

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Overview: Economic conditions deteriorated further during November, according to the District reports. Growth in consumer spending slowed or fell in many regions. The slump in manufacturing worsened, and layoffs, production cuts, and plant shutdowns appeared to be spreading. Residential construction failed to revive despite a decline in interest rates. Nonresidential construction activity continued strong in some Districts. While consumer lending remained soft, business borrowing strengthened in a few Districts. Low prices depressed agricultural incomes and created anxiety about farmers' abilities to meet loan obligations. Economists have revised their forecasts of near-term economic growth sharply downward. Many believe the downturn will reach the trough by the first or second quarter of 1981 and that the economy will then rally over the second half of the year.

Consumer Spending: The retail sector was soft throughout the country during November. Many areas experienced reduced sales growth or actual declines, although the pace improved after Thanksgiving in the Northeast. Real sales, however, were lower in Richmond, Atlanta, Chicago, and Minneapolis. After falling in October, nominal retail spending in San Francisco recouped the loss in November, but in real

* Prepared at the Federal Reserve Bank of New York

terms holiday expenditures are not expected to reach last year's mark. Although high quality products were selling better than low-cost goods in Boston, durables and other big-ticket items were moving especially slowly in many other locations. Merchants in numerous Districts were counting on a late surge to produce an acceptable holiday season, with some stores relying on heavy promotions and price markdowns to increase activity. Despite the overall sluggishness in retail sales, inventories were mentioned as a problem in only five Districts. No improvement in automobile sales was evident, and dealers in Cleveland were prepared for one of the worst months ever.

Manufacturing: Manufacturing activity nationwide appeared to be worsening from last month's depressed levels. All Districts reported drops in new orders or shipments for at least some industries. Hard hit by the downturn were producers of capital goods, building materials, textiles, paper, steel, and consumer durables. Even demand for high technology products has slipped. Difficult conditions persisted in mining in Minneapolis and San Francisco. Strong spots were noted in defense industries in Boston and New York and energy-related industries in St. Louis and Cleveland. Layoffs rose in all Districts but Dallas. Manufacturers in Philadelphia and Chicago indicated an easing of price pressures.

Construction: Residential construction and home sales remained virtually at a standstill, as little additional activity resulted from recent declines in interest rates. Housing prices have begun to fall in Atlanta and Chicago, but Dallas reported that further interest rate reductions were likely to cause prices to jump sharply.

Nonresidential construction continued to be strong in New York, St. Louis, and Dallas. Office construction in Chicago received a boost when financing problems were resolved for some large projects. Richmond, Atlanta, and San Francisco had moderate activity in the non-residential sector.

Financial Developments: Consumer loans continued to languish, but increased demand for business loans was observed in some areas. In Philadelphia, consumer loans declined by as much as 20 percent. In contrast, business loans were rising in New York, Philadelphia, Kansas City, and Dallas. Inventory financing, mergers, cash shortages, energy development, and below-prime lending were cited as factors contributing to the upturn.

Agriculture: Although good-to-excellent crops were reported in several Districts, lower-than-expected prices were reducing net returns in agriculture. Consequently, the financial positions of farmers prompted growing concern. In Kansas City, the low prices prevented any improvement in customers' creditworthiness as interest rates fell. Agricultural loan delinquencies continued to climb in Atlanta, but lenders hoped foreclosures could be held to moderate levels. In Dallas, private lenders were carefully watching their agricultural loan portfolios, although few immediate problems were foreseen.

The Outlook: In the face of widespread sluggishness, economists lowered their forecasts of real GNP growth. Fourth quarter declines are projected to be as large as 7 percent, but the recession is generally expected to bottom out in the first or second quarter of 1982. Many observers

anticipated a strong recovery by the second half of the year, although Chicago warned that any subsequent upturn expected next year would leave that District far short of full prosperity. Manufacturers differed about when they thought that business would pick up. At the extremes, Philadelphia firms hoped for expanding orders between now and June, while many Richmond companies believed the slump will deepen over the same period. Fears that increased inflation will accompany the recovery were voiced.

FIRST DISTRICT - BOSTON

Manufacturing in the First District has weakened over the past month and a half. Many more firms than usual have announced shutdowns over the Christmas season. The retail situation is more difficult to assess; since Thanksgiving, sales have been strong in some areas, weak in others. Also, last year the Christmas season began slowly but ended on a strong note and the season as a whole was quite good; it is impossible to tell yet if this is happening again. Retailers are somewhat concerned about inventory levels; most manufacturers, despite the recent downturn, do not view inventories as a problem. The housing market remains weak, but mortgage rates are now beginning to fall.

Until Thanksgiving, New England retail sales in November continued to reflect the weakening economy. As a result, inventories are higher than planned. Since Thanksgiving, retailing has been very mixed. Some areas are showing unexpected strength, and in others, sales have fallen well below the usual seasonal levels. The picture in Massachusetts is complicated by a heavy weekend snowstorm that closed most stores for a day.

One merchant cites particular strength in sales of high quality goods, partly a result of that firm's efforts to attract more high income customers and partly because the recession is affecting high income shoppers less. This is consistent with sales reports showing greater weakness for discount stores than for full price department stores.

All the merchants are optimistic about Christmas sales. If last year's sales pattern is repeated, sales may fail to show real strength until the last week before Christmas. Retailers are currently uncertain as

to whether to repeat the pre-Christmas markdowns and promotions they undertook last year in response to the sluggishness of the early holiday season.

November brought a downturn in First District manufacturing. In a survey of local purchasing agents, the number of firms reporting that orders increased over the month fell sharply while the number reporting lower orders increased. There were also substantial increases in the numbers with lower backlogs and reduced employment levels. The downturn appears to be quite general; high technology industries have been affected and the region's leading computer manufacturer is shutting down plants for the Christmas week for the first time in its history. Only the defense business remains really strong. Areas which were weak have remained weak or weakened further - housing products, consumer hand tools and hardware, aircraft engines and parts. In addition, new areas of weakness are developing. A machine tool company has no backlog at all and orders are flat. A manufacturer of word processing equipment reports a gradual softening in sales. A producer of packaging equipment and materials has seen a downturn in capital goods orders in the past six weeks. For some the change has been very sudden: one high technology firm in the instruments industry reports that domestic business was very strong through the first three quarters of 1981 but "on October 15 someone threw a switch."

The downturn in orders will be reflected in a downturn in employment. The manufacturers of aircraft equipment have been laying off for some months; the producer of word processing equipment has recently cut back; a large camera manufacturer has announced publicly that workforces will be reduced by 1,000 in 1982; and the high tech instruments maker has

instituted a hiring freeze. Many First District firms are choosing to shut down for two weeks over Christmas rather than reduce workforces indefinitely. Some firms have always shut down over Christmas but the number this year is unusually large and there are more shutdowns for two weeks. Because employment statistics are based on the week including the twelfth day of the month, the statistics will not pick up the Christmas closings and will not fully reflect the downturn.

