

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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## SUMMARY\*

Deteriorating economic conditions appear to be spreading, and most respondents do not anticipate a recovery before spring, according to this month's District reports. Exceptions are energy, non-residential construction, defense, recreation, and some high technology firms. Real consumer spending has slipped, and the outlook for Christmas sales is mixed. New car sales declined sharply in October, and the depressed housing market continues to slump. Declines in manufacturing and employment are spreading, but inventory levels are generally not reported to be excessive. Bumper crops are in prospect, and farm incomes are depressed. Demand for most loans has slowed, but business borrowing is up in some districts. Concerns about a continued deterioration in the quality of loan portfolios are cited.

Consumer Spending

All districts report further weakness in consumer spending, as increases in nominal sales failed to keep pace with inflation. Prospects for Christmas sales are described as strong-to-optimistic in Philadelphia, Cleveland, Atlanta, and Kansas City and cautious-to-pessimistic in New York, Chicago, Dallas, and San Francisco. Consumer durables account for much of the current weakness, although sales of soft goods and apparel are off in Boston and Richmond. Non-auto retail inventories do not appear to be excessive in most districts.

New car sales declined sharply in October after the rebate and incentive programs expired. High prices and interest rates, a lack of new

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\*Prepared at the Federal Reserve Bank of Dallas.

models, and consumer caution are primary reasons cited for why auto sales are not likely to improve soon.

### Construction

Most districts indicate the depressed housing market continues to deteriorate. Even a softening in home prices and creative financing have failed to stem the decline in sales. Atlanta and San Francisco noted a growing incidence of foreclosures and real estate related bankruptcies. Residential builders in those districts also resorted to auctions to reduce inventories.

Nonresidential construction remains active in the Dallas District and is holding up reasonably well in Cleveland, Richmond, and Atlanta. Chicago and San Francisco report postponements in some projects.

### Manufacturing and Employment

Weakness in manufacturing is becoming more widespread, and price discounting is evident in some districts. However, output remains steady in St. Louis and Dallas, and the backlog of unfilled orders has temporarily sustained production at a low level in New York. Declines in factory output center on motor vehicles, household appliances, and construction materials. Boston and Cleveland report demand for packaging products has begun to fall, suggesting a further slowdown in the economy. Nonetheless, production of oil field equipment, defense-related goods, and recreational items remains high.

Most factory inventories appear to be within manageable limits, although semiconductor firms in California are planning shutdowns to reduce inventories, and steel producers in the Cleveland District are liquidating

stocks. Cleveland and Minneapolis note businesses are financing unplanned inventories. Richmond reports some buildups of finished goods, but Chicago indicates "pipelines are virtually empty" in various wholesale markets.

Demand for labor is softening, as evidenced by increased layoffs and reductions in hours worked. Two exceptions are St. Louis where total employment rose and Atlanta where increased demand for high-technology and communications workers continues. Chicago indicates the demand for workers may be at the lowest level since the 1930's, and many employers are seeking substantial concessions when renewing labor contracts.

#### Financial Conditions

Deteriorating economic conditions dampened loan demand in most districts, but a pickup is generally expected before next spring. Consumer and mortgage loan demands remain weak, and lackluster business loan demand is reported by several districts. Cash shortages, the poor bond market, and inventory financing are noted as key factors contributing to non-production business loan demand.

Rising delinquency rates and business borrowings to finance interest payments on prior loan commitments are causing concern for bankers in Cleveland. Signs of growing financial strain are also noted by Boston, Richmond, Atlanta, Kansas City, and San Francisco. Richmond cites increasing financial difficulties among auto dealers, farm machinery and equipment dealers, construction firms, and wholesalers.

Deposit growth is generally sluggish. Sales of all-savers certificates, although below expectations, were strong initially but generally fell off in mid-October. However, Atlanta indicates growth in

these certificates at thrifts remained rapid, and Boston and Philadelphia note renewed growth in sales. Estimates of new funds in those deposits ranged from 5 to 50 percent.

### Agriculture

Agriculture production is up, but dry weather has constrained yield prospects further in Atlanta and heavy flooding caused damage to the cotton and wheat crops in North Central Texas. Minneapolis reports wet weather has delayed corn and soybean harvests. Continued weakness in farm and livestock prices and higher production costs have severely squeezed farm incomes and are causing concern among agricultural lenders.

## FIRST DISTRICT - BOSTON

The First District economy appears to have softened in the last month. The downturn is most pronounced in the retail sector with sales falling sharply from the relatively healthy volumes of September. There has not been a comparable deterioration in manufacturing; rather the weakness that has characterized this sector since the summer has continued and become more pervasive. In banking, smaller banks serving smaller businesses are encountering increasing numbers of problem loans. The all-savers certificates have been somewhat less popular than most respondents expected; several banks have estimated that between two-thirds and three-quarters of their all-savers funds are transfers from accounts in the same banks.

The retail sector has weakened. Several "soft goods" retailers reported October sales well below the reasonably strong September, and only slightly ahead of last year in nominal terms, thus not matching inflation. The weak sales and resulting rise in inventories are visible across the board, but two department store representatives mentioned that the downturn is particularly noticeable in women's, misses, and junior sportswear. Because these lines usually contribute more than proportionally to gross margin, slack here has a greater impact on profits.

Merchants are "wary" about the next six months. They intend to control inventory investment carefully, stimulate sales with discounts and other promotional activities, and watch expenses. Because some stores began placing orders for next spring's products in August, inventory adjustments can be made only with a substantial lag and have consequences for later next year. One retailer said little change in employment is

planned because the workforce is as "lean" as is consistent with customer service and store security.

