

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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SUMMARY*

According to this month's district reports, economic activity in the nation remains very weak. Retail sales, after finishing 1981 with a robust performance, have sagged again, and prospects for a quick recovery are not widely perceived. Auto sales are down across the country. In the manufacturing sector, softness cuts across geographic and industry lines, as unwanted stock piles up and leads to production cutbacks. Financial institutions say business loan demand continues to be strong, but consumer borrowing is still in the doldrums. Deposit flows are mixed, and response to IRAs has been disappointing for the most part. The housing market is universally acknowledged to be depressed, and will probably remain so until interest rates come down and the economy picks up, according to builders and brokers. Finally, reports from the agricultural sector indicate falling commodity prices, with farmland prices dropping too, as many farmers find it impossible to stay in business.

Retail Trade. Most districts report weak consumer spending in early January, the result of a combination of factors. Many retailers feel that the strong sales experienced in the week before Christmas were basically borrowed from January sales. That is, consumers simply burned themselves out taking advantage of unusual pre-holiday markdowns, and simply have no money to spend now. Frigid weather has also played a part in holding sales down, with a large portion of the country held in the icy grip of one of the coldest winters on record. Finally, there is some feeling on the part of retail merchants that the flow of dollars into IRA accounts has also acted to take the wind out of the consumer's sails. (This is unlikely, given the reports on IRAs. See FINANCE.) The softness in retail spending has led to an inventory buildup in some areas. Atlanta,

*Prepared at the Federal Reserve Bank of Philadelphia.

Chicago, and St. Louis all report inventory accumulation. On the other hand, stock levels in Minneapolis, Kansas City, and Dallas are reported to be in reasonable shape.

Looking ahead, retailers around the country do not seem to expect much from the first half of 1982. Although contacts in Kansas City and Philadelphia are optimistic, they are exceptions. Most other districts say merchants expect the current sluggishness to continue at least through the first quarter, and possibly through the first half of the year.

Auto sales are depressed nationwide. The recession has combined with high interest rates to give auto dealers their worst year in many. There is some hope for improvement though, should price reductions follow the General Motors-United Auto Workers negotiations. That might be good news for consumers, but, as noted by St. Louis, could put a squeeze on used car dealers if price cuts in that market follow.

Manufacturing. Weakness in the manufacturing sector is widespread according to district reports, and industry still appears to be on a downtrend in many areas. While the softness spreads across many industries, a few seem to be particularly hard hit—automotive products, building materials, and steel. Inventory growth has led to production cutbacks, furloughs, and temporary plant closings in an effort to let accumulated stock run off. Just where the industrial sector is heading, and how long it will take to get there, is a matter of diverse opinion. Manufacturers in Philadelphia, New York, and Richmond seem to think that the trough is near. On the other hand, reports from St. Louis and Minneapolis point to further deterioration. Contacts that do see improvement in the situation don't expect it to come until at least the second quarter, and many expect it to be only slight at that.

Finance. The year-end surge in business loan demand has held over into 1982 in most districts, but some bankers interpret that as a sign of weakness on the part of

borrowers. Many firms are borrowing to finance unwanted inventory accumulation. Some cutbacks in credit extension may be anticipated, as banks are becoming more and more concerned with the creditworthiness of their customers. Consumer lending remains weak across the board.

Deposit flows are mixed. S & Ls continue to have trouble attracting money in most areas. The response to IRA plans has been sluggish in most districts, despite heavy promotion in some parts of the country, and banks that have experienced a strong demand for IRA deposits have often found very little new money going into them.

Real Estate and Construction. The residential housing market is universally depressed, with the worst conditions indicated by Philadelphia, Richmond, San Francisco, and New York. Only houses in the highest price brackets are selling. A retightening of the mortgage market has held home loan rates in the 17 to 18 percent range and effectively choked off demand. Home prices are reported falling in several districts. Residential construction is at a virtual standstill in many districts, as homebuilders try to work off inventories.

As for the future, reactions are mixed. While most real estate businesspeople agree that a large drop in mortgage rates will have to precede any increase in demand, there is also some feeling that that alone won't be enough. Public confidence in the economy may have to be restored, through general economic improvement, before a housing recovery is seen.

Commercial construction, while sluggish in some areas, is generally better than residential, and is even reported to be strong in Dallas.

Agriculture. Weakness in agriculture rounds out the generally gloomy economic picture painted by this month's Redbook reports. Falling commodity prices combined with rising costs have put a squeeze on many farmers and placed them in a

precarious financial position. Agriculture banks, concerned over the creditworthiness of many farmers at this time, have been monitoring borrowers closely and tightening policies on credit extension. The result has been foreclosures in some areas, and an increased number of farms on the market. Farmland markets are thus weak in many areas, with price declines noted by Chicago, Minneapolis, and Kansas City.

FIRST DISTRICT - BOSTON

The recession has taken hold in the First District. Retailers' reports of the Christmas season were mixed, ranging from "disappointing" to "strong"; but all made gloomy predictions for the first quarter of 1982. In the manufacturing sector, orders and backlogs have fallen. Manufacturers are responding by cutting back on inventories and overhead. One encouraging development was a report that sales are picking up in Europe. Also, despite the problems in retailing and manufacturing, banking directors report very good earnings in 1981.

Retail

Among retailers contacted, December sales in New England as compared to December 1980 ranged from a "disappointing" seven-percent increase to "strong double-digit" growth. The seven-percent increase was disappointing because it was well below what was planned and supported; however, it still compared favorably with a 5 to 6 percent inflation rate for merchandise.

Last year's timing problems were repeated this year, with considerable bunching of December sales into the week just before Christmas. Because of the soft retail market in October and November, many stores began holiday promotions and discounting earlier than usual in December to reduce their inventories. These efforts increased sales but cut profit margins. All respondents commented that consumers bought very selectively this year, focusing on value. Customers were said to buy items that were promoted and discounted, with little spillover to other

merchandise. No one reported excessive or unusual post-Christmas returns or exchanges, and sales continued at acceptable levels during the week after Christmas. However, stores that did not adjust to the weakness in November found themselves at the end of December with larger inventories than they had planned.

Even those who met or exceeded December plans said the momentum would not carry over. All expected poor January results, partly because of the extended bad weather already experienced in most of New England. One noted that large increases in the unemployment rate make all consumers more cautious. Not believing that the worst of the recession is over, all the merchants with whom we spoke predicted that their first quarter (February through April) would continue the pre-December weakness, probably yielding sales growth below the merchandise inflation rate.

Manufacturing

Economic conditions have deteriorated over the past two months for First District manufacturers. In a survey of local purchasing managers conducted in December, the number reporting that production and employment increased during the month fell sharply; fewer than 15 percent reported increased orders, almost 60 percent experienced order reductions. Among firms contacted directly, business ranged from "grim" to "pretty good," but most reported some falloff in activity. The commercial aircraft business has been particularly hard hit. Financial difficulties have forced the airlines to postpone purchases of new aircraft and engines, and the lighter schedules since the controllers' strike have enabled them to cut back on replacement parts as well. Increases in defense work have not prevented

substantial layoffs in this industry. However, defense remains one of the bright spots for many New England manufacturers. The problems of the auto industry are reaching back to their suppliers; several firms reported that sales of automotive products have fallen in recent months. A machine tool plant, heavily dependent on the auto industry, finds business very soft. A producer of heavy capital equipment reports that decreases in orders and backlogs in the automotive area are particularly pronounced; this executive believes that the auto companies are sharply cutting back their capital spending. Electronics is another weak area, although one manufacturer attributed his difficulties more to price competition from the Japanese than to the recession. Business remains poor for consumer electrical products and for electrical equipment installed in new industrial buildings. Because of the declining orders, firms are cutting back on inventories and overhead. One firm, on the other side of the inventory adjustment process, reports that he is getting the same number of orders as before but the orders are smaller.

