

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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by the Staff

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SUMMARY*

The nation's economic activity, as reported by the twelve District Banks, was generally slow during August and September. Only Dallas reported a relatively strong regional economy. Consumer spending was weak for most goods and services in most districts. Automobile sales, even with rebates and promotions, were strong in only three districts. Manufacturing orders and production were sluggish. Some inventories increased in some districts. Construction, particularly for new homes, was slow almost everywhere. Agricultural growing conditions were very good in most districts, and farm prices generally declined. The demand for most types of loans slowed, and the quality of loan portfolios at financial institutions deteriorated somewhat.

Consumer Spending

Consumer spending generally has declined in most districts, with only a few bright spots. General merchandise sales are reported weak or mixed by nine districts, and San Francisco reports that even retail food sales are slowing in some areas.

Sales of consumer durables, such as major appliances, have been languid in most of the nation. Sales are "down" in St. Louis, "disappointing" in Kansas City, "weak" in Cleveland, and similarly slow in many other districts. Only Dallas reports that appliances are "selling well."

Sales of automobiles have been stimulated by rebates, interest subsidies, and other promotions, but they are still low in most areas. Richmond calls auto sales "weak." Chicago notes that production schedules for the

*Prepared at the Federal Reserve Bank of Minneapolis.

fourth quarter have been cut. Only Dallas, St. Louis, and New York have experienced strong auto sales.

Some districts observe that certain other goods and services were selling well. St. Louis and Philadelphia report strong sales of electronic equipment and entertainment systems, such as video tape recorders; Philadelphia and Boston report a good showing in sales of soft goods, such as apparel; Dallas indicates that back-to-school sales were strong; and Minneapolis reports that tourist spending was good.

Manufacturing

Manufacturing orders and production have been sluggish. Except for Philadelphia, all districts report that orders and production have been weak or declining. Boston attributes the weakness in manufacturing to the strong U.S. dollar making U.S. goods uncompetitive overseas. Minneapolis, St. Louis, Atlanta, and San Francisco attribute the weakness to the soft homebuilding industry, which has depressed the forest products industry. Cleveland and New York attribute it to cutbacks in capital spending; St. Louis attributes it to poor auto sales; and Chicago attributes it to both of these developments. Oil field equipment is the only product that has enjoyed strong orders and production.

In spite of the sluggishness in new manufacturing orders, there are no reports of serious general increases in inventories. A few districts do report some build-ups. Minneapolis and Richmond report slight general inventory build-ups; Cleveland reports build-ups in steel; and Atlanta reports build-ups in forest products. Chicago, on the other hand, reports that inventories of certain manufactured products are below comfortable working levels.

Construction

Construction, particularly homebuilding, was weak in most districts. Home construction and sales were depressed almost everywhere. Atlanta, for example, reports that housing construction has been "reduced to a trickle" by high interest rates. St. Louis reports that single-family housing permits in the St. Louis area were down about 50 percent from a year ago.

In some areas, weak homebuilding activity was partially offset by strong commercial and industrial building. Dallas, Richmond, and Atlanta report vigorous activity in nonresidential building.

Agriculture

Crop production has been very good in most districts. Virtually all districts indicate that crops and harvests have been robust. Richmond expects gains over last year in peanuts, cotton, soybeans, and corn. St. Louis expects above average output in corn, soybeans, milo, and rice. Kansas City looks for record production in corn and near-record production in soybeans. Minneapolis anticipates a 20 percent increase from last year's corn crop, which was harmed by drought.

Farm prices have generally declined. Minneapolis reports that cash grain and livestock prices since July have remained the same or declined. San Francisco reports that crop prices in its district have been depressed by the impact of the strong U.S. dollar on crop exports and by fears of the Mediterranean fruit fly infestation. The one exception to the soft farm prices is tobacco prices, which Richmond reports up 15 percent over last year.

Financial Conditions

High interest rates and weak economic conditions appear to have slowed demand in most districts for most types of loans. Weak consumer or mortgage loan demand is reported by half the districts: Philadelphia, Richmond, Atlanta, St. Louis, Kansas City, and San Francisco. Richmond and St. Louis report that business loan demand is easing. However, energy-related loan demand is reported as strong by Kansas City, Dallas, and Chicago.

The quality of loan portfolios also has declined at financial institutions in some districts. Farmers in the Kansas City district are continuing to have trouble servicing their debt, and Dallas reports that its banks expect more carry-over loans this year because of low prices for grains and cotton. San Francisco reports that much of the business loan demand in its district is attributable to cash flow problems, and Boston reports that problem loans are showing up among home developers and home furnishing firms.

FIRST DISTRICT - BOSTON

Economic conditions in the First District have not changed significantly since the last report. Manufacturers are generally operating below capacity; there are no indications of an upturn. Foreign sales remain a problem area. The retail picture seems somewhat brighter; sales tax revenues over the summer were up strongly from year-ago levels. Banking respondents see an increasing number of problem loans.

Manufacturers have been saying the same thing since spring. Sales are soft; backlogs are low. For firms engaged in the export business, foreign sales are a source of weakness. The problem appears to be the strong U.S. dollar more than the state of foreign economies; firms with subsidiaries abroad are not experiencing sales declines comparable to those suffered by exporters. One large exporter, the first to report exchange rate problems, believes that the European situation has bottomed out; new orders seem to be picking up. This respondent thinks that the improving U.S. inflation rate is starting to offset the effects of the strong dollar. Among the domestic areas which are particularly weak at present are commercial aircraft components; heavy capital equipment for glass-making and other process industries; and circuit breakers, appliances, and other construction-related products. The demand for automotive parts, on the other hand, has strengthened slightly.

The manufacturing firms contacted are proceeding with capital spending plans despite disappointing sales. They are "building for the long run." However, all those contacted are large firms which rely heavily on internal financing. Also, sales of electrical equipment used in industrial construction have now begun to fall off.

Reports from the retail sector are more encouraging. Sales tax revenues over the summer months were up sharply from year-ago levels, suggest-

ing that retail sales were stronger than previously thought. Food sales are reported to be keeping pace with inflation while general merchandise sales have been running ahead of inflation. Apparel has been particularly strong. Credit sales are said to be picking up. One large department store chain recently announced a major capital expansion in the region; however, a supermarket chain and another department store chain have just closed operations.

Banking respondents report an increasing number of problem loans. For a large southern New England bank, these problems are concentrated in real estate related areas; developers and, more recently, manufacturers in the home furnishings business have been encountering difficulties. These banks are generally unenthusiastic about the "all-savers" certificates but are gearing up to pursue IRA funds.

