

CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS 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	24
Ninth District - Minneapolis	27
Tenth District - Kansas City	29
Eleventh District - Dallas	32
Twelfth District - San Francisco	35

SUMMARY*

Overview. Reports from Reserve Banks this month indicate, on balance, a definite weakening in the economy, with widespread prospects for a W-shaped recession resulting from sharply rising interest rates. While manufacturing is generally slowing, modest gains in orders are still prevalent. Inventories at the manufacturing and retailing levels are considered to be satisfactory, but in some cases are described as lean. Consumer spending in the early part of the Christmas season has been disappointing, but retailers expect heavy discounting to provide a strong finish. Bank loan demand is weak, with business loans generally holding up better than consumer loans. Mortgage lending is depressed, as rates reach as high as 16% in some districts. Farm price increases have strengthened the agricultural sector.

Outlook. The effect of rising interest rates on housing, autos, and business investment is blamed for a weakening economic outlook. Economic activity in the past month has been relatively unchanged in Boston and St. Louis, but is becoming sluggish in most other Reserve Banks. Only Atlanta reports strengthening, except for housing and auto sectors. Expectations of a resumption of recession are mentioned by Philadelphia, Cleveland, Chicago, and San Francisco. Several bank economists in Cleveland now view the recent recovery as a temporary lull from the recession. Respondents in New York, Philadelphia, Cleveland, and Richmond expect conditions to improve by the second half of 1981.

Manufacturing Activity. Sluggish or slowing manufacturing activity is indicated in Boston, Chicago, Minneapolis, St. Louis, and Kansas City. However,

*Prepared by the Federal Reserve Bank of Cleveland.

high interest rates have not prevented widespread gains in manufacturing employment in Atlanta, or increases in new orders in Boston and Chicago. Manufacturing has improved somewhat in Dallas, based on strength in chemical and energy industries. Richmond reports mild declines that cut across most industry groups, while Philadelphia reports a sharp downturn in early December. Cleveland and Chicago are experiencing sustained strength in steel orders, partly related to a turnaround of inventories, but both report that no revival in capital goods orders has occurred yet. Some machine toolmakers in New York report weakening sales.

Inventories. Inventories are generally reported to be under tight control at both manufacturing and retailing levels, mostly because of the high cost of financing. Several Reserve Banks note that inventories of some items are quite lean at the retail level. However, inventory problems with autos and housing are cited by Boston and Richmond. St. Louis and Cleveland expects quick adjustments to inventories, notably in steel and autos, following an economic slowdown. Chicago reports that retailers may still find January liquidation sales necessary despite clamps on stocks.

Consumer Spending. Retail sales have shown mild strength in Kansas City, Dallas, Richmond, and Atlanta, but are flat or sluggish in most other Reserve Banks. Heavy traffic is reported by Chicago, but buying is said to be restrained, especially for big-ticket items. Consumer durable sales fell substantially in San Francisco, and Richmond reports durable goods sales remain weak. Heavy promotions are reported in most districts and are the basis for relative optimism among retailers for a healthy Christmas season.

Auto Sales. Auto sales are generally described as weak or declining, according to most Reserve Banks, because of rising interest rates and high

prices on new models. Sales are off in Minneapolis, Kansas City, Dallas, and San Francisco. Some gains are noted in Boston over year-ago levels and in St. Louis over summer levels, but dealers view such gains as unsatisfactory. While domestic sales are stagnant in New York, foreign car sales picked up. Dallas sales are hampered by a usury ceiling that makes auto loans unprofitable. Some banks in Cleveland and Chicago are reluctant to finance dealer floor plans.

Housing. Mortgage lending activity continues to weaken, with Boston, Chicago, Atlanta, and San Francisco experiencing a virtual halt in mortgage loans. Mortgage rates at or near 16% in Chicago and San Francisco are apparently the highest in the nation. Philadelphia reports that seasonal declines and tight mortgage money have contributed to curtailed sales at a level 40 to 65% below last June. The difficulty over qualifying for financing is particularly noted by San Francisco, while St. Louis reports that three-fourths of loan applications are rejected. Some banks in Cleveland are providing preferential rates to builders who they financed, and St. Louis reports that builders are subsidizing home buyers by offering below market rates.

Banking. Although loan demand is generally soft, some improvements in business loan demand are cited by Dallas, Kansas City, and St. Louis. Sources of the loan strength are restricted to energy and agricultural industries, although business loans in St. Louis appear to be supporting Christmas inventories. Richmond reports a mild increase in instalment credit. Bankers in Minneapolis state that funds are available, and several districts report that deposit growth is supported by large CDs. Both St. Louis and San Francisco stress that much of the business borrowing is short-term. Strong business loan demand, centered in inventory financing and in substitution of business loans for commercial paper, is also reported by New York.

Agriculture. Agricultural production and farm income are relatively strong as a result of rising farm prices. St. Louis reports a sharp increase in wheat acreage and expects a substantial increase in double cropping of wheat acreage in 1981, if prices hold. Kansas City states that credit conditions have shown sustained improvement and Dallas notes an increase in the usage of Government agencies for loans at lower interest rates than banks. However, farm income prospects have dimmed in Atlanta, as prices for meat, citrus crops, and cotton decline.

FIRST DISTRICT - BOSTON

There has been no major change in the level of economic activity during the past month. Retailers are generally optimistic about the Christmas season, although recent experience has been mixed. Surveys of manufacturing activity show that increases in production and new orders are more prevalent than decreases. In the banking sector, loan demand is sluggish and mortgage business is minimal.

Retail sales performance during the past several weeks has been quite varied and does not provide a clear indication of what the Christmas season will be like. In Connecticut early Christmas sales were somewhat disappointing; this has led to more discount sales than usual for this time of year. On the other hand, post-Thanksgiving sales in northern New England were encouraging. The heads of two major chains of general merchandise stores report that recent sales figures have been strong; however, there appears to have been some weakening in the first days of December. Whatever their recent experience, retailers are fairly optimistic about Christmas. If these expectations are realized, there will be real gains relative to year ago totals. Inventories are in the lean to normal range. Auto dealers are an important exception to these general comments. Sales have been disappointing, although dealers in Connecticut have seen a modest increase over last year.