The one positive development in the manufacturing sector is an apparent improvement in European demand. Two firms, one a manufacturer of industrial machinery and the other a supplier of high technology printing equipment and supplies, have seen a pickup in European sales. In both cases these firms produce in Europe, so that the strong U.S. dollar is not a disadvantage. However, the manufacturer of heavy capital equipment had been operating on a 3 and 4 day workweek in the United Kingdom and has now returned to a full schedule. A large manufacturer of electrical equipment also reports that new export orders are good, but this firm had not previously seen a downturn.

Of three large manufacturers who were asked about labor strategies in 1982, one said they would be looking for concessions; one said they were not altering their bargaining strategy but they expected the settlement to be more moderate; and the third foresaw no change.

Professors Houthakker, Samuelson, and Tobin were available for comment this month. Houthakker believes the relatively low rate of M-1B growth last year and the relatively low M-1 target for 1982 will restrain real growth in 1982 and 1983 more than is desirable. M-1B, at best, only attained the bottom of its target in 1981. The M-2 target was too low to be consistent with the M-1B target last year, so Houthakker is not consoled by M-2's exceeding its 1981 target. In 1982, Houthakker believes the Fed should announce a 4 percent to 6 percent range for M-1 growth. He believes midrange money growth of 4 percent is too low, and he fears that M-1 growth may fall below 3 percent, especially if the Fed once again pays attention to the inconsistent, relatively tight M-2 target. Houthakker believes "it is not unreasonable to expect the inflation rate to decline as much as 2 percentage points a year," but he believes "the announced targets would require more deceleration in inflation than we can reasonably expect."

Samuelson was not surprised by real GNP's 5.2 percent decline in the fourth quarter of 1981. The current data suggest that production may decline only slightly in the first quarter of 1982 and may "hold its own" in the second quarter before beginning a recovery in the second half of the year. Samuelson believes "there is no reason for the Fed not to adhere to the upper range of its money growth target in 1982."

Samuelson, Houthakker, and Tobin agree that the Fed should not be concerned about the large increases in the weekly money stock in early

January. According to Samuelson: "The Fed is not pursuing a 'money-out-of-control' policy -- there is poor empirical evidence and no theoretical basis for believing the short-term variance of money growth is important. Domestic money growth has been much more stable and smooth than money growth in other countries. Now that money growth is so stable, the Madison Avenue residents of Wall Street are down to examining every minute entrail of the goose. But this preoccupation doesn't apply to Main Street or to Henry Kaufman and Albert Wajnilower who are capable of handling these generally offsetting changes in the short-term money stock."

Tobin is astonished by the contention that the demand for investment goods, housing, and autos could be stimulated by lower interest rates if only the government would increase taxes and cut spending to reduce its budget deficit. Such a restrictive swing in fiscal policy would lower disposable incomes and would ultimately lower interest rates only by depressing GNP. "There is no shortage of capacity in the real economy today; if there is any crowding out, it is due to a shortage of financial capital. The monetary targets are not sufficient to support a prosperous level of activity no matter whether it is the government or business seeking financing." Unless the money growth targets are relaxed, contractionary fiscal policy would only lower investment because this policy would lower the demand for business output. A business replacing the cash flow lost due to lower sales by increased borrowing -- even at unchanged interest rates -- suffers a financial setback, and its capital budget ordinarily is cut back.

Tobin is also concerned that the Fed was misled by paying close attention to M-2 growth in 1981. "M-2 growth reflected the credit market's

shift from the use of long-term financing (bonds) to short-term financing (bank loans and commercial paper held by banks and money market mutual funds) which was a reaction to tight money itself and uncertainty about long-term yields. Long-term financing is not counted in M-2, but the liabilities of many institutions providing short-term financing are counted in M-2. In the coming recovery, as interest rates rise from already high levels, M-2 growth probably will overstate 'money' growth in 1982 as the credit market continues this shift from long-term to short-term financing."

SECOND DISTRICT--NEW YORK

Economic activity in the Second District remained sluggish through the end of the year. Few respondents reported a further decline, but none believed that an upturn had begun. For retailers, the Christmas season ended on a surprisingly strong note, though with the recent bad weather sales have fallen off substantially. Manufacturing activity continued generally weak, with some firms cutting their work forces and capital spending. The only industry reporting additional declines in orders, however, was capital goods manufacturing. Conditions in the construction industry remained mixed, with the housing market still depressed and the nonresidential market buoyant. Looking to 1982, most business economists expect a first quarter decline, followed by a consumer-led recovery in the spring. On the financial side, the demand for business loans stayed high.

Consumer Spending

After a slow start, the holiday selling season picked up momentum, with a surprisingly strong surge as Christmas approached, and most department stores wound up exceeding their December goals. While merchants were worried that pre-Christmas promotions and markdowns would cut into January sales, inclement weather has proved to be a more serious problem, causing business to drop sharply at most establishments. According to the retailers contacted, only a small proportion of these weather-related sales losses are likely to be recouped. Nevertheless, inventories are generally considered to be in satisfactory condition, and respondents have become less pessimistic about the near future.

Manufacturing

Manufacturing remained depressed, but there was some evidence that the bottom may be near. Electronics firms reported that sales had stabilized at a low level or increased slightly, and some other companies recorded small gains in orders. A manufacturer of aerospace equipment cited strong demand from the defense sector again this month. Only producers of machinery and machine tools experienced additional deterioration in demand.

Work forces were reduced further by some concerns through attrition or layoffs. Despite press reports of widespread moderation of wage demands, the only respondent engaged in labor negotiations reported aggressive bargaining by its union. Other businessmen from upstate New York noted examples of wage settlements near 10 percent. Businesses have become more selective in their capital spending, and a few have trimmed their plans. Inventories have generally been held to desired levels.

Real Estate Activity

Construction activity continued to be very low in the residential sector, yet generally strong in the nonresidential sector. Homebuilders were still reluctant to begin work without a signed order in hand. Sales of existing homes remained stalled, except for those in the very high-priced bracket. Housing prices were reported to have softened. As for nonresidential construction, one major project recently got under way in New York City and plans for others are apparently proceeding normally. Also in New York City, conversion of industrial lofts to office uses has not abated. In suburban areas, the healthy rate of commercial construction

was maintained, although developers were relying increasingly on joint ventures among themselves to overcome financing difficulties.

Economic Outlook

Business economists continue to forecast a small decline in real GNP during the first quarter of 1982. Most feel that stronger consumer spending will fuel a modest rebound as early as the spring. Anticipated declines in interest rates are expected to spur investment, housing, and the automobile industry, adding momentum to the recovery. If interest rates do not fall, however, the upswing will likely be delayed, according to the respondents. Inflation projections have been lowered about a percentage point, with a 7 to 8 percent rise now predicted for 1982.

