

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Overview. The economic retrenchment reported earlier this summer appears to have slowed or stabilized in August and September, but District reports continue to show almost no indications of recovery. Consumer spending remains cautious, and after a disappointing back-to-school season retailers as well are ordering with prudence. Manufacturing activity is widely described as deteriorating: new layoffs are reported; capital spending plans have been further deferred; and inventories in many industries are mounting. Residential construction shows signs of improvement in a few Districts, but commercial building activity is still on the wane. Abundant agricultural supplies threaten to depress many crop prices, thereby reducing net farm income even further despite more favorable conditions for livestock producers. In the financial sector demand for both business and consumer loans in most Districts is characterized as soft, while deposit growth remains sluggish. Most Districts are not optimistic regarding the outlook for recovery in 1982.

Retail Sales. There is virtually no indication that a consumer-led economic recovery is underway. Back-to-school and total retail sales are generally reported as sluggish or disappointing. Sales of soft goods continue to outperform such consumer durables as household furnishings, and new auto sales remain depressed.

Caution seems to be the key trait in the retail sector. Despite slow-rising retail sales, due in part to buyer uncertainty about jobs and still high interest rates, merchants are apparently satisfied with inventory levels. Retailers have been trying to keep a tight rein on inventories and are buying cautiously for the December holiday season and winter.

*Prepared at the Federal Reserve Bank of Atlanta.

Scattered signs of optimism for faster-growing retail sales later this year include reports from Boston and Philadelphia that a strong post-Thanksgiving selling season is expected and from Kansas City that merchandise cost and profit margins are stabilizing. Chicago, on the other hand, finds orders of goods for the winter season considerably below normal and store closings increasingly frequent; Dallas notes a faster-than-usual deceleration of sales following the back-to-school selling period.

Manufacturing. With the exceptions of Dallas and New York, most Districts describe a further slowing of industrial activity in September. Production, employment, orders, and shipments are weak, and additional layoffs and shortened workweeks are reported.

Cleveland finds that manufacturing activity has yet to trough and the outlook for the steel industry is dismal. Inventories of oil-field equipment continue to climb; Dallas and Atlanta report that petroleum refineries and chemical plants are operating far below capacity. With the exception of defense-oriented industries, orders at most manufacturing firms have contracted further. Defense contracts are shoring up electronics, aerospace, and related manufacturers in Dallas, San Francisco, Atlanta, and St. Louis. Chicago observes that imports, aided by the high value of the dollar, are taking a growing share of the markets for machine tools and farm and construction equipment.

Capital spending plans are conservative at best. Low demand for the services of plant location advisors in Atlanta and Chicago suggests little new capital expansion for some time. San Francisco reports scant response to the recent decline in interest rates from corporate investors.

Construction and Real Estate. Residential construction evidences some signs of improvement in several Districts, but the nonresidential sector continues to decline slowly almost everywhere. The number of building permits issued and of new homes

sold has increased in several areas, particularly Dallas and Atlanta. Lower mortgage rates have attracted more buyers to the housing market, but most are waiting to see whether rates continue to fall or stabilize before they purchase. Realtors claim the industry needs a 12-13 percent "stable" mortgage rate before activity perks up substantially.

Commercial construction is no longer supporting the rest of the construction sector to the extent it did earlier in the recession. In the Cleveland District industrial construction is in a state of "depression"; only St. Louis reports any improvement in commercial building activity. The market for office space remains soft to weak.

Agriculture. Substantial stocks, expected large harvests, and weak demand have caused prices of most field crops to fall sharply. In the Minneapolis and Kansas City Districts late plantings and delayed maturation of crops have given rise to fears of frost damage. Large grain harvests in the Midwest threaten to overtax storage capacity.

Higher costs and lower prices render increasingly remote the possibility of substantial debt reduction for the farm economy in 1982. Atlanta finds growing indications that farm bankruptcies and liquidations will rise in coming months. Bright spots in the farm economy do exist, however. Hog producers and tobacco farmers are in a position to take profits, and lower feed costs should benefit the entire livestock and poultry sectors. Nonetheless, net income for the farm sector as a whole is likely to be below that of 1981.

Financial Conditions. Reduced inventories and low utilization rates are keeping business lending soft. Philadelphia, however, notices an increase in such lending and attributes it to distress borrowing. Dallas reports a similar rise but points instead to greater stability as the cause. Other Districts characterize business loans as flat or down.

Although isolated, there are reports of increased consumer borrowing in the aftermath of declining interest rates. Kansas City finds improved loan quality as well.

San Francisco, in contrast, witnesses a sharp increase in delinquencies and foreclosures. Deposit growth remains sluggish. Atlanta and San Francisco observe little interest in the 7- to 31-day certificates.

FIRST DISTRICT - BOSTON

Still no signs of a recovery in the First District. Retailers continue to exceed modest sales goals, but only through extensive promotional activity. Bargain hunting is very prevalent. The manufacturing situation has improved to the extent that more firms reported sales which are "bumping along the bottom" than reported further declines. Planning for 1983 is based on the assumption that current sales and order rates continue for another six months. However, most of the manufacturers contacted this month felt that payrolls and inventories had been brought down to levels consistent with current sales rates.

Retail

Most retailers in the First District continue to report sales exceeding their expectations, expectations that have been severely tempered by the recession. Bargain-hunting is very much in evidence, making promotional activity a critical element in maintaining sales. No contacted merchants believed the July tax cut or Social Security increases were being spent in their stores yet.

One discount retailer reported sales in August up 13 percent over a weak August last year, and cited extra promotional activity this year as an important reason for the improvement. A store selling appliances and other consumer durables reported sales over the last 60 days flat to plus 5 percent compared to last year. Although this was the worst 60 days so far in 1982 (the sales increase for the year to date is in double digits),

their market share has continued to rise. Promotional activities and careful comparison-shopping by customers have both worked to their advantage. A general merchandiser in the Hartford area reported "fair" performance, citing sizable but very bargain-oriented responses to promotions. A clothing and hardgoods merchant operating nationwide largely through catalog sales was contacted for the first time this month. They have averaged 30 percent annual sales growth over the last five years, and are "mystified" by August and year to date sales more than 40 percent above last year.

The retail inventory situation is mixed. Several stores reported that they are buying cautiously for the Christmas season to keep inventories down and retain flexibility. Others are building inventories to improve customer service and "make volume happen." One of the "cautious" buyers expressed concern that widespread weak buying will discourage production, and goods will not be available if needed later.

All the firms contacted are expecting an improved fourth quarter and a strong Christmas season. But all said they would have to work to get the customers inside their doors.

Manufacturing

Most of the manufacturers contacted described the present situation as one of "bumping along the bottom." Included in this group were manufacturers of machine tools, small appliances, automotive products, computers and products for the home. Several firms in printing-related fields reported further declines in the late summer months. Firms divided on whether domestic or overseas sales are weaker. Canadian sales of printing equipment were reported to be particularly weak. Sales of

productivity improving equipment are holding up better than other sales, according to a machine tool manufacturer and a producer of packaging equipment. A computer manufacturer expects a strong response to a new product advance, although overall sales are expected to be flat.

With few exceptions firms do not look for a recovery in their own industries within the next six months. Budget plans are being developed assuming a continuation of the present situation. However, most of the firms contacted feel that inventories and employment levels are generally consistent with current sales volumes and they do not plan any further corrections. This contrasts with the responses last month, when even firms with stable orders were making additional cutbacks. It also contrasts with the responses to a recent survey of local purchasing agents; this survey shows firms continuing to reduce inventories and payrolls.

Professors Solow, Eckstein, Samuelson, and Houthakker were available for comment this month. The first three share similar views concerning the state of the economy and how the Fed should respond to it. They all believe that the economy is dangerously weak and could deteriorate further before finally turning around. None envisions a particularly robust recovery.

