhere.

Financial Panel. This month we have comments from James O'Leary (U.S. Trust Company) and Donald Riefler (Morgan Guaranty Trust Company).*

O'Leary: The forces behind the upward movement of interest rates this year are: (1) the continuing strong fear that the decline in the inflation rate is only temporary; (2) continuing very strong private short-term business credit demand, caused importantly by the fact that long-term debt markets are still closed down; (3) the determination of the Fed to persist in its policy; (4) the impact of high short-term rates on the cash flow of life insurance companies and the thrifts; (5) heavy U.S. Treasury financing; and (6) a huge backlog of demand for long-term, fixed-rate financing.

The course [that] the Federal Reserve and the financial markets are now on threatens a mass failure of the thrifts which would undoubtedly cause a tremendous shock to the economy and would present very serious problems for public policy.

There are risks in a Fed move to relax credit--and there are risks in not doing so. There is no easy choice. At this point, my own rather uncertain judgment is that a modest and guarded relaxation would be the wisest course of policy. I think the financial markets would understand and accept a moderate and careful relaxation of credit without concluding that inflation is off to the races again.**

*Their views of course are personal, not institutional.

**This paragraph was written before I saw the recent comments of Secretary Regan.

Riefler: Concern about the thrift industry is growing as market expectations for significantly lower interest rates are waning. We see evidence that savings bank deposit withdrawals are on the increase. Concern about other credit problems persist, and the passage of a few months time at these interest rate levels will probably bring more distress situations to the surface. The Fed should watch these developments carefully and be ready to adjust to any surprises that may occur.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business activity in August has been showing some signs of expansion, but still remains mixed. In the industrial sector, manufacturers say general activity appears to be stronger this month than at any other time so far this year. As for the future, area manufacturers are maintaining their optimism, anticipating a widespread upswing within the next six months. Local retail merchants report August sales to be up compared to last year's levels and appear to be more optimistic than they have been in recent months about the future. Area retailers expect sales to grow by the end of the 1981 and, in order to meet the increased demand, they plan to make some additions to stock levels. Third District bankers indicate mixed loan activity in August. Business loan volume is slightly ahead of year-ago figures, while consumer loans are said to be soft, for the most part. Local bankers forecast no change in consumer loan volume over the next six months, but predict slight gains in business borrowing.

INDUSTRIAL

Manufacturers responding to the August Business Outlook Survey say that the local industrial sector is showing some signs of expansion this month, the strongest such indication so far this year. This report, however, comes on the heels of a reported decline in July's manufacturing activity which may have been only a seasonal slowdown, typical of area industrial activity in July.

Supporting the claims of renewed strength, new orders are said to be up for the first time since March and shipments have increased as well this month. Manufacturers have added to inventories, although only fractionally, putting at least a temporary halt to the recent cuts in stock levels. It appers that factory employment has been helped by the industrial spurt too. Survey participants report small increases in their payrolls but no change in working hours is indicated.

Looking ahead, survey participants are maintaining their optimism about economic conditions over the next six months, anticipating a widespread upswing in general industrial activity by the start of the new year. In terms of specific indicators, about two-thirds of the survey respondents forecast climbing levels of new orders and shipments between now and February. Plans for meeting the anticipated demand include hiring more labor, lengthening the average workweek, and boosting expenditures on plant and equipement.

On the inflation front, prices paid to suppliers have risen again for about 45 percent of the survey participants in August, and over one-quarter of the area manufacturers responding to the survey report charging higher prices for their finished products. Prices are expected to continue climbing, as 9 out of 10 of the survey participants anticipate higher input costs by February and about 7 out of 10 plan price hikes for the goods they sell.

RETAIL

According to local retailers, August sales are up compared to year-ago figures by 5 to 20 percent, but only slightly, if at all, ahead of expectations for this period. District merchants attribute the gains to, among other things, the expected tax cut, which may have given consumers a psychological boost. Sales of soft goods, particularly apparel, shoes, and small household items, are doing well, while big ticket items remain sluggish.

As for the future, area retailers are more optimistic than they have been in recent months, and are hoping to be posting year-over-year sales gains of about 9 percent by the end of 1981. Once sales start to climb, retailers plan to increase their stock levels. As one contact put it, though, we should expect "only a marginal increase, certainly nothing alarming."

WHOLESALE

There has been no clear decline in Third District wholesale firms' orders from abroad, despite a strengthening dollar and recessionary condition in parts of Europe. Orders from Canada and Japan appear to be stronger than those from other nations.

FINANCIAL

Third District bankers report mixed loan activity in August. C&I loan volume is up 4 to 8 percent over year-ago figures, with some banks reporting below-prime lending which has, at least in part, boosted their business loan volume over budget by about 2 percent in August. Also, they say, aggressive marketing has helped. Consumer loans, on the other hand, are flat to slightly off, about 4 percent, and generally below budget. Looking ahead to the start of the new year, area bankers expect business loans to be showing gains of 2 to 6 percent over early 1980 levels, while retail loans are expected to remain soft.

Reports of deposit flows in the Third District indicate demand deposit levels to be mixed, running 2 percent below to 4 percent above last year's figures. Time and saving deposits, on the other hand, are 4 to 10 percent ahead of August '80 levels. Bankers say depositors are leaning toward longer-term higher-yielding time deposits. In an effort to aid deposit flows, a number of area banks and thrifts has been planning to offer long-term (more than four years) time deposits carrying an unregulated interest rate, before such instruments were barred by a U.S. District Court ruling on July 31.