Financial Developments

Lending officers at the major New York City banks reported that last month's moderate to heavy demand for business loans has not subsided. Commercial and industrial loans booked at international banking facilities (IBFs) added to the growth. Although the sluggish economy has restrained overall credit demand, short-term bank loans are expected to remain strong as long as long-term bond rates are high. Corporate mergers have contributed to the steady activity at some banks.

Financial Panel

This month we have comments from David Jones (Aubrey G. Lanston & Co.), James O'Leary (U.W. Trust), and Donald Riefler (Morgan Guaranty):*

*Their views, of course, are personal and not institutional.

Jones: The financial markets are in a highly unsettled state and near-term conditions are likely to get worse before they get better. Contributing to this volatile market environment are growing uncertainties over near-term Federal Reserve policy intentions. Increases in the Federal funds rate are serving to destabilize the bond market and to push longer term rates back up to record levels. Adding to the market gloom, are prospects for continued heavy Federal Government borrowing. At the same time, short-term business credit demand remains puzzlingly strong--perhaps reflecting unintended inventory accumulation, liquidity strains, and the inability to fund already excessive short-term debt in the bond market. The result could be an intensifying credit crunch for all but the most creditworthy business borrowers and for state and local governments.

O'Leary: The national economy is in a "trap" caused by the inflation of the past sixteen years, with the expectations it has created, and the Federal deficit. The huge deficit for this year and apparently for years to come negates the helpful influence which the financial markets should be receiving from the promising decline in the core inflation rate. Volatility in the markets is bound to continue, with long rates on average remaining very high. Any recovery is apt to be weak and short lived, and for the foreseeable future growth is almost certain to be very low, at best, and unemployment very high. This spells rising political pressure on the Fed to pour money into the economy which would be a disaster. The only basic way out is a major change in policy which will offer real assurance that this year and beyond the Federal deficit will be reduced to more reasonable levels.

Riefler: Loan demand has shown some signs of tapering off at Morgan Guaranty since the peak was reached late in November. Although we continue to view the economy as weak, we are reassured by the Fed's relative quick resistance to excessive monetary growth and believe this will have a positive effect on longer-term fixed income markets. We do not believe that short-term rates are headed back to 1980-81 highs, but are keeping our fingers crossed.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate that business activity in the month of January is down, but hold some hope for improvement by July. Manufacturers report further slippage in the industrial sector, but are optimistic about the future, anticipating a general upswing in manufacturing activity by summer. Retailers say sales are down from a year ago, but write off the slowness to the cold weather. Third District bankers report C&I loan volume up from last January, but consumer loans are off substantially. Contacts in the financial sector are forecasting modest increases in business loan volume as the economy picks up, but disagree on exactly where interest rates are heading.

Industrial

Manufacturers responding to the January Business Outlook Survey report further decline in area manufacturing activity, extending the slump in the industrial sector to four months. Thirty-nine percent of the executives polled indicate deterioration in the business climate while only 13 percent report improvement. In terms of specific indicators, new orders are off in January but not by as much as in November and December. Shipments, on the other hand, have held steady following two months of decline. Inventories have been trimmed slightly again in January. As for labor, payrolls continue to shrink while manufacturers report a further shortening of the workweek.

The continued slowdown has not put a damper on manufacturers' forecasts, however, as approximately three-quarters of the survey participants anticipate improvement in general industrial activity within the next six months. Over two-thirds of the respondents expect new orders and shipments to take off between now and July, and, as production picks up, manufacturers foresee increases in payrolls along with longer working hours. Survey respondents continue to be cautious, however, and many plan to keep a lid on stock levels. Capital expenditures will be kept to a minimum in coming months as well.

On the inflation front, industrial prices are up again in January but price hikes appear to be softening. Almost two-thirds of the survey participants report stable input costs in January, and nearly three-quarters say they've kept the prices on their finished products the same as in December. Prices are expected to climb over the next six months, though. Close to 8 out of 10 of those polled anticipate paying more for raw materials by July and about 6 out of 10 plan price hikes for the goods they sell.

Retail

The record cold weather that's been holding the Third District in its grip for several weeks now has put a freeze on area retail sales as well in January, according to local merchants. Reports of current sales volume indicate sales running 15 to 25 percent below year-ago figures, falling far short of retailers' expectations for this month. Suburban stores appear to be weathering the cold a bit better as sales are said to be off but to a lesser degree than at downtown facilities. Of the items being sold, weather-related goods, particularly heavy winter clothing, are making a better showing this month than other lines.

Looking ahead, area retailers expect sales to begin gaining momentum by the end of the second quarter, if a recovery gets underway, as they expect, but shopkeepers are planning cautiously. Contacts project sales over the next six months to run only slightly ahead of last year's levels, about 5 percent. Inventories remain in-line with no changes in stock levels planned as local retailers may be waiting for stronger signals on the economy before building inventories.

Finance

Area bankers report mixed loan activity in January. Commercial loan volume is up 8 to 10 percent over year-ago levels, but activity in the last two months has dropped off slightly. Consumer loans, on the other hand, are off as much as 20 percent from January '81 figures as most area bankers continue to shy away from retail

marketing efforts they feel would be fruitless anyway. As for the future, Third District bankers expect little loan activity through the rest of the first quarter, but anticipate some pickup in the second, although nothing really robust. Projections are for C&I loan volume to grow by 4 to 10 percent by July, but for consumer loans to remain flat for the most part, as the recession bottoms out.

Reports of deposit flows indicate that demand deposits are mixed, running 8 percent below to 10 percent above January '81 levels. Local bankers say depositors continue to watch the rates closely waiting to shift their deposits to higher yielding accounts. Time and savings deposits are running 7 percent ahead of year-ago levels and are expected to continue climbing.

Third District bankers are currently quoting a prime rate of 15 3/4 percent. Projections of the prime over the next six months are mixed; some bankers predict a hike in the rate to over 16 percent, while others forecast the rate to drop by 175 to 275 basis points.

Despite aggressive marketing efforts by banks in the last few weeks, response to IRA offerings has been sluggish so far in the Third District. Currently, deposits average between \$1,000 and \$1,200 with 30 to 50 percent of the deposits representing new money. Local bankers are optimistic, anticipating some pickup in IRA deposits over the next six months with the strongest thrust coming from corporate payroll deductions.

Real Estate

Home sales in the Third District remain weak in January. New residential sales are virtually at a standstill this month, while resale volumes are off by as much as 50 percent compared to year-ago figures. In efforts to bolster sales, many real estate brokers report dropping prices, about 5 to 15 percent, but mortgage rates of 17 to 18 percent have pretty much shut down the market in any case. Mortgage money is available if, as one contact put it, "you pay the piper." Area brokers say if mortgage

rates drop to under 14 percent consumers would be given a psychological boost, and sales would improve.

On the construction side, activity appears to be mixed. No new starts on detached single homes are reported, although contacts say new groundbreakings for condominiums in the Philadelphia area are picking up.

FOURTH DISTRICT - CLEVELAND

Summary. Most Fourth District respondents expect the economy to reach its trough near the end of the first quarter, and anticipate recovery in real GNP by year-end in a 3%-4% zone. Capital-goods producers are generally pessimistic, citing low capacity utilization and high interest rates. Steel shipments should begin to rise near the end of the first quarter, as the current phase of rapid inventory liquidation by steel users about runs its course. Some relief from steel imports should also boost shipments in the second quarter. Department store sales fell sharply in January, and bank installment loans show weakness. A little improvement is expected in national car sales but car sales locally are very weak. Prospects for house construction, house financing, and savings and loan associations in the District remain dismal.

