

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICTS

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## SUMMARY\*

Introduction. All districts reported that economic conditions continued favorable in July. Atlanta, Kansas City, New York, and San Francisco noted a further "quickenig" or "acceleration" in the expansion. Job markets continue to improve, but at a disappointing pace in much of the Midwest. All districts emphasized strength in retail sales, especially big ticket items. Price inflation continues moderate. Capital expenditures by business continue to lag the consumer sector. Inventories remain lean and businesses are cautious about restocking. Virtually all goods are in ample supply. Manufacturing output is rising gradually, except for most heavy capital goods. Higher mortgage rates threaten the upswing in housing, but momentum in new construction is still strong in most regions. Nonresidential construction is relatively weak because of overbuilding of office space, but several districts note signs of improvement. Hot, dry weather has seriously damaged corn, soybean and other crops. Business loan demand continues very slow, while consumer credit is relatively strong. Boston, Chicago, and Richmond expressed concern over increased foreign competition related to the high value of the dollar.

Industrial Output. Further increases in factory output, shipments, orders, and backlogs were widespread. Atlanta, Dallas, New York, Philadelphia, and Richmond emphasize the breadth of the recovery including building materials, textiles, apparel, chemicals, electronics and other sectors. Boston, New York, and St. Louis report further gains in defense procurement. Cleveland points to a contrast, strength in aluminum accompanied

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\* Prepared at Federal Reserve Bank of Chicago

by continued sluggishness in steel. Minneapolis mentions depressed iron ore mining and Dallas the much reduced rate of oil and gas development.

Employment. Although job markets have strengthened in most regions unemployment remains generally high. Rehiring of laid-off workers is cautious. Despite relatively low jobless rates, Boston says employment figures show "no recovery". Chicago reports substantial worker recalls in motor vehicles, but not in capital goods. New York reports shortages of skilled workers in residential construction. Cleveland notes rising employment but no improvement in unemployment.

Consumer Purchases. Retail sales and other consumer outlays have been excellent. New York, Philadelphia, and San Francisco report merchants to be highly enthusiastic. Large autos, compact trucks, recreational vehicles, furniture, and appliances are selling especially well. Air conditioners and summer apparel benefitted from the heat wave. Consumers are using credit more freely and delinquency rates are low. Dallas notes weakness in sales near the Mexican border associated with the weak peso. Several districts commented on strong tourist business.

Housing. Residential construction continued high relative to a year earlier. But higher mortgage rates since May have reduced home purchases. Realtors have lowered their expectations for the year. The backlog of contracts already signed will keep many builders busy throughout year-end. Demand for adjustable rate mortgages has held up better than for fixed rate financing.

Nonresidential Construction. Some improvement in office building or leasing activity was reported by New York and Atlanta. San Francisco expects increased commercial construction activity in coming months despite high

vacancy rates. Cleveland and Dallas reported substantial excess office and suburban shopping center space, with sizable incentives offered to secure tenants. Significantly increased highway building is expected in the second half of this year.

Capital Expenditures. In general, business capital expenditures are not as vigorous as consumer buying. Electronic type equipment is doing much better than mechanical equipment. Chicago reports little improvement in producer equipment from the "abysmal" levels of the recession. Richmond sees emphasis on modernization and replacement. Dallas reports a slight improvement in oil and gas well drilling, which had dropped sharply last year. San Francisco notes a recent rise in orders for commercial aircraft. Minneapolis reports computer sales "unexpectedly strong."

Business Inventories. Retailers and manufacturers report inventories to be lean but adequate. Inventory investment policies are described as "conservative" or "cautious" in most districts, but New York reports some rebuilding by retailers. Additional merchandise is generally available when needed, prices are expected to remain relatively stable, and carrying costs continue high. All these factors encourage business to keep inventories low relative to activity.

Agriculture. Several districts noted the adverse impact of hot, dry weather on growing crops. Corn, soybean, cotton, alfalfa, tobacco, and vegetable yields have been seriously affected and further damage is possible if moisture conditions do not improve. The reduction in supply caused by the drought reinforces the large acreage cuts associated with PIK and other government programs. On the bright side, Kansas City reports a record

winter wheat crop harvested before the drought struck. Also, San Francisco reports improved supplies of fresh fruits and vegetables following the losses caused by wet weather earlier in the year.

Financial. Business loan demand at banks generally has remained sluggish. Balance sheets have strengthened as cash flow has increased, inventories have been reduced, and short-term debt has been refinanced. Consumer and mortgage borrowing have been growing, but higher mortgage rates are expected to dampen demand for real estate loans.

## FIRST DISTRICT - BOSTON

Business conditions are improving in the First District but the improvement has yet to be reflected in employment gains. For manufacturers the pace of recovery remains modest. Capital goods manufacturers in particular see only hints of an upturn. The retail sector, on the other hand, is enjoying very good sales. Both manufacturers and retailers are satisfied with current inventory-to-sales ratios. Prices remain well behaved.

Labor Market Conditions

Employment and unemployment statistics for June paint inconsistent pictures of the strength of the recovery in the First District. Unemployment rates in both Massachusetts and Connecticut in June were below 7 percent. Rhode Island was not quite so fortunate, but at just over 8 percent the state's unemployment rate was still well below the national average. In contrast to the relatively favorable unemployment situation, employment figures show no recovery. Nonfarm wage and salary employment (seasonally adjusted) changed very little in the first six months of the recovery and the June figures continue this trend, with employment actually declining slightly in the larger states. Durables and nondurables manufacturing as well as nonmanufacturing have all been slower to recover in New England than in the nation, but the biggest difference has been in durable goods manufacturing. The relatively weak performance of the durables sector may reflect the region's orientation to the production of investment goods, which tend to lag the business cycle.

Manufacturing

Most manufacturing respondents report increasing business, but the pace of recovery is still quite modest. Several noted that summer is a difficult period in which to assess performance because of vacation shutdowns. Demand appears to have increased most strongly for automotive and housing-related products. The defense business is good. Sales of packaging and various component-type products, which are tied to the general level of industrial production, are also coming back. Demand remains very weak for heavy capital equipment, aerospace products and machine tool accessories. Overseas markets are improving slightly but the high value of the U.S. dollar is a major impediment to exports. Japanese and European firms are said to be making inroads into what have traditionally been markets for U.S. products. Manufacturers fear that some of these markets will be lost for the foreseeable future.

Firms, even those enjoying good sales gains, are taking a very cautious approach to recalling laid off workers. Almost all of the workers who have been brought back so far have been direct production workers. Overhead and support staff levels are said to have been permanently reduced.

In general, manufacturers feel comfortable with present inventory levels. Inventories will increase as sales pick up but most of those contacted do not plan large changes. The major exception was a firm which had previously cut inventories to bare minimums; now as demand strengthens, inventories must be increased substantially. Others in this same industry, packaging, are said to be in a similiar position. One manufacturer of machine tool accessories is also adding to inventories but for different reasons: demand is still very weak, so the firm is producing for inventory in order to, first, maintain

employment and hold on to its skilled workforce and secondly, be able to respond rapidly when orders finally materialize.

Prices of materials and components remain stable. However, one manufacturer noted that he has recently seen more attempts to increase prices; several others spoke of how they had successfully "resisted" price increases from their suppliers. Resistance to price increases cuts two ways and some of these same firms have found their own attempts to raise prices successfully resisted. Lumber prices are said to have eased a bit; demand has stabilized and more mills have opened. None of those contacted is experiencing any shortages of supplies.