Eckstein is particularly alarmed by the recent surge in unemployment insurance claims. Samuelson bases his pessimism on declining production, weak auto sales, and sagging consumer confidence. Solow fears that the widespread gloom in the business community could become a self-fulfilling prophecy.

In light of their sobering assessments, Solow, Samuelson, and Eckstein all recommend that the Fed should exceed its money growth targets

in the near future. Samuelson thinks above-target growth should continue until a recovery is clearly evident. Eckstein has reluctantly concluded that the Fed should explicitly raise its 1983 M1 growth target to 6 percent. None of the three economists have strong feelings about achieving growth targets for the other monetary aggregates.

Although sensitive to the risk and costs of rekindling inflation, all three believe that without a further drop in interest rates the risk and costs of severe economic decline would be even greater. Solow and Samuelson maintain that the Fed has already established its credentials as an inflation-fighter which would not be seriously jeopardized by above-target money growth under such distressed economic conditions. As evidence of this credibility, Samuelson pointed out that financial markets have strengthened considerably in recent weeks in spite of a widespread perception that the Fed has eased. He concluded that any moderation in inflation gained by strict adherence to monetary targets would be small and clearly not worth unemployment in excess of 10 percent. Yet, he did advise the Fed to bring money growth within targets at the first signs of "credibility erosion," such as increasing long-term interest rates.

In contrast to the other three economists, Houthakker believes that a modest recovery is already underway and, consequently, no emergency measures are needed to bail the economy out. He would keep M1 growing at a 5 percent annual rate for the foreseeable future. He is unconcerned about recent upward "blips" in M1 growth as long as it is brought within range by the end of the year. He also thinks that the recent tax increase played a major role in reducing interest rates and that additional deficit-reducing measures would promote further rate reductions.

Second District--New York

The rate of economic deterioration in the Second District appeared to be slowing in August and September. While it is still too soon to tell when the recovery will begin, economic conditions do appear to be less bleak than they were in our last report. Retail sales have improved slightly. Construction activity has held steady with the residential sector still in the doldrums and nonresidential building strong. In manufacturing, layoffs have continued but generally were smaller than in previous months and some recalls occurred. The reopening of a major steel facility offset other plant closings. Business leaders still expected no significant upturn before the end of the year.

Consumer Spending

Retail activity improved slightly from July's low level but has only now returned to year-ago levels. Merchants had hoped for larger gains from back-to-school shopping and so were somewhat disappointed. Nonetheless, sales were actually better in the Eastern region than elsewhere around the country for at least some of the national retailers contacted. Apparel remained one of the stronger lines; the slump in big-ticket items like furniture and appliances showed no signs of ending. Stores intended to continue heavy promotions and aggressive pricing to move merchandise, and were restraining their own buying until signs of an improvement appear. Inventories tended to the high side at a few stores, but stocks were not expected to pose problems.

Construction and Real Estate Activity

The construction picture was essentially unchanged from that reported over the last six months. Residential construction remained

depressed in much of the District. Some builders expressed hope, however, that the usual autumn increase in demand for new homes to be delivered in the spring will manifest itself again this year. While the recent decline in mortgage rates has not had a stimulative effect on new home building, it has sparked some renewed interest in the purchase and renovation of existing homes. Home prices have generally held steady in recent months.

Nonresidential real estate activity remained strong with the outlook still cloudy. Projects currently underway were viewed as sufficient to maintain construction employment at current levels for at least the next few months. But softness in the office market was still evident in the New York City metropolitan area with vacancy rates up marginally and rents stable or down slightly. Consequently, developers were reluctant to make long term commitments and were expected to continue to postpone some groundbreakings until the economy revives and the office market tightens. New startups have not disappeared entirely, however. Projects begun included office complexes in Queens and on Long Island, a shopping center in Rochester, and a large truck stop in Buffalo.

Business Activity

Business leaders cited conflicting evidence on whether the economic slowdown in the District was bottoming out. These mixed signs marked at least some improvement from the pervasive deterioration observed in August. Permanent shutdowns occurred at plants producing computer circuits and paper products, as well as at the Courier-Express, a major newspaper in Buffalo. In addition, layoffs continued in a wide range of industries, including autos, chemicals, electronics, office equipment, and machine tools. But the workforce reductions appeared to

be generally small relative to those of the past couple of months. Moreover, a few firms, even in some of these same industries, indicated that their businesses had finally stabilized and that some had even recalled workers. Another encouraging sign was the reopening of a major steel facility, surprising employees who had been worried that the plant would be phased out altogether, despite company assurances to the contrary.

Outlook

Business leaders remained skeptical of any significant upswing before year-end, but overall the pessimism did not appear as deep as in August. Although our contacts reported that many businessmen across the District still forecast stagnation or even further deterioration into 1983, more now saw a glimmer of hope for early next year. One survey of upstate companies' plans for the fourth quarter found that the majority expected to maintain stable employment levels through the rest of the year, and that those hoping to hire new workers slightly outnumbered those anticipating workforce cuts. As for retailers, many feared that the expected resurgence in consumer spending would be thwarted by concern over continued weakness in the economy.

Financial Panel

This month we have comments from David Jones (Aubrey G. Lanston & Co.), Robert Stone (Irving Trust), and Alfred Wojnilower (First Boston Corp.):*

Jones: The recessionary U.S. economy has, in all likelihood, not yet hit bottom. Consumer psychology has deteriorated sharply. Businesses are continuing to try to cut back on spending on inventories

*Their views of course are personal, not institutional.

and plant and equipment. There is increasing emphasis on cost cutting measures including wholesale layoffs of white-and blue-collar workers. It may well be that interest rates, particularly in the longer term corporate bond and mortgage markets, must fall 200-400 basis points further in order to set the stage for recovery. Further declines in interest rates, particularly in the longer term areas, are likely to be limited by the clash between heavy Federal government borrowing and desperate businesses seeking to borrow long to repay short-term debt. The Federal budget deficit for fiscal 1983 could climb to \$160-170 billion.

The income velocity of money is likely to fall far below its normal 3 percent growth trend both this year and next. The Fed's current tentative M1 target for 1983 leaves virtually no room for economic recovery. Given this prospective drop in velocity growth, the Fed might consider raising the upper limit of its tentative 1983 target for M1 growth, from 5 1/2 percent to perhaps 6 1/2 or 7 1/2 percent.

Stone: It seems to me that monetary policy is exactly on course. It is appropriate that the Fed persist in its efforts to limit the growth of the money supply. But given the state of the economy, the existence of serious financial problems, and the continuing uncertainties surrounding the interpretation of the money supply, it is also appropriate that the Fed be pragmatic and flexible in its approach to limiting its growth.

The System has earned a good deal of credibility among market participants, and I think there is little danger in losing it by being flexible in its approach to controlling the aggregates.

Wojnilower: Reports from sources in industry continue grim as to both current business conditions and attitudes toward the future. They do reflect, however, considerable disinflationary momentum.

Institutional investors assume that the summer's Federal Reserve actions mark a fundamental shift away from money-supply rules toward an employment-oriented policy focused on interest rates such as is believed to have prevailed before October 1979. The stock market advance resembles the similar rather brief and spectacular bull markets that used to occur toward the end of recessions when the economy was seen as bottoming and the Federal Reserve as guaranteeing stable or falling short-term rates until the fact of sustainable recovery had become statistically certain. As a result the financial community is quite complacent that all will turn out well, and tension in regard to potential default problems has subsided to an amazing degree.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District are mixed but point to continued weakness in the local economy overall. Conditions in the manufacturing sector still show no conclusive signs of a turnaround, and retail sales are sluggish at best. In the banking sector, loan demand has risen and a drop in interest rates is reported. The home building industry, despite a drop in mortgage rates, remains in very poor shape.