Professors Eckstein, Houthakker, Samuelson, and Tobin were available for comment this month. Professor Eckstein feels the climb in initial claims may be signalling a recession. He feels real GNP in the third quarter fell more than the "flash" estimate and predicts less than 1 percent growth this quarter. He argues the Fed should "live by our principles"--i.e., seek to achieve the M1B target by the end of the year. He believes the lower end of next year's targets are "disastrous" and the mid-points are "highly ambitious." Eckstein believes that the Fed cannot ignore nominal interest rates and favors a floor of 12 percent at present for the Federal funds rate. He argues that "our understanding of the relationship between either interest rates or reserves and the aggregates is sufficiently loose that we should not use those instruments too aggressively."

Professor Houthakker favors giving "absolute priority to fighting inflation unless it raises unemployment a lot." Since present policy has not raised unemployment so far and is working to slow inflation, he sees no reason

to change policy. He is concerned about the recent rapid growth of reserves. Neither the dollar nor the current account should be of concern to current monetary policy.

Professor Samuelson notes that the weakness in housing and autos is spreading to fixed equipment and durable goods. He regards the recent drops in the stock and bond markets as "hysteria." It is not reasonable to regard increased deficits due to weak economy as inflationary rather than as a symptom of weakness. Federal spending is not out of control; most of the recent revisions reflect higher interest costs. When the economy is weak a deficit is not unhealthy. With the economy weak, he sees no dilemma in returning money growth to the target range. This is no reason to resist a drop in rates in a weak economy. Further easing is fully consistent with the stated policy of pursuing moderate money growth regardless of the level of the deficit or prevailing rates of interest.

Professor Tobin raised the issue of the appropriate mix between monetary and fiscal policy. He noted that the commitment to steady reduction of the monetary growth targets makes no allowance for the recently proposed increases in fiscal restraint or for the performance of the real economy.

Tobin sees ample room for easing within present policies without destroying the System's credibility. He noted that any undershoot this year would be built into next year's targets, making that policy stance tighter. He is suspicious that the strength of M2 relative to M1B may reflect a shift from long- to short-term financing triggered by high rates and uncertainty rather than a more generous monetary policy. Tobin notes that the Treasury's continuing to issue long-term bonds is not consistent with the conviction that long rates are out of line with future short-term rates and inflation. With this conviction, an "Operation Twist"--with the Treasury borrowing short and

the Fed selling bills and buying bonds--would reduce future government interest costs.

SECOND DISTRICT - NEW YORK

Economic activity in the Second District remained sluggish in August and September. The retail sector showed limited signs of recovery. Department store sales recouped some of July's decline, and rebate and interest rate subsidy programs spurred automobile sales. Lackluster conditions persisted in manufacturing industries, with high financing costs said to be discouraging new orders. Business economists do not anticipate any gains in real GNP until the end of the year despite small reductions in the prime rate. They expect real GNP to grow between 2.5 percent and 3 percent in 1982. On the financial side, consumer resistance to upward adjustment on renegotiable-rate mortgages was evident.

Consumer Spending

In August and September, retail activity in the Second District rebounded somewhat from the one-month drop that occurred in July. While the fall season began slowly due to the late Labor Day and school openings, most department stores are now achieving their sales goals. Products for the home exhibited weakness, with a retailer attributing the softening to the appreciation of the dollar and consequent fall-off in tourism and foreign business. Merchants believe the rest of the year will be "good." National retailers reported that sales in the New York area were generally healthier than in other parts of the country. In contrast to the relative strength of suburban locations evident in July, city and suburban stores are now performing equally well. None of the establishments foresaw any need to cut their inventories.

Automobile sales improved in August, matching the previous year levels which most of the dealers considered respectable. Strength appeared in both domestic and foreign automobile lines and across the price and size

spectrums. Rebate and interest rate subsidy programs were credited for the upturn. Dealers expect a slowdown with the expiration of these programs. The higher prices of the new 1982 models could depress sales further. Inventories are at acceptable to low levels, as the higher activity removed the excesses existing in prior months. The used car market has remained strong and truck sales have picked up.

Manufacturing Activity

Weakness in manufacturing industries lingered into September. New orders received by capital goods producers stayed at the low levels of July, though one firm recorded an additional 40 percent to 50 percent decline. Consequently, some companies have laid off workers and cut production from already contracted rates. Many businesses indicated that high interest costs have caused customers to defer purchases and reduce inventories. Two establishments noted an increase in returned items as clients sought to avoid payments. None of the respondents expected any immediate upswing, and even defense contractors were uncertain whether rising national defense expenditures would result in much new business.

Some firms have reacted to the sluggish activity by trimming inventories of final output, even to the extent of eliminating less profitable product lines. One concern has maintained sales by cutting prices, but its growth has fallen to a fraction of the earlier pace. Companies are trying to proceed with planned capital spending especially in high technology industries such as electronics. These expenditures are seen as essential to protect competitive positions. Increases in capital spending due to recent tax changes are not yet apparent. Negotiations on wage settlements are easing as job security is being emphasized over pay hikes.

Economic Outlook

Business economists foresee no growth or a small drop in real GNP during the third quarter and a flat fourth quarter. Real growth in GNP during 1982 is expected to be in the 2.5 percent to 3 percent range as some economists have revised their forecasts downward. Interest rate projections indicate a prime rate of 17 percent to 18 percent by the end of the year, a more modest fall from current levels than some previous estimates. In reaction to a sluggish economy, the inflation rate is predicted to decelerate through 1982.

Financial Developments

In recent years, a number of mortgage instruments containing rate-adjustment provisions have been adopted by mortgage lenders. The paucity of experience with rate adjustments on these loans magnifies the importance of a recent episode in upstate New York. Buffalo Savings Bank recently abandoned plans to raise the rates on callable loans written in 1975 and 1976 from 8.5 percent to 14 percent. The loans had been made at below-market rates because of a binding usury ceiling, which has since been removed. In response to the public outcry, the bank extended the 8.5 percent rate for the full 25- or 30-year amortization periods of the loans.

Financial Panel

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

Schott: Long-term financial markets are seriously depressed. Disintermediation is once again impeding the supply of institutional funds. But high short-term rates have only very recently become a deterrent to the use of short-term credit for long-term needs.

Federal Reserve credibility is growing month by month as long as the move toward ease is very slight and aggregate targets are observed. I see no viable alternative to this well-judged policy.

Stone: The short-run aim of policy at this juncture should, I think, be to maintain a posture such that interest rates continue to decline gradually to levels that would permit moderate real economic growth and that would not threaten significant under-shoots or overshoots in the aggregates.

In my view the tactic most likely to achieve that result would be to provide nonborrowed reserves such that "basic" borrowings (those exclusive of seasonal borrowings and extended credit) be maintained in the general area of \$600 to \$900 million. To go much below that range for an extended period would in my view risk a troublesome overshoot--the last thing anyone wants under present circumstances.