#### Retailing

Retailers in the First District are enjoying a very good summer. The strength is across the board - shopping centers and downtowns, northern and southern New England, hard and soft goods. Sales of seasonal products, such as air conditioning, barbeques, and lawn furniture, have been especially strong. Big ticket items like major appliances and TVs are also moving very well. Not only are people buying, but one large appliance store finds that they are also paying their bills faster than ever.

Retail inventory-to-sales ratios are satisfactory. According to one retailer, "I tell my buyers 'Buy, buy, buy', but sales have been so good that inventories never increase". For another, the ratio of inventories to sales is at the low end of the normal range. One chain reports that, despite very good sales, inventories are a little higher than expected; however, since the store plans a major promotional effort with heavy emphasis on having products in stock, the higher inventory levels are not a problem.

## SECOND DISTRICT - NEW YORK

In recent weeks the economic recovery grew stronger in much of the Second District. Retail activity was very brisk in June, and though the July pace was a little slower, sales remained well above year-ago levels at most stores. Additional signs of strength were evident in the housing and non-residential real estate markets. Business activity continued to pick up in the manufacturing sector where producers of many different goods reported rising orders. However, manufacturers remain generally cautious about production increases and new hirings, and demand for new business loans is still slack. Agricultural conditions are mixed. Fruit and field crops look good, but the dry weather in July has hurt the vegetable crop.

Consumer Spending

Retailers described their June sales as "outstanding" and "extraordinary." Most of our respondents, representing a broad range of income markets, also posted double-digit gains over year-ago levels in July. One suburban discount chain reported that July sales were "gangbusters," up 25 to 30 percent. Others felt the July pace was not quite as good as the prior month but attributed the slight falloff to special factors such as hot weather or store remodeling. They saw nothing to indicate a slowdown in the recovery. The only report of sluggish demand came from an upstate New York chain of department stores; lingering weakness in some local economies held gains there to only two percent above last year. Respondents indicated they were increasing their inventories in anticipation of greater activity. Two were letting their stocks rise faster than sales. The competitive environment, which had been quite fierce earlier this year, appeared to be easing, but the level of promotional activity generally remained high.

Construction and Real Estate

Residential construction activity remained at a high level during recent weeks. Many homebuilders have enough contracts to carry them through the rest of the year. In fact, the industry has been so busy in some areas that a significant shortage of skilled labor has materialized. While the current levels of sales and construction activity are quite high, builders are wary about the recent upturn in interest rates; they fear higher mortgage rates could cut the demand for homes next year. However, future construction activity is likely to be stimulated by recent New York State legislation which will provide millions of dollars in low interest loans for the private construction of multifamily, rental housing.

The nonresidential real estate sector appeared to be strengthening further, especially in suburban areas. The rate at which available space is being leased has picked up significantly, and ground was broken for a number of office buildings in New Jersey and Connecticut. Work on ongoing projects continued strong. Although announcements of new construction projects in New York City are expected to remain scarce for awhile, several promising properties were purchased by developers in the downtown Manhattan area--indicating a definite firming in market conditions.

Manufacturing

Business activity continued to pick up in the manufacturing sector. Manufacturers of diverse producer and consumer goods, such as chemicals, electrical equipment, home weather stripping, and toys, reported that orders were rising. Auto parts suppliers noted that their upswing has been maintained, and several defense companies were awarded sizable contracts. Businessmen generally are now convinced that the economy will continue to expand but they remain cautious, nonetheless. Production increases still are

being scheduled primarily to meet incoming orders rather than to rebuild inventories. Moreover, while recalls have significantly reduced the number of employees on layoff, few firms are expected to add new workers soon. One respondent thought it would take several more months of improvement before firms would make long-range commitments to capital projects or substantial new hiring.

#### Agriculture

Conditions in the agricultural sector vary by product. The New York fruit crop looks favorable, and growers are anticipating attractive prices as well. Field crops have recovered from earlier bad weather, although first cuttings are occurring a few weeks later than usual. In contrast, vegetable yields have been threatened by an unusually dry July. Dairy farmers are concerned about rising production costs; grain prices have begun moving upward in response to PIK-related crop reductions, and a general buildup in herd size is expected to exert further pressure on feed costs.

#### Financial Developments

The strong economic recovery nationwide has not been reflected in the demand for business loans at Second District regional banks. In July, these banks reported only a slight increase in business loans outstanding, mostly stemming from take-downs under existing lines of credit, and almost no increase in new applications for business loans. In contrast, in the consumer sector, strong increases in the demand for credit--for auto purchases, personal loans, and charge card purchases--seem to reflect rising consumer confidence and ample loanable funds at banks. The demand for mortgage credit appears to have backed off a bit because of recent increases in long-term rates.

## THIRD DISTRICT - PHILADELPHIA

Indications from the Third District in August are that business activity, though still spotty, continues to improve. Local manufacturing has posted major gains again, and retail sales have been excellent. Loan activity at area banks, however, has turned mixed, and mortgage rates have risen since June, causing a slowdown in real estate sales activity. Resort businessmen report booming activity at most area vacation spots, but agriculture officials say regional crop yields are down.

Most Third District businessmen are looking for further improvement over the next six months. Industrial expansion is expected to remain at healthy levels into 1984, department store operators say sales should maintain their robust upswing, and banking contacts project increases in both commercial and retail lending by February.

AGRICULTURE

Third District agriculture officials indicate that poor weather conditions have reduced many area crop yields, some to unprofitable levels. This has been a disastrous year for grain in New Jersey and Pennsylvania because the cold, wet spring delayed planting and hot and dry weather now is hampering growth. Grain production levels are estimated at only 71 percent to 83 percent of 1982 yields, and prices are not expected to rise enough to offset these losses in volume. Pennsylvania alfalfa hay growers plan four or five cuttings this year, but the yield on the third cutting, underway now, is well below a normal year's, due to low rainfall in recent months.

Area vegetable farmers say the hot temperatures have also been harsh on their crops. The tomato crop will be about 91 percent of last year's production, and potatoes, soybeans, and peppers are all running below 1982 levels. Vegetable prices are strong, though, and growers are projecting a pretty good year profit-wise. Many of the summer's fruit crops, especially apples and blueberries, have also been sub-par.

Some crops are doing well this year despite the weather. Peach growers are expecting a bumper crop, with yields as high as 38 percent over last year's levels. The Delaware corn crop, although a little bit late, also looks good. Delaware poultry farmers are also turning a sound profit for the first time in quite awhile.

#### REAL ESTATE AND CONSTRUCTION

Activity in the Third District housing market has dropped off somewhat since June, but sales are still 30 percent to 100 percent higher than a year ago. Mortgage rates have risen as much as 100 basis points in the last six weeks and that, contacts say, has been enough to dampen demand slightly. With the recent rise in the FHA mortgage rate expected to push conventional rates even higher, realtors' outlooks for housing demand are not as good as in recent months. Also, new construction has been heavy, and the inventory of unsold new units, which is about as high as that of a year ago, now presents a serious problem to builders if demand deteriorates much more.

#### MANUFACTURING

Third District manufacturing has continued its rapid expansion through July, according to the most recent Business Outlook Survey. Survey results indicate that, after adjusting for seasonal pressures, the overall growth from June to July is the most substantial observed so far this year. New orders and shipments are up over June levels, and, for the first time in two years, inventory liquidation has slowed to marginal levels. Manufacturers, however, report only slight expansion of either employee ranks or the average workweek.

