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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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PREFACE

This edition of Redbook contains a special section. In addition to preparing their regular reports on general economic conditions, District Bank staffs assembled and summarized additional information on conditions in their regional construction industries. The construction industry was selected for special attention because it appears to be playing an especially important role in the current economic recovery and because analysts have been concerned about the sustainability of the first quarter's marked pickup in housing starts.

District Bank contributions were assembled at the Federal Reserve Bank of New York, where a summary was prepared. That summary appears as an appendix to this Redbook.

SUMMARY *

Overview: District reports suggest that the recovery is gaining momentum. Consumer spending has strengthened further across the nation. Manufacturing activity is generally on the upswing, although weakness persists in some industries, capital goods for example. Lending activity is mixed, with mortgage loans showing a widespread increase and commercial loans sluggish. Agricultural conditions vary considerably; bad weather continues to plague farmers and there is no consensus on how much the payment-in-kind (PIK) program will help them. As more signs of recovery have emerged, businessmen have gained confidence that economic activity will continue to pick up through the rest of the year.

Consumer Spending

The recovery in consumer spending intensified in recent weeks, expanding both geographically and across product lines. All Districts reported continued or growing strength, except for Kansas City, where gains over 1982 were smaller than at last report. Boston reported the largest sales growth, more than 10 percent above 1982. Apparel and electronics continued to move well in most Districts. Many also noted increases in sales of furniture and other home durables, which some attributed to the recent strength in housing demand. Automobile sales strengthened in seven Districts.

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* Prepared at the Federal Reserve Bank of New York.

Retail inventories generally remained lean, but there were some signs of expansion in Atlanta, New York, Philadelphia, and Richmond. Optimism for future sales growth is widespread; only Atlanta reported expectations of weakening, and only for the short term.

Manufacturing and Mining Activity

District Banks reported that recovery in the manufacturing sector advanced broadly, but areas of weakness remained. Substantial increases in orders have led to backlogs and longer delivery times in many regions, and production has been stepped up accordingly. Average workweeks have been growing, and a majority of Districts indicated that employment was moving up as well, albeit slowly in many cases. Boston, Richmond, and St. Louis reported broad-based improvements affecting a wide variety of industries such as inks, castings, textiles, and furniture. In other Districts however, strength was narrower. In Atlanta, the signs were uneven, with revival in lumber and phosphates countered by continued slack in textiles and petrochemicals. The pickup in San Francisco was confined to housing-related and defense sectors, with many others still reducing production and employment. And Minneapolis reported that the pace of improvement slackened in all but paper and building input industries.

Capital goods and mining remained dark spots. Producers of machine tools and other business equipment have seen no turnaround and future prospects are uncertain. Chicago was concerned that few capital projects were being planned, and St. Louis and Cleveland also foresaw no improvement in the next few months. However, Boston and Philadelphia noted that businesses were at least beginning to express some interest in capital projects. Mining also remained depressed, with low energy prices hurting coal mine operators in the Midwest and Far West.

Finance

Loan activity remained mixed in almost all Districts. Commercial and industrial borrowing continued to be weak across the country; only St. Louis reported an increase in volume. Demand for consumer loans was somewhat stronger, growing in St. Louis, Richmond, Philadelphia, and Cleveland. Mortgage lending continued to pick up throughout most of the nation.

On the deposit side, funds continued to flow into MMDA and Super NOW accounts. The inflows appeared to be moderating in a few Districts though. Banks are reported using these accounts primarily to fund short-term or adjustable rate loans, and are selling off fixed rate mortgages in the secondary market.

Agriculture

Agricultural conditions varied among Districts in recent weeks. Unusually wet and cool weather continued in many parts of the country. As a result, planting of corn is behind schedule in a number of areas. Farmers in California face additional losses due to delays in plantings of important crops such as lettuce, tomatoes and onions. In Atlanta, however, recent improvement in the weather allowed farmers to make up much of their planting. In addition, Kansas farmers are expected to harvest the second largest wheat crop ever.

There was no consensus on the effects of the PIK program. Dallas, St. Louis, and Minneapolis expected the resulting crop reductions to improve the incomes of grain farmers. However, Atlanta noted the program was disrupting the poultry industry by pushing up feed prices. Some agricultural suppliers were aided by the increased spending associated with higher farm incomes, but others were hurt by the removal of land from cultivation.

Outlook

The emergence of more signs of recovery has engendered a climate of optimism. Businessmen in many Districts are now confident that strong consumer spending and residential construction will spur increases in demand through the rest of the year. Accordingly, they expect manufacturers to continue expanding output and employment. However, in Boston, New York, and Minneapolis, there still is concern that the recovery will be weaker than usual. And Chicago reports that much of the ground lost during the recession will not soon be regained in the Midwest. On the inflation front, the evidence is encouraging. While prices are beginning to edge up, economists do not foresee a significant acceleration of inflation over the next year.

FIRST DISTRICT - BOSTON

The First District is in the early stages of a recovery. Retailers are enjoying stronger sales than expected and are developing fairly optimistic plans for the future. Most manufacturers have also seen an upturn in orders, although, in contrast to the retailers, several think the recovery is weaker than normal. Interest in capital spending is apparently quite high but firms are unwilling to make commitments until the recovery is more clearly established.

Retail

Retail sales in the First District continue to outpace expectations. The strength appears to be general; no specific product lines were reported to be especially strong or weak. Sunday retail openings in Massachusetts have had a small positive effect on total sales in the state, but the other New England states are also doing well. Price increases have slowed considerably from a year ago.

The range of sales increases reported for recent months compared to a year earlier was from a "very successful" 11 percent to an "excellent" 15 percent. Two merchants mentioned that these results compare even more favorably to recent years than the nominal figures indicate, because inflation accounts for a much smaller share of the growth than has been typical recently. A pet store chain, more cyclically sensitive than many retail operations, said this pickup was stronger than usual after a recession, but the slowdown had also been more severe.

Plans are fairly optimistic over the long run. The pet store chain said they thought sales growth would slow somewhat over the next six months, but then would pick up again. They and another contacted firm have new stores in the planning stages and expressed confidence in New England's continuing growth potential.

Comparisons with other regions were mixed. A discount chain with 13 percent sales growth in New England in April contrasted that result with 4 percent for the chain nationwide. A department store chain with affiliated chains in other regions said they no longer stood alone at the head of the pack -- other regions were beginning to catch up.

Manufacturing

Most of the manufacturers contacted have seen an upturn in orders over the past several months; the products of firms reporting increases include inks, adhesives, specialty steel, bearings, castings, hardware, specialized industrial machinery and process controls. The increase in demand is said to be broadly based with no one industry or group of industries responsible for the improvement. Exceptions to the reports of increased activity come from two firms in the machine tool industry; orders are no longer declining but they have not risen from the very depressed levels of year-end. Opinions differed on how this recovery compares with past recoveries. A large manufacturer of fabricated metal products and machinery described the upturn as "typical": orders for construction related products picked up first, automotive products followed, light machinery is beginning to show encouraging signs, and heavy machinery remains depressed. Several manufacturers said the recovery has been weaker than normal; three, producing castings, bearings and control equipment, said demand has picked up a little sooner than they expected. A number noted that inquiries about capital purchases have risen sharply but customers are not following through with committments. This development was interpreted to mean that customers are planning capital programs but are waiting to see if the recovery will be sustained. One firm said that when customers do place orders they want delivery in an unusually short time period.

Several manufacturers are starting to increase employment. One, the castings manufacturer, has recalled all those previously laid off and is planning to expand. No one plans substantial layoffs, although two or three expect their workforces to fall through attrition.

In general, the firms contacted have not seen any increases in the prices of materials and components. However, one reported that the prices of nickel, cobalt and molybdenum are rising. These metals were selling at prices below the cost of production.

Construction

New England housing construction has improved markedly in recent months. Between December 1982 and March 1983 seasonally adjusted housing permits in the region jumped 89 percent. Despite the sharp increase, a building goods supply house reported no shortage of supplies in any major category -- roofing, insulation, and lumber. Lumber prices in the first quarter of 1983 were about 5 to 6 percent above year-ago levels.

Commercial office building activity continues at a vigorous rate in the major cities of the First District. Most of the projects will become available for occupancy over the next year and a half. Very few definite plans have been made for the period after 1985 but real estate brokers report that interest in further building remains high. Vacancy rates have increased, but are considered manageable.

Professors Houthakker, Eckstein, Samuelson, and Solow were available for comment this month. Their comments focused on the economic outlook, monetary policy, and the federal deficit.