In the latest survey of New England purchasing managers a small majority of firms reported that production was unchanged from a month ago, with most of the rest reporting higher production levels. A majority of firms has also seen an increase in new orders. The number of firms

experiencing lower orders has declined steadily for the past three months. Firms are holding down inventory levels, in part because of the high cost of financing these inventories. These efforts to conserve inventories are leading to a "hand to mouth" style of managing inventories which in turn is causing longer delivery lead times and shortages. Firms are also taking a cautious attitude towards capital purchases.

Despite the generally favorable business picture, several respondents have reported an increasing number of bankruptcies among small manufacturers. This development is attributed to high interest rates. Also, in Massachusetts, which has fared very well to date, there have been some major layoffs in the western part of the state and the number of firms announcing Christmas vacations is noticeably above the levels of the past two years.

Banking respondents report that loan demand has been fairly flat. Mortgage demand has dried up and there is little demand for automobile credit. Bank profits vary considerably depending on the extent to which a bank's assets are sensitive to interest rate fluctuations.

Professor Houthakker was the only academic correspondent available this month. He is concerned about the inflation outlook for next year. The price of imported oil will soon start to rise, because oil stocks--which may be needed--are still running down. The Fed should not try to compensate for foreign price inflation, however. The enactment of a Kemp-Roth tax cut will also worsen the inflation outlook. His main concern is that the aggregates are exceeding the upper limits of the target range. It is absolutely necessary, in his view, to try to return to the ranges and to follow through in lowering the ranges for 1981. He feels "something

spectacular" needs to be done in the monetary area since traditional policies have not been sufficient. Houthakker proposes auctioning 5 million ounces of gold to supplement domestic open market policy. He is skeptical that 1980 was a "real" recession but expects a "short dip" in economic activity in 1981.

SECOND DISTRICT - NEW YORK

Business activity in the Second District was mixed in November. Retail sales were generally flat on a constant-dollar basis during the month. Foreign car sales picked up, but domestic car sales continued to stagnate. Outside the consumer sector, signs of weakness were spreading among machine toolmakers and in the steel industry. The respondents, for the most part, do not anticipate any major economic recovery before mid-1981. On the financial side, the suspension of usury ceilings in New York State is expected to raise rates sharply on personal borrowing and weaken demand for such loans. Strong demand for business loans was reported. In the mortgage market, financing has generally been available, but the demand weak because of the high rates.

Consumer Spending. Retail sales in the Second District advanced during November only because of price increases. After adjusting for inflation, retail sales were either flat or showed slight declines except for a few isolated areas of strength. There were reports of higher retail inventories, but these are not a source of concern at this time of year. Christmas sales are generally expected to show a moderate increase in nominal terms, but to be flat on a real basis. The recent removal of usury ceilings on most types of consumer borrowing in New York State is expected to be of little consequence for Christmas sales. Evaluations of the longer-term impact were uncertain, but retailers anticipate at least some negative effects, especially in cases where customers have maintained fairly high average balances.

Automobile sales in the Second District followed the pattern of the last few months. Imports have shown consistent strength, while domestic car

sales have been generally stagnant, as consumers continue to show resistance to the high prices for the newly introduced small cars. Used car sales are still sluggish. Reactions to the lifting of state usury ceilings varied. Although some negative impact on car sales is anticipated, most dealers feel that the high auto prices will be the primary factor limiting sales.

The Manufacturing Sector. Outside the consumer sector, results were variable. In contrast to most other sectors, sales of paper products and chemicals were reported strong. The recent strength in chemicals, however, was credited to the respondent's aggressive new management and not to increased demand throughout the industry. Sales in the petroleum industry were down in November, continuing a year-long trend which has been attributed primarily to price increases. Demand for such items as digital watches and small calculators have been strong, but this was viewed in part as an indirect result of consumer reluctance to purchase large-ticket items. Inventories of durables were reported to be too high, and some cutback in production is anticipated early next year. Some machine toolmakers were reporting weakening sales, particularly for lower-priced items.

Economic Outlook. The outlook of most District respondents remains bearish. Most expect no improvement in general economic conditions before the middle of 1981. Higher interest rates were cited as a principal cause of the sudden slowdown in the economy. Indeed, recent developments in interest rates have altered the outlook for the steel industry significantly because of its heavy dependence on plant and equipment spending and on the production of durable consumer goods. All of these are expected to be adversely affected by rising interest rates. Respondents also believe that the housing market will decline significantly because purchasers will be

reluctant to make commitments at such high rates, although mortgage money will be available. In the business sector, borrowings by large firms from commercial banks at below prime rates are expected to increase. Respondents also observed that because industrial production is too high for the level of retail sales, inventories will begin to accumulate and this will add to the demand for business loans.

Financial Developments. With the suspension of usury ceilings on personal loans effective December 1, consumers in New York State will pay sharply higher rates on personal borrowing. With rates of 19 percent for unsecured loans and 18 percent for secured loans, demand for personal loans is expected to be weak. In the mortgage market, the December 4 rise in the discount rate has heightened concern over the availability of mortgage money. New commitment activity is down, though this is partially seasonal. Demand is weak throughout the region but is least sluggish in New Jersey. Although there was a net inflow of deposits at S&Ls during November, following outflows the previous two months, mortgage lending is not expected to increase as a result. In the corporate sector, even though demand for business loans is strong, banks are still aggressively competing for loan customers. There seems to be little demand for capital improvement loans, strong demand for inventory financing, and some substitution of business loans for commercial paper.

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

*Their views of course are personal, not institutional.

Riefler: The Fed's policy is beginning to work. Inflationary expectations as reflected in the commodity markets (and to some degree the stock market) are being adjusted downward. Before too long money supply numbers will also weaken. The long-term financial markets have shown remarkably good stability, given what has happened to short-term rates. It is important to remember two things: Markets do overshoot and interest rate levels are reversible. Because rates can come down, there is less reason to be fearful about the longer-term impact of today's interest rates on the economy. Prospects for autos and housing are not great, but otherwise spending should not fall precipitously in the months to come.