In manufacturing, signs of weakness are less pronounced than in the retail sector but longer term and more pervasive. After a vigorous recovery in the early part of the year, manufacturing activity levelled off early in the summer and has remained fairly constant--well below capacity. For many products this continues to be the situation; a local survey of purchasing managers has shown little change in the past several months. However, signs of further weakness are beginning to appear. The most dramatic deterioration has been in the already weak home furnishings business. A representative of this industry reports that at a recent home furnishings show, attendance was down 50 percent from attendance in 1980 which was down, in turn, 30 percent from attendance in 1979. He characterized this industry as a "disaster area" and predicted numerous bankruptcies in the carpet, yarn, and furniture industries. The wire and cable industry, which like home furnishings, is affected by the level of new housing construction has also begun to experience difficulties. Other products which were identified as problem areas included original equipment tires, jewelry, lumber, and belting for farm machinery. New orders for packaging have also begun to fall, indicating a more general slowdown. A manufacturer of packaging for products ranging from cookies to chemicals to medical supplies reports that sales were good through September and October, but in the last couple of weeks there has been a slowing in orders for packaging for consumer products and a marked downturn in the demand for industrial packaging.

Despite the weakness in manufacturing, all respondents reported success in keeping inventories down. Several firms have seen an increase in accounts receivable, but most respondents have been watching receivables closely and have been able to prevent increases.

Financial respondents report large inflows to the "all-savers certificates" in the first ten days of October. Interest has tapered off since then although there was some pickup in early November. Overall, the response to the all-savers has been somewhat less than expected. Most of the funds for the all-savers are transfers from other deposits within the same institution. According to three bank spokesmen, only a quarter to one-third of the all-savers at their institutions represent new money. Loan difficulties appear to be more pronounced among smaller banks serving smaller businesses. Two small-to-medium-sized banks in northern New England report that bad loans are appearing with increasing frequency. On the other hand, representatives of two of the region's larger institutions claim that, despite some problems, loan losses compare relatively favorably with last year.

Professors Eckstein, Houthakker, Samuelson and Solow were available for comment this month. Eckstein summarized his remarks at the academic consultants' meeting as follows: (1) the Fed should allow interest rates to fall with the recession but maintain a positive real rate of interest (2) the FOMC should make sure to hit at least the mid-point of the 1982 growth targets for the monetary aggregates (3) the Fed should plan seriously for use of its lender of last resort function.

Although Houthakker remains an "unreconstructed hard money man," he anticipates a considerable downturn in the economy, with the unemployment rate rising to 10 percent. In contrast to most previous recessions, the foreign sector will hinder rather than help real growth this time. He believes this will help reduce wage inflation and he expects a 5 to 8 percent increase in the CPI next year. He does not favor a formal incomes policy but recommends establishing a dialogue with labor unions to stress the implications of inflation when monetary policy limits the increase of nominal GNP.

Samuelson noted that the signs of a recession are fairly clear. The Federal Reserve has no mandate from the Congress, the Administration, or the American public to initiate or countenance another recession in the name of fighting inflation. In the interest of preserving long-run credibility--and bound by a previous commitment, however misguided--the Fed should encourage lower interest rates and allow M1B to return to within its target range. M2 growth should not deter these efforts. Notwithstanding the historical association between "old" M2 and GNP, there is no reason to expect the velocity of the part of M2 that provides market yields would be the same as its low-yield components.

Solow felt there is a good chance of five consecutive quarterly declines in real GNP. His major concern is that the Fed has been so sensitized by attacks by Secretary Regan and so intent on avoiding being perceived as "caving in" that it will be too rigid to allow the short-term easing that it normally would have done. An objective of achieving a prolonged period of minor slack in the economy does not preclude short-term

variations to lean against the cyclical winds. Solow urged the Fed to use the opportunity of "the stupid M1B being below the stupid target" to support the economy. The time has come for the Fed to abandon monetarism on the grounds that in the modern financial world "as soon as you impose a rigid target on any particular aggregate, the financial system will find its way around that aggregate." The Fed's goal should be to try to influence the economy not any particular monetary aggregate.

## SECOND DISTRICT - NEW YORK

The sluggishness in the Second District became more widespread during October. The retail sector worsened, as department store gains tapered off and automobile dealers reported bleak conditions. Manufacturing industries remained depressed. Our directors reported a sharp deterioration in business conditions nationwide, with the weakening spreading beyond housing and autos to basic industries in general and retail sales across-the-board. On the financial side, demand for business loans was high due to cash shortages and a poor bond market.

Consumer Spending

In October, growth in retail activity in the Second District slowed from the modest rise in August and September. While many stores in the New York region outperformed those in many other areas of the country, few local retailers achieved their goals. A slackening national economy, with rising unemployment and high interest rates, was blamed for the downturn. Slow sales have led to somewhat inflated inventories. Expectations regarding holiday business ranged from cautious hopes to outright pessimism.

Automobile sales slumped in October as rebate and interest rate subsidy programs expired. Even the previously strong market for used cars showed some signs of weakening. Floor traffic has dwindled as potential buyers worry about uncertainty in the economic outlook and high interest costs. Dealers attempting to minimize carrying charges are paring inventories and reducing factor orders. No improvement is anticipated before January, as the holiday months of November and December traditionally are slow.