All agreed that the recovery is weak and fragile. Eckstein is confident that consumer spending will pick up shortly, assuring that the recovery will not dissipate later in the year. He is concerned, however, that high "real" interest rates are limiting expansion of housing, auto sales, and capital spending. None were concerned about a near-term resurgence of inflation.

Nevertheless, Houthakker cautioned against a shift toward ease in monetary policy. He feels that technical factors are still distorting growth in the monetary aggregates, depriving the Fed of the information needed to determine whether such a shift would be appropriate. He would like to see more attention paid to a credit target. When it was pointed out to him that business loan demand has been weak, he still counseled against easier money on the grounds that it would take pressure off of Congress to deal with the deficit problem. He feels that by maintaining its current stance the Fed props up interest rates, which in turn provides Congress with an incentive to cut deficits. He is concerned about deficits several years out, not those projected for the short run.

Eckstein feels that monetary policy is pretty much on track, although ideally he would like to see short-term interest rates fall another 100 basis points. Over the next several quarters he thinks the Fed should try to stabilize short-term "real" interest rates at between 3 and 5 percent in order to promote steady, moderate growth. He warned against the "excesses fueled by cheap credit of previous postwar expansions." Like Houthakker he fears that huge deficits in 1985 and beyond could cause interest rates to rise, choking off the recovery.

Samuelson also believes that the Fed is supplying just about the right amount of stimulus to the economy, although he wishes that the near-term prospects for economic growth were better. Over 1983, he would like to see fourth-quarter-to-fourth-quarter growth of between 5 and 6 percent instead of the 4 to 5 percent currently predicted. To this end he cautions the Fed not to adopt a tighter stance, which he believes monetarist doctrine would demand at this time. In his opinion inflation will not be a problem in 1983 or 1984 because of the oil glut; dissonance in OPEC; plentiful crops, meat, and fiber; weakness in markets for primary metals; and decelerating unit labor costs. He believes that the growth rates of the monetary aggregates will regain their target ranges without a change in course of monetary policy. He urges the Fed not to try to lower the inflation rate by another 1 to 2 percent at all costs, because the sacrifices we have made over the last few years in lost profits, investment, and employment have been too great.

Solow also thinks that the rate of economic growth over the year should be higher. He thinks that the Fed should insure the recovery by easing its current stance. He doubts that a shift toward ease would fuel inflation down the road. He is not worried about the deficit in the short run and would accept measures to reduce it in 1983 and 1984 only if monetary policy were much more lenient. He concedes that three to five years from now deficits could be a problem.

SECOND DISTRICT--NEW YORK

The Second District economy continued to show evidence of recovery in recent weeks. Major retailers reported that consumer spending remained strong, and sales generally were above plans. The residential real estate market picked up further, but some slowdown in nonresidential construction was anticipated. The upswing in manufacturing spread to more areas, and firms in many industries were increasing hours and workforces. On the financial side, retail deposits at all classes of depository institutions have grown with the introduction of MMDAs and Super NOWs. The consensus among business leaders is that the economy will continue to improve.

Consumer Spending

Retailers continued to enjoy year-over-year sales gains over the past two months, despite some temporary weakness in early April. Business at most department stores was running ahead of their plans. One respondent did note, however, that promotional efforts "light-years ahead of last year" were necessary to coax shoppers into buying. Soft goods and electronics continued to be sources of strength. One merchant indicated that furniture began to pick up as well. Inventories remained at desired levels, with one store keeping them "aggressively heavy." The outlook varied by respondent. One discount chain was considering an upward revision in its sales goals, while another retailer felt that the general optimism about the economy was unfounded.

Construction and Real Estate Activity

The residential real estate market showed further improvement recently and respondents believe that an upswing is definitely underway. Both sales and starts showed healthy increases. Most of the growth was limited to high priced homes, however. Some contacts believe a further drop in mortgage rates is needed before low- and middle-priced homes will move. While no one foresees a boom, builders expressed a good deal of optimism about the next few months.

The outlook for nonresidential construction remained cloudy. Brokers reported that the absorption of office space improved in recent weeks. A number of major leases were negotiated or signed in New York City and surrounding suburbs. But observers see the pace of construction slowing. With new space being completed and vacancy rates trending up, rents have been flat and landlord concessions more prevalent. Consequently, new projects are expected to be limited.

Business Activity

The onset of recovery in the manufacturing sector was confirmed by recent reports from business leaders around the District. Areas hit particularly hard by the recession finally noted signs of an upturn, and regions that had remained relatively healthy reported somewhat faster growth. The upswing in auto-related industries has continued. Furniture orders finally rebounded, leading one supplier to that industry to believe that recent signals could foreshadow one of his best years ever. As backlogs developed and delivery times lengthened, firms picked up production schedules. Shortened workweeks became much less common. While some more layoffs occurred, such diverse industries as autos, aluminum, and communications equipment were adding to their workforces.

Outlook

Business leaders are virtually unanimous in believing that the recovery has arrived. Although there is some disagreement concerning its strength, our contacts have become more confident that the upswing will be sustained. One respondent noted that while businessmen are still cautious, they are expressing as much enthusiasm about the future as he can remember. Another believes prospects for economic growth look good for the next two or three years. But one state labor official still fears that the recovery will be one of the slowest on record.

Financial Developments

Reflecting national trends, home mortgage rates offered at banks and thrifts in the Second District have fallen by as much as 5 percentage points since last summer. While some of the institutions contacted offer only variable rates on home mortgages, most of those that offer both fixed and variable rates report that a very high proportion of new mortgages (about 75 percent) have fixed rates. In part, this reflects a narrowing of the spreads between the fixed and variable rates. In addition, most said that at least 20% of the mortgages now being made represent refinancings wherein households prefer to substitute one fixed rate instrument for another.

Many of the banks and thrifts contacted said that they are selling the bulk of their new mortgages in the secondary market. One institution specified that it is now mainly selling the fixed rate mortgages and using MMDAs to fund the variable rate mortgages. All in all, the institutions appear aware of the potential for mismatching assets and liabilities resulting from the inflow of MMDAs.

Since the introduction of MMDAs and Super NOWs, all classes of depository institutions in the Second District have gained retail deposits. The commercial banks, however, were clearly the biggest gainers, in both dollar volume and market share. According to our estimates, between mid-November 1982 and mid-March 1983, Second District commercial banks raised their share of the retail deposit market by as much as 5 full percentage points, from 30 percent to 35 percent. By comparison, in the rest of the nation it appears that the commercial bank gains in retail market share were considerably smaller. Some New York banks have expressed concern about the need to replace funding sources as the market for money-center CDs shrinks along with money market mutual funds. Perhaps because of this concern, competition for MMDA money has been particularly keen in New York City, where the rates offered on these accounts have been consistently higher than the national average.

Financial Panel

This month we have comments from David Jones (Aubrey Lanston & Co.,), Donald Maude (Merrill Lynch) and Albert Wojnilower (First Boston Corp.):*

Jones: The "critical mass" for economic recovery is now in place and the question now is whether the recovery will be moderate or brisk. The seeds of recovery were planted by a sharp decline in interest rates in the second half of last year. More recently, there has been a pick-up in demand in such interest-sensitive sectors as housing, autos, and other durable goods. In the improved economic climate, businesses cut their rate of inventory liquidation roughly in half in the first quarter of this year and some actual restocking may begin in the second quarter, thus further strengthening new orders, production, employment and income. The recovery is, however, likely to remain moderate and uneven through 1984. Serving to limit economic gains are likely to be abnormally high real rates reflecting the clash between recovery-related increases in consumer and business credit demands and excessive Federal borrowing demands arising from mounting structural deficits. Accordingly, the recovery is likely to stall from time to time as business spending on new plant and equipment remains depressed (both because of high real rates and a huge margin of unused capacity) and as U.S. exports continue weak (because of a

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* Their views of course are personal, not institutional.

strong dollar). All in all, real GNP might show gains of 5.0 percent in the second quarter, 2.0 percent in the third quarter and 4.0 percent in the fourth quarter. In 1984, the pattern might be 6.0 percent in the first quarter, 7.0 percent in the second quarter, 3.0 percent in the third quarter and 4.0 percent in the fourth quarter.

Maude: While progressing at an uneven pace, as is almost invariably the case in the early recovery phase, the present economic recovery should remain intact going into 1984 in an environment of restrained inflation and inflationary expectations. Presently, we envision a second half 1983 gain in real GNP of 5 percent and an annual rate of increase of 5.7 percent in the consumer price index. Under such conditions, private credit demands throughout the remainder of the year should remain sufficiently restrained to allow the Treasury to raise a projected 110-120 billion net new cash over the final two quarters of 1983 without much disruption to the financial markets on balance. However, even a controlled slow growth recovery runs the risk of being aborted as early as the first half of 1984 as rising private credit demands begin to clash with fiscal 1984 Treasury financing requirements exceeding $200 billion -- potentially leading to a meaningful upward spike in interest rates. Indeed, even at present real interest rate levels, the sustainability of the recovery remains tenuous. However, monetary policy is once again perceived by the financial markets as credible and latitude for further accomodation in an interest rate sense presently exists.