Schott: A renewed slowdown in the economy--again led by housing and automobiles--is now in the making, provided the Federal Reserve sticks to the objective of curbing the growth of the aggregates. Interest rates in excess of previous peaks may be required to accomplish the objective, partly because there are no direct credit restraints and partly because some sectors of the financial market are still in a relatively liquid position. The alternative to restraint now is even more restraint later since underlying inflationary forces are very strong.

Wojnilower: Economic activity is still expanding rapidly, though less so than a few weeks ago. Except for usury-related kinks in bank credit for autos, credit is freely available. There is virtually no institutional interest in long-term fixed-rate bonds, nor is such likely to revive in view of the impending conflict between fiscal and monetary policy.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District point to a slowdown in business activity for the month of December. This could mark the beginning of the second part of the "double-dip" recession many economists have been forecasting. Area manufacturers say industrial activity has taken a sharp downturn this month, but remain optimistic, anticipating a widespread upswing in general industrial activity by next June. Local retail merchants report real dollar sales to be even to slightly ahead of last year's levels, and look forward to moderately strong sales in 1981. In the financial sector, District bankers indicate sluggish loan activity. Business loan volume is generally flat, while consumer loans are down again in December. Area bankers forecast no change in consumer loans, but predict slight gains in business borrowing. On the residential construction side, sales have dropped off sharply owing to seasonal factors and tight mortgage money, according to area real estate contacts. Contractors and developers are holding off on new ground breakings until they are less uncertain about future mortgage rates.

INDUSTRIAL ACTIVITY

Third District manufacturers responding to the December Business Outlook Survey report a sharp downturn in general business activity relative to November. This follows a three month respite from the downward trend area industry has been in since mid-1979, and could signal the start of the second part of the "double-dip" recession many economists have been predicting. Supporting the reports of decreased activity, both new orders and shipments are down substantially. The employment situation looks dimmer as well as payrolls have been cut fractionally and the average workweek has been shortened again. Inventories, on the other hand, have remained stable for the second month in a row.

As for the future, area manufacturers remain optimistic projecting a widespread upswing in overall industrial activity within the next six months. New orders and shipments are expected to increase and area manufacturers plan to make fractional additions to inventories. Labor, too, may get a boost as local manufacturers plan to increase their work forces and lengthen working hours by next June. Increased capital outlays are also projected as demand begins to grow.

On the inflation front, industrial prices are up again in December, as 52 percent of the respondents report paying more for raw materials than they did last month, and about one-fifth indicate charging higher prices for their finished goods. No relief from inflation is expected as better than 9 out of 10 of the managers surveyed anticipate input costs to rise by next June, and 8 out of 10 plan price hikes for the goods they sell.

RETAIL ACTIVITY

According to area retailers, December sales are mixed compared to year-ago figures but pretty much as merchants had expected. Reports of current dollar sales volume range from 0 to 9 percent above December '79 levels, but after adjusting for inflation, these are only small gains at best. However, the picture may not be as bleak as it looks. For one thing, this year's sales are being compared to the record volume of last December, when the economy was in a healthier state. Also, inclement weather on "Black Friday," the day after Thanksgiving and traditionally one of the biggest shopping days of the year, kept many holiday shoppers at home, thus keeping the lid on recent sales. Finally, most merchants started Christmas promotions in mid-November; so, instead of posting large gains in early December, many retailers have been experiencing small gains for several weeks now, which may amount to the same thing.

The retail community is optimistic about holiday business in general, projecting Christmas sales to run 3 to 6 percent ahead of last year's levels. Looking

ahead to 1981, retailers expect another moderately strong year and are hoping for sales gains of about 8 1/2 percent.

FINANCIAL ACTIVITY

Area bankers report sluggish loan activity in December. Reports of C&I loan volume range from 1 percent below to 1 percent above year-ago figures. Business borrowing is generally below budget. Consumer loans are down this month also, by 3 to 5 percent. For the longer term, local bankers project commercial loans to increase by 3 to 4 percent within the next six months, while consumer loans are expected to remain flat.

Third District bankers are currently quoting a prime rate of 19 percent. Projections of the prime indicate an expected turnabout from the recent trend of climbing rates. Cuts in the prime are expected to come soon, leaving the rate about 250 to 350 basis points below its current level by mid-1981.

Reports of deposit flows in the Third District indicate demand deposit levels to be down as much as 7 percent from year-ago figures, and savings deposits down 2 percent over the same period.

HOUSING

December seasonal factors have combined with tight mortgage money to produce a further drop in housing sales this month, leaving current sales volume 40 to 65 percent below June levels, according to area brokers. As mortgage rates continue to climb, running 15 1/4 to 15 1/2 percent at the present time, more and more buyers are pulling out of the market causing a slowdown in the upward spiral of residential prices. At the same time, contractors and developers, uncertain about the direction of future mortgage rates, are holding off on new starts.

FOURTH DISTRICT - CLEVELAND

Summary. Sharply rising interest rates have caused most respondents in the Fourth District to adjust their 1981 forecasts downward, with several now expecting at least one quarterly decline in real GNP in the first quarter. Capital goods producers continue to experience weakening orders, especially in machine tools. Orders in the primary metals industry continue to hold up surprisingly well, but industry spokesmen expect a decline next quarter in response to a weakening economy. Post-Thanksgiving day department store sales have been better than expected, but several area retailers are concerned about softening Christmas season sales because of rising interest rates. Bankers report continued weak loan demand. S&Ls expect an intensified profit squeeze as costs rise and loan demand slackens because of rising mortgage rates.

Outlook. Although a sluggish recovery was generally anticipated at the Fourth District Economists' Roundtable meeting on November 7, most participants now expect a decline in real GNP in the first and possibly second quarters of 1981. Several bank economists envision the negative quarters as part of a continuation of the 1980 recession. The release of pent-up demand following credit restraints provided a brief third quarter recovery in consumer spending and economic activity. Positive quarters during a recession are not uncommon, such as occurred during the 1973-75 recession. However, interest rates never went to double-digit levels, notes a bank economist, because inflation was viewed as a short-term problem. Now, inflation is viewed as a serious long-term problem. Several business economists anticipate at best a flat first half and a strong recovery in the second half of 1981 based on tax cuts, pent-up demand, and falling interest rates. A

business economist notes that, despite rising industrial production, inventories are still generally tight and inventory liquidation is unlikely to sustain a recession.