Looking ahead, the recovery in the industrial sector is expected to forge ahead over the next six months. Three-quarters of the manufacturers participating in the survey foresee better overall conditions by early next year; none predict any deterioration in activity over that time. New orders are projected to continue to outrun

shipments, resulting in higher levels of unfilled orders, and manufacturing inventories are expected to grow. Survey respondents also say they will increase their capital spending by early 1984 and are likely to hire more employees and lengthen working hours as well.

Industrial prices have risen again. Reports of price hikes are slightly more prevalent than in June, as 30 percent of the respondents indicate that input costs are higher this month, and just under 20 percent say they have raised their own prices. Projections of further price inflation by next year are widespread.

#### RETAIL

Sales at Third District department stores are progressing smartly in August, according to local store operators. Dollar volume is as good as, if not better than, merchants had anticipated, notching solid gains of between 8 percent and 12 percent on a year-over-year basis. Retailers believe that consumer balance sheets have been in good order lately and that shoppers are spending the money received as a result of the July tax cut. Wealth gains from the stock market have also had an influence on sales activity. Virtually all lines, including durables, have been moving quickly this month, with men's and children's clothing doing especially well.

With the best part of the sales year yet to come, area retailers are highly optimistic about the future. Merchants are projecting a banner holiday season and a solid start in 1984, but they say that gains on a year-over-year basis are likely to slip from this month's highs because sales in early 1983 were fairly strong. Store operators are planning conservatively, though, and they have brought inventories back in line with year-ago levels. Stocks will be kept lean, but not so tight that merchants risk losing sales if activity exceeds their projections.

FINANCIAL

Loan activity at major banks in the Third District is mixed in August. Local bankers report that commercial lending has been declining slightly over the last six weeks, somewhat out of tune with lenders' projections. C&I loans, which contacts say currently range from 15 percent below to 14 percent above last August's figures, are exhibiting the "summer doldrums" at many banks and that seasonal softness has caused further deterioration of already weak business loan demand. Consumer loan activity, on the other hand, has risen again this month, and volume remains ahead of a year ago. Expanding credit demands and aggressive marketing by lenders have given retail lending a strong boost despite some recent softening in mortgage and automobile lending.

For the next six months, area bankers are forecasting modest gains in lending activity. Commercial loan demand is expected to firm up slowly as businesses begin to rebuild inventories and to expand capital expenditures. Consumer lending is also likely to show further improvement, but bankers expect that further weakening in the housing sector will continue to limit retail loan growth.

Most local bankers agree that we have now seen the trough of an interest rate cycle. Financial contacts foresee rates trending upward as commercial loan demand picks up and financing of the federal deficit expands. The rise, however, is likely to be slow and irregular with the prime, currently holding steady at 10.5 percent, creeping up about 100 basis points by the middle of the first quarter of 1984.

Deposit flows in the Third District continue to weaken this month. Demand deposits have declined again, and are now only about 3 percent ahead of a year ago. That change is partly seasonal, however. Time deposits, on the strength of the MMDA, are still far ahead on a year-over-year basis. Several contacts have noticed a drop-off in

other time deposits, chiefly in 26-week and 30-month certificates, apparently reflecting depositors' anticipation of higher interest rates.

#### TOURIST SERVICES

Officials at vacation spots in the Third District report a substantial resurgence of tourist activity this summer. Tourist traffic and spending is ahead of last year's volume at most major resorts in the tri-state area. Business at seashore resorts in Delaware and southern New Jersey has been booming so far this season. Contacts there attribute the strength to perfect beach weather, an improved consumer outlook on the economy, and excellent fishing. Attendance at area amusement parks has also been very heavy because of the weather. Pennsylvania's mountain vacation spots are the exception to the good news, though. Rain and bad weather washed out several important early season weekends, and tourist traffic is just beginning to gain on year-earlier levels. Pocono spokesmen say the current pace of activity is good, but heavy competition from Atlantic City and lingering unemployment in the nearby steel regions of Pennsylvania have kept tourist business below expectations thus far.

The outlook for the balance of the season, however, is equally bright across the district. Advance reservations have nearly filled available lodgings at the seashore for the rest of the summer, and incoming inquiries are 20 percent to 30 percent ahead of last season's pace in the Poconos. If the weather holds out, tourist business is expected to approach record levels by season's-end.

## FOURTH DISTRICT - CLEVELAND

Summary. Economic conditions in the Fourth District continue to improve. Employment is rising although unemployment rates show little change. Real incomes are rising, and retailers are experiencing broad-based sales gains. Manufacturing activity continues to grow but perhaps at a slower pace than in June. Demand is strong for aluminum but remains sluggish for steel. Retailers and manufacturers report lean inventories and caution about inventory growth. Builders expect construction activity to slow when current contracts are completed. Mortgage lenders report declines in mortgage applications in response to higher interest rates. Banks remain highly liquid.

District Labor Market Conditions. Employment continues to rise in this District but unemployment rates show little change. In Ohio, manufacturing employment rose in June for the sixth consecutive month and is 3.3% above last December's low. Nonagricultural nonmanufacturing wage and salary employment rose in June for the fourth consecutive month and is 3.1% above its February low. In May and June, total employment increased by 160 thousand workers but the labor force expanded by 179 thousand, leaving Ohio's unemployment rate unchanged at 12.8% (nsa). Unemployment rates in the District's eleven largest SMSA's ranged from 9.3% to 17.3%. Local indexes of leading indicators for Pittsburgh and Cleveland have risen for seven consecutive months and point to continued improvement in those industrial centers.

Prices, Wages and Earnings. Incomes of production workers have been rising faster than prices. Hourly earnings for production workers in manufacturing in Ohio have been rising at a 6.4% annual rate since last

October. Average weekly hours worked have also been increasing so that in the same period average weekly earnings have been advancing at a 13% annual rate.

The Consumer Price Index for all urban consumers in Cleveland rose 9.3% in the last twelve months and 1.5% in the last two months. For Pittsburgh, the index advanced 7.1% and 0.1% and for Cincinnati 7.8% and 1.2% in the same two periods.

Retail Sales. Fourth District retailers are experiencing broad-based sales gains. Most major general merchandisers report between 9% and 11% nominal sales improvement between the first and second quarters (a.r.). They anticipate continuing, albeit more modest advances in the third quarter. The July sales pace has moderated from June. Consistent with national trends, sales of cars, particularly large domestic models, are leading the sales strength in the District. Retail food sales are lagging, registering between 2% and 3% nominal growth from last year. Retail sales growth is occurring throughout the District, although Northern Ohio retailers appear to be lagging the region.

Manufacturing. Growth of District manufacturing activity may have slowed in July. A survey of purchasing managers in the Cleveland area reveals new orders and production rose in July, but at a much slower pace than in June. Similarly, the pace of price increases slowed from June. Raw materials and finished goods inventories were stable in July.

A survey of purchasing managers in the Cincinnati area shows new orders, production, and backlogs continuing to rise through June. Increased proportions of firms surveyed report prices paid for commodities, services, and equipment are rising while vendor deliveries are reported to be slower. Raw material inventories are stable while finished goods inventories continue to fall.

Primary Metals. Demand for aluminum is strong while demand for steel remains sluggish. Aluminum orders and shipments have increased substantially since December, boosting the price of primary aluminum ingots by about 50%. A major producer reports its U.S. smelters are operating at the highest level since 1980. Aluminum inventories are very low relative to current shipping rates.

Steel producers report new orders are slow, shipments are flat and order backlogs are falling. Product prices remain weak. At current prices steel producers would have to operate at over 70% of production capability to break even but they are operating at only about 50% to 60% of capability.