Wojnilower: Domestic business contacts suggest that the economic recovery is broadening somewhat and that confidence for the longer pull has increased materially. At the same time, the nearly explosive attitude displayed previously by executives in some segments of the department store, steel, and building materials industries has sobered, as what in their perception were initially extraordinary sales gains have slowed considerably. In the security markets large amounts of new issues of all types continue to be placed. Demand by foreign investors is enormous but a torrential reversal well might ensue if policies to weaken the dollar were officially adopted. During a visit to Europe last week, I gathered the impression that the reported business pickup on the continent may be more an improvement in sentiment than in performance. In France, of course, a sharp setback in business is anticipated. In the United Kingdom, Mrs. Thatcher's reelection is taken virtually for granted and people are quite sure that business is rebounding.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District in May are that business activity is generally on the upswing. Local manufacturers report substantial improvement in business conditions since March. Retailers say sales at area stores are growing steadily. Loan activity has turned mixed recently; retail lending has gained ground but commercial loans have slipped slightly. In the construction industry, overall activity is healthy.

Third District contacts foresee these trends continuing for the next six months. Gains in industrial activity and retail sales are expected to continue at a brisk pace into the fall. In the banking sector, declining interest rates should reinforce current diverging lending trends. Strong demand for housing will bolster residential construction, according to builders, but commercial demand looks weak.

REAL ESTATE AND CONSTRUCTION

Representatives of the Third District construction industry indicate that construction activity is in good shape in May. Real estate brokers report a steady increase in sales at current mortgage rates, with more sales spilling over from pre-owned homes into the market for new units. As a result, residential construction is showing the first real signs of strength in over two-and-a-half years. Builders say demand is sufficient to sustain, if not boost, the current pace of residential activity, but expansion at the present rate will press on already tight supplies of building materials. Commercial construction business has also improved recently, despite relatively high vacancy rates. Commercial developers, however, say demand for office space is very weak and expect office-building to wind down considerably.

MANUFACTURING

Respondents to the Business Outlook Survey indicate that industrial activity in the Third District continues to pick up steam. The gains reported in April and May are on a par with the vigorous growth recorded earlier this year, providing further evidence that a sustained recovery is underway. Specific indications of the pick-up include booming new orders and shipments. Producer backlogs have also increased for the first time since mid-1979, and delivery times are getting longer. Inventory liquidation continues, but some employers have begun adding to payrolls and extending working hours as activity levels have climbed.

Survey respondents are very confident that industrial rebuilding will continue and are projecting more gains for the next six months. Expanding new orders and shipments are forecast by four out of five respondents to the May survey, and businessmen are planning to hire additional workers and to lengthen the average workweek by late fall. In addition, modest growth in stock levels is foreseen, and increased outlays for capital equipment are in the works.

Increased activity is pushing industrial prices up slightly in May, according to survey results. Input costs have risen at just over one-quarter of area plants, and a few reports of price hikes for finished products have surfaced this month, too. Respondents foresee further escalation in raw material prices by November and, to a lesser extent, are planning to boost their own prices over that time, as well.

RETAIL

Sales at Third District department stores have climbed steadily through April and into May. Dollar volume is right where retail executives expected it to be, about 5 percent to 6 percent ahead of a year ago. Merchants say an improving economic climate has buoyed consumers' confidence and, as big tax refunds keep rolling in, customers are parting with more dollars. In addition, this spring's excellent weather is credited with taking the edge off the usual post-Easter sales slump. Activity remains good across the board including some new movement in durables, especially household furnishings, which are benefiting from the housing pick-up.

Retailers predict that sales will continue to grow over the next six months. Declining unemployment rates and an expanding economy are expected to provide an increasingly strong stimulus to sales. Larger tax refunds will still be a factor, according to contacts, and the mid-summer tax cut also should give retail business, particularly durable goods, a boost. Merchants are projecting that, by November, sales activity will be 6 percent to 8 percent ahead of the year before.

Stock levels are about even with those of a year ago, and retailers report a little easing in their tight grip on inventories as sales have improved. Inventories remain very lean, nonetheless, and there are no plans at the present time for further rebuilding.

FINANCIAL

Loan activity at Third District banks has turned mixed since the last Redbook. C&I loan volume, as expected, has dropped slightly since March, owing to weaker commercial loan demand and cutbacks in below-prime lending, according to contacts. Reports of commercial loan volume now range fom 6 percent below a year ago to 4 percent above a year ago. Retail loan activity, on the other hand, is building slowly. Although interest rates are still high enough to keep a somewhat tight lid on demand, consumers' attitudes toward credit have improved this spring, according to bankers. In the wake of a push by lenders, consumer loan volume has risen by 5 percent to 10 percent from a year ago. Area banking contacts say these trends in borrowing are likely to continue into the fourth quarter. Lenders expect that demand for commercial loans will be soft for the next few months. The shift to the bond market is likely to be enhanced by further declines in interest rates, and a "hesitating" economic recovery should keep capital investment plans flat until fall. Lower rates, however, are likely to bolster retail lending activity, especially if economic indicators continue to point to strength.

The prime rate has held steady at 10.50 percent at major banks in the Third District. Pressures are building, according to bankers, that should push rates down between 50 and 100 basis points by the middle of the third quarter. These pressures include good inflation news and weak demand for commercial credit. By fall, however, much of the downward pressure should begin to disappear as more consistent economic growth awakens business loan demand.

Deposit flows are still very strong in May, although activity has settled down recently. Demand deposits are a healthy 4 percent to 6 percent ahead on a year-over-year basis, down slightly from March levels. Bankers attribute that slide to April seasonal problems and a surge of IRA activity at tax time. Time deposit growth has slowed as well, indicating that the shift to MMDAs may be nearing completion. In fact, some outflows from MMDAs have been reported. Nevertheless, time deposits remain far ahead of year-ago levels.

FOURTH DISTRICT - CLEVELAND

Summary. Economic conditions continue to improve. Employment is rising and unemployment is falling. Retailers report improving sales. Manufacturing activity appears to be expanding slowly. Prices and orders for primary metals are strengthening. Construction continues to be a bright spot. Demand for fossil fuels remains weak, and farm prospects remain uncertain despite the new program to curtail production. Banks are reported to be liquid, with residential mortgage lending the only sector showing strength.

District Labor Market Conditions. Employment is rising and unemployment is falling in this District. Manufacturing employment in Ohio (nsa) rose slightly in January, February, and March, and average hours worked per week has a slowly rising trend. Recalls have begun at some firms as orders have improved but firms generally are cautious about expanding their workforce. Indexes of leading indicators point to recovery in Pittsburgh and Cleveland. Indexes for both areas have risen for five consecutive months.

Unemployment rates in the District are falling but remain well above the national average. Unemployment rates in the District's eleven largest SMSAs averaged 14.0% in March (nsa), down from 15.4% in January, and the rate fell in every SMSA except Toledo.

Retail Sales. Major retailers report improving sales. Department store sales have been very good in recent weeks. One major firm reports sales up 4 percent in real terms from the year-ago level. Another reports April sales up 1.7 percent (s.a., monthly rate) from March, and similar gains in early May. Both firms report higher priced "upscale" goods doing especially well, and both are optimistic about the sales outlook. The intensity of price promotions has ebbed some in the last two or three months. Inventories are described as "clean and lean;" neither firm plans major adjustments up or down.

A major automobile service and tire retailer reports unit volume of tire sales up 10 percent from last year and dollar volume of service sales up 7 percent. The firm describes the market as "extremely competitive," with more price cutting this year than last. Inventory levels are satisfactory and no adjustments are planned. Customers continue to replace tires only when absolutely necessary, except for buyers of "prestige" tires.

Manufacturing. Manufacturing activity appears to be expanding slowly, but capital goods production remains weak. A survey of purchasing managers reveals increases in orders and production, and stable employment. Inventories of raw materials, supplies, and finished goods are stable. Many orders are "rush," apparently because of lean inventories. Price increases outnumber price decreases by a growing margin but most prices are stable.

Preliminary results of this Bank's May survey of Fourth District manufacturers shows new orders, shipments and backlogs are rising while inventories are flat. Prices paid for supplies are generally stable, as is employment, but there is some increase in average hours worked per week.