Capital Goods. Although capital spending remains weak, industry officials state that the decline in orders has not been as sharp as in some past recessions and the worst is probably over. While their overall order pattern was late in turning down (i.e., orders were strong until July), a machine tool producer notes that orders remain strong from energy and aerospace industries. Cancellations from the auto industry have not occurred, but softening of machine tool orders in the first quarter of 1981 is expected as major programs reach completion. A producer of trucks and heavy equipment reports that orders are not showing strength from recent very low levels. Investment in trucks is not taking place, except for replacement. Despite the unlikeliness of a strong recovery, a capital goods producer expects such positive factors as defense spending and an underlying need to modernize to provide a good recovery in capital spending, especially in the second half of 1981.

Primary Metals. November orders in the steel and aluminum industries have held up surprisingly well, according to industry economists. November's volume of steel orders was slightly above October's rate, although a steel economist reports signs of a tapering off toward the end of the month. Bookings in January remain solid, including flat-roll products, and even February has shown no letup. Nevertheless, orders in February and March are expected to slacken as effects of rising interest rates and tax increases dampen consumer durable goods, housing and producers' goods. The turnaround in steel this quarter to about 80% of capacity from a low of about 50% last summer, largely represents a swing in inventories from substantial liquidation last quarter

to a mild buildup in December. Aluminum orders, reports an industry economist, have been supported by the relative strength in defense, aerospace and auto sectors. Although normally a net importer, the country has been a net exporter for 14 months. However, with a worldwide slump underway, orders are expected to drop.

Retail Sales. Several retailers report stronger-than-expected sales the day after Thanksgiving. A department store official states that sales are currently doing well, compared to last year, with the heaviest volume days yet to come. Inventories appear to be adequate, but in some cases are lean. However, pre-Christmas discounting may still be necessary to avoid an unwanted overhang. An economist with a major retail chain in the District expects an 8% year-over-year increase in December's GAF sales, and a slight increase in real PCE in the fourth quarter from the third quarter level. However, an apparel producer estimates a 5 to 6% decrease in company sales over the next six months.

While several area automotive dealers are concerned about sales, an industry economist reports that small cars continue to sell relatively well despite rising interest rates. An area auto dealer states that rebates are essential to sales and notes that domestic producers are beginning to provide credit support for dealers. An auto industry economist states that production schedules are already being adjusted downward to minimize inventory overhang.

Banking. Consumer and business loans are still relatively weak, according to several area bankers, partly because many consumer loan applications are being rejected. A bank economist notes that the volume of outstanding consumer loans declined in recent weeks, which is unusual for this time of year. Auto loans have been the most interest-sensitive consumer loans in recent weeks and declines in loan applications have been more than seasonal.

A bank official notes that a disproportionate share of auto loans is for 1980 models at the expense of 1981 models, reflecting higher cost of new models. Loans for dealer floor plans are off because some dealers still have sizable 1980 inventories, which must be reduced before banks will risk financing higher inventories. Some pickup in business loans has occurred in the last month, according to a bank economist, as corporations avoid long-term markets.

Mortgage Lending. Weak mortgage loan demand and the rising cost of funds are causing serious earnings pressure on area S&Ls. However, an economist with a regional FHLB in the District notes that the improvement in earnings that began in August has continued through October, and probably in November, although profit declines are expected by January 1981. Earnings next quarter could be worse than in early 1980, but the net worth condition of S&Ls is strong enough to sustain profit declines. While conventional mortgage rates on 80% loans range between 14 and 15½%, an S&L official states that preferential rates are being offered by some banks to move unsold new homes. While savings flows have been good in November, mainly because of money market certificates, several S&L officials state the funds are used either to repay advances or to invest in money markets.

Fifth District - Richmond

Fifth District business was characterized by change in November. In most sectors and in most areas that change was toward somewhat weaker performance. Some areas of strength seem to have emerged, however. Retail sales, in particular, picked up over the past month according to our survey. Sales of consumer durables have kept pace recently but have not reversed earlier declines. Manufacturers surveyed report declines in new orders, order backlogs, inventories, and employment over the latest survey period. Inventories, of other than automobiles, have not become a problem for most businesses. Housing sales and construction showed renewed weakness in recent weeks after having recovered somewhat in most areas. Price increases continue widespread. The outlook for business activity over the next six months remains generally positive.

Consumer Spending

Sales at department stores showed some improvement over the past month. One respondent terms the improvement over the past two weeks dramatic. Pervasive strength is not evident, however. Sales of big items and such lines as building materials continue to languish. Inventories are up from a month ago and are somewhat above desired levels. Inventories will not present a problem to most retailers unless Christmas sales come in substantially below expectations. Current expectations are apparently for healthy, though unspectacular, Christmas sales. Sales in the automobile sector remain soft and inventories are of some concern there.

The Manufacturing Sector

Manufacturers surveyed recently report shipments holding steady but new orders, order backlogs, and inventories all declined over the past

month. Employment and the length of the average workweek were also down from a month earlier. These declines, while not deep, seem to have cut across most industry groups. The effects appear to have been greatest in the electrical machinery and equipment group and least in the furniture industry. Inventories, while declining in absolute terms, also fell relative to desired levels. There remains some concern over current stocks, but this concern seems to have diminished over the last month. There appears to have been some effort among manufacturers to draw down inventories slightly. Many have been able to do so without significantly reducing production. Monitoring inventories carefully, many manufacturers have allowed minor gains in shipments in recent months to reduce inventories while production was held stable. Current plant and equipment capacity remains above desired levels, but there is some scattered sentiment for enlarging expansion plans. Increases in prices, other than employee compensation, were more widespread last month than in other recent survey periods.

Housing

Almost all of our directors questioned perceive a weakening of housing activity over the last month or so. In several areas housing starts are described as nearly nonexistent. Single-family starts, and particularly speculative building, are severely depressed almost across the district. Some multi-family construction is being supported by subsidy programs. Inventories of new and resale housing units are substantial. Sales activity is also down in recent weeks. In many areas the improvement registered in late summer has been lost. In some areas no improvement developed and housing activity is continuing to trend downward. Expectations are that there will be little improvement before spring.