### Manufacturing Activity

Manufacturing activity remained depressed during October. Capital goods producers reported that sales, shipments, and new orders have generally stabilized at the low levels of prior months; only one firm mentioned any additional drop. Backlogs have enabled some establishments to maintain production; but at the current rate at which these past orders are being filled, cutbacks will occur soon. Electronics and defense companies also experienced flat or slightly dampened sales, but one firm noted high demand for its aerospace products. A number of producers reported declining profits or actual losses.

Stringent control of inventories was widespread. Two companies have trimmed raw materials supplies, while others are tightening inventories of work-in-progress. Desire for cuts in stocks of finished goods was expressed, but in some cases slow sales have prevented a rapid adjustment to lower levels. Despite slow activity, some businesses seem reluctant to curb capital spending, but others emphasized only sluggishness ahead.

Plans for sizable layoffs by a major upstate manufacturer of office equipment suggest that unemployment in some localities may jump. Many concerns are relying on attrition and careful hiring practices to hold employment down. Poor economic conditions have moderated wage increases for firms not locked into pre-existing contracts.

### Economic Outlook

The outlook of our business directors changed from "wait-and-see" to outright gloom: the weakness has now spread to all basic industries, and while high technology industries and services may be holding up, they

fear a serious recession is in the making; the weakening in retail sales of department stores and mass merchandisers have left inventories at undesirably high levels and the outlook for holiday sales has turned quite uneasy. Other respondents were less pessimistic, with the fourth quarter flat to slightly down and moderate growth -- 2-3 percent -- foreseen for 1982. These respondents' current projections indicate the prime rate could fall to the 14 percent to 16 percent range by the end of the year, a larger drop than was anticipated in September. The inflation outlook is unchanged, with an 8 percent to 9 percent CPI expected for 1982 as a whole.

#### Financial Developments

Senior lending officials at the major New York City banks generally reported strong demand for business loans in the month of October. The major reasons cited for the firm loan demand were the deterioration of the long-term bond market and the dwindling cash flow of corporations. It was noted that inventory financing has not been excessive and is unlikely to create any problems in the near future. During the coming months, credit demand is expected to soften slightly as business activity declines. However, in anticipation of a short recession, bank officers also expect lending activity to pick up by the beginning of next year.

#### Final Panel

This month we have comments from James O'Leary (U.S. Trust Company) and Donald Riefler (Morgan Guaranty Trust Company):

O'Leary: Virtually all of the economic indicators are now confirming that general business activity is worsening. High interest

rates are biting. Federal Reserve policy is on the right course. There is room for the authorities to encourage a stronger rate of increase in M1B and a continuing decline of short-term rates. But such a move should be carried out with great care so that it will be perceived as being within the framework of maintaining a "steady" policy position and not one that aggressively expands money supply to head off a serious recession. I anticipate a further significant decline of short-term rates in the next few months, which would be healthy if it does not go too far as it did during the second quarter of 1980. It would surprise me, however, if long-term rates declined very much in any lasting way during the next several months due to the fact that the supply of funds for the purchase of long-term, fixed-rate bonds and mortgages is not apt to be large enough to satisfy the huge backed-up demands for such financing.

Riefler: A marked shift in sentiment has occurred and we now expect negative real growth for at least this quarter. Recovery may be slow because long-term interest rates will probably remain quite high in relation to underlying conditions. The Fed should continue its current policy along gradual easing of short-term rates -- any abrupt changes could be counter-productive by arousing fears of a rapid reversal such as was witnessed in the fall of 1980 and the spring of this year.

### THIRD DISTRICT - PHILADELPHIA

Reports from the Third District indicate a slowdown in general business activity for the month of November. Manufacturers in the District say industrial activity has dropped off quite a bit this month, but anticipate an upturn in the industrial sector by mid-1982. Local retail merchants report weak sales performance in November but are gearing up for a strong Christmas season. As for the new year, the current trend of weak sales is expected to continue with a slight pick up by next fall. In the financial sector, area bankers report sluggish loan activity. Consumer loans are down from a year ago, while C&I loan volume is slightly better, but still not strong. Looking ahead to May, Third District bankers expect modest increases in overall loan activity. On the residential construction scene, sales are off sharply again this month as high mortgage rates have discouraged many buyers. Contractors and developers are holding off on new groundbreakings until sales pick up.

#### INDUSTRIAL

Area manufacturing activity appears to have slowed quite a bit this month, according to the most recent Business Outlook Survey. About 45 percent of the manufacturers polled in November say industrial business conditions are worse than they were in October, while only about 10 percent report improvement. In terms of specific indicators, new orders have dropped significantly, for the first time in three months, with shipments down also, but to a lesser degree. Hence, backlogs continue to shrink at over 40 percent of the firms surveyed, and a commensurate cut in inventories is noted. As for labor, the situation appears to have worsened, as nearly 40 percent of the manufacturers surveyed report cuts in factory work forces and reductions in working hours.

Looking ahead, respondents to the survey are optimistic, predicting an upswing in general industrial activity by May. New orders and shipments are expected to show widespread improvement over the next six months, and, as production picks up,

many manufacturers anticipate adding to their payrolls, lengthening the workweek, and increasing capital expenditures. Despite the anticipated strength, though, manufacturers plan to keep a lid on inventories.

Inflation continues in the local industrial sector in November, according to the survey, but price hikes are less prevalent this month than they've been in some time. Just over one-third of the respondents report paying higher input costs than they did in October, and only about one-tenth say they are charging more for their finished products. Manufacturers expect inflation to rekindle in the near future, however, as three-quarters of the respondents expect to be paying more for raw materials by May and nearly two-thirds plan to raise the prices of the goods they sell.