A major producer of machine tools is very pessimistic. Except for those from the defense industry, he is obtaining practically no orders, not even for spare parts for which orders usually improve at this stage of a business cycle. He sees no sign of upturn in his business before 1984. A major producer of components for capital goods reports orders were flat in April and are likely to be flat in May.

Primary Metals. Orders and prices are strengthening for steel and aluminum. A major steel producer reports that orders for flat rolled steel had surged earlier this year as customers feared that supply might tighten, but that flurry of orders quickly died. Steel users have ceased liquidating inventory. Shipments to steel users have risen to equal steel consumption, which is rising slowly in line with the general business recovery. Steel mills are still reducing their own inventory to raise cash to offset losses from operations that are still below the break-even point. The gap is slowly closing, however, as volume and prices gradually rise.

A major producer of aluminum reports that orders have improved substantially since last fall, at times coming in at a rate that exceeded capacity. The strength in orders has come from customers hedging against rising prices and a possible strike in June, from refilling the supply pipeline after customer inventories had become too low, and from some strengthening in underlying demand, especially from housing and autos. Ingot prices have risen by half since last summer but remain below some producers' costs of production as there is strong competitive pressure for market share.

Construction. Construction continues to be a bright spot. House construction continues to rise and respondents are confident the improved level of house construction in the District can be maintained at current mortgage interest rates. House prices are firming and larger houses are being built and bought. House builders expect shortages of lumber, gypsum board, and skilled workers. Office construction is likely to remain strong in the District for another year or two as major projects already underway are carried to completion, but few new projects are being planned. Construction of shopping space is weak, but construction of general purpose industrial buildings is firm. Rental rates for non-residential properties are very soft.

Energy. Demand for fossil fuels remains weak. A director reports spot market demand for coal is practically non-existent. Small mine operators are in difficulty and their numbers are shrinking. Oil and gas exploration is drying up. There is an excess of drilling rigs, and drilling is expected to be weak for at least another year.

Agriculture. Farm income is low and prospects remain uncertain despite the payment in kind (PIK) program. A director is concerned that the PIK program may not take enough land out of production to avoid another bumper crop. Prices are rising sharply for grass seed required to prevent erosion of idled land that has more than an 8 percent grade. Commodity prices are recovering, but only because of speculation on PIK's impact. Some farmers, expecting higher prices, are fertilizing crops more heavily than usual, and others are considering reducing the amount of land they will withdraw from production.

Some farms still are being sold at distress prices but others are now selling at reasonable prices. Another director reports farm equipment sales are rising and dealers are accepting PIK commodity warrants as payment for equipment. Fertilizer sales are reported to be slow.

Commercial Banks. Banks are very liquid, putting downward pressure on interest rates as residential mortgage lending is the only sector with strong demand. Inflows of deposits to MMDAs are reported slowing, especially as offered interest rates are lowered toward market rates. Business loan demand is soft, while consumer loans are up a bit. Bankers report getting a smaller-than-usual share of automobile financing business. Residential mortgage lending activity continues to grow rapidly, and the proportion of it used to refinance older high-interest rate mortgages is shrinking.

FIFTH DISTRICT - RICHMOND

Overview

A broadly based economic expansion appears to have gotten underway in the Fifth District in recent weeks. In the manufacturing sector, shipments and new orders rose across a wide front. Order backlogs, employment, and the average work week also increased among manufacturers. District retailers also report gains in activity over the month, with sales and relative sales of big ticket items having both increased. In addition, the construction industry has begun to gain support from the housing sector, at least in the metropolitan and resort areas. The outlook among District businesses is generally positive. Prices remain relatively stable. Inventories, despite modest recent increases, are at comfortable levels.

Manufacturing

Gains in shipments, orders, and order backlogs have been widespread among Fifth District manufacturers in recent weeks. Most industries appear to be sharing in these gains, but some, like textiles and furniture, seem to be leading the way. Also, these recent gains are beginning to affect the production side. Manufacturing employment edged up over the month, while the length of the average work week rose across a broad front. Stocks of materials were up slightly, but finished goods on hand held steady. Nonetheless, total inventories seem to be very nearly in line with desired levels. Current plant and equipment capacity, however, remains somewhat in excess of present needs.

Consumption

Most evidence points to a fairly substantial rebound in consumer spending since our last survey. Sales appear to have advanced broadly in most areas, although some rural areas appear to be lagging in this respect. Retailers experienced increases in sales and in relative sales of big ticket items over the month. Our directors also note improved levels of consumer activity in most areas. The most widespread gains appear to have been in autos, although other durables and non-durables have also done well. Furniture and appliance lines are getting support from both primary and replacement markets. Activity in the housing sector has picked up sharply in some areas so that builders and new owners are actively furnishing new or recently purchased houses.

Despite the increase in sales, retail inventories are reported to have risen slightly in the past few weeks. Nonetheless, total stocks are well in line with desired levels. The feeling appears to be that retailers will continue to maintain very trim inventory positions, at best allowing their growth to keep pace with sales.

Housing and Construction

Fifth District construction and real estate activity continues to vary widely from sector to sector and from region to region. To the extent that it is possible to generalize, housing construction and sales appear much improved in the metropolitan and resort areas. In most other areas of the District, with only a few exceptions, the residential sector continues sluggish to severely depressed. There is generally thought to be very little inventory of new, finished homes and prices are characterized as stable to firming. By and large, current construction in the commercial sector consists of projects in their later stages. There appears to be little work in the pipeline. Estimates of the time before any pickup run generally in the 6-12 month range.

Materials prices are coming under upward pressure and in some cases, e.g., lumber, have risen substantially. Wages, on the other hand, are generally stable, and have been for some time. On balance, construction costs would not appear to be in for any major shocks originating within the District.

Banking and Finances

Business loan demand has been flat to slightly declining recently while consumer demand has been stable to slightly rising. Mortgage rates have generally declined to the 12-13 percent range and activity is up significantly. There is a feeling that current mortgage rates will permit a modest but sustainable recovery in housing sales and construction.

Most depository institutions seem to feel that total MMDAs consist of about 10-50 percent new money.

Agriculture

District farm credit conditions during the first quarter of 1983 remained much the same as in the previous quarter but showed signs of slight improvement over the situation a year ago. Further declines in interest rates and continued improvement in bank fund availability highlighted conditions for the second consecutive quarter. By and large, liquidity conditions at rural banks eased again, while farm loan demand remained soft. Both loan repayment rates and requests for renewals took a modest turn for the better, compared with those a year earlier. Farmland values increased for the second quarter in a row, rising moderately over the revised previous-quarter level but remaining under a year ago.

SIXTH DISTRICT - ATLANTA

Evidence of recovery continues to grow, but certain sectors, particularly agriculture and the textile and chemical industries, remain weak. Retail sales, especially of consumer durables, are still on the upswing. Construction continues the previously reported resurgence. The financial sector shows modest improvement, but uncertainty prevails in some local markets. The upsurge in tourism remains concentrated geographically, but the increase in the volume of air travel appears to be spreading.

Employment and Industry. Signs of recovery in manufacturing output and employment are uneven. Orders in the lumber industry are strengthening. After an extended period of economic slack, shipments of phosphates have revived in Florida. In contrast, output and employment in the textile industry have not yet responded to the upturn in economic activity. Nonetheless, industry representatives are optimistic. They expect increasing auto sales and new housing construction to boost orders for tire cord, upholstery, carpeting, and draperies. Still, they express concern about the cost of financing new equipment required to become competitive with foreign producers. Spokesmen for the petrochemical industry in Louisiana and Mississippi foresee little improvement in demand for petrochemicals. Engineering firms report that companies are not expanding product lines but are exploring alternatives with higher profit potential. Many establishments are shifting to more lucrative specialty chemicals.

Consumer Spending. District retailers report continued sales gains in March and April. Retail sales performance in the Southeast, especially in Orlando and Atlanta, is reportedly better than in other parts of the country. Department store officials say that current promotional activity rather than recovery in the housing industry is spurring sales and higher-than-usual inventories. Merchants expect retail sales to weaken in May but look for a strong back-to-school season. Both attendance and orders at the fall apparel buyers' market in Atlanta were up 15 percent over last year. Retailers reportedly stepped up their buying because sales have been strengthening in recent months. District motor vehicle sales in April continued the upward trend of the past few months. Automobile dealers say that sales of full-size, luxury models and light trucks are responsible for most of the improvement.