Even firms which are cutting back on employment feel that inventories are under control and generally satisfactory. Price increases and lead times are no longer seen as problems, although one firm claims that lead times for some products have lengthened because inventories are so lean and goods are not in stock. With respect to prices one executive, who previously expressed some bitterness about the restrictive monetary policy, made the following comment: "I foresee a return to a time when business raises prices only with great care."

The only positive development other than the improving price situation was one firm's statement that the overseas market has improved slightly as buyers have become accustomed to a stronger dollar. Other respondents have not observed any change abroad.

Professors Eckstein, Houthakker, and Samuelson were available for comment this month. Eckstein continues to forecast that this recession will be "routine"--the peak to trough decline in real GNP will be 2 percent and the recession will last ten months, ending in May. Eckstein also expects a "routine" recovery in 1982 and 1983. Although he previously recommended that the Fed not allow short-term interest rates to fall below 12 percent, Eckstein now feels that short-term yields should be allowed to

fall to 10 percent as quickly as possible. This lower "floor" is justified because "the important longer-term yields have not fallen all that much recently," M1-B remains below its target range, and short-term yields of 10 percent "are consistent with" the current state of the economy. Eckstein does not now advocate yields as low as 7 or 8 percent, but he is prepared to reduce his 10 percent floor for interest rates if the economy should become weaker than he now expects.

Professors Houthakker and Samuelson believe there is no good justification for an interest rate "floor." Houthakker contends that such an interest rate target is a return to a discredited policy. By observing such a provisional floor or ceiling, monetary targets are abandoned when they matter most--when real GNP is falling or rising too rapidly. If the Fed believes it can buy a degree of interest rate stability by increasing the volatility of money growth and real GNP growth, then "it has taken a big step backwards." By restricting the movement of short-term yields the Fed can only exaggerate cyclical swings in economic activity, thereby disrupting capital markets and capital market yields all the more. The Fed switched to monetary aggregates targets because interest rate targets ultimately failed to stabilize either GNP growth or interest rates.

Samuelson contends that the Fed needs to defend any deviation from its avowed "monetarist policy" with good reasons, otherwise the credibility of monetary policy is eroded. There seems to be no good reason to suspend the monetary targets at this time because the economy is weak, M1-B is below its target (despite the all-savers rush, M2 is only at the top of its more restrictive target), and credit market yields remain high. "Those who would observe the money growth targets when interest rates are high and

then suspend the targets when yields are low are not true friends of monetarism, they are shoppers for arguments for restraint." No one has accused the Fed of "chickening out" in 1981, and it should not allow provisional interest rate targets to create procyclical swings in policy which may exaggerate the current recession and the ensuing recovery. Indeed, interest rate forecasts are most error prone during economic swings and the corresponding interest rate targets are most unreliable. Samuelson never understood the argument that low yields early in 1980 caused the overly vigorous expansion that ensued. If the Fed made an error, it may be accused of allowing yields to rise too slowly during the expansion.

SECOND DISTRICT--NEW YORK

Economic activity remained sluggish in the Second District during November, with some further softening evident. Retail activity unexpectedly slowed before Thanksgiving but has since recovered somewhat. Poor conditions persisted in manufacturing and additional weakening in capital goods orders was observed. Residential construction continued to be depressed, but a falloff in nonresidential construction contracts was believed to be temporary. Business economists now expect sizable declines in real GNP during the fourth quarter and no real pickup until the second quarter or half of 1982. On the financial side, mergers, acquisitions, and cash shortages pushed up the demand for business loans.

Consumer Spending

Retail activity virtually stopped growing in early November, with some department stores experiencing a drop in business. The pace has quickened since Thanksgiving, but most retailers are still slightly below plan. Since the bulk of Christmas buying has been occurring later in the season in recent years, merchants are hopeful that the pickup in sales will continue, producing a reasonably good holiday season overall. Many stores are depending on heavy promotions and price markdowns to spur sales. All respondents expressed serious concern about January and beyond.

Manufacturing Activity

Manufacturing activity remained depressed during November, with further weakening reported by some firms. After appearing to bottom out during September and October, new orders received by capital goods producers declined again. Although one capital goods supplier maintained output by depleting its backlog, all others cut production levels. Workforces have been reduced through layoffs or attrition. One establishment, however, preferred to retain highly skilled employees and to add the excess output to its inventories. Capital spending by many of these producers of durable equipment has been lowered, and, in one instance, stopped altogether.

Other manufacturers also experienced flat or slightly lower sales. Even the previously strong demand for data processing equipment has slipped. The only increase in business was reported by a company whose aerospace division received a large quantity of new defense contracts. Businesses are adjusting to the bleak situation with stringent cost controls, the elimination of internal inefficiencies, and in one case, a restructuring of pricing policies to curtail price cutting competition.

Construction and Home Sales

Construction activity continues to be very low in the residential sector and strong in the nonresidential sector. Home sales are down from October's poor level. High financing costs are blamed for the sluggish activity in the residential area. Recent declines in interest rates have not yet improved conditions. Any gains that do occur are expected to be modest and temporary. As for nonresidential construction, a drop in the value of contracts let in New York City is

viewed as only temporary. Major projects such as Battery Park City are scheduled to begin soon, and the new work should be sufficient to sustain a high rate of office construction activity.

Economic Outlook

Business economists have revised their forecasts of economic growth sharply downward. A dismal fourth quarter is expected to yield a real GNP decline as large as 7 percent, followed by negligible growth at best during the first quarter of 1982. Manufacturers generally agree with this outlook, anticipating no significant upswing in business until the second quarter or later. Overall growth for next year is estimated to be one percent or lower by all but one economist. The prime rate is projected to average 14 percent during the coming year. The 1982 inflation outlook is unchanged from the 8 to 9 percent level forecast last month.

Financial Developments

Lending officers at commercial banks report that there have been moderate to significant increases in demands for business loans during recent weeks. Mergers and acquisitions were an important source of the increased demand, as was the greater-than-expected deterioration of corporate cash flows. A related source of the strength in loan demands has been the need to finance unintended inventory accumulations. While demands for bank loans have been strong, the growth of commercial paper outstanding has been sluggish. Although rates on commercial paper are appreciably below the posted prime rate, bank borrowing demands have remained strong because of the flexibility of such borrowing arrangements and the widespread use of below-prime lending facilities.

Financial Panel

This month we have comments from Francis Schott (Equitable Life Assurance), Robert Stone (Irving Trust) and Albert Wojnilower (First Boston Corporation):

Schott: Institutional money flows are beginning to improve under the influence of lower interest rates. But demand for long-term funds is very heavy, partly in order to improve liquidity ratios and partly to finance investment projects, especially in energy. Therefore, long rates may stay relatively high.

Financial markets are less concerned with fiscal 82 Federal deficit than with the grim prospects for fiscal 83 and 84. Money growth targets and fiscal prospects are viewed as clashing, with the private sector the likely victim.

