

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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by the Staff

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TABLE OF CONTENTS

SUMMARY	i
First District - Boston	1
Second District - New York	4
Third District - Philadelphia	8
Fourth District - Cleveland	11
Fifth District - Richmond	15
Sixth District - Atlanta	18
Seventh District - Chicago	21
Eighth District - St. Louis	25
Ninth District - Minneapolis	28
Tenth District - Kansas City	31
Eleventh District - Dallas	34
Twelfth District - San Francisco	37

SUMMARY*

Overview. With respect to current and prospective business activity, reports from Reserve Banks this month are generally less optimistic than they were last month. The recent deterioration in financial conditions is seen as responsible for a slowing of economic activity in several districts in September. The rise in interest rates is the major reason many respondents have adopted a less sanguine view of the strength of the recovery next year. The outlook for inflation is about unchanged from last month, with some districts reporting an easing of price pressures and others reporting a resurgence. While commercial lending is up in several districts, mortgage lending has slackened everywhere. Automobile dealers are "cautiously optimistic" on balance about the prospects for the 1981 model year, although there is widespread concern that the combination of high prices and high financing costs will dampen new car sales. However, most respondents agree that it is too soon to know if these factors will significantly weaken car sales in the months ahead.

Business Conditions and Outlook. With few exceptions the recent rise in interest rates apparently has stalled the recovery and caused many respondents to revise downward their forecasts for 1981, judging from Reserve Bank reports. Boston and St. Louis report little change in business conditions since last month, while the recession is still on in San Francisco. Defense spending is mentioned as a source of strength by Boston and Dallas, but in the latter case this is offset by an expected decline in construction caused by rising interest rates. The effect of

higher interest rates on construction also has slowed the recovery in Minneapolis. Philadelphia, Cleveland, Richmond, and Chicago say that business has improved since last month, but Cleveland and Chicago are concerned that the recent improvement in steel demand may evaporate if high prices and interest rates weaken auto sales next year. Respondents in New York do not expect the economy to improve significantly before the middle of next year, and Atlanta and Kansas City note that the rise in interest rates has caused growing concern about the future in their districts as well.

Prices. Where mentioned, district reports indicate that price pressures are about unchanged from last month. While Dallas notes that lumber prices are off significantly from a year ago and purchasing agents in Boston and Kansas City report a stabilization of input prices in recent months, surveys conducted in Philadelphia and Chicago indicated that industrial input and output prices are rising and probably will continue to do so for the rest of the year.

Financial Developments. The most notable feature of district reports was the widespread decline in mortgage lending due to recent interest rate increases. New York and St. Louis report an increase in the use of VRMs and RRM's; Atlanta notes that equity participation mortgages issued by a Florida S&L have been well received. Auto loans are available and rates and terms generally are unchanged from last month. Business loan demand is strong in Philadelphia, Cleveland, and St. Louis. Deposits are up in Kansas City and Dallas but down in San Francisco.

Consumer Spending. Although retail sales are reported as steady or up slightly (Boston, Cleveland, Richmond, St. Louis, Minneapolis,

Kansas City, Dallas), mixed (New York, Philadelphia), or sluggish (Atlanta, Chicago, San Francisco), the overall tone of the district reports indicates that consumer spending remains flat in real terms. Hard goods are doing relatively well in Philadelphia, consumers buying in advance of price increases have buoyed big ticket sales in Richmond, catalog shopping is growing in Atlanta, price cutting and sales are common in Chicago, St. Louis and San Francisco, and soft goods are doing better than durables in Kansas City and Dallas. Auto sales are the best in months in Cleveland and are up a bit in Minneapolis, but other districts report car sales are flat or down slightly. Chicago notes that auto loans are available at commercial banks in the 14-16 percent range but that lenders are becoming more selective; Cleveland and Kansas City note that in-house financing at below market rates still is available for some makes; New York, Atlanta, Chicago, and Dallas note that the high interest rates are reducing dealers' desired inventories of new cars. High new car prices seems to be at least as important as high interest rates in explaining weak car sales. Most districts conclude that it is too soon to tell what effect these factors will have on 1981 sales volume, however.

Residential Construction. Conditions in the housing market have deteriorated in the past month in all districts. Higher mortgage rates are cited by all Reserve Banks as the cause of the downturn. Rates have increased as much as two percentage points in some districts (New York, Chicago, St. Louis, Kansas City) and mortgage demand has dried up almost everywhere. Descriptions of the housing market range from severely depressed (Chicago) to weak (Richmond) with no district citing improved conditions.

Business Fixed Investment. The outlook for capital spending is mixed. Cleveland, Chicago, and St. Louis see a continued gradual downward trend in overall spending plans. Cleveland and Chicago also note that order cancellations are becoming a problem, although not as severe as in the last recession. On the other hand, Philadelphia reports that increased capital outlays are planned at a third of the firms they surveyed; Atlanta says that order backlogs at high technology firms are the highest ever; Dallas cites an ongoing boom in oil drilling, commercial building, and power plant construction; and New York, Cleveland, and Chicago report strength in sales of machine tools.

Inventories. Both retail and manufacturing inventories are described as lean but generally acceptable by most districts. New York, Chicago, and Minneapolis note that high carrying costs have reduced desired inventories of some respondents, especially automobile dealers.

Agriculture. The outlook for agricultural production and farm income is mixed. Drought has reduced crop yields in Richmond, Atlanta, St. Louis, and Dallas. The resulting price increases are not expected fully to offset the decline in output in these areas, so farm income probably will decrease further. Atlanta and Dallas also note a heavy use of emergency credit in their districts. While Kansas City expects meat supplies to tighten next year, San Francisco expects them to increase. Chicago and Minneapolis are optimistic about the corn and soybean harvests this year, both citing favorable weather and high prices.

Academic and Financial Consultants. The academic consultants agreed about the current state of the economy but disagreed about monetary policy. Professor Houthakker believes the economy is stagnant and will

remain so for another year at least. He thinks the weak economy has restrained price increases, and he expects a modest improvement in the balance of payments and the exchange rate in 1981. Professor Samuelson foresees a weak recovery during the coming year. It is his view that the money growth targets for 1981 are consistent with this outlook and probably will not induce additional weakness. Professor Eckstein thinks the recession is over but that real GNP will expand only 1.9 percent in 1981. He believes 1981 money growth targets may be inconsistent with the prospective growth of the economy. Professor Tobin thinks that the money growth targets for next year are unrealistically low given the high core inflation rate and probably will cause stagnation. He advocates an incomes policy to alter wage and price behavior in addition to restrictive monetary and fiscal policies.