Inventories. Retailers and manufacturers report lean inventories. Retailers expect some inventory accumulation by yearend 1983 but less than typical for a recovery because of high carrying costs and skepticism about the durability of the recovery. Industrial firms generally report their inventories are at desired levels and are lean relative to sales. Plans to expand inventories as sales increase are cautious, as many firms plan permanently lean inventories.

Construction. Builders expect construction activity to slow when current contracts are completed. Home builders report a substantial drop in new contracts following recent increases in mortgage rates. However, construction of new homes is likely to remain strong through the Fall as builders work down their backlog of orders. Office construction remains strong as work continues on projects underway. Realtors, however, report an excess of office space, and prospective tenants are being offered substantial incentives, such as several months free rent. Suburban office space and shopping centers have been over-built in recent years and developers expect very little new construction. Prices of building materials and supplies have

begun to stabilize following several months of sharp price increases, and expected shortages have not materialized.

Mortgage Lending. Mortgage lenders report declines in mortgage inquiries and applications last month. Lenders offering conventional 30-year fixed rate mortgages report a substantial drop in mortgage activity, and without exception attribute it to an increase in mortgage interest rates. Rate increases ranged from 50 to 100 basis points bringing conventional mortgage rates into the 13% to 14% range. Lenders offering variable rate mortgages have not experienced a substantial drop in mortgage activity, and in several cases, lenders have had an increase in the number of loan applications. The majority of loan inquiries and applications have been from existing home owners seeking to trade up to more expensive homes. Lenders report a significant decrease in their refinancing activity.

Commercial Banks. Banks in the District remain highly liquid. Continuing strong core deposit growth and relatively sluggish commercial loan demand are allowing banks to reduce their reliance on large denomination CD's as a source of funds. Banks are using deposit growth to increase investments in federal funds, repurchase agreements and U.S. government and agency securities. Some funds are also being used to satisfy the somewhat higher demand for consumer loans.

## FIFTH DISTRICT - RICHMOND

Overview

The Fifth District economy is continuing to experience a broad based expansion. Manufacturers are continuing to report gains in shipments, orders, and order backlogs. Also, manufacturing employment is reflecting this increased activity. Retail sales remain relatively robust, particularly in big-ticket lines. Housing construction and sales are generally holding at or near the vastly improved levels of recent months, and there are scattered reports of some resurgence in commercial construction activity. Principal areas of concern are the export markets, particularly for textile products, and the farm sector in light of recent adverse weather patterns.

Manufacturing

Activity in the manufacturing sector continues to expand broadly. Shipments, new orders, and order backlogs are generally up over the past month and inventories have apparently continued to run off. Manufacturing employment has also risen, as has the length of the average workweek. Textile and furniture manufacturing appear to be experiencing particularly rapid recoveries, although export markets for their products remain very soft.

Manufacturing inventories and plant and equipment capacity appear generally satisfactory. There remains, however, little expectation of much capacity expansion this year. Capital spending, it is thought, will go to modernization and relocation, each with cost and/or labor saving objectives. Current distress points in District manufacturing are almost entirely older or less efficient plants that are being phased out of operation.

### Consumer Spending

By and large, District consumers remain moderately active, although much of the recent sales gains appears to have been concentrated in big ticket items, particularly automobiles and durable goods associated with purchases of houses. Furniture and appliances, in particular, seem to be doing well. Otherwise, retail sales have been moderate. There is some evidence that retailers, at least in some cases, are continuing to allow inventory run off despite the generally held expectation that sales will pick up as the recovery progresses and reports that delivery times are beginning to stretch out for some types of products.

The widely, though not universally, held expectation of continued growth in consumer spending is based largely on growing consumer confidence, improved consumer liquidity, and the belief that the recovery is still gaining momentum. The possibilities of a short-lived or very moderate recovery have not been ruled out, however, and could lead to little or no growth in sales, particularly of autos and other big-ticket items.

### Housing and Construction

While remaining somewhat spotty, the housing sector is still a bright spot in most parts of the District. Construction and sales have continued strong although there are some signs of slowing activity in recent weeks. Mortgage interest rates have increased slightly in most areas in the past few weeks. Fixed rate mortgages are still popular and reports are that the variable rate instruments are not being received well by consumers. As a result, there has been a tendency for mortgages to have shorter maturities and

higher down payments in return for lower rates. The markets remain basically optimistic.

There are also reports of a resurgence of commercial construction activity in some areas, although these remain exceptions. Highway work is apparently providing a significant boost to the non-residential sector in some areas as well.

#### Banking and Finance

Loan growth appears to have been moderate recently. The greatest strength has been in demand for residential mortgage and consumer installment credit. In most quarters, this pattern of growth is expected to continue for the rest of the year. Recent business loan demand is generally described as more sluggish.

#### Agriculture

There is widespread concern over the prospects for the District farm sector. Reduced acreages resulting from PIK program participation combined with unusually hot, dry weather experienced of late are giving rise to concern over the level of output of some crops and over the potential availability of feed grains.

## SIXTH DISTRICT - ATLANTA

Recovery continues to gain momentum in most of the Southeast. Deposits and loans at large financial institutions increased in the early summer, and the improved climate is stimulating innovations and expansion of services. Manufacturers in housing-related industries are operating at substantially increased levels of capacity. The resurgence in construction is helping to buoy consumer spending as well. However, spokesmen for the construction industry, as well as some realtors and manufacturers, are apprehensive that recent increases in mortgage rates may curtail the current, brisk pace of growth. Strength in the tourist industry remains concentrated in Florida and Georgia. Adverse weather presages declining crop revenues in the troubled agricultural sector.

Employment and Industry. Comments from industry representatives reinforce the strength shown by the latest labor market statistics. The southeastern unemployment rate in June dropped to single-digit levels for the first time in eight months. Respondents indicate that the upturn in housing and auto sales has boosted production in the textile industry. Georgia mills are now running at about 80 percent of capacity, the highest utilization rate in 30 months. For the first time in three years some Georgia carpet manufacturers are concerned about production keeping pace with demand: a recent uptick in the price of carpet yarn suggests acceleration of demand growth. North Georgia carpet mills produce about 60 percent of American-made carpets.

Southeastern corporations producing timber-related products are registering marked increases in activity; they are approaching full productive capacity and 95 percent employment levels. However, industry contacts are concerned about the possible negative effects of the recent rise in mortgage rates. Louisiana's petrochemical industry

is beginning to experience a general increase in orders, but firms are not yet recalling workers.

Consumer Spending. Consumer spending is maintaining the strong performance reported earlier this summer. June taxable sales in the District rose 12.8 percent from 1982 levels. Increases of over 20 percent in Florida and Georgia outweighed decreases in Louisiana and Tennessee. Some retailers report increases in June of up to 40 percent over their 1982 levels. Most merchants polled expect sales figures for July to be lower than in June, but they confidently anticipate back-to-school sales in August will prove strong. June was the best month yet in 1983 for new motor vehicle sales in the Southeast. Georgia led the District in sales. Not only durables and home furnishings but also apparel and personal luxury items are moving well in most localities. Merchants expect these increases to continue as the improved housing market and heightened consumer optimism stimulate new purchases. Retailers report little effect from the July 1 tax cut except that it augmented consumer confidence. A number of retailers point to the increased use of credit as an indicator of growing consumer confidence in the economic recovery.