The Economic Outlook

Despite recent reverses in business activity, survey respondents remain generally optimistic. Manufacturers expecting activity to improve over the next six months out number those who expect a worsening by about two to one. Nearly half of those surveyed expect the level of business activity nationally to improve, while nearly as many expect improvement in their respective firms and market areas. Half the retailers surveyed expect similar improvement.

The Financial Sector

Commercial and industrial lending has been very nearly level recently. Lenders expect little change in business loan demand in coming months. For the most part lenders left have standards of credit worthiness unchanged. Their response to market conditions has been almost entirely in the form of interest rate increases. There have been only moderate increases in consumer installment debt in recent weeks. Richmond directors expect little change in the near future although some feel that consumer installment debt may rise slightly in the near term.

SIXTH DISTRICT - ATLANTA

Weakness in housing and auto sales has darkened an otherwise strengthening economic picture in the District. Retail sales were up in real terms, factory payrolls advanced notably, and nonfarm employment accelerated. Rapidly rising interest rates, however, have about shut down housing starts, and auto dealers express concern over slumping sales.

Consumer Spending and Inventories. Stores were crowded with customers, and parking lots were overflowing in retail shopping malls and stores after Thanksgiving. Business volume exceeded expectations of many merchants in the District as gross sales were up over the previous year, even allowing for inflation. The customer is not giving much consideration to prime rate advances or other financial news, although one report indicates reduced credit sales. Retailers in central Florida and eastern Tennessee attribute the strong sales to heavy promotions. Special buys are also helping to lure potential customers.

This year's Christmas buying season is a full week shorter than last year, although many merchants began Christmas advertising before Thanksgiving. The shortened period may hurt impulse buying. A southern Mississippi merchant notes selective buying of practical items. High-priced quality merchandise, such as televisions and stereos, is selling well. A major department store's strongest sales were in furs, jewelry, high-quality apparel, and items with a western touch. Specialty store proprietors report good sales of investment-priced items. People want something that will last. Retailers catering to the luxury market and discounters selling top-quality goods seem to be doing better than mass

merchandisers and low-end discounters, whose customers are the hardest hit by inflation. Retailers report inventory stockpiles up as much as 10 percent over the same period last year in anticipation of a heavier-than-usual post-Thanksgiving Christmas crunch.

Auto dealers are encountering difficulties as high interest rates and buyer resistance to price increases draw down sales. One dealer reports that the only small cars available from the manufacturer are loaded with expensive options. Many prospective buyers are failing to qualify for loans under current interest rates. Dealers expect conditions to persist through December but are optimistic about 1981.

Financial and Construction. High construction and financing costs are putting home builders in a bind. New housing starts are down notably throughout the District. The homes that are being built are scaled down and lots are smaller. Interest rates on home loans are pushing 15 percent. The current slowdown is affecting not only detached homes but also condominiums. Condominium conversions have slowed in Florida where many construction projects have been deferred or cancelled because of high interest rates. Pre-existing home sales have also slowed there. There are very few large projects on the drawing boards of commercial contractors due to the high cost and limited availability of funds; plus, most lenders are now requiring an equity position. Corporate long-term borrowing in the form of tax-free industrial revenue bonds indexed to the prime rate is becoming more prevalent.

Employment and Industry. At least through October, the high interest rates have not adversely affected employment. Gains in manufacturing employment were widespread, but levels were still well below those of last

year. Worker recalls lifted primary metals employment, and the machinery and paper industries registered strong increases. Services and trade also showed solid employment advances. Rising factory employment and a boost in hourly earnings have caused considerable increases in manufacturing payrolls.

We have received mixed reports about the tourist industry at this time. The recession in other parts of the country is being reflected in central Florida as attendance at major attractions there was off 25 percent from last November. In south Florida, however, bookings at a luxury hotel are 30 percent ahead of last year, perhaps indicating the affluence of the international visitors in that area. October was characterized as the biggest month ever for tourists in New Orleans.

Agriculture. Farm income prospects dimmed further. Prices received by farmers declined in mid-November for the second consecutive month. A downturn in prices for meat, citrus crops, and cotton was partially offset by higher prices for grains, eggs, peanuts, tobacco, and vegetables. Falling livestock prices and high feed costs influenced farmers to reduce their breeding stock. Outstanding farm loans at District banks continued well above year-ago levels during October, suggesting a slowdown in rates of repayment.

SEVENTH DISTRICT - CHICAGO

Summary. Fears are growing that the economy is slipping back into a recession. Christmas traffic is heavy at outlying shopping malls, but actual buying is said to be restrained, especially for Big Ticket items. Forecasts for autos and trucks are being scaled down. Sharply higher interest rates are putting a damper on many activities, but there is no sudden, drastic impact such as occurred last March and April. The strongest sectors are electronics, computers, telecommunications, oil and gas development, and defense. Steel operations are holding at an improved rate. Most other sectors are weak, both for consumer and business products. Housing activity has practically come to a halt except for site preparations. Inflation is accelerating. Fuel supplies appear adequate for the winter, but problems may begin to appear next spring.

Output and employment. Purchasing managers in Chicago and Milwaukee reported higher output in November, but employment was stable or lower. New orders rose in November, but backlogs continued to decline.

Prices and wages. Last August only about one-third of the purchasing managers in Chicago and Milwaukee reported paying higher prices, while about 10 percent reported lower prices. In November, over 60 percent reported higher prices, while less than 4 percent reported lower prices. Steel, aluminum, and gas and oil were up most. Chicago area employers boosted white-collar salaries and wages about 9.5 percent in 1980, up from 8 percent in 1979. Another rise of 9.5 percent is seen for 1981.

Retail sales. Customer traffic at big retailers has been heavy on weekends. Nevertheless, most customers are buying very cautiously, especially

when instalment credit is required. Worried retailers are promoting specially-priced merchandise heavily, a practice reminiscent of the 1974 Christmas season. Stocks had been held down intentionally, but there may be need for liquidation sales in January.