The financial consultants urge the Fed to hit its money growth targets. Mr. Riefler argues that the Fed will gain credibility and reduce inflationary expectations only by hitting its announced targets. Mr. Schott believes that the recent round of interest rate increases is related to the deteriorating Federal budget outlook for next year. He thinks another crunch can be averted if the Fed stands firm now. Provided that M1 does not erupt again, reigniting concerns over further interest rate increases, Mr. Wojnilower expects a relatively strong recovery in 1981.

FIRST DISTRICT - BOSTON

First District respondents have seen little change in the level of activity over the past month. Retailers, manufacturers and bankers all say much the same thing: there has been no deterioration recently, but neither has there been a significant pickup. An exception to this generalization is housing, which has been adversely affected by the increase in interest rates.

Higher interest rates have discouraged the demand for housing. Construction of new homes is down in Connecticut. In northern New England, the demand for mortgages, which was already depressed because of the economy and seasonal factors, has dropped still further. One banking respondent says that he has seen an increase in the number of mortgages past due and the papers report more foreclosures - although his bank has not been forced to such measures. The demand for automobiles is also weak, but this is attributed to higher prices as much as higher interest rates.

Retailers in the department store and general merchandise areas report that sales are rising with inflation, but there are no real gains. This continues the experience of the past several months. According to the head of one large department store chain, retailers are now optimistic about the recovery and are placing fairly large orders for the spring.

Manufacturing respondents also see little change in activity. Areas which were weak before are still weak, while areas which were holding up well remain strong. This impression of "no change" is generally confirmed by two recent surveys of New England manufacturers, although both surveys show an increase in order rates. Defense is more and more frequently mentioned as a source of strength. Inventories are thought to

be under control. According to one of the surveys, lead times have shortened and price increases for materials and components have moderated considerably in the past several months.

Professors Houthakker, Samuelson, Eckstein and Tobin were available for comment this month. Houthakker believes the economy has been stagnant for at least a year. Growth will not resume until late 1981 or 1982. Referring to the recent slower rise of commodity prices, Houthakker thinks that the economic stagnation has restrained past and prospective price increases. Adversities in food and fuel production should not end our progress to lower inflation rates. Though we have yet to pay the full price, most of the bad news about food production is now behind us, and the war damage to Iraqi and Iranian oil fields is limited. Houthakker expects a modest improvement in our balance of trade accompanied by an increase in dollar exchange rates during 1981.

Samuelson expects a weak recovery during the coming year. A "double-dip" recession is unlikely, though not impossible. Accordingly, Samuelson believes the Fed should observe its money growth targets, at least for the time being. The targets are consistent with the expected sluggish recovery, and it is too early to indict these targets for inducing additional economic weakness.

Eckstein believes the recession is over. The prospects for growth, however, are not good: real GNP will expand only 1.9 percent during 1981. The demand for investment goods may decline throughout the first half of next year, rising taxes and energy prices will restrain consumption spending, and housing demand may slump once more late this year or early next year. Because of the sluggish recovery, Eckstein believes the Fed

should "watch the money growth target, real interest rates, and the economy and not get excited until they clash." The current targets are consistent with prospective growth for the remainder of this year; a potential conflict may arise next year however.

Tobin believes that the problems of high inflation and slow growth cannot be solved by the FOMC alone. Unless the Fed and the Administration coordinate fiscal and monetary policies--perhaps including an income policy--our "money growth targets will collide with an unyielding core inflation rate causing stagnation." Acting alone, the Fed's current targets cannot finance a "normal" recovery given our persistently high inflation. Accordingly, these targets, by themselves, are not realistic. They are too harsh, and they invite withering criticism and offsetting fiscal stimulus. Price controls, however, could "keep a lid on the pot" while coordinated fiscal and monetary policies reduce inflation's full boil to a simmer. Price controls could be lifted once contracts and expectations accept a slower rate of inflation.

Second District--NEW YORK

Business activity in the Second District continued weak in September. Although retail sales were uneven for the month, some strengthening is anticipated in the coming months. Automobile purchases remained slow. The outlook for car sales is very uncertain because of rising interest rates and recent price hikes for domestic models. Outside the consumer sector, some increase in demand has been reported for machine-tool makers and is also expected for chemicals. The respondents, for the most part, do not expect any major economic recovery until the latter half of 1981. On the financial side, reports indicate that lending terms for automobile purchases remained unchanged during September. In the housing market, however, credit conditions have tightened considerably.

Consumer Spending

Consumer spending in the Second District was generally erratic during September. Sales for the month as a whole, both in New York City and nearby suburbs, were about in line with retailers' expectations. In contrast, retail sales upstate were somewhat stronger than expected. Throughout the District, inventories were generally satisfactory since most retailers have stressed the importance of following conservative policies. Credit sales appear to be running at about the same volume as last year. Retailers are generally optimistic that sales will strengthen as the Christmas season approaches.

Automobile sales in the Second District were also mixed in September. Foreign car sales appeared better than in the comparable month last year, while domestic car sales were reported to have "declined

drastically" since the beginning of the month. Used car sales also appeared to be depressed. The October 1 price increases combined with the high financing costs were cited as likely to hurt sales in upcoming months. Although the report from a major automobile manufacturer suggests a very sharp increase in sales by the third quarter of 1981, the present outlook is described as "nervous". Particular concern was raised over sales of leftover 1980 models and of the 1981 models which are not in the new fuel-efficient lines. At the same time, however, it is believed that energy considerations are fading in consumers' minds. Both manufacturers and dealers are deeply concerned over the effects of rising interest rates on the costs of financing 1981 inventories. Some dealers are considering trimming their inventories again, although they fear the reduced selection of cars for potential buyers could hurt sales in future months.

The Manufacturing Sector

Outside the consumer sector, a few signs of improvement are beginning to appear. Some machine tool-makers are reporting strengthening sales. Inventories in this industry are very lean and could result in slow deliveries if a large increase in demand occurs. Some pick-up in orders for chemicals is expected in the next month. Similarly, an increase in steel production is anticipated in 1981 (although not enough to reverse the decline experienced in 1980) in association with an expected rise in auto sales. In contrast, demand for construction materials has weakened and a major manufacturer of sewing machines is phasing out local production, idling 850 workers by the end of the year. Inventories in the oil industry remain high and there are no plans for further additions to stocks. Elsewhere

in the manufacturing sector, there has been further inventory liquidation reflecting continued uncertainties at the retail level.

Economic Outlook

The economic outlook of most District respondents was rather bearish. Although retailers anticipate a strong Christmas season, other respondents expect consumer spending to remain weak at least through the remainder of this year. The principal reasons are high food and fuel prices and rising interest rates. The recent upturn in housing starts was widely viewed as temporary, and the rise in mortgage rates was expected to produce a downturn relatively soon. Respondents were divided in their outlook on auto sales. No one outside of auto manufacturing, however, expects a sharp increase in total car sales.