Stone: By letting borrowings get so low the Fed has effectively severed the connection between the discount rate and the Federal funds rate. The funds rate will nevertheless hold up in December, if only because of the seasonal strength in short term credit demands. But when these demands subside in January, for seasonal and perhaps for cyclical reasons as well, short term rates could fall sharply. Such a drop in rates could well be followed by a surge in the aggregates at what might be a most unpropitious time.

Recent increases in aggregates should push required reserves up, and I believe the Fed should respond by letting enough borrowings emerge to reestablish the connection between the discount rate and the funds rate. "Enough" borrowing for this purpose are \$500-600 million exclusive of seasonal borrowings and

extended credit. Once that connection is reestablished the Fed can again do what it did so effectively over the past two or three months -- lead the rate structure downward at its own pace by periodic reductions in the discount rate.

By this means the Fed is most likely to achieve the objective of lowering interest rates while minimizing the risk of a serious overshoot in the aggregate.

Wojnilower: Such indications as I am able to gather from business contacts support the view that the business decline may soon slow materially. This prospect, coupled with apparent acceleration of monetary growth, is roiling the bond market. Severe securities market repercussions are to be expected if average Federal funds rates were to rise.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District point to a slowdown in business activity for the month of December. Area manufacturers report a substantial decline in industrial activity this month, but anticipate improvement by mid-1982. Industrial prices are up in December, but at a smaller portion of surveyed firms than at any time since December 1977. In the retail sector, December sales are off to only a fair start, but are in-line with retailers' expectations for the most part. Most merchants say shoppers are holding off on high volume holiday buying until later in the month. Third District bankers report mixed loan activity in December. Consumer loans are down from a year ago, while C&I loan volume is better, but still not strong. Local bankers forecast little to no improvement in business borrowing over the next six months, but anticipate growing strength in retail loan activity by mid-1982.

INDUSTRIAL

Respondents to the December Business Outlook Survey report a substantial decline in area manufacturing activity this month as the recession settles in in the Delaware Valley. About 65 percent of the executives polled in December indicated some deterioration in the business climate, while only 7 percent noted improvement. These results suggest the most pervasive one-month drop in local industrial activity in over a year. In specific terms, new orders dropped for the second month in a row, and shipments are down as well. December also marks the fourth consecutive month in which inventories have been cut back. On the labor scene, the situation appears to have worsened, as the largest percentage of respondents since the survey began reports cuts in factory employment accompanied by a further shortening of working hours.

Despite the slump that has beset area industry, manufacturers remain optimistic, anticipating a general upswing in business within the next six months. About two-thirds of the survey participants project climbing levels of new orders and shipments

between now and June, and the anticipated step-up in manufacturing may prove beneficial to labor, as respondents plan to increase factory work forces and lengthen the average workweek. It appears that manufacturers will wait for stronger signals on the economy before really preparing for a boom though. Many plan to keep a lid on inventories and capital expenditures over the next six months.

Industrial prices are up again in December, but at a smaller portion of surveyed firms than at any time since December 1977. Just over one-quarter of the respondents report paying higher input costs than they did in November, and only about one-tenth say they are charging more for their finished products. Looking ahead, manufacturers expect inflation to rekindle, however, as 8 out of 10 of the survey participants expect to be paying more for raw materials by mid-1982 and nearly 6 out of 10 plan price hikes for the goods they sell.

RETAIL

Retail merchants in the Third District say December sales are off to only a fair start this month, running about 8 to 10 percent ahead of last year's sales volumes. This leaves only small gains in real terms. The sluggishness comes as no surprise to most store operators. Local retailers say that most shoppers are still comparing prices on their Christmas purchases at this point, and high volume buying won't get underway until later in the season. In an effort to bolster sales volumes, and compensate for a shorter Christmas shopping season this year, many area merchants are keeping longer hours this season, running big promotions, and marking down merchandise earlier than usual. One major chain already kept its doors open until midnight for a special one-day only sale.

As for the remainder of the Christmas shopping season, area retailers expect to finish ahead of last year, but not by much. Shopkeepers generally feel that uneasiness about the economy will make shoppers somewhat reluctant to part with their money, and they expect to finish the season only slightly ahead of last year, perhaps by as little as

10 percent in nominal terms. As a result, most retailers are keeping a close watch on stock levels. Although no shortages are expected, storeowners are not laying in as much merchandise as they did last year.

With regard to overall sales in the fourth quarter of 1981, local retailers expect to show only slight improvement over year-ago levels. They hope for current dollar sales gains of about 7 1/2 percent.

FINANCIAL

Third District bankers report soft-to-mixed loan activity in December. Consumer loan volume is down as much as 20 percent, but this is pretty much by design, according to local bankers. Contacts say they are holding off pushing consumer loans until the rates come down a bit further and marketing efforts might prove more fruitful. Reports of C&I loan volume range from 3 percent below to 10 percent above year-ago figures. Some banks report modest inventory financing which has, at least in part, boosted their business loan volume to the upper end of this range. In attempts to bolster business loan demand, many banks have increased below-prime lending activity and are willing to make fixed rate loans. Also, area bankers say, aggressive marketing is helping. Looking ahead to June, Third District bankers expect C&I loan volume to remain flat, for the most part. Consumer loan activity is expected to show some strength by mid-1982, as local bankers plan to start emphasizing retail borrowing should the rates continue to drop. Retail loans are expected to grow by 2 to 3 percent by summer.

Reports of deposit flows in the Third District are mixed. Demand deposit levels are down as much as 14 1/2 percent from last year's figures. Local bankers say depositors are shifting their deposits to longer-term, high yielding time deposits which accounts, at least in part, for the lackluster performance in demand deposits over the

last quarter. Reports of time and savings deposit levels run from 2 to 11 percent over December '80 levels.

Third District bankers are currently quoting a prime rate of 15 3/4 percent. Further cuts in the prime are expected to come soon, leaving the rate 100 to 375 basis points below its current level by mid-1982, when contacts expect the recession to bottom out.

FOURTH DISTRICT - CLEVELAND

Summary. Respondents in the Fourth District have generally lowered their forecasts of real GNP to show deeper declines this quarter and next, especially because of inventory correction. Capital goods orders are deteriorating, except in limited cases such as energy and aerospace. Steel production continues to decline, as inventory liquidation weakens orders. Post-Thanksgiving Day retail sales rose less than anticipated, and several retailers are pessimistic about the remainder of the shopping season. District unemployment is expected to rise further in December, because manufacturing industries are experiencing shutdowns and seasonal hiring in nonmanufacturing is relatively light. Housing may be bottoming out, but several S&Ls expect a very sluggish recovery.