Wojnilower: Business activity is weakening on a broad scale and this is beginning to affect investment planning. There is no reduction whatsoever in credit availability for large companies, even those of lower credit quality. The President's speech, in my judgment, will probably have a negative impact. In practical terms, cutting the budget will intensify rather than ameliorate economic and financial problems. Nevertheless, I still expect some modest upturn in the economy by year end. Our people believe that the tax benefit transfer provisions of the new tax law will have the result that many major companies will pay no corporate profits tax at all for several years.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District point to mixed business activity for the month of September. Area manufacturers say industrial activity is showing some signs of expansion, for the second month in a row, which could signal the start of the upward trend they've been predicting for some months. As for the future, they project a strong boost in industrial activity by March. Local retail merchants report mixed sales volumes in September but look forward to a strong Christmas season this year. In the financial sector, District bankers indicate sluggish loan activity. Business loan volume is slightly ahead of year-ago figures, while consumer loans are said to be down sharply in September. Area bankers forecast little to no improvement in loan activity over the next six months. On the residential construction side, sales have dropped off sharply, owing primarily to a tight mortgage market according to area real estate contacts. Some new groundbreaking for townhouses and condominiums are reported, but area contractors and developers are said to be holding off on starts for detached single homes.

INDUSTRIAL

Area industrial activity is showing more signs of expansion in September. Manufacturers responding to the September Business Outlook Survey report, for the second consecutive month, a slight pickup in overall manufacturing activity. This could signal the start of the upward trend in business they've been predicting for some months. Reflecting the upturn in industrial activity in September, reports of rising new orders and shipments are more widespread than at any time since April 1977. On the employment front, the situation looks a little better as well this month. Manufacturers responding to the survey report lengthening the average workweek, marginally, for the first time in over two years. However, no real changes in payrolls are reported.

For the longer term, survey participants continue to be optimistic as over one-half of the respondents are projecting a strong boost in industrial activity by

March. New orders and shipments are expected to take off and producers' backlogs to swell by then also. The upbeat outlook may be good news for area labor as well, as survey participants plan to increase factory payrolls and add hours to the workweek within the next six months. Growing expenditures on plant and equipment are also forecast at 1 out of 3 firms polled.

Local industrial prices are up again in September with over one-half of the survey participants paying more for raw materials than they did in August and about one-third charging more for their finished products. Area manufacturers expect inflation to continue over the next two quarters, as 9 out of 10 survey respondents anticipate higher input costs by March and nearly 8 out of 10 are planning price hikes for the goods they sell.

RETAIL

Although September is traditionally a big month for "back to school" business, overall retail activity remains mixed. Reports of current dollar sales range from 4 percent below to 10 percent above September '80 levels. Area retailers say sales of soft goods (apparel, shoes, and small household items) and luxury goods (electronic equipment and entertainment systems) are making a better showing than other lines this month. Credit card sales continue to be strong and collection is good.

As for the future, District retailers are optimistic about the next six months. Some area contacts say the October 1 tax cut may give sales an added boost, about 2 to 3 percent. Other merchants, on the other hand, fear the Administration's budget cuts will pinch household budgets even more, leaving retail sales volume lower by March. Nevertheless, a strong Christmas season is expected and retailers are beginning to build up their stock levels. Inventories remain in-line and inventory-sales ratios are reported to be healthy.

FINANCIAL

Third District bankers report mixed loan activity in September. C&I loan volume is up 5 to 10 percent over year-ago figures, with some bankers reporting below-prime lending which has boosted their volumes to the upper end of this range. Consumer loan activity, however, is down as much as 21 percent this month from a year ago and is well below budget. Business borrowing is in-line with area bankers' expectations, for the most part. Looking ahead to March, local bankers say they are not too optimistic about the next six months. Some contacts are projecting commercial loans to increase only modestly, about 2 to 3 percent, if at all, while others forecast a slight slippage, 5 to 6 percent, in business borrowing. No improvement in retail loan activity is expected over the next two quarters as area bankers expect consumer loans to slide further by March.

Reports of deposit flows in the Third District indicate demand deposit levels to be mixed, running 11 percent below to 2 percent above last year's figures. Time and savings deposits, on the other hand, are up 4 to 11 percent and generally as planned.

Local bankers in the Third District are currently quoting a prime rate of 19 1/2 percent. Area contacts are anticipating a slowdown in the economy over the next two quarters which, they say, will drop the prime to about 16 to 16 1/2 percent by March.

HOUSING

Housing sales in the Third District are down sharply this month compared with year-ago levels, according to area brokers. New residential sales are reported down 50 to 75 percent from September '80 figures, while resales have fallen 25 to 50 percent. Prices are said to be softening by as much as 10 percent on new homes and by about 5 percent on resales. Mortgage rates of up to 18 1/4 percent have discouraged many buyers. Area brokers say if mortgage rates drop 4 to 6 points by next spring, their sales could increase by 25 percent.

On the construction scene, activity appears to be mixed. No new starts on detached single homes are reported, although contacts say new groundbreakings for townhouses and condominiums in downtown Philadelphia and the New Jersey shore are picking up.

FOURTH DISTRICT - CLEVELAND

Summary. Respondents in the Fourth District generally report scaling down their GNP forecasts for the third and fourth quarter of 1981 because of sustained high interest rates. Current interest rates are expected to prevent improvement in capital goods spending over the remainder of the year. Steel orders have experienced across-the-board weakness in September, caused by a weaker-than-expected economy and ample availability of steel. Although retail sales have been virtually flat, retailers and manufacturers expect some improvement in household appliances at the expense of auto sales. Housing construction remains at a standstill, with S&Ls continuing to experience heavy outflows in September.

Outlook. Several economists now expect real GNP in the third quarter of 1981 to have declined at a 1% annual rate. One, however, expects a slight gain from higher consumer spending. A capital-goods producer forecasts a slightly positive growth in real GNP in both the third and fourth quarter of 1981 because further declines in already depressed cyclical industries, especially autos and housing, are unlikely. Some expressed concern that loss in consumer confidence could have more serious dampening effects on spending than now anticipated in most forecasts. A financial economist expressed the view that interest rates are two to three percentage points higher than warranted in view of the federal funds rate, and expects money market rates to ease further as commercial credit demands weaken. Several revised forecasts of real GNP show a reduction in real GNP growth from over 3% to about 2% in 1982. Most of that growth is expected to occur in the second half of 1982, in response to lower interest rates and further tax cuts.