Third District bankers are currently quoting a prime rate of 20.5 percent. Cuts in the prime are expected to come soon, leaving the rate 150 to 450 basis points below its current level by year end.

TOURISM

Summer business at area vacation spots in the Third District is reported to be mixed this season, according to spokesmen from major resort areas in New Jersey, Pennsylvania, and Delaware. Business at South Jersey seashore resorts is off slightly from last year, but merchants there expect trade to pick up as they head into the rest of the season. The slowdown seems to be stemming primarily from a reduced number of longer-term vacationers. The number of daytrippers to the shore is up compared to a year ago, boosted by a plentiful supply of gasoline, "packaged" bus trips, especially to Atlantic City casinos, and generally good fishing. Nevertheless, the "bottom line," according to seashore businessmen, is that tight household budgets have kept the lid on business so far this season.

Such has not been the case in Delaware resorts. Tourist volume there is running about 9 percent ahead of 1980 levels and occupancy rates are said to be close to 100 percent. Delaware officials say their increased business this season is owed, at least in part, to a major advertising campaign.

Pocono Mountain vacation spots are having a fairly good season in terms of volume. But while tourist trade is up about 9 percent over last summer, people are again spending less money, leaving business, as measured by dollar volume, about 2 percent behind 1980 levels. Again, tight household budgets are cited as a major factor by Pocono officials.

FOURTH DISTRICT - CLEVELAND

Summary. Respondents in the Fourth District generally view the growth potential of the economy as strong and expect a quick rebound in real GNP if interest rates fall. Real retail sales are expected to show only mild gains over the next few months. Current interest rate levels, along with a slowdown in orders, have led to deferring of some capital spending projects and liquidating of inventories. District employment continues to slide toward the 1980 recession trough level. Effects of dollar appreciation on exports and imports are mixed, but few respondents expect exports to rebound. Large savings outflows at S&Ls continued in July.

Output and Prices. Most respondents have scaled down their third and fourth quarter forecasts of real GNP, but the core inflation rate is expected to remain around 9%. A bank economist, who previously forecasted strong growth in real GNP for the second half of 1981, now expects only 1% growth in the third quarter and 2.5% in the fourth quarter. A steel economist and a retail trade economist see prospects for a negative third quarter and possibly fourth quarter, if interest rates do not fall. However, several respondents expect that tax cut incentives and declining interest rates will provide stimulus by September to support a positive third quarter. The fall in interest rates assumes that business loan demand weakens and monetary policy eases.

Inflation continues to be a major concern of respondents, with a widespread view that further moderation involves bringing down wage and employment cost increases. Also, several respondents are concerned that the effects of tight monetary policy on output will limit productivity gains that are necessary to reduce the core rate of inflation.

Consumer Goods. Some retailers expect sales, excluding autos, will grow at a slower pace the balance of the year than earlier this year, because of the slow growth of income and rising unemployment. An economist for a major department store chain projects a 2% increase in real retail sales of department store-type goods during the second half of 1981. A nondurable goods producer reports that sales volume has been soft in recent months, with year-over-year gains at 1-2%, rather than an anticipated 3-4%. While several department stores report small gains in real sales, a local chain store that caters to blue-collar workers reports declines in real sales. An area auto dealer reports new car sales rose slightly in the last 10-day period of July, partly because of a revised Ohio sales tax law that can reduce sales tax on new cars.

Manufacturing Activity. High interest rates and slackened final demand are contributing to some curtailment of inventories and deferment of capital spending. While most respondents report that inventories at the plant and customer level are generally lean, some spot excesses have occurred in recent weeks. Larger-than-desired inventories are apparent, especially in steel, petroleum, and construction supplies. A petroleum economist reports that refinery operating rates range between 66-70% because of an excess of crude stocks. A steel economist states that the moderate buildup of steel inventories in the second quarter of 1981, while low by historical standards, is in the process of being cut back. Steel orders generally have weakened as a result of unwanted inventories and rising imports. Order rates in the last few weeks are equivalent to only a 60% operating rate, compared to the current 75% operating rate. An official with a machine tool producer reports that new orders amount to 50% of capacity and that production, which has been at capacity, will be cut back by the end of the year even if orders rebound. Several respondents state that some capital spending programs are being deferred because of slackened demand and high interest rates. A steel economist expects business fixed investment to improve if the volume of sales returns, regardless of the interest rate.

Employment. Employment conditions in the District have been weakening steadily in recent months. Nonagricultural employment, which peaked in November 1980, is currently approaching the July 1980 trough level. Nonmanufacturing employment, especially government and construction, accounted for most of the decline from the November peak. Manufacturing employment has drifted downward since March, with declines concentrated in the auto industry. An auto economist reports that temporary layoffs are likely to continue throughout the third quarter as plants are closed for a week at a time. A steel economist expects that slackening in steel orders and production will cause shortened work weeks and some layoffs throughout the second half of 1981. The latest monthly Survey of Fourth District Manufacturing has shown a steady decline in rate of employment expansion since the end of last year, and virtually no change in hours worked since February.

Exports/Imports. Respondents acknowledge the difficulty in differentiating effects of dollar appreciation on U.S. exports and imports from economic weakness abroad. Several small producer/exporters in the District report little loss in export business despite dollar appreciation, while several others attribute the recent decline in their exports to dollar appreciation and softness in economics abroad. A machine tool builder reports growing competition for orders from foreign producers and estimates that 25% of his market is absorbed by imports. A manufacturer of pigments for appliance paints states that sales in Europe have been declining since mid-June and expects the decline to continue for the next few months. In contrast, a chemical manufacturer reports a 10% increase in sales during the first half of 1981 over the first half of 1980. Imports have been rising noticeably in the steel industry, according to a steel economist, but may partly reflect attempts to maintain production levels abroad as demand softens. A chemical manufacturer reports shifting to foreign sources of raw materials because of the price advantage.