Construction. A month-long increase in mortgage rates during July has raised fears that the pace of recovery in the housing industry may decelerate. As of August 1, FHA/VA interest rates for 30-year, fixed-rate mortgages increased by a full percentage point to 13.5 percent. Because FHA/VA mortgage rates are determined at closing, some home buyers will not be able to close loans for which they applied up to nine to twelve weeks ago when rates were 11.5 to 12.5 percent. The industry's near-term outlook for mortgage rates is mixed. Some lenders feel that rates are now plateauing and will decline later in the year, but others believe that federal deficits will continue to compete for funds and will keep mortgage rates high. Although the rise in mortgage rates should reduce required discount points, the higher rates will

raise minimum income levels required to qualify for loans and thereby eliminate some buyers. Realtors expect the rise in FHA/VA rates to reduce sales by 5 to 8 percent.

According to real estate agents polled, residential sales remained vigorous through July although sales were not quite as strong as in May and June. Building permit activity continued an upward trend through June. Single-family permits in the District rose by 2.2 percent. Contacts indicate that building permits were holding up well through July. In some areas single-family permits issued were running 50 percent ahead of year-to-date figures for last year. The commercial real estate sector is finally gathering some momentum. Leasing companies report that office vacancy rates are dropping throughout the Southeast. They attribute this increased activity to a "recovery psychology." Reportedly, many managers believe the recession is over and are leasing new offices before increased demand begins to put upward pressure on leasing prices.

Financial Services. Both thrifts and commercial banks added to their deposit bases in June. With the exception of business loans, which backed off slightly from their May levels, loan demand at large District banks continued strong in June. Southeastern bank earnings, at several Florida institutions in particular, improved in the first half of 1983 because of the declining cost of funds and growing loan activity. The improved business climate seems to be encouraging regional banks to introduce innovations and expansion of services, such as discount securities brokerages and statewide automated teller networks.

Tourism. The travel industry is faring best in Florida and Georgia. Conditions have changed little since June except for an apparent slowing of the "boom" in central Florida. Although the most popular attraction is doing well, its margin of growth relative to last year is less now than in the winter and spring, and occupancy rates at central Florida hotels have dipped somewhat from near capacity levels earlier this year.

Other attractions, particularly in south Florida, report that attendance is flat or off from 1982 levels. Miami's cruise ship industry is suffering from overbuilding and price cutting; some lines are offering 50 percent discounts on fares. However, expansion and refurbishing continue in anticipation of continuing growth in certain younger markets.

Pass-through traffic into Florida is contributing to the strong performance of Georgia's tourism industry. The Georgia Hotel/Motel Association reports that hotel occupancy along interstate routes is quite healthy. Convention business in Atlanta's central business districts has been off 10 percent during the first six months; however, this drop-off may be more a lagged effect of earlier crime problems than of recent economic trends. Overall attendance at Georgia attractions is more than 18 percent over last June. In other southeastern states, summer tourist business has been off. June lodgings tax receipts in Mississippi, Louisiana, and Tennessee were below year-ago levels. Attendance at a number of Tennessee attractions also is below last year's levels, and at some it is below even 1981 levels. Travelers to Tennessee's largely middle-income tourist market are reportedly quite cost-conscious.

Agriculture. Recent hot and dry weather throughout most of the Sixth District is having a severe impact on crops, especially corn, soybeans and cotton. Soybeans face the greatest potential loss because plantings occurred later than usual, and crops lacked sufficient maturity to withstand prolonged dry conditions. Weather seems to have had the least effect on corn in southernmost parts of the District because crops there are near maturity. Reliable estimates of yield losses are not yet available, but preliminary figures suggest a decline of up to 10 percent on average and a concomitant 15-25 percent drop in net farm revenue. Reduced acreage, unfavorable weather conditions, and plant diseases augur a near 40 percent reduction in revenue for the District's 1983 tobacco crop.

## SEVENTH DISTRICT--CHICAGO

Summary. The outlook for total business activity in the Seventh District is still favorable, but there are disturbing signs. Most important, the modest recovery in housing is seriously threatened by recent increases in mortgage interest rates. Secondly, the District's important producer goods industries have shown only scattered gains from abysmal levels. Inventories remain lean, overall, and are not expected to increase significantly because of ready availability of new supplies.

Increases in total income and employment in the District since last December have lagged the nation. District employment had declined much more sharply from the prosperous levels of the late 1970's than the national total and this gap has widened further. The strongest sectors have been home construction, full-sized autos, light trucks, furniture, appliances, recreational vehicles, and defense equipment. But most of these are far below past peaks. Paperboard shipments have increased in line with the general economy. Steel shipments will be up in 1983, but probably less than had been anticipated earlier. Retail sales are well above last year, with both hard and soft goods aided by hot weather. Among construction materials, demand for gypsum board is strong for both residential and nonresidential uses. Prices are rising again, on average, but no resurgence of general inflation is foreseen in the months immediately ahead.

Corn and soybean crops in the Corn Belt have been damaged significantly by several weeks of hot, dry weather. Yields will be down at least 8-10 percent, possibly much more if conditions do not improve soon. While the effect of lower crop yields on farm income is probably positive, farmers have sharply reduced purchases of operating supplies in line with reduced needs.

Heat Wave. Most of the District has been afflicted by unusually warm weather since mid-June. Effects on economic activity have been multiplying. Retail sales of summer merchandise have been stimulated. Electric power consumption, mainly because of air conditioning, has set new records, with electric bills further inflated by high summer rates. Traffic through housing developments was reduced, in the opinion of builders. Finally, crop damage from hot, dry weather is the largest in years.

Mortgage Credit. The rise in the FHA/VA rate from 12.5 to 13.5 percent, effective August 1, merely recognized the increase that had already occurred in market rates. The going rate on 30-year conventionals is now 14-14.5 percent, up almost a full percentage point in the past month, and up two points since early May. The rise in mortgage rates has taken many potential buyers out of the market. Unless rates decline, the peak in housing probably is at hand if not already passed. Some S&Ls report a drop of 40 to 50 percent or more in loan applications since May. Total transactions are not off this much because mortgage bankers (and some S&Ls) are achieving increasing success with programs to sell home buyers on various types of adjustable rate mortgages.

Construction--Residential. Building permits for housing, which remained at improved levels through June, may have slipped in July. In the first half, single-family permits in the Chicago area were more than triple last year's level, but apartment permits were up less than 20 percent. Despite the large increases from last year, single-family permits were only half as large as in the comparable period of 1977 (the record level), while apartment permits were only one-fifth as large.

Producer Equipment. Experience of producers located in the Seventh District generally does not reflect the improvement indicated by national aggregate data on orders, production, and purchases of equipment. The

difference is traceable to the relatively small involvement here in electronic equipment--data processing, communications, and robotics--which is doing well. There has been a small rise in demand for heavy trucks and trailers, but demand for most types of equipment for construction, agriculture, electricity generation, railroads, mining, oil and gas well drilling, materials handling, and metalworking has remained very slow. In some cases operations are at the lowest level since the 1930s. Some plants are closed for good and others have been idle for 6 months or more at a time. Domestic producers of equipment often have large margins of excess capacity, and much good used equipment is available. In addition, there have been sharp declines in exports to OPEC nations. Imports have increased, particularly from Japan. In many cases, imports (including a widening range of equipment and components) are of excellent quality. Imports are readily available at low prices and on favorable credit terms.

Employment. In the first half of 1983 the rate of increase in payroll employment in Michigan exceeded the national increase as auto firms recalled workers. Data for Illinois, Indiana, and Wisconsin showed smaller percentage increases than the nation, while Iowa showed no rise at all. For the five states combined, payroll employment in the second quarter was 10 percent below the level of 1979, while manufacturers' employment was off 25 percent. Hiring intentions are somewhat stronger than last year, but there is no near-term prospect of significantly reducing the shortfall relative to 1979. Many companies that reduced employment by one third to over one half have no intention of rehiring significant numbers. Recruitment of new graduates at colleges is down 10 percent from last year, and down 40 percent from two years ago. Help-wanted advertising in Chicago-area papers was 10 percent above last year in the past two months, but it was less than half of 1981 volume.