Capital Goods. A major reason for the weakness in capital goods spending is the sustained high level of interest rates, according to several respondents. However, several report that low utilization rates and low profitability are equally important in restraining capital spending programs. A capital goods producer notes that a large share of investment funds is going into acquisition rather than new capital. A machine tool producer reports that shipments of cutting tools in 1981, which have been supported by substantial reduction in backlogs, will exceed 1980 by about 15% in nominal terms and 6% in constant 1972 dollars. The oil field equipment industry remains among the few bright spots in capital expenditures, as even auto producers are canceling or delaying machine tool orders. A motor vehicle supplier reports that truck-related orders are very weak, and truck sales are projected to fall 3% below last year's depressed level.

Steel. A slight pickup occurred in steel orders during August and early September, but orders have since flattened. Orders, according to a steel economist, are now falling behind expectations, as the economy fails to strengthen and customers become less concerned about steel availability. Operating rates are currently between 75% and 80%, with the order intake equal to about 70% to 75% of capacity. Shipments in the second half of 1981 are expected to decline 10% from the first half levels. Some inventory building appears to be occurring at the warehouse level, apparently because of a sharp increase in steel imports. An industry economist is also concerned that a typical year-end inventory liquidation could reduce shipments below the expected 90 million tons in 1981. Shipments in 1982 are expected to increase about 3%.

Consumer Spending. Retailers generally report sluggishness in sales. Some are still optimistic over prospects for the next quarter, while some expect smaller year-to-year gains. Sales of household appliances, such as dishwashers and ranges, are weak, while microwave oven and air conditioner sales are among the few bright spots. A weak housing market will prevent much of a recovery in production and sales of consumer household goods, according to an appliance producer, but some improvement is likely in the fourth quarter if consumers decide to shift their spending pattern from autos to other durable goods. Several respondents report that inventories of consumer durable goods are low. A major national retailer, however, asserts that retail inventories in the third quarter were boosted across-the-board involuntarily because retailers generally over-anticipated sales gains. Therefore, he expects curtailment of stocks in the fourth quarter in response to moderate increases in sales and price promotions. Retail sales in the Pittsburgh area so far this year have amounted to about 1% below the national rate, according to a bank economist.

Higher auto sales since the August rebates have reduced inventories substantially, according to some area auto dealers. However, an economist with an auto producer reports that sales in September were well below their expectations. Even though inventories were reduced in recent weeks, dealers are unlikely to build stocks of 1982 models because of sluggish sales and high cost of floor plans. He expects a 5.7 million annual rate of sales for at least the next two quarters, with little prospects for recovery until the second round of tax reductions next summer. A local dealer reports that dealer margins have held steady because of less willingness to negotiate price. An import dealer reports a well-balanced 30-day supply of new cars.

Housing. Housing construction remains depressed, reports a major regional builder, with orders for custom houses well below half of year-ago levels. Consumer traffic has been off only about 10-15%, but many applicants fail to qualify for mortgage loans. A local builder has reduced his work force to a fraction of last year's levels, and fears the prospect of closing when his current line of bank credit ends in October. Several respondents expect no improvement in residential construction for the remainder of 1981, and a consumer durable goods economist is forecasting new housing starts at 1.5 million units in 1982. A housing analyst anticipates a recovery beginning mid-year 1982, even if mortgage rates were to fall to 14%.

S&Ls continues to be hard pressed by heavy outflows of funds, despite some success in attracting funds away from banks through repurchase agreements, jumbo CDs, and 30-month certificates. Losses in passbook accounts, certificates of deposit, and money market certificates have more than offset gains from repos, according to an economist for a regional FHLB in the District. September outflows are expected to be worse than August, but not as bad as the near-record losses in July. Several respondents expect the "all savers" certificate to improve the cost position of S&Ls, along with the recent decline in interest rates. Nevertheless, a sharp step-up in merger activity is expected over the next few quarters.

FIFTH DISTRICT - RICHMOND

Overview

There are numerous signs that Fifth District business activity has slowed in recent weeks. Manufacturers have experienced declines in new orders and order backlogs. Manufacturing employment appears to have softened during September after a period of significant growth. Retail sales, particularly of durable goods, have also weakened. Housing construction continues depressed and sales of houses are very slow in most areas. There remain pockets of strength in commercial and industrial construction, however. Loan demand also seems to have slowed generally. Indications at this time suggest that gross income of most District farmers this year will be well above last year's level.

The Manufacturing Sector

According to District manufacturers surveyed this month shipments held steady while new orders and order backlogs fell sharply. The performance of inventories was mixed as stocks of materials fell while finished goods on hand were somewhat higher than a month earlier. Inventories generally grew relative to desired levels, however, and now nearly 40 percent of the manufacturers surveyed feel current stocks are excessive. Survey results also suggest a reduction in employment among manufacturing respondents and the first reduction in the average work week in quite some time. Approximately one third of the respondents find current plant and equipment capacity somewhat in excess, but there is virtually no sentiment for altering current expansion plans. Survey responses further suggest, however, that much of

the weakness in the manufacturing sector was concentrated in the various consumer goods industries. Responses from such diverse industries as textiles and apparel, furniture, and consumer electronics indicate weakness. On the other hand, the primary metals, chemicals, machinery and equipment, and ship-building groups seem to have held their own.

Consumer Spending

The retail sector also appears to have slumped over the past month. Total sales and relative sales of big ticket items were reported to have declined. Indications are that durable goods accounted for much, although by no means all, of the weakness. Employment by retail respondents was unchanged to down slightly. Inventories at the retail level, exclusive of automobiles, showed little change according to our respondents. Automobile sales continue weak and inventories in that sector remain a problem. Other retail inventories are viewed as somewhat higher than desired.

Housing and Construction

Residential construction continues very weak in most areas of the District. Inventories of new and previously owned housing are substantial and, according to our Directors, are having the effect of holding the line on sale prices, at least once financing concessions are factored in. There is still evidence that commercial and industrial construction is taking up some of the slack created by the residential sector. In addition, public sector construction is proceeding as planned in most areas, as projects already funded are being pushed to completion. Several of our Directors, however, note an increasing reluctance of state and local governments to begin moving on new projects.

Financing costs and rising operating expenses are tending to cap future capital projects. There is some concern about what this portends for construction once projects now in the pipeline are completed.

The Financial Sector

According to our Directors there has been a noticeable easing of loan demand in recent weeks. Demand for home mortgages has weakened almost across the District. Weakness in consumer installment loan demand has also been widespread. There is increasing evidence of a general softening of business loan demand.

Agriculture

During the first half of the year, total cash receipts from farm marketings were 13 percent above those in the same period last year, with gains recorded in all states except South Carolina. Crop production prospects as of September 1 were even brighter than they were a month ago, pointing to significant increases over last year in the peanut, cotton, soybean, and corn crops. Marketing of a good quality crop of flue-cured tobacco continues, with the general average price 15 percent above a year ago and the value of gross sales up 21 percent. But of course final crop output is still far from certain, and the improvement in crop prospects nationally has weakened prices.