Financial Developments

On the financial side, commercial banks in the Second District report no change in either lending terms or credit standards for automobile loans during the month of September. In the mortgage market, however, conditions have tightened appreciably. Commitment and application activity in September are reported to be significantly down from August levels. A number of lenders have been offering renegotiable rate mortgages (RRMs) or variable rate mortgages (VRMs) in addition to conventional instruments, and some institutions have even shifted to an exclusive RRM-VRM policy. Mortgage rates have increased by about 1 percentage point since early September. At present, the rate on new conventional mortgage commitments ranges from 13 1/2 percent plus 2 points to 14 1/4 percent plus 3 points. Commitment rates of RRMs and VRMs are lower.

Financial Panel

This month we have comments from Donald Riefler (Morgan Guaranty Trust Company), Francis Schott (Equitable Life Assurance Society), and Albert Wojnilower (First Boston).*

Riefler: While wide swings in both interest rates and money supply figures should be viewed as normal for periods of high and volatile inflation, they were exaggerated this year by the imposition and subsequent withdrawal of the Credit Control Program. It is essential to the Fed's credibility and to curtailing inflationary expectations that the Fed hit its annual money supply targets. I see some tentative early signs that the move upward in rates may be having some effect on inflationary expectations: in commodity prices plateauing, stability and strength of the dollar, and better performance of the bond market.

Schott: The recent interest rate run-up is closely related to market perceptions of the deteriorating fiscal 1981 Federal budget picture. Precautionary business borrowing--short-term and long-term--is also again a factor. By standing firm now, the Federal Reserve may be able to nip in the bud the potential need for another crunch. The market may then realize that renewed rapid economic expansion is not actually in the cards.

Wojnilower: The tone of asset markets has become more strongly bullish. Now bond prices have joined, triggered mainly by reports that Chairman Volcker had asserted the market had overanticipated the rise in money rates. If M_1 does not erupt again, concerns as to housing weakness and "double-dip" are apt to recede. My own forecast remains for a relatively robust business upturn with some tendency for inflation to reaccelerate.

* Their views of course are personal, not institutional.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business activity in October is mixed, but that the outlook is improving. Manufacturers report major improvement in industrial conditions over September, and are very optimistic about the next two quarters. New orders, shipments, inventories, and factory employment are all expected to increase between now and April.

Retail sales are still mixed overall in October, with hard goods ahead of most other lines. Merchants are cautious about coming months, and are planning conservatively.

Local bankers report good business loan activity this month, but say retail borrowing is down. Continued strength in commercial loan activity is expected, as interest rates are forecast to drop through the first quarter of 1981.

In the housing sector, sales have levelled off in recent weeks as mortgage money has become tighter. New starts have slowed as well.

INDUSTRIAL ACTIVITY

Respondents to the October Business Outlook Survey report widespread pickups in industrial activity over last month, the first such positive sign since May 1979. Supporting the claims of renewed strength, both new orders and shipments are up significantly from September, and manufacturers have added to inventories, although only slightly, for the first time in two years. It appears that factory employment has been helped by the industrial spurt too. The widespread payroll cuts of recent months are disappearing, with only marginal layoffs and hour reductions reported.

As for the future, survey participants continued to be optimistic, projecting a significant upswing in general industrial activity within the next six months. In terms of

specific indicators, about half of the survey respondents forecast climbing levels of new orders and shipments between now and April. Plans for meeting the anticipated demand include building stocks, hiring more labor, and lengthening the workweek. Increased capital outlays are also planned at about a third of the firms surveyed.

Industrial prices are up again in October, as 56 percent of the survey participants are paying more for inputs than they did a month ago, and 52 percent report charging more for their finished goods. Looking ahead, inflation is expected to continue as nearly 90 percent project raw material costs to increase by April while 80 percent plan price hikes for the goods they sell.

RETAIL ACTIVITY

Although early October retail sales have rebounded from a sluggish third quarter at some stores, overall retail activity remains mixed. Reports of current dollar sales range from 1 percent below to 10 percent above October '79 levels. A Director of this Bank in the retail business says luxury goods and apparel are making a better showing than other lines. He also notes that credit sales are growing, and are expected to continue to do so in coming months.

Local merchants continue to plan cautiously for the next six months, expecting stable but lethargic sales performance in the fourth quarter, one reason being the lack of real strength in consumer disposable income. This seems to reflect the attitude of other area retailers, as they anticipate a steady, no-growth schedule and hope to keep inventory-sales ratios healthy.

Auto dealers in the Third District say new car sales are mixed. Current sales volume reports range from 20 percent below to 25 percent above those just a few months ago, with even the more successful dealers noting some levelling off in recent weeks. Part of the slowdown can be attributed to financing problems, as interest rates have

risen and banks have become reluctant to make car loans. Most financing is being done through in-house financing agencies now, such as GMAC and Ford Motor Credit. Area dealers are optimistic about the 1981 lines, however, and expect a pickup in sales, despite higher prices on the new cars.

FINANCIAL ACTIVITY

Area bankers report mixed activity in October. Commercial loan volume is up 3 to 19 percent over year-ago figures, slightly above budget for the most part. Consumer loans, on the other hand, are off by about 3 to 4 percent. Looking ahead to the next six months, consumer loan levels are expected to remain flat. Most area bankers are shying away from marketing efforts to attract retail customers, for as one spokesman put it, "consumer loans are hard to make a nickel on." Commercial loans, however, are expected to pick up.

Third District bankers are currently quoting a prime rate of 13 1/2 percent. Projections of the prime indicate a turnabout from the recent trend of rising rates, leaving the rate 350 basis points below its current level by end of first quarter 1981.

HOUSING

Third District housing appeared healthy in the third quarter, when mortgage rates fell below 14 percent, but sales have taken a sharp dip recently as money has become tighter. Current mortgage rates are running 13 3/4 to 14 1/2 percent, with some 90 percent loans available at the upper end of this range. Mortgage market conditions may ease soon, if it becomes legal in Pennsylvania next month to offer renegotiable rate mortgages, as some thrift institution officials anticipate.

On the construction side, housing starts have slowed, with builders finishing in-progress projects but holding the line on new ground breakings.

FOURTH DISTRICT - CLEVELAND

Summary. Recent improvements in Fourth District business activity are expected to be dampened by rising interest rates, according to this month's respondents. Despite real improvements, several business economists express doubts that third quarter figures have yet to reflect the extent of inventory liquidation. Steel orders, however, continue to receive an impetus from inventory re-stocking. Capital spending is continuing on a gradual downward trend, but backlogs appear to be strong enough to sustain shipments until a recovery begins in mid-1981. Retailers and automobile dealers report some rebound in sales from the abnormally low levels brought on by the March credit restraint program. Bankers report that business loans have benefited from inventory investment, but consumer loans continue to be weak. Mortgage lending has virtually halted as a result of interest rates that are at or above 13%.