#### RETAIL

Area retailers say sales are off to a weak start in November and little to no improvement is expected for the rest of the month. Currently, sales are running about 9 percent over November '80 levels, in nominal terms. In efforts to boost their volumes, District merchants have run big promotional campaigns, but November sales are still below expectations. Local retailers attribute the sluggishness to, among other things, unseasonably mild weather which has discouraged consumers from buying heavy winter clothing. Credit card sales are up over last year and collections are slowing but remain good.

As for the future, Third District merchants are anticipating a strong Christmas season, but are somewhat bearish about 1982. Area merchants expect the current trend of weak sales to continue into the new year, projecting sales to increase by, at best, 3 1/2 to 5 percent. As a Director of this Bank in the retail business notes, area merchants will have to fight hard for business through the spring.

Retail inventories are healthy at this point, despite November's softness.

Inventories are at peak levels now as area retailers gear up for a strong Christmas season.

### FINANCIAL

Third District bankers report sluggish-to-mixed loan activity in November. Consumer loan volume is down by as much as 21 percent from last year's figures, mainly because banks continue to take a restrictive posture toward retail lending. Business loan volume is better but still not strong. C&I loan activity is running between 8 and 11 percent ahead of November 1980 levels. In attempts to bolster their commercial loan volume, some area bankers report a nominal amount of below-prime lending. For the most part, however, business borrowing remains in line with bankers' expectations. Consumer loan activity is well below budget. Looking ahead, contacts expect commercial loans to post only modest, if any, gains of up to 5 percent over the next six months and retail loans are expected to pick up slightly as well.

Reports of deposit flows in the Third District indicate that demand deposit levels are down about 11 percent from year ago figures. Time and saving deposits, on the other hand, are up slightly and generally as planned. Demand for all-savers certificates, introduced October 1, got off to a good start, but fell short of area bankers' projections. Demand for the certificates appears to be gaining momentum again though, as contacts note a slow, steady growth in their volumes. Of the money going into all-savers certificates, 35 to 40 percent is estimated by bankers to be new.

Area bankers are currently quoting a prime rate of 17 1/2 percent. Projections of the prime over the next six months are mixed; some Third District bankers expect the rate to drop by 150 to 250 basis points, while others anticipate a hike in the rate to 18 1/2 percent by May when they expect the recovery to be underway. On October 27, Philadelphia's First Pennsylvania Bank announced that it was raising the interest rate on MasterCard loans to 19.8 percent, 4.8 points above the legal limit in

Pennsylvania. In making the move, the bank is relying on the "most favored lender" doctrine. Neither state nor federal regulators have indicated whether they will fight the move.

### HOUSING

November seasonal factors have combined with tight mortgage money to produce a further drop in housing sales this month, according to area real estate brokers. New residential sales are reported to be down 90 percent from November '80 figures, while resales have dropped by 50 percent. Prices are said to be softening, but mortgage rates of 18 to 19 1/2 percent have kept most buyers out of the market. Area contacts have cut their sales forces 15 to 20 percent and are beginning to put their own capital into their business, hoping to hold on until rates slide back down. In the meantime, contractors and developers are holding off on new groundbreakings until sales pickup.

## FOURTH DISTRICT - CLEVELAND

Summary. Economists and officials in the Fourth District see signs that weakness in economic activity is spreading, and most respondents have lowered their forecasts of real GNP growth to show sizable decline for the fourth quarter. Despite reports of spot weaknesses in capital spending, orders are still relatively strong. However, steel orders continue to be weak, apparently because inventories are being liquidated. Consumer spending in the District has deteriorated in recent months, and several respondents are concerned that pre-Christmas inventories are too high. Commercial bank lending is relatively strong for C&I loans, but is virtually flat for consumer loans. S&Ls have attracted a limited amount of new funds with the All-Savers certificate, but continue to experience weak or negative net savings flows.

Outlook. Economists who attended the Fourth District Round Table on October 30 at this bank scaled down their forecasts of economic activity for the fourth quarter of 1981 and the first quarter of 1982 from their June forecasts. The median of 31 forecasts shows only a 0.5% annual rate of decline in real GNP this quarter. However, nearly a third of the group indicated that the decline is more likely to be between 3 percent to 5 percent (a.r.), because signs of weakness are spreading and deepening. They expect some downward adjustment in inventory investment, and continued (though less severe) declines in residential construction and net exports this quarter from last. All of the forecasters expect revival of growth in real GNP by next spring; the median forecast shows annual rates of increase of 4.5 percent to 5 percent in the second half of 1982, in response to

further moderation in inflation and the second stage of personal income-tax cuts. From the fourth quarter of 1981 to the fourth quarter of 1982, the median forecast shows an increase in real GNP of 4.0 percent and an increase in the GNP implicit-price deflator of 7.6 percent. About two-thirds of the forecasters now expect money stock (M-1B) growth in 1981 will remain below the target range, and most have scaled upward their estimates of the Federal deficit for FY 1982 by \$10 to \$20 billion from their June range of \$45 billion to \$55 billion.

Capital Goods. Capital-goods producers report mixed conditions, with no recent significant decline for some goods but depressed business for others. Capital spending plans are still near their planned levels of a year-ago, according to several respondents, despite high interest rates and a weakening economy. A capital-goods producer states that heavy-duty trucks and farm equipment remain depressed. However, energy and electronics industries are expected to continue to be strong, while nonresidential construction is holding up reasonably well. Capital-goods orders, according to an economist for a major capital-goods manufacturer, are still strong, except in railroad-related equipment, auto-related metal cutting, and construction equipment. However, a small producer of industrial lift trucks reports that incoming orders are the lowest in the company's history.