The outlook for some recovery in the next six months is generally optimistic, but cautious, across all industries. Both manufacturers and retailers are certain that improvement will occur, but are planning on it being slow and late starting. Bankers expect a hesitant recovery, as well, with further distress borrowing pushing up loan volume.

CONSTRUCTION AND REAL ESTATE

The housing market in the Third District remains mired in the slump that has plagued it for well over a year now, according to area real estate brokers. Industry contacts report some recent improvement in market conditions, highlighted by a dip in mortgage rates to the 14 to 15.25 percent range. Buyers, however, apparently still view rates as too high to buy. Traffic through new and older homes is up a little, but sales are still below year-ago levels by as much as 50 percent. In addition, nearly all current sales are of previously owned homes. As a result, housing starts are at a virtual stand still as builders react to stalled sales and declining new home prices.

MANUFACTURING

Respondents to the September Business Outlook Survey report that business conditions in the local manufacturing sector are unchanged from August. Third district industry continues to exhibit the lingering weakness that has been evident for the last seven months. While reports of improvement in manufacturing conditions have been on

the rise recently, there are still no firm indications that the industrial sector has begun to really recover. New orders and shipments show modest growth, their first gains since June, but shipments have again outpaced new orders and forced producers' backlogs down further. Cutbacks in both working hours and the factory work force are reported again this month, and widespread reports of stock level reductions indicate that liquidation of manufacturing inventories has not yet showed.

Survey participants are still highly optimistic that a recovery will occur within six months, but appear to be maintaining a cautious stance while awaiting further signs of strength. Nearly 80 percent of the businessmen polled are looking for improved conditions over the next six months. New orders are expected to take off, and, with shipments projected to show slightly less growth, growing backlogs and longer delivery times are foreseen. Producers say the anticipated spurt in activity between now and March will push payrolls and working hours upward and bring inventories into check. But, reflecting continued caution, there is little stock building planned, and capital spending increases will be kept to a minimum.

Industrial prices are holding steady again in September, having shown little inflationary movement at all since April. Flat input and finished good prices are reported at well over 80 percent of responding firms this month. As for the next six months, the projected turnaround in manufacturing activity is expected to rejuvenate inflation but manufacturers foresee only moderate increases in both the cost of raw materials and the prices they charge for their own products.

RETAIL

Department store sales, which appear to have stabilized somewhat since the last Redbook, are mixed. The uncertainty about jobs and income that has kept consumers away from retail outlets all summer continues to put a damper on spending. Retail sales

volume is now running from about one percent below to slightly above that of a year ago, but well below the expectations of merchants. Retailers had been looking for a "back to school" surge in September to pump up sales. Current reports, however, have these soft goods moving sluggishly and most other lines showing even less life.

Looking ahead, weak sales volume is expected to linger on until a projected holiday surge in December. End-of year forecasts are in the 1 to 4 percent range. A Director of this bank, however, notes that small gains over last year's fourth-quarter sales will not be a strong positive signal, as last year's sales were less than robust. Nevertheless, contacts are "guardedly optimistic" that a weak recovery will finally take hold in three to four months, and that sales will climb by two to five percent above year-earlier levels by early spring. Merchants remain cautious about inventories, currently lean and generally below last year's levels, and plan to maintain the present tightness for at least the next six months.

FINANCE

Third District bankers report improved loan activity in September. Commercial lending inched upward this month, pushed along at least partly by increased distress borrowing that outweighed the recent shift toward long-term debt. According to banking contacts, the volume of business loans is ahead of year-ago figures by as much as 11 percent, slightly better than lenders had anticipated. Retail loans, held down by design for most of this year, have increased recently in response to lower interest rates, but are still well below last September's levels. As for the future, indications that recovery will be weak have changed bankers' outlooks for Third District lending activity. More distress borrowing is now expected to keep C&I loan volume on the rise in the near future, and growth in consumer loans is also projected to continue as long as interest rates don't begin to rise again.

Area bankers have lowered their prime rate to 13.50 percent during September and foresee it dropping further if the recovery continues to sputter. Lenders are now predicting that the prime may go down to 12 percent before levelling off. The expected timing of the trough in interest rates has been pushed back into early 1983 when the projected recovery is forecast to be underway.

Deposit flows in the Third District show a few signs of minor slippage. Time deposits are not as strong as in recent months, but are still 10 to 12 percent higher than a year ago. Demand deposits are reported to be mixed, with some bankers reporting a loss of deposit dollars to various interest bearing assets, including the new 7-31 day time deposit.

FOURTH DISTRICT - CLEVELAND

Summary. Economic conditions and the outlook in the Fourth District remain bleak. Unemployment is high. Survey results and leading indicators suggest continued sluggishness in economic activity. Capital goods production is unlikely to recover until next year. The steel industry remains in depression. Weakness continues in construction with few signs of improvement. Retailers are cautious, expecting slow sales gains. Municipal employment and creditworthiness have fallen.

Unemployment. Labor markets in the District remain weak. Unemployment rates continue higher than the national rate, but are demonstrating no clear trend. In Ohio, the unemployment rate (s.a.) was 12.7 percent in August, up 0.3 percentage points since April. Among the District's eleven major SMSA's, unemployment rates (n.s.a.) in July ranged from 9.1 percent in Columbus to 18.2 percent in Youngstown, and most SMSAs had rates about 2 percentage points higher than the national rate.

District Outlook. Continued sluggishness in District economic activity is suggested by leading indicators and our latest survey of manufacturers. An index of leading indicators for the Pittsburgh SMSA posted its fourteenth consecutive monthly decline in July. An index of leading indicators for the Cleveland SMSA rose in July but has declined in eight of the last twelve months. Results from our September survey of Fourth District manufacturers indicate District manufacturing activity has yet to trough. New orders and shipments are expected to expand, but at a slower rate than in August. Manufacturers continue to liquidate inventories at about the same rate as in August. Contractions in employment and hours worked are expected to be less severe than in August.

Capital Goods. Capital goods production continues to weaken with no recovery seen until next year. A producer of recording instruments for the natural gas industry reports a sudden drop in orders. A large diversified capital goods producer reports his backlogs are low and there is "complete disarray" in capital goods markets with little prospect for recovery in the next six months. A major bank expects the lag between an upturn in economic activity and an upturn in real expenditures on capital goods will be longer than usual in this cycle and will not occur much before the second half of 1983.

Steel. Current conditions and outlook in the steel industry remain dismal. Output remains extremely weak, with producers operating at about 40 percent of capacity. Workers continue to be furloughed. Republic Steel has cut exempt employee salaries 7 percent effective October 1 and is planning to layoff about 13 percent of currently working non-union employees in early autumn. One major producer reports that the steel market "is on hold," with no meaningful improvement expected until the fourth quarter. Another major firm reports that "near-term cutbacks in auto production and continued declines in capital goods production are depressing steel demand. A slowing of steel-user inventory liquidation should produce moderate improvement in fourth quarter steel demand. Steel mill inventories will be liquidated through year end and into early 1983." A medium size steel producer reports his orders fell 20 percent in August after some improvement in June and July.

Construction. Weakness continues in construction with few signs of improvement. A builder describes industrial construction as being in the "depths of depression" and showing no signs of improving. He looks for industrial, commercial, and highway construction to start growing in second quarter 1983. A director reports several office building construction projects nearing completion have not yet been able to attract permanent financing. A home building executive reports strong customer

interest but weak sales because of a wait-and-see attitude toward interest rates. Fixed rates on mortgages in the Cleveland area have been lowered to about 15 percent and variable rates are in a 14 percent to 15 percent range but there is still very little consumer response. Some thrifts are not encouraging loan activity because of continued deposit losses and are worried that they will not be able to roll over the maturing All Savers Certificates, now 5 percent to 6 percent of total deposits, in light of intense competition. They expect little let-up in their earnings and net worth squeeze. Moreover, some point out they own the highest proportion of non-productive assets in years because of repossessed houses.