Savings Flows. The heavy outflow of funds from S&Ls continued in July, as many area S&Ls look to new four-year certificates, "all-savers" certificates, and repurchase agreements for new sources of funds. Savings outflows, according to an economist for a regional FHLB in the District, were not as severe in the second 10 days of July, compared with the first 10 days, but were still massive by historical standards. S&Ls appear to be more aggressive in promoting the new four-year certificate and retail-repurchase agreements than banks. Some banks are apparently reluctant to make long-term commitments at present interest rates, but an S&L official states that the new saving instrument adds stability to their source of funds. A local S&L offers both a fixed and a variable rate on its four-year certificate. An economist for a large S&L expects the "all savers" certificate to be more helpful to the industry than the four-year certificate in attracting funds and should shift funds away from the money market certificates. Retail repurchase agreements are being promoted in several major metropolitan centers of the District, mainly by S&Ls.

FIFTH DISTRICT - RICHMOND

Overview

Despite scattered sources and areas of strength it is apparent that business activity in the Fifth District has turned decidedly sluggish. The manufacturing sector where orders, shipments, and employment have recently declined is indicative of this general weakness. Retail sales are spotty with the durable goods sector serving as a depressant. Construction activity continues slow and is characterized as weak to severely depressed in many areas of the District. The recent strength of the dollar on foreign exchange markets is a factor, having apparently curtailed export demand in some manufacturing sectors, notably textile products. The rebound from the end of the coal strike is a positive factor in some areas lending support to retail sales and consumer lending, but some secondary effects of the strike persist.

Consumer Spending

Retail sales appear to have weakened over the past month although reports are somewhat mixed. Indications are that sales of department and general merchandise stores have held up reasonably well and that even big ticket items are continuing to hold their own. In addition, there has been a rebound in sales in those areas directly affected by the coal strike. More generally, however, retail sales, particularly of durable goods such as autos and furniture have declined, at least in terms of unit sales. Building materials also appear to be moving slowly at the retail as well as the wholesale level.

Manufacturing

District manufacturers surveyed experienced minor declines in both shipments and new orders over the past month. Backlogs of orders and materials inventories were essentially unchanged, but stocks of finished goods grew and remain above desired levels. Manufacturing employment also declined in recent weeks, but the length of the average work week was unchanged. Current plant and equipment capacity also remains somewhat in excess. Nearly half of the manufacturers responding to the question on the effects of the recent strength of the dollar report that business has been affected. From this sample it would appear that export demand for textile products, primary metals and machinery and equipment has declined as a result of the dollar's appreciation. One textile manufacturer reports a drastic decline in export demand. A major manufacturer in the machinery and equipment sector notes a significant impact on international business while another in the same line finds both import and export sectors being affected and new business opportunities restricted.

Housing and Construction

Housing and construction generally appear to have weakened further in recent weeks, although conditions vary widely from area to area. Some areas are now reporting a virtual dearth of construction. In some scattered areas housing is holding up reasonably well and in a number of localities commercial and industrial activity is supporting the industry at a modest level.

Prices and Expectations

Price increases have become significantly less widespread in the past month judging from responses to our survey. A large majority of the manufacturing respondents, for instance, report no change in prices paid or received over the month. Increases in employee compensation seem also to have moderated. This latter impression is supported by Richmond directors who perceive a moderation in wage demands by labor in their respective areas. Survey respondents still expect little change in the level of business activity over the next six months, but one-third of the manufacturers expect production in their respective firms or establishments to improve over that period. Retailers are somewhat less optimistic but most forsee little change in the level of activity nationally, locally, or in their individual firms.

Agriculture

Generally improved crop production prospects so far this year, a better quality crop of flue-cured tobacco, plus stronger demand and higher grade prices for the golden leaf, are encouraging to both District farmers and farm lenders. While these conditions suggest increased farm income, better repayment rates, and fewer renewals this fall, weather and price developments the remainder of the year will, of course, determine whether or not current favorable farm income prospects materialize.

Farm credit conditions at midyear were similar to those in the first quarter. Both the slowdown in farm loan demand at banks and growth in the availability of loanable funds continued in the second quarter but at an accelerated pace. Bank interest rates on farm loans remained volatile, registering sizable increases over rates in both the spring quarter and a year ago. There was some improvement over the previous quarter in loan repayment rates and requests for renewals. Repayment rates were below those at this same time last year, however. Liquidity pressures of banks active in farm lending rose slightly but remained well below a year earlier.

SIXTH DISTRICT - ATLANTA

An air traffic controllers' strike early in August administered another setback to a Sixth District economy that's been ailing for months.

Tourism was anemic even before the controllers walked out, with Atlanta's visitor traffic down for the first summer in the past four. Consumer retail spending has slowed and residential construction continues in the doldrums, as interest rates and prices continue to discourage buyers. Weakness is evidenced further by shrinking nonfarm employment, while selected District exports have come under pressure because of the run-up in the value of the dollar. A rise in farm costs, meanwhile, has about offset a recent gain in farm cash receipts.