Outlook. Most respondents expect the recession to reach its trough near the end of the first quarter, as inventory adjustment is largely completed, although one bank economist expects the trough near the end of the second quarter. All respondents expect the recovery to be sluggish by historical standards with perhaps 3% or 4% (a.r.) growth in real GNP in the fourth quarter. No respondent looks for either consumer or business spending to surge in 1982. An economist with a major automobile producer asserts that if the July tax cut was cancelled or delayed consumer confidence and auto sales would fall sharply. He asserts Chrysler and Ford would go bankrupt, and General Motors would have to sell some non-automotive assets to obtain cash.

Capital Goods. Capital-goods producers are generally pessimistic, rejecting the notion that capital goods could lead the recovery. To the contrary, some expect a trough next quarter and cite low capacity utilization, sluggish sales of consumer goods, and high interest rates as reasons for expecting

a mild second half recovery. One producer sees no sign of higher business spending in response to changes in the tax code, and notes that rising interest rates in the second half could choke off recovery in capital-goods production. A producer of machine cutting tools notes that his shipments are being supported by backlogs, but backlogs are falling rapidly because shipments to customers exceed new orders by a ratio of 3 to 1. Users of his capital goods are still laying off workers and he expects it may be 1983 before real spending on capital goods increases. Another capital-goods producer reports that the long decline in his orders seems to have bottomed out in recent months, but he expects a "U" shaped instead of a "V" shaped recovery.

Steel. An economist for a major steel producer reports that shipments, new orders, backlogs, and employment at his firm are expected to fall again in January. He expects more layoffs and shorter work weeks in the first quarter. An economist for another major steel producer notes that steel mill inventories are still high, and the near-term production outlook is dismal. Steel users currently are engaged in a very rapid inventory liquidation that he believes will be largely completed in the first quarter, permitting an upturn in shipments at the end of the first quarter. He expects some relief from imports in the second quarter because of anti-dumping and countervailing duty petitions and he expects some stimulus in the third quarter from an increase in steel consumption. He notes some weakness in demand for oil country goods used in shallow wells, although demand for deep well goods is still firm.

Inventories. Excess inventories of new autos, auto-related products, steel, and aluminum will hold down operating rates to 60% or lower at least this month and next. A retailer, however, believes sales of department store-type goods were underestimated in December and that inventories thus were

overstated. Consequently, inventory adjustment this quarter should be less than last. A major appliance producer reports that the sharp production cutbacks in recent months were associated more with effects of declining housing starts than with excess retail inventories.

Consumer Spending. Some respondents believe the trough in real consumer spending occurred in October, although recovery will be sluggish this half year. Sales of department store goods apparently fell sharply in January. One economist notes that price promotions usually held in January were moved to pre-Christmas, causing December to borrow from January sales. Another economist believes January sales were depressed by unusually bad weather. He expects growth in real consumer spending this year of about 2% or 2 1/2%. Some local bankers report a collapse of demand for installment loans.

Automobiles. An economist for a major producer looks for slowly rising sales in 1982, from 7.8 million (a.r.) (including imports) this quarter, to 10.0 million (a.r.) in the fourth quarter, assuming no change in the scheduled tax cut and no price reduction from GM/UAW bargaining. First quarter sales should be helped by price promotions (Chrysler and Ford) and introduction of some new models.

A large domestic automobile dealer notes that his sales in the first 19 days of January were the worst he has ever experienced. Sales are retarded by high interest rates and customers waiting for price reductions from GM/UAW negotiations. Another dealer of both domestic and foreign automobiles reports that traffic in his import showroom has slowed as much as in his domestic showroom.

Housing and Thrifts. Officials associated with the thrift industry in the District anticipate a very sluggish recovery in housing starts in 1982. Very little loan business has been transacted because of prevailing mortgage rates.

Some officials believe mortgage rates no higher than 14% will induce substantial demand, because inflationary psychology is no longer a factor since prices of houses have stopped increasing. They are also skeptical that nonconventional financing will support a recovery, and assert that neither some lenders nor buyers are yet adjusted to variable rate mortgages or other kinds of nonconventional financing. Thrifts are very cautious about commitments and loans because of uncertainty over deposit flows. Many aggressively promoted the new IRA account but one thrift official claims that IRA deposits in January amounted to only three-fourths of one percent of their deposits. He also complains that the new accounts are adding further to their cost of funds, which in 1981 was about 10.9% and which he expects will rise to 11.8% in 1982. Some officials are also concerned that cash flow generated from repayments of existing mortgages has been cut by almost one-half in the past two years. A few savings and loan associations that made slight profits last year expect losses in 1982. They assert that costs cannot be cut much further because substantial reduction in employment and salaries has already taken place. A major regional builder of houses in the District plans to respond to the bleak outlook by building smaller houses in 1982. He expects mortgage interest rates to be higher in the second half of this year than the first, and will build and market as many new houses as possible this half.

FIFTH DISTRICT - RICHMOND

Overview

Most available information suggests that business activity in the Fifth District has not yet bottomed out. Continued deterioration over the past month is evidenced by further declines in manufacturers' shipments, new orders, employment, and the return to sluggishness of retail sales activity. Layoffs continue to spread, involving transportation, machinery, and government in a widespread pattern of layoffs and falling employment. Construction activity seems to have slipped further and the prospects for a near-term recovery are fading according to Richmond directors. On the positive side, growth of inventories has abated, wage demands have softened, and manufacturers surveyed are decidedly less pessimistic than in recent months.

Manufacturing

Although the rate of decline may have moderated over the month, the trend in manufacturing activity is clearly down. More than half the manufacturers surveyed report further declines in new orders and order backlogs over the month. Employment and the length of the workweek fell broadly so that despite further cutbacks in shipments, inventory growth was brought under control, at least temporarily. Stocks of finished goods were essentially unchanged over the month while materials on hand fell slightly. Inventories fell relative to desired levels but remain substantially in excess. Current plant and equipment capacity also far exceeds present needs. Price increases continued moderately by recent standards. These signs of weakness remain pervasive. There are still no apparent exceptions in the manufacturing sector of the Fifth District other than, perhaps, some defense contractors. Several of the District's major

industries-textiles, furniture, and building materials-remain very weak.

Consumer Spending

Most indications are that the Holiday Season brought a respectable, if unspectacular, surge of consumer activity. More recent information suggests, however, that the buoyancy was short lived. Retail sales, particularly of big ticket items, have fallen further according to our respondents. One respondent, a major department store, finds customers just waiting for sales, unwilling to buy at full price. There is some feeling that the scope of pre-Christmas promotional activities, particularly discounting, sapped the retail sector of some of its late winter potential. Partially because of this thinking, District retailers remain basically pessimistic. There is little expectation that conditions will improve over the next six months. In fact, several respondents expect conditions to be worse at mid-year. Retail respondents managed to hold inventories and prices at previous levels this month. Nonetheless, inventories remain above desired levels and the recent pricing policies are expected to adversely affect profits for the year.

Housing and Construction

Construction in general, and particularly residential, remains very weak. In many areas of the District, housing construction is almost non-existent. In addition, there is less optimism regarding the near-term outlook for housing. A number of our directors feel that a decline in mortgage rates, even to the 13% level, will not induce a major turnaround. They see the situation as now more complex requiring a combination of economic growth, rising employment and incomes, and greater confidence in addition to lower interest rates before significant improvement will occur.