Retail Sales. Retail sales are weak but some growth is expected. A national retailer of general merchandise reports consumer outlays are slow, but a regional retailer of do-it-yourself building supplies says his sales are still holding up. A department store executive is cautiously optimistic about Christmas sales and has ordered more merchandise for fourth quarter this year than last. A banker observes that the saving rate has jumped but consumer debt has increased only slowly, so prospects for recovery in consumer outlays are promising. An economist with a national retail chain headquartered in this District still expects consumer spending to lead an economic recovery, but revival will be smaller and later than usual. He expects real PCE this quarter to increase only 0.5 percent from last, but a larger increase in fourth quarter if the saving rate recedes to 6 percent, interest rates decline further, and retailers continue to price aggressively. An economist with an auto producer is also cautious about near-term prospects. He expects total new car sales in fourth quarter to increase only 6 percent from this quarter's dismal 7.8 million a.r., partly because high interest rates on instalment loans remain a constraint on sales. He expects that dealer rebates will be sufficient to reduce inventories of 1982 models over the next few months.

Municipal Finance. Tight fiscal conditions have reduced municipal employment and creditworthiness. Local governments in Ohio reduced employment by 1,600 non-school employees in August while public schools and colleges reduced employment by 2,700 workers. Cleveland expects to furlough about 100 workers soon. A municipal bond dealer reports that the market views municipal debt in Ohio as not as good as in many other areas of the country, and most issues have been downgraded a notch, reflecting general economic conditions and federal grant reductions. Nevertheless, he believes the quality of debt in Ohio is generally good, and the debt is being received favorably in the market. He knows of no local government that has had difficulty issuing or servicing its debt. In contrast, a major banker reports that weaknesses in the fiscal positions and financial information systems of some municipalities are hampering their access to capital markets.

FIFTH DISTRICT - RICHMOND

Overview

Fifth District business activity remains generally weak, with little substantive evidence of any significant improvement in recent weeks. Manufacturers report some further declines in shipments, orders, and order backlogs. Reports suggest, however, that there may have been some increase in employment and only a very slight rise in inventories. The retail sector was perhaps the weakest recently with general merchandise sales off somewhat. There are reports of stirrings in the early stages of homebuilding projects, but many houses remain on the market and sales activity has picked up little, if at all. There are no apparent trends in bank lending activity as reports from around the District are conflicting. On balance, total crop production prospects in the District changed little during August.

Manufacturing

In the manufacturing sector shipments, new orders, and order backlogs all declined somewhat over the past month. There were scattered reports of improvement in those measures, however, and there is no clear pattern either by industry or location. Inventories were virtually unchanged as stocks of materials were steady and finished goods on hand rose only very slightly. Nonetheless, nearly half our respondents find inventories above desired levels. The employment situation was also mixed. Responses suggest a net increase in total manufacturing employment, but quite a few establishments continue to report employment on the decline. Also, the average number of hours worked per week continued to fall. Prices at the manufacturing level

apparently rose more broadly than in the past several survey periods. Plant and equipment capacity remains well above current needs. Expansion plans are generally viewed as about right. Considerable optimism continues to characterize our manufacturing respondents. As a group, they expect economic conditions nationally and within their respective markets to improve over the next two quarters. They are slightly less enthusiastic about the prospects for the level of production in their own firms, but even these remain generally positive.

Retail Sales

Responses from the retail sector suggest that retail sales have yet to get on track. Our survey indicates further declines in total sales and in relative sales of big ticket items since the last survey. One respondent terms it the worst one month decline in his more than thirty years of experience. Inventories were unchanged to up slightly. Surprisingly, respondents, on balance, report inventories and the number and size of outlets as inadequate. Also, this group is divided on the future course of the economy. There is no generally held view as to the direction of activity over the next six months.

Housing and Construction

There is very little evidence of any significant change in housing and construction since the last report. There are scattered reports, however, that activity or at least the contemplation of activity is being revived, if slowly. Most Richmond directors expect housing starts to be little changed to somewhat higher over the remainder of the year despite the recent easing of mortgage rates. Several points are made to support this view. Many unsold houses, new and used, remain on the market. Builders are

reported to have been buying interest rates down into the 13-13½% range in recent months with little effect. Some feel that rates will have to demonstrate some stability at lower levels before there is a significant response.

In some areas commercial construction is still giving a boost to the industry, but this is less generally the case than a few months ago.

The Financial Sector

Our directors report loan demand little changed to down somewhat in recent weeks. In the business loan area, inventory reductions and a lack of expansion activity have contributed. Consumers seem to be concentrating on reducing debt and increasing savings. Delinquencies are reportedly normal to low suggesting that consumers are managing their finances cautiously.

Bankruptcies remain a concern. Most Richmond directors from the financial sector expect little improvement, and perhaps some further deterioration, in bankruptcy rates.

Agriculture

September 1 estimates of 1982 output pointed to much smaller crops of tobacco, peanuts, and cotton than in 1981, due to both reduced acreage and lower yields per acre. Feed grain output is forecast at about the same level as last year. The soybean crop is expected to be at a record level, however, showing a sizable gain over 1981.

Flue-cured tobacco prices have been stronger in recent weeks and have averaged 6 percent above the year-ago level for the season to date. Marketings have been down, however, so the value of gross sales is running only 2 percent above a year earlier. The projected increase in production

expenses, plus the additional marketing fees required by the new tobacco program, suggest that tobacco producers will realize little profit from the 1982 crop.

SIXTH DISTRICT - ATLANTA

Late summer economic conditions in the Sixth District remain weak. Consumer spending patterns show no increase from mid-summer. Employment conditions are worsening. Falling grain and soybean prices threaten to reduce farm income further. Only the lower-cost sectors of the tourist industry show improvement over last year or earlier this season. Virtually the sole harbinger of recovery in the region's economy is construction, which has begun to realize a previously predicted upturn.

Employment and Industry. Regional labor markets display further signs of deterioration in August and September. Reports of layoffs and plant shutdowns combined with preliminary, partial employment figures indicate the likelihood that the District's unemployment rate rose again in late summer. Alabama's August unemployment rate climbed to 14.1 percent (S.A.). Layoffs have recently been announced in such diverse industries as pharmaceuticals, rubber, food processing, shipbuilding, agricultural chemicals, paper, lumber, textiles, apparel, electrical and agricultural machinery, steel, aluminum, and coal. At some companies, such as McDermott, the large offshore construction firm headquartered in New Orleans, layoffs extend to white-collar personnel. Even firms which traditionally try to retain employees through periods of slack demand, such as Stockham Valves and Fittings and American Cast Iron and Pipe, have furloughed workers. Although respondents are generally optimistic that the recession has passed its trough, almost none have plans to increase hiring in the next few months. Since the Red Book employment panel is weighted toward the most successful manufacturing firms headquartered in the District, this response does not augur well for the region's near-term employment outlook.

Orders at regional pulp and paper mills are weak, and paper inventories in Tennessee are termed by one observer as "exploding." Aluminum and steel inventories

remain at high levels in Louisiana and Alabama, respectively. A spokesman for the petrochemical industry in Louisiana reports that no chemical processing companies in the state have expansion plans at present. In fact, most plants are operating substantially below capacity. One encouraging sign in Florida is that phosphate rock and fertilizer inventories have dwindled significantly. The first-half downtrend in capital spending appears to be continuing in the third quarter. General Electric postponed indefinitely plans to build a \$1.5 billion plastics plant in Alabama.