Steel. Current operating rates in steel average less than 70 percent of capacity, according to an industry economist, with order intake rates equivalent to slightly above half of operating capacity. Steel consumers are attempting to liquidate inventories at a time when imports remain relatively high. The high level of orders last spring and summer

was supported by a 3 million ton inventory buildup and strong demands from the oil industry. However, steel consumers are expected to liquidate 1.5-2.0 million tons of inventory this quarter. Some forecasts of domestic steel consumption and production in 1982 show increases of a few percent from 1981, but not until after the liquidation phase is completed by next spring.

Consumer Goods. Round Table participants expect that consumer spending will weaken again in the fourth quarter of 1981, following the spurt last quarter. Some see signs that the weakness in consumer spending has spread into major household goods and even into some consumer nondurable goods. Weakness in auto sales has been complicated by the lack of new models this season, according to an auto industry economist. He also pointed out that deterioration in consumer balance sheets and a weak economy for another six months will hinder a rebound in new car sales. He asserted that high interest rates have only cost the industry about half a million sales during 1981, but that the main cause of weakness has been inflation. A local auto dealer reports sales down 20 percent over year-ago levels and down 65 percent from 1978 levels. District retail sales have deteriorated somewhat in September and October, according to a bank economist. Merchants are anticipating a pick-up in sales as the Christmas shopping season approaches, but sizable inventories may require considerable discounting before the end of the year. A producer of consumer-durable goods reports that order cancellations are occurring, resulting in substantial layoffs in some appliances. Another economist pointed out that the decline in real nondurable goods, excluding gasoline sales, coupled with a substantial drop in corrugated box shipments in the

last two months, suggests weakness in the economy is spreading and that an upper turning point in the business cycle may have occurred in August or September.

Banking. Business lending activity in the District continues to be supported in part by inventory financing, rather than merger-related activity. Bank loans are increasingly important to both large and small companies, according to a bank economist, because trade credit is scarce. Large and small companies have slowed payments, forcing some to borrow because of delinquent payments. A banker is concerned that firms may be borrowing to pay interest on previous loans. Lending activity, however, is expected to fall in the fourth quarter of 1981, as the economy weakens and businesses reduce year-end inventories. Consumer lending has been flat for the last three months, according to an area banker, and remains well below the peak of March 1980. A rise in delinquent rates on loans is causing some concern.

Savings Flows. The All-Savers certificate, intended to ease both liquidity and earnings pressures, has not worked as well as expected. A large S&L in the District reports another substantial quarterly loss in the third quarter, associated with a further rise in costs and a sharp decline in mortgage loans (55 percent below a year earlier). Nevertheless, the S&L reports that revenues exceeded year-ago levels and the All-Savers certificate experienced strong growth in early October. A bank economist reports some shift to All-Savers from money-market certificates, but cautions that much of the All-Savers growth is derived from passbook savings accounts. An economist for a FHLB in the District notes that growth of All-Savers dropped 80 percent from the first ten-day period to

the second ten-day period in October. Retail repos, which have been tied to the All-Savers, were negligible in October. All-Savers is not having much adverse effect on money-market funds, according to a bank economist, and S&Ls are unlikely to achieve sizable net savings inflows until an instrument is created to compete with money-market funds.

## FIFTH DISTRICT - RICHMOND

Overview

Most indications are that the number of soft spots in the Fifth District economy increased over the past month. In the manufacturing sector, weakness which began to develop in September has spread and become pervasive in some industries, textiles and primary metals in particular. Retail sales continue to be depressed by very weak demand for durable goods, including autos, and building materials. Residential construction continues very slow despite pockets of relative strength, but commercial and industrial construction is still lending support to the industry. Several of our Directors cite an increasing incidence of financial difficulties among auto dealers, farm machinery and equipment dealers, construction firms, and even some wholesalers. With further improvement in crop production prospects and flue-cured tobacco prices still running well above a year ago, the outlook for increased gross farm income in 1981 continues favorable.

Manufacturing

Responses from our sample of manufacturers suggest that on balance, shipments, new orders, and order backlogs all declined in October. Once again, inventory performance was mixed as manufacturers held stocks of materials at the September level but experienced some accumulation of finished goods. Total inventories remain well above desired levels. Employment and the length of average work week were also down markedly according to these respondents. Over half of the manufacturers surveyed find current plant and equipment capacity somewhat in excess, but there is still very little sentiment for altering current expansion plans. Interestingly, the diffusion of responses suggests

an actual decline in prices received by District manufacturers and a decided reduction in the incidence of increases in prices paid. Employee compensation was virtually unchanged over the month. Among individual industries, furniture and consumer electronics continue soft while the weakness in the textile sector seems to have spread significantly in recent weeks. In addition, primary metals turned down within the latest survey period. Construction related industries, particularly stone, clay, and glass products, remain very slow. District manufacturing continues to get some support from the electrical equipment, chemicals, and shipbuilding groups, however.

#### Consumer Spending

The slump in the retail sector appears to have continued through October, and may have widened. Sales of big ticket items and building materials have certainly not improved. There are indications that consumers have begun to cut back in other areas such as apparel.

#### Housing and Construction

Construction activity does not seem to have changed much in recent weeks. Residential construction continues to be generally depressed despite pockets of substantial activity. Such areas of strength, however, may have become fewer over the last month. Other construction is still holding its own in most areas.

