

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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by the Staff

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SUMMARY *

While a number of Reserve Banks (Boston, Philadelphia, and Richmond) report further slowing in overall business activity in July, others (Chicago, St. Louis, and Kansas City) report a leveling off, and New York, Cleveland, Minneapolis, and San Francisco report signs of recovery. Economic weakness characterizes the Atlanta District, and activity in the Dallas District continues to expand slowly. With the exception of farm products, prices continue to increase but at a slower rate than previously (New York, Cleveland, and Kansas City), and some price cutting was noted in wholesale markets (Chicago). Farm commodity prices have increased rapidly in recent months. Although commercial loan demand is either flat or weak (Boston, Atlanta, St. Louis, and Kansas City), some Districts (Chicago, Minneapolis, and San Francisco) reported that mortgage lending is increasing.

Consumer spending apparently began to increase in July. An upturn in retail sales was reported in about one-half of the Districts (New York, Cleveland, Chicago, Minneapolis, and Kansas City), while most of the others reported that sales were unchanged. Automobiles and air conditioners were among the items that gained during July. Rising credit sales were apparently a factor in the increased sales in July.

Three Federal Reserve Banks (New York, Cleveland, and Chicago) reported the beginning of a slowdown in the capital goods sector. This is the first indication of a decline in this sector at New York and

* Prepared at the Federal Reserve Bank of St. Louis.

Cleveland. Chicago reported that capital goods are weakening on a broad front.

Most Districts report that retail inventories are at satisfactory levels with the exception of San Francisco where such inventories remain high. Some inventory excesses were also reported by purchasing agents in the Kansas City area. In contrast, commercial construction in the West remains plagued by materials shortages.

Manufacturing activity continues to decline in most of the Districts. Orders are down in numerous sectors such as consumer durables, steel and other primary metals, and some nondurables. Philadelphia reported another large drop in industrial activity this month, Boston reported some declines in manufacturing, and Richmond foresees further declines over the remainder of the year. Some leveling off, however, was reported by St. Louis and some rebound in manufacturing was reported by Minneapolis and by manufacturers of construction supplies in Dallas.

Residential building is beginning to recover, and commercial construction continues at a high level in those Districts where mentioned (Dallas and San Francisco). In the latter District commercial construction is described as booming. Residential construction rose somewhat in July in several Districts from the relatively low level of May and June, but remains low when compared to year ago levels. Of those Districts that commented, all except Chicago reported an upturn in residential construction in July.

Rising unemployment was reported by most Districts that commented on the subject. Further layoffs were reported by Philadelphia, Cleveland, Atlanta, and Richmond, and unemployment is expected to rise further in the

Twelfth District as the recession affects a wider range of industries. Layoffs, however, have slowed in the Minneapolis area, where unemployment remained at a relatively low 6.0 percent rate in the second quarter.

Unusually hot and dry weather conditions in July over most of the nation have reduced current and future prospects for agricultural production. Partially in response to these developments, agricultural prices have risen, and overall farm income prospects have improved. Livestock production has been affected by substantial deaths of broiler chickens (Richmond, Atlanta, and St. Louis) and by cutbacks in livestock herds due to poor pasture and range conditions (Kansas City and Dallas). These cutbacks have led to some increase in current meat supplies, but will reduce future supplies. Extreme heat and drought have also reduced crop prospects throughout the major growing areas of the nation.

FIRST DISTRICT -- BOSTON

Economic activity in the First District is slowing further. However, the character of the slowdown is essentially the same as described in earlier reports. Among manufacturers, firms which produce consumer goods or which are associated with the housing and auto industries are experiencing weak sales. High technology companies and those in the defense business are doing well. Retail sales are up significantly over year ago levels which were depressed by the gasoline shortage. There has been a slight revival in housing activity.

Surveys of manufacturers show fewer and fewer firms with increases in new orders and more and more with reductions. Declines in production and shipments are less common, but in one recent survey of purchasing managers 40 percent of the respondents reported lower production levels compared to 20 percent reporting increases. The brunt of the slowdown thus far has been felt by manufacturers of consumer goods, automotive products and items associated with the housing industry. The tire manufacturers in New England are having a particularly difficult time. Production is down at the region's sawmills. Sales of siding and roofing material are weak although the worst occurred in March and April; there has been some recovery since then. On the other hand, many of New England's high technology firms, particularly those in instruments and electrical equipment, continue to operate at high levels. The defense business remains very strong.

Aside from those firms associated with the auto industry and housing, the recession seems to be falling most heavily on firms which were

already in some difficulty. Frequently, weak sales and financial problems are attributed to inadequate management in the past rather than to the recession. One respondent in northern New England reports several closings of older, high cost operations of national companies; he does not consider the recession responsible. However, such reports are more common than during the expansion period.

The retail sales situation in the First District is difficult to assess because sales a year ago were very adversely impacted by the gasoline shortage. Most retailers have seen a significant year over year increase in sales, and those respondents with national affiliations report that sales in New England seem to be stronger than in the country as a whole. Even so, sales are probably not keeping pace with inflation. Two respondents observe that discount operations are faring somewhat better than traditional stores; this pattern is seen as a sign of recession-induced price consciousness.

In the banking sector, loan demand declined earlier in the year and is now holding steady at the reduced volume. Two smaller banks say that they are putting more emphasis on collections than selling loans. These respondents feel that the quality of loans has deteriorated. This deterioration is attributed to special factors rather than to the recession. However, as mentioned, special factors seem to be more prevalent and more acute than in the past. Mortgage demand has increased slightly.

Professors Eckstein and Samuelson were available for comment this month. Both remarked on the widespread confusion about current monetary policy. Both interpreted Chairman Volcker's congressional testimony as

"backing away from true monetarism."

Eckstein describes current monetary policy as "rudderless at sea" and fears that policy has returned to interest rate management. Until a superior alternative is known he hopes that policy will aim at reasonable growth in the aggregates.