Consumer Spending. August taxable sales were up moderately (in real terms) over last year in Alabama, Georgia, and Tennessee but down in Florida, Louisiana, and Mississippi. Retailers report generally flat back-to-school sales. Although hopeful of improvement by the Christmas season, they are ordering conservatively and holding inventories taut. Consumers, too, are widely reported to be very cautious. Sales of big-ticket home furnishings remain weak, reflecting the depressed housing sector, while first-time purchases of such new products as microwave ovens, video recorders, and personal computers remain strong. Auto sales still appear to be sharply below last year's levels. Factory incentive plans are proving less effective for southeastern dealers than earlier customer rebates, and the tax cut has not spurred car sales. Dealers also link weak August-September sales to consumer uncertainties regarding employment, interest rates, and 1983 car prices. Dealers are ordering new models cautiously.

Construction and Real Estate. According to our survey of building codes departments, real estate firms, and savings and loan institutions (S&Ls), housing has begun to improve slowly. Codes departments report a slight rise in August building permits for single-family residences and a moderate increase in some areas during the first half of September. Building permits for "additions" remain strong. S&Ls indicate that loans are up somewhat. Commercial sales and leasing remain slow but steady. Even more encouraging are reports from realtors that home sales are finally improving,

especially in Atlanta, Jacksonville, Knoxville, and Nashville. However, slower growth areas as well as much of Alabama and Louisiana have yet to pick up. Moreover, realtors and thrift officers repeatedly state that mortgage rates need to fall to 12-13 percent before the market really gets moving. Many potential home buyers are reportedly postponing purchases to see if rates decline further or stabilize. Aside from these qualifications, the mood in the District is definitely more positive than earlier this summer.

Tourism. Tourist industry representatives and partial statistics indicate that higher priced sectors of the industry continue to languish; moreover, the bright spot of earlier reports—the World's Fair—has continued the decline reported in August. If average daily attendance does not increase, the Fair will not reach the break-even level of 11 million visitors. Fair officials, however, remain optimistic. Across the District, less expensive facilities, such as campgrounds and state and national parks, are enjoying sharply increased usage, especially by in-state visitors, whereas hotels and motels have fewer guests, and convention business, particularly in Atlanta, is off from last September. Florida and Louisiana remain the weakest areas. New Orleans' most popular restaurant reports that this summer was the worst in its history. Respondents continue to attribute Florida's poor performance to recession here and abroad and to the World's Fair; in addition, many have begun to suggest that the October 1 opening of Disney World's EPCOT is postponing travel to the state.

Agriculture. Farm income prospects have become decidedly more dismal in recent weeks. Soybeans produce about two-fifths of the region's noncitrus crop income. Prices have fallen 10 percent in the past month, reducing prospective soybean income by \$350 million and dropping the estimated total 13 percent below last year's drought-reduced level. Prices of most other crops have also declined recently, leaving tobacco

as the sole bright spot with prices averaging 9 percent above last year. Income prospects of livestock producers have been bolstered somewhat by recent price gains for hogs and calves. On balance, however, aggregate net farm income in the District will be lower than in 1981, and debt problems of farmers will grow more severe. A major lender reports that an increase in foreclosures of relatively large Mississippi Delta farming operations is already occurring.

Finance. A telephone survey of Sixth District banking and thrift institutions regarding the new 7- to 31-day small time deposits reveals little consumer interest in these accounts, which only the larger institutions have offered. Because alternative instruments which yield competitive rates and/or offer substantially the same maturity are available, our contacts believe no market exists for this service. They view it as a defensive move to maintain customer relationships. The Sixth District's experience with these accounts suggests that third-party transaction privileges and much smaller minimum deposits are necessary to elicit adequate consumer interest.

Panel of Economists. Our panel of state forecasters and academic, banking, business, and investment economists continue to approve of current monetary policy, finding it conducive to moderate recovery without rekindling inflation. A smaller majority recommends monetary growth in excess of targets, while nearly one-third of those polled urge a rapid return to within-target growth. Virtually all feel their state is near the trough of the business cycle, with no signs of recovery and some of further deterioration. The majority, revising their previous outlook, foresee a later, weaker recovery. All respondents mentioned lower, stabilized interest rates as critical to inducing increased consumer spending; a majority also regard GNP growth as important to overcoming consumer resistance. There is no clear consensus among those surveyed regarding the recent drop in business loan demand, but bank economists note that recent corporate loan demand has been better here than in the nation.

SEVENTH DISTRICT - CHICAGO

Summary. The expected upturn in economic activity has not developed in the Seventh District. Purchasing managers in Chicago and Milwaukee reported further declines in shipments, orders, output, inventories, and employment in August with no indication that September would see improvement. State and local governments are also cutting staff. Projections of demand for motor vehicles and steel have been reduced again for September and the fourth quarter. Although some producers report a levelling off in orders, most capital goods producers have laid off additional workers and more plants have closed. Retail sales remain slow with no help from "back-to-school" buying. Although lower interest rates have not helped housing materially, some improvement in "attitudes" is reported. Expected record corn and soybean harvests will keep prices low and increase financial pressures on the farm sector. However, mainly because of lower feed costs, the outlook has improved for livestock farmers, especially hog producers. Also on the upside are sales of grain storage bins and equipment to handle the excess production. A scattering of defense procurement orders is providing a few jobs. Inflation continues at moderate rates with heavy discounting in wholesale and, to a lesser extent, in retail markets.

Forecasts Reduced. District businessmen and lenders are losing hope that a revival in activity will occur in the remainder of 1982. Particularly for capital goods and heavy construction, doubts are increasing that a recovery will be manifest before mid-1983 at the earliest. Lower interest rates will not have as large an impact as in earlier cycles because

of substantial unused capacity, financial stress, and abysmal morale. Even service industries such as medicine, advertising, and law note the effect of hard times. However, firms specializing in bankruptcy procedures--accountants, lawyers, and liquidators--are doing a booming business. Complaints of past due accounts, business and consumer, are much more common than in past recessions.

Employment and Wages. New claims for unemployment compensation continue at high levels. Many employers, including governmental units, are cutting staff. New hires generally are held to the minimum necessary to fill essential slots. Help-wanted ads bring a flood of resumes and some employers prefer to fill openings by transfers from within or on personal recommendations. Many companies have frozen or reduced salaries this year. Where increases have been granted, the 7-8 percent range predominates, down from 9-10 percent in past years. Current plans are for much smaller increases in 1983.

Consumer Expenditures. Retailers reported disappointing sales of most soft and hard goods in August and September. "Back-to-school" promotions did not bring the normal response. Nevertheless, children's merchandise--clothing and toys--is generally doing better than adults' merchandise. Appliances, carpets, and other home furnishings are especially weak, a trend attributed, in part, to reduced sales of houses. Auto parts and service and video games continue to be star performers. Larger chains report favorable delinquency experience, but more careful monitoring of accounts has been necessary. Because of slow sales, retail inventories are adequate to excessive, and ordering of goods for the winter season is well

below normal. Closings of stores and fast food operations are increasingly frequent, and few new outlets are being added.

Capital Expenditures. The recession in business equipment is in full swing. Layoffs in many plants have reached 20 to 50 percent of the peak force, with high seniority hourly workers and white collar types affected to a much greater extent than in earlier postwar recessions. Some farm and construction equipment plants will be closed for most of the fourth quarter with reopening tentatively scheduled for January. Most rail freight car plants are closed indefinitely. One heavy truck plant is closed and may not reopen. A machine tool producer sees no pickup in the current low level of demand until late 1983. Imports are taking a growing share of the markets for machine tools and farm and construction equipment, helped by the high value of the dollar. Export demand is restricted by limited availability of government financial aid, compared with foreign competitors. Low demand for services of plant location advisers, architects, and design engineers suggests that the capital spending slump will be deeper and longer than in earlier cycles.