Consumer Purchases. Consumer buying has increased in the District in the first half of 1983, but not as much as in the nation--according to national chains. Hot weather permitted large sales of summer merchandise with less price discounting than last year. All types of appliances have been selling well. Room air conditioners have been the star, with shortages of some models. RVs are up 50 percent, and furniture up 30 percent from 1982. Sales of full-sized domestic cars and many popular imports would have been even stronger if larger numbers had been available. Despite favorable sales trends in most consumer durables, physical volume is still well below the peak years of the 1970s. Retail inventories, overall, are somewhat low relative to sales based on historical comparisons. However, additional supplies of most general merchandise are available within one or two days. Blanket orders for general merchandise already negotiated indicate that significant price increases will not occur this year.

Agriculture. Extremely hot, dry weather during the second half of July apparently resulted in extensive damage to spring plantings in the Corn Belt. Local analysts believe that damage through the end of July lowered probable corn yields by a tenth from last year and soybean yields by 8 percent. Prospective yield declines, coupled with sharp cuts in acreage under federal programs, may reduce corn and soybean harvests by 36 and 20 percent, respectively.

Weather damage varies throughout the District, but it is most extensive in central and southern Illinois and Indiana and southern Iowa. Further damage is possible if the hot, dry conditions extend into mid-August as some weather forecasters predict.

## EIGHTH DISTRICT - ST. LOUIS

Economic expansion continued during June and July in the Eighth District, and most respondents anticipate that their activity will rise further during the fall and winter. Although July is typically a slow month for production, with some plants closed for taking inventories, model changeovers and vacations, the interruption this year was less than usual. The greatest strength, both in retailing and manufacturing, was in consumer durable goods, while the weakest area continued to be in business capital goods. Total employment has risen slowly. Hot and dry weather has prevailed over most of the District, and it is critical for crops that a soaking rain come soon.

Outlook

The average forecast made in late July by 11 members of the St. Louis Chapter of the National Association of Business Economists was that real GNP would rise at a 5.9 percent annual rate in the last half of 1983 and that the price deflator would increase at a 4.7 percent pace. The chief longer-run concern was the threat of accelerating inflation resulting from continued growth of government spending and rapid monetary expansion.

Sales

Sales at seven District retail stores were 9 percent higher in June and July than in the corresponding months last year. Promotional activities played a role in generating sales, while the July tax cut provided additional buying power. Most lines sold well, especially appliances and other consumer durables.

District automobile sales continued to be strong in June and July. One large St. Louis dealer reported sales 40 percent above year ago levels; he attributed the rise to incentives offered the consumer, particularly the low subsidized interest rates. Used car and truck sales were also sizable. One major dealer sold more used cars in June and July than any two months on record.

Home sales in the Memphis and St. Louis areas, which began weakening in May, remained rather sluggish in June and July. The hot weather and increased mortgage rates and home prices contributed to the slowdown. Housing starts in the District, however, remained large. In greater Louisville, a number of new homes are being built in older subdivisions that had been dormant, and in the St. Louis area housing starts were triple the level of June and July 1982.

### Manufacturing

Most industrial firms in the District reported further increases in orders and shipments since May. Two of the companies making business equipment, which had reported no improvement earlier, noted a small gain in orders. On the other hand, a major glass container firm announced it would permanently close a plant in early October, resulting in the loss of over 300 jobs; at the peak, this plant employed 2,400 people.

Inventories at most District firms are near desired levels, but a recent survey found that about a third of the manufacturing companies planned to increase inventories this fall. A few firms, which raised the prices of their products moderately, could not make the higher prices stick.

### Employment

Total employment rose modestly in the District in June and July as firms in the automobile and aircraft assembly, airline, construction, retail trade, printing, paper products and service industries added workers. In addition, one automobile company announced that it will recall 3,100 workers in September, and another will recall 1,500 in the near future. A few business firms and local governments, however, were still reducing their work forces, primarily through attrition.

### Finance

A survey of eight savings and loan associations in the Louisville and Memphis regions found that, in June, the dollar volume of mortgage loans made and acquired was about four times greater than in June of last year. Moreover, during that month these associations were able to reduce Federal Home Loan Bank and other borrowings. At large District banks, consumer installment loans rose substantially, and commercial and industrial loans increased moderately in June and July. On the other hand, outstanding real estate credit at these banks drifted lower.

### Agriculture

The hot dry weather over much of the District since mid-June has adversely affected the corn, soybean and tobacco crops. Some areas went seven weeks without a substantial rain. Although there has been irreversible damage, harvests are still expected to be sizable if rain falls in the next week or so. Vegetable, peach and apple crops also have been severely affected. In addition, dairy farmers probably will be facing higher operating costs because of the drought damage to the alfalfa crop.

## NINTH DISTRICT - MINNEAPOLIS

Signs of the economic upturn continue to be evident in the district. Consumer spending for general merchandise, autos, and housing are up. Tourism is helping to maintain the momentum. There is strong demand for products produced by several important industrial sectors, and the financial sector is busy. Employment is up slightly. However, agricultural performance is still mixed, and mining related business is still depressed.

Consumer Spending: Despite oppressively muggy weather, the recovery fueled increase in consumer spending shows no sign of ending. Leading the way are large Twin Cities retailers, who continue to report healthy sales increases in the district. One reported its best sales in two years, while another is experiencing its best June and July in "a great many years." The region's largest retailer had a whopping sales increase over the previous month. Sales in cities appear to be strongest. Another indicator of retail strength is the 5 percent increase in sales tax revenues paid in one district state to date.

Housing activity is continuing to build. Twin Cities housing sales for the first half of 1983 finished around 40 percent higher than in the first half of 1982. June sales were up over 15 percent from May sales and South Dakota sales were up 35 percent over the same period. Building permits in Minneapolis/St. Paul are running at close to twice the rate of a year ago. Condominium and luxury home building appear to be particularly strong in Billings, Montana. Activity is also up in Fargo and Bismarck, North Dakota.

In addition to the positive economic outlook, state low-interest housing programs are helping the trend to continue. South Dakota and Minnesota housing programs seem particularly active.

Auto sales are also moving ahead at a rapid clip. One of the big four domestic manufacturers said that June was its best month in Minnesota in three years. The trend is evident in other district states, too. From the Upper Peninsula of Michigan to Montana, district directors report auto sales to be good. Large automobile sales have been particularly strong in South Dakota, showing a 60 percent sales gain over 1982.

Competitive factory financing and an imminent sales tax increase in Minnesota are complementing the economic upturn in producing these good figures.

Tourism: Tourism plays a large role in the district's summer economic picture, and provides further evidence of the district's improving condition. Tourist information inquiries were up 10 percent over a year ago in both Montana and Minnesota, and are also higher in the Upper Peninsula of Michigan and in the Indianhead region of northwestern Wisconsin. Mount Rushmore, South Dakota had 28 percent more visitors over the July 4th weekend this year than last year. The majority of respondents to a July survey of Minnesota resorts reported that business was up this summer, and that they plan to invest in resort expansion projects. Sundecks, for example, are a popular investment. Similar sentiments are reported in Montana.

The economy affects more than just the number of visitors, though. Many tourism officials perceived a trend toward shorter vacations, with less lengthy stays at resorts. One official attributed this to consumer uncertainty about the economic outlook.