Consumer Spending and Inventories. Retail sales in the District have softened somewhat recently as consumers cut back on durable goods purchases. Purchases of home furnishings have also slowed, mirroring flagging new home sales. In contrast, relatively good sales levels were reported for discount stores due to the heightened price-consciousness of consumers. Inventories are being closely monitored; no excessive accumulations were noted.

Auto dealers continue to encounter difficulties as high interest rates hold down sales. For many, though, stepped-up parts and service receipts have blunted the impact of the sales slump.

The all-item Consumer Price Index for Atlanta rose 11.1 percent from June 1980 to June 1981. Falling apparel and upkeep prices helped the index retreat from the 13 percent gain during the April reporting period. The housing component posted the largest increase.

Financial and Construction. Residential construction remains weak throughout the District. In Atlanta, the number of homebuilding permits issued showed a year-to-year decline for the second consecutive month in June. The trade-up market has been particularly hard hit. Upwardly mobile families no longer are buying newer or larger houses every three to five years. According to a real estate expert, a lot of people are in houses they could not afford to buy today.

The high level of interest rates is not the only factor being blamed for the slowdown. High home prices are hurting sales. Inflation has dramatically changed the availability of homes at various price ranges in just one year. Today, 39 percent of sales in south Florida are for more than $100,000 and 10 percent are under $50,000. One year ago, the $100,000 plus share was 19 percent and the share under $50,000 was close to 18 percent.

Savings and loan associations have begun to see a flurry of activity since the interest rate "caps" were liberalized on the "small saver" accounts. It is still too early to evaluate the impact of the change, but contacts indicate sales of these certificates are brisk.

The commercial and industrial construction picture appeared strong in the District during the first half of 1981. In Florida, contracts soared 61 percent over last year. Florida, Louisiana, and Tennessee ranked among the top five states with $400 to $600 million in industrial contracts during the period despite slipping public construction.

Employment and Industry. Nonfarm employment contracted somewhat in most sectors in June following little change for the previous month. Manufacturing payroll income remained basically unchanged, as hours worked and weekly earnings advanced only slightly.

The air traffic controllers' strike is more bad news for many businesses connected with the convention and tourist trade, already faring poorly so far this summer. Local officials attribute the problems to the high prices of fuel, airplane tickets and motel rooms. A promotional campaign for both Atlanta and Jacksonville, Florida, aimed at attracting travelers from neighboring states, has been undertaken.

Spot checks reveal that many companies are bracing for a drop in business during the traffic controllers' strike. A major hotel announced that it would cut rates by 50 percent for any stranded passengers, a move to fill empty rooms caused by cancellations. August had been traditionally Atlanta's busiest tourism month.

District export growth varies by commodity and trading area. Soft markets for such products as poultry, textiles, phosphates and other chemicals, and timber are mainly due to the currently weak European economies and the growing foreign exchange value of the dollar. Markets for poultry, paper, and timber products in Latin America, the Middle East, and the Far East, particularly Japan, remain steady. Soybean export markets generally have weakened under increased price competition. Foreign tourist receipts are up, but the growth in numbers and spending per capita are down. First half-year 1981 imports of food and live animals, manufactured goods, and machinery are declining while oil imports, due to higher prices, are up over the first half of 1981.

Agricultural Highlights. Farmers increased acreages of six major crops, with cotton plantings growing most. But, dry weather is again restricting crop growth and yields most notably in Georgia and Florida.

A recent spurt in hog prices has lifted farmers price levels, and the large winter wheat crop has helped boost farm cash receipts by 10 percent from the level during the first half of 1980. However, the rise in farm costs, led by the increase in interest rates, has about offset the gain in cash receipts.

SEVENTH DISTRICT--CHICAGO

Summary. Economic prospects for the Seventh District have deteriorated in the past month or two--at least for the short term. Most observers still anticipate improvement late this year and in 1982. Current high interest rates clearly are dampening many activities. Forecasts for a number of sectors have been scaled down. However, there is little fear of a precipitous decline such as that of the spring of 1980. The new fiscal package is viewed favorably by most executives, but no substantial early benefits for business are foreseen. Demand for workers is very weak, but some unions have won large gains in compensation and labor unrest is rising. Consumer outlays apparently slowed in July. The higher value of the dollar has encouraged some imports and discouraged some exports. Residential construction remains depressed and some nonresidential projects have been postponed. Crop prospects are favorable, but farm income continues weak.

Business attitudes. Important district industries have scaled down their forecasts for the remainder of the year. Included are agricultural, construction, and industrial equipment; motor vehicles, electronics, cement, steel, paperboard, and the airlines. Purchasing managers reported declines in employment, new orders, and backlogs in July.

Value of the dollar. The higher exchange value of the dollar has had some impact on imports and exports. A number of exporters attribute a decline in demand from Western Europe to this development. The local Department of Commerce office notes a substantial drop off in inquiries from abroad concerning availability of U.S. products.

Employment. Despite improvement from last year's depressed level in some sectors, particularly motor vehicles, payroll employment in our five-state area was 4 percent below two years ago in June, compared with a rise for the nation. Total employment was off at least 5 percent in the two year comparison in Indiana, Iowa, and Michigan, and manufacturing was off more than 11 percent in these states. Help-wanted ads are about at last year's reduced level. Employers report very heavy response to ads for vacancies of various kinds. Very few employers, public or private, are hiring actively.