Motor vehicles. Some auto and truck plants are closed to cut inventories at a time when production is usually at high levels to supply dealers with new models. On September 1 stocks of 24 domestic models exceeded 100 days supply, an unprecedented situation. Price incentives have been pushed to move the large carryover of 1982 models--and some 1981s. Meanwhile, various imported models are in short supply. Even the new domestic compact trucks, strong sellers earlier in the year, have slumped in recent months.

Steel. One forecast of steel shipments for 1982 has been reduced to the 60-65 million ton range, lowest since 1958. Demand for steel continues at extremely low levels. All products are weak, but structurals and heavy plates for capital goods are "terrible." Oil field steel has plummeted in an unprecedented fashion. The only improved demand categories are ordnance and grain bins.

Defense Procurement. The principal facilities devoted exclusively to defense procurement in the Seventh District are a tank arsenal, an electronic counter-measures plant, and the Rock Island Army Arsenal. In addition, District companies have obtained orders for small naval vessels, armored cars, personnel carriers, fuel trucks, special rail cars, communications equipment, aircraft engine parts, and a variety of other components. Overall, however, this region is not sharing proportionately in the defense buildup.

Agriculture. Projected record corn and soybean harvests, as in 1981, will exceed utilization and augment already burdensome carryover stocks. Corn and soybean prices have declined sharply in anticipation of the expected surplus production and are expected to remain well under the low year-ago levels. Many District crop farmers will remain in the grip of a cash-flow squeeze, partly reflecting the small proportion of farmers eligible for government price supports on their 1982 crops. Prospects for livestock farmers have improved. High prices and low feed costs have generated large profits for hog farmers. Cattle prices have weakened in recent weeks, but low feed costs and reduced finance charges suggest that cattle feeders will be able to cover production costs.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth District changed little during August and early September. Retail sales were about the same in real terms as in June and July, after adjusting for seasonal influences. Orders and production at most manufacturing firms contracted further, but many service firms reported improved business. Also, construction activity increased moderately in August and early September from earlier depressed levels. Crop harvests will be large, but selling prices for many farmers are below production costs. On the other hand, most livestock and dairy operations have been profitable.

Retail sales, adjusted for both price increases and seasonal differences, were virtually flat in August and early September at about the June-July level. In nominal terms, sales were up at a 3 or 4 percent annual rate. Automobile sales rose slightly from the June-July pace, though they remained below the level of a year ago. This improvement was greater for used cars than for new models. Department store sales have changed little in real terms since early in the summer, though consumer preferences shifted toward higher quality goods and away from "fad" items. Inventories at department stores rose, reflecting earlier purchases of stock in anticipation of improved August-September sales; however, inventories are not considered a major problem. Grocery sales have risen moderately since the earlier summer months.

Merchants are currently expecting a moderate improvement in sales during the coming Christmas season. They believe there is significant pent-up demand. They also cite the improved financial condition of consumers, in terms of both disposable income and volume of liquid savings. Further, the recent decline in interest rates and the rise in stock prices are likely to stimulate an increase in consumption.

Industrial activity in the Eighth District contracted during August and early September, with the exception of defense, food and livestock feed production. Most other manufacturing firms, both large and small, reported declines in orders. Production schedules were trimmed in order to prevent a build-up of inventories, and employment decreased at firms producing consumer durables, chemicals, aluminum, steel, industrial equipment and wood products. A major chemical firm offered early retirement incentives to 1,900 salaried employees to facilitate staff cuts. A collection agency for industrial companies reported that collections in August were 23 percent below normal.

In contrast, service firms in the District reported an improvement in activity. Business was particularly good at repair shops for automobiles, air conditioners and televisions. A computer service company, operating at capacity, noted that the demand for processing medicare claims has risen. A restaurant and a fast-food chain reported excellent business. A printing shop also claimed business was near capacity. A casualty insurance company experienced a moderate increase in business.

Construction activity, which has been severely depressed in the District, improved slightly since July. Homebuilders in the St. Louis area report increased traffic through model homes and a slight upturn in sales to about 20 percent of normal. Lower interest rates, an increase in consumer disposable incomes, the rise in stock prices and several special public bond issues (which provide mortgage funds to home buyers at subsidized rates) have been beneficial for residential sales. Despite the depressed conditions, unions representing both plumbers and electrical workers obtained a \$2.32 an hour increase in wages recently by maintaining tight control on entrance into the unions. Commercial construction, which has been less depressed than homebuilding, also improved moderately in August and early September.

Weather has continued to be favorable, and crops in the Eighth District are excellent. For many farmers, however, selling prices are less than production costs, leaving them with a net loss for their efforts. With the current level of interest rates, many farmers are finding it difficult to service their debts. On the other hand, relatively favorable feeding margins are benefiting hog, cattle, dairy and poultry producers.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District economy has remained depressed. The construction industry continued in the doldrums, with the only signs of revival appearing in nonbuilding construction (work on highways, bridges, sewer and water facilities, and energy projects). The weak manufacturing, mining, and lumbering industries reported in the last Redbook did not improve in August or early September. Consumer spending remained weak. Farmers were still troubled by falling crop prices, and an early frost could substantially reduce their crop yields. As a result of these continued weaknesses in the real sectors, bank lending in the district remained sluggish.

Construction

District construction activity remained depressed. In the second quarter, for example, construction employment, which accounts for approximately 5 percent of district nonagricultural employment, was down 3 percent from a year earlier and 22 percent from the second quarter of 1979, construction's last good year. Nonbuilding construction has started to revive, but its impact has not been sufficient to offset the decline in the other sectors.

Nonresidential Building. Weak commercial and industrial building has been holding down nonresidential building. Commercial and industrial building accounts for about 60 percent of the district's nonresidential building. According to F. W. Dodge, during the first seven months of this year, the dollar value of district nonresidential contract awards was down 8 percent from a year earlier and 13 percent from the first seven months of 1979.

Conversations with builders, industrial developers and realtors from throughout the district confirm the shrinkage in contract awards. Most of them describe commercial and industrial building as slow. For example, the marketing director of a large Minneapolis builder says that his firm's business this year is down about 50 percent from a year ago. Commercial and industrial building activity is still considered good, however, in Billings, Montana, and in St. Cloud and Rochester, Minnesota.

An immediate pickup in commercial and industrial building is not likely because excess space exists and interest rates are still too high. Our contacts think that many businesses do need additional space and that now is a good time to obtain it; new commercial and industrial building prices are presently very attractive. But interest rates, they believe, are still too high for businesses to take advantage of favorable construction prices. Two executives with large Minneapolis builders indicate that long-term interest rates would have to drop another two percentage points and stay down for several months for any significant pickup in commercial and industrial building to occur. Also, for certain types of commercial and industrial building, excess space is a problem. The current vacancy rate for office buildings in the Minneapolis-St. Paul suburbs, for example, is 15 percent, more than twice the 6 to 7 percent rate that realtors consider normal.

Residential Building. Residential building has also been very weak, and recent home sales suggest no immediate improvement. The number of district housing units authorized by building permits during the first six months of this year was 23 percent below the number authorized a year earlier and 56

percent below the number authorized in the first half of 1979. Homebuilding is not likely to pick up soon, because consumers have simply not been buying homes. According to the Minneapolis Board of Realtors, August home sales in Minneapolis and its suburbs were down 28 percent from a year ago. Although no immediate rebound is likely, homebuilding could pick up in several months. Our Bank directors and district realtors indicate that the recent interest rate declines have substantially increased shopping, if not buying.