Motor vehicles. Sales of cars and trucks remain below expected levels, especially for Chrysler. Dealers are in jeopardy again, partly because of the rapidly rising cost of floor planning. A major Milwaukee bank has withdrawn from floor planning entirely. Most banks have raised rates on consumer vehicle loans, and more are restricting loans to customers or are taking other restrictive measures. Observers believe that first quarter output schedules will be reduced. Purchase of vehicles by business are fairly strong.

Capital goods. No revival is yet apparent in producer equipment. Backlogs have leveled off in some cases, but continue to decline overall. Demand for components needed for maintenance has increased moderately. Hopes are growing for an improvement in farm equipment sales in the spring. Construction equipment remains at a very low ebb. Several plants have been closed temporarily and some permanently.

Steel. Deliveries of steel are up significantly and will continue at an improved level into the new year. Demand for oil and gas country items is well in excess of capacity. Sheet orders are on extended lead times, while other lead times are normal. More bidding is being done on structural steel. Some of the improvement in steel demand represents a desire of companies to rebuild depleted inventories to protect their LIFO base.

Housing. Mortgage rates have moved into the 15.5 to 16 percent range with very few transactions taking place. The inventory of finished

and semifinished houses is low, but builders have been preparing tracts of land.

Nonresidential. Contracts for caissons and bidding on structural steel suggest a continued high level of construction for office buildings, hotels, and luxury apartments in Chicago's downtown area. Other major cities report similar trends on a smaller scale. An overhang of unrented space is reported for the suburbs, however. Substantial contracts are also being let for renovations of existing office buildings and hotels.

Fuel. Fuel supplies appear adequate for the winter, but analysts expect severe trouble next year if the Iraq-Iran war is not settled by April 1. A crisis is certain if the war spreads. Estimates of the rise in oil prices next year have been raised. Natural gas is increasingly looked to as the nation's best energy hope for the years ahead. Canada and Mexico have surpluses, and domestic supplies are being augmented by findings of huge quantities of gas below the 15,000 foot level.

Municipal finance. State and local governments are under pressure to cut outlays to reduce budget deficits. At least one governor has frozen hirings. Tax receipts, especially gasoline taxes, have been running below projections, and tax increases may be needed. In Chicago, newly organized militant fire and police unions, already among the highest paid anywhere, are threatening to strike to get increases equal to the rise in the CPI.

EIGHTH DISTRICT - ST. LOUIS

The overall level of economic activity in the Eighth District has remained virtually unchanged in recent weeks. Largely reflecting the impact of sharply rising interest rates, the optimism expressed by many businessmen immediately after the November election has diminished. Several businessmen have suggested that the recovery is losing momentum, and that the chances of a W-shaped recession have increased. Consumer spending appears to have stalled in November, with department stores reporting that sales in current dollars are only slightly above levels of a year ago. Automobile dealers note that sales have improved from earlier in the year but that recent sales have been disappointing. Manufacturing activity, which had posted some gains in certain industries such as steel, consumer durables and paper, showed no further increases in November. On the positive side, some increase in orders for military equipment and energy-related products continues. In the building sector, nonresidential building activity remains relatively strong, but homebuilding has declined again and concern over the survival of many homebuilding firms has been expressed. Loan volume at banks has increased in recent weeks, but saving and loan officials report that mortgage lending activity is at a very low level.

Retail sales have made only slight gains in recent weeks in contrast to rapid price increases; hence, sales have declined in real terms. Retailers report that higher quality merchandise is selling better than other goods. As a result of the sluggish sales outlook and rising interest rates,

some retailers report that they are paring down their orders for spring inventories. Although automobile sales are mixed, they appear, on balance, to be modestly above last summer's level but substantially below the level of a year ago.

Manufacturing activity has remained unchanged in recent weeks.

Automobile manufacturing, which registered modest gains as the new models were introduced, has remained steady in recent weeks, but at levels far below those of a year ago. Similarly, manufacturers of paper products, metals, appliances, and furniture report no further gains in recent weeks, following a rise in the late summer and early fall. Some manufacturers noted adverse outlook signals such as sluggish retail sales, deteriorating home sales, and sharply higher interest rates. A number of building materials manufacturers and an appliance manufacturer reported that the slowdown in residential construction could likely affect their businesses in the near future. On the other hand, the manufacturing of military aircraft and energy-related products continues at a strong pace.

Inventories are reported to be at satisfactory levels. Some firms report that a downturn in business activity would lead to inventory adjustments with one major chemical firm reporting that some customers are already realizing unplanned inventory increases.

Homebuilding continues to slow in the District because sharply rising mortgage interest rates have discouraged homebuying. Home mortgage interest rates are now in the 14 to 15 percent range with lenders reporting few loans at these rates. One savings and loan official noted that three

out of four applicants are rejected because of inadequate income or savings. Consequently, most home sales entail some kind of special financing arrangements. Some builders, for example, are making loans at below market rates and absorbing the difference. Nonresidential building activity appears to be holding stable and at a relatively high level. One nonresidential contractor noted that his company has a full calendar of work for the next few months and that new projects are on the drawing board. It was also revealed that a considerable portion of current construction projects is being financed by short-term credit.

Loan volume at commercial banks has continued to increase in recent weeks, reflecting increases in business and agricultural loans. Increases in business loans reflect a seasonal increase in loans to finance Christmas inventories. Higher than normal demand for agricultural loans is reported because poor harvests and depressed farm income are requiring an abnormally large carryover of loans. In contrast, bank installment loans have remained essentially unchanged in the past two months, partly because of slow consumer spending on cars and other large purchases. Several bankers report that loan delinquencies are up and personal bankruptcies are unusually high. In Arkansas, bank lending to consumers has almost evaporated, reflecting the low usury ceilings. The attempt to amend the state's 10 percent usury law failed again in a recent election.

In the agricultural sector, harvesting of this year's crops and fall plantings of wheat are nearing completion. Wheat acreage is reported to be up sharply throughout the District. A substantial increase in the double cropping of wheat acreage is expected in 1981, if current prices hold.

NINTH DISTRICT - MINNEAPOLIS

Last month, the Ninth District's recovery was again sluggish. Between October and November, general merchandise sales and manufacturing production expanded very modestly, mining activity remained weak but showed signs of improving, and car and home sales declined. Mirroring these weaknesses was the continuing sluggishness in commercial bank lending. Agricultural conditions, however, were quite strong, even though price changes were mixed.