Outlook. Several economists, who expected a decline in real GNP between 3% and 5% in late October, now have lowered their fourth quarter forecasts to show a decline between 5% and 7% (annual rates). Effects of high interest rates and a sizable inventory accumulations are primary reasons given for the larger than expected weakness in economic activity. The peak-to-trough decline in real GNP is expected to be milder than the 1980 recession. Although most respondents expect the recession to trough in the first quarter of 1982, a bank economist expects a turnaround no sooner than mid-1982, when consumer tax cuts and capital spending provide stimuli. Since sharp recoveries often follow an inventory adjustment, an initial surge in economic activity is likely, followed by a sluggish advance until capital-goods spending accelerates in the second half of 1982, according to a capital-goods economist.

Capital Goods. Capital-goods spending is still basically flat, according to several respondents, but a few producer-goods manufacturers report that orders have been deteriorating a little more rapidly recently. Generally, weakness in capital spending for trucks, industrial machinery, and farm machinery has been offset by continued strength in computer equipment, energy, and electronics. Within electronics, an economist for a capital-goods producer notes a slowdown in orders for production-related equipment, even though order books for advanced technology equipment are full into 1984. Recent weakness in construction of office buildings has resulted in some decline in commercial air conditioning parts, according to one producer. Weakness has also occurred in utilities and their construction-related activities, according to a capital goods supplier, because of declining power consumption. Several respondents expect capital spending to decline in the first half of 1982 because of concern that interest rate will remain high, as well as because of declining operating rates and a lagged effect of weak profits during the second half of 1981.

Steel. The pace of decline in steel orders is slowing, but steel production still exceeds demand. Current operating rates, according to a steel economist, are at about 60% of capacity, while order rates are equivalent to only about 50%. Inventories are accumulating at the mill and among customers, although a steel distributor reports some customers are requesting immediate delivery to maintain production. Operating rates could fall below 50% in the weeks ahead in an effort to control steel inventories. However, an industry economist states that inventory liquidations underway may cause shortages and could result in a recovery in steel orders by next

March. A steel fabricator reports business activity has slowed substantially since mid-August, with even some softness emerging among oil industry customers where oil projects have been disrupted by bankruptcies.

Consumer Spending. Retail sales in the District have deteriorated more than nationally during November, in contrast to recent months. An economist for a major department store chain believes that some pickup in retail sales began in late-November, mostly in auto sales, but further gains in December are expected to be divided between auto sales and GAF. Several local retailers report post-Thanksgiving Day sales slightly below year-ago levels, but total sales through November were slightly above year-ago levels. Heavy promotions are expected through the remainder of the year. An economist for a major grocery-store chain reports a gradual slowdown in sales as customers experienced falling disposable income in recent months. Spreading unemployment has made consumers more cautious. A producer of home and personal care goods reports mild year-over-year gains in sales (about 2-3%), but these gains are considered to be below expected normal increases (about 4-5%) under present economic conditions.

Auto sales were very weak in November, according to several local auto dealers, and December could be among the worst sales months ever. No sales promotion are being offered in December, although new promotions may begin in January. An area dealer has cut orders from producers by 75%, while retaining a 90 day stock. Several import dealers also report weak sales, although less severe than domestic dealers. A turnaround is not expected until next spring, and possibly not before the next round of consumer tax cuts.

Employment. Plant shutdowns for inventory control are expected to produce a substantial further increase in District unemployment in December.

Declines in manufacturing employment have already exceeded nationwide declines since the mid-1981 high. The sharpest decline in the District, in absolute and relative terms, occurred in auto and auto-related industries. Only in primary metals has the decline in the District been less than nationwide. Most respondents to the latest Fourth District Manufacturing Survey report tightening control on labor costs and overtime, but virtually all of the recently announced lay-offs are occurring among durable-goods producers.

Housing. Some housing officials believe a trough in housing could be in the fourth quarter, if easing mortgage rates, which have declined to about 17%, continue to ease and if an economic recovery occurs early next year. Housing orders, according to a major builder, are below year-ago levels, although recent year-over-year percentage declines have narrowed since summer of 1981. A local builder is skeptical that falling mortgage rates will contribute much to increasing the number of qualifying loan applicants.

Also, mortgage lending may be slow to pick up, according to several S&L officials, because increased savings flow will be absorbed by repaying FHLB advances. Savings flows thus far continue to be weak but positive. S&L have been more aggressive than banks in promoting IRA accounts. Some S&L officials note that All-Savers certificates have shown only marginal increase in November, with most the funds coming from existing accounts.

FIFTH DISTRICT - RICHMOND

Overview

Although there is now evidence that earlier reports may have understated the strength of the Fifth District economy, most current information suggests a marked deterioration of business activity in the past month. Manufacturers surveyed report a broad decline in shipments, new orders, and order backlogs over the past month. Retail sales activity also softened with most respondents in this sector also reporting month to month declines in activity. Residential construction and sales, auto sales, and several industries dependent on those are showing pervasive weakness which has led to layoffs and reduced workweeks. As a result, unemployment has risen significantly in some, though not all, areas of the District. Several of our Directors find the confluence of cyclical and structural (tax changes, IRAs, etc.) factors promoting personal savings at the further expense of retail sales, particularly of durable goods.

Manufacturing

Somewhat more than two-thirds of the manufacturers surveyed experienced declines in shipment, new orders, and order backlogs over the past month. Increases in any of these measures of activity were rare. Stocks of finished goods continued to rise and remain somewhat worrisome. As noted, employment and the length of the average workweek have declined among District manufacturers. The textile industry seems to have been particularly hard hit as demand for housing and auto related products continues extremely weak.

Such industries as furniture, primary metals, and building materials appear little better off, however. A notable change from recent periods is the virtual lack of strength in any significant District industries. Prices were essentially stable over the past month, with indications that prices received

by District manufacturers may actually have declined slightly. Generally, plant and equipment capacity is in excess of present needs, but current expansion plans are considered appropriate.

Consumer Spending

Consumer spending seems to have weakened further in recent weeks. Retailers surveyed report declines in total sales and relative sales of big ticket items. Our impression is that this weakness has become generalized. Sales and discounts, unusual for this time of year, are widespread. Although our survey results suggest further inventory reductions have occurred at the retail level there remains some concern about current stocks. Several of our Directors attribute the consumers' reluctance to buy to doubts about the course of the economy, the interest rates available on savings, and the recent and prospective changes in the tax treatment of savings (all-savers, IRAs). Some of them perceive in this a lasting change in the attitudes concerning consumption and savings which they find encouraging for the longer term. Its immediate effect on economic activity, however, is apparent and not at all encouraging.

Housing and Construction

There has been no discernible change in the construction sector in the past month. Housing construction remains spotty, but generally depressed. Non-residential construction continues to provide some support, although, this too, is becoming somewhat more localized.