Nonbuilding. In contrast to residential and nonresidential construction, nonbuilding construction, although still depressed, has shown signs of reviving. During the first eight months of this year, contracts for highways, bridges, and sewer and water facilities in Minnesota and the Dakotas were still 21 percent below their level in the first eight months of 1979, but they were 11 percent above their level in those months last year. This component got an additional boost when contracts were let earlier this year for a \$1.2 billion coal gasification plant in North Dakota.

Other Industrial Activity

The weak manufacturing, mining, and lumbering industries reported in our last Redbook have yet to show any evidence of recovery. The slowdown in manufacturing orders and production appears to have continued, and district firms have still been curtailing operations and laying off workers. For example, the district's only auto assembly plant closed for a week in mid-September, and a large Wisconsin manufacturer of heating and cooling equipment recently laid off 250 workers. Also, lumber production remained depressed in August and early September, and although some iron mines have resumed production, others have extended previously announced shutdowns.

The district was fortunate that the recent rail strike disrupted very little industrial activity. Minneapolis-St. Paul business executives have actually been more upset by the prospect of lost revenues due to the NFL players' strike. In Minneapolis, this strike could prevent a planned reduction in a hotel and liquor tax which was imposed to pay for our new \$55 million domed stadium.

Consumer Spending

Consumers' reluctance to spend has slowed the recovery of auto and other retail sales. Major Minneapolis-St. Paul retailers and our Bank directors report that back-to-school sales were disappointing. Furthermore, the recent declines in interest rates and increases in stock prices have not relieved the previously reported sluggishness in furniture and automobile sales. One major Twin Cities retailer calls August furniture sales "lousy." And a regional sales manager for a large domestic automobile manufacturer indicates that recent developments have not spurred car sales. In fact, his firm's sales in Minnesota and the Dakotas declined more than seasonally between July and September.

Agriculture

Declining crop prices have continued to trouble district farmers. An announcement in August by the USDA, that corn and soybean harvests would be larger than expected, pushed down already weak crop prices. Between July and September, cash prices for soybeans, corn, and wheat in Minneapolis declined 12, 8, and 5 percent, respectively.

Livestock prices have exhibited a mixed pattern. Lower crop prices increased the attractiveness of feeding livestock, which has helped to keep feeder cattle prices at their midsummer levels. Also, hog prices have remained at the high level reached this summer. Increased slaughter cattle supplies, however, have pushed the prices of these livestock down; and in mid-September in South St. Paul, they reached their lowest level in 18 months.

In addition to price problems, district corn and soybean farmers also have major concerns about the weather. Due to wet weather delaying spring planting, district crops are maturing later than usual. Normally, for example, about 50 percent of Minnesota's corn crop is mature by mid-September. This year only 23 percent is ready for harvest. A frost in the next few weeks (a distinct possibility) could substantially reduce yields. Although reduced yields in the district would ease the storage problem discussed in our last Redbook, they would not significantly affect prices because the district's share of total U.S. production of corn and soybeans is small. Thus, until crops are harvested, district farmers are faced with the possibility of a bleak scenario: low crop prices, which are virtually certain, and poor crop yields which will depend on the vagaries of the weather.

Bank Lending

As reported in our last Redbook, these weaknesses in the district economy continued to be reflected in sluggish bank lending. In mid-September, lending at district member banks did not increase from its weak level of early August.

TENTH DISTRICT—KANSAS CITY

Overview. Business conditions in the Tenth District are mixed with only hints that a weak recovery is under way. Retail sales are growing slowly and the pressures to decrease inventory have declined. Purchasing agents, however, are still attempting to decrease inventories and do not anticipate increases in prices until next year. While savings and loan associations are still having problems, recent declines in interest rates are improving their situation. Lower interest rates are also improving sales of expensive houses, but lower priced house sales still languish. Without a severe frost a large harvest of corn and soybeans is assured, continuing the downward pressures on crop prices. Both loan demand and deposit growth in the Tenth District are flat. There are some reports that the decline in loan quality has stabilized.

Retail Trade. Retail sales grew moderately in the Tenth District during the first eight months of 1982 as compared with the same period last year. Most of the sales gains came in apparel and softgoods during July and August. Merchandise costs remain stable as do profit margins. Inventories are slightly higher than expected but are not causing concern heading into the fall and Christmas selling seasons. District retailers expect continued growth in sales during the rest of the year.

Purchasing Agents. Tenth District purchasing agents report input prices have risen from 2 to 6 percent during the past year. Prices are expected to remain stable for the remainder of the year and to begin increasing early next year. All firms contacted are decreasing inventories. A few firms are experiencing slightly longer lead times on purchases, but input availability is not

considered a major problem in the Tenth District. All firms continue to have excess capacity, and a few have laid off workers recently.

Savings and Loan Activity. Savings inflows at Tenth District savings and loan associations are advancing but have still failed to lift many institutions out of a net outflow position. Most officers at those associations expect higher inflows for the rest of the year. District associations continue to commit funds to blended rate mortgages for existing customers. Commitments to first time applicants, however, remain at very low levels. Officers quote rates on blended mortgages averaging 13 1/2 percent and rates on first time conventional loans averaging 15 1/2 percent. These mortgage rates have fallen one to two percentage points since July. Officers at most associations expect rates to drop one more percentage point by the end of the year.

Home Builders' Associations. Tenth District home builders' associations indicate that housing starts are showing slight increases over last year's levels, with single-family units doing considerably better than multi-family units. Sales of new homes in the \$150,000 and higher bracket are increasing, but sales of lower priced homes continue to be sluggish. Inventories of new homes are at very low levels, with no change expected until the signs of economic recovery are more definite. Building materials are, for the most part, plentiful in the Tenth District. However, some shortages are occurring for some types of lumber.

Agriculture. Crops are maturing at a rate only slightly behind normal in most areas of the Tenth District. Harvesting of corn is well under way. Soybeans, though, are still maturing and harvesting is expected to begin in the next two weeks. The possibility of an early severe frost threatens areas in Colorado,

Kansas, Missouri, and Nebraska with potential damage to soybeans and grain sorghum of 25 to 50 percent. Parts of Nebraska have already been exposed to light frost—but with little damage. Some shortages of grain storage capacity are beginning to appear throughout the Tenth District. Higher prices for hogs have improved the financial condition of producers, but very little expansion of hog production is being reported thus far.

Banking Developments. Overall loan demand is steady throughout the Tenth District. Business loan demand is declining primarily due to the slowdown in oil and gas exploration. Lower rates are causing a modest increase in real estate and automobile loan demand, however. Agricultural loan demand remains low. The deterioration of loan quality which has been observed over the last year seems to be stabilizing. Only a few bankers are experiencing a modest decline in loan quality. The prime rates charged by the banks surveyed range from 13 1/2 to 15 1/2 percent. The range in August was 14 to 15 3/4 percent. Most bankers do not expect an increase in rates during the next month.

Overall deposit growth at Tenth District banks is flat. Several bankers report strong growth in existing NOW accounts, but very few new accounts are being opened. Almost no growth in All Savers Certificates is reported. Most bankers are not concerned about the possible loss of these funds at maturity. One banker reports the cancellation of a planned repurchase agreement account due to the position taken by the FDIC that holders of repurchase agreements at the failed Mount Pleasant Bank and Trust Company have no claim to government securities pledged to back up the agreement.

ELEVENTH DISTRICT--DALLAS

Economic signals from the Eleventh District are still mixed. Residential construction is returning to a healthy pace, but commercial construction activity is slowing. Renewed downward pressure on drilling activity is keeping overall manufacturing production low despite increasing defense expenditures. Loan growth at commercial banks is shifting from the business sector toward the consumer sector, and deposits at S&L's are growing. Retailers are cautiously optimistic about the fourth quarter even though current sales are weak.