SIXTH DISTRICT - ATLANTA

High interest rates continue to undermine seriously the financial stability for a number of Sixth District businesses. The home building sector remains depressed and the forest products industry is on the brink of a major phase-down. Economic problems have caused an acceleration in savings and loan mergers. Positive developments are spotty, with an uptick in retail sales and expansion in the high-technology industries notable bright spots.

Consumer Spending and Inventories. Retail sales have strengthened recently compared with last year. Gains appear to be spread uniformly along product lines. Back-to-school sales were particularly healthy. Perhaps characteristic of the consumer's mood was the observation of one retailer that video tape recorders (clearly a luxury item) were his hottest sellers. He thinks that, since housing and auto sales have been stalled by high interest rates, more consumer dollars are being spent on retail items. Inventories were reported as being under control, but "profits have been cut back due to high carrying costs," according to several merchants. Credit card use has picked up. Retailers contacted were generally optimistic—expecting strong sales through December.

Auto dealers say that promotions offering below market financing rates have stimulated new domestic car sales somewhat. Nonparticipating agencies reported declines in sales. All dealers contacted expressed a belief that conditions were unlikely to improve over the next three to six months.

Financial and Construction. Home buying and building have been reduced to a trickle by high mortgage interest rates. A spokesman for one of Atlanta's largest savings and loans characterized construction lending as "substantially terminated." At this time of year, builders are usually restocking their inventory before winter, he

added. The only people still buying homes are those who don't have a choice such as transferees. Homes that are being sold require some type of owner financing and/or second mortgage arrangement. In northern Alabama, banks report a large overhang of unsold houses which were financed by construction loans to builders.

One response to the high cost of funds and weak loan demand has been an increase in savings and loan mergers in the District as across the country. In Georgia, a Gainesville savings and loan and one in Savannah formed a holding company that plans to expand statewide. One of Georgia's largest associations also plans to merge with three others in the state to reach combined assets approaching \$1.4 billion. A Miami-based association will combine with one in New York and California to form the largest savings and loan association in the nation. In an attempt to maintain their loan volume, some District financial institutions are seeking loans outside their immediate lending area.

Brisk activity in office and industrial construction continues throughout most of the District; however, softness in the rental market for office space is anticipated in a number of areas as buildings that were just starting up when interest rates began to soar reach completion. This softness is expected to be only temporary.

Employment and Industry. The home building dilemma has seriously affected the forest products industry. Due to lack of demand for lumber and plywood, mills are on the brink of a major phase-down. Large companies have all the inventory they can handle and small companies cannot afford to borrow at high interest rates to stay in operation. Significant layoffs have occurred as a result of mill closings and curtailments of operations. Mills in the District are concentrated in Georgia, Alabama, and Mississippi. Building supply outlet sales to residential builders have declined noticeably, a reflection of the decreased building activity. There seems little hope for a quick turnaround, since there is always less demand for building materials during the fall and winter.

Tourism traffic in Florida appears to have fallen far short of expectations. The southwest region of the state had its slowest season in ten years, off almost 25 percent from last year. At the Port of Miami, cancellations of cruise reservations are growing and attendance at major central Florida attractions has been down significantly from year-ago figures. Business lenders hope that the recently completed \$300 million futuristic Orlando Airport will help boost the central Florida tourist industry.

On a brighter note, clusters of high-technology companies are emerging in the District. Expansion has been rapid in southern Florida with its economic ties to the Kennedy Space Center and at Huntsville, Alabama, site of the National Aeronautics and Space Administration's Marshall Space Flight Center. Technology Park in Atlanta has attracted more than 40 high-tech firms to the area.

Atlanta-area employers predict an improved employment outlook for the next three months, according to a recent survey by a temporary help firm. Openings are expected mostly in the service industries.

Agriculture. Crop production prospects are much improved from 1980's level because farmers planted more acres of most crops and 1981's weather has been a good deal more favorable. Projected yields for most crops are up one-fifth or more from 1980's level; however, lingering dry weather in some areas has prevented a return to normal. Cattle producers are somewhat encouraged by the prospective abundance of feed crops, but calf prices remain 22 percent below the year-ago level. The poultry industry has also suffered with lower prices and high production costs. A strong dollar overseas has curtailed egg exports.

Quick action in Florida on the Medfly problem now appears to have averted damage to the state's crops.

SEVENTH DISTRICT--CHICAGO

Summary. Economic activity in the Seventh District shows no signs of the revival that had been hoped for by this time. Orders for capital goods have slowed further. Inventories are being held at low levels, and reduced further. Retail sales of general merchandise slipped back in recent weeks. Employment prospects are bleak, but compensation continues to rise rapidly. The housing market dropped even lower in late summer. Excellent crop forecasts reduce farm income prospects. Financial markets are strained, but credit is available to qualified borrowers. Some important district companies are experiencing severe financial problems. Despite the generally gloomy outlook, we do not detect signs of a sudden sharp drop in total activity such as occurred in the fall of 1974 and the spring of 1980.

The tax act. District executives are carefully examining the complicated Economic Recovery Tax Act to determine how it might affect demand for their products and their own investment plans. Faster depreciation, liberalized investment tax credits, and other tax reductions are expected to have a distinct positive impact on the demand for capital goods, but only after some easing of credit terms and clarification of uncertainties, here and abroad.

Attitudes. Surveys and public statements indicate that confidence of consumers, businessmen, farmers, and lenders eroded in the third quarter. For many this reflects a failure of the upturn to appear as predicted rather than a sharp decline in income and sales.

Companies in trouble. Some large district corporations are hard-pressed financially. Facilities are being closed or offered for sale, work staffs are being trimmed, payments delayed, and debts restructured.

Capital expenditures. Order backlogs of most capital goods producers are declining and further cuts in output are probable. Order cancellations have become more common. Included are equipment for agriculture, construction, railroads, trucklines, and various factory facilities. The motor industry has deferred various large projects for new products. A large nuclear power plant has been cancelled and construction of other power plants is in doubt. On the other hand, some well-financed capital goods producers are going ahead on schedule with programs for new products.

Inflation. Price discounting is reported for building materials, metals, gasoline, and some capital goods. However, most district companies are paying higher prices on average each month. Prices that are depressed currently could recover lost ground rapidly if demand strengthened.

Inventories. Stocks of steel, non-ferrous metals, building materials and various equipment components are below comfortable working levels. Nevertheless, an "inventory squeeze" is in progress under pressure from financial executives who wish to improve year-end balance sheets and reduce borrowing costs. Fortunately, low inventories reduce the chances of a cumulative recession, and improve prospects for an upturn after the turn of the year.