The Financial Sector

Bankers are apparently continuing to experience positive responses to market interest rate instruments. Although it is still too early to know, they expect significant inflows of funds into IRAs. Our directors in banking generally expect anywhere from 40-80% of a large pool of IRA funds to wind up in banks and thrifts. They are very much encouraged by this prospect.

The Outlook

Changes in the outlook were mixed over the month, but in general there seems to have been a shift toward the positive. Of interest is the recent segmentation of this outlook picture. The generally held outlook for the manufacturing sector is positive, while for retailing and construction the recovery is thought to be somewhat more remote.

SIXTH DISTRICT - ATLANTA

The Sixth District's economy appears to be slowing. Retail sales have stalled due to inclement weather and slack labor markets. The construction sector continues to contract as the housing industry grinds to a halt. Unemployment insurance rolls are expanding; layoffs are mounting. A severe freeze destroyed large portions of citrus and vegetable crops and hampered livestock production.

Consumer Spending. Holiday sales were only fair in much of the District, about the same as last year. Exceptions are Georgia and Louisiana, where merchants noted substantial gains over 1980. Weak sales, combined with heavy promotion expenses and pre-Christmas discounting, continued to erode retailers' profits. Reports of fewer return items in the post-Christmas period may confirm that buyers were especially price and quality conscious. The recent severe weather has slowed sales of many non-food items. Retailers expect softer than normal sales, especially of low-quality goods, early in the year because of the deepening recession. In response, they are attempting to lower inventories.

Auto sales continue at severely depressed levels throughout most of the District. State auto dealers association representatives in some District states note that sales of large cars are holding up better than sales of small cars. Spokesmen attribute this to the stable-to-lower price of gasoline and to the small additional cost of buying desired features on larger cars. There are widespread reports that auto dealer bankruptcies and auto repossessions are trending upwards.

Financial and Construction. Interest rates continue to wreak havoc with the real estate and construction industries. Across the District, December sales of single family homes fell to half the year-earlier level. Transferees are declining in number. The only purchasers are those in high income brackets and/or two-income families with

no children. Lower and middle-income families have been locked out of the market. Realtors claim that 85 percent of financing involves assumable mortgages and/or owner financing. An increasing number of sales come from actual and impending foreclosures.

The apartment market is also severely affected. Many cities are experiencing severe drops in the apartment vacancy rates as potential home buyers wait out high interest rates. In other cities, low vacancy rates and construction cost factors have caused rent increases which in turn caused drastic increases in the apartment vacancy rates. Singles are doubling up or moving back home. The housing market effect on apartment vacancy and rental rates has varied considerably from city to city.

Most realtors are pessimistic about 1982. Customers cannot afford high interest rates and have concerns about job security. Realtor agencies are closing branch offices while independents are closing shop.

Employment and Industry. New applications for unemployment insurance soared in Georgia from November to December as layoffs in the automobile, construction, and carpet industries mounted. Some 1,500 federal government workers are expected to be laid off between February and March, bringing to 2,000 the total number of federal civilian jobs lost in Atlanta since October. Federal officials are confident, however, that enough new jobs will be created in defense to place these workers if they are willing to relocate.

Labor market conditions in Florida are healthy by national and regional standards. The inflow of migrants to the state has moderated somewhat due to the depressed national housing market. Florida's jobless rate has risen only slightly since the national recession began. On the other hand, unemployment rates are well above the national average in Alabama, Tennessee, Mississippi, and Louisiana. Unemployment insurance was extended for 13 additional weeks in Tennessee, with one in ten of the

state's workers unemployed. Alabama's unemployment rate is around 12 percent and reports of layoffs suggest that higher rates are in the offing.

Although airlines have recently announced price increases for most domestic routes, fares to Florida vacation cities remain at cut-rate levels due to slack passenger traffic. Hotel managers in South Florida fear that publicity about their recent cold snap could have further adverse effects. Cruise ship travel is down, with Miami's port director predicting a dismal year. Corporate travel is also being reduced. The sluggish economy is affecting theme park attendance as families take trips closer to home. A spokesman for Walt Disney World—with the largest volume of visitors of any park in Florida—notes attendance figures down 8 percent from the same time last year. New promotional campaigns aimed at in-state residents have been undertaken.

Agriculture. In January, the southeast was nipped by severe freezes that extended well into South Florida. Below-freezing temperatures destroyed about 25 percent of the orange crop and 55 percent of Florida's winter vegetables, according to preliminary (and disputed) estimates of a federal agency. Sugar cane was also damaged, but most of the crop can be salvaged if it reaches processing plants before deterioration sets in. Some damaged oranges were also salvaged, but the rapid return of warmer weather hastened spoilage.

Prices of orange juice have risen sharply since the freeze, but future increases may be held in check by relatively large stocks of juice in storage and the likelihood of increased imports of Brazilian juice. Retail vegetable prices are expected to rise at least 15 percent by March, as they did following a similar freeze a year ago.

Widespread snow and ice across most of the southeast increased feed requirements of livestock and slowed poultry production. Broiler prices have risen abruptly in January, reversing a decline of several months.

SEVENTH DISTRICT--CHICAGO

Summary. The business recession continued in the Seventh District on a broad front through the fourth quarter and into January. Output, new orders, and employment declined further in most manufacturing industries. Severe weather in January caused hardship and hampered business operations in various areas. Sales of general merchandise firms improved significantly late in the Christmas season and in early January, in response to promotions and price discounts. (Bad weather depressed sales in some areas later in the month.) Price discounting also is widespread in wholesale markets for materials and components. Housing activity is almost nonexistent. Agricultural conditions remain very depressed, but there is hope that December marked the low point for farm prices. Farmland prices have softened. The upturn in interest rates since late November has depressed credit demands, but business borrowing at large banks was strong in December.

The Outlook. While forecasts vary significantly, most analysts in the region believe the decline in activity will end some time in the spring, followed by at least a modest uptrend in the second half. Several reasons are offered. The lead role probably will be played by consumers with buying power augmented by tax cuts starting July 1. Excess inventories are being eliminated by price discounting and production cutbacks. A slower underlying rate of price inflation, aided by union wage and benefit concessions, will improve business confidence. Defense procurement, although not a major factor in the district, will provide some stimulus. Backlogs of deferred demand for housing, consumer durables, and some producer equipment are building up. Accelerated depreciation under the new tax law will help capital outlays.

Translating backlogs of demand into sales and orders probably will depend on a reversal of the recent upturn in interest rates, which most analysts anticipate.

Inflation. Published price indexes probably do not fully reflect recent price cutting, for both producer and consumer goods. But the recent slowdown in inflation may be temporary. Electric and gas utilities are seeking large increases, and many manufacturers and trade firms will raise prices at the first favorable opportunity. Inventories of materials and components are at such low levels that any upturn in demand would spark price increases.

Consumer Purchases. Sales of vehicles, furniture, and appliances remain very weak, but most general merchandise stores reported significant strength in sales just before and after Christmas. Although consumers responded to bargain prices, inventories remain somewhat excessive. Airlines report improvement in traffic starting in December. Some analysts fear that vigorous promotion of IRA accounts will draw away consumer dollars.