Texas housing permits rose to a near-record high in July. The increase was concentrated in apartment construction as investors reacted to a tight rental housing market. Although single-family permits declined in July, they remained above year-ago levels and respondents indicate that new home starts picked up again in August.

Commercial construction activity is in what is expected to be an extended decline. Announcements of office projects, the bulk of nonresidential construction, are off sharply. Retail and industrial construction is climbing, but the value of these projects is comparatively small. The decline in nonresidential construction should be gradual since many projects will not be completed until late 1983 or 1984.

The unemployment rate in Texas declined to a seasonally adjusted 6.7 percent in August, down from 7.0 percent in June and July. It is suspected, however, that the decline is a result of unemployed workers leaving the labor force and misleading seasonal adjustment factors. Total

nonagricultural employment fell 0.4 percent from July to August as the five major industries in durable goods production all registered declines.

The number of operating drilling rigs is still falling, and the seismic crew count, a leading indicator of drilling activity, has resumed its downward trend. Both the number and total footage of wells drilled fell for the second consecutive month. Low oil prices are decreasing natural gas demand. Thus, many energy companies are lowering their projected expenditures for exploration during 1983.

Production in the manufacturing sector generally appears to have stabilized at low levels. Most firms have already made the necessary cutbacks in production and employment. Petroleum refineries and chemical plants are operating at roughly two-thirds of capacity and are expected to continue at that rate. A sharp August drop in steel orders for commercial construction was partially offset by an increase in orders for residential construction. However, inventories of oil field equipment continue to climb. Conditions in the electronics and apparel industries are unchanged. Electronics sales are being supported by the defense industry, and orders for apparel products are less than the seasonal norm.

Outstanding loans at commercial banks in the District increased 1.1 percent in August, up from a sluggish 0.1-percent gain in July. Loan growth for the year-to-date is substantially above average. Business loans at large weekly reporting banks declined slightly for the first time in 15 months, due partly to lower inventory financing needs. Increases in consumer and real estate loans account for the major part of the increase in total loans in August. Total deposits at member banks were virtually unchanged as time deposit growth offset shrinking demand deposits.

Deposits at federally insured S&L's surged upward by 1.0 percent in July. The increase was led by a 4.9-percent jump in the dollar volume of CD's of \$100,000 or more, although other nonpassbook deposits also increased. Total mortgage loans outstanding for construction increased 2.0 percent in July while nonmortgage consumer loans jumped 2.3 percent.

Department store sales were below expectations for August and appear to be falling off faster than usual following the back-to-school selling period. Sales were greater in August than in July. The dollar volume of sales is 4 percent ahead of last year at this time. Reorders of fall merchandise are low, and orders for the Christmas season are being delayed. Department store managers are trying to keep a reserve of "open cash" in case Christmas sales exceed current expectations. The recent devaluation of the peso has reduced sales in the Border areas substantially, and stores in San Antonio and Houston also report significant declines. In addition, some firms are wondering how to collect on outstanding debts owed by Mexican Nationals.

New auto sales dropped in early September despite factory incentives to dealers. The slowdown is evident in both domestic and imported models. As a result, inventories have begun to creep up again. Respondents attribute the sales decline to continued high financing costs and the imminent introduction of next year's models. Used cars continue to sell well, and demand for auto servicing remains high.

TWELFTH DISTRICT--SAN FRANCISCO

The Twelfth District economy continues to struggle with recession conditions. Consumer spending in August was down or flat in nominal terms relative to a year ago and does not appear to have responded as yet to recent declines in interest rates or lower Federal taxes. Commercial construction is joining residential construction as a depressed industry, although there are exceptions to this weak construction picture in certain areas of the District. The aerospace and electronics industries, although weak, continue to be reliant on military spending for their remaining strength. In the agricultural sector, the picture is highly varied, as bumper crops in certain commodities depress prices but boost processing activity, while other areas--such as potato processing--have suffered severe cutbacks in activity. The most notable developments in banking in the District are the widespread reports of loan delinquencies and foreclosures, and the rapid spread of "sweep" types of consumer deposit accounts. There appears to be little response of corporate investment or finance activity to the recent decline in short- and long-term interest rates.

Consumer Spending

The recent declines in interest rates have not sparked a recovery of consumer spending in autos, housing or department store sales. All four major department stores in the Los Angeles area, for example, report nominal sales for August below that of a year ago. Although there is

increased optimism in the automobile and housing sectors, reports of increases in activity are spotty. In Bakersfield, California, for example, several dealerships report sales nearing "profitable" levels, particularly for the larger size vehicles. Throughout the District, however, continued high levels of unemployment hamper consumers' spending enthusiasm. The State of Washington, for example, has a persistent 12 percent unemployment rate. Even in the normally busy harvest season in California's Central Valley, unemployment rates are in the 12 to 17 percent range. The conservative spending attitudes of the District are also reflected in the relative strength of maintenance-type activities such as automobile service and home improvement companies. Consumers prefer to fix their old items rather than buy new ones.

Manufacturing and Mining

Twelfth District manufacturing and mining activity continues to be depressed. The recent resurgence of gold prices has raised hopes of increased activity in Nevada, the country's largest gold producing state, but there has been little actual production response. Similar hopes abound in Idaho's Silver Valley, but major mines such as the Bunker Hill Mine continue to operate at low capacity, with 4,000 of its 5,000 workers still laid off. The aerospace industry would be at extremely depressed levels because of heavy order cancellation were it not for military contracts. As it is, many plants in the industry are closed or operating only 3 or 4 days per week. Boeing is considering consolidating its 727 and 757 divisions, which would reduce its workforce still further. In a recent survey of Twelfth District Directors, little optimism was expressed that the recent

declines in interest rates and Federal taxes would spur corporate sales or change corporate investment and inventory behavior in the near term. Much of District industry apparently has taken a "wait and see" attitude toward these developments.

Construction and Real Estate

The level of depression of the housing industry varies widely in the District. In Idaho, housing starts in August were 45 percent below the level of a year ago. In Los Angeles, a large overhang of unsold homes reflects the continued weakness of that market. In stark contrast to the general housing picture in the District, however, Alaska reports an increase in single-family residential construction permits of 47 percent over last year and a sevenfold increase in multi-unit permits. Commercial construction is reported throughout the District as "weakening" or "quiet," suggesting that this one prop to the recession-weary construction industry is gradually giving way.

Agriculture

Until there is a revival in the housing industry, the weakness in the District's forest products industry can be expected to continue. Overall, the lumber industry is operating at less than 70 percent of capacity, supported in part by sales of logs to Far Eastern customers. The picture in other agricultural products depends upon the commodity. In Idaho, 2 potato processors recently closed plants, laying off 1,200 workers. In the grain and grape markets, bumper crops are severely depressing prices. These developments, coupled with recent reductions in agricultural price

supports, have severely hampered growth in farm income. In contrast, California tomato canners are working 24 hour shifts handling increased production.

Financial Institutions

The savings and loan industry continues to suffer in the Twelfth District, although there is increased optimism that declining interest rates will brighten the picture over ensuing quarters. Consumer "sweep"-type deposit accounts, whereby bank and savings and loan association depositors can enjoy the features of money market funds, have been widely introduced and are expected to be popular, although costly to the financial institutions. In contrast, the enthusiasm for the new 31 day accounts seems to be reserved. Loan demand is very slack and a recent survey suggests that the declines in long-term interest rates have been insufficient to prompt many borrowers to convert short-term to long-term financing. The most prominent development in the financial services area is the startling increase in loan delinquencies and foreclosures. This phenomenon is widespread, but typified by the report of one bank that delinquent loans had risen to 6 percent from one and one-half percent a year ago. The overhang of seller-financed housing debt adds to apprehension about these developments.