Labor unrest. Despite slack job markets, various labor groups have obtained large gains in recent negotiations. In the building trades, carpenters, cement masons, and laborers won 10.5 percent first year increases in wages. Heavy equipment operators struck on July 20 in the Chicago area after turning down an offer of a 12 percent increase. Chrysler workers, having accepted wages well below those paid by competitors, are aggravated at reports of salary boosts for executives and designers.

Inflation. Prices of petroleum products are down slightly, and cement is off sharply. But most prices continue to rise. In July, 68 percent of reporting Chicago-area companies paid higher prices than in June and only 2 percent paid lower prices, a marked acceleration compared with a year ago. Business equipment prices will average at least 10 percent higher this year. Even larger increases are being reported for utilities and mass transit.

Inventories. Further involuntary increases in inventories have occurred in motor vehicles, farm and construction equipment, and, possibly, steel. Most other retailers and manufacturers insist stocks are under close control.

plus 3 points and fees. Few potential buyers can manage the high monthly payments. S&Ls are now offering AMLs, some exclusively. Much of the lending activity at S&Ls involves transfers of existing loans with "blended rates", and a variety of novel features. Some S&Ls have been forced into joint ventures with builders to avoid foreclosing on projects.

Nonresidential construction. Since July 20 the equipment operators' strike has halted work on many projects in Northern Illinois. Starting last spring many smaller commercial projects were postponed because of high interest rates. In July work was stopped on two large buildings for similar reasons. Foreign investors are providing financing for large downtown buildings in increasing volume.

Agriculture. District crops are rated "good to excellent" following near ideal weather. Harvest estimates have been scaled upward. Crops in the eastern Cornbelt remain vulnerable to an early frost because of late plantings. Corn and soybean prices are now well below year ago levels. Export demand remains sluggish. District farmland values rose about one percent in the second quarter to a level almost 14 percent above year ago. (These prices have quadrupled since 1973.) The slower rate of increase in the first half is attributed to low farm earnings and high interest rates. District agricultural banks have ample funds, but loan demand remains slow. Loan rates at these banks are at a new high and are above the rates charged by other farm lenders.

EIGHTH DISTRICT--ST. LOUIS

Economic activity in the eighth district has remained sluggish in recent weeks according to area business representatives. Retailers reported that real consumer spending was generally flat in July, and some inventory accumulation occurred for air conditioning equipment and other mid-summer sale items. Overall, manufacturing activity has shown no marked change. Sales of building supplies, metals, and some chemicals have weakened, whereas sales of energy-efficient equipment, oil and gas drilling equipment, and military hardware continue to rise. Home construction remains at a very low level, and numerous bankruptcies of small builders were reported. In the financial sector, little overall change in loan volume has occurred. Savings and loan associations are beginning to offer mortgage loans with adjustable interest rates, and officials of these institutions are pleased by the inclusion of the tax-exempt saving certificates in the recent tax legislation. In the agricultural sector, crops are generally in excellent condition.

Consumer Spending. Retailers report little strength in consumer spending in recent weeks. Some department store representative noted that sales have been holding up fairly well, but others noted a softening in early July. Inventories of some items, particularly air conditioning equipment, were reported excessive, but the excesses were expected to be eliminated by late August. On the whole, car dealers report no improvement in sales, although a few individual dealers reported gains based on heavy advertising campaigns.

Manufacturing. Manufacturing activity remains generally unchanged as gains in some industries have been offset by declines in others. Automobile manufacturing continues at the low level of recent months. Manufacturers of various building materials, such as lumber, gypsum, and connector plates, report weakening sales as homebuilding continues to decline. Primary metal producers also report sluggish sales. Steel producers report that a weak domestic market and stiff foreign competition have reduced their sales, and aluminum producers indicate that declines in foreign sales have adversely affected their business. Chemical manufacturing representatives report increased sales of agricultural and specialty chemicals, whereas those products tied closely to the housing and automobile markets remain sluggish. On the other hand, manufacturers of oil and gas drilling equipment report increasing sales. Military equipment producers also report that backlogs of orders have increased.

Construction. Despite substantially higher interest rates, housing permits issued in the St. Louis metropolitan area during the first half of this year have averaged somewhat above the very low level of a year ago. Unlike last year, however, builders do not expect a significant pick up in building in the second half of the year, and bankruptcies are occurring in the industry with increasing frequency. In St. Louis, 14 small builders have filed for bankruptcy since April. Nonresidential construction continues at a strong pace based to some extent on large backlogs. New contracts, however, have fallen below the pace of a year ago.

Financial Developments. Business and agricultural loans in the district have remained essentially unchanged in recent weeks, whereas consumer loans declined and real estate loans increased. Mortgage lenders are adapting to new regulatory rules by offering the new adjustable interest rate mortgage loans. S&L officials, however, expressed little interest in the new graduated payment adjustable mortgages. One major St. Louis S&L is now offering adjustable mortgages tied to the national average cost of funds to savings and loan associations. This institution is fixing the payments for a five-year period but adjusting the rate every six months, with changes in interest payments amortized over the remaining life of the contract. S&L representatives also indicated they are attempting to encourage the turnover of existing low interest loans in their portfolios by offering below-market rates of interest to buyers of homes on which they currently hold mortgages. Mortgage interest rates continue to increase with rates commonly in the range of 16-1/2 to 17-1/2 percent.

Deposits at area financial institutions continue to increase despite stiff competition from money market mutual funds. Although passbook savings accounts at district banks continue to moderately decline, time deposits have increased rapidly. Deposit growth at savings and loan associations has been less rapid than at banks, and there are reports that some deposits, primarily, large CDs, have been moved from S&Ls to banks due to the financial condition of some S&Ls. Some S&L officials expressed optimism that the new tax-exempt saving certificates would help them compete for relatively low-cost funds.