Employment. Employment has been declining faster in the district than in the nation. In November, wage and salary employment in district states was 3 percent below November 1978 and manufacturing was off 13 percent. Indiana, Iowa, and Michigan have suffered the largest job losses. Layoffs in the motor industry and construction have been most significant, but layoffs also have been mounting in capital goods industries. White collar jobs are affected increasingly. Some state and local governments are reducing employment, reversing a steady rapid rise in the 1960's and 1970's, mainly because of cuts in federal programs.

Plant Closing. Many industrial plants have been closed in recent weeks to cut finished goods inventories, and many others are on short workweeks. Hopefully, most temporary closings will end as scheduled later this month or

in February. Some plants have already reopened. However, certain freight car plants have been closed with no schedule for reopening. Several plants in the meat packing, motor and cement industries have been closed permanently.

Packaging Materials. Orders for steel and plastic strapping, and paperboard for boxes, were very weak in late 1981, and apparently in January as well. Demand for these products parallels manufacturing activity in a broad range of industries. Inventories of paperboard rose suddenly as demand dropped off.

Labor Negotiations. Management and unions in various hard-pressed industries are engaged in negotiations to scale down compensation, or at least to slow increases. Restrictive work rules are under review. So far, confirmed concessions have been most significant in the auto, meat packing, and airline industries. A bitter struggle lies ahead over industry "take away" demands. The most important discussions are in the bellwether motor industry where management is seeking drastic modifications of the existing contract.

Capital Goods. Contracts for new industrial buildings, and new orders for capital goods, suggest a sharper decline in capital spending in the district than the 0.5 percent decline indicated by the recent government survey. Faster depreciation and other new investment incentives will have an impact, but only after confidence improves and margins of excess capacity are narrowed. Capital spending programs are dominated by projects intended to cut energy costs, e.g. continuous casting installations in the steel industry.

Motor Vehicles. Sales of cars and trucks continue at severely depressed levels. The first quarter auto output schedule of only 1.4 million, may be cut again. Inventories are at an all time high in terms of days supply.

Steel. After showing strength last spring, steel demand slowed in the second half of 1981, and December marked the low for the year. A pickup in demand expected for January has not materialized, and no improvement is now seen before March. User inventories of steel are low and would have to be replenished if durable goods sales revived.

Construction. After a slight easing in availability of mortgage funds in November and early December, the market tightened again. Very few new loans are being negotiated at quoted terms of 17-18 percent or more, plus three points, with 20 percent down. New home construction is at a virtual standstill. Nonresidential construction prospects also are bleak, but permits have been approved recently for several additional large office buildings in Chicago's Loop area.

Agriculture. Two years of depressed farm earnings, with little hope of a near-term recovery, has led to weakness in district farmland markets. Reports from many areas indicate little buyer interest at current prices. Our latest survey of agricultural banks shows an average decline of 3 percent in district farmland values during the fourth quarter, with weakness most apparent in Illinois, Indiana, and Iowa. However, with farmland prices in the region four times the level of 10 years ago, equity in land provides a basis for coping with a prolonged period of depressed earnings for most farmers.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth District has continued to decline since Christmas. The relatively severe winter weather has combined with a soft economy in contributing to the weakness. Retail sales have been slow, and orders for new merchandise have been reduced further in an attempt to avoid large inventory build-ups. Manufacturing firms also report a reduction in new orders, and as a result a number of concerns have pared production schedules and reduced employment. Many farmers in the District are in serious financial difficulties due to the high and rising operating costs and relatively low selling prices. Reports on the number of new IRA accounts established at banks and savings and loans are mixed.

Consumer spending has declined more than usual for the post-Christmas period. Price concessions and other promotions at department stores in late November and early December reportedly left potential customers with fewer funds than usual in early January. One store reported that the flow of savings into the new IRAs is hurting sales of big ticket items. In addition, the unusually cold weather has kept potential shoppers home. Because of weak sales, department stores have been reducing their orders for new merchandise, and inventories have risen.

Automobile sales generally continued at a low level in early January. However, one auto dealer and one auto supplier reported slight sales improvements, and another dealer had sold 72 cars in the four days preceding the survey--the best four days in 1-1/2 years. One agency expressed concern with the negotiations between the automobile manufacturers and the unions regarding sizable reductions in new car prices. If the

prices of new cars are lowered suddenly, it was feared that used car prices would decline proportionately, causing substantial losses to dealers with large inventories of used cars.

Manufacturing activity in the District has weakened further since mid-December. Orders declined at seven of the eight larger manufacturing firms contacted, including chemical, agricultural supply, consumer durable and industrial machinery. Moreover, two medium-sized firms--an electrical company and an automobile supplier--cut back operations substantially. A trucking firm in Arkansas reported that freight volume is 21 percent below the year-ago level. On the other hand, it was reported that defense, oil drilling equipment, process control machinery and food sales continued at a high level.

Reflecting the decline in orders, inventories at most manufacturing firms inched up. In order to avoid excessive inventories, production was cut back and more employees were laid off. Additional workers would have been furloughed except for the fact that several plants were forced to close several days because of bad weather. One firm went to a four-day week, and another firm reduced weekly hours from 40 to 36. In view of the prolonged economic weakness, one large firm has stretched out its future capital spending plans.

Construction remains generally unchanged from late-1981 levels. However, builders report some increase in traffic through model homes and express some optimism that the decline has bottomed out. To attract customers, some builders are now offering zero interest rate loans on new

homes. In this plan, the customer must pay 1/3 down and the remainder over 5 years. This makes the payments large, but the attraction of no explicit interest has increased home sales.

Many farmers in the District have experienced reductions in real income and are in financial difficulty. Crops were generally large last fall, but prices have declined, and interest and other costs have continued to rise. Particularly hard hit are those farmers who purchased a farm three years ago, financed by a 10 percent three-year mortgage, and who now face refinancing at a 16 percent or higher rate.

Commercial banks reported a moderate increase in savings balances in the past four weeks, and outstanding loans have inched up. Deposits at savings and loan associations declined on balance, as flows to money market funds continued. Experience with the new IRAs is uneven. Those institutions that have aggressively priced and promoted them report a large inflow of funds; other firms report little IRA activity.

NINTH DISTRICT - MINNEAPOLIS

Despite a few bright spots, the Ninth District economy remained fairly depressed in December and early January. Spending on general merchandise, autos, and homes was still weak; most manufacturing orders and production declined further; the forest products and iron mining industries remained depressed; and farm income was hurt once again by falling prices. Reflecting these weaknesses in economic activity was bank lending, which was still very slow. The district had only three positive signs: the winter sports industry was still thriving, high technology manufacturing seemed to be expanding, and the iron mining industry, although still depressed, resumed some operations.

Consumer Spending

The slump in general merchandise sales, which began last summer, persisted into early January. Sales improved some around the holidays in late December, but not enough to compensate for the weakness earlier in the month. Major Minneapolis-St. Paul retailers and our Bank's directors indicated that overall, in December as in November, poor sales of large durable goods depressed general merchandise sales. Furthermore, the late December sales rally did not last into January. One major Minneapolis-St. Paul retailer said his firm's sales declined more than seasonally in early January, partly because of abnormally cold weekend weather. The late December rally apparently was strong enough to reduce the early December inventory buildup, however. Retailers did not report any unusual inventory problems in early January.