Consumer Spending

Consumer spending remained sluggish. November's gains in general merchandise sales matched October's modest increases, according to bank directors and major Minneapolis/St. Paul retailers. Not only were consumers hesitant to purchase general merchandise, but they cut back their auto and home purchases. The modest pickup in car sales noted in our last Redbook report did not carry over into November, as bank directors and regional sales offices indicate that car sales declined between October and November. Home sales, which have been declining since September, also fell last month, as the dollar value of mortgage loan applications at Minneapolis/St. Paul area S&Ls dropped 25 percent.

Industrial Production and Inventories

Industrial activity also continued to be sluggish. Bank directors report that manufacturing production rose modestly in November as it did in October. This is consistent with a University of Minnesota survey which indicates that Minnesota manufacturers have been increasing production, but not enough to start hiring more workers. This slow growth, directors believe, stems from recent interest rate increases pushing up inventory costs and causing businesses to cut back on their ordering. Unlike manufacturing activity, mining

activity has at least been improving, although it is still slow. Iron ore inventories have been reduced enough in the Upper Peninsula of Michigan so that iron ore production was increased modestly in November. And in Montana, the copper mining strike which began July 1 was settled in November.

Financial Developments

Because the district's recovery continued to be sluggish, bank lending continued to be weak. Directors from outside the Minneapolis/St. Paul area indicate that their areas' banks still have plenty of funds to lend, and that lending did not pick up in November. In the Twin Cities, banks also have funds to lend, but loans outstanding at commercial banks did increase modestly between October and November.

Agricultural Conditions

In contrast to the sluggishness elsewhere, farm conditions were generally strong. Last summer and early this fall, good growing conditions and rising crop and livestock prices boosted farm income considerably. The income of crop farmers, who account for about half of the district's farm income, continued to rise in November. In Minneapolis between October and November, the average cash prices for corn and wheat rose about 5 percent, and for soybeans 9.6 percent. Farmers have been able to take advantage of these higher prices, as no transportation bottlenecks have been encountered. Despite the sizeable increase in crop prices, however, district gains in farm income were probably held down somewhat by declines in livestock prices. In St. Paul, the average cash prices for cattle and hogs fell about 5 percent between October and November.

TENTH DISTRICT—KANSAS CITY

Overview. Economic activity in the Tenth District remains generally sluggish, although retail sales show some strength. Sales of new automobiles are off sharply, however. Manufacturers are trimming inventories of inputs and reducing orders accordingly. Agricultural credit conditions are improving with improved prices for farm products. Deposits and loan demand at commercial banks are generally flat.

Retail Sales and Inventories. Most Tenth District retailers report that sales in recent months have improved, relative to the first three quarters of 1980. Mild winter weather has slowed sales of winter clothing and accessories but appliance sales and sales of higher priced items have improved slightly. Advertised promotional merchandise has sold well recently to very price conscious consumers—a price awareness that is expected to continue through the Christmas season. Most retailers, who intend to continue to expand advertising expenditures and promotional price cutting, are optimistic about 1980 Christmas sales.

Higher advertising and promotional expenses have put downward pressure on retailer's profit margins, even though merchandise cost increases have not been substantial in recent months. Retail prices during December of this year are not expected to increase markedly because of the influence of promotional price cutting in Christmas merchandise. The practice of tightly controlling inventory levels has benefitted District retailers, as most of them are satisfied with current stocks. Recent improvements in sales have left some retailers slightly understocked, but most retailers expect to have enough merchandise to meet anticipated Christmas sales. District retailers will continue to monitor actual sales closely in order to adjust inventory purchases accordingly.

Manufacturers' Inventories and Input Prices. Half the purchasing agents contacted report a slowing trend in input price increases in the past three months, but most feel that prices will accelerate in early 1981. Current lead times on deliveries are lower than normal, but many purchasing agents expect lead times to lengthen because their suppliers have cut back production and depleted their inventories. New purchase orders are mostly down from last year as most companies have been trimming their materials inventories. Most companies are producing at somewhat below their normal levels, but only one-third of them report having workers on layoff.

Automobile Sales. District Automobile Dealers Associations report that auto sales in November declined markedly from their early fall levels. High sticker prices seem to be the main factor, but high interest rates are also having a depressing effect on sales even though loan money is available. High interest rates are forcing dealers to carry fewer cars in stock, which may also be having an effect on sales. Association spokesmen warn that there will be a wave of dealer closings if there is not relief from high interest rates in the next two or three months.

Agriculture. Agricultural credit conditions in the Tenth District are showing sustained improvement. Many bankers report they are experiencing higher pay downs on agricultural loans this year than in the past three or four years. Most attribute this increase to the substantial improvement in crop prices during the latter part of 1980. Loan demand remains slow in most District states as farmers continue to reexamine their credit needs. Sales of machinery, equipment, and buildings to agricultural producers are very slow, in most cases. Some replacement equipment is being purchased, but many farmers have decided to

"make do" with their present equipment for another year. Machinery and equipment dealers appear to be suffering from this loss of trade.

Banking Developments. Loan demand is flat at most Tenth District banks contacted this month. Several banks in Oklahoma report moderate increases in commercial and industrial loans related to the energy industry, one of the few categories of loans that exhibits any strength. In other parts of the District, commercial and industrial loans have increased slightly because of an apparent involuntary rise in business inventories. Most bankers report that agricultural loans are relatively weak, with high borrowing costs causing some reductions in livestock herds. The recent rise in lending rates has also virtually eliminated any demand for mortgage and consumer instalment credit. All of the banks contacted raised their prime or base lending rates in the past month. Most of the metropolitan area bankers currently have prime rates of 18 1/2 per cent, following the lead of large money center banks. Base fees at some country banks have recently increased to 20 per cent.

Deposits at Tenth District banks contacted are generally flat. Demand deposits have increased slightly at some banks, but in most cases remain flat. Savings deposits are down uniformly throughout the District. The major source of deposit strength is large CD's, which increased at banks experiencing some loan expansion.