Construction. Officers of financial institutions expect mortgage rates to continue declining through May. Reports from building permit offices indicate April and May applications are at least as strong as March, during which they were up sharply in spite of bad weather. Our respondents believe the strong permit data during the first four months of the year reflect the true strength of residential housing demand. Those we polled see a general firming of house prices and in some areas outright price hikes by means of the elimination of builder buy-downs and other discounts.

Respondents in Tennessee, Mississippi, and Georgia anticipate new construction and office space absorption to be at lower levels in 1983 than in 1982. Sources in Florida, Louisiana, and Alabama are more optimistic yet cautious. Contacts report a hiatus in new construction of large shopping centers in Georgia, Alabama, Mississippi, and Tennessee. Shopping center construction in Florida and Louisiana is characterized as steady with good prospects for picking up in the near future.

Finance. Legislators in Florida and Tennessee have effectively defeated bills to allow interstate banking in their respective states. Proponents of the Florida legislation maintained that interstate banking would provide more capital for loans, expand the state's tax base, and create some healthy competition. Although tabled, the Florida bill could come up later this year. Advocates of the Tennessee legislation argued that out-of-state acquisition of some local banks would relieve the lack of confidence in the state's financial industry caused by the failure of United American Bank (UAB). Bankers claim the FDIC's failure to honor loan participations purchased by Tennessee and Kentucky banks from the now defunct UAB could further weaken some already shaken institutions.

Tourism. Contacts report an expanded increase in the volume of air traffic at regional airports. Smaller carriers are introducing service to many local airports that major airlines abandoned following deregulation. However, financial conditions for southeastern carriers remain troubled despite a slight abatement in the intensity of airfare competition. Our contacts do not expect financial conditions for District-based carriers to improve until at least the third quarter. In other sectors of the travel market strength remains concentrated geographically: Central Florida is booming, while lodgings and attractions in south Florida, Tennessee, and Louisiana languish. Atlanta's convention trade continues to be troubled by shortened stays and drop-offs in bookings although volume is up.

Agriculture. Declining demand for short-term credit by District farmers reflects continuing weakness in agriculture. Except in Georgia, loans outstanding from the Production Credit Association fell in every District state in the first quarter relative to the previous quarter. The poultry industry is reeling from the side effects of the Payment-In-Kind program. Feed grain price increases of $10-30 per ton have resulted in a 2-5¢ per dozen climb in the cost of egg production. Large supplies, a declining export market, and weak domestic demand have led to a sharp drop in egg prices here. A substantial improvement in the weather has allowed farmers to make up much of their planting, but corn and cotton crops remain behind schedule, and yield reductions on late-planted corn are possible. Corn supplies are likely to be below normal in southern states in July and August.

Panel of Economists. Our panel of economists is almost evenly divided in its recommendations for monetary policy. Half believe that current Fed policy is appropriate, and half think that money supply growth should be reduced to a steady rate, ranging from 5 to 10 percent. Similarly, about half of those surveyed expect inflation to average 4 percent in 1983; the remaining members anticipate a more rapid acceleration in prices. Almost all expect inflation to reach at least 5-6 percent in 1984. By a narrow majority, they look for the foreign exchange rate of the dollar to fall this year. The most frequently cited signs of local recovery continue to center on the construction industry—housing and commercial building, real estate, and lumber manufacturing. However, a few respondents mention improving labor markets, increases in consumer spending, and some upturn in manufacturing. No pattern is evident in regard to the next phase of recovery. Nearly everyone on our panel regards housing demand as strong enough to sustain the current pace of construction activity.

SEVENTH DISTRICT--CHICAGO

Summary. The economic picture is definitely brighter in the Seventh District, but there is scant hope that employment and output will soon regain a substantial portion of the ground lost in the steep descent from the prosperous levels of 1978. Confidence has been at least partially restored. Households are spending more freely, especially on motor vehicles and other durables. Employment appears to be rising gradually and factory hours have lengthened. Output schedules for autos and trucks have been raised. The uptrend in housing activity, both transactions and new construction, seems to have substantial momentum, assuming interest rates do not rise. Nonresidential construction remains weak with widespread evidence of overbuilding. Except for a few items such as double trailers, demand for producer goods remains very depressed. Depleted inventories of steel and other materials and components are being cautiously replenished. In the farm sector, adverse weather has delayed field work, but income prospects have improved, mainly because of PIK. The decline in District farmland value ended in the first quarter.

Caterpillar Strike. With the ending of the seven-month Caterpillar strike on April 25, one of the District's largest manufacturers resumed ordering steel, castings, and other supplies. Demand for Caterpillar's earth-moving equipment remains weak, but its inventories of finished goods and replacement parts had declined so much that sales were being lost.

Company Restructuring. Business confidence has improved to the point that "mere survival" is no longer the principal concern of hard-pressed enterprises. But many prominent District companies are emerging from the recession smaller, leaner, and less aggressive. Breakeven points have been lowered by "drastic blood-lettings", with deep cuts in supervisory and white-collar staff that will not be restored, and closings of less efficient plants that will not be reopened. Refinancing of debt will continue as opportunities develop, but new debts will be incurred only reluctantly.

Producer Goods. Demand for most capital goods produced in the District remains very slow. However, depressed lines are no longer getting worse. Moreover, a pronounced pickup has occurred in orders for double truck trailers permitted by new federal regulations. Also, sales of some types of mining and construction equipment have improved. The longer-term outlook for capital goods is clouded by the lack of large programs in the planning stage in basic industries such as steel, chemicals, electric power, and energy development.

Motor Vehicles. Auto dealers believe a solid, if moderate, rise in demand for domestic cars and light trucks is underway. Easier credit terms, improved product quality, and stronger consumer confidence are cited. Auto demand is centered in full-sized, conventional cars, which are generally in short supply. A large proportion of these cars are built to order. Recreational vehicle sales also are much improved. Auto output will not decline as much as usual in the third quarter. Rapid, "rolling" model changeovers are planned for most makes. Output of both cars and trucks will be up sharply in the third quarter from last year, but still well below the high levels of 1978.

Steel. The industry's reduced capacity to produce cold-rolled and coated sheet is fully booked for the near future, mainly because of increased vehicle production. Light structurals also have picked up. Demand for plates and large structurals remains very weak.

Retail Sales. Some large retailers are pleased with recent increases in sales, with appliances, furniture, consumer electronics, and some types of clothing showing good gains. Inventories are on the low side.

Housing. Transactions in existing homes are up sharply, particularly in the Chicago area. Many purchasers are first-time home owners, often two-income couples, who have been waiting for "affordable" mortgages. Residential construction is up by about two-thirds in the District from last year, but is less than half the level of early 1978. Prices of building materials have increased, but no significant shortages are expected if starts do not exceed the expected 1.5-1.6 million range.

Nonresidential Construction. Most types of nonresidential construction in the District will be lower this year. Office space is overbuilt, especially in downtown Chicago, and substantial concessions are offered to attract tenants. No large new shopping centers are planned, but work on small "strip" retail developments and renovations are at a good pace. Utility construction and most public works also will decline. However, highway and bridge repair work will increase substantially.

Agriculture. Cold, wet weather has substantially delayed spring field work, caused death losses and slow weight gains for livestock, and disrupted production of fruits and vegetables. However, projections of net farm income for this year have been raised. Planting intentions suggest that corn acreage will be down 31 percent in District states, and soybean acreage down 4 percent.

Our April 1 survey of agricultural bankers indicates that the downturn in District farmland values ended in the first quarter, aided by the PIK program. Each of the District states noted at least a slight upturn. Potential land buyers who had been waiting for land prices to "bottom" have reappeared, and landowners wanting to sell are less inclined to accept low bids.

EIGHTH DISTRICT - ST. LOUIS

The economic recovery in the Eighth District picked up momentum in April and early May. Retail sales continued significantly above year-ago levels, and construction activity has been robust. Orders and shipments of manufactured goods have been increasing, and inventories are relatively lean. Employment is inching up, and a few plans for future capital expansion have been revised upward. On the adverse side, many plants are operating substantially below capacity, unemployment remains high, and price increases have accelerated slightly. Expectations are widespread that economic activity will continue to expand during the summer and fall of 1983.

A recent survey of 166 executives in the St. Louis area by a local management association found that 25 percent of the businessmen expected their business will continue to be good in the next six months, another 48 percent anticipated their business will improve, 18 percent said it will remain at about the same depressed level, and 3 percent thought it would deteriorate. Six percent did not predict. A number of other respondents noted that a climate of optimism had developed, and that the mid-year tax cut should further bolster sales and production. Producers of business equipment, especially for the petroleum industry, seemed to be the least optimistic. They believed that any significant upturn for them would be delayed until at least the fourth quarter of this year.