The Financial Sector

The shift toward savings, whether it is transitory or permanent, is being felt by financial institutions. Bankers we have contacted have experienced positive responses to market interest rate instruments and expect a

pickup in activity after the first of the year with the expanded eligibility for IRAs. There is some disagreement as to the aggregate effects of the IRA, but general agreement that it will be a significant source of long term funds to the financial sector. It is probably fair to say that a majority of our respondents do expect IRAs to generate a large amount of new money for financial institutions in the District.

The Outlook

The outlook continued to deteriorate over the month judging from our survey responses. About half of all respondents expect the level of business activity nationally and in their respective market areas to decline over the next six months, while almost as many expect further declines in business at their own firms or establishments.

SIXTH DISTRICT - ATLANTA

The recession is continuing in the Sixth District. Consumer spending is flat compared to last year, housing remains severely depressed, and labor markets are slack, with layoffs occurring frequently throughout the District. Agricultural loan delinquencies are increasing.

Consumer Spending and Inventories. Retail sales are flat to down in real terms. Merchants hope that a late surge in holiday spending will brighten the outlook. The high- and low-priced ends of the merchandise spectrum are holding up better than middle-ranged goods. Employment in department stores for the holiday season this year is about the same as last year. Consumers appear to be taking advantage of markdowns and discounts, watching their pocketbooks closely. Tenants in large Atlanta malls express concern over high inventories in relation to sales and many are actively promoting to generate business.

Financial and Construction. Throughout the Sixth District, construction activity continues at a low ebb. Only nonresidential construction shows signs of life, mostly on the part of large firms. Overall residential sales and starts are at a standstill. Many county zoning departments report a November 1981-over-1980 increase in building permits for additions and improvements, while permits for new residential dwelling units are down. In south Florida, for the first time in three years, asking prices for houses have shown a decline, with virtually no change in the number of listings. Apartment vacancy rates have dropped sharply over the last few months as potential home buyers wait out high interest rates. Only 10,000 realtors attended the National Association of Realtors Convention on Miami Beach in November—20,000 less than in 1980. Large numbers of

realtors are leaving the business. In Georgia, for example, new real estate licenses are down 47 percent from last year.

Employment and Industry. Employment growth is slowing, unemployment rates are easing upward, and layoffs have been more common. Although some areas are more depressed than others, slow employment growth and higher unemployment were frequently mentioned. Even in sunny Florida, past observations of robust job growth and falling unemployment rates were noticeably absent from directors' reports. Air Florida, with most of its employees based in south Florida, recently announced widespread layoffs and pay reductions.

Alabama has been particularly hard hit. The state unemployment rate was bordering 12 percent at last reading and some directors reported rates above 13 percent. Those high unemployment rates are supported by a growing number of layoffs. In Alabama, weak demand forced General Electric Company, to place its entire work force on furlough last month. Fruehauf, producer of bodies for tractor-trailers, has half of its work force on indefinite layoffs. Exxon closed one of its subsidiaries in the Orlando, Florida area, and the Ford Glass Plant in Nashville laid off a large portion of its work force and will close earlier than usual for the holiday season.

In north Georgia, where 50 percent of the nation's carpets and rugs are produced, shipments dropped sharply in October after having shown some growth during the prior nine months. The fourth quarter will likely show a drop-off of 20 to 30 percent in shipments. A slowdown in the paper industry is causing temporary closings at paper mills during December. Although the factory employment picture looks bleak at this time, for the most part, manufacturers believe the forecasts of economic recovery in the spring of 1982.

Persistent high interest rates have dealt a severe blow to car rental companies. In Florida, believed to be the largest car rental market in the nation, a large rental franchise recently declared bankruptcy. Attendance at Florida's major tourist attractions is down somewhat from the same period last year, and the outlook for the winter season is not bright.

Agriculture. Contacts with lenders across the District reveal that the number of agricultural loan delinquencies is continuing to rise, but the major problems rest with the Farmers Home Administration where many borrowers' financial problems have grown more severe during 1981, thanks to the drought and low agricultural prices.

Borrower liquidations will increase in cases where collateral for additional indebtedness is unavailable, but lenders hope to keep foreclosures to a moderate scale.

Southeastern farmers have planted as much or more winter wheat as they did in the fall of 1980 when acreage jumped by 225 percent from the year-earlier level. Farmers are again in need of a quick cash-earning crop.

SEVENTH DISTRICT--CHICAGO

Summary. Economic conditions in the Seventh District deteriorated rapidly in the fourth quarter. Manufacturers of both consumer and producer durable goods are scheduling extended plant closings in December and January. Layoffs and short work weeks are increasing. Demand for workers is very weak. General merchandise and specialty stores have been trying to boost lagging sales with selective price discounts. Inflation has also slowed in wholesale markets. Complaints are widespread about slow payments by trade creditors, including governmental units. State and local governments are paring operations because of financial stringencies. The prolonged downturn in agricultural prices--especially corn, soybeans, and livestock--with no sign of a significant reversal, has raised increasing concern over the financial viability of farm entrepreneurs carrying substantial debt burdens. Construction activity is in a depressed state, except for large office buildings, but there is hope that lower interest rates next year will increase transactions. The list of sectors showing continued gains is limited to business services (especially law and accounting), and medical care and supplies. Recreational vehicles and mobile homes also have reported gains this year, but from a low base.

Confidence Ebbs. Important sectors in the Seventh District have had serious problems for two to three years. (The region had been reasonably prosperous until early 1979 when the gasoline shortage hit.) Not since 1929-33 has the region been afflicted by declines of more than a year or so, and, typically, downturns since World War II did not strike all sectors simultaneously. In recent months the malaise has broadened further. Now motor

vehicles, most capital goods, recreational equipment, home appliances, furniture, agriculture, and government are all in a depressed state. Confidence has been further eroded by a series of incipient upturns all of which proved abortive, e.g. farm prices late last year, housing activity in 1980 and again last spring, and auto sales in August. These experiences have drained the morale of many who now say they see "no light at the end of the tunnel". The slump in housing, building materials, motor vehicles, and farm and construction equipment is unprecedented since World War II in magnitude and duration. A growing number of older plants are being closed permanently. Many small businesses, retailers, distributors, and component suppliers associated with these depressed sectors are being pushed out of business or have cut back the scale of their operations. In short, confidence in the district has suffered a damaging blow which will not be corrected in the short run. Most observers here expect demand to bottom out in the first half of 1982, perhaps as early as February, but any subsequent upturn anticipated next year would leave the district far short of full prosperity.

Inflation. The proportion of purchasing managers reporting paying higher prices is down sharply from last year. Discounting is reported for steel, nonferrous metals, scrap iron, and building materials. Because inventories of materials and components are typically at very low levels, price cuts are expected to be reversed as demand revives. The big inflation issue for 1982 is the push by management for labor concessions on compensation and work rules, which so far has achieved only scattered success.

Employment. Many district manufacturers normally shut down for a week between Christmas and New Year's Days. This year many plant closings will begin before Christmas and extend into January. Other firms are eliminating extra shifts or reducing work weeks. Plant closings are reported for farm and

construction equipment, motor vehicles, home appliances, and tires. Some district companies that avoided layoffs in past downturns have been forced to follow the trend because of continued declines in orders. White collar staffs are also being reduced.