Professor Samuelson feels it is too early in the recession for interest rates to rise. He is concerned that policy has returned to the late 1950s mode of concentrating on restraining the expansion before the recession is over. He is encouraged by the recent pick-up in monetary growth and acknowledges that "the light at the end of the tunnel" is becoming visible. Nevertheless, he warns against a "Thatcher-like crusade against inflation" with several years of below-trend growth. Such a policy has many counter-productive consequences. For example, it may encourage protectionism by invalidating the counterargument that displaced workers can find employment elsewhere.

SECOND DISTRICT -- NEW YORK

Business activity in the Second District remained weak in July, although there were some scattered signs of improvement. Consumer spending strengthened at several higher-priced department stores, but sales remained soft at other retailers. Merchants anticipate some near-term pickup in demand due to the dismantling of the credit control program. Outside the consumer sector, new orders declined further and several respondents are reassessing their capital spending plans. For the first time in the current downturn, capital goods producers reported a slowdown in new orders. But with large backlogs of unfilled orders, no production cutbacks are planned. Price pressures appear to be abating, although strong wage pressures still persist. On the financial scene, some business lending is reported to be taking place below the prime rate.

Consumer spending in the Second District strengthened in July, but the improvement was not widespread. Department stores catering to upper income customers registered moderate to strong gains. At mass marketers and discount chains, however, sales gains were negligible, although most of these retailers expect a pickup this fall from back-to-school purchases. Credit card usage has been weak at these stores but relatively normal at higher-priced retailers. Catalogue sales of specialty apparel also have declined. While domestic and foreign tourists are a source of strength at Manhattan stores, most retailers expect sales to be largely unaffected by the influx of visitors associated with the Democratic Convention. Inventories are reported to be in line with sales at all stores across the District.

Domestic automobile sales in the Second District rose moderately in July, although dealers report some weakening in recent weeks. Foreign car sales during this period were excellent, however, with unusually heavy floor traffic. Used car sales also have been strengthening. The relaxation of credit controls has had a varied impact on automobile sales thus far. Several respondents report that although financing is now more available in New York State, many customers believe that credit is still scarce and rather than risk being refused credit, continue to postpone automobile purchases. In New York City, greater credit availability was cited by respondents as an important factor in the sales upturn. Automobile inventories are lean with reports of shortages of particular models -- both compact and full-sized -- hampering sales in some instances and causing dealers to swap among themselves in other cases.

Outside of retailing, little improvement in overall business conditions has been noted. New orders slackened further at manufacturers of chemicals, steel products and photographic and optical equipment. But with few exceptions, inventories have been well-managed and little excessive buildup appears to have occurred. Indeed, for some product lines, such as plastics, fibers and fertilizers, inventories are so low that orders are beginning to rise. Other firms also expect to see a modest rise in orders as a result of customers' depleted inventories.

On a positive note, some moderation of price pressures has been reported due to easing in the cost of raw materials. Heavy energy users, however, are not benefiting from lower costs all that much. Wage pressures have shown little abatement and one chemical producer is bracing for a strike even though workers in the industry are being laid off. Capital

investment plans at several companies are under review and while spending in 1980 will go ahead as scheduled, investment outlays are likely to be reduced in 1981. Many companies plan to stretch out and defer spending rather than actually slash investment. As a result, capital goods manufacturers, which until now have been unaffected by the recession, are beginning to see a slowdown in new orders. Their backlogs are sufficiently large at present, however, that production cutbacks are not necessary. Moreover, these companies expect orders to bounce back in the first half of 1981. In general, the overall outlook of respondents is less pessimistic than it has been for the past several months. The dismantling of the credit control program is viewed as contributing to overall demand, although having little direct impact on individual companies.

On the financial side, business loan demand at large New York City banks, while stronger than in recent months, remained below the levels posted in the first quarter. Most of this weakness is attributed to a shift from bank loans to the corporate bond market and to the generally lean inventory situation. Some short-term loans to low-risk borrowers are being made at rates below the prime, although there are significant differences among the banks as to non-price lending terms. Over the remainder of the year, senior loan officers are unsure about the strength in loan demand because of the great uncertainties over the outlook for the economy.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District in July point to a slowdown in business activity. Manufacturers in the District say industrial activity has taken another large drop this month, and retailers report sales to be even with a year ago. As for the future, manufacturers anticipate an upward swing six months from now, but retail merchants expect sales to remain flat through year-end. In the financial sector, C&I loan volume is up, but remains below plan. Forecasts indicate little change through year-end as the recession bottoms out.

Manufacturers responding to the July Business Outlook Survey report another significant drop in area industrial activity. July seasonal factors have combined with the continuing downturn to produce the largest one-month drop in general business activity since December 1974. Both new orders and shipments have taken a sharp dip and producers' backlogs continue to shrink. Inventory trimming has resumed, after a temporary halt last month, and the employment situation has worsened somewhat. Both payrolls and the average workweek have declined significantly.

For the longer term, survey participants expect an upward swing in general business activity six months from now. New orders and shipments are expected to increase and manufacturers are planning to add to inventories although only marginally. The brightened outlook may be good news for labor as respondents expect to maintain the current level of factory employment and lengthen the average workweek.

Prices are up again in July in the industrial sector. Input costs are higher for about 40 percent of the survey participants and approximately 30 percent report charging higher prices for their finished goods. As for the future, nearly 80 percent of the

respondents expect to be paying more for raw materials and 70 percent plan price hikes for their products.

Area retailers report no change in sales in July as compared to the sales levels of July 1979. Local merchants had anticipated this slowdown though, and planned conservatively, so inventory-sales ratios are "in line." Sales of soft goods, particularly men's and women's apparel, are strong while big ticket items are still very sluggish. An exception to this, however, is air conditioners which, owing to the recent heat wave, are in high demand. Suburban stores are doing a little better than the center city stores with sales up slightly over last year, owing to longer operating hours and a differing market. Credit sales are down slightly but area retailers expect a turn-around of credit sales as the credit situation is resolved and stabilizes.

Retailers continue to plan cautiously as sales are expected to remain flat through year-end, despite December Christmas buying. Local merchants plan no changes in inventories. A steady, no-growth schedule will be followed as retailers hope to keep their inventory-sales ratios healthy.