Sales at six department stores in the District were 8 percent higher in April and early May than in the comparable period in 1982. Most types of merchandise shared in the improvement; furniture and other home furnishings sold particularly well. Two retail shoe chains reported that sales averaged 12 percent above the year-ago pace. A restaurant chain and a fast food firm also reported that business had improved. Automobile sales improved in April and early May at five dealers and declined at two dealers. A large Ford dealer sold 40 percent more cars, 25 percent more trucks and 12 percent more used cars in April and early May than in the same period last year.

Both new and existing homes have sold well since March. Reflecting the demand for homes, as well as a slight increase in orders for office buildings, construction activity has expanded. The average size of new homes, however, has decreased, reflecting high costs of construction, relatively high interest rates, and higher gas heating prices.

Most industrial firms in the District reported an increase in new orders and shipments since March. The gains were largest for consumer goods and for products sold to automobile manufacturers, residential construction contractors and related businesses. Firms producing business equipment and metals reported little change in sales or only a slight pick-up. Inventories at most firms are either at or below desired levels, a positive sign for future production. Trucking companies reported an increase in tonnage hauled, but rail and river barge traffic has changed only slightly.

Total District employment inched up, reducing the unemployment rate slightly in April and early May, but the number unemployed is still relatively high. Whirlpool is adding 2,000 workers at an Arkansas appliance plant, and many other firms have hired selectively as activity has improved. On the other hand, businessmen are still striving to control costs, and some further reductions in employment have occurred. These attritions and layoffs, however, are becoming less frequent.

While financing of District business has come from increased cash flows and from borrowing in capital markets, the demand for commercial and industrial credit at large District commercial banks also rose in April and early May. In addition, both real estate and consumer loans increased moderately at these banks. Bank deposits rose more sharply than loans, with both money market deposit accounts and super NOW accounts continuing to rise rapidly. Savings and loan associations likewise have experienced a huge inflow of funds to these new accounts, enabling them to increase their lending and improve their liquidity.

Because of unseasonally cool weather and heavy rains, planting of cotton, rice, corn and other crops in the District has been delayed. There is still time to plant these crops, however, if the weather improves. The PIK (payment-in-kind) program, which limits the amount of land in production, has provided more flexibility for timely planting. Livestock production has become less profitable than during 1982 since feed prices have risen relative to selling prices. Because the PIK program reduces acreage planted, it has adversely affected both farm implement and seed sales at many dealers. Some implement dealers, however, have had an expansion of sales, reflecting the bargain prices available and the more favorable income outlook resulting from the PIK program.

NINTH DISTRICT - MINNEAPOLIS

The previously reported upswing in Ninth District consumer spending and agriculture has continued, but the recovery in industrial activity has slackened. General merchandise and home sales were still improving in April and early May, and auto sales have begun to expand again. In addition, as expected, the Payment-In-Kind Program appears to have started to provide some relief for district farmers. The recovery in manufacturing, however, appears to have softened this spring after a spurt in early 1983. Rail and truck shipments showed only modest increases, confirming this slackening in industrial activity, and increases in airline passenger travel were also weak. Finally, lending remains sluggish at Ninth District banks.

Consumer Spending

District consumers continue to spearhead the recovery. The improvement in Minneapolis/St. Paul department-discount store sales, which began last fall, continued in April and early May, according to two major Twin Cities retailers. They say that clothing and electronics have been the best selling items. Bank directors report that outside Minneapolis/St. Paul, general merchandise sales have also continued to improve since last fall, particularly at large shopping centers.

District home sales have continued to improve as well and have sparked an increase in homebuilding. A South Dakota director indicates that home sales in Sioux Falls doubled between January and April, and other directors report increased home sales in their communities. Rising home sales, in turn, have led to a pickup in homebuilding. The executive secretary of the

Minneapolis Association of Homebuilders, for example, reports a marked increase in homebuilding this spring. District residential building permits in March were up 48 percent from a year ago. Many of the homes being built, however, are the low-priced or starter homes (costing less than $80,000).

District auto sales rebounded in April, after pausing in the first quarter. A regional sales manager for one of the nation's largest auto manufacturers states that his firm's sales in April increased 20 percent from a year ago after decreasing 8 percent in early 1983. Another sales manager reports a noticeable pickup in medium-sized car sales. The directors' generally positive remarks about April auto sales in their communities confirm these upbeat sales reports.

Agricultural Conditions

The faint signs of recovery in agriculture, which were reported previously, have intensified. The upswing in corn and wheat prices, which began in January with the announcement of the Payment-In-Kind (PIK) Program, continued in April. The Minneapolis cash corn price, for example, rose 8 percent, from $2.87 to $3.09 per bushel, between March and April; it has increased 33 percent since January. The Minneapolis cash wheat price rose 7 percent, from $4.01 to $4.31 per bushel, between March and April and has increased 13 percent since January. These increases, according to bank directors, have boosted farmers' confidence, which has resulted in some increase in farm spending. In North Dakota, for example, some implement dealers have reported increasing implement sales, while in western Wisconsin, prices have risen at farm auctions.

Although district agriculture appears to have started to recover, corn planting is behind schedule. Due to excess moisture in Minnesota, only 14 percent of this year's corn acreage had been planted by May 10; normally, 33 percent has been planted by this time. Because of PIK, however, farmers will plant only about two-thirds of their normal corn acreage. Therefore, they are less worried than usual about catching up once the fields dry out or about a late crop that might reduce yields. In contrast to corn, district spring wheat planting is on schedule.

Industrial Activity

In contrast to the further strengthening in consumer spending and agriculture, the advance in manufacturing, which began last fall, appears to have slackened in April and early May. Paper and building inputs are the only areas where directors report a continued pickup. One director, for example, reports that paper and wafer board plants in Minnesota have recently been running at capacity. Prices for these commodities have risen modestly as well, reflecting some strengthening in demand. In addition, in southern Minnesota, a manufacturer of heavy construction equipment recently recalled three-fourths of its previously laid-off workers. But even in these areas, some signs of softening have emerged. A Montana director, associated with a national forest products company, reports some letup in lumber sales in April. A large Minneapolis manufacturer of residential temperature controls recently laid off 100 of its 4,000 local employees because recent sales haven't been up to expectations. In both instances, this softening was attributed to worries about excess inventories.

Transportation

The recent softening in district manufacturing is reflected in transportation activity. This industry, which employs around 90,000 people in the district and accounts for 5 percent of district personal income, is a good coincidental indicator because it moves the goods produced by the district's major industries. An economist with a large district railroad says that this movement has recently been lackluster and that he believes the region is experiencing a "spit and sputter" recovery. His firm's rail shipments rose sharply in January, then sagged in February, March and early April, before picking up a bit in late April. Shipments of lumber products and other manufactured goods have not been as good as expected. He attributes this to business concerns about excess inventories and believes businesses are ordering smaller amounts and relying more on trucks than usual.

Trucking firms, however, have yet to see a major pickup in their business. The total truck tonnage shipped by general freight carriers from Minneapolis/St. Paul businesses has only increased modestly since early January. A trucking executive with a large general freight carrier, like the railroad economist, believes concerns about inventories are curbing shipments and says that building input shipments have been increasing faster than other shipments.

Like the transportation of goods, the transportation of people has increased only modestly. The number of people arriving and departing from the Minneapolis/St. Paul International Airport in the first quarter was up 1.1 percent from a year ago. But it was still down 10.7 percent from the high reached in 1980.

Financial Developments

Lending continues to be soft at Ninth District banks. Sixty percent of the respondents to our Agricultural Credit Conditions Survey in early April, for example, indicated that their loan to deposit ratios were lower than desired. Directors' comments about weak loan demand in their communities confirm this survey.

TENTH DISTRICT—KANSAS CITY

Overview. Tenth District business firms are generally optimistic about economic conditions in 1983. Their optimism has not been reflected in loan demand at District commercial banks, which remains unchanged for the third consecutive month. While retailers expect sales growth throughout the year, inventories are still being trimmed in many instances. Housing starts activity is strengthening, but new house sales are lagging. Wet conditions are delaying corn planting in the District, but the winter wheat crop is generally in good condition.

Retail Trade. Retailers report that nominal sales in early 1983 range from unchanged to 5 percent above last year, due largely to a rebound in home appliance sales in the last two months. Sales of apparel have tapered off. Forecasts of nominal sales growth in 1983 are in the 3 to 10 percent range. Despite increased optimism, abundant supplies and short lead times allow retailers to continue to trim inventories. Half of the respondents expect inventory levels to bottom out soon, however. For 1983 as a whole, retailers anticipate little change in prices or markups.