Industrial Activity: Signs of improvement continue to be seen, with some exceptions. In Minnesota, one large multi-sectoral manufacturing concern reports that unit sales are much further ahead than a year ago. A manufacturer of large computer mainframes is having trouble meeting the unexpectedly strong demand for its products. A logging equipment manufacturer in the Upper Peninsula of Michigan has hired more workers. And other sectors in the wood product industry report encouraging signs, too. Both waferboard and coated printing paper demand is very strong. Even with increased demand, though, South Dakota manufacturing is still well below capacity. And as reported last month, mining and its related industries are still in a bad state. A taconite operation, open during June in Minnesota, closed recently and won't reopen until late October.

The economic upturn is not the only reason for these generally encouraging signs. Some firms report that the recession forced them to adopt improved cost containment and managerial strategies, which are contributing to a healthy profit outlook.

Agricultural Conditions: Agricultural conditions are still mixed. While the dry conditions in Montana were somewhat alleviated by recent rains in the northeast section of the state, crops are still reported to be in only fair to good condition statewide. The northwestern and western parts of South Dakota are still suffering from drought conditions. Also, corn borer infestations are widely reported. But, while crop conditions are behind normal in Minnesota, they are catching up. And in North Dakota and the rest of South Dakota, crop conditions are good to excellent. Price performance is also mixed. While corn prices are moving up, soybean and wheat prices are only

holding equal to last year's low prices. A recent survey of district agricultural lenders showed that farm spending was no higher than it was last year.

Employment: Employment conditions continue to improve throughout the district. The seasonally adjusted district unemployment rate fell in June to 8.0 percent, down from 8.5 percent in April and 8.2 percent in May. District employment grew about 10,000 workers in June, the first such increase since January. A director reports that South Dakota Job Service placements are way up, and the Conference Board's Help Wanted Advertising Index corroborates these data. The Minneapolis index was 16 percent higher in June than in May, and was 13 percent higher than in June 1982.

District employment should continue to improve as output and capacity utilization pick up.

Financial Developments: District member banks' performance reflects the recent strength of the district economy. Total lending in June and July was up by nearly a billion dollars, with both country banks and large Twin Cities banks sharing in the growth. Total deposits also grew substantially during this period, although a few large Twin Cities banks' deposits fell in July. When compared to July 1982, total loans and deposits grew in July by 14.3 and 9.6 percent, respectively.

## TENTH DISTRICT—KANSAS CITY

Overview. The business recovery in the Tenth District appears to be quickening, led by strong growth in retail sales in recent weeks. New car sales are improving, with some depletion of stocks below desired levels. Other retail inventories, as well as materials inventories, are generally viewed as satisfactory. A moderate slowdown in housing activity is expected for the rest of the year, with demand for mortgage funds weak at thrift institutions. Record yields were recorded in the harvest of winter wheat, but corn yields will suffer if extreme high temperatures continue. Loan demand at commercial banks has increased moderately, with most of the increase in consumer loans. Deposits are also up moderately.

Retail Trade. Retailers report nominal sales gains in the 3 to 10 percent range for the first half of 1983 compared to the same period a year earlier, with particularly strong growth in the past 4 to 8 weeks. Sales of apparel are showing considerable strength due in part to the beginning of back-to-school sales. Retailers expect sales to continue growing through the remainder of 1983. Inventory levels are generally satisfactory, and little further correction in these levels is expected during the rest of the year.

Purchasing Agents. For about half of the firms contacted, input prices remain lower than in July of last year. But most input prices either have increased over the last three months or have quit falling. Most purchasing agents expect prices to increase somewhat over the rest of the year, although a few foresee no further changes. Firms are generally satisfied with current inventory levels and plan to keep inventories low as the recovery proceeds.

Auto Dealers. Automobile dealers report improved sales in the first half of 1983 compared to the first half of 1982. Dealers have depleted their stocks of 1983 model cars, in part because of the attractive rates offered by captive financing companies. Inventories of larger cars are especially low. Most dealers express optimism about the outlook for car sales but state that sales could be adversely affected by increases in interest rates.

Housing Activity and Finance. Housing starts are about double last year's rate, with single-family starts improving more than multi-family starts. Because sales of new homes are also higher, inventories remain low. For the rest of 1983, the improvement in housing starts is expected to moderate because of recent increases in interest rates and uncertainty about future rates. Even with a moderate slowdown, however, housing starts this year are expected to significantly exceed housing starts last year. Most savings and loan associations report an improvement in savings inflows in the first half of 1983 compared to the first half of 1982, and continued improvement is expected through the third quarter. Mortgage rates range from 12 percent on variable rate mortgages to 13 5/8 percent on fixed rate mortgages. At those levels, demand for mortgage funds is reported to be weak at almost all institutions. Mortgage rates are expected to remain steady until near the end of 1983 and then decline slightly.

Agriculture. Harvesting of winter wheat throughout the Tenth District is virtually complete with record crop yields. Most wheat farmers stayed with the PIK (Payment-In-Kind) program resulting in a significant amount of wheat being plowed under to comply with acreage restrictions. Some District farmers receiving PIK payments have used the receipts from sales for debt repayment, but most grain received is being held rather than sold in the market. Corn growers

report little damage yet from persistent high temperatures but damage will likely escalate sharply if the heat persists. Corn released from the reserve program is being held for cattle feeding rather than being sold in the market. The overall condition of livestock in the District is good, in spite of slower weight gain in cattle due to heat related factors. There is little evidence of herd expansion activity by hog producers. Although farmland values throughout the Tenth District are reported by bankers to be stabilizing or rising slightly, not much land is changing hands. The PIK program appears to be aiding farmers as they have increased loan repayments and are making fewer requests for renewals or extensions of existing credit.

Banking. Tenth District banks report a moderate increase in loan demand due mainly to growth in consumer loans, especially automobile loans. Although residential mortgage lending also increased, the demand for home loans is expected to decline sharply in the coming months as mortgage rates drift upward. Commercial and industrial loans increased very slightly at Tenth District banks, and agricultural lending remains flat throughout the District. Tenth District banks report no change in loan quality since last month's survey. The prime lending rate is 10.5 to 11 percent, unchanged from last month. Deposits are up moderately at Tenth District banks. Growth in money market deposit accounts, money market certificates, and small saver certificates is responsible for most of this increase. About half the responding banks report increases in IRA and Keogh accounts. Demand deposits, conventional NOW accounts, and Super-NOW accounts remain constant. Tenth District banks are allowing large CDs to run off, reflecting expectations of only modest loan demand in the immediate future.

**ELEVENTH DISTRICT—DALLAS**

The recovery in the Eleventh District is strengthening despite continued weakness in energy-dependent manufacturing. Industrial production in Texas has been climbing since last December. Residential and retail construction is booming. Retail sales are up in most major metropolitan areas, but sales in energy-dependent communities and along the Mexican border remain well below year-earlier levels. Oil and gas drilling, production of oilfield equipment, and the energy service sector remain weak, but some signs of improvement have emerged.

Manufacturing production in this District is responding to increased demands from the construction industry and from sectors tied to the national recovery. The turnaround in these sectors has been sufficient to overshadow energy-related weakness. Total manufacturing employment increased in June, the first increase in more than a year. Strong demand for primary metals, construction supplies, and electronics pushed durable goods production up despite declines in fabricated metals and nonelectrical machinery. Oil drilling activity recently picked up, but production of oilfield equipment is not expected to respond until excess inventories have been worked off by the first half of 1984. Increased production in apparel and chemical industries together with higher operating rates at Texas oil refineries helped to accelerate growth in nondurable goods production.