Consumer Purchases. Large general merchandise chains reported poor sales in both October and November, with volume down 5 percent or more after inflation. This has led to a buildup in inventories, and a rash of pre-Christmas price cutting, to an extent not seen since late 1974. Consumers are especially cautious on purchases of big ticket items, and luxury services such as air travel, restaurant meals, and recreation. However, merchants have not given up on a late surge in Christmas sales.

Inventories. Stocks of motor vehicles, appliances, farm and construction equipment, and most general merchandise are now excessive because of poor sales. Production cuts have been ordered. Oil industry inventories have been reduced to comfortable levels. Manufacturers' delivery times are very short, but most distributors are working on minimal stocks.

Capital Goods. Virtually all lines of business equipment produced in the district for farms, factories, offices, and transportation reported deteriorating demand in recent months. Components such as castings, forgings, engines, power transmission, and electrical controls are also affected. Auto companies and electric utilities have cancelled additional major capital spending plans, because of reduced estimates of demand and financial pressures. On the brighter side, some large office buildings started in downtown Chicago earlier this year, but halted for lack of financing, have been given the green light.

Motor Vehicles. Demand for cars and trucks remained near the depressed October level in November. Fourth quarter output will be the lowest since

1959, and schedules for early 1982 have been reduced. Used car sales, which had been strong, dropped off recently. Cars at the "high end of the line" are selling best, often for cash.

Steel. Orders for steel declined sharply in the fourth quarter. Operating rates dropped back to the severely depressed level of the third quarter of 1980. All products are now weak, including oil line pipe. Demand is expected to remain near the December level in January, with some rebound in February as customers' plants reopen.

Housing. Residential activity is at a post-World War II low throughout the district. Effective prices are down 10-20 percent, threatening the equity of many owners. Few potential buyers accept the concept of variable rate mortgages, particularly if adjustments are frequent. Recent rate declines stimulated a few transactions. A drop in the conventional rate to 13-14 percent, analysts believe, would boost home construction substantially because the inventory of finished units is very small.

EIGHTH DISTRICT - ST. LOUIS

The sluggishness in the Eighth District economy has persisted through early December. Retail sales are generally lower than expected, resulting in excess inventory. Most manufacturers report declining orders for spring deliveries, and some have made additional layoffs of personnel in the past month. Construction activity remains mixed. Both commercial and residential construction have leveled off, commercial at a relatively high, and residential at a very low level. Financial institutions report a moderate increase in time and savings deposits, while commercial banks report a moderate increase in loans. In the agricultural sector, favorable weather permitted the harvesting of record crops. In addition, the outlook is for a relatively large livestock production.

Consumer spending, based on department store sales, generally weakened in November and early December. One major St. Louis department store reported excessive inventories given the current sales volume. Elsewhere in the Eighth District, reports of consumer spending are mixed--some retailers reporting sales declines and some reporting gains of 15 percent or more from year-ago levels. Most of the firms surveyed reported slim margins and declining profits. Automobile sales are about in line with sales of other consumer goods. Of the five dealers reporting, three reported weaker sales, one reported no change and one, stronger than year-ago levels.

Manufacturing activity in the District is generally weak. One large paint manufacturer reported that declining sales had resulted in the

first layoffs in his firm's history. One major shoe manufacturer reported that orders and output were from 0 to 10 percent below year-ago levels. Similar reports were received from manufacturers of electric motors and equipment, home appliances, and paper box construction. One uniform manufacturer reported that business was down 2 to 3 percent from a month ago. Optimistic reports were received only from the manufacturers of oil drilling and energy-related equipment.

Inventories have now become somewhat burdensome in a number of cases. A major St. Louis retail outlet reported that inventories were 5 to 10 percent too high at the retail level, that September inventories were the third highest in the decade and that price cutting was in prospect to reduce them.

Construction remains generally unchanged from early autumn levels. Commercial construction is at a relatively high plateau, while homebuilding is at a standstill. A St. Louis area reporter for commercial contractors estimated that 1982 would be as good a year as 1981, which was considered very good. He reported a number of major projects soon to be started. More pessimism is heard, however, than a year ago and a number of former general contractors have now become subcontractors.

A moderate increase in savings was reported by most financial institutions. A major savings and loan company in St. Louis reported that November savings were up 1.3 percent from a month earlier. Also, time and savings deposits were up moderately at Eighth District commercial banks. Loan demand, however, remains weak. A major savings and loan association

reported little or no loan activity. Loans at large Eighth District commercial banks have increased moderately since the end of October, but, some banks indicate that this increase is largely seasonal. Some increase in collection problems is surfacing. A Louisville industrial collection firm reported that the percentage of collections per million dollars dropped significantly in October as compared to a year ago.

Record-breaking crops have been harvested over most of the District, but net returns to farmers are about the same as a year ago. Prices received have generally been lower than expected; hence, the good yields and high production have been offset by lower prices. Consumers, however, are being favored by relatively large food supplies at relatively moderate price increases.

NINTH DISTRICT - MINNEAPOLIS

The slump in business activity that the Ninth District has been experiencing since midsummer deepened in November and early December. Consumer spending remained depressed; new manufacturing orders continued to decline, with consumer durables and home building supplies hard-hit; the iron mining and lumbering industries weakened further; and falling farm prices continued to plague agriculture. The continued softness in the district economy has kept bank lending depressed. The one bright spot is that the winter sports industry has been buoyed by above-normal snow.

Consumer Spending

The slow drop-off in general merchandise sales that began in midsummer continued. In November, the four large Minneapolis-St. Paul retailers that we survey reported that poor sales of large durable goods continued to depress general merchandise sales. All four also indicated that early December sales were disappointing and inventories are now higher than desired. To encourage holiday buying, these retailers have been holding sales promotions earlier than usual. According to our Bank directors, general merchandise sales outside the Minneapolis-St. Paul metropolitan area were also weak. The only durable goods reported as strong sellers were high technology products like video tape recorders and big screen televisions.

Consumers were still very reluctant to purchase homes and autos. The Minneapolis Board of Realtors reported that home sales in Minneapolis and

suburbs declined 15 percent between October and November. New car sales in November, according to regional sales managers for domestic manufacturers, remained at September's depressed level.

Spending on winter sports appears to be the exception to the general sluggishness in the district's consumer spending. A lack of snow during the last two winters hurt businesses dependent on snowmobiling and skiing. While Montana still needs snow, in Minnesota early snowfall is about 12 percent ahead of normal and spending on winter sports has been good. Sales of tow tickets at one major northern Minnesota ski area, for example, are up 30 percent from of a year ago.