ELEVENTH DISTRICT--DALLAS

The recent rise in interest rates is beginning to take a toll on economic activity in the Eleventh District. Retailers are cutting prices to clear inventories and reduce financing costs. High interest rates also continue to depress sales of new cars and housing. Nonresidential construction is at the same high level of activity as last month, and drilling for oil and gas continues at a record level. Factory output continues to expand, but some industries show signs of weakening. Commercial loan demand is rising, while consumer credit continues to decline.

Price cutting is widespread at District department stores as merchants attempt to reduce inventories. Some retailers are paring orders for spring merchandise, as they anticipate a sales decline in the first quarter. Survey respondents report slim increases in dollar sales. Consumers are characterized as cautious, and credit card usage is down significantly. Part of the decline in use of credit cards, however, is the result of recent changes in billing procedures, as banks now charge interest from the date of posting.

New car sales continue to decline as many traditional sources of auto loans dry up. Because of state usury ceilings, banks no longer find auto loans profitable. In addition, only half of all potential customers can qualify for loans with the higher prices and interest rates. Normally, four out of five qualify. Commercial banks are refusing loans to customers without perfect credit records. They are also requiring larger down payments and shorter loan maturities.

Construction activity is mixed. Housing starts are declining, as high interest rates are discouraging both mortgage and interim construction financing. There is a slight buildup of inventories of unsold new homes. The level of nonresidential construction activity shows no change due to the large number of projects underway. While high interest rates are causing plans for some projects to be cancelled, the outlook is for little slowing from current levels of activity as builders of large projects supply their own funds or receive unsecured interim construction loans from commercial banks. Furthermore, most large commercial projects in the District utilize foreign equity, typically with a lower return than is acceptable to U.S. investors.

Drilling activity is running at a record level. Shortages of rigs, drill pipe, and crews persist in most fields. A number of domestic drillers are expected to pull out of Canada in response to the Trudeau government's effort to nationalize that country's oil industry. That may help to alleviate shortages in some areas of the United States.

The growth in the dollar volume of loans at District banks is very strong. The rise in loan demand is being led by the oil and gas, transportation, and wholesale trade industries. Borrowers in good financial positions are continuing to utilize credit, since they believe they can ride out the current rise in interest rates. The weakness in bank loans is confined largely to consumer credit. Bank deposits have risen in recent weeks, but much of the increase has been in large CDs.

Mortgage loans at S&Ls are down substantially from a month ago. Deposit inflows are also slowing. Most of the funds S&Ls are attracting

are in the form of large CDs. S&Ls are maintaining their liquidity levels by making fewer mortgage commitments.

Manufacturing has improved somewhat from a month ago; the outlook is for slow growth. Oil field equipment manufacturers are operating at full capacity, as are many defense contractors. Chemical production, while still weak, shows signs of further recovery. Production of building materials and aluminum is still declining. Fabricated metals producers report a slowdown in new orders in the last month, while a major electronics firm has scheduled layoffs in its consumer products division.

Agricultural conditions are little changed from a month ago. Winter plantings, as well as late harvests, are on schedule. Farmers are increasingly turning to Government agencies, rather than commercial banks, for loans in order to take advantage of lower interest rates.

TWELFTH DISTRICT - SAN FRANCISCO

Fears of a downturn in the economy are widespread throughout the twelfth district. Expectations are that the recent increases in interest rates will exacerbate the recession. The swings in interest rates have made doing business more difficult and businesses more cautious. Retail sales are stagnant, but hopes are that they may rebound during the Christmas season. The housing market has come to a complete standstill with mortgage rates in the 16% range. Agriculture remains a bright spot in the region. Financial institutions are gloomy about their profits during 1980 and a general pessimism is expressed about economic prospects for 1981.

Retail sales volume is down both from last month and last year. While nondurable goods are selling at about last year's level, consumer durable sales are down substantially. Consumers appear to be postponing capital outlays. Very few credit card transactions are taking place since consumers are avoiding paying the high interest charges and because of the purported change in attitude towards the use of credit. Most retailers are taking a wait-and-see attitude before judging the magnitude of Christmas sales. Some fear the concern over economic conditions may put a damper on initially brisk sales activity. Automobile sales, which had been rebounding somewhat in October and early November, have been drastically reduced because of recent increases in interest rates.

The high cost of borrowing has also hurt the housing market. With mortgage rates in the range of 16%, housing activity has come to a complete standstill. The cushion of prearranged financing that held up through October has been exhausted. Potential home buyers are finding it difficult to qualify for financing. Banks and savings and loan institutions are reluctant to make

mortgage loans at any rate. Expectations for the housing industry are grim since a greater slowdown in construction activity is forecasted for December.

Interest rate volatility is of major concern throughout the district. Respondents have universally indicated that the great swings in interest rates have made doing business much more difficult. Developing forecasts and planning strategies is virtually impossible because of the uncertain economy. The implementation of effective asset and liability management is essential. Businesses are also more cautious. Loan demand is down and businesses are reluctant to borrow because of the unpredictability of interest rates. As a result, businesses are delaying capital expenditures and are cutting inventories. The borrowing that is being done is short-term.

Agricultural prospects remain bright throughout the region. Most farmers are reporting large harvests and good prices. Cattle sales are expected to be well above last year's levels and ranchers are expecting adequate profits. Mixed feelings were expressed over what effect the recent increases in price supports will have on dairy farmers. Some fear that the price increase will be offset by a substantial decrease in consumption. The lumber industry remains depressed and additional layoffs are occurring.

Financial institutions are reporting that high interest costs are pushing profits down significantly. Financial institutions increasingly are unwilling to make long-term, fixed-rate loans. Loan losses and delinquencies are high. No widespread outflow of deposits has occurred yet. However, higher interest rates prompt concern about this possibility. Uneasiness over the impact of NOW accounts was also indicated. Financial innovations and regulatory changes are spurring greater competition for funds, complicating portfolio management. Some optimism was expressed that housing could be made more available

as savings and loan institutions make greater use of equity sharing as a means of financing.

Expectations are pessimistic for 1981. It is feared that the rise in interest rates will choke the recovery and lead to very slow growth in real GNP next year. Energy and food prices are expected to skyrocket and play a significant role in increasing inflation. Both wage-rate increases and unemployment are expected to be high in the coming year.