Area bankers report mixed activity in July. Reports of C&I loan volume range from 3 to 11 percent over year ago figures, but are generally below plan. Consumer loans, on the other hand are down, and are expected to decline even further. Looking ahead to the next six months, most contacts are forecasting little change between now and year-end as the recession bottoms out.

Banks in the Third District are currently quoting a prime rate of 11 percent. Projections of the prime indicate a continued drop, leaving the rate 100 to 200 basis points below its current level by year-end. Deposits are up moderately at commercial banks as corporate customers increase their deposits.

Summer business at Pennsylvania and New Jersey vacation spots' is reported to be very strong this year as compared to 1979, according to spokesmen from the New Jersey shore, Pocono Mountain resorts, and area theme parks. Excellent fishing and high gas prices have kept vacationers close to home this year, benefiting the local resort areas. Tourist volume at the New Jersey shore is up 20 to 25 percent over 1979, with occupancy running 90+ percent. Pocono Mountain tourist trade is reported to be between 30 and 50 percent higher than last year and executives at the area's major amusement parks report that their business is up also, about 9 percent over last year. Despite the increase in the number of vacationers, however, less money than expected is being spent at most resorts, owing to the current recession and the drain to the Atlantic City casinos. The total effect of the casinos is unclear though. Many food and service dollars that might be spent widely over South Jersey are going to Atlantic City instead. However, Atlantic City cannot offer adequate accommodations for all its customers, and the spillover is often absorbed by the surrounding shore spots, giving their business a boost. A spokesmen from the Pocono Mountain Vacation Bureau reports a loss of their market to Atlantic City, as well, mainly senior citizens, but the gap is filled by more families and single people who are still keeping their business strong.

As for the rest of the season, officials at the summer vacation resorts are optimistic and expect to continue to increase their volume as they head into the peak of the summer season. Advance reservations in the shore area are booked as far ahead as late September to mid-October and the convention trade in Atlantic City looks good. Given continued good weather, entertainment park operators are striving to maintain the strong and steady trade they are presently experiencing.

FOURTH DISTRICT - CLEVELAND

The sharpness of the second quarter decline in real GNP has not altered the outlook among most Fourth District respondents that the recession will bottom out in the late fall and a sluggish recovery will begin in the fourth quarter. The increase in PCE during June is generally viewed as a sign that a trough for some types of consumer spending has past, but spending patterns may be irregular until early next spring. Residential construction appears also to have reached a trough in the District, but builders are still discouraged by high mortgage rates. The business sector has begun to feel the impact of the consumer-centered recession beyond the already weak steel-rubber-glass industries. Respondents expect a sharp slowing in the pace of inflation during the next quarter, but see little abatement in the underlying rate of inflation. Layoffs, especially in the steel industry, appear to have peaked, with unemployment rates through June that were still below 1973-1975 levels.

The current recession is in the process of shifting from the consumer and construction sectors to the business sector, according to several officials in the Fourth District. However, the need for long-delayed capital expansion and continued auto retooling should provide some underlying strength to the business sector. Despite the sharpness of last month's decline in real GNP, several business economists are more confident that the recovery will begin in the fourth quarter than they were early this summer. Although the recovery is generally expected to be sluggish, an auto parts supplier asserts that new car models will provide stimulus needed for a slow recovery. A steel economist cites the need to rebuild steel inventories by the fourth quarter, along with renewed orders from the auto industry, as providing additional strength to the

economy. According to a bank economist, however, the current level of consumer debt, along with job insecurity and scheduled increases in social security taxes in 1981, will prevent a strong rebound in consumer spending, especially for housing and appliances, until next spring.

Several consumer goods producers and retailers believe that the strength of the recovery in retail sales remains uncertain, but are more confident that the trough in real PCE is past. Some believe, however, that further declines in furniture, appliances, and housekeeping goods (such as paper products because of their soaring prices) are likely at least until Christmas. A major appliance producer reports that demand from dealers has been a little better than expected, partly because housing starts did not decline as much as expected and partly because hot weather induced sales of refrigerators and air conditioners. He expects the contraction in production and inventories of major appliances to end no later than next month. A supplier of packaging materials notes that nondurable goods and some durable goods, such as color TVs have held up better-than-expected. An official for a major department store chain expects a 1-2% (annual rate) increase in real PCE during the fourth quarter as auto sales strengthen, but expects a mild recovery in real PCE because of continued high inflation.

Record low levels in mortgage commitments in recent months suggest to several S&L officials that residential construction in the District may have reached a trough. Although sufficient funds are available to meet loan demand, consumers are still unwilling to accept current mortgage rates. A bank economist believes that a rate below 11% is required to produce a significant improvement in home buying. An S&L official notes that one home builder has been unable to attract customers with a 9.75% mortgage rate. An

area banker expects construction activity to be limited to completion of homes in progress, with virtually no speculative building. Mortgage rates, according to an economist with a regional FHLB in this District, have stabilized between 11-12%. However, some S&Ls have raised their rates slightly and more are expected to adjust their rates upward if demand rises much during the summer season.

The business sector, especially capital goods, has begun to soften. Despite a five month backlog, a small machine tool producer reports new orders down 30% from year-ago levels and expects at least three more months of downturn. A producer of highway and nonresidential construction materials states that new orders in June were down 10% from year-ago levels and backlogs were 13% below last year. However, the declines seem now to be leveling off as the company moves into its peak sales period. An official for an industrial construction company notes that capital goods typically lag the business cycle, but the sharpness of the declines in April and May suggests the lags may shorten in this recession.

New orders for steel probably bottomed out in May, according to a steel economist, and are now rising irregularly toward consumption, which has been weakening. Steel consumption should stabilize when an upturn begins in automotive production, probably in the fourth quarter.

The consumer price index is expected to moderate to as low as 8% by year-end, but several respondents expect accelerated inflation in 1981. An official for a major food store chain expects the July CPI to be discouraging because of food price increases, although August through October should be steady. Industrial prices will be held down by the severity of the recession and may help offset food price increases. An S&L official notes that increases

in housing prices have slowed and some builders are offering rebates. Several business economists expect inflation to rise to 11-12% rates through 1981.

Further increases in layoffs comparable to the second quarter are generally not expected. A spokesman for a steel company states that layoffs currently represent 30% of their work force that serves the auto industry and 10% for specialty steel. Layoffs continue in coal mining in southern Ohio where high sulfur steam coal is restricted by environment regulation, according to an area banker. Layoffs are also being affected by business closings among auto and real estate dealers, according to a bank official. However, a state labor market analyst reports that about 50% of unemployed workers in Ohio are receiving supplemental income. Unemployment rates among major District SMSAs ranged from 5.8% to 13.2% in May, but still average about a half percentage point below the highs in the 1974-1975 recession.

FIFTH DISTRICT - RICHMOND

Most indications are that business activity in the Fifth District continued to decline through July. Manufacturers responding to our monthly survey experienced further declines in shipments, new orders, and order backlogs. Manufacturing employment also declined, as did the average workweek. Inventories continued to rise relative to desired levels as stocks of finished goods rose broadly and materials on hand showed little change. Retailers around the District also report continued slowing of activity. Total sales and relative sales of big ticket items declined in July. Manufacturers foresee further declines in activity over the remainder of the year while retailers are coming to expect a turnaround of some magnitude in that time frame. Large banks have experienced a slight decline in total loans in recent weeks as lower volumes of commercial and industrial and personal expenditures loans were only partially offset by gains in loans secured by real estate. While the current outlook for many segments of the Districts' agricultural economy is far from rosy, farm credit conditions have improved.

Of manufacturers contacted recently over one-third experienced declines in shipments and new orders over the past month. Much of this weakness was concentrated in such industries as chemicals, primary metals, and machinery and equipment lines. Other industries, particularly textiles, apparel, furniture, and building materials and supplies appear to have held their own in recent weeks while paper lines made some gains. Nearly half of the respondents reduced order backlogs over the month. Inventories were up from the previous survey period as finished goods were accumulated by nearly half the firms and stocks of materials were essentially unchanged. Nearly half of our respondents view current stocks as excessive, a somewhat lower proportion than a month ago. Manufacturing

employment and the length of the manufacturing workweek continued to fall sharply. Approximately one-quarter of the respondents find current plant and equipment capacity in excess, but we found no sentiment whatever for cutting back current expansion plans.

On balance, retail sales among survey respondents were down but the performance of individual firms suggests that in some areas sales activity was stable to slightly improved from June. Relative sales of big ticket items were also down, but this movement, too, was not widespread. Most retailers report further inventory accumulation in recent weeks, but generally find current stocks about right. Employment at retail establishments shows no significant change from the previous survey period. Most respondents remain satisfied with the current number and size of outlets. Some respondents continue to encounter customer resistance to regular prices. There was also some mention of receivables building as customers take longer to pay bills.

Over one-third of our manufacturing respondents expect further declines in activity, nationally, locally, and in their respective firms, over the rest of the year. On the other hand approximately one-fifth now see improvement taking place over that period. All retailers surveyed, however, expect conditions to be at least as good in six months as they are now. Price increases, increasingly uncommon among manufacturers, became more widespread among retailers over the past month.

Drought and searing temperatures have cut crop prospects and broiler output, adding to the financial troubles of many farmers. But interest rates on farm loans, though still well above a year ago, have dropped markedly, reducing the cost of farm credit significantly. Bank supplies of farm loan funds, which remained relatively ample throughout the period of the expected crunch,

have improved from both the spring quarter and year-ago levels. Both loan repayment rates and the number of renewals or extensions showed improvement over the previous quarter, and collateral requirements were sharply lower. Farm loan demand at banks continued to be substantially weaker than usual, thus helping to ease the liquidity pressures that had faced some banks heavily involved in farm lending. Loan-to-deposit ratios of banks reporting in our latest survey of District farm credit conditions averaged fractionally higher than in the spring quarter but well below a year earlier.

SIXTH DISTRICT - ATLANTA

Although economic weakness still characterizes business activity in the District, record-setting temperatures and the effects they have caused received the most attention this month. Consumers are holding spending only to items needed. Residential housing construction is still weak; however, savings and loans report renewed consumer interest in loan applications. Manufacturers of carpet, steel, and aluminum have had substantial layoffs. Parts of Georgia and Mississippi were declared disaster areas due to drought-caused losses by farmers.

Layoffs and threat of layoffs, declining real incomes, and very high energy bills have all led to cautious consumer spending. Department store sales are about even with year-ago figures, implying a decline in real terms. Durable goods sales for the most part remained weak; however, purchases of window air conditioners and fans are up sharply. Several movie theaters reported long lines as patrons seek refuge from record-setting temperatures. Television sales and servicing were thriving as more people stayed home in an attempt to avoid the heat and conserve money. Consumers continued to search for bargains and limited their use of credit cards. Sales promotions are becoming more prevalent in an effort to reduce inventories.

A spokesperson for the Southern Company, a holding company for utilities in the Southeast, said that electricity demand was expected to reach a new high for the entire system in July. Generating capacity was said to be adequate, with most generating plants in good condition.

Automobile sales are still very weak. However, our central Florida, eastern Tennessee, and central Alabama directors reported recent improvement in sales. The used car market has become more active, with heightened demand for both small- and large-sized used cars.

At least temporarily, the downturn in residential housing has bottomed out. Home sales have turned up in various parts of the District. Applications are increasing considerably at savings and loans, particularly in Florida, but builders of single-family houses are not yet convinced that the housing slump is over. Residential construction is especially weak in areas with rising unemployment such as central and northern Alabama.

Loan demand is soft at many banks due to uncertainty about the duration and severity of the current recession. Delinquency rates are rising but not enough to warrant concern. There appears to be a discernible effort by businesses to reduce their outstanding loans and refrain from borrowing new money.

A substantial weakening in employment has become evident throughout the District. The latest declines have been concentrated in manufacturing, but slower growth and declines are also occurring in other sectors. Layoffs have been high in the North Georgia carpet industry, which has been harder hit than in the 1974 recession because of the construction and credit squeeze. Sixty-five percent of carpet sales are on credit. In addition to the steel plant cutback, northern Alabama has had recent layoffs in its aluminum industry due to declining demand for aluminum from the auto industry. Jobless claims have accelerated rapidly in most District states but seem to be leveling off.

The tourist trade can be characterized as mixed. While attendance at state parks is booming, more expensive commercial campgrounds are almost empty. Traffic counts along major tourist arteries have sunk appreciably since last summer. Occupancy rates at a chain of "economy motels" are only matching that of last year, and a higher priced chain reports lower occupancy rates. More families are driving at night and lodging during the day because of the heat and lower day rates.

Capital spending projects of note include plans for "Little England," a huge tourist attraction reproducing English history from the Stone Age to modern time. The \$500-million complex will be constructed near Disney World and is expected to attract more than 9 million visitors per year and employ more than 10,000 workers by completion in the late 1980s.

An expansion of the Port of Miami, announced recently, is one of the largest projects in South Florida history. By doubling its size, the estimated direct and indirect economic effect of the port will ultimately add about \$3.8 billion of income to the port.

Lockheed-Georgia Company was selected as the primary contractor for retrofitting the wings of C-5A "Galaxy" transports. A spokesman for Lockheed-Georgia reported that the retrofit program will permit the "rolling over" of 2,000 company employees currently working on the C-141 program.

The Federal Farmers Home Administration declared parts of Georgia and Mississippi disaster areas because of the heat and drought damage in June and July, making farmers eligible for low interest loans. Georgia crop losses are valued at \$450 million. Hay and pasture suffered the largest losses, followed by corn, soybeans, and peanuts. Record temperatures and high humidity have also damaged the poultry industry in Georgia and

Mississippi. Broiler prices had just begun to climb to break-even levels in Mississippi before the bird losses began. The losses are expected to result in an increase in broiler prices at the retail level. A brighter picture is that vegetables in Florida have done very well; a record tomato and watermelon crop was harvested there.

SEVENTH DISTRICT - CHICAGO

Evidence is increasing that some of worst hit consumer sectors will level off or improve moderately in the third quarter. Capital goods, however, are weakening on a broad front. Consumer and business borrowing activities are assuming more normal patterns. Price cutting is common in wholesale markets. Housing transactions are picking up. Farm income prospects have improved with higher prices.

Sectors that appear to have touched bottom in May, June, or July include retail sales of general merchandise, passenger cars and light trucks, RVs, manufactured housing, gypsum board, cement, and steel. In no case, however, has a dramatic reversal occurred. Also, the improvements are largely associated with the consumer sector.

Most business managements are pushing stringent programs to cut costs to a point that may impair their ability to respond to increases in final demand later in the year. Cost-cutting measures include layoffs (even of valued, experienced people), hiring freezes, short weeks, suspension of COLAs and various nonwage benefits, halting contributions to pension funds, paring of inventories (even to the point that standard items are not stocked), using only the most efficient equipment, deferral of all but the most essential maintenance and repair, and delaying payments of bills. Clearly, these measures will adversely affect long-term competitive strength, but they are undertaken in a spirit of quiet desperation.

Complaints of slow pay on outstanding debts by both businesses and consumers are widespread. Actual inability to pay on time is responsible in some cases, but more commonly debtors are attempting to avoid interest

costs by shifting the burden to their suppliers. Delinquencies on consumer credits have increased significantly, but are still not at the high level of 1975. Personal bankruptcies are becoming a much more serious problem, partly because of the new law. Businesses complain of a surge in bad checks, and a rise in shoplifting (already historically high). Bank robberies in the Chicago area have tripled from last year's rate.

Retail sales appear to have improved moderately since the May low. Consumers continue to buy cautiously and tend to patronize discount stores. (If K-Mart sales increase relative to Sears at the rate of the past 12 months, K-Mart will be the nation's top retailer a year hence.) Some old-line chains are expanding their discount type operations to meet competition.

Vehicle dealerships, small builders, and trucking companies continue to close their operations, some filing for bankruptcy, in numbers unknown since the early 1930s. Dealership closings, many large and long-established, will have far-reaching consequences. Not only are numerous employees involved, but a healthy dealer organization is essential for mass marketing of new and used vehicles and for servicing new cars under warranty. High interest costs for carrying inventories of slow-selling models have been a large factor in the dealer crisis. Captive finance companies have stretched their resources to help stronger dealers to survive. Dealer mergers have been tolerated and even encouraged by manufacturers.

With short lead times and unused capacity in virtually all lines, price-cutting is common in wholesale markets, including steel, nonferrous metals, and cement. Vendors are ready to negotiate prices on such items as office equipment and heavy trucks. Such concessions are thought to be a temporary reaction to weak markets.

Steel shipments are believed to have reached a low point at about 50 percent of capacity around midyear, down from 83 percent in April. Since then, there has been a slight uptrend. A smaller Chicago steel company has closed permanently. One of the largest Chicago-area mills is operating only one of six blast furnaces. Customer inventories of steel are said to be "extremely low," and any strengthening of final demand must quickly be reflected in orders for steel.

The farm and construction equipment industries continue in a slump, but there are hopes that demand will revive with the prospective improvements in farm income and residential construction. Demand for heavy trucks remains very weak. Order backlogs for rail cars are eroding. Since March, demand for capital goods has been slipping on a broad front. Notable exceptions are metal-cutting machine tools, and items related to oil and gas well drilling. A producer of large castings is operating at only 50 percent of capacity and demand for forgings, in tight supply a few months ago, has dropped sharply.

Home mortgage lending has picked up with rates in the 11-12 percent range plus 2-3 points. Housing starts remain at a postwar low for the summer months, but the unsold inventory is small and some rise in starts is seen before year end. Several large commercial buildings nearing completion in Chicago's Loop area are virtually 100 percent leased. Starts on several additional large commercial buildings will occur in the fall.

Farm income prospects improve as crop prices rise substantially in response to growing evidence that harvests will be affected adversely by weather-related damage. Crops look good in most of the Cornbelt, but pollination problems apparently will reduce yields. Hot weather also has adversely affected prospective meat supplies because of increased mortality, mainly of

chickens, and poor weight gains for hogs and cattle.

Loan demand at rural banks in the district continues soft. Partly, this reflects lagging declines in the interest rates they charge. At midyear rates on farm loans averaged about 14 percent, down only 3 points from the end of the first quarter.

Our survey of farmland values shows an average decline of 2 percent in the second quarter which followed a similar decline in the first quarter. Values still averaged about 3 percent over the year-ago level.

EIGHTH DISTRICT — ST. LOUIS

The rate of decline in economic activity in the Eighth District moderated in July, according to reports from area businessmen, and some expressed the opinion that the bottom of the recession is near. Although automobile and home sales are still below year ago levels, both showed improvement in July compared with June. Department store sales remain below year ago levels in real terms, but did not decline further in July. Manufacturing of consumer durables and primary metals has generally leveled off at well below year ago levels, after declining the first half of the year. Capital goods manufacturing continues to hold up fairly well. In the financial sector, mortgage interest rates have declined about 1/2 percent in the past month. Bankers report little change in loan demand in recent weeks but somewhat higher interest rates at the end of July. In the agricultural sector, hot and dry conditions have adversely affected agricultural production prospects in much of the District.

Retailers continue to report sluggish sales. Department store representatives note that sales are below year ago levels in real terms, but that July sales were about the same as in June. Quality items and very low-priced items are reported to be selling best. Retail margins are under extreme pressure as heavy sale promotions have been necessary to move inventories. On the other hand, automobile dealers report improved sales in recent weeks. July sales were about 80 percent of the year ago level, compared to 60 percent in the previous two months.

Substantial declines in manufacturing activity have occurred in the past three months among consumer durables, primary metals, and some

nondurables. While most manufacturers of these products report that sales are still well below year ago levels, incoming orders have not fallen further in recent weeks. For example, automobile manufacturing tended to stabilize in July. A major appliance manufacturer reported that sales are expected to remain about 20 percent below normal for the next three quarters. Representatives of paper and chemical manufacturers, however, noted some further declines in sales over the past month.

Capital goods manufacturing continues to hold up well, as only one firm contacted reported a cutback in capital expenditures. Included among items in strong demand were oil and gas drilling equipment, railroad and barge equipment, high-efficiency motors, hydroelectric turbines, and environmental equipment. Manufacturing of commercial airplanes also continues to be strong, based on a large backlog of orders built up during the past three years. No cancellations of these orders has occurred as yet, despite some decline in airline traffic. Manufacturing of military equipment is also rising and is expected to be boosted further as a result of projected increases in next year's defense budget.

Homebuilding activity has increased over the past two months, but remains at a relatively low level. Housing starts in the St. Louis metropolitan area were only about 25 percent of normal in June, up from about 10 percent in May. Starts in July, however, are expected to show further improvement. Falling mortgage interest rates are reported to be the major factor underlying the upturn. Mortgage rates have continued downward in the past month, and two of the largest S&L's in the St. Louis area are now offering mortgages at 11-1/2 percent. Loan demand at these rates is reported to be very brisk, particularly for purchases of older

homes .

Business loans at commercial banks in the District have remained unchanged in recent weeks. Fewer loans at below prime, however, were reported. Loan demand for real estate and consumer purposes was also unchanged. Deposit inflows into financial institutions continues, but at a moderate pace. The increase in passbook savings accounts, noted in June, has continued in recent weeks.

Abnormally hot and dry conditions have adversely affected agricultural production in the District. For example, during a two-week period in July, about 20 percent of the broilers ready for market in Arkansas were lost due to high temperatures. In addition, a small portion of the laying flock for broiler eggs was lost, which is likely to have adverse effects on broiler production later in the year. These weather conditions have also adversely affected crops over much of the District, but the most seriously affected areas are confined to southwestern Missouri. Very dry conditions were also reported in the soybean and cotton producing areas of Arkansas; however, recent rains have reduced the severity of the drought conditions there. Most areas report that pastures and hay crops are also in poor condition and that livestock weight gains have been slowed by both the hot weather and poor pasturage crops.

NINTH DISTRICT -- MINNEAPOLIS

Economic activity has slowed somewhat in the Ninth District, but not nearly as much as in the nation as a whole. And in July the district economy showed signs of strengthening.

Slower District Growth -- But Only Moderately

The district has had its troubles lately. Drought and low crop prices have been hurting farm income. Consumers have been hesitant to buy much of anything, but especially homes and cars. Firms in some industries have thus been receiving fewer orders and have responded by cutting back output and laying off workers. As a result, lending has weakened at district banks and savings and loan associations.

Despite these troubles, though, the district has been outperforming the nation. In the second quarter, the seasonally adjusted unemployment rate was 6.0 percent in the district compared to 7.5 percent in the nation. Consistent with that, most Bank directors report that economic activity has been considerably stronger in their communities than nationally. Much of this difference can be traced to the smaller impact the depressed auto industry has had locally. Measured by the number of people the industry employs, auto production accounts for just 2 percent of the district's economic activity, but a full 6 percent of the nation's.

July's Signals of Strength: Higher Crop Prices . . .

The district economy may stop slowing soon, for in July all the district's trouble spots showed some improvement.

The farm sector is still suffering from the drought. Some of the

district's crops and grazing lands have been irreversibly damaged by the hot, dry weather. North Dakota farmers, for example, are expected to harvest only 15 bushels of durum wheat per acre, about half as much as last year. The district's corn and soybean crops, however, could still be quite good if they get adequate moisture in August.

In spite of the drought, farm income in the district has stopped falling. This is mainly because the prices that farmers are getting for their products leaped between June and July. In Minneapolis, for instance, average cash prices (per bushel) increased from \$2.52 to \$2.82 for corn, from \$4.19 to \$4.55 for wheat, and from \$5.95 to \$6.94 for soybeans. Farm income was also buoyed in July by the administration's increased price supports for these products.

. . . Freer Spending, Fewer Layoffs . . .

District consumers seem to have started to recover in July, too. Although not yet considered strong, sales reportedly improved last month at retailers in Minneapolis-St. Paul and other parts of the district. Home buying also picked up in July, according to Bank directors. But new car and truck buying did not — though it didn't fall any further either.

The freer consumer spending has given manufacturing activity a boost. Two large Minneapolis-St. Paul manufacturers report a larger-than-seasonal increase in new orders between June and July. While business at those firms may not be back up to the level a year ago, across the district production cutbacks have slowed and so have layoffs. In Minnesota, for example, the average number of initial claims for unemployment dropped from 6,400 to about 5,000 per week between June and July, a time of the year when these claims usually don't change at all.

. . . and More Lending at S&Ls

This improved activity has not yet reached banks; their lending remained essentially unchanged in the last month. It has, however, reached savings and loans. Reflecting the pickup in home sales, mortgage loan applications at Minneapolis-St. Paul S&Ls increased 63 percent between June and July.

TENTH DISTRICT—KANSAS CITY

Business activity in the Tenth District remains sluggish, but the rapid declines experienced during spring have not continued into summer. Retailers report that sales strengthened somewhat in June and July and that inventories are at satisfactory levels. Purchasing agents report that prices have stabilized, materials are easily obtainable, and inventory levels need to be reduced. The hot, dry weather has affected the agricultural sector by reducing expected crop yields and forcing increased cattle marketings. Bankers throughout most of the District report that loan demand remains weak, while deposits have been level or rising in recent months.

A majority of Tenth District retailers report that nominal sales for the year to date are greater than for the same period last year, due primarily to a rebound in sales during June and July. The recent surge in retail sales is due in large part to the strong impact the summer heat wave has had on the sale of such items as fans, air conditioners, refrigerators, and freezers. Most retailers indicate that their merchandise costs are continuing to increase, though at a moderate rate. Most of these cost increases are being passed on to consumers so that profit margins are being maintained.

Inventories are reported by most retailers as at satisfactory levels. Tight inventory control plus recent sales gains have kept inventories at very low levels, which retailers intend to maintain throughout the remainder of the year.

Over half the purchasing agents contacted report that input prices

have risen by less than 10 per cent over the last 12 months. Most purchasing agents indicate that prices have recently stabilized, and that prices are expected to remain stable throughout the rest of the year. Almost all materials have become more easily obtainable.

Due to the slowdown in business activity, about half the purchasing agents contacted say that their materials inventories are too high, and that they plan to reduce future orders to compensate. The remainder plan to maintain cautiously low inventory levels. Most companies contacted are running at lower than normal production levels, and half the firms have laid off some workers in recent months.

Sustained hot, dry weather has placed substantial stress on spring seeded crops throughout the Tenth District. Reductions in yields are anticipated for dryland—and possibly for irrigated—crops. Estimates of corn and soybean production for 1980 continue to be reduced.

The continuing drought has caused pasture and range deterioration, leading cattlemen to increase marketings substantially in recent weeks. Yearlings and cull cows make up the bulk of the recent increase in marketings. The movement of cattle to market is expected to return to more normal levels in August, unless a continuation of the hot, dry weather causes further range deterioration.

Early marketings combined with slow herd buildup this year will probably keep beef supplies near current levels throughout 1981. Other meat production will probably decline due to cutbacks in production by both broiler and hog producers. All of these factors point toward a significant

reduction in total meat supplies next year, putting upward pressure on meat prices.

Loan demand has recently remained flat or weakened somewhat at most Tenth District banks contacted this month. The exceptions are some banks in Wyoming and Oklahoma where energy-related loans remain buoyant. Consumer loans show the greatest weakness. Agricultural and real estate loans are also generally level to down, due in part to the heat and drought recently affecting the Midwest. All but one of the banks contacted lowered their prime or base lending rates in the last month. Some of the metropolitan area bankers currently have prime rates of 10 3/4 to 11 per cent, following the lead of the large money center banks. Others, however, are at 11 1/2 per cent. Base fees at some country banks remain relatively high, 14 to 16 per cent. Most bankers contacted expect further declines in the prime rate of 1 to 2 percentage points by yearend. Loan demand is generally anticipated level to up slightly over the next few months.

Deposits at Tenth District banks have been level or rising in recent months. Six-month and 2 1/2-year certificates show the greatest strength. Demand deposits, other small time deposits, and savings deposits also appear firm. Large CD's, however, have softened recently. Most bankers contacted expect flat deposit growth in the near future. A few bankers in Oklahoma and New Mexico are more optimistic due to their relatively robust regional economies. One banker expressed concern over a possible runoff next fall in the large number of high-yielding money market certificates he issued last spring. Other bankers, however, expect their spring MMC's to be rolled over at current interest rates.

ELEVENTH DISTRICT--DALLAS

The economy of the Eleventh District continues to expand slowly in the current recession. A survey of department stores showed little improvement in unit sales, while sales of new cars have picked up slightly from their previously very depressed levels. Some pickup in speculative residential building is underway, and nonresidential construction continues its relatively strong pace. Lending at most S&L's and commercial banks is showing slight response to declining interest rates. Manufacturing output is soft, with some improvement in orders from suppliers to the construction industry. Drought conditions are having substantial impact on agricultural production in the District.

Unit sales at department stores throughout most of the District remain lackluster, although stores in the Houston and Austin areas report increases from last year's levels. Credit sales are rebounding from the low level following March 14 but remains a smaller proportion of total sales than in the previous year. Department stores continue to rely heavily on sales and promotions to generate store traffic and move merchandise. Inventory levels are generally described as desirable, although a few retailers have excess stock where sales have not met projections. The outlook for the rest of the year is optimistic, with an aggressive sales push planned for the Christmas season.

New car sales in the District are still as much as 50 percent below last year's levels, but a few dealers are reporting substantially increased sales in recent weeks. Foreign auto manufacturers have signifi-

cantly expanded market share in the last year, but domestic dealers describe the sales of larger models as currently surpassing those of smaller cars. Dealers attribute the improved sales volume to the increased availability of funds and the lower interest rates on auto loans. Most inventories of new cars are lean, and dealers' floorplan costs have eased with recent declines in the prime rate.

While residential construction permits are 32 percent below 1979's level and many unsold homes remain on the market, recent declines in interest rates and improved home sales have led some builders to begin limited numbers of speculative starts in Dallas and Houston, while such activity appears considerably stronger in San Antonio and in the Rio Grande area. Commercial construction activity has offset much of the slump in the residential sector. The number of non-residential projects underway in the Eleventh District has declined less than 9 percent from last year's levels. Commercial and industrial building activity is strongest in the Dallas-Ft. Worth area, as well as in areas where the oil and gas industry is important. Nonbuilding construction for highways and utilities shows continued strength. Projects formerly shelved are being reconsidered as interest rate drops make financing more feasible.

Demand for mortgage loans at District savings and loan associations remains sluggish, except in Dallas-Ft. Worth, where lending is brisk. In the south of the District, mortgage commitments are 9 percent below last year's levels, but much of this strength is due to loans for residential construction rather than the purchase of homes. Savings inflows are positive at S&L's, with most of the funds going into 30 month

and jumbo certificates of deposit. With yields on money market certificates currently not competitive, 30-month CD's are attracting a rising proportion of savings. S&L's are reducing the high levels of liquidity recently accumulated by repaying advances from the Federal Home Loan Bank as well as attempting to increase mortgage lending. In Dallas, rates have moved up slightly from 11 5/8 to 12 percent in response to the strength of mortgage loan demand. Elsewhere in the District, the outlook is for lower rates on mortgage loans.

Loan demand at commercial banks remains flat, except for interim construction lending to the oil and gas industry. Consumer lending continues to be soft and is declining in some areas of the District. Consumers are expressing greater interest in auto loans, but many are not willing to pay the currently high rates.

Manufacturing output in the Eleventh District continues to slump, despite a recent rebound in orders from the construction industry. Utilization of capacity for most steel manufacturers remains at about 50 percent, while producers of aluminum, chemicals, and primary nonferrous metals foresee no changes in their currently low production levels. Oil refineries are at 75 percent or less of capacity, due to substantial inventory buildup in the Gulf. Suppliers of construction steel and air conditioning however, report a 30 to 50 percent rebound in orders from the low levels at the first of the year. Manufacturers of computers and other high-technology electronic equipment have had sales growth of 30 percent over last year's levels, while sales for producers of fabricated metals and machinery

to the oil and gas industry have grown 25 percent from 1979. Inventories are lean for most of the District's manufacturers. Electrical companies report few problems in meeting demands created by the current heat wave.

The toll of the unusually hot, dry weather on the District's agricultural production is becoming substantial. Feedgrain output may be reduced by one-third or more, while livestock herds are being trimmed heavily in Southwest Texas to levels that dry grasslands can support. The impact on the District's most important crop, cotton, is not yet described as serious, although much of the crop is under stress and yield potential will decline rapidly if the current conditions continue. Approximately one-half of the nation's cotton acreage is in the Eleventh District.

TWELFTH DISTRICT -- SAN FRANCISCO

The recession continued to affect Twelfth District statistics during the early-summer period, although a few signs of an upturn have been seen in homebuilding and certain other sectors. Retail sales remained slow, inventories remained high, and manufacturers' orderbooks became slimmer during this period. Unemployment remained high, and it may continue to increase as the recession affects a wider range of industries throughout the District. Most observers now expect prices to stabilize in many non-food sectors, but in contrast, they expect food prices to rise substantially because of nationwide weather problems.

Some directors believe that the sharp declines in housing and auto sales have not yet been fully reflected throughout the economy. As a result, unemployment may continue to rise in durable-goods manufacturing and retail trade. Auto dealers, in particular, appear to be in trouble in Southern California and other regions. Some dealers have survived only because of the equity they hold in their dealership real estate.

In the retail area, many small businesses are in trouble. However, several large Southern California department-store chains posted 12 percent year-to-year gains in June -- far above the national-average increase -- and Southern California fast-food chains also reported good results. In tourism, increased cancellations are plaguing the Northwest hotel and motel industry, despite the rapid clean-up after the Mt. Saint Helens' eruptions. Resort areas untouched by ash -- such as the Oregon coast -- also are experiencing a falloff in tourist traffic, due to the recession and high energy costs.

Western railcar loadings fell about 10 percent below year-ago levels in June, because of a downturn in industrial production and a softness in the forest-products industry. One major aircraft producer reported a decline in sales because of the nationwide weakness in airline travel. Meanwhile, a major aluminum producer recorded its second highest earnings figures in history during the second quarter, despite the recession. However, aluminum sales and earnings probably will weaken in the second half because of a downturn in orders.

Homebuilders in California report a paradoxical situation: a strong demand exists for residential dwellings, but home construction remains in the doldrums. Potential buyers are experiencing financial difficulties, while the inventory of available homes is declining. Meanwhile, commercial construction is still booming throughout most of the West, although it remains plagued by materials shortages. Construction costs are expected to increase further in Southern California, because of very large wage increases recently negotiated. The Northwest lumber industry reported improved inflows of orders in the early-summer period, but production remained far below normal. Also, the unemployment rate in lumber-oriented Oregon counties remains in the range of 20-25 percent.

The short-term energy picture in California and elsewhere remains relatively bright, mainly because of reduced consumption during an abnormally warm winter plus adequate current supplies. Plenty of gasoline is now available for consumers, but the region still faces the long-term problem of import-dependency. The Northwest, meanwhile, reported a current surplus of hydro-electric power.

Most agricultural leaders reported soaring prices of farm products, such as cattle, grains, fruits and vegetables. Weather-caused shortages elsewhere in the country suggest that farm prices will remain high, leading to an upsurge in consumer food prices later in the year. In the Northwest, the Mt. Saint Helen's eruptions created significant damage to apple, pear and hay crops -- although recent damage estimates are far below those reported just after the eruption.

Financial institutions throughout the West reported an increase in passbook savings. For example, one major bank in Southern California witnessed a savings inflow of \$10 million per day in late June. In this area, certificates with 2 to 3-year maturities were also strong, although some weakness was evident in the sale of money-market certificates. Commercial-loan demand remained weak in California, except from construction firms. Some improvement was evident in real-estate loan applications, which should later be translated into an upturn in housing starts.

Many small business firms throughout the West are still very cautious about borrowing plans. The first-half interest-rate volatility, as well as the abrupt recession-caused decline in demand, have reduced borrowing needs of such firms. Small businesses apparently have been increasing their commercial-loan demand only slowly in response to lower interest rates.