Agriculture. Crop prospects are generally good in the district. Areas hard hit by drought last year, such as Missouri and Arkansas, have received adequate to excessive rainfall this year. Thus, low subsoil moisture conditions have not been a problem in these regions. The wheat harvest is complete and yields were very good. Some intended plantings of soybean following wheat were not realized, however, due to wet field conditions.

NINTH DISTRICT - MINNEAPOLIS

The economy of the Ninth District was sluggish in June and July. Most developments were disappointing or at best neutral. Several strikes curtailed economic activity; the recovery in district manufacturing orders apparently stalled; excess moisture curbed crop production and harvests. Farm prices continued to be weak; auto and home sales continued to be low; mining and lumbering production continued to be weak. Although the increasing foreign exchange value of the dollar affected different sectors in different ways, it does not appear to have contributed substantially to the general weakness of the economy. The one promising sign was that general merchandise sales expanded modestly.

The overall sluggishness of the district's economy was reflected in the continuing weakness in bank lending.

Consumer Spending

The improvement in general merchandise sales which began last spring continued at a modest pace this summer. Two major Minneapolis-St. Paul retailers stated that their sales rose in June and July, but not as rapidly as in April and May. Similarly, bank directors reported moderate gains in general merchandise sales this summer. These sales gains were helped by the dollar's increasing value. One large retailer said that the dollar's increasing value has held down the costs of imports, thus enabling his firm to offer more attractive prices in its discount stores.

While general merchandise sales have improved, auto and home sales have remained in the doldrums. According to regional sales managers for domestic automobile manufacturers, auto sales in June and July remained at last spring's depressed level, and according to a director from the Upper Peninsula of Michigan, several new car dealers have gone out of business. Home sales have not improved either; mortgage loan applications at Minneapolis-St. Paul S&Ls did not budge from last spring's low level.

Industrial Activity and Inventories

Industrial activity has also been sluggish this summer. Many district manufacturers continued to operate well below capacity, and the recovery in manufacturing orders noted in our last Redbook report now appears to have stalled. One large Minneapolis-St. Paul manufacturer which supplies construction inputs reported that its orders declined in June and July and were below expectations and that its customers were holding excess inventories. Other manufacturers and directors also indicated that no pickup in manufacturing activity occurred this summer.

The sluggishness in manufacturing orders cannot be attributed to the dollar's increasing value. Several Minneapolis-St. Paul manufacturers indicated that if the dollar remained high, it could eventually have an adverse effect on their overseas sales, but so far, it has not substantially affected them. Because most of these firms export specialized products that are not available elsewhere, the crucial factor influencing their sales is economic conditions in other countries, not the value of the dollar.

Like manufacturing, mining and lumbering have remained lackluster. Directors reported that coal and oil production and exploration in the western end of the district were still increasing, but that low iron ore production at the eastern end of the district cancelled these gains. In addition, weak residential building continued to depress the forest products industry at both ends of the district.

Agricultural Conditions

Growing conditions and farm prices have not improved much since our last Redbook report. Last spring drought was a big worry, but many farmers in the eastern half of the district are now worried that too much moisture will slow crop development and harvests. Although a North Dakota director in early July was anticipating excellent crop yields, he now only looks for good yields because of excess moisture.

Most prices have remained below last year's highs, and cash grain and livestock prices at Minneapolis and South St. Paul either remained the same or declined between May and July. The one exception was hog prices, which rose 22 percent during this period.

The higher value of the dollar, by depressing international demand for the district's crops, has helped keep farm prices down. An economist with a large railroad indicates that grain shipments from our district to ports for export have not been as strong as his firm anticipated. He partially attributes these smaller shipments to the dollar's higher value making U.S. grain and soybeans less competitive in foreign markets.

Labor Disputes

The sluggishness in various sectors of the district economy has recently been complicated by strikes. The district, like the rest of the country, is experiencing slower deliveries and less travel-related business because of the air traffic controllers' strike. The district is also being adversely affected by several other labor disputes. Since mid-July, 14,000 State of Minnesota workers have been on strike, reducing state services. In addition, labor disputes between residential builders and carpenters and between foundries and workers have been slowing down construction and manufacturing activity in the Minneapolis-St. Paul metropolitan area.

Financial Activity

The sluggishness in the district's economy is manifested in weak bank lending. Loans at Minneapolis-St. Paul area banks in June and July were essentially unchanged from their lackluster level this past spring. According to directors, bank lending outside the Twin Cities also continued to be weak.

TENTH DISTRICT—KANSAS CITY

Overview. Tenth District economic conditions continue mixed, with signs of weakening perhaps outweighing those of stability and improvement. Retail sales were down in July, although sales of new cars recently have been revived somewhat by dealer promotions. Purchasing agents note a decline in manufacturing activity. Inventory reductions are apparently underway at all stages, from material suppliers to retailers. Crops are in good-to-excellent condition in the District, but many farmers are under severe financial stress. Directors and representatives of the Mid-Continent Independent Small Business Association say that high interest rates are ruining many small businesses. Residential construction and automobile sales are depressed most everywhere, but business conditions otherwise vary considerably across the District. In Denver, for example, nonresidential construction is booming, while in Omaha it has virtually stopped. Bankers in energy-rich regions report heavy demand for commercial, industrial, and commercial construction loans. Elsewhere, loan demand is flat-to-weak in all categories except agriculture, where it is strong.