Purchasing Agents. A majority of manufacturers' purchasing agents report average prices of major inputs as unchanged to 10 percent higher than a year ago. Larger increases are reported for lumber, however. Most price increases have occurred in the past three months. For the rest of 1983, purchasing agents expect further increases in input prices to average less than 4 percent. With minor exceptions, respondents are not experiencing problems with lead times or material availability, nor do they expect such problems this year. Inventories are now at very low levels, and are expected to remain low for the rest of the year.

Housing and Housing Finance. Tenth District respondents report substantial increases in housing starts, especially single-family units, in early 1983 compared with early 1982. Most respondents believe that the present level of housing starts is sustainable at the current level of mortgage interest rates. Sales of new houses are not showing as much strength as starts. The current level of housing activity is putting little pressure on supplies and prices of inputs, with the exception of lumber. Further declines in mortgage rates are expected to bring further improvement in housing activity with no hindrance from supply constraints.

Most Tenth District savings and loan associations report improvement in deposit inflows in the first four months of 1983 compared to last year, due both to an improving economy and to new deposit instruments. Almost all associations expect continued gradual gains in inflows throughout the remainder of 1983. Demand for mortgage funds is also increasing. Mortgage interest rates range from 11 3/8 percent on adjustable rate loans to 13 percent on 30-year fixed rate loans. Rates declined slightly in April and are expected to decline gradually through the rest of the year.

Agriculture. The winter wheat crop in the District is generally in good condition, with some localized damage due to adverse weather conditions. Although the nation's winter wheat harvest is expected to be 10 percent less than last year, Kansas farmers should harvest the state's second largest crop ever. Wet conditions continue to delay corn planting in the Tenth District. Cattle grazing on wheat acreage idled by the PIK program is prevalent in the southern part of the District. Calving has proceeded normally with only isolated instances of unusually high death losses, despite a wet, cold spring.

While it is too early to determine the full impact of PIK on input suppliers, sales are substantially lower than last year for fuel, fertilizer, and agricultural chemicals. New machinery sales are very sluggish, though some areas report brisk used machinery and haying equipment purchases. Agricultural credit conditions are generally improved throughout the District, as indicated by increased availability of funds, higher loan repayment rates, fewer requests for loan renewals and extensions, and lower interest rates. District farmland prices remain weak.

Banking. Loan demand at Tenth District banks is unchanged from last month. Real estate lending continues to show modest growth, while demand for commercial and industrial lending is experiencing modest declines. Most District banks surveyed report that deposits continue to grow although a few have experienced a normal seasonal runoff. Demand deposits are up slightly, while both NOW accounts and Super-NOW accounts are beginning to stabilize. In contrast, most of the banks surveyed report growth in money market deposit accounts (MMDA's), with funds still being attracted from outside institutions. Money market certificates, small saver certificates, and large CD's are holding steady. The prime lending rate is either down slightly or unchanged from last month. It ranges from 10.5 to 13.25 with most banks at the lower end of the interval. Most bankers surveyed expect further small declines in the prime rate. Consumer lending rates are reported to have declined slightly.

ELEVENTH DISTRICT--DALLAS

The District economy continues to show evidence of a recovery. Electronics and construction-related manufacturing is rising, but oilfield equipment production remains very low. The District drilling rig count is unchanged, but the U.S. count has been rising steadily. District retail sales slowed in April from March's surge, but auto sales are stable. The outlook for farm income has improved. Construction continues at a rapid rate, but material availability has begun to vary. S&L construction financing and mortgage lending remain high. Deposits and bank credit are both well above levels posted a year ago.

Construction is robust in the District. The first quarter saw a record number of single-family and multifamily housing permits. Apartment construction will probably decline later this year, in the wake of rising vacancy rates, but suppliers of construction materials expect high levels of single-family homebuilding through 1984. The square footage of nonresidential projects showed surprising strength in the first quarter. This sector is expected to remain healthy all year.

The availability of materials for homebuilding is mixed. There is plenty of lumber, plywood, and particle board, but sheetrock and exterior siding are in short supply. Because of rising demand from homebuilders and steady demand from commercial construction, suppliers may have to ration sheetrock until the third quarter, when new production capacity will come on line. The supply of exterior siding had been plentiful in the District, but it is now insufficient owing to increased demand from other regions. Prices of residential construction materials have generally increased since year-end, but they will remain at or below their 1978 levels.

Manufacturers in electronics report rising sales to businesses and consumers. Production of steel rose as distributors rebuilt low inventories. Manufacturers of insulation for commercial construction expect very high rates of capacity utilization during the rest of 1983. Output of oilfield equipment remains very low.

The number of drilling rigs at work in the District states in the first half of May was slightly below April's weekly average. But several factors suggest that drilling may increase. The number of crews seeking potential drilling sites increased slightly in April. The recession appears to be over, and the price of oil is stabilizing.

Retail sales increased substantially in March, aided by an early Easter, but they rose at a much slower pace in April. Furniture and appliances are selling well, and inventories are generally at planned levels. Some stores are increasing orders to replenish stocks of consumer durables which were reduced during recent promotions. Retailers in District cities with diversified economies are optimistic about sales increases, but respondents along the Gulf and Mexican border expect slow sales all year.

Although recent shortages of more popular models have held down volume, new car sales have been stable since March, and they are much higher than a year ago. Inventories are low. Factory orders for some models are being returned unfilled. Dealers expect stable to increasing new car sales over the next few months, if discount financing continues. After special new car financing programs appeared again in April, used car sales slowed, but they picked up in early May.

Recent increases in some crop prices and widespread participation in the payment-in-kind (PIK) program have improved the prospects for farm profit margins this year. Agricultural bankers anticipate a declining rate of bankruptcies/liquidations during the rest of 1983, and they expect to be able to help marginal farmers stay in business another year.

Total deposits at the District's financial institutions continued to increase at a healthy rate in April and savings deposits were 154 percent above last year's level. MMDAs now account for 12 percent of total deposits. The first quarter's runoff of small time deposits and buildup of large time deposits continues.

In April, loans and securities at member banks were 16 percent higher than a year earlier. Bank loans grew slowly as firms' liquidity improved, and business loan demand at large weekly reporting banks remains sluggish. Real estate lending in April slowed from its first quarter pace, but it remains significantly above last year's level. Loans to consumers declined slightly in April.

S&Ls continue to fund residential construction and home purchase loans at a brisk pace. Most new residential loans are being packaged and promptly sold in the secondary market. Several S&Ls are losing money on new but unfilled apartments they built in joint ventures with developers. Increases in net deposit inflows have further improved S&L liquidity positions. Excess funds are being placed in short-term investments and federal funds. Recently, the first and second largest S&Ls and the fourth and fifth largest S&Ls merged, resulting in two associations with 114 and 110 branches, respectively. The 38th largest S&L in Texas applied to the Comptroller of the Currency for permission to open a commercial bank.

TWELFTH DISTRICT -- SAN FRANCISCO

Consumer spending and residential construction continue to lead the Twelfth District economy into recovery. Retail sales at department stores and auto dealerships continue to improve, while the decline in mortgage interest rates has held Western homebuilding and sales activity at levels far above those of a year ago. Manufacturing activity is picking up in a few important industries such as lumber and aluminum, but most of the region's capital goods and mining industries continue to experience extremely weak demand. Despite ample funds and aggressive promotional efforts on the part of the institutions, commercial and consumer loan demand at Twelfth District banks remained sluggish during April, but the banks report a significant increase in real estate lending activity.

Consumer Spending

Reports throughout the Twelfth District confirm the growing strength of retail sales in March and April. Major department store chains in Southern California reported that sales increased in both months and in April ran about 8 percent above the level of a year earlier, representing a solid gain in real terms. One respondent described sales at smaller stores, such as those selling women's apparel and shoes, as "the best in years, even better than Christmas". In the Pacific Northwest and Intermountain states, department stores also are experiencing strong year-to-year sales increases. The pickup is extending beyond apparel, which remained relatively strong even during recession, to a broader spectrum of product lines. In particular, the upturn in home sales is helping to spur sales of household goods, including furniture, appliances, and other big ticket items. Interest rate concessions by automobile manufacturers, and declining gasoline prices, have stimulated sales of automobiles and recreational vehicles. Retail credit delinquencies are returning to more normal levels.