Outlook. While most respondents now acknowledge that real GNP may be slightly positive in the third quarter of 1980, they have not changed their earlier forecast of a slow recovery over the next three quarters. Because this decline was associated with a severe cutback in consumer spending rather than inventories, the recovery will be sluggish. Several economists concur that the consumer's balance sheet is not strong enough to support a strong resurgence in either consumer spending or overall economic activity. They expect little improvement in consumer spending once the catch-up from credit controls is completed. Rising interest rates are expected to weaken a recovery, but most respondents place a low probability on a double-dip recession. A most likely scenario is for real GNP to alternate between small positive and negative changes through the second quarter of 1981.

Inventories. Several business economists, while encouraged by the turnaround in production and employment, remain cautious with respect to the outlook because of inventories. Although inventories were generally in better shape going into the recession than in past pre-recession periods, a steel economist believes that there has been substantial liquidation of inventories in manufacturing in addition to steel. Several economists state that either third quarter inventory data will show liquidation, or the fourth quarter GNP forecasts will have to be adjusted downward to allow for a liquidation phase in the inventory cycle.

Steel. Significant improvements in steel orders, following heavy inventory liquidation especially by service centers and declining import commitments, are reported by industry economists. New orders in September rose consistent with almost an 80 percent operating rate, but actual fourth quarter operating rates will probably be closer to 70 percent. Steel economists report some pickup from the auto industry, but auto production schedules so far have remained conservative.

Capital Goods. Because of a seventeen month backlog in metal cutting tool orders, machine tool expenditures in real terms have increased, while new orders have continued to decline. However, machine tool producers state that order cancellations are becoming a bigger problem, although not yet comparable to past recessions. September orders may have picked up slightly because of very low August levels and a response to the annual machine tool show. Although a capital-goods producer expects a recovery in capital spending to begin in the first quarter of 1981 at the earliest, several expect the recovery to be centered among small OEM suppliers. Auto suppliers especially have been hurt by weakness in the auto industry and have curtailed purchases of machine tools and parts.

Consumer Spending. Most of the recent improvement in consumer spending is associated with a rebound from the second quarter credit controls. A durable goods producer believes that if it were not for the severe cutback in consumer spending in the second quarter, consumer spending would still be declining. An economist for a major retail chain states that unseasonably warm weather in September caused consumers to postpone fall and winter apparel purchases. Sales in the first week of October soared, suggesting that the September slump was partly a weather phenomenon.

Auto sales in the first week of October have been the best in months for area dealers. Ohio dealers have benefited substantially from a state sales tax reduction from 4 percent to 2 percent since mid-September. (K cars did not qualify for the tax reduction). Several dealers are encouraged by favorable initial response to 1981 models, but they believe that improved sales represent buying ahead and that November and December sales may weaken as a result. Several dealers are concerned about consumer response to the higher prices of 1981 models. Interest rates on auto loans, which in some areas has moved up to 16 percent, have not yet hindered auto sales partly because company financing is available at below market rates.

Banking. Rising interest rates have not had a significant effect on business or consumer lending over the past month. Business loans continue to be relatively flat, according to several bank economists, with most of the demand coming from inventory financing for companies with large declines in profits. Loans to medium-sized businesses continue to be on a plateau. Although consumer lending rates have moved upward in recent weeks, a bottoming out pattern of consumer loans does not appear to have been altered. Credit card usage rebounded significantly in August from July levels, according to both bankers and retailers.

Mortgage Lending. Increasing mortgage rates have again resulted in a substantial decline in mortgage lending, according to District S&Ls. Current rates charged by S&Ls range from 12½ percent to 13 percent for an 80% loan, while banks generally are already above 13 percent. An S&L official believes that the volatility of mortgage rates over the past year has been more important than the level in reducing demand. Buyers are still very inflation conscious and perceive real estate as the best inflation hedge. Currently, most of the lending activity is at the lower end of the price range of houses. An economist with a regional FHLB in this District expresses concern that the second half profit outlook for S&Ls may be worse than the first half. Unless rates fall drastically, many S&Ls in the District will suffer net losses. So far liquidity is adequate to meet commitments without relying on advances. Several S&L officials doubt that interest rates will fall back to 12 percent before spring.

FIFTH DISTRICT - RICHMOND

Recent contacts with District businesses suggest that business activity in the Fifth District turned up within the past month. Our survey of manufacturers indicates increases in both shipments and new orders in the latest survey period. Also, backlogs continued to be worked off and inventories, while remaining somewhat above desired levels, fell broadly. Responses of retailers also suggest a recent pickup in activity. Little change in employment occurred among respondents over the month. There is no consensus among our directors as to whether a recovery has begun. Most are able to point to particular soft spots they feel will have lingering effects. No consistent pattern seems to have emerged in consumer borrowing. The impression here is that such borrowing is up, perhaps significantly, from earlier in the year but is not yet approaching what would be considered normal levels. Mortgage lending remains slack in most areas. The heaviest general rainfall since early spring arrived during the past two weeks and should prove beneficial to late crops and pastures.

Consumer spending, on balance, appears to have picked up in recent weeks. Retail survey respondents report increased total sales in the past month and indicate that big ticket items have about kept pace. Once again there are reports of consumers buying to beat price increases. With unemployment rates down sharply from their peaks in some District states, consumer confidence may be re-emerging. A number of reports, principally from bankers, concern a short-lived surge in auto sales in early September. Such sales have apparently slacked off considerably in the past two weeks, however.

There is no evidence of any significant change in residential construction or sales in the past month. Construction is well up from earlier in the year, but hardly buoyant. Sales and the requisite mortgage lending continue spotty.

Manufacturers in the District continued to work down inventories in September. Stocks of both materials and finished goods fell on balance, but were little changed relative to desired levels. Most respondents are comfortable with current stocks. Retailers experienced further inventory accumulation over the month, but find present levels appropriate. Manufacturers, by and large, also feel current plant and equipment capacity is about right. The number and size of retail outlets is also seen as appropriate to present and anticipated circumstances.

Expectations of the future level of business activity continued to rise over the month. Over one-third of the manufacturers surveyed expect business conditions nationally, locally, and in their respective firms to improve over the next six months. Only about one in six expects the level of activity to fall over that period. Sixty percent of the retailers responding expect conditions to improve.