Employment. District employment continues to lag the national performance. New layoffs have been announced in various industries, but the real problem is reduced hiring by both industry and government.

Compensation. Increases in compensation in the district have averaged close to 10 percent this year, despite substantial unemployment. Most employers are budgeting similar increases for 1982. Some compensation increases have been much larger. Construction equipment operators recently accepted a 14 percent first-year increase after a long strike. Truckers and the steel and auto firms are pressing hard to moderate increases in

compensation, especially COLA clauses, but strong union resistance is certain.

Consumer purchases. General merchandise retailers report that sales weakened in the summer after showing strength in the spring. Weakness is "across-the-board", but has been most pronounced in big ticket items including appliances and furniture.

Motor vehicles. Sales of cars were stimulated artificially in August and early September by rebates and interest subsidies. Although inventories were reduced significantly, production schedules for both cars and trucks for the fourth quarter have been cut.

Steel. Demand for steel has ebbed and, shipment estimates have been reduced. The main cause is lower demand from the auto industry, but inventory reductions are in progress in most industries. Leadtimes are very short.

Housing. Sales of both new and used housing have sunk to an extremely low level. Many builders and subcontractors have gone out of business and others are expected to follow. Most builders are building only to order, and orders are few. An unusually high proportion of mortgage loan applications are being rejected because potential borrowers are unable to meet credit standards. The housing slump is expected to continue into next year.

Nonresidential construction. Most heavy construction in the Chicago area was halted by an equipment operators' strike that began July 20 and lasted eight weeks. Many projects will be pushed ahead with long hours at overtime to make as much progress as possible before bad weather hampers operations. Contract data suggests a decline in nonresidential construction next year.

Agriculture. Abundant summer rains raised estimates of yields on principal crops. With the exception of Indiana, prospects for the district are especially good. Corn output in the district is expected to set a new record while soybeans are likely to match the 1979 record. Depressed crop prices suggest very low earning for farmers for the second year in a row and analysts do not expect a significant improvement next year. This means continued depressed sales of equipment and other items to farmers.

Financial. Extremely high interest rates continued to dampen activity in most sectors. But credit remains available to borrowers who can meet strict standards, in contrast to the situation in the spring of 1980. Hopes for an early, substantial decline in interest rates are fading. Local analysts complain that credit demands of the federal government and the energy sector crowd out many other borrowers. The new "All Savers" certificates are being promoted actively, but little benefit for housing is expected. A decline of three or four points in long-term rates, we are told, would stimulate a surge of demand for funds for home mortgages, corporations and municipalities.

EIGHTH DISTRICT - ST. LOUIS

Area business representatives report that economic activity in the Eighth District has remained sluggish and generally unchanged over the past month. Retailers report a mixed pattern of consumer spending. Sales of apparel and other nondurables are up, while sales of household appliances are generally down. Home construction has fallen from the low levels of the previous month. Representatives of financial institutions report no major changes in either loans or deposits from the previous month. Manufacturing activity appears mixed. Area manufacturers of shoes, textiles, carpet, oil-related products and military equipment report strong sales, while sales of building materials, household appliances and primary metals are weak. The outlook for agricultural output in the Eighth District is good.

Consumer spending - Reports on consumer spending are mixed.

Department store representatives report that sales are up from last month, but still below what they had anticipated. Consumer expenditures on major appliances are down. The demand for electronic video recorders and related products was the only strength in an otherwise weak market. However, industry representatives indicate that some of the softness may be seasonal. Auto sales appeared to be strong in August, but some auto dealers reported a significant decrease in sales in the past few weeks. Consumer resistance to high prices and high interest rates was cited as the reason for the recent drop in sales.

Construction - The number of single-family housing permits issued in the St. Louis metropolitan area declined in August, and is running at about 50 percent of the level of a year ago. Industry experts indicate that

this general decline in construction worsened through September, and are forecasting very low levels of construction activity for the last five months of 1981. Nonresidential construction remains fairly strong but has shown some signs of weakening in recent weeks. The switch of insurance company portfolios from debt to equity assets was cited as a possible problem for nonresidential construction. Construction activity elsewhere in the Eighth District appears to be following a similar pattern to that in St. Louis.

Financial developments - Total loans in the Eighth District have showed marked fluctuations over the past month with no basic trend, although they are down somewhat from their levels of the previous month. Commercial and industrial loans dropped about 1.5 percent in August. Agricultural loan demand has increased in recent weeks, while consumer installment loans remain essentially unchanged.

Real estate loans declined somewhat over the last two weeks. S&L officials have indicated a reluctance to make new mortgage loans. S&Ls lending activity appears to be aimed at shortening the maturity of their loan portfolio. Most S&Ls are offering loans at below market interest rates on homes on which they hold the mortgage; however, several S&L officials indicated that even this loan activity is light.

Deposits of financial institutions have remained fairly steady over the past month. Area commercial banks report modest increases of demand deposits and a general leveling off in the outflow from passbook accounts. S&Ls report a continued, and perhaps accelerating, outflow from passbook

savings. Some S&Ls have been able to offset passbook deposit losses with high interest rate deposits which can be converted to "All-Savers Certificates" at the depositor's option. S&L officials continue to be optimistic about the prospects for "All-Saver Certificates."

Manufacturing - Manufacturing activity continues to vary greatly from industry to industry. The production of building materials, household appliances and other products particularly sensitive to high interest rates is at relatively low levels. Automobile output in the St. Louis metropolitan area remains sluggish, with no significant change reported in the past month. However, other Eighth District auto plants have reported increased production. Producers of shoes, textiles and carpet report increased sales, while chemicals appear to be steady. The manufacture of oil-related products and military equipment remains strong. Primary metal producers continue to report sluggish sales. One area steel manufacturer has closed shop because customers have failed to honor their commitments. Some manufacturers who reported declining sales over the past month indicated that they continue to be in fairly good shape due to backlogs of orders.

Agriculture - The agricultural outlook for the Eighth District remains good. Greater than average production is expected for corn, soybean, milo and rice. Crop maturity and harvesting are normal for this time of year. The topsoil moisture is adequate in most areas of the District.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District's economy was lackluster in August and early September, despite some positive developments. The positive developments were good tourist spending, strong oil and gas exploration and production, and good growing weather. But more than offsetting these positive developments were depressed levels of consumer spending on general merchandise, automobiles, and homes; a drop-off in manufacturing orders; cutbacks in output of forest products and mining companies; and weak farm prices. The overall weakness in the district's economy was reflected in a continuing slackness in bank lending.