Manufacturing and Mining

Twelfth District manufacturing industries that serve the housing and defense sectors are showing improvement. But the majority of industries--namely, those that manufacture durable capital goods--continue to reduce output and employment. Perhaps the brightest spot in the district economy in terms of a turnaround is the Pacific Northwest lumber industry. The recovery in national homebuilding activity enabled the industy to boost production during the first quarter 46 percent above the level of a year earlier and to raise prices on average by 11 percent. The region's aluminum industry also has reactivated some idle capacity. But layoffs continue in a number of other important industries however. The paper industry continues its cost-cutting efforts in the face of weak demand. In both California and Washington, the aerospace equipment manufacturing sector has been benefiting from increased defense business, but weakness in civilian markets for aircraft and electronic equipment have continued to reduce overall industry payrolls. In the Intermountain states--Arizona, Nevada, Utah--the nonferrous metals industries are once again experiencing depressed demand now that the likelihood of a copper strike has diminished. Throughout the District, capital goods industries that produce such goods as trucks, machinery and equipment and ships, have yet to experience a turnaround in demand. The decline in oil prices is depressing oil drilling activity and revenues in Alaska and California and causing layoffs at Intermountain coal and uranium mining sites.

Construction and Real Estate

The West shared in the moderate decline in housing starts and building permits recorded nationally in March, suggesting that the pace of residential construction in the district in coming months may not be quite as high as during the first two months. But housing analysts still expect regional homebuilding activity to be at least 50 percent better for the year than last year's depressed level. They stress, however, that homebuilding activity could drop much more sharply during the rest of the year if mortgage rates do not fall further. This is because homebuilders built inventory during the first quarter in the expectation that rates would fall further, qualifying more buyers. If the decline is not realized, they will be caught with excess inventory and reduce construction sharply. The fact that most of the new homes being constructed are at the lower price range and that many carry subsidized FHA/VA mortgages also suggests that the recovery will not be sustained unless rates fall further to make homes affordable to a greater segment of the public. Lower rates also are needed to offset rising home prices. In the non-residential sector, construction is reported to be slowing due to the high vacancy rates in most metropolitan areas.

Agriculture

Rain storms continued in California through April causing further adverse consequences for the agricultural sector. In addition to an estimated $300 million in crop losses sustained earlier in the year, farmers face further financial losses as a result of continued delays in plantings of important row crops such as lettuce, tomatoes and onions. Prices for these products have risen sharply in the past few months but volume has been so reduced as to result in far less than normal revenues. Also, the storms seriously reduced the prospective nut crop by preventing pollination of blooming orchards. Although prices for livestock, grains and a wide array of other farm products also rose in April, District farmers and ranchers expect 1983 to be another difficult year, with net income showing little, if any, improvement over 1982's depressed level. Large world crop supplies, weak overseas economies and the rising value of the U.S. dollar are combining to lower exports.

Financial Institutions

Although Twelfth District banks have been aggressively promoting commercial and consumer loans as an outlet for the huge inflow of funds generated by the MMDA's, demand for those types of loans remained sluggish during April. Real estate loans showed a similar pattern. But since institutions are reporting strong real estate lending activity, this probably just means that the recovery in the housing market has yet to translate into an increase in the aggregate statistics on real estate loans. Banks are noting an increase in both loan inquiries and new loan extensions which coincides with the fall in mortgage rates and consequent surge in housing starts and permits during the first quarter. An additional favorable indicator that a homebuilding recovery is underway is that the majority of the lending activity in recent months has represented new credit extensions, rather than the refinancing of old loans.

REDBOOK SPECIAL REPORT

CONSTRUCTION AND REAL ESTATE ACTIVITY

NATIONAL SUMMARY

This summary is organized around the answers to four key questions about current levels of construction activity.

- How robust is the current upturn in housing sales and construction?
- How serious is the current downturn in nonresidential construction activity?
- How sensitive would activity in the housing sector be to interest rate changes of different magnitudes and directions?
- What is the likelihood of bottlenecks and upward price pressures in the construction supplies industries?

Housing Sales and Construction

The recent upswing in housing is widespread geographically, with all Districts reporting substantial improvements over the extremely depressed levels of the first quarter of 1982. Moreover, a moderately high rate of housing construction appears to be sustainable at least through 1983. Cautious estimates by economists in the construction supply industry indicate an annual rate of housing starts of at least 1.5 million units, and the consensus among forecasters centers on levels between 1.5 and 1.6 million.

The general feeling is that a marked pickup in the underlying demand for houses has occurred, and it was not just January and February's good weather that generated the remarkably high figures for those months. Moreover, the bad weather in March was probably responsible for that month's small drop in seasonally adjusted starts, especially in the Richmond, Atlanta, and San Francisco Districts.

Most Districts reported that sales of low priced homes had picked up especially rapidly and there is an apparent tendency toward construction and sale of smaller houses. While the houses may be smaller than ever, they are apparently still being equipped with a full array of appliances. In some regions, Cleveland and Philadelphia for example, sales of medium or luxury priced homes have also picked up, but the performance of the middle and upper markets has been spottier.

While all the Districts reported current improvement, the medium term outlook is more mixed. St. Louis and Dallas have started off very strong, but starts are expected to slow considerably by the end of the year. New York and Boston report activity that is already rivaling previous peaks and regional industry observers anticipate continued growth. In the other Districts the current level of activity falls well below previous peaks, and analysts are uncertain as to what the rest of the year will bring.

Nor is there a nationwide pattern in builder confidence. San Francisco reports speculative building in anticipation of healthy sales later this year. In Richmond and Dallas contractors are only completing already-sold homes, and Philadelphia reports a substantial, but diminishing, inventory of unsold houses.

Construction of rental housing has also increased, but the strength of the upswing varies from District to District in line with the tightness of local markets. Rental markets are tight in New York and Minneapolis; loose in Atlanta, Chicago and Dallas.

In general then, while there is little doubt that a strong recovery in housing is underway, it is not at all certain that the rest of 1983 will continue as strong as the first quarter.

Nonresidential Construction

The nonresidential construction sector remained generally strong over the course of the last recession. Now, however, a slowdown is beginning nationwide as large office projects are completed and fewer new starts are planned. Vacancy rates have started to climb in most reporting regions--exceeding five percent in most places and as high as 8 percent in Chicago and 9 percent in Minneapolis. Advertised rents for office space have not declined, but several Districts report an increasing incidence of rent-reducing special deals such as one year's free rent, extensive remodelling, and free amenities. Under these conditions developers are taking a "wait and see" attitude about future construction plans. Vacancy rates will have to decline and effective rents will have to increase before office construction starts begin to increase again.

The Districts differ in the expected duration of the slowdown in commercial starts. Indeed activity has just started to pick up in Florida and in some of the smaller Texas cities. Industry analysts in New York expect 1984 to be a good year, and new projects are being talked about actively in Boston and St. Louis. By contrast, observers in Minneapolis fear that it will be three to five years before commercial construction activity begins to pick up in that District.

None of the Districts reported large amounts of new retail construction. Work on smaller shopping malls can be expected to begin later this year, about six months after the increase in housing construction activity. Only Kansas City reported current work on a large shopping mall, and an analyst of large regional retail centers does not expect any such projects to be started this year across the nation.

Sensitivity to Interest Rates

It is generally agreed that the decline in mortgage rates is the single most important factor behind the increase in housing activity. Indeed, most respondents tended to feel that a further increase in housing sales could still happen even without any additional decline in rates. The basic question, however, appears to be whether another large drop in conventional, fixed rate, 30 year mortgage interest rates--to 10.5 or 11 percent--would bring out a great many more potential buyers. Observers in Boston, Philadelphia, Atlanta and Minneapolis believe that lower rates would touch off something like a boom in housing sales. Analysts in Chicago and Dallas are more dubious on this point.

The use of variable rate mortgages, which might reduce the sensitivity of housing activity to interest rate fluctuations, does not appear to be gaining in consumer acceptance. District reports that discussed this issue indicated that the practice of "creative" financing had diminished markedly with the drop in rates. The conventional 30 year fixed rate mortgage remains, by far, the most popular home finance instrument.

The general optimism about the sustainability of a healthy market appears to be based on a widespread belief that interest rates will not increase. Several Districts report the fear that any increase in mortgage interest rates, of say fifty basis points or more, could dampen recent growth rates. Market analysts in the New York region, however, believe that activity could be sustained, even given a small interest rate increase--especially if this were taken as a sign that mortgage costs had "bottomed out" and would be increasing further in the future.

Input Prices

While there have been a few instances of temporary input shortages (notably for lumber and dry wall) and some price rises, observers do not expect any sustained pressure on construction costs through this year. Construction supply industries are operating far below capacity and are apparently capable of increasing production quickly; so it is unlikely that anything more than temporary and localized shortages will occur in the near future.

However, if mortgage interest rates do fall another percentage point or more, and if, as some predict, this leads to an annual level of housing starts closer to 1.8 than to 1.6 million, input bottlenecks and upward price pressure could begin to become problems.