#### The Financial Sector

Several of our Directors from the financial sector anticipate financial problems developing among businesses in their respective areas. Their comments suggest that businesses generally are under a great deal of financial

stress and that already specific problems are on the rise. Although most current problems involve auto dealers and construction firms, these Directors do not expect all future problems to be restricted to these sectors.

Farm credit conditions changed little between the second and third quarters except for a further rise in interest rates. Generally, however, conditions varied quite a bit from a year ago. Farm loan demand at banks was considerably weaker, while the availability of loanable funds was much greater. Both loan repayment rates and requests for renewals or extensions indicated significant improvement. Bank interest rates on farm loans were sharply higher. And collateral requirements were stiffer. Meanwhile, liquidity pressures facing some rural banks declined.

Our Directors in the financial sector have found that most of the funds going into "all-savers" certificates are being switched from other accounts at the same institution. Individual estimates generally lie in 50%-90% range.

### The Outlook

Expectations held by our survey respondents took a decided turn for the worse since the last survey. Almost half of the manufacturers surveyed expect the level of general business activity nationally to decline over the next six months, and nearly as many expect a similar performance in their respective market areas. On balance, even the outlook for production in their individual firms has turned negative. Very few manufacturers expect improvement at any level over the coming two quarters and no retailer surveyed foresees any improvement nationally, locally, or for his respective firm.

## SIXTH DISTRICT - ATLANTA

Economic activity appears to have slowed in the Sixth District in October. Retailer's sales have weakened. The outlook for housing remains depressed, and foreclosures of builders and real estate firms have become more common. Industrial expansion continues for the District's high technology companies while other industries have registered little growth or are cutting back operations. Inventories are being kept quite lean. Bank lending has been anemic, businessmen seem wary of the volatile interest rate situation. Yield prospects for the District's late-growing crops have been further reduced due to continued dry weather.

Consumer Spending and Inventories. Retail activity remains sluggish. Sales, for the most part, exceed last year's levels, but inflation has negated any real growth. A favorable trend that has persisted in the retail sector has been the apparent maintenance of a low level of credit delinquencies. Most merchants contacted are also experiencing a decrease in credit card sales. Retailers are stocking cautiously although we do hear some optimism about the approaching Christmas season. Some merchants, however, express fear that early shoppers will clean the shelves and reorders could be slow on delivery.

Apparently, the incentive programs offered by the auto dealers have lost their effectiveness. New car sales have been extremely slow throughout the District. Most dealers were not optimistic about near-term prospects.

Financial and Construction. The outlook for housing is bleak. Many builders do not expect substantial improvements over the next 8-10 months. High mortgage interest rates continue to stifle the housing industry and builder foreclosing has become common. The public auction of the entire 85-house \$7 million inventory of Atlanta's seventh largest builder is just one case in point. The seven-year-old firm, which had 1980 sales of \$14 million, had built a total of 900 houses originally priced from \$60,000 to \$115,000. The president of the company said that "our situation became critical in

August when a large number of buyers who had contracted to purchase homes already under construction could no longer qualify for mortgages or backed out of deals as interest rates climbed." Mortgage loans closed in Atlanta in September were down 82 percent from the year earlier figure. Moreover, in Atlanta, the apartment market is softening. Offers of \$200 rebates, free microwave ovens, and 1978 rent levels are being promoted to shore up rising vacancies.

Severe financial stress in the thrift industry persists. Growth of the small savers certificates has been rapid and there is evidence that the all savers certificate is lowering the cost of funds to the thrifts. Nevertheless, savings and loans have continued to borrow extensively from the Federal Home Loan Bank. The latest information from the Fourth Federal Home Loan Bank of Atlanta shows that advances to Georgia savings and loan associations were up 30 percent in September from September of last year.

Business loan demand has remained low in most of the District. Some bankers attribute softness in loan demand to cut-rate loans offered by auto companies. Businessmen are skeptical of the recent drop in short-term interest rates. The high costs of carrying inventories has caused most businesses to keep their inventory levels at an absolute minimum.

Employment and Industry. The building materials industry continues at a low ebb. A cement plant in Tennessee has closed part of its production line and has reduced its labor force due to slack product demand. In north Florida, lumber mills are closing due to lack of volume. A brick plant reports a very unprofitable year so far. Building supply firms also report slow sales. September, October, and November are usually good months for building and supply companies—a period when contractors normally would be starting houses, hoping to have their crews under a roof before bad weather sets in. The lumber and wood industry has been particularly hard hit in Alabama. Average weekly hours in the sector have fallen to only 36.3 in September

from 41.7 at the same time last year. In Mississippi, where the lumber and wood industry is the state's third largest manufacturing employer, hours worked in the sector have also fallen sharply.

The employment outlook for the Atlanta area is mixed at this time. Our survey of 14 of metropolitan Atlanta's largest employers gives some insight into recent economic conditions and prospects for the immediate future. It appears that the heavy durable goods industries (automobile assembly, cable manufacturing, aircraft manufacturing) have limited hiring plans at best for the near term. The service industries contacted report no hiring plans at the present time. In contrast, the high technology and communications industries are growing at a rapid pace. A manufacturer of satellite earth stations and communications equipment has added 1,200 employees in the past 12 months and is still hiring. A manufacturer of word processing equipment has also had dramatic employment gains recently.