All of our directors from the banking industry feel there has been a moderate recent resurgence in consumer loan demand in their areas. Other bankers contacted also perceive a pick-up, but nearly everyone stresses the word moderate. In several areas auto loans accounted for much of the new demand, but there is some feeling that this activity has subsided in the past two weeks. There are also isolated reports of moderate increases in demand for home improvement and debt consolidation loans. One bank calls recent activity in home improvement loans strong. Bankers contacted are unable to evaluate the relative effects of recent changes in credit market

conditions and the auto model year-end in the recent swings in auto loan demand. There is some concern that prices and discount schedules on new American cars will prove unpleasant surprises for potential customers. There is also scattered optimism about sales of 1981 models, however. Residential mortgage activity remains generally slack. Where recent improvement is noted it was from extremely low levels. In some instances the recent changes in credit market conditions have had a negative effect, but this has not been universally the case. Some bankers see evidence that it has provided an incentive for consumers to try to lock in existing rates.

District agriculture continues to suffer from the effects of last summer's drought, although recent rains should help pastures and late crops. Production prospects for the District's major money crops are pessimistic, suggesting a further decline in farm income from crop marketings as the harvest progresses.

SIXTH DISTRICT - ATLANTA

Last month's general feeling of optimism turned to one of concern as higher interest rates threatened to stall the recovery in home building. Consumers are still cautious in the use of credit and are postponing major purchases. Merchants are reacting by keeping inventories lean. Employment brightened in August but may be less buoyant in September due to the ripple effect of slower housing demand and weaker retail sales.

Consumer Spending and Inventories. Retail sales have been slack in most areas. Home furnishings and appliance sales were weak, and the new fall fashions got off to a slow start, hampered by extended summer-like temperatures. One large retailer noted increased preference for catalog shopping as consumers continued their efforts to avoid higher floor prices. Use of cash is also more prevalent.

Although traffic is high at most new car dealer showrooms, sales have only been fair. Dealers are not optimistic about new car sales over the next three months. Consumers are taking a "wait and see" approach on the performance of the widely promoted American-made fuel-efficient cars. Many consider them overpriced. Inventories are at low levels by design--carrying charges have been rising rapidly.

Financial and Construction. The recent surge in interest rates is slowing home sales throughout the District. The typical 13 1/2- to 14-percent mortgage rate has about eliminated the first-time buyer, and trading buyers are finding difficulty qualifying for conventional financing. There is much uncertainty among building contractors and potential home buyers. They are unable to plan ahead due to rapidly changing interest rates. Savings and

loan associations report applications tapering off. Some lenders are returning to a policy of restricting loans only to their customers. Unconventional financing is becoming much more prevalent. One Florida S&L reported good reception to its new equity-participation mortgage. A large south Mississippi supplier reports a sharp reduction in orders for construction materials since interest rates have moved up, and lumber prices in north Florida have fallen considerably from last month's level. About the only market not yet affected by the high interest rates are the luxury condominiums in south Florida as building continues strong.

Capital investment plans are mixed at this time. Northern Alabama businessmen are leary of making plant expansions or building inventories because of escalating interest rates, but in south Florida, firms are said to be still expanding with minor exceptions. Backlogs at high-technology companies are the highest ever. In Louisiana, industrial construction is strong due to continued petrochemical expansion.

Employment and Industry. For the most part, the employment picture has brightened, although there still are some rough spots. Manufacturing employment turned upward for the first time in over half a year. The factory workweek edged up, but hours worked in many industries are still far behind those of last year. Cutbacks are anticipated by the farm machinery and food processing industries as the record-breaking heat wave and drought curtailed crop and animal production. Unemployment continues to escalate in northern Alabama, with renewed layoffs and a "general across-the-board slowdown" by industrial concerns. Datsun, Japan's second largest automotive manufacturer, will build a major truck plant in middle Tennessee. The

plant, set for production in 1983 at a cost estimated at nearly \$500 million, will ultimately employ 2,200 workers, nearly all of them local.

Tourism has shown some slackening in most areas except for southeastern Florida, which continues to attract foreign visitors. Eastern Airlines reported that passenger revenue miles were down 12 percent in south Florida. Deplanements were also off in New Orleans, and hotel reservations in Nashville were down 10 percent from the year-ago level.

Agriculture. The drought has made further reductions in District crop production; however, additional price increases have offset some of the drag on income. Corn and soybean prices have risen significantly. The cow-calf industry faces a severe squeeze resulting from drought-reduced forage supplies, rapidly escalating feed costs, and feeder calf prices averaging 25 percent below a year ago. Farm credit outstanding is well above year-ago levels, and farmers have made heavy use of emergency credit.

SEVENTH DISTRICT - CHICAGO

Activity in the district apparently strengthened moderately in the past two months, but remains well below the levels of either the first quarter or last year. No substantial revival is expected for the next several months. Consumer buying is sluggish. Capital spending, overall, is in a downward phase. Inventories are lean and under tight control. Wholesale prices are strengthening again after a brief period of discounting last summer. Housing remains severely depressed. Farm income prospects have improved. Credit is generally available, but high rates and tighter lending standards hold down new credits. Complaints of "slow pay" by businesses and consumers are widespread.

Purchasing managers in Chicago and Milwaukee report that the modest improvement they noted in August continued in September. For many companies, however, this means merely a slower rate of decline. Some uptrend in orders, output, and employment has occurred, but activity remains well below the levels of the first quarter. Prices paid are strengthening again.

Retail sales. Retailers report that sales were somewhat disappointing in September and early October, following an improvement from the low point of April-May. Price cutting and special sales are common. Except for strength in auto parts and service, no categories are singled out as particularly strong or weak. Credit use has revived, but customers are using their lines cautiously. Delinquencies continue to rise, but not alarmingly. Retail inventories are definitely lean, so a strong Christmas season, should it develop, would cause some stockouts.

Airline traffic has been declining for several months. In September

passenger miles on trunk airlines were 13.5 percent below year ago. Advance bookings and customer surveys suggest the picture will weaken further. The recession and higher fares, up 40 percent on full-pay tickets, are blamed.

Autos and trucks. Motor vehicle sales were slow in September, partly because of depleted inventories of large cars. No clear reading on the strength of demand for 1981 models will be possible until late October or November. New models appear to be selling well, but high prices shock some potential buyers. Inventories are in much better balance than a year ago at this time. Most dealers have moved out stocks of big cars and consumer-type trucks. Rates on car loans have stabilized in the 14-16 percent range. Credit is available, but lenders are very selective on new credits, especially on 42 and 48 month loans. Finance companies are now charging over 14 percent on floor plan loans, and dealers are complaining bitterly. Dealers are determined not to overstock again, partly because they fear that carrying costs, subject to change day-by-day, will increase further. Dealerships continue to close as losses accumulate, but not as frequently as last spring. Captive finance companies have reestablished some closed dealerships under new managements. Showroom traffic to view new models generally has been disappointing, partly because new features are not apparent in styling. There is little hope for a substantial revival in vehicle sales in the next 3 to 6 months. Sales are especially weak in Chicago, and the Midwest generally.