Retail Trade. Sales during the month of July declined at most retail stores across the District. During the last several months, sales of appliances, furniture, and other big ticket items have been relatively weak. In particular, air conditioner sales have been slack this summer compared to the summer of 1980.

Retailers say that the cost of their merchandise rose about 5-6 per cent during the first seven months of 1981, as compared with gains of about 7 per cent in total dollar sales. Nearly all cost increases have been passed on to the consumer; retailers have maintained profit margins and inventory markups.

The recent weakness in sales has left most stores overstocked, but retailers are optimistic that sales will improve in the coming fall and Christmas seasons.

Automobile Sales. Dealers say that recent promotions offering below-market financing have given a boost to new car sales, which had been "horrible" for three months "because of high interest rates and the difficulties potential buyers have in getting bank loans." Although their inventories are at historic lows, dealers are trying to reduce them more. Dealer closings continue, including four in July in Denver alone, where economic activity is generally strong.

Purchasing Agents. Almost all purchasing agents note a recent stabilizing in input prices, but only half are optimistic that this stability will continue. Suppliers are keeping inventories very low, which is lengthening some lead times. Most purchasing agents say that business has slowed, and that they are buying fewer materials than last year. About one-half say their firms have excess operating capacity, while just under half report workers on layoff.

Agriculture. Crops across the Tenth District are in good-to-excellent condition. Growing conditions have been very favorable this summer because of widespread, generous rainfall and normal temperatures, a sharp contrast to the drought conditions of one year ago. The corn crop in Tenth District states is in very good condition, having received favorable temperatures and timely rains during the critical tasselling stage. The corn crop in western Nebraska and northwestern Missouri may be the best ever. The soybean crop is also in very good condition across the District. Grain sorghum is reported in good condition in Kansas and Nebraska.

Demand for loans at Tenth District agricultural banks increased during the second quarter of 1981, and is now stronger than at anytime since

1979. The average loan-to-deposit ratio for reporting agricultural banks was 61.2 per cent at the end of June, up from 59.6 per cent at the end of March. Half the banks responding to the survey of credit conditions preferred a loan-to-deposit ratio higher than the level they reported.

Financial Developments. Reports on loan demand at Tenth District banks are mixed this month. Banks in regions serving the energy industry report continuing strong demand both in commercial and industrial loans and in the commercial construction area. Other parts of the District indicated flat-to-weaker growth in these loan categories. In the face of high borrowing costs, demand for automobile loans and for mortgages remain severely depressed across the District. Basic lending rates at the larger banks range from 19 per cent to 21 per cent.

Growth of deposits at Tenth District banks continues to be slow, with the exception of those institutions experiencing strong loan demand in the energy area. Most banks feel that the shift into NOW accounts has been completed and that recent activity in these accounts reflects the normal behavior of transactions accounts. With the exception of a few large banks using large CD's to fund loan demand, money market certificates continue to be the main source of deposit strength.

The introduction of retail RP's is not yet widespread. Much of the activity seems to be concentrated in the Omaha market, with few banks participating in Denver, Oklahoma City, and Kansas City. Most bankers are not enthusiastic about retail RP's and in most cases are introducing them only in response to competition from other depository institutions.

ELEVENTH DISTRICT--DALLAS

The Eleventh District economy continues its expansion. Wage and salary employment increased in June, manufacturing output is rising, and the pace of construction is holding. Total loans and deposits are up at commercial banks, but deposits show a slower rate of increase. Lending at S&Ls is slow as deposit losses continue. Department store sales have increased in the last month, but their growth is slightly below retailers' projections. The level of automobile sales is unchanged from last month's. The air traffic controllers' strike is not significantly affecting economic activity in the District, but airlines do not expect to recover their losses this year. Agricultural conditions are little changed from last month, except that farmers are facing higher interest rates on agricultural loans.

The demand for labor in most industries has remained firm. Employment rose from May to June in all major industry groups, and the Texas unemployment rate returned to the neighborhood of 5% in July after spending a month above 6-1/2%. Nevertheless, employment in electrical equipment, apparel, textiles, and food preparation are below year-ago levels, as sales of semiconductors remain low and some small garment manufacturers have closed.

In manufacturing, output is rising, inventories are tight in most industries other than refining, and production cost increases are moderate. Oil and gas drilling and arms purchases by the U.S. and other nations are the main sources of growth. But sales to commercial buyers of aircraft and some electrical equipment are also holding up well, and chemical and steel manufacturers report increases in new orders. Although steel producers have fairly high rates of capacity utilization and low inventories, orders had been low the past two months. Chemical producers report they have been passing cost increases through to buyers more quickly, and they attribute the modest rise in new orders to inventory building by their customers.

The pace of construction in the Eleventh District is little changed from last month. The strength of commercial construction shows few signs of slowing, and the depressed rate of housing starts persists. Most residential building is apartment and condominium construction. Prices on heavy, municipal, and utility projects are described as extremely low, held down by increased bidding from firms in other regions.

The growth of total loans at commercial banks is up since May. Respondents attribute the growth in loans to strong demand from mining and related industries and commercial construction. Consumer lending is up slightly after the decline in May that was precipitated by the rise in usury ceilings in Texas. The increase in total deposits is small. Demand deposits are declining slowly, while time and savings deposits continue to increase at a moderate pace. Respondents describe the growth of NOW accounts as slowing. Bankers in international finance are aware that the increased foreign exchange value of the dollar is affecting trade with other countries but describe its effects as difficult to single out.