The tourism industry is beginning to show signs of improvement following the usual post-Labor Day slowdown. Opryland in Nashville expects to equal or come close to its 1978 attendance, which was a banner year; hotel occupancies are up four percent from last year. Hotels and motels throughout Florida are receiving advance bookings for the winter season. Airlines also report heavy bookings. Because of the forced cutback of flights due to the air traffic controllers' strike, airlines are fully utilizing wide-body equipment to assure more seats in the Florida market than last year. In south west Florida, less expensive family hotels are full while large, expensive hotels have some vacancies—reflecting the fact that visitors to that part of the state are vacationing on a more modest budget.

Agriculture. Continued unusually dry weather has further reduced yield prospects for the District's late-growing crops. Reduced production combined with October's additional price declines for important crops indicate continued shrinkage in 1981's farm cash receipts and growing financial problems for farmers. Over 50 percent

of the outstanding farm loan volume of the Farmers Home Administration in Georgia is currently in a state of delinquency. Prospects seem brightest for the region's citrus producers. Production is down less than was earlier expected and prices to growers are anticipated to be substantially higher than a year ago.

## SEVENTH DISTRICT--CHICAGO

Summary. The recession in the Seventh District accelerated in the past six weeks. Virtually all sectors showed new weakness--producer and consumer goods manufacturing, construction, retail trade, transportation, services, and government. Perhaps the only sector reporting real growth is medical care, including the manufacture of hospital supplies and equipment. Signs of financial stringency in business and agriculture are widespread. Inventories are being reduced, because of poor sales in some cases, but primarily to reduce cash needs. Demand for workers may be at the lowest level since the 1930s. Price discounting is common in wholesale markets, but much less so at retail. Capital expenditure programs are being curtailed, and many equipment producers plan reduced operations and extended Christmas shutdowns. Retailers report disappointing sales of both hard and soft goods. Auto and truck output is being slashed. Housing is near rock bottom and most nonresidential construction is weak. Excellent harvests are pulling downward pressure on farm prices and farm income. Recent declines in interest rates are helping to boost sagging morale, but substantial further declines are needed to stimulate depressed sectors.

Pessimism prevails. Our last Redbook contribution emphasized the failure of expected improvements in demand to materialize. Now attention centers on cutbacks in output and spending plans. Fourth quarter shipments of motor vehicles, steel, building materials, and various producer and consumer durables will be significantly below last year's unsatisfactory rates. Reports of layoffs and plant closings, temporary or permanent, are widespread. The heaviest blows are scheduled for the mid-December/mid-January

period, preceding and following the normal Christmas shutdowns. Unlike most earlier post-1945 slowdowns, declines are not balanced by increases in employment in services and government, or by prosperity in the farm sector. In fact, these sectors are reinforcing weakness elsewhere. Despite general pessimism, most businessmen and analysts expect a revival in the future, but the timing has been pushed back to next spring or early summer.

Foreign competition. The high value of the dollar is encouraging imports and discouraging exports of various items, but particularly motor vehicles, steel, and machine tools. Demand from Europe for district producer goods is depressed. However, some companies, especially construction equipment producers, report increased demand from the Southern Hemisphere and the Middle East, partly reflecting stepped-up sales efforts.

Labor negotiations. Many district employers are demanding concessions by labor unions on wages, COLAs, medical insurance, pensions and other fringes. Some are emphasizing changes in work rules to improve productivity. Results of these efforts have been mixed, with success usually dependent on a realization that plants would be closed or activities drastically curtailed if agreement was not reached. Foreign and nonunion competition play large roles in these negotiations. Confrontations will be frequent and prolonged, especially in trucking, motor vehicles, steel, and meat packing.

Prices and inventories. Price discounting is reported in various wholesale markets, notably in steel, nonferrous metals, and building materials. Company analysts insist that the "pipelines are virtually empty". With output reduced and capacity being withdrawn, a revival in demand could bring a resurgence in price increases in these sectors. Profit margins of manufacturers,

retailers, and utilities are low or nonexistent, and prices will be raised as soon as supply and demand come into balance.

Capital expenditures. Many companies are cancelling or postponing major capital spending projects. Most prominent is the auto industry, where spending plans have been scaled down drastically. A sizable drop in interest rates would reactivate plans for many smaller commercial and industrial buildings, but the adjustment in auto industry plans reflects inadequate cash flow resulting from poor sales. Given an uptrend in demand the 1981 Tax Act will aid the eventual recovery in capital spending.

Cars and trucks. Motor vehicle sales in October dropped to new lows, and resulted in further cutbacks in production schedules for late 1981 and early 1982. Output of heavy-duty trucks has been cut very sharply. The auto industry blames high interest rates for poor sales, but high prices, lack of appeal of heralded new models, the depressed economy, and consumer caution are probably more important.

Retailing. Sales of both hard and soft goods are weak except when pushed by heavy promotions and price cuts. Credit buyers are being screened more closely. Some analysts believe that All Savers CDs and the new IRA accounts will adversely affect consumption of nonessentials. Stores have ordered cautiously for the Christmas season.

Housing. Builders see a ray of light in the recent, slight easing of mortgage rates, but even a substantial cut in rates will not help the extremely low level of construction activity this year. However, builders would begin to make commitments for materials for a fast start in 1982. Conventional financing is virtually nil. Most creative financing, in effect, cuts asking

prices on homes by as much as 20 percent, but this does not show up in published data.

Government. State and local governments have been postponing construction projects, curtailing services, restricting hirings, and even laying off workers, (unprecedented since the 1930s). The reasons include reduced tax collections, less federal aid, increased welfare claims, high interest rates, and union demands. On November 3, moreover, voters rejected 75 percent of the proposed tax increases, usually by wide margins.