Capital goods. Overall, new orders for equipment are continuing to decline, and backlogs are still eroding, but at a slower rate. There is no evidence of heavy cancellations of orders as in 1974-75. The oil and gas sector and machine tool builders have large backlogs. Demand for farm

equipment and heavy trucks shows some improvement after a sharp decline earlier in the year. Construction equipment is in its worst slump ever. Orders for heavy castings have stabilized at a rate equal to about 60 percent of capacity. Freight car deliveries are declining at an accelerated rate.

Steel orders have improved since early July. Operations have moved from a low of 50 percent of capacity to about 75 percent, but remain well below the levels of 1979 or early 1980. Some laid off steel workers have been recalled, and closed furnaces have been started up. Lead times on sheets have returned to normal, but leads on most other products remain short. Steel inventories at all levels have been low for the past year, which explains the up and down nature of steel demand.

Housing. Residential construction activity is at a postwar low in most district centers. An incipient revival in the summer was aborted in August as mortgage money tightened and rates moved back past 12 percent. Currently, most posted rates range from 13 to 14 percent plus fees of 2.5 to 3 points. Some lenders offering 13 percent loans say there is no need to go higher because demand has "dried up." The failure of builders to get "holes in the ground" this fall will slow the seasonal uptrend in activity next spring. Used house sales also remain at a low ebb, with most realtors down to skeleton crews.

Nonresidential construction is at a high rate, but is expected to decline in 1981. A large volume of work is in the planning stage, with contracts expected to be let some months hence. Financing will be a problem unless the insurance companies return in force to the commercial mortgage market which they largely closed off in late August.

Agriculture. Crop prices have declined somewhat, and livestock

prices have leveled, but farm income and credit remain healthier than was the case early in the year. Corn and soybean harvests are ahead of normal. Recent frosts were light and did not significantly alter yield forecasts. The Wisconsin dairy industry has been relatively prosperous. It will be strengthened further by the semiannual adjustment which raised the milk support price to 14 percent above last year as of October 1.

Inventories. Businesses of all types are striving to keep inventories low, partly because of high financing costs. Only oil product inventories are deemed excessive, but this would be a stabilizing factor if the Iraq-Iran war drags on or spreads.

EIGHTH DISTRICT - ST. LOUIS

Overall economic activity has changed little in recent weeks according to Eighth District businessmen. Consumer spending at department stores has increased somewhat from August to September. In contrast, automobile sales, while on an uptrend since April, declined slightly from August to September. Manufacturing activity is mixed but, on balance, has changed little since early September. Increased orders and production were reported by manufacturers of metals, chemicals, and construction materials, while orders for capital goods declined further. Home sales in September were adversely affected by rising interest rates. Overall loan volume increased in recent weeks, led by business loans to manufacturers. Even though agricultural harvesting is proceeding rapidly, sharply reduced crop yields in parts of the District will substantially reduce farm incomes this year.

Consumer spending has increased modestly in recent weeks according to area retailers. Department store representatives report that September sales were up from both August and from a year ago. Some retailers noted that recent gains have been achieved by markdowns and promotions, so that profit margins remain depressed. Retail sales in some rural areas are reported to have shown little improvement in recent months due to depressed farm incomes. Automobile sales have generally risen since last April, although September sales were down somewhat from August. Car dealers report that substantial showroom traffic has been generated recently by the newer energy efficient models of domestic manufacturers, but that is too early to assess their sales potential.

Inventories are at generally acceptable levels at both the retail and manufacturing firms. A major chemical firm reported that excessive inventories of

some plastics, intermediate chemicals and industrial chemicals have been reduced to satisfactory levels.

Manufacturing activity appears to have been unchanged in recent weeks, and no further substantial layoff of workers was noted. Gains were reported by manufacturers of construction materials, metals, chemicals, and feeds. A producer of construction materials noted, however, that the recent gains are likely to be short-lived because higher interest rates are expected to reduce housing activity. Some manufacturers of clothing and appliances noted little change in recent weeks. Capital good orders are on the downside; high interest rates and anticipated tax benefits from legislation next year are reported to be reasons for the falloff.

Residential housing sales declined in September after increasing in the early summer months. A representative of the St. Louis home building industry reports that home sales in September may have declined to one-half the level of July and August, and that, for the year, they may be only about 20 percent of normal. Rising interest rates are cited by homebuilders for the decline. Rates have risen from 11-1/2 percent to around 13-1/2 - 14 percent since mid-summer. Virtually no backlog of home sales exists, so that residential construction layoffs will occur as sales decline. Nonresidential building continues at a high level as a result of existing projects. A representative of one St. Louis firm noted, however, that an office building project has been shelved because of the recent rise in mortgage interest rates.

Recent financial developments include somewhat higher loan volumes at area financial institutions and higher interest rates. Business loan volume at banks is reported to have increased in recent weeks. Higher demand for loans was noted by manufacturing firms, particularly textiles, petroleum refining, and chemicals. In

addition, a small increase in consumer installment loans and a seasonal increase in agricultural loans associated with grain storage from the fall harvest was noted. Partially offsetting these gains were declines in loans to retailers and wholesalers. Lenders report that the movement away from long-term fixed rate mortgages is gathering momentum, and that such mortgages may soon be regarded as a thing of the past. Some banks report a reluctance to lend to consumers since a change in the personal bankruptcy law has increased bad debt expenses.

Agricultural producers in the District, particularly in Arkansas and Missouri, face substantially reduced incomes this year due to poor crop yields, death losses of poultry, and higher production costs. In Arkansas, the soybean and rice crops are reported to be down 50 and 25 percent, respectively, from original estimates. In addition, Arkansas poultry producers suffered heavy financial losses last summer due to heat related deaths of poultry. As a result of reduced incomes in these areas, local banks report the potential for bad loans is the highest in many years.

NINTH DISTRICT--MINNEAPOLIS

September's rise in interest rates has slowed but not stalled the district recovery we've reported for the last two months. The higher interest rates reduced home sales and inventories and discouraged some bank lending. Retail sales and manufacturing activity continued to improve, though, and auto sales started to pick up. Also, generally favorable weather and high prices cheered district farmers.

Consumer Spending

Recent interest rate increases choked off some consumer spending in the Ninth District, but not much. Home sales have undoubtedly been cut back. At one of the largest S&Ls in Minneapolis-St. Paul, for example, the conventional mortgage rate jumped from 11 1/3 percent to 13 3/4 percent between August and September. At the same time, the firm's average weekly mortgage applications dropped from 200 to 74. However, the revival in retail spending, which began in July, does not seem to have been slowed by the higher rates; most directors report some increase in their areas in the last month. Auto sales actually began to improve in September. Representatives of regional sales offices for two large domestic auto manufacturers say their new car sales rose modestly between August and September. Both directors and auto sales representatives believe that so far interest rates have had little effect on retail and auto sales.