Industrial Activity

Our Bank directors reported that declining orders have led to cut-backs by many manufacturers in the district. Manufacturers of consumer durables and building supplies indicated that they have been particularly hurt by falling demand. For example, a large district manufacturer of household freezers reported that its new orders began slowing in mid-August. Inventory build-ups at its plant and dealerships have induced it to cut production and lay off one-half of its workers. A manufacturer of microwave ovens stated that business has been "rotten" for the last six months. The firm has laid off about a third of its workers and is concerned about high inventories. A large Minneapolis-St. Paul manufacturer of building supplies, which had reported a sizeable sales decline in October, reported an even bigger decline in November.

The iron mining and forest products industries also remained in the doldrums. In November, the unemployment rate for Minnesota's iron ore workers remained at around 20 percent. Likewise, sawmills throughout the district that were closed in October remained closed through December. In Montana, of 56 sawmills, 16 are closed and 20 have curtailed operations.

Agricultural Conditions

Falling prices continued to trouble district farmers. Prices for district farm commodities, which have generally been declining since late 1980, fell again in November, except for wheat prices. All prices, including those for wheat, were considerably below their year-earlier levels. Cash livestock prices in November at South St. Paul, for example, were down about 10 percent from a year earlier, and cash prices at Minneapolis for wheat, corn, and soybeans were down 9, 24, and 28 percent, respectively.

The falling prices for grains and soybeans can be attributed to abundant supplies and falling demand. As reported in our last Redbook, district farmers had bumper crops this fall. But the markets for these crops haven't been strong. Grain shipments going east on the Great Lakes totalled 3.2 million tons in October this year as compared to 4.2 million tons in October last year. Shipments west by rail also were reportedly down this fall.

Financial Developments

The softening in the district economy continued to show up in weak bank lending. Outstanding loans at Minneapolis-St. Paul area banks in November remained at last spring's lackluster level, and Reserve Bank directors indicated that loan demand was very sluggish in most areas. In addition, several directors noted an increase in personal and small business bankruptcies.

TENTH DISTRICT—KANSAS CITY

Summary. Economic activity in the Tenth District continues to be relatively weak. Although retail sales have been soft, retailers generally report satisfactory inventory levels. Residential construction and sales are weak in most areas. Improvement in mortgage demand and mortgage commitments at savings and loans institutions depends on hoped-for greater inflows of savings and lower mortgage rates after the first of the year. The new winter wheat crop is off to a good start, but cattle prices remain unfavorable to producers. Loan demand at Tenth District banks remains mixed, as does deposit growth.

Retail Trade. Most retailers in the Tenth District report sales for the first 11 months of 1981 about 10 percent higher than last year. But sales in October and November of 1981 were less strong, due to weakness in sales of winter clothing, furniture, and appliances. Sales of Christmas merchandise throughout the District also have been less than most retailers anticipated. In spite of relatively weak sales, most retailers express cautious satisfaction with their inventories, in part due to optimism about sales during the rest of December.

Industry Costs and Inventories. Most purchasing agents contacted in the Tenth District report input prices have increased from 6-12 percent over the past year. No further price increases are expected this year, but many expect increases of up to 10 percent in early 1982. Although fuel costs have been relatively stable, total aviation industry costs rose 12-20 percent over the past year, with further increases expected. Input availability is generally not a problem for Tenth District manufacturers. Half the companies contacted report inventory levels well above desired levels due to declining sales and are planning to trim their inventories as much as possible in the coming months.

Housing Construction and Finance. Most Tenth District homebuilders associations indicate that housing starts have decreased 25-50 percent over the past year, with single-family units leading the decline. Albuquerque seems to be hardest hit, with a decline in housing starts of approximately 80 percent. Denver, on the other hand, continues to have a strong market, with declines of less than 5 percent and single-family starts 6 percent above a year ago. Apart from Denver, house sales are sluggish but inventory levels are near normal. Building materials availability is expected to become a problem in the coming months, particularly for lumber, due to lumber mill shutdowns in some parts of the country.

At savings and loan institutions in the Tenth District, savings inflows in 1981 were down considerably from last year. Most savings and loans hope for some slight improvement in inflows in the near future, primarily due to hoped-for inflows from the new IRAs that the institutions plan to offer after January 1, 1982. The demand for mortgage funds at Tenth District savings and loans is reported as low-to-nonexistent, resulting in abnormally low levels of mortgage commitments. Most of the weakness in mortgage demand is attributed to high mortgage rates, which are currently averaging 17 percent at Tenth District savings and loans. Those rates are expected to fall slightly by the end of the first quarter of 1982, resulting in some slight improvement in mortgage demand and mortgage commitments.

Agriculture. The winter wheat crop in the Tenth District is currently in good condition, with approximately the same acreage planted as last year. Despite the unfavorable cattle price situation, lower feed costs and lower prices for calves entering feedlots point toward somewhat more profitable fed cattle

production by the spring of 1982. Some livestock producers are holding calves because of currently unfavorable prices, and grazing them on abundant wheat pasture. Other cow-calf producers have sold off breeding stock to generate cash to repay loans, but are also holding calves over the winter. At the same time, District bankers report that many feedlots in their area are currently at full capacity. The recent declines in interest rates may not significantly improve customers' creditworthiness for new loans, since bankers feel that continued low commodity prices have offset the relief brought by lower interest rates.

Banking Developments. Loan demand at Tenth District banks is following the mixed pattern of recent months. Commercial and industrial lending is very strong in those areas serving the energy industry. Consumer lending remains sluggish across the District, and real estate loans are nonexistent. Prime rates range from 15 3/4 to 16 1/4 percent, down from 16 3/4 to 18 percent last month.

Deposit growth continues to be strong in areas with sizable loan demand but is relatively flat elsewhere. Most of the growth has occurred in the large CD category. While some banks continue to rely on CD's to finance new lending, other institutions are using CD's to reduce their exposure in the overnight market. Across the District, bankers report more than adequate liquidity.

After an initial spurt, consumer interest in All-Savers Certificates has tapered off and most institutions contacted anticipate little activity in the future. Attention has now turned to IRA/Keogh programs. Most bankers surveyed are extremely optimistic about these accounts becoming a stable source of long-term funds. However, there are considerable differences of opinion about the volume and sources of funds that might be attracted to these accounts.

ELEVENTH DISTRICT--DALLAS

With the exceptions of the energy and nonresidential construction, signs of recession are becoming more widespread in the Eleventh District economy. Christmas sales are off to a slow start, and auto sales remain at a low level. Manufacturers indicate new orders are declining, some production schedules are being pared, and the number of layoffs is rising. The recent decline in interest rates resulted in small increases in housing sales and mortgage demand. The rise in bank loans is largely energy related, and consumer loans continue to decline. Deterioration in farm incomes is cause for concern among agricultural lenders.