Sales of autos and homes remained weak too. According to regional sales managers for two of the largest selling domestic automobiles, new car sales were depressed throughout 1981, and they did not revive in early January. The two managers said their new car sales dropped 16 and 21 percent

in 1981. Also, Bank directors reported that home sales in the district remained very weak in December and early January.

Spending on winter sports, however, continued to be very strong. Snow conditions at both the western and the eastern ends of the district have been excellent this winter, and ski area operators indicated that their business was quite a bit better than usual. One large ski lodge in northern Minnesota, for example, reported that in December its business was up 21 percent from a year ago.

Industrial Activity

One manufacturing industry also seemed to be fairly strong this winter, but manufacturing generally was weak and getting weaker. The strong industry was high technology manufacturing; orders at a large Twin Cities computer manufacturer recently increased more than seasonally. Some manufacturing activity remained essentially unchanged. Production at a major food products manufacturer increased only slightly in December and early January, and a big manufacturer of packaging equipment said business was holding steady. Most manufacturers continued to experience declines, though, stemming especially from weak demand for building supplies, consumer durables, and automobiles. New orders and production at a large Minneapolis-St. Paul manufacturer of windows, for example, decreased in December and early January, and its inventories were reportedly higher than desired. New orders at a large Wisconsin manufacturer of consumer durables recently declined too, and the district's one auto assembly plant was shut down during the first two weeks of January.

The forest products and iron mining industries remained depressed as well, but iron mining recently showed signs of improvement. Directors from Montana, northern Minnesota, and the Upper Peninsula of Michigan reported that

the forest products industry was still very depressed in December and early January. During this period, production at taconite (iron ore) plants was down considerably from earlier years. According to Bank directors, however, several plants that were closed in November and December recently resumed operations.

The recent weakening in most industrial activity has been accompanied by an increase in initial claims for unemployment insurance. In Minnesota, for example, these claims, seasonally adjusted, rose 7 percent between November and December and another 5 percent in early January.

Agricultural Conditions

The farm sector was also still depressed at year-end. The prices farmers receive for their products have been falling since late 1980, and they fell again in December 1981. In Minneapolis, cash prices for soybeans, corn, and wheat declined 2, 3, and 4 percent, respectively, between November and December. At the same time, in south St. Paul, cash prices for slaughter steers, feeder cattle, and hogs dropped 1, 5, and 7 percent, respectively. As a result of the price declines, farm income was hurting in the district: 87 percent of the rural bankers responding to our latest Agricultural Credit Conditions Survey said the income of farmers in their areas in the fourth quarter was less than the year before.

Financial Conditions

The weaknesses in the district economy continued to be reflected in bank lending. Outstanding loans at Minneapolis-St. Paul banks in December and early January remained at November's very low level, and Bank directors from outside the Twin Cities reported weak loan demand in their areas. Because of this weakness, a North Dakota director said, loan-to-deposit ratios at banks in his area were at their lowest level since the early 1970s.

TENTH DISTRICT—KANSAS CITY

Overview. The Tenth District economy continues to show softness, apart from local areas benefitting from strength in the energy sector. Recent strength in sales has left District retailers satisfied with inventory levels. Auto sales continue to be sluggish, however. Residential construction remains depressed, but commercial construction activity is strong where the energy industry is important. Farmland prices appear to be softening somewhat. Loan demand ranges from weak in agricultural areas to strong in areas serving the energy industry.

Retail Trade. Retailers in the Tenth District reported that nominal sales gains were in the 8-15 percent range in 1981 compared to 1980. While sales in October and November of last year were relatively weak, December sales in the District were equal to or greater than the year-over-year increase. Sales of apparel and electronic games were particularly strong during December 1981. The recent strength in sales left most District retailers satisfied with inventory levels at the end of 1981. Strong sales also firmed up profit margins for most retailers, who report merchandise cost increases in the 5-6 percent range. Those cost increases are still being passed on to the consumer as most retailers continue to maintain their inventory markups. However, all retailers indicate that consumers are still very price conscious and, if necessary, retailers will cut prices to maintain sales levels. Most District retailers expect sales to be about 10 percent greater in the first half of 1982 than in the first half of 1981.

Automobile Sales. District Automobile Dealers' Associations report generally sluggish sales, with the exception of Oklahoma which boasts a

6 percent increase over last year. High interest rates are dampening demand and increasing the cost of floor planning to nearly prohibitive levels, prompting dealers to trim inventories as much as possible. In addition to high interest rates, banks are resorting to higher down payments and longer residency requirements to ration credit to auto buyers. The depressed credit conditions are discouraging primarily small- and medium-sized car sales. Dealers hold a bleak short-term outlook, but most predict an upswing during the summer contingent upon lower interest rates.

Industry Activity. Most purchasing agents contacted report that input prices have increased 8 to 12 percent in the last year, with similar increases expected during 1982. Materials are readily available, although some lead times have been extended due to adjustments in production and in the work force. Inventory levels are satisfactory for most of the firms contacted, and will remain at or below current levels until the economy exhibits signs of recovery.

Residential construction activity remains weak in most parts of the Tenth District. Commercial construction activity is strong in areas where the energy industry is important. Although energy activity continues to grow, there are some indications of a slight slowing—particularly in gas well drilling in Oklahoma and in Colorado's oil shale industry.

Agriculture. Tenth District farmers may be holding slightly larger amounts of grain off the market than in a normal year, due mainly to the unfavorable price situation. As a result, more stored grain is entering the farmer-owned reserve program. Agricultural banks in the Tenth District are carrying over into 1982 more 1981 farm loans than is seasonally true. Bankers

are continuing to maintain lines of credit for long-standing farm and ranch customers, although many bankers are not comfortable with this situation given the less-than-optimistic outlook for agriculture in 1982. In some instances, farmers are being asked to liquidate a portion of their assets to keep their farm businesses solvent. Fund availability remains adequate but the creditworthiness of farm borrowers continues to deteriorate. In some areas of Oklahoma, nonbank agricultural lenders are increasing loan restrictions, which has forced the foreclosure of several farming operations. Declines in farmland prices have occurred in some parts of the District, but agricultural bankers generally report that land prices are holding steady.

Banking Developments. Reported loan demand at Tenth District banks ranges from weak in rural areas to strong in those areas serving the energy industry. Commercial and industrial lending continues to be the only source of strength Districtwide. A number of bankers report still further weakness in the balance sheet situation in agriculture. Prime rates range from 15 3/4 to 16 1/4 percent, unchanged from last month's survey. Several bankers express concern over a reduction in loan quality and indicate tighter lending restrictions. While deposit growth was generally stronger than last month, much of the growth was seasonal in nature. Banks in areas with sizable loan demand continue to rely on large CDs to fund these loans. Some of the growth in transactions accounts and passbook savings accounts is attributed to precautionary motives. Despite the very heavy promotion of IRA/Keough programs, most banks report smaller-than-expected activity in these accounts. Several bankers indicate that the bulk of the funds being transferred into these accounts is coming from passbook savings and from thrift institutions.

ELEVENTH DISTRICT--DALLAS

The economy of the Eleventh District shows further signs of softness. Department store sales rose sharply before Christmas, but auto sales remain weak. The pace of drilling is slackening, and manufacturers indicate further declines in new orders. Nonresidential construction remains at a high level, while interest rates remain a major obstacle to recovery in residential construction. Business loans continue to outpace consumer loans. Declining commodity prices are squeezing farm incomes.