Industrial Activity and Inventories

Industrial activity doesn't seem to have been hurt much by the higher interest rates either. Manufacturing may have been held down some, since the rate increases made some businesses more hesitant to add to inventories. Auto

dealers, for example, have cut back new car orders even though their sales just picked up. But manufacturing activity generally still seems to be expanding. Directors and the Minnesota Department of Economic Development say that in September manufacturers continued to recall laid-off workers and step up production rates.

One district industry not noticeably affected by the higher interest rates is mining--but unfortunately it is still depressed for other reasons. Reduced steel demand is still holding down iron ore shipments from Minnesota and the Upper Peninsula of Michigan. Copper mining in Montana is still shut down by a strike. And 1,500 of 2,500 striking workers lost their jobs in September when the Anaconda Company closed its copper smelting operations in Anaconda and Great Falls.

Agriculture

A more fortunate industry not noticeably affected by the September interest rate increase is agriculture. Although too little rain in parts of South Dakota and Montana kept some winter wheat from germinating and too much rain in North Dakota held up the durum wheat harvest, the weather elsewhere was good and helped the corn, sunflower, and soybean crops mature properly. Prices also looked good for farmers in September. In Minneapolis, the average cash prices for soybeans and corn continued to increase. Wheat prices declined slightly but remained above last spring's levels. In St. Paul, average cash livestock prices also remained above last spring's levels. Feeder cattle prices rose again, while slaughter steer and hog prices declined slightly.

Financial Developments

Higher interest rates probably did discourage some lending at district financial firms in September, for while the economy continued to show signs of

improvement, bank lending remained sluggish. Between August and September, loans at district member banks did not grow as much as expected for that time of year. Directors also report no lending pickup at commercial banks in their areas. They believe the higher interest rates are partly to blame.

TENTH DISTRICT—KANSAS CITY

Overview. Growing concern about the future prospects for business activity is apparent among Tenth District businessmen. An increasing pessimism is evident among auto dealers and in the homebuilding industry, as rising interest rates appear to be dampening activity in those sectors. Lighter inventories are being sought by retailers, and manufacturers are trying to reduce materials inventories. Meat supplies, now plentiful, are expected to tighten next year, bringing higher prices. Loan demand at District banks is generally flat, and deposits are growing moderately.

Retail Sales and Inventories. The majority of Tenth District retailers surveyed report that sales in the latest three months were slightly better than sales in the first half of 1980. Sales appear to be strongest in apparel and nondurable home furnishings, with some weakness still existing in big ticket items such as appliances and furniture. Remarkably, all District retailers report slight or nonexistent increases in merchandise costs in recent months. A majority of retailers contacted intend to approach the fall and Christmas seasons with lighter inventory levels than last year, which will in some cases require reducing their purchases of merchandise. Most retailers expect only slight sales gains in the last quarter of 1980 compared to the last quarter of 1979.

Automobile Sales. Recent changes in credit market conditions have adversely affected District auto sales, particularly in Missouri and Colorado, as consumers have become noticeably more reluctant to buy cars since the recent rise in interest rates. Fewer banks are making auto loans, and dealers and consumers are relying more heavily on credit from the automakers' finance

companies. Although dealers generally have reduced their inventory plans in the last month, they are still guardedly optimistic about the 1981 models—though somewhat less optimistic than a month ago.

Manufacturers' Inventories and Input Prices. Although almost all of the purchasing agents contacted report a stabilizing of input prices in recent months, over half feel that this trend will not last, and that prices will resume rising by yearend. Most input lead times are considered short, but are expected to start lengthening because most suppliers no longer have excess inventory. Most purchasing agents are ordering less than last year, and are trying to reduce materials inventories.

Homebuilding and Home Finance. According to Tenth District homebuilders and savings and loan associations, recent increases in interest rates have had a negative impact on the housing sector. New house sales in some areas have dropped to the low levels experienced in the spring of this year, but inventory levels of new homes are not now critically high. Housing starts have slowed to a near standstill, with few builders willing to make advance commitments. Savings inflows have improved slightly because of the lag between recent increases in interest rates paid by savings and loans and the adjustment of fixed rate money market instruments that compete with those associations for funds. Current mortgage rates average about 14 per cent on conventional loans at District associations, an increase of 1 to 2 per cent from two weeks ago. At the higher mortgage rates, demand for mortgage funds has slowed appreciably.

Agriculture. U.S. meat supplies, which appear plentiful now, are expected to be substantially tighter during most of next year. Hog inventories for Tenth District states are 8 per cent below year-earlier levels, while nationwide inventories are only 3 per cent lower. Although hog marketings

for the remainder of 1980 are expected to equal or exceed marketings during late 1979, farrowing intentions suggest a substantial reduction in pork slaughter during the first three quarters of 1981. Consequently, hog prices are expected to improve through mid-1981. September 1 cattle on feed numbers indicate a 14 per cent decline from year-earlier levels in feedlot inventories for Colorado, Nebraska, and Kansas. Marketings of fed cattle during August were 13 per cent below 1979 levels for the three District states. Placements of cattle into feedlots in the seven major feeding states increased 20 per cent from August 1979 levels, while District states' placements rose 16 per cent during this same period. Feeder cattle prices have increased 5 per cent during the past quarter, but remain 8 per cent below year-earlier levels.

Banking Developments. Loan demand remains flat at most Tenth District banks contacted this month, with exceptions at some banks in Oklahoma, Wyoming, and New Mexico where local economic conditions remain strong. Commercial real estate lending continues to be strong in Oklahoma and Colorado, but in other areas of the Tenth District all types of real estate loans are weak. Most bankers report that consumer instalment loans for automobiles are unchanged from earlier low levels. The recent rise in interest rates has raised bank lending rates significantly above the rates offered by automobile finance companies such as GMAC. Other categories of consumer loans increased somewhat from last month's levels.

Deposits at most Tenth District banks contacted rose this past month, with six-month and 30-month certificates showing the greatest strength in response to the rise in interest rates. Demand deposits experienced moderate growth in regions with strong economic activity and are flat in most other areas.

ELEVENTH DISTRICT--DALLAS

Economic recovery in the Eleventh District is slowing as a result of higher interest rates. Residential construction is most affected, but a growing number of firms are altering business decisions in light of higher rates. Department store sales are growing slowly, while new car sales show little improvement. Nonresidential construction remains active, but some plans for future projects are fading. Factory output is mixed, as is the demand for labor. Growth of total bank loans is tapering off although C&I loans continue to expand rapidly. Many farmers are unable to pay back production loans. S&Ls report strong demands for available mortgage funds, and deposits are increasing.

Department store sales are recovering slowly, according to survey respondents. Soft goods, particularly clothing, are showing relatively more strength than consumer durables. Retailers are optimistic regarding Christmas sales. Retail inventories are in line with sales expectations.