Lending at S&Ls is curtailed as the loss of deposits continues. Migration to the District is supporting the limited number of closings of first-lien mortgages. Respondents at S&Ls report withdrawals from passbook as well as six-month money market certificate accounts. The use of retail repurchase agreements to bolster earnings is slowly increasing. Liquidity is above required levels but is down from the levels maintained at the beginning of the year.

Nominal sales at department stores are up 15 percent from year-ago levels. This represents a 1 percentage point rise in sales growth from June. Respondents at department stores describe sales as slightly below projections, resulting in larger inventories and more markdowns than anticipated. But inventories are not a source of concern, and the outlook for department store sales is good.

The pace of auto sales is about the same as last month. Respondents report adequate traffic at dealerships but low sales of new cars. Most purchases are financed by manufacturers' credit companies. Sales are not expected to strengthen significantly this year. Used cars are selling well, but sales volume has been held down by low inventories.

The initial impact of the air traffic controllers' strike is lessening, but airlines will not be able to recoup the resulting losses this year. Airlines are flying an average of 80 percent of their usual flights, up from 70 percent last week. Passenger loads were as low as 35 percent of capacity after the strike began (50 percent is considered the breakeven point), but airlines report that the number of reservations is rising. The Dallas Chamber of Commerce and the World Trade Center report no losses of attendance at recent conventions and wholesale markets. The volume of summer traffic--traditionally a seasonal peak--was low before the strike began, and airlines begin their reduced fall schedules soon. Regional airlines will probably withstand losses better than the trunk carriers because of their more efficient planes and route structures.

TWELFTH DISTRICT - SAN FRANCISCO

Reports from the Twelfth District indicate that economic activity is weakening. Respondants report little recent change in consumer spending, but volume remains below the level of a year ago. Consumers are especially hesitant to buy large items. Unemployment is rising, especially in construction-related industries. District homebuilding activity has slowed further recently, and sales and permit activity point to still further declines. Agriculture continues strong, but exports are beginning to slow because of the rising foreign exchange value of the dollar. Exports of aircraft and forest products also are being curtailed by currency developments. Commercial loan demand is increasing moderately, but because of business cash flow problems rather than improved conditions. Mortgage lending activity at financial institutions is nearly non-existent, with rates as high as 18 percent. Financial institutions are experiencing increasingly severe earnings pressure. Savings and loan associations are especially hard hit as a result of a continued record outflow of funds and the heavy burden of low-yield mortgage portfolios.

Consumer Spending

Respondants report little change in retail sales from the slow pace reported last month. Sales are up from year-ago levels in dollar terms but down in volume. Sales of expensive durable goods, such as appliances and domestically-produced automobiles, are said to be especially sluggish. Dealer inventories of automobiles are excessive. Retail stores throughout the area are reported to be discounting prices and advertising heavily to attract customers. Still, their inventories also are reported to be building.

Employment

Respondants throughout the District report that unemployment has been rising recently except for states where energy developments are helping to boost payrolls. Further layoffs are reported in the construction-related industries where employment already is severely depressed. Significant improvement is not expected until interest rates fall substantially. The Pacific Northwest continues to be expecially hard hit because of the heavy dependence of the forest products industry on national homebuilding activity. Aerospace industry employment has remained fairly stable in recent months as rising defense business has helped offset a slowdown in orders for commercial aircraft and electronic equipment.

Real Estate

Respondants report a further slowdown in homebuilding activity and housing sales, with areas that previously were holding up rather well now showing weakness. Developers and other sellers are lowering prices in an effort to dispose of property. Mortgage loan demand remains very slow, with few potential buyers willing or able to pay rates as high as 18 percent. There is concern that creative financing -- especially "balloon payments" -- could cause a wave of foreclosures in two or three years when refinancing is required. With the exception of a continuing boom in office building, non-residential construction appears to be slowing.

Agriculture

Crop production in the Twelfth District is generally reported as good to excellent. Bumper crops are reported for cotton, wheat, potatoes and almonds. Financial losses due to the Mediterranean fruit fly have not been great to date but could become considerable if other states renew their quarantine on California fruits and vegetables. Infestation to date has not spread to major California producing regions, and aerial spraying appears to be working. Prices for some export products are weakening, not only because of abundant worldwide supplies, but the rising foreign exchange value of the dollar.

Foreign Trade

The rising foreign exchange value of the dollar is said to be having a significant depressing effect on Twelfth District exports. Aircraft, forest products and agricultural commodities are the product lines reported to be most seriously affected. Sales of aircraft to overseas customers are being lost to French manufacturers, pulp and paper to Swedish and Canadian producers and agricultural products -- especially wheat -- to Canadian and Australian exporters. In those product lines where losses of market shares are being reported, rising costs have prevented District producers from lowering their prices sufficiently to remain competitive.

Financial Institutions

Bankers report a moderate increase in overall business loan demand and a shift in composition. Heavy increases are reported in the demand for working capital to support slow inventory turnover and aging accounts receivable. Loan demand for capital spending purposes has been decreasing however, because of substantial unused manufacturing capacity. Mortgage lending has been extremely slow, both because of the record outflow of funds from savings and loan associations and the unwillingness of potential home buyers to borrow at current high mortgage rates. Foreclosures and losses on consumer loans are reported to be increasing. Concern over the financial difficulties of S and L's is growing, and these institutions are pressing for legislation that would permit them to compete more effectively with mutual funds and reduce the earnings burden of low-yielding mortgage portfolios.