Consumer Spending

Consumer spending for most goods and services was sluggish. Three major Minneapolis-St. Paul area retailers, who had reported a modest increase in sales at the time of our last Redbook, indicate that their sales declined slightly between July and early September. Our Bank's directors from outside the Twin Cities also report some letup in general merchandise sales. Home and auto sales have been disappointing as well. According to directors, home sales remain at the depressed levels reported in recent Redbooks. According to regional sales managers for domestic automobile manufacturers, new car sales in late August and early September were still at their depressed levels of June and July.

The only positive development, according to directors, is that the late summer tourist and travel business in the Upper Peninsula of Michigan, northern Minnesota, and Montana has been good.

Industrial Activity and Inventories

Industrial activity in the district has generally been slow. In a recent University of Minnesota survey of Minnesota manufacturers, only 36

percent of the respondents indicated increasing orders in August as compared to 46 percent reporting increases late last spring. In addition, 39 percent of the current survey's respondents reported recent inventory increases as compared to 32 percent reporting inventory increases late last spring. Our directors confirm this letup in new orders. A large Twin City manufacturer of building supplies reports that its orders declined more than seasonally in August and early September, and an Upper Peninsula of Michigan director reports layoffs at his area's manufacturing plants because of declining new orders.

The depressed forest products and iron mining industries have sunk further into the doldrums. Because of weak demand for building products, one large forest products company recently closed three mills in western Montana. Also, Minnesota's largest Iron Range taconite plant announced in mid-September that it was cutting its output by 40 percent.

Energy exploration and production has been the one bright spot in industrial activity. One Montana director, for example, states that 10 to 12 oil leases in his county alone in the last 60 days have provided considerable economic stimulus.

Agricultural Conditions

Growing conditions have improved since July. Excess moisture was slowing district crop development in July, but recent hot, dry weather has enabled most district crops to catch up. Most crops have now matured enough so that even an early, heavy frost wouldn't damage them, and district farmers are now expecting their corn harvest to be 20 percent larger than last year's drought-depressed crop.

To the disappointment of district farmers, however, agricultural prices have dropped. Since July, cash grain and livestock prices at Minneapolis and South St. Paul have either remained the same or declined.

Financial Conditions

Reflecting the sluggishness in the district's economy, lending at district banks has been slack. Bankers throughout the district indicate that loan demand remains at the weak level reported in earlier Redbooks. They attribute this to the high level of interest rates.

TENTH DISTRICT—KANSAS CITY

Summary. The Tenth District economy is showing signs of weakening, although no clear trend is evident. The primary indicators of slippage are in retail sales and housing, where reports of slowing activity and expressions of concern about the outlook have increased from a few weeks ago. Nevertheless, parts of the Tenth District continue to enjoy very strong economic activity which is primarily energy-related. These differences in business conditions across the District show up clearly in the growth rates of bank deposits and in loan demand. All-savers certificates, bankers also say, will not have any impact on the interest rates they charge. Despite good crops and some improvement in cattle prices, farmers continue to have trouble servicing their debt.

Retail Sales. Most retailers are satisfied with their current stocks of merchandise, but some are concerned that sales may weaken soon, with a resulting excess of inventories. Retail trade has picked up in some parts of the Tenth District in recent weeks, but slowed in others; sales of new cars and other durable goods continue to be disappointing.

Purchasing Agents. The aircraft and electronics industry representatives report some difficulties obtaining certain items, but buyers for other industries say supplies are plentiful. Agents report that the prices of industrial inputs average about 7 percent above those of a year ago.

Homebuilders and Savings and Loans. Sales of new homes continue to be very sluggish. Housing starts are down almost everywhere in the District including the energy-related boom towns. Homebuilders believe that they will

not see any improvement in their business until interest rates come down. Current mortgage rates average near 17 percent on adjustable rate loans. Savings and loan institutions expect the all-savers certificates to improve their inflows, which have been deteriorating.

Agriculture. Cattle producers continue to experience financial difficulties. Cattle feeders who took advantage of recent increases in fed cattle futures prices can anticipate marginal profits. Cow-calf operators appear to be retaining more calves this year than last due to favorable range and pasture conditions. The September Cattle-on-Feed report indicates increased marketings and reduced placements compared to one year ago, which should mean continued strength in fed cattle prices during coming months. An expected record corn crop should keep feed costs down and improve profit margins. The financial position of hog producers appears to be holding steady according to District bankers. The September Hogs-and-Pigs report suggests a larger supply of pork during autumn months than had been expected, so some moderating in hog prices may result.

Crop condition reports from District bankers are consistent with USDA estimates of a record corn crop and near record soybean crop. Because of late plantings, both corn and soybeans are still susceptible to a hard, early frost in some areas. Due to the depressing effect of large crop supplies on market prices, more farmers are expected to participate in government grain reserve programs this year.

Financial Developments. Reports on loan demand at Tenth District banks are mixed this month. Banks in areas where economic activity is robust due to energy-related investment spending report strong demand for commercial

and industrial, commercial construction, and consumer loans. Banks in other areas of the Tenth District report flat-to-weaker growth in these loan categories. Agricultural and residential real estate loan demand remains weak. Prime lending rates, which range from 19 to 20 1/2 percent, have declined 25 to 100 basis points in recent weeks.

Deposit growth has increased moderately in areas of the Tenth District affected by energy-related investment spending and has been flat in other parts of the District. In all areas of the Tenth District, growth in deposits is concentrated in large CD's and money market and small saver certificates; little or no growth is occurring in other deposit categories. A few banks are paying less than the ceiling rate on small saver certificates.

The majority of bankers do not expect the volume of all-savers certificates to be substantial. They think the bulk of these funds will come from current deposits, especially money market certificates. Bank respondents expect the all-saver certificates to marginally decrease their aggregate cost of funds, and to have almost no impact on lending rates, including mortgage rates.

ELEVENTH DISTRICT--DALLAS

Economic growth in the Eleventh District continues to be centered around energy and commercial construction. These two sectors account for most of the increase in business loans at commercial banks. Department stores and auto dealers report sales are proceeding briskly, but growth in consumer loans at banks remains sluggish. Durable goods manufacturers that sell in markets extending beyond the Southwest report considerable slack in production. Residential construction continues to slide, and S&L lending is extremely low. Lenders in agricultural areas are expecting a large number of carryovers this year.

Durable-goods manufacturing is expanding on the boom in output of oil field equipment. Production of durable goods that are sold nationally and internationally is considerably weaker. Steel manufacturers report much of their production is going into oil field equipment and nonresidential construction. However, they anticipate a decline in new orders from the construction industry in the fourth quarter. Orders for steel products from general manufacturing industries, already low, have declined in the last two months. A large manufacturer of hand tools reports a year-long increase in orders may have peaked in September as retailers have placed unusually small orders for Christmas. Producers of semiconductor and aluminum products report continued slumps in sales.