Christmas sales at District department stores are weak, and retailers have revised their forecasts downward. Credit sales as a proportion of total sales is about even with last year. Inventories are over plan, and advertising and price discounting are being used liberally to stimulate sales. Merchants hope a surge in sales during the week of Christmas, as occurred last year, will reduce inventory levels and boost revenues. Increased buying by Mexican nationals is bolstering retail sales along the Border. The seasonal demand for retail clerks is down from a year ago.

Auto sales are little improved from the low in October, and respondents expect negligible improvement in the near term. Imported models are selling slightly better than domestic new cars, and used car sales are described as good. New car inventories are high, and dealers expect it will take some time to work off current stocks.

District manufacturers report declines in new orders, and no significant strengthening is expected before spring. New orders have slowed for nonelectrical machinery, fabricated metals, and electrical communication and computing equipment. With sales weakening and inventories rising, firms in these industries are reducing production schedules, although most firms have not yet laid off a significant number of workers. Some oil field suppliers report a slowdown in new orders, but output still remains high. The demand for structural steel for nonresidential construction continues strong. Most manufacturers report small increases in materials and production costs.

The Texas Employment Commission reports a "fairly sharp" drop in number of job openings. But inquiries from job seekers in as many as 30 states are on the increase. The unemployment rate for the state is expected to rise this month from the 5.5-percent rate reported for November.

Nonresidential construction continues at a high level. With so much office space becoming available, prospective tenants are playing one developer off against another to get the best rental agreement.

Sales of new homes perked up slightly with the recent decline in interest rates and increased availability of subsidized financing by some builders. Respondents indicate further declines in mortgage rates will unleash demand for housing at such a fast rate that builders will not be able to keep pace. As a result, they expect housing prices to move up sharply.

Loan volume is rising moderately at commercial banks. Demand for funds is greatest by the mining industry, followed by nonresidential construction and retail trade. Consumer loans continue to decline, and credit card delinquencies are up slightly. Growth in demand deposits is outpacing the rise in time deposits. Sales of all-savers certificates have slowed considerably since October. Commercial banks are relying heavily on the Federal funds market to finance the growth in credit. IRA and Keogh accounts are expected to spur an increase in deposits in 1982.

S&Ls report small increases in mortgage loan demand and savings deposits. Respondents are generally optimistic, but expect no significant rise in mortgage lending until next summer. Demand for "all-savers" certificates is very low.

Favorable weather across the District has speeded crop harvests and improved winter pastures. Crop yields have been good, but prices are below early-season expectations and will not provide the income that many farmers need to cover costs. Banks and production credit associations continue to be concerned about the quality of their agricultural loan portfolios, although few expect significant problems in the near future. However, approximately 30 percent of FHA's 15,000 farm borrowers in Texas are delinquent in making loan repayments, and FHA contacts indicate that funding is unlikely to be adequate to carry all of these borrowers through another year.

TWELFTH DISTRICT - SAN FRANCISCO

The Twelfth District economy appears to have weakened further in the last month. Retailers report stability in sales in November, following October's decline. But early indications point to a disappointing Christmas season, with December sales just about matching the year-earlier level and thus failing to keep up with inflation. Serious deterioration is evident in the manufacturing and mining sectors, where production cutbacks and layoffs are becoming deeper and more widespread. Moreover, growing inventories point to further production cutbacks. Residential construction and home sales continue at extremely depressed levels with the recent decline in mortgage rates having no appreciable stimulating impact. Farmers are experiencing a further reduction in income as a result of a continuing decline in commodity prices. Commercial loan demand remains slow for capital spending purposes but has increased to finance excess inventory. Banks continue to suffer an outflow of deposits to higher-interest bearing market instruments. Sales of the All-Savers Certificate have dropped sharply after an initial flurry. These certificates have had little effect in bringing in new savings or reducing the cost of deposits.

Consumer Spending

Respondents generally describe retail sales in November as having been "flat." After declining in October, sales in nominal terms in November apparently just about matched the month-earlier pace. Consumers are exhibiting an extremely cautious spending attitude, and department stores and other retail outlets are having to engage in intense pre-Christmas

promotional campaigns -- including widespread price discounting -- to attract business. Partly as a result of discounting, most merchants expect December retail sales in nominal terms to just about equal last year's level, representing a decline in real expenditures. Faced with rising costs and markdowns, retailers complain of a squeeze on profit margins. Adding to their financial problems, collections are slowing.

Manufacturing and Mining

Respondents report serious further deterioration in industrial production and employment. Depressed industries -- such as lumber, construction and metals -- continue to experience cutbacks, while weakness also is spreading to other industries that had been expanding. Alaska -- benefitting from energy development -- apparently is the only Twelfth District state to still be experiencing growth of payrolls.

In the Western lumber and metal industries, further price weakness is forcing additional closures and curtailments. Western lumber production currently is running about 45 percent below the 1978 peak and a further drop in output is expected. Copper producers in Arizona and Utah recently announced further production cutbacks. The Bunker Hill Company will permanently close its silver and zinc mining facilities in Idaho this month, laying off 2,000 workers. Kaiser Steel Corporation plans to phase out primary steel production at its Fontana, California, plant and to continue only fabricating operations.

Slow commercial orders are forcing further layoffs in the aerospace equipment manufacturing industry. Lockheed Aircraft Corporation plans to discontinue production of its L-1011 jet transport. Orders had slowed to a trickle due to the poor financial performance of the nation's airlines. Semiconductor firms in California have scheduled extended shutdowns during

the Christmas holiday period to reduce excess inventories. In fact, excess inventory is becoming a more pervasive problem in the manufacturing sector, pointing to a further broad-based production decline.

Real Estate

Respondents report little change in homebuilding activity or home sales recently, with both remaining at extremely depressed levels. The recent decline in conventional mortgage rates has had no appreciable effect in spurring home sales, and bankers and builders do not expect a significant upturn in housing activity until rates drop to around 13-14 percent. Nonresidential construction is reported to be slowing, although activity remains above the level of a year ago.

Agriculture

Twelfth District farmers and ranchers are experiencing growing financial problems as a result of continued weakness in farm and livestock prices. One respondent reported that cattle prices have now dropped below production costs for most ranchers. Agricultural production is up from year-ago levels, but bountiful supplies and weak export demand continue to depress prices for a wide range of products. The combination of falling prices and rising production costs is severely squeezing farm incomes.

Financial Institutions

Business loan demand remains slow except for a pickup in short-term credit requirements to finance inventory. The recent decline in domestic interest rates has had no appreciable effect in spurring borrowing for capital spending purposes. Rather, firms are reported to be turning increasingly to foreign sources for funding. Consumer and mortgage borrowing from banks continue to be extremely slow; declines in mortgage

rates thus far have been insufficient to rekindle consumer enthusiasm. The money market mutual funds continue to siphon off low-cost core deposits at banks and S&Ls and these institutions continue to rely more heavily on consumer-type certificates and other more expensive funds. Sales of the All-Savers Certificate were strong in October, but fell sharply in November. These certificates apparently have had little effect in bringing in new savings or reducing the cost of deposits.