Department store executives report that sales surged in the last two weeks of December, as they did a year earlier. But profit margins were much lower than expected because of heavy advertising and price cutting. Ladies' and children's apparel sold especially well. Retail inventories are at desired levels, and respondents anticipate consumers will be cautious in the next few months.

Auto sales remain low, and there is little hope they will recover soon. Imported models are selling slightly better than domestics. Used car sales are described as good. Dealers report low inventories of imported models and moderately high inventories of domestic models.

Drilling has been hampered by winter weather, and there are indications activity is slowing. New orders for rigs are declining, and some idle units are being stacked. Currently the lead time from date of order to delivery of a new rig is less than three months. Four months ago, the lead time was 12 to 18 months.

Manufacturing output is declining slowly. The high level of commercial and industrial construction in the District is holding up steel production, but excess capacity is increasing. Steel manufacturers are not able to pass on cost increases. Steel fabricators from outside the District are bidding on projects here, and work is being let at close to cost. Output of highway construction equipment is low. Manufacturers of electronics report increased sales to the Federal Government and a slowdown in sales to the commercial sector.

Labor markets are still fairly strong. Despite some layoffs and temporary plant shutdowns in manufacturing, the unemployment rate in Texas declined to 4.5 percent in December.

The pace of commercial construction remains high and is not expected to moderate this year. There is mounting concern the boom in office building will lead to an overhang in available space. As a result, some developers are finding it difficult to secure permanent financing for announced projects. Housing sales are up slightly. Starts of new houses will remain low until builders work off current inventories, which are in much better shape than in the 1973-75 recession.

The small volume of lending at S&L's is for condominiums or homes worth \$300,000 or more. These loans are usually variable rate mortgages. Lenders report there are some takebacks on builder loans. Mortgage delinquencies and foreclosures are running a little higher than usual but are considerably below the national rate. Deposits are declining, as outflows to the money market continue. The small volume of new money deposited in IRA accounts is being used to increase liquidity.

The major strength in commercial bank loans continues to be in energy and related industries, but borrowing by many other businesses is also on the rise. The small gains in consumer loans continue to lag well behind the increase in business loan demands. Delinquencies are rising but are not considered to be a major problem. Banks are tightening restrictions on the issuance of credit cards. Deposits are increasing slowly. Activity in the new IRA accounts is fairly strong, but most of these balances are being transferred from existing accounts.

The outlook for farm incomes remains bleak. Bumper crops (both domestic and foreign) give farmers little hope for higher commodity prices. Cattle prices also continue to fall, but ranchers are optimistic prices will strengthen as marketings are reduced to build up herds.

TWELFTH DISTRICT - SAN FRANCISCO

The Twelfth District economy appears to have weakened further in the past month. A late burst of spending pushed December retail sales moderately ahead of the year-ago level in nominal terms, but sales still failed to keep up with inflation. Moreover, in January, sales apparently have dropped below the year-ago level in nominal terms. In the manufacturing and mining sectors, further production cutbacks and layoffs are evident among a broad spectrum of industries. Residential construction rose in December, but builders are skeptical that the improvement will be sustained, given the recent rise in mortgage interest rates. Apparently the region's supply of unsold homes actually has increased recently, contrary to the pattern elsewhere. Farmers are experiencing a continuing decline in commodity prices and are finding it increasingly difficult to obtain credit. Commercial loan demand at banks increased in December but not because of increased confidence but to finance excess inventory. Regional banks are becoming increasingly worried about the creditworthiness of borrowers. At regional S&Ls, mortgage lending continues to be very slow, with no significant improvement in savings flows to the industry.

Consumer Spending

A spending flurry late in the Christmas season pushed December retail sales in various Twelfth District states about 1-5 percent above the year-earlier pace in nominal terms. This represented a decline in real terms, however. Moreover, since early January, sales have slowed, dropping below the year-ago level in nominal terms and widening the year-to-year real decline. Retailers believe that the pre-Christmas burst in sales was "borrowed" from later periods. Indeed, they expect sales

to remain sluggish through the early months of 1982 due to an expected further increase in unemployment and the cautious spending behavior being exhibited by consumers. As evidence of consumer caution, retailers point out that they achieved the pre-Christmas flurry only by offering severe price markdowns and that consumers stayed away from durable goods and focused on apparel and other necessities. The retail sector is experiencing a squeeze in profit margins. Collections also are slowing. Unlike the 1974-75 recession, inventories are not excessive relative to sales, however, in that retailers have tried to hold down short-term borrowing. The exception is at automobile dealerships, where new car sales early in 1982 have dropped even further below year-ago levels.

Mining and Manufacturing

Respondents report further cutbacks in production and employment among a wide number of industries. In the forest products industry, weakness in the paper segment of the market is offsetting slight gains in lumber employment, resulting in continued net layoffs. In the metals industries, further price weakness is forcing additional closures and curtailments in January. Many of these cutbacks can be traced to weak demand from the national automobile, housing, appliance and aircraft manufacturing industries. Copper producers in Arizona and Utah are extending Christmas holiday shutdowns, indefinitely in some cases, until prices recover. Employment also is being cut back at silver-lead-zinc mining facilities in Idaho, at steelmaking facilities in California and in the Pacific Northwest aluminum industry. In the automobile industry, General Motors Corporation plans to close temporarily its Fremont, California plant on February 1 to reduce excess inventory. In the aerospace industry, lagging orders for commercial jet aircraft and electronic products are forcing further layoffs, with

the Lockheed Corporation actually phasing out production of its L-1011 transport.

Real Estate

Twelfth District respondents report no sign of the pick-up in new home sales reported elsewhere. On the contrary, they contend that the region's inventory of unsold homes is still increasing. Moreover, the value of residential real estate is depreciating 5-10 percent annually, both as a result of actual price reductions and seller-financed transactions at less than market interest rates. Failures and bankruptcies in the real estate and homebuilding industries are mounting. Although Western homebuilding activity picked up in December, builders tend to downplay the improvement, stressing that Western homebuilding remains further below the 1978 peak than is true nationally. Moreover, they are concerned that the recent increase in mortgage rates will arrest the homebuilding recovery. Nonresidential construction activity has shown little change recently and is running at approximately the year-ago pace.

Agriculture

Twelfth District farmers and ranchers experienced further deterioration in their financial situation in December as a result of a further decline in commodity prices. Price weakness continued to reflect bountiful supplies and weak export demand. In January, regional farmers have been benefiting from higher prices for citrus fruits as a result of the Florida freeze. Cattle prices also have been rising. Nevertheless, the farm sector is in serious financial difficulty. Many farmers need to extend debt acquired during past periods of drought but are finding it difficult to qualify for loans because of decreasing creditworthiness. A growing number of farms are for sale, especially in California.

Financial Institutions

Credit extended by Twelfth District banks rose substantially in December, with lending to businesses and consumers accounting for most of the increase. Bankers regarded this increased demand for loans as a sign of further economic weakness, however. Involuntary inventory accumulation and inadequate generation of working capital were the most frequently cited reasons for the increased business loan demand. Banks are becoming increasingly concerned about the creditworthiness of their borrowers, and have generally tightened their credit standards. Loans to the forest products, agriculture, automobile and farm equipment industries are being subjected to particular scrutiny. In December, real estate lending continued sluggish throughout the District, particularly for residential construction.