Housing is in critically short supply in such areas as Odessa, Texas, where drilling activity is booming. One major reason is that oil

field wages are higher than construction wages. Some families have booked motel rooms indefinitely. The lack of housing has limited the expansion of oil field services and equipment manufacturing in such areas.

Construction of office buildings, warehouses, and shopping centers continues at a rapid pace. Many municipal projects, particularly water and sewage treatment plants, are under construction to accommodate the population growth in the Southwest. These projects continue to attract bids from contractors in other areas of the country. One municipality received 52 bids on one project, compared with the usual 6 to 8.

Loans at commercial banks are advancing at an increasing rate, and deposits are rising moderately. Energy-related industries and nonresidential builders continue to account for most of the growth. Respondents report the decline in the prime rate has temporarily dampened loan demands as some borrowers anticipate further reductions in interest rates. However, many bankers expect rates to remain high in the fourth quarter as a result of heavy credit demands by the U.S. Treasury. Larger payments resulting from higher interest rates are cited as the primary factor in the slow growth in consumer loan demand, but bankers also indicate they are not actively promoting these loans. Respondents report that delinquency rates are lower than expected, but they remain cautious because the number of bankruptcies is rising in some areas. Deposit growth is moderate and is concentrated in the higher interest-bearing certificates. Bankers indicate NOW accounts continue to grow slowly with all the funds coming from demand or savings deposits at their own institutions.

New housing starts are declining. Construction loan rates are a few points above the level acceptable to most builders. Most residential building is townhouses and condominiums. Lending by S&L's is almost at a standstill, and these institutions are experiencing continuing slowdowns or declines in deposits. When loans are made, builders often are having to assume some of the interest costs. There are some indications of increasing delinquencies and foreclosures. S&L's expect "all savers" certificates to be fairly popular but see funds coming only from their own depositors--passbook savings and 6-month money market CD's. At best, they view the new instrument as an aid to reducing deposit drains.

Back-to-school sales were strong at District department stores. Sales are expected to grow into the fourth quarter despite evidence of a slowdown in the first two weeks of September. Sales of soft goods are increasing rapidly; furniture and appliances are also selling well. Respondents report inventories are near desired levels, and no special promotions are planned.

Domestic auto sales are up in response to rebates and low interest rate financing programs. Dealer financing on 48-month contracts accounts for a high proportion of sales. However, dealers expect lower sales when these programs end and the higher priced 1982 models are introduced. Respondents report inventory levels are satisfactory.

A Director reports concern is still rising over the ability of farmers in Southwest Texas and New Mexico to repay their crop loans. Commodity prices for cotton and the grains grown in that area have fallen further, and many observers are now beginning to worry that an early freeze may hurt cotton production.

TWELFTH DISTRICT - SAN FRANCISCO

Respondents in the Twelfth District report further weakness in the regional economy and express less optimism that significant improvement will occur before mid-1982. Consumer spending is slowing, except for automobiles, leading to an unwanted buildup of inventory. Unemployment has been falling in most District states, but because of a decline in the labor force rather than growth in jobs. In fact, weakness is developing in certain key industries -- such as aerospace -- where employment had been stable. District homebuilding is in the doldrums, and sales and permit activity point to a further decline. Agricultural prices have been dropping, partly due to slow overseas demand. Commercial loan demand is increasing, but because of business cash flow problems rather than improved conditions. Mortgage lending activity at financial institutions is virtually nonexistent, with rates for conventional loans now as high as 19 percent. Savings and loan associations continue to experience a sharp decline in deposits, but it is unknown whether this movement is being offset by a shift to retail repurchase agreements.

Consumer Spending

Respondents report a further slowdown in retail sales, except for new automobiles which have been bolstered by dealer rebates and internal discount-rate financing by manufacturers. Sales of expensive durable goods, such as furniture and appliances, are said to be especially slow and to be running below year-ago levels in real terms. In some areas, even retail food sales are reported to be slowing. Particularly disturbing to retailers is

the fact that the slowdown in volume -- except for autos -- is occurring even with price discounting. Reduced final demand is resulting in an unwanted buildup of inventory which could lead to further cutbacks in production as retailers try to hold down the cost of inventory financing by cutting back purchases.

Capital Spending

Respondents report that manufacturers have sharply scaled down their capital spending programs for 1981 and 1982 relative to plans formulated early in the year. These cutbacks have occurred in response to record-high interest rates, declining profits and reduced operating rates experienced thus far this year. Allowing for inflation and cutbacks in planned expansion, it now appears that most firms will experience little or no growth in real capital outlays in 1981. Even with the incentives in the Administration's tax program, respondents express little optimism that capital outlays in their region will rise significantly in real terms in 1982, unless interest rates drop sharply.

Employment

Unemployment rates throughout the region have been declining recently. But in many states, improvement has come from a drop in persons seeking work rather than growth in jobs. In the Pacific Northwest states -- where unemployment rates still range from 9 to 11 percent because of the heavy dependence of the forest-products industry on national homebuilding activity -- respondents speculate that discouraged workers are leaving the area. Throughout the District, further layoffs are reported in the construction-related industries where employment already is severely

depressed. Aerospace industry employment is beginning to weaken because of a further slowdown in commercial orders for electronic equipment and aircraft and an erosion in defense order backlogs due to delays in the Administration's new defense program.

Real Estate

Respondents express growing concern over the deepening slump in homebuilding and housing sales. Reports from all areas mention the distress being experienced by builders, realtors and material suppliers. Homes are not moving, despite reductions in prices. Mortgage loan demand at financial institutions is widely described as "dead." With the exception of a continuing boom in office building, nonresidential construction also is reported to be slowing.

Agriculture

Conditions in the Twelfth District agricultural sector appear to be less favorable than last month. Although crop production is generally reported to be good to excellent, prices for wheat, cotton, nuts and certain fruits and vegetables have been declining. Declining export demand, resulting from weakness in overseas economies and the strength of the dollar, has been responsible for the erosion in prices for some products. In the case of fruits and vegetables, fears about possible medfly infestation have caused buyers both here and abroad to be wary of California products.

Financial Institutions

Bankers report a strong increase in short-term business loan demand to support slow inventory turnover and aging accounts receivable. Loan demand for capital spending purposes has been decreasing, however, due to

unused manufacturing capacity. Mortgage lending has come to a virtual halt, apparently not so much as a result of a lack of available funds, but rather the unwillingness of potential home buyers to borrow at current high mortgage rates. In California, savings and loan associations are asking 19 percent interest on fixed rate, 30-year mortgages on single-family residences and 17.75 percent on variable rate loans. Regional S and L's continue to experience a decline in deposits, but it is unknown to what extent this movement reflects a shift to retail repurchase agreements at the same institutions.