Agriculture. Corn and soybean harvests are rapidly nearing completion, and production estimates have been raised further. Prospects for a large crop carryover suggest no improvement in prices, now about 20 percent below last year. Soybean exports are above last year but corn is down. Market speculation centers on the probable size and composition of Soviet purchases.

Farm land prices rose one percent in the third quarter and were 8.5 percent above last year, according to our survey, but there are signs that demand for land is weakening. Bankers report slower repayment on production loans and more extensions and renewals. Credit is available to farmers at current rates, but loan demand is slow.

## EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth District remains sluggish.

Current-dollar retail sales have tended to be stable over the past month with declining auto sales being offset somewhat by increased sales on other consumer items. Home construction dropped again in September, and this pattern appears to have continued through October. Representatives of financial institutions report some increase in total time and savings deposits as a result of All-Savers Certificates. Manufacturing activity remains steady with no significant changes in output reported. Agricultural output in the District is very good with production of most crops running well above 1980 levels.

Consumer Spending - Auto sales in the St. Louis metropolitan area declined markedly in October. Only one of the auto dealers surveyed reported an increase in unit sales, which was attributed to a heavy advertising campaign. Other auto dealers reported unit sales ranging from 30 to 50 percent below the previous month. The decline in auto sales was attributed to consumer uncertainty about the state of the economy and to the introduction of All-Saver Certificates which purportedly caused consumers to postpone auto purchases.

Other components of consumer spending appear to have increased in October. Department store representatives reported dollar sales increases up to 6 percent over the previous month. Clothing and electronic products continue to lead the sales list, and retailers report that sales of major appliances are holding steady. Nevertheless, all retailers reported that

unit sales were down as compared with the previous year and that dollar sales continue to fall short of the level they had anticipated earlier this year.

Construction - The number of single-family housing permits issued in the St. Louis metropolitan area declined again in September. Home construction is about 30 percent of normal for this time of year. However, multiple-family building permits took an unexpected sharp increase in September. Industry experts believe this increase was a response to increased demand for rental housing but indicate that it is too early to determine if it will continue or whether it will be substantial enough to help the ailing construction industry.

Manufacturing - Nearly all of the Eighth District manufacturers surveyed reported no significant change in production over the past month. Chemical, textile and clothing manufacturers reported the strongest sales, while production in building materials, electric motor, and household appliances remains sluggish. Manufacturers report changes in raw material prices over the last month ranging from -1.5 to +5.0 percent and indicate that current raw material prices are about 7-9 percent higher than a year ago. Only two of the manufacturers surveyed reported plans for increased capital spending over the next year, while none of the firms surveyed reported a significant change in inventories over the past month.

Financial Developments - Commercial and industrial loans at Eighth District reporting banks were virtually unchanged in October, while agricultural and consumer loan demand decreased somewhat.

S & L's continue to be reluctant to make new mortgage loans. Mortgage rates on new conventional 80 percent loans range up to 19 percent

plus substantial closing costs. However, some S & L officials reported that they are making some FHA and VA Loans at 16.5 percent plus points.

Area financial institutions report some increases in total time and savings deposits primarily resulting from the introduction of All-Savers Certificates. The financial institutions surveyed reported that net new deposits from All-Saver Certificates ranged from 5 to 25 percent. One S & L representative reported that only 15 percent of the All-Savers accounts which were transferred from other accounts came from passbook savings. Demand deposits at Eighth District reporting commercial banks have declined about 9.5 percent in the first three weeks in October.

Employment - Employment in the St. Louis metropolitan area increased .7 percent last month and the unemployment rate dropped from 7.8 to 7.4 percent. A shift recall at a local truck plant and seasonal variations in employment were cited as the primary factors accounting for the increase.

Agriculture - Farmers in the region are completing the harvest of a near record crop. Yields of corn, soybeans, wheat and cotton were larger than average. Prices received by farmers, however, were less than expected and net incomes are generally well below planned levels. Farm land prices are reported to be increasing at a slower rate than in recent years and, in some instances, declines have been reported.

## NINTH DISTRICT--MINNEAPOLIS .

Business conditions in the Ninth District were sluggish again in October, as they have been since mid-summer. Consumer spending on durable goods, homes, and autos continued to be weak. Industrial activity also continued to be weak, particularly in manufacturing, forest products, and taconite mining. Agricultural conditions once again were not favorable to farmers. Reflecting this sluggishness in the district's business activity, demand for loans at the district's banks remained at a low level.

Consumer Spending

Consumers continued to be reluctant to spend on durable goods in October. Sales of nondurables were good, but the decline in durables dominated. In a recent survey, four major Minneapolis-St. Paul retailers indicated that their total sales declined slightly in October, continuing the slow drop-off that began in mid-summer. Despite this weakening in sales, the major Twin Cities retailers did not report any excessive buildup of inventories. Weakness in retail sales elsewhere in the district was reported by our directors. A Wisconsin director, for example, reported that several retailers in his community recently went out of business.

Consumers also continued to be very reluctant to purchase homes and autos in October. Home sales, as indicated by mortgage loan applications at Minneapolis-St. Paul S&Ls, remained very depressed, as they have been since last spring. New car sales, according to regional sales managers for domestic automobile manufacturers, remained at September's very depressed level.

### Industrial Activity

Additional softening in the district's industrial activity occurred in October. Manufacturing orders, which were slow in September, were even slower in October. For instance, orders for building supplies and automobile