Residential construction is still the strongest sector in the District economy. Apartment and condominium construction is proceeding faster than ever before in most of the major SMSAs in Texas. Occupancy rates continue to fall, and respondents are concerned that the market will be tremendously overbuilt by the time new projects are completed. Starts of single-family homes are roughly twice last year's slow rate, but rising mortgage rates may curtail activity during the second half of this year. Builders expect the recent increase in the FHA/VA rates to reduce sales to first-time home buyers.

The year-to-date permit value of commercial construction is slightly below last year's level. This reflects the slowdown in new office projects in Dallas and Houston. Office construction in other Texas SMSAs is accelerating. Moreover, some of the slack in the Dallas and Houston markets is being offset by increases in retail, industrial, and government construction projects.

Projections of farm income in Texas have been adjusted downward for 1983 because of drought conditions in West Texas. In-kind transfer payments from the PIK program will tend to mitigate income losses. Crop yields on PIK acres are likely to be higher than yields on planted acres. Texas ranchers have a higher proportion of the nation's cattle-on-feed this year than last. This will result in a greater share of revenues as well.

Department store sales for the District are only slightly ahead of last year's, largely because of year-over-year sales declines along the Border and energy-dependent Gulf areas. In non-energy dependent regions, the highest rate of sales gains are reported for home appliances,

furniture, and home furnishings. Growth in apparel sales slowed in July but this reflects a normal seasonal occurrence. Moderate increases were reported throughout May and June. Sales in the Border areas are stable to increasing but well below a year earlier. Houston area sales fell off again in July after showing some signs of life in May and June.

Auto sales remain relatively strong and are increasing throughout the District. Sales in June and July were well above year-earlier levels when special incentive financing plans were not being used. Auto sales picked up in Houston during the last two months after being stable at low levels for almost a year. Availability is becoming a growing problem for dealers in the stronger markets. Accordingly, respondents are planning to place larger orders for 1984 models.

District member banks are still facing slack loan demand, largely because of sluggish business loan demand. Growth in business loans at the large banks has been trending downwards since the fourth quarter of 1982. This has been offset with an increase in security purchases and real estate lending. Long-term financing of large real estate projects has picked up through the use of "mini-perms," 7- to 10-year fixed rate financing packages. Deposit trends have not changed. Demand and time deposits have slowly declined while growth in savings deposits continues strong.

## TWELFTH DISTRICT -- SAN FRANCISCO

In recent weeks, the recovery in Twelfth District economic activity has gained momentum, with nearly all manufacturing and mining industries experiencing some degree of improvement in orders. Consumer spending increased at an accelerated pace, widening year-to-year gains in retail sales. Western homebuilding activity also continued to pick up through June, in contrast to the national slowdown. In the manufacturing sector, even the capital goods industries are reporting increased demand. While the recovery appears to be extending into the third quarter, a slowdown in home sales in July suggests that the pace could slacken. Commercial and industrial lending at Twelfth District banks continues to be weak, but the weakness is due to firms' improved cash flow and access to the bond and equity markets. Moreover, although District banks have begun to experience a slight outflow from MMDA's, that movement has been offset by a shift into longer-term and higher yielding consumer certificates.

Consumer Spending

Respondents throughout the Twelfth District report that retail sales have been rising at an accelerated pace. Major department store chains in Southern California reported that sales rose sharply in June and ran nearly 17 percent above the year-earlier level. In the Pacific Northwest, sales at some major stores were up as much as 30 percent. Business apparently remained strong through July. Since competition for sales is extremely intense and prices are up only a few percentage points, most of the gain represents increased volume. Retailers report that inventories are low and they are not planning any significant buildup as long as the price increases realized on merchandise remain small relative to interest carrying costs. Sales of durable goods, including expensive items such as furniture and appliances, are rising

even faster than nondurables. Consumer credit outstanding is growing, but the delinquency rate is declining. Sales of automobiles have been rising far above year-earlier levels and would be greater if some models were more readily available.

#### Manufacturing and Mining

The recovery has now extended in varying degrees to nearly all Twelfth District manufacturing and mining industries, except those engaged in energy production. The important lumber industry, which was one of the first sectors to show improvement because of the turnaround in national homebuilding activity, continues to boost production and employment, despite some recent weakness in lumber prices. The aluminum, copper and other metal industries are raising their capacity utilization rates as orders continue to strengthen from such important metal consumers as the automobile, appliance, container and housing industries. Even the West's major capital goods producing industries--including those that manufacture machinery, electronic equipment, trucks and aircraft--are experiencing a modest pickup in orders. Not only has consumer and defense demand for these goods increased, but business demand has risen. Improved airline profitability is finally enabling the world's airlines to boost orders for commercial aircraft.

#### Construction and Real Estate

Through June, indicators of housing activity in the West were exceedingly strong. Regional housing starts continued to rise to a level more than double that of a year earlier, and permit activity pointed to still further gains in the months ahead. But in the last month as mortgage interest rates have risen, home sales are reported to have slowed. As yet, there are no signs of overbuilding. Developers have been proceeding very cautiously, building mainly on a pre-sold basis and holding their speculative units to a minimum. But many respondents fear that even a modest further increase in mortgage rates, say 50 basis points, could cause a substantial

decline in residential construction during the second half of 1983. Even with the recent increase in rates, they expect the average level of starts during the last six months to be moderately lower than the hectic first-half pace. They point out that the majority of the new units started have been in the lower-price category aimed at the first-time buyer and that the recent increase in conventional mortgage rates to nearly 14 percent will price a sizeable number of potential homebuyers out of the market. Some builders already are beginning to "buy down" mortgages once again to keep effective interest rates affordable. In the nonresidential construction sector, activity continues to lag behind the year-earlier pace as vacancy rates remain high for office and other commercial buildings. The rising level of permits issued points to increased spending in the months ahead however.

#### Agriculture

California farmers have been experiencing sharply declining prices for fruits and vegetables in the past two months as crops have been higher than had been predicted when flooding early in the year caused late plantings. Prices for these items are still above levels of a year ago, however, and California farmers are expected to experience a year-to-year increase in net income from fruits and vegetables. The heavy winter rains also have had a positive side effect in working down excess inventories of many tree crops at higher prices. California farmers also are expected to benefit greatly from the combined effects of the Federal payment-in-kind (PIK) program and the Midwestern drought in boosting prices for cotton and grains. The Federal government is having problems fulfilling its PIK inventory return obligation to California cotton growers, however, in that those farmers do not have sufficient cotton under loan to the government to compensate for the huge acreage taken out of production. Elsewhere throughout the District, smaller gains in net farm income are expected, except perhaps in Utah, where net income could be down because of recent flood damage to the farm sector.

Financial Institutions

Commercial and industrial lending at Twelfth District banks has shown continued weakness in recent weeks, following the typical pattern in the early stage of recovery. Banks attribute much of the weakness to improvement in sales and cash flow, which is reducing their need for bank financing. The inventory liquidation which has accompanied increased sales has reduced their need for short-term bank borrowing, while weakness in capital spending continues to depress businesses' need for long-term bank financing. In addition, the improvement in bond and equity markets has given large firms the opportunity to turn to those sources for long-term capital. Banks in the region also have begun to experience their first outflows from MMDA's which had risen to over 21 percent of their total deposits. Since mid-June, both industrial and business MMDA's at District banks have shown slight declines. However, the slight outflow appears to have been offset by a shift into longer-term consumer certificates as depositors attempt to lock in relatively attractive long-term rates.