New car sales continue to run about the level a month ago, and dealers fear sharply higher sticker prices on the 1981 models will depress sales further. Trucks are outselling cars in some areas, and respondents indicate demand for used cars is on the increase. Dealers are trying to hold down stocks of new cars because the recent rise in interest rates has added significantly to inventory costs. Good used cars are generally in short supply.

Demand for housing continues to grow rapidly as indicated by a persistent rise in prices, but high interest rates have slowed the recovery in residential construction. Current sales reflect the number of people

moving into the District and to a smaller degree purchasers who had commitments before interest rates rose. The slowdown in homebuilding is causing a modest buildup in inventories of unsold houses for some builders.

Nonresidential construction activity remains robust, especially in the large urban areas. But higher interest rates and the long-run outlook for inflation are dampening future construction plans. Financing is difficult to arrange from domestic sources. In addition to interest on their loans, a growing number of lenders want a percentage of the rents or an equity share of the ventures in which they participate. Foreign funds are readily available, with investors willing to provide high proportions of equity and with returns on investments as low as 7 percent before taxes. Financing by the Federal Government is being reduced for such projects as highway construction.

Manufacturing output remains mixed, and rising costs are cutting profit margins. High inventory levels of finished goods continue to depress production in refining and chemicals. Output of most building materials has leveled off, but a maker of fiberglass insulation is running at full production to rebuild inventories that were depleted during the summer heat wave. Lumber production is down, and prices of 2x4s, particle board, and wallboard are off significantly from a year ago. Demand for steel products continues to grow apace of commercial building, power plant construction, and the boom in oil field activities. Electronics firms reported a brief slowdown in shipments, but an acceleration in defense spending is offsetting a softening in consumer demand.

Current labor market conditions reflect the mix of economic activity in the District. Unemployment is rising among construction workers,

while growth of manufacturing employment is abating. Still, many employers report shortages of skilled workers in a broad range of occupations.

The growth in volume of bank loans is slowing, largely as a result of the increase in interest rates. Consumer borrowing, especially mortgage loans, is down sharply. Many banks are reluctant to make auto loans as business loans are more profitable. C&I loans continue to expand. Much of the strength is related to oil and gas activities, but loans are up in many manufacturing industries. Total deposits are increasing at District banks with demand deposits outpacing time deposits.

Preliminary results of our quarterly survey of agricultural credit conditions indicate the rate of loan repayment is slower than usual. Severe drought conditions caused significant, widespread declines in crop yields, and in some cases crop abandonments. As a result, an unusually large number of farmers are unable to repay production loans as scheduled. Bankers also report many young farmers with high debt/equity positions may not be able to withstand the drop in income caused by this year's crop failure. Government credit agencies have been actively making emergency loans.

Deposit growth is strengthening at S&Ls. Mortgage loan rates are reported as high as 14 1/2 percent plus two points. S&Ls report profits are being squeezed by the high cost of funds, but the situation has eased somewhat by the rollover of certificate accounts originated in the first quarter. Mortgage loan demands are strongest in large urban areas, and 80 percent of all loan applications are by buyers moving into the Southwest. Delinquencies remain at a low level.

TWELFTH DISTRICT -- SAN FRANCISCO

The recession continues to be felt in the Twelfth District, as sluggish economic activity was reported throughout the region. Retail sales generally were down despite increased promotional activities. A variety of labor issues were of major interest during the past month. Strikes and the potential for strikes involving a substantial number of workers were reported throughout the district. Interest rates and unemployment both continue to be high and concern is expressed over this continuing phenomenon. Mortgage loan demand has fallen drastically in response to movements in interest rates. Commercial loan demand has also fallen but large corporate borrowing remains at its past rapid pace. The agricultural picture remains bright as good harvests and profits are anticipated. Industrial activity remains stable with little change in behavior expected.

The EMPLOYMENT picture in the region has centered on a variety of labor negotiations. Both the 71 day old Kennecott Copper strike and the strike by winery workers have ended. One mine workers' agreement has been reached while another is still in negotiations. The possibility of an aerospace workers' strike involving over 30,000 employees was diverted with the recent acceptance of a contract package. The unemployment situation is regarded as serious in many industries, but particularly in the automobile, steel and construction sectors. A notable exception to this situation is the electronics industry where demand for skilled workers is still high.

A number of respondents feared that the unemployment picture for minorities may aggravate racial tensions.

AGRICULTURAL ACTIVITY is reported to be good throughout the Twelfth District. Excellent harvests are predicted for a variety of crops, with record harvests expected in some areas. The drought conditions in some areas of the country have created high prices for a number of crops, especially potatoes. The current heat wave in some parts of the district has created concern for the plum, peach, and nectarine harvests. The high price of cattle feed has brought on expectations of higher meat prices in the coming months. However, given reports of increases in herd size, some believe that increased supply will help to hold down meat prices next year.

Little change in the INDUSTRIAL sector was reported. Most businesses are continuing with past investment plans despite the rise in interest rates. In general, investment activity is low and inventories are reported to be below normal in a number of industries. This was created concern of higher prices when the recovery begins. For some industries, the slack in domestic business is made up by above normal foreign sales.

The recovery of RETAIL SALES continues to be slow. Although some areas are reporting an increase in sales brought about by seasonal factors, retail sales in most areas are down. The use of credit cards is still way below normal. While some specialty shops and more expensive stores are reporting increased sales, most stores are reporting sluggish sales and large inventories. A number of areas note a sharp rise in promotional activity.

Whether this increase in advertising is in response to feelings of a shift in consumer spending moods or an attempt to decrease inventories is uncertain. Also present are reports of manufacturers offering discounts off list price.

The HOUSING market has been drastically hurt by the increase in interest rates. Mortgage rates of 14 percent and higher have severely reduced the demand for mortgage loans. The filing of permits for new construction has also been sharply curtailed. Property is staying on the market much longer than in the past few months. The lumber industry has been especially hard hit by the decrease in housing activity. Demand has been flat and unemployment in the sector is very high.

The outlook for FINANCIAL INSTITUTIONS is widely regarded as gloomy. Expectations of higher costs and declining markets are expressed. The rise in interest rates has brought about an outflow of deposits as savers are moving their funds to money market instruments. Rising rates have also had a dampening effect on the demand for loans by small borrowers. However, the demand for loans by large corporate borrowers does not appear to be affected by the increase in interest rates. This stable behavior is believed to be due to the fear of even higher rates in the future, deferment of long-term financing due to conditions in the bond market, and the relative narrowness of spreads between the prime and commercial paper rates. A great deal of concern was expressed over the coming of NOW accounts. Also discussed was the potential for problems created by a change in the pricing behavior of financial institutions brought on by movements towards deregulation. Additional concern was expressed about the increase in bankruptcies and loan losses.