

CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Overview. Reports from Reserve Banks this month are, on balance, more cheerful than were those of last month, at least with regard to both current and prospective business activity. The improvement in the assessment of business conditions is attributable primarily to several Districts who see the recession as having bottomed out or as ending soon. Several other Reserve Banks, however, continue to report weakening economic activity, with no prospects for a recovery beginning before the end of the year. With regard to inflation, a consensus view is not clearly discernible. Some Districts report an easing of price pressures at the materials and retail levels because of weak demand, while others hear nothing from manufacturers that suggests a slowing rate of inflation. Most Districts report slowly rising deposits at commercial banks and at thrift institutions. Commercial banks say their interest rates are higher and their lending is on the weak side. The most notable development appears to have been in mortgage lending, where renewed strength is being sapped by rising mortgage rates.

Business Conditions and Outlook. Production and sales in the United States stabilized further in recent weeks and prospects for recovery improved, judging from Reserve Bank reports. Boston, Philadelphia, Richmond, St. Louis, and Minneapolis, who last month reported further deterioration in their District economies, now report business conditions are firming up. Atlanta and Chicago are also more upbeat in their assessments this month. Cleveland respondents still expect a sluggish recovery will begin next quarter. Dallas sees a quickening in the pace of economic activity, up from the slow rate of expansion reported last month. San Francisco identifies several favorable developments,

*Prepared by the Federal Reserve Bank of Kansas City

but believes the recession has months to go, while New York and Kansas City report, as they did a month ago, continued weakness in their District economies, with a likelihood of more weakening until yearend.

Prices. Weak demand is apparently reducing price pressures at the retail and commodity levels. St. Louis, Kansas City, and Dallas report reduced profit margins at retail stores, where cost increases are being absorbed rather than passed on, and prices are being cut to move merchandise. Boston and Chicago are hearing about moderation in price pressures for some materials, but manufacturers responding to Philadelphia and Richmond say they can relay no evidence of relief from inflation. Recent increases in farm product prices are reported by Chicago, Minneapolis, and Kansas City. Chicago and San Francisco call attention to the inflationary implications of the rising cost of inputs, especially labor.

Financial Developments. Commercial bank lending continues sluggish except in parts of the Southwest, and scattered exceptions elsewhere. Weakness in consumer credit is explicit in the reports of most Reserve Banks, and implicit in the rest. San Francisco says financial institutions are concerned that the rise in interest rates may result in deposit outflows, although neither San Francisco nor any other Reserve Bank tells of any decline in deposits. Atlanta notes the rapid growth of international banking in south Florida.

Consumer Spending. Lackluster retail sales characterize District reports. Atlanta and Chicago think consumer confidence is improving, but San Francisco does not. Dallas and Atlanta find their dealers in domestic autos increasingly optimistic about the new model year, but New York does not. Most department stores are not counting on sales to improve much in coming months.

Residential Construction. The summer improvement in homebuilding activity has been reversed by higher mortgage rates, according to Chicago, St. Louis, and San Francisco respondents. Other Districts relay concern about the possibility of such a reversal, or point to recent declines in mortgage lending (New York, Cleveland, Richmond, Atlanta, Minneapolis, Kansas City, Dallas).

Business Fixed Investment. Business spending on plant and equipment is expected to decline. New orders for capital goods are weak, except for oil field equipment (Cleveland, Chicago, St. Louis, Dallas). Boston and New York report that sales of capital goods are holding up, but only because of backlogs of unfilled orders. Richmond notes that low rates of capacity utilization in most manufacturing worsen the outlook for business fixed investment.

Inventories. With a few exceptions, businesses consider their stocks of goods and materials to be just about where they want them (Philadelphia, Richmond, Atlanta, Chicago, St. Louis, Kansas City, Minneapolis).

Agriculture. The hot dry weather this summer seriously damaged several crops, reduced weight gains in livestock, and forced sales of livestock intended for breeding herds. Although farmers in some regions will suffer large income losses, net farm income in certain other areas and perhaps in the nation as a whole, will be higher than it would have been otherwise because of higher farm product prices resulting from reduced marketings (Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, San Francisco).

Professors and Financial Panel. Professors Eckstein, Samuelson, and Tobin agree that monetary and fiscal policies now in place will generate a sluggish recovery. Eckstein, concerned about the snugness of monetary growth targets,

says allowing another housing setback would be "pointless nonsense." Samuelson believes the Fed should make clear its willingness to violate the targets if they interfere with a satisfactory recovery. Tobin thinks an incomes policy is required in addition to monetary and fiscal policies to reduce inflation, and he considers targets for monetary aggregates to be ridiculous. New York now features the views of a Financial Panel as a regular part of its report, beginning this month with Henry Kaufman, James O'Leary, and Albert Wojnilower. Kaufman expects the economy to begin recovering next quarter, despite the back-up in interest rates which, he says, is slowing the reliquefaction of businesses. O'Leary finds a universal expectation of no decline in the basic inflation rate—an expectation that he believes is not fully appreciated by the authorities. Wojnilower feels the recession is ending, and anticipates surprises on the high side in business conditions.

FIRST DISTRICT—BOSTON

Although there are a few reports of further deterioration, First District respondents are generally optimistic that the worst of the recession is past. Retail sales are not keeping pace with inflation, but tourism related sales are substantially ahead of last year. Many manufacturers are seeing a pickup in domestic orders and exports remain strong. Price pressures have moderated; one large manufacturer is very concerned that if industrial commodity prices fall any further there will be cutbacks in capacity with the risk of greater inflation in the future.

Reports from the retail sector are mixed. Establishments associated with the tourist industry are enjoying substantially stronger sales than a year ago. However, the comparison is distorted because the tourist season was very poor last year. The head of a chain of general merchandise stores reports a slight improvement in sales in recent weeks. On the other hand, a large department store operation finds that, relative to year-ago levels, sales have weakened in the past month. For both chains cost increases are exceeding sales gains.

Manufacturing respondents are optimistic for the most part. A survey of New England purchasing agents shows an increase in the numbers reporting higher production and new orders and a large decrease in the numbers reporting lower volumes. Sales to the auto industry, however, are still depressed. Partly as a result of the weakness in autos and housing, several brass plants in southern New England have announced plans to close. Exports sales remain strong despite reports of developing weakness abroad.

Sales of capital goods have held up well thus far. One manufacturer

of energy saving capital equipment reports that orders are more than 20 percent above last year's level. Because of its strong performance this firm has revised upwards its own capital expansion plans. Another respondent is also reassessing its capital program in the light of a favorable sales performance. On the other hand, a very large manufacturer of electrical equipment sees signs of a turndown in equipment sales to the machine tool industry and to builders of new industrial plants.

Prices increases have moderated. The economist for one of the region's largest manufacturers reports that prices for many commodities—lumber, cement, copper, and aluminum—are now being discounted. This analyst does not think that prices for these commodities can be reduced any further, marginal producers are not covering costs and if this situation is prolonged there are likely to be cutbacks in capacity.

Professors Eckstein, Samuelson, and Tobin were available for comment this month. All agree that the recovery from the recession will be sluggish. They also agree that the monetary and fiscal policies now in place are responsible for this outlook.

Professor Eckstein believes that the combined effect of scheduled tax increases and expected energy cost increases will prevent the normal "snapback" of consumption spending in 1981. In his opinion the most appropriate moment for a tax cut already has passed, but he still favors relief from some of the tax increases due next year. Eckstein is concerned that the money growth targets may prove snug in 1981. He warns the Fed not to permit another housing setback, claiming that it would be "pointless nonsense."

Professor Samuelson thinks that the anti-inflationary thrust of monetary and fiscal policy is not compatible with making an early dent in

unemployment. On the other hand, citing recent British experience, he is equally pessimistic that "credible" policies in this country will succeed in reducing the core inflation rate in the short run. Samuelson is comfortable with the money growth targets for 1981, although he feels there is a risk that they may be inadequate for the economy to achieve even modest real growth next year. In his opinion the Fed should make clear its determination to violate the targets if they interfere with a satisfactory recovery.

Professor Tobin is not convinced that the economy has reached the trough of the recession. He believes administration and Federal Reserve statements that countercyclical policies will not be forthcoming in 1981; thus, he expects the recovery to be weak. Tobin argues that if the intent of anti-inflation policies is to match the rhetoric, then an incomes policy must be added to existing monetary and fiscal policies. He has no confidence in indirect, global policies that are a threat to everyone in general but no one in particular. In this view, such policies are not an important factor in wage negotiations. Tobin also feels that it is ridiculous to pay attention to monetary aggregates whose meaning changes frequently and whose velocity is difficult to predict. He would prefer nominal and real income targets instead of monetary aggregate growth targets.

SECOND DISTRICT--NEW YORK

Business activity in the Second District continued to be weak in August. Although several department stores reported gains spurred by back-to-school purchases, sales were soft at others, and merchants were uncertain about the outlook for sales in the coming months. Automobile purchases also remained slow. Dealers are expecting little improvement until mid-1981, despite the introduction of new models. Outside the consumer sector, capital spending plans are still being reassessed at some firms and new orders at capital goods producers continued flat. The backlog of unfilled orders at these companies, however, has forestalled layoffs. The respondents, for the most part, discounted the favorable economic signals recently, and generally agreed that the recession was not about to end. On the financial side, business loan demand, while remaining generally weak, has shown some signs of picking up. At the same time, many banks have increased the prime rate to 12 per cent in response to rising market rates. The tighter money market conditions have been felt in the mortgage market as well.

Consumer Spending. Consumer spending in the Second District was uneven during August. At both higher priced department stores and mass marketers, activity early in the month was stagnant. This weakness, however, was linked to the very hot weather rather than to the recession. Spurred by back-to-school purchases in the latter part of August, many department stores were able to compensate for the earlier weakness and ended the month with fairly strong year-over-year gains. As has been the case for the last couple of months, New York City stores outperformed their suburban branches, while in upstate New York, the opposite sales pattern prevailed with suburban stores reporting

better sales than in the large cities. Although inventories at most stores were not burdensome, one large department store was still concerned over its level of stocks in light of the very uncertain sales outlook. This store preferred high stocks, however, to the possibility of losing sales when demand strengthens. In general, the outlook of most merchants was cautious and uncertain. But, on a more positive note, one retailer felt that continued caution in consumer spending now may well result in an exceptional Christmas season when many postponed purchases might be made.

Automobile sales in the Second District were also mixed, soft early in August but stronger towards the end of the month. Demand for smaller-sized used cars has held up well and truck sales were on par with last August. According to one respondent, however, this upturn will not be sustained because it largely stemmed from purchases which could no longer be postponed. High interest rates and the sizeable downpayment currently being required for automobile loans continue to be major deterrents to sales particularly for lower and middle income customers. (In some cases, however, inventory shortages and slow deliveries are hampering sales, primarily for foreign cars.)

The Manufacturing Sector. Outside the consumer sector, little evidence of improvement has developed. New orders at capital goods producers are minimal although backlogs of unfilled orders are sufficient to prevent layoffs at present. Inventories at most manufacturers are very low and with liquidation continuing, according to one respondent, a pickup in economic activity may begin soon, albeit a very moderate one, as inventories are rebuilt. Nevertheless, one major steel manufacturer has revised downward its long-term capital spending plans and a "major review" of all plant and equipment spending is underway at a large producer of paper and related products. In addition, this producer

may close certain marginal paper plants soon because it expects to lag the nation during the recovery just as it did in the downturn.

Economic Outlook. The economic outlook of most District respondents was rather pessimistic. The recent signs of an upturn were not considered sufficient to trigger a sustained, broadbased recovery this year. In particular, the housing sector is expected to remain weak for some time. Respondents were divided, however, in their forecasts of consumer behavior. Some felt that the current cautious attitude and higher saving rate were only temporary aberrations while others expect consumers to continue to restrain their spending in light of an anticipated renewal of strong inflationary pressures.

Financial Developments. On the financial side, business loan demand at large New York City banks remained soft, although a little stronger than in previous months. Senior loan officers attributed this weakness to the lack of major capital spending programs, little acquisition activity, and the limited need for inventory financing. Only in the apparel industry was the demand for inventory financing fairly heavy. Reflecting the increasing cost of funds throughout August, banks increased the prime rate to 12 per cent. Higher interest rates have had a noticeable impact on the mortgage market. Lending activity has tapered off as the rates on new commitments have been increased from 1 to as much as 2 1/4 percentage points.

Financial Panel. Starting this month we will have comments from several of a group of financial market experts. This month we have comments from Henry Kaufman (Salomon Brothers), James O'Leary (U.S. Trust Company) and Albert Wojnilower (First Boston).

Kaufman: The backup in interest rates will not prevent a fourth-quarter recovery in the economy, but it is slowing the reliquefaction of

businesses. There are now two corporate bond calendars—a "highly likely" new volume and a "shadow" calendar which hinges on a 50-75 basis point decline in long-term interest rates. This decline, however, can only come about if short-term interest rates fall. Otherwise, long-term interest rates will be under some upward pressure. Corporate reliquefaction is also being retarded by the involuntary inventory accumulation, the fall in profits and the temporary oil glut. The first two factors are likely to be reversing in the period ahead.

O'Leary: I find almost a universal expectation that the basic inflation rate will not decline appreciably in the near term and that the odds are strong that the inflation rate will escalate again in 1981 and beyond. As a result of this expectation and the expectation about interest rates which follows, one cannot expect long-term institutional investors to behave as they have in past cycles. The authorities need more than ever to take the intensifying expectation of inflation into account.

Wojnilower: Notwithstanding some comments to the contrary, my own feeling is that the recession is ending. This view confirmed by many nonfinancial contacts. In financial markets widespread expectation of a double dip recession. Accordingly, despite rise in interest rates, lenders more aggressive in pushing out credit. Thus would anticipate surprises on the high side in business conditions. Ten percent inflation clearly imbedded in the economy, but not in the markets.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business activity in the month of September is sluggish, but hold some hope for improvement. Manufacturers indicate a slight increase in overall industrial activity, the first in over a year, but are still playing a close hand, cutting inventories and payrolls, albeit marginally. Local manufacturers also report continued inflation with no foreseeable relief within the next six months. Retailers say September sales are about even with a year ago, but write off the slowness to a late summer heat wave. District bankers report C&I loan volume to be up from last September, but say consumer loans are slightly off.

As for the future, representatives of the industrial sector expect a major upswing within the next six months. Retailers are also planning for recovery, but remain more cautious than the manufacturers. Contacts in the financial sector are forecasting increased loan volume as the economy picks up, but disagree on exactly where interest rates are heading.

MANUFACTURING ACTIVITY

Area manufacturers responding to the September Business Outlook Survey report a marginal increase in industrial activity this month. This increase, although very small, is the first noted in fourteen months, and may signal the end of the downward trend in general business. (Survey respondents have been forecasting a pickup since March.) Specific indicators of business activity also offer some hope. New orders, although off fractionally in September, look better than at any other time this year, and shipments have held steady for the first time since January. Moreover, manufacturers' inventories, which have been cut significantly six times in 1980 according to the survey, also appear to be stabilizing, and are down only marginally in September. The same is

true of District industrial payrolls, which have been shrinking steadily since May. Manufacturing executives have, however, continued to shorten working hours.

Looking ahead to the next six months, survey respondents are projecting a strong boost for industrial activity, marked by steep increases in new orders and shipments and swelling producers' backlogs. To meet the renewed demand, manufacturers plan to increase inventories, lengthen the workweek, and add new employees by next March. Increased expenditures on plant and equipment are also forecast, as the expected recovery gets underway.

On the inflation front, industrial prices are up again in September, as 55 percent of the survey respondents report paying more for raw materials than they did last month, and about one-quarter are charging higher prices for their finished products. For the longer term, over 90 percent anticipate higher input costs six months from now, and over 70 percent plan price hikes for their finished goods.

RETAIL ACTIVITY

Area retailers report this month's sales to be flat to slightly off as compared to year-ago levels. Local merchants note, however, that their fall line is in and is not expected to sell until the hot weather breaks. Therefore, sales levels are comparable with expectations and inventory-sales ratios are still considered healthy. Credit sales appear to be picking up as the economy is perceived to begin its move out of the current recession.

Local department store executives are projecting a marginal increase in sales as they head into the Christmas season, but continue to plan cautiously. No changes are planned for future inventories. This year's Christmas season is expected to be fair to good, but definitely "not a banner year."

FINANCIAL ACTIVITY

Area bankers contacted this month report mixed activity in August. Reports of C&I loan volume vary, ranging from 0 to 12 percent over September '79 figures, slightly below plan for the most part. Consumer loans, however, are down slightly, by 1 to 3 percent. Looking ahead to the next six months, bankers expect the economy to begin its gradual recovery and are therefore projecting a moderate increase, up to 7 percent, in loan volume.

Banks in the Third District are currently quoting prime rates of 11 1/2 and 12 percent. Projections of the prime rate are mixed as some contacts expect the forecasted first quarter recovery and concurrent "easy money" to drop the prime rate to between 10 and 11 percent. Others foresee a slight increase to 12 to 13 percent.

Deposits are generally up over last year's levels, although saving certificates are reported to be flat. All deposits are below budget, though.

FOURTH DISTRICT - CLEVELAND

SUMMARY. Most respondents in the Fourth District expect that further weakening in capital spending and sluggishness in consumer spending will contribute to another slight decline in overall economic activity this quarter and next. Recent improvements in consumer spending and housing, however, have raised the possibility that real economic activity will increase in the fourth quarter, according to some officials. Recent strength in real retail sales may have been supported in part by a slim return to credit card usage, but most retailers and bankers doubt that the consumer sector will provide much impetus to a recovery until mid-1981. Respondents tend to be skeptical over reduced consumer inflation rates in August, and are concerned about a return to double-digit rates in 1981. Savings flows have improved slightly, but lenders anticipate that recent marginal gains in mortgage lending activity are likely to be dampened as mortgage rates in the District have firmed.

OUTLOOK. Although most respondents still expect a trough in the fourth quarter, several expect real GNP growth in the fourth quarter to be zero or slightly positive. Most still expect a peak-to-trough decline in real GNP of about 3%. A bank economist cites a revival in growth of consumer debt, the stabilizing of car sales, and the bottoming out of housing as the first signs of recovery. Negative factors most often mentioned that lessen prospects for a prompt recovery include a continued weakening of capital goods with no bottom yet in sight, rising interest rates and prices that may hold down the demand for consumer durables and housing, and a combination of low savings rates and high debt levels going into the recovery that will limit the ability of consumers to increase spending substantially. Weakening in

capital goods is likely to continue into next year and, according to a durable-goods producer, declines in the capital-goods sector will partly offset strengthening in consumer goods and housing. A producer of household goods expects that it will be the end of 1981 before the economy gets back to pre-recession levels of real economic activity.

STEEL. The steel industry has experienced a reversal from the steep decline in orders that began in March, and operating rates in the industry should rise gradually from the 50-55 percent rates experienced in June and July. However, the 20-25 percent increase in new orders in late July and August was still 20 percent below February and March levels, according to an industry economist. Although the source of the order strength is widespread, much of the improvement is due to an ending of inventory liquidation. Demand related to oil field equipment remains strong, but demand from machine tools and construction customers is easing and cancellations are reported from railroads. However, a better-than-expected upturn in auto sales this fall may produce a rush to re-stock steel inventories.

AUTOS. Auto sales in July were higher than the underlying rate of demand (9 million units), according to an industry economist, but sales for August and September should be below that rate (8.4 and 8.6 million units, respectively). While some purchases may have been advanced by dealer and producer promotions, many buyers are thought to be awaiting the 1981 models. The price of many of the new models will be above imports, but an auto supplier notes that fuel-efficiency should be comparable and domestic models will be larger, safer, and more stylish than imports. A steel economist reports that orders from the auto industry indicate a conservative production schedule, averaging 9.9 million units for 1981. A manager of several area dealerships

expects no strong increase in auto sales until next March and has reduced his inventories and staff to the lowest levels of any time.

CONSUMER SPENDING. Retail sales in August rose again in real terms particularly for soft-goods, but remain weak for furniture and appliances. An economist in the appliance industry reports that orders continue to be weak, but declines have moderated, with orders 10 percent below last year in real terms. Several bankers report some increase in credit card usage in August by existing cardholders. However, retailers report cash sales up, but credit card usage has not shown any improvement since the decline in April. An economist for a major retail chain believes that a prerequisite for a sustained consumer recovery is increased credit card usage, because incomes will remain depressed by further price increases. Most producers and retailers expect a slower-than-usual recovery in consumer spending. They assume a tax cut and increased small car availability that should improve retail sales by early 1981.

INFLATION. Despite moderation in consumer prices in August because of lower mortgage rates, most respondents expect upward price pressures through the first half of 1981. They view the underlying rate of inflation to remain about 9 - 10 percent. An auto economist expects consumer prices to rise from 8.1 percent in the third quarter to 12.7 percent in the first quarter of 1981, before dropping back to 8.1 percent in the fourth quarter of 1981. Food prices are a major factor in the expected acceleration in the inflation rate, but several economists express hope that tight monetary control would reduce the rate further in 1982.

LOAN DEMAND. Loan activity in the District remains weak. Consumer loans continue to decline in most areas and business loans are still on a low

plateau. An area banker expects some seasonal pickup in consumer loans in the fall, but notes that consumers seem more concerned about paying back loans. However, an auto dealer is encouraged by the increasing interest of banks in financing auto sales. Business lending remains soft, but banks are now more active in the commercial paper market. A durable-goods producer states that many firms are more liquid now since inventories have been reduced. Loan demand will continue to be weak in early 1981 because of better cash flow during the early stage of recovery, according to a bank economist.

Savings flows improved slightly among banks and S&Ls, especially in passbook accounts. Several respondents note a tendency among customers to prefer liquidity over higher paying time deposits with withdrawal penalties, which typically occurs when times are uncertain.

MORTGAGE LENDING. Mortgage activity, especially loan commitments, picked up in July and early August, but loans are still 30 to 40 percent below year-earlier levels. Although builders were never too optimistic about a recovery in housing, according to an economist with a regional FHLB in this District, rising mortgage rates could postpone a recovery until 1981. Housing starts may be erratic over the balance of this year, and average about a 1.3 million rate monthly. Mortgage rates rose about 1 percentage point last month according to an S&L official, because lenders are more sensitive to rate changes in secondary markets and to cost of funds. Although most respondents expect a downward trend in mortgage rates because of improved deposit flows, current rates offered by banks are generally at 13 percent plus points, while S&Ls offer rates that range from 12-1/4 to 12-3/4 percent plus points.

FIFTH DISTRICT - RICHMOND

Responses to our latest survey of Fifth District business conditions suggest that the level of activity has stabilized over the past month. Manufacturers, on balance, continue to report month-to-month declines in shipments and new orders, but the declines narrowed sharply in August as more individual respondents experienced increases in these measures. Backlogs of orders continued to fall over the month, but here too the decline was much less widespread than in recent months. Inventories were little changed in absolute terms, but fell relative to desired levels. Manufacturing employment continued to fall as did the average workweek. Retail sales were unchanged to up slightly, but sales of big ticket items declined somewhat. Demand for mortgage loans has apparently picked up in most parts of the District despite the recent back-up in rates. There is little indication of any substantial increase in demand for commercial and industrial loans.

For the most part consumer spending continues to lag. Survey responses suggest little change in overall retail sales in the past month and continued weakness in big ticket items. Department store sales are up slightly from a month ago, but continue to run well behind year earlier levels. Several of our directors note recent improvement in automobile sales in their respective areas, but this is by no means universal.

Most indications are that residential construction is improving in many areas. Gains to date, however, have been modest on balance. The recent back-up in mortgage interest rates and pockets of tight supplies of mortgage funds are apparently impeding progress toward a broadly based recovery in District construction.

Business inventories continued to improve relative to desired levels during the latest survey period. Manufacturers report little change in actual

inventory levels, a slight increase in stocks of finished goods being nearly offset by reduction of materials on hand. Nonetheless, there is much less concern over excessive stocks than in most recent months, and one-sixth of all manufacturers surveyed find current inventory levels inadequate. Retailers apparently experienced further inventory accumulation over the month, but they, too, find current stocks nearly in line with desired levels.

Most manufacturers surveyed find current plant and equipment capacity appropriate to their needs. Almost none feels any change in current expansion plans is necessary. Among our directors, however, there is some feeling that what little improvement there has been in the demand for commercial and industrial loans is at least partially due to expansion activity.

Price increases were somewhat more widespread among manufacturers in the latest survey period. Nearly half the respondents report paying higher prices over the month, while almost 25 percent received higher prices. Among retailers, however, there was little change in the frequency of price increases since last month. Gains in employee compensation, among both manufacturers and retailers, ran at about the same pace as in most recent months.

Employment rose slightly among retailers over the past month, but continued to fall sharply among manufacturers surveyed. There are scattered reports, however, of recalls in such industries as auto parts and construction. One director cites the absence of plant closings and further layoffs in his area as a sign of stabilizing activity.

Expectations of District businessmen turned positive during August. For the first time in over a year survey respondents expect business to be no worse in six months than it is now. Over one-third of our manufacturing respondents expect the level of business activity nationally and within their respective

firms to improve over the next two quarters. Very few expect conditions to worsen. Retailers also expect business to be at least as good in six months as it is now.

The drought and searing temperatures that continued during August and early September have cut crop production prospects significantly, pointing to sharp reductions in 1980 farm income. Corn, soybean, and peanut farmers will probably suffer the biggest losses. Reportedly, corn yields in many cases will not cover the costs of production, and some soybeans have been cut for hay. Hardest hit areas are in Virginia and the Carolinas. Because of the drought conditions, 70 counties and three independent cities in Virginia and 67 counties in North Carolina have been designated as disaster areas, making farmers in these localities eligible for low-interest Federal loans.

Flue-cured tobacco marketing, now in full swing in all belts, is characterized by a large proportion of low-quality offerings. Season average prices to date have thus averaged only 1.6 percent above the year-ago level. With total sales volume just slightly above a year earlier, the value of gross sales is up only 2 percent.

SIXTH DISTRICT - ATLANTA

Guarded optimism characterizes most reports throughout the District. There is growing sentiment that the recession has bottomed out. While consumer spending continues to be restrained, confidence seems to be returning. Inventories are in line, with few exceptions. Laid-off workers are being recalled in some industries. Several large capital investment projects are recently under way. Alabama, with its large share of heavy industry, has been hardest hit--unemployment has reached nearly 11 percent. The unrelenting heat wave exacted a heavy toll from livestock and crop production.

Consumer Spending and Inventories. Stronger-than-expected back-to-school soft goods purchases have been encouraging in an otherwise sluggish retail sales picture. Auto supply sales, primarily tires, have contracted substantially. Part of the downturn is attributed to fewer and shorter vacation trips this summer. Home furnishings and appliance sales were off; however, paint and other household improvement items have been selling briskly. One contact noted an increase in cash sales as credit usage declined; another expressed concern over the spate of bankruptcy filings under the more lenient code.

New auto sales have improved in most areas, and used car activity has picked up in parts of the District. There is greater optimism among dealers than earlier in the summer. Consumers are exhibiting an acute awareness of prevailing rates for instalment loans--they are shopping for the cheapest money. There is a lot of potential buyer interest in the new introductions by Ford and Chrysler due out this fall. Many new car dealers report lean inventories in preparation for the new model year.

Inventories have been closely monitored, and most contacts note no appreciable buildup. Merchants are buying closer to the time of a sale, as heavily promoted, sale-priced merchandise is turning over quickly.

Financial and Construction. The dramatic downward movement of interest rates in early summer had rekindled demand for mortgage loans. Residential contracts surged to the year's highest level in late summer. However, the recent upturn in rates has slowed applications at most savings and loans appreciably. Lenders in Atlanta have raised their rates by a full percentage point. The range is now 12 1/2 to 13 1/2 percent.

While some commercial banks report soft consumer loan demand, the District's large banks posted good gains in real estate and instalment loans. Continued funding for existing projects characterizes commercial lending activity. With the opening of the sixteenth foreign agency branch in Miami and more on the way, international banking is maintaining a rapid growth rate in south Florida.

Employment and Industry. Although employment rolls were trending downward for some sectors in the District, there have been some positive developments regarding jobs lately. U. S. Steel announced the recall of 700 workers in Alabama, although more than 4,000 other employees remain laid off. Georgia-Pacific Corporation put the last of its 17 southern pine plywood plants back into operation after shutdowns because of declining home building activity. Firestone has recalled 430 laid-off workers in a Georgia tire plant, and in Alabama, Ford's aluminum casting plant recalled about 200 workers. Alabama's unemployment situation, the worst in the District, has been aggravated by strikes and unrest, particularly in Mobile.

Tourism has fared reasonably well this summer. The percentage of foreign visitors continues to increase. One central Florida tourist attraction reported that 27 percent of its current visitors are international. The boom in Latin American visitors to the Miami area shows no letup. While the domestic tourist market has been off significantly, the slack has been taken up by the international tourist. Southwest Florida, which is more heavily dependent on automobile arrivals, has been lagging behind last year. Visitors to Opryland in Nashville are down about 7 percent, mostly due to a decline in out-of-region travelers. The convention trade seems to be relatively recession proof. One contact noted that visitors are responding to the recession by reducing the length of their stay and spending less, but they have not stopped coming.

High-technology firms are not feeling the adverse effects of recession to the same extent as other industries. Scientific-Atlanta, for example, offers productivity-enhancing products, such as communication devices and, as a result, continues to receive orders when capital spending is down.

Business Fixed Investment. Several important large projects have been announced. The A. E. Staley Company, makers of Karo corn syrup, plans to build a \$200-million corn processing plant in eastern Tennessee. For the first six months of 1980, Tennessee had a record \$346 million in manufacturing investment. Chevron's \$1-billion refinery improvement project in Pascagoula will employ about 3,000 workers. It is the largest single investment in any economic enterprise in the State of Mississippi. Western Electric will construct a \$500-million electronics manufacturing facility in central Florida. The plant will have initial employment of more than

1,900 and will represent the largest new capital investment in manufacturing in the state.

Agriculture. Income prospects for farmers in the District are dim due to ravages of drought and heat. Corn and soybean production are off by 40 and 20 percent, respectively. Livestock weight gains have been curtailed by the heat. Pasture and forage conditions have deteriorated, forcing premature marketings.

SEVENTH DISTRICT—CHICAGO

Despite conflicting trends among industries, the tone of business activity has improved somewhat in the Seventh District during the summer months. In general, the consumer sectors have shown modest improvement, while most capital goods have weakened further. Recent increases in interest rates have dampened the incipient improvement in housing, and have reduced the availability of large commercial mortgages. C and I loan demand picked up at large commercial banks in August, but this is believed to reflect largely commercial paper facility credits. Prices have been soft in some wholesale markets, but this is believed to be temporary with the underlying inflation rate remaining at 10 percent or more. Layoffs have slowed down markedly, and workers have been called back in autos and steel. Most workers returned early in August from plant-wide vacations, which started earlier and lasted longer than usual. Farm income prospects have firmed up as farm prices rose, but there is substantial variability among individual farmers.

Psychology of consumers, business executives, and lenders, which had fallen to a very low ebb during the credit squeeze of the second quarter, has improved noticeably. Fears of a very long and deep recession have been replaced by feelings that the downturn in general activity may be near its bottom. However, almost no one expects a return to full prosperity for at least a year and perhaps longer.

Consumer spending has revived somewhat for both hard and soft goods, but real volume remains below last year. Among the items that are selling better are cars, small trucks, recreational vehicles, and a variety of household goods. Most people are after bargains, and discounters, big and small,

seem to be gaining at the expense of old-line general merchandise retailers.

Consumer credit is being used more freely again. Most instalment lenders have dropped "customers only" policies. Interest rates have come down from their peaks, but remain well above last year's levels. Delinquencies have increased, but not to the worst levels of 1974-75, except in certain hard-hit localities.

Order backlogs of most capital goods producers have eroded rapidly. Producers of oil and gas exploration equipment, however, report insatiable demand. Producers of machine tools required by the vehicle and aircraft industries see high demand well into 1981. Farm equipment prospects have improved with farm income. Construction equipment remains very weak. The dominant construction equipment producer, which sailed through previous recessions without layoffs, has announced a second sizable furlough of indefinite length. Sales of heavy trucks and trailers are still declining with good buys available on the second-hand market. Railroad car deliveries remain at a high rate, but order trends point to a long, slow period ahead. Mining equipment and materials handling equipment also are slow. A producer of heavy castings for a variety of customers reports "no backlog," operations below 50 percent of capacity, one shift operation rather than two and a half, and no improvement in sight for any customer group except farm equipment. Foreign demand for U.S. equipment, which had been stronger than domestic demand, began to weaken in the summer.

Orders for steel picked up in August (especially for cars and light trucks and appliances which had dropped most), but remain far below capacity. Steel buying is hand-to-mouth, and a significant pickup in demand could mean a stretchout in delivery times. Inventories are very lean at the mill, ware-

house, and customer levels. Steel mills have been able to boost some prices recently.

Except for petroleum products, petrochemicals, and such items as heavy trucks and trailers, the view that inventories are low seems to be well substantiated. Deep-seated caution, high carrying costs, and weaker financial positions that inhibit borrowing help explain this phenomenon. Prices of residential building materials softened in recent months, but analysts are concerned that the failure of builders to order ahead for 1981 will limit residential activity.

The worst of the car and truck dealer crisis appears to be over. Weaker dealers have gone out of business. Manufacturers have relaxed rules to allow their dealers to offer other lines, including foreign cars and trucks, and even the lines of domestic competitors—previously an unheard of practice. Inventories of 1980 model large cars and trucks have been largely depleted with prices strengthening. The 1981 model line-up, featuring greater fuel economies, is expected to keep car sales moving up from depressed levels.

Home mortgage rates in the Chicago area jumped to 13 percent on conventionals, and to 12.5 percent on RRM's in the past two or three weeks. As rates moved past 12 percent, builders reported a sharp drop-off in customer traffic. Plans of tract builders, which were starting to come to life, have been shelved again. The Chicago area, despite an apparent 4 percent loss of population 1970-80, is on the verge of a serious housing shortage. Despite the recession, sales prices of existing homes have continued to rise. New home prices have been even stronger. The situation is reflected in the conversion of better grade rental units to condos, against the desires of tenants who find alternatives scarce. New unsubsidized apartments are almost all condos with many

units purchased by investors. A strong push is expected for expanded subsidy programs for both rental and owner-occupied dwelling units.

About 8 million square feet of office space nearing completion in downtown Chicago is almost all leased. A new wave of large office buildings, hotels, and luxury condos will get underway soon. Since mid-August, however, new commercial mortgage commitments "have dried up."

Labor unions have not moderated demands because of the recession. Offers of 10 percent first-year wage increases have been rejected, with demands for 12 percent or more, plus other "improvements." In addition, demands for "inflation protection," both for workers and retirees, are often dominant issues.

Because of increased competition from nonunion truck operators under deregulation, unionized truck operators have invoked the renegotiation clause in the 1979 Teamsters contract. With COLA, straight-time drivers' pay now exceeds \$11 per hour. The main effort of the operators will be modification of work rules that impede efficiency.

EIGHTH DISTRICT - ST. LOUIS

Indications are that overall economic activity in the Eighth District has stopped declining. Retailers report that sales have improved somewhat and that inventories are at generally desired levels. Manufacturers of consumer durables, primary metals, chemicals, and paper products noted that sales have apparently bottomed out, and in some cases have increased. Residential building activity has also improved in the past three months; however, rising interest rates are expected to dampen further improvement. On the negative side, capital spending is reported to be declining somewhat more than expected. Not only are orders for capital goods deteriorating, but highway and other government construction projects are being reduced due to declining government revenues. Weather conditions generally improved in August, although rainfall was too late to substantially improve crop prospects.

Consumer spending continues to show some improvement over the depressed spring sales, but gains after adjustment for inflation have been modest. Department store retailers note that big-ticket items, particularly furniture and appliances, remain depressed. They also report that credit sales have increased but that cash purchases remain high relative to credit purchases. August car sales in the St. Louis area are reported to have been the best in the past year. Most retailers continue to report low profit margins, reflecting price cutting measures necessary to reduce summer inventories.

Inventories continue at generally desired levels. Some department store retailers, however, report that the stocking of fall items may have been excessive and that they are closely watching buying trends in order to quickly reduce these inventories if necessary.

Manufacturing activity may have bottomed out according to several respondents. While new orders are still at a low level, those producing appliances, housing materials, other durable goods and primary metals note a leveling off of sales. A firm producing boxboard, largely for food packaging, reports that sales have improved substantially and are now near the pre-recession level. A major chemical firm notes that overall sales are still at a low level, but that some recent improvement has occurred in fiber sales. Most capital goods firms report that orders have deteriorated somewhat more than expected, but orders remain strong for equipment used in the oil, gas, and defense industries.

Residential construction has picked up in recent months from the very low level of last spring, but recent increases in mortgage interest rates have clouded the prospects for further improvement. Mortgage interest rates have risen from approximately 11-1/2 percent to about 12-1/2 percent in the St. Louis area. Some builders have already noted a marked change in sales and express considerable pessimism about future sales. Builders also note that long-term mortgage loan commitments are nearly impossible to arrange, complicating their planning of new projects. Nonresidential construction has remained relatively high during the recession, however, highway and other government projects are now declining, reflecting reduced revenues from such sources as gasoline and sales taxes.

Financial activity has picked up slightly in recent weeks. Saving and loan associations officials report that mortgage loan demand has been rising, but with higher interest rates they expect loan volume to drop off somewhat. S and L officials also report that higher rates paid on deposits have substantially reduced profit margins again, and some firms are reacting by placing restrictions on the issuances of some

types of certificates. Banks report increases in both loans and deposits in recent weeks. Bank loan volume has increased slightly for business and real estate loans, but consumer installment loans have remained essentially unchanged.

Agricultural production in the District has been severely affected by the hot and dry weather in June and July, particularly in Arkansas and Missouri. While weather conditions generally improved in August, the improvement came too late to help crop prospects substantially. For example, the Missouri corn crop is expected to be less than half the 1979 crop. Soybean production is expected to be down substantially in both Arkansas and Missouri, although recent rains will help improve yields of late plantings.

NINTH DISTRICT—MINNEAPOLIS

In August, the District economy continued to show signs of improvement. Retail sales, home sales, and manufacturing activity all picked up, leading to increased lending at savings and loans. Reflecting these developments, fewer District workers were laid off and more were hired in August than in July. Auto sales, metal mining, and commercial bank lending remained fairly weak, however, and excess autos and iron ore were the District's two biggest inventory problems.

Consumer Spending. The freer consumer spending begun in July appears to have carried over into August. Directors say that in their areas retail and home sales either stayed the same or increased between July and August. Directors were concerned, though, that higher mortgage interest rates could stall the home sales recovery.

In contrast to retail and home sales, District auto sales have not yet begun to recover. New domestic car and truck sales declined between July and August.

Industrial Activity. Manufacturing activity, like consumer spending generally, continued to show signs of improvement in August, but mining activity did not. A large Minneapolis-St. Paul manufacturer says its new orders increased between July and August. In Montana, lumber manufacturing started to revive, and in the upper peninsula of Michigan, a large foundry's new orders picked up, which is usually a good sign for other types of manufacturing. In contrast, metal mining did not improve. Copper mining in Montana was shut down by a strike in both July and August, and reduced demand for steel held down iron ore shipments from Minnesota and the upper peninsula of Michigan

during both these months.

Inventories. Reflecting conditions in the District's industries, inventories were generally satisfactory in August. District businesses were reportedly being cautious in their inventory policies. The only serious inventory imbalances were in the two weak industries: There was an excess of autos and taconite pellets (that is, iron ore, resulting from the drop in steel production).

Labor Markets. Consistent with the other signs of recovery, District firms laid off fewer workers and hired more in August than in July. Although initial claims were up considerably from a year ago, the number of laid-off workers applying for unemployment compensation dropped 8 percent between July and August. Help-wanted advertising in Minneapolis' two major papers increased 22 percent between July and August.

Agriculture. Complementing the improvements in nonagricultural activity, recent rains and rising farm product prices were helping the District's farmers and ranchers. Drought conditions eased in August. Although the rains came too late to help the wheat crop, prospects improved for the District's corn and soybean crops. Prices for most farm products improved between July and August too. In Minneapolis, average cash prices increased 7 percent for corn and 3 percent for soybeans. Wheat prices, however, did decline 6 percent, but they were still above last spring's level. In St. Paul, average livestock prices rose 5 percent for feeder cattle and 13 percent for hogs.

Financial Developments. The District economy's recent improvements increased lending at savings and loans, but not at commercial banks. Reflecting the recent pickup in home sales, the dollar value of mortgage loan applications at Minneapolis-St. Paul saving and loans rose 60 percent between July and August.

At the same time, lending at commercial banks in that area was unchanged. Directors from outside the twin cities also report no change in their banks' lending.

TENTH DISTRICT—KANSAS CITY

Overview. Business conditions continue to be poor in the Tenth District, with only residential construction showing some improvement. Consumer spending is showing no vigor and retailers are generally pessimistic about prospects for the rest of this year. Manufacturing may be slowing further, judging from reports of plentiful supplies of materials. Inventories of materials of producers and of goods at retail are considered to be at satisfactory low levels. Prices of materials and of retail goods are stabilizing somewhat. Corn, sorghum, and soybeans have been hit hard by the heat and drought; the yields of these crops are expected to be only about three-fourths or less of the harvest once anticipated. Agricultural credit appears adequate. Bank deposits are increasing, but loan demand is flat. Interest rates have taken an upward turn. Bankers are about evenly split on the question of where the prime rate will go in the months ahead. Most savings and loan officers, however, expect further increases in mortgage rates.

Retail Sales and Inventories. Retail sales in recent weeks are down from their pace a year ago. Sales of durable goods are off the most. Retailers are now absorbing rather than passing on increases in merchandise costs. Store managers, expecting weak sales through Christmas, are holding down inventories and currently have their stocks of goods at satisfactory levels.

Materials: Prices, Availability, and Inventories. Purchasing agents note an easing in the rate of increase of input prices. Inputs are readily available, with most lead times shorter than normal. Inventories of materials have been cut; most purchasing agents plan to maintain the current low levels. Several companies have recently reduced their orders for materials; about half

have some workers on layoff and are operating at less than full capacity.

Homebuilding and Mortgage Rates. Homebuilders associations report that new home prices have resumed rising. Despite slow sales, the inventory of unsold new houses is not considered a problem. Building materials are readily available at rising prices. Shutdowns by suppliers, however, are causing concern over a possible materials shortage next year. Homebuilding activity picked up somewhat during the summer, but the outlook remains mixed, with builders keeping a close watch on mortgage rates. Rates on conventional mortgages have risen recently to their current level of 12 3/4 per cent. Mortgage demand was fairly strong for most of the summer, but has slowed of late. Executives of savings and loan associations expect mortgage rates to increase to the 14 to 15 per cent range by the end of the year, despite some expected improvement in savings inflows.

Agriculture. USDA sources estimate a reduction of 25 per cent in District corn production and a decline of 30 per cent in the production of both soybeans and sorghum this year, due to the drought and hot weather. The Farmers Home Administration (FmHA) has applied a disaster designation to all Missouri and Oklahoma counties and to 70 per cent of the Kansas counties, thus making farmers in these counties eligible for low-interest FmHA loans. Additionally, some counties in Nebraska are presently being considered for disaster designation. The declines in crop production throughout the Tenth District probably will mean lower net farm income, but these declines will be partially offset by higher grain prices.

Winter Wheat Planting Conditions. Many areas in the District have received moisture in the past few weeks and the heat has abated somewhat. Therefore, expectations of good planting conditions for the winter wheat

crop are reported throughout most of the District states.

Agricultural Credit. Credit conditions for agriculture appear favorable throughout the District, with most states reporting interest rates in the 13-14 per cent range. Most bankers are not optimistic about net farm income this year, but they do not expect a larger-than-normal number of farmers to be in financial difficulty at yearend.

Loan Demand. Loan demand remains flat at most banks. The exceptions include some banks in Oklahoma and New Mexico where loans are up due to relatively robust local economies, and some rural banks where loans are down because of seasonal factors associated with agriculture. Agricultural and consumer loans show the greatest weakness. Business loans are generally flat, while real estate loans are level or rising. Loan demand is generally anticipated to be level in the near future.

Prime Rates. All banks contacted raised their prime or base lending rates in the last month. Most of the metropolitan area bankers currently quote prime rates of 11 1/2 per cent, but a few are at 12 per cent. Base fees for local loans at some country banks remain somewhat higher, 13 per cent or more. About half the bankers expect their prime rates to ease somewhat in the months ahead, to perhaps 10 per cent by yearend. The other half, however, expect the prime to be steady or up slightly over the next few months.

Bank Deposits. Bank deposits have been level or rising in recent months. Small-denomination, floating-rate certificates show the greatest strength. Other deposits also appear firm. Bankers expect level-to-rising deposit growth in the near future. Rural bankers appeared to be most optimistic, citing seasonal factors associated with harvests.

ELEVENTH DISTRICT--DALLAS

The pace of economic activity in the Eleventh District has quickened, but further increases in interest rates would be expected to reverse the current recovery in the housing sector. Back-to-school purchases have bolstered department store sales, and new car sales are slightly improved. The number of office buildings to be constructed is rising sharply. Factory output is mixed, while drilling activity has reached a 25-year high. Loan demands are strengthening a bit at District banks and S&Ls, but these institutions are finding it difficult to attract deposits. Drought conditions have cut deeply into crop production and are retarding the current expansion phase of the cattle cycle.

A pickup in back-to-school sales has improved somewhat the sales outlook at District department stores. However, dollar sales volumes are only slightly above a year ago, despite price cutting and heavier than normal promotions by some stores. Consumers continue to buy selectively, and the low level of credit card usage suggests consumer buying patterns were sharply altered by the special credit constraint program. The prolonged heat wave also continues to discourage some shopping. All respondents indicate retail inventories are under control.

Auto sales show only slight improvement, but most dealers are optimistic about future sales after the new models are introduced. Many dealers attribute increased sales to an easing in credit availability. The pattern of new car sales, however, remains unchanged with foreign and small domestic models outselling large domestic models. "Good" used cars are

selling well and are in tight supply. Chrysler dealers report heavy inventories of new cars, while other dealers expect most stocks will thin out before the 1981 models are introduced if current sales hold up.

Further increases in interest rates threaten to stifle the recovery in residential construction. Conventional mortgage rates for single-family homes rose about 1 3/4 percentage points in August. The rise triggered a scramble by buyers for available credit before interest rates rose even higher. Interest rates of 16 to 17 percent are helping put a damper on interim construction loans for multifamily dwellings. Demand is high for apartments in the Dallas-Fort Worth area where the occupancy rate is about 94 percent, but Houston is somewhat overbuilt with an occupancy rate of about 85 percent.

Construction of office buildings is in full swing across the District. Activity is well ahead of a year ago, and the number of large projects is up sharply. It was recently announced two 50-story buildings will break ground in Dallas before next summer, and a 35-story office will be constructed in Fort Worth. Three new projects in Houston valued at \$100-\$150 million each are currently being negotiated. Canadian firms are constructing a number of these buildings, and the equity in nearly all of them is reported to flow from foreign sources.

Manufacturing activity is mixed. Output in construction-related industries is recovering slowly in response to the recent rise in housing starts but will falter if high interest rates again throttle down the number of housing starts. Lower demand and excessive inventories continue to weigh down production in the refining and chemical industries. Aluminum production in Texas is down sharply as a result of weak demand and rising

energy costs. The nationwide copper workers strike has disrupted copper and zinc production in the District. A major men's apparel firm reports new orders have risen sharply in the past six weeks, and output may reach a record level for the current quarter. Drilling is at a 25-year high, and demand for oil field equipment remains strong. Because delivery schedules for new rigs have stretched to more than a year, many drillers are building rigs from available new and used components.

Total loans at commercial banks are rising slowly. Energy and construction-related loans continue to be the areas of greatest strength. Home improvement loans are also strong, while commercial loans are increasing. Auto loans are weak in part because interest rates quoted by nonbank sources of credit are often lower than bank rates. Deposit inflows at commercial banks are sluggish as declines in demand deposits are offsetting increases in time deposits.

District S&Ls report further deterioration in net savings inflows. S&Ls have been competitive in issuing jumbo CDs, while passbook savings are on the decline. One institution reported that passbook savings are being used for back-to-school purchases. The underlying demand for mortgages is strong, but many potential home buyers were squeezed out of the housing market in August.

The drought affecting most of the District continues unabated. Only the lower Rio Grande Valley and South Texas Plains received beneficial rainfall from Hurricane Allen. Damage from high winds and flooding totaled \$80 million and was confined to a seven-county area along the coast. Showers revived rangelands but did little to boost crop yields. Damage to most crops is irreversible. Cotton production, the District's leading crop, is expected to be 25-30 percent below a year ago.

TWELFTH DISTRICT -- SAN FRANCISCO

Uncertainty and concern about economic conditions continues to be widespread throughout the Twelfth District, where concern centers on current and expected inflation. While some observers have indicated that the recession may be over, the general consensus is that claims of an economic recovery are premature. The recession is expected to continue throughout the year with recovery coming in the early part of 1981. Recent increases in interest rates are said to be having a strong dampening effect on the recovery in housing. Retail sales and credit card use continue to be sluggish. The agricultural and industrial sectors are reporting that sales and profits are strong. However, fears are expressed about rising input and labor prices. Losses in the Northwest due to the eruptions of Mt. Saint Helens have been less than initially anticipated and the region appears to be moving back to normal conditions. The inflow of deposits to banks and savings and loans remains strong despite the rise in interest rates.

CONSUMER SENTIMENT is still decidedly pessimistic. Concern is expressed as to whether consumers in the near future will have either the ability or the willingness to resume spending. Uncertainty about economic conditions is cited for the low level of consumer attitudes. Consumer debt has been decreased and so has credit card use. However, a few areas report that auto and truck sales appear to be showing a slight rise from the low levels of the past months.

The recent increases in MORTGAGE RATES are dampening the recovery of the housing industry. With some areas reporting mortgage rates as high

as 13 1/2%, a downturn in home purchases and new construction has been reported. A mortgage rate in the 12% - 13% range is felt to be necessary before any significant recovery in the housing market could occur. With the rise in short term interest rates creating the fear of an outflow of savings deposits, the increased demand for funds in the bond market, and the recent rise in inflation expectations, no significant decrease in mortgage rates is anticipated for the rest of the year.

The UNEMPLOYMENT figures remain largely unchanged from the previous period. Expectations of increased employment were expressed in a number of areas due to plans for expansion by firms. The possibility of adverse effects created by strikes and increases in wage demands was raised. "Catch-up" wage increases, along with declines in productivity, are anticipated to greatly increase labor costs.

RETAIL SALES volume continues to be low but some feel that the bottom has been reached and that increases can be expected for the remainder of the year. Weak credit card sales were blamed on the reluctance of consumers to increase their installment debt, resulting in a low demand for durables. It was felt that significant increases in sales would not occur until consumer confidence and real personal income increase.

The general state of INDUSTRIAL AND AGRICULTURAL ACTIVITY is regarded as good to very good. Despite decreases in domestic airline business, one major aircraft producer remains at a near record level of activity. Agricultural prospects remain bright as many areas are reporting output well above projections and earnings prospects are good. However, weather conditions have had an adverse effect on crops such as cherries, potatoes, and grapes. The lumber industry continues to be sluggish as a result of the Mt. St.

Helens ashfall and the general weakness in the economy. Low lumber inventories present the potential for a price explosion once housing rebounds.

MT. SAINT HELENS still is a major topic of discussion in the Northwest. Hardest hit by the ashfall were the agriculture and tourist industries. The lumber industry reports that some operations are returning to normal for the first time since the first eruption. Shipping traffic has returned to normal in many areas. The tourist industry has been depressed by adverse publicity created by the ashfall and recent eruptions. Campaigns to counteract this publicity have met with some success. However, tourism is still down and is felt to be a significant factor in the low level of retail trade in the area. But most observers conclude that the losses due to the ashfall will be substantially smaller than originally estimated.

The current rise in interest rates has touched off concern in some FINANCIAL INSTITUTIONS. Of primary concern is the fear of an outflow of deposits to money market funds. But no such outflow has been felt yet, and deposits have been recovering from the drop in earlier periods. Aggressive marketing, especially for 2 1/2-year time deposits, is cited for the lack of deposit outflow. One respondent reports a sharp increase in commercial loans. Concern is expressed over possible bankruptcies and loan losses, although these are not yet a reality. The earnings picture created some comment, as profits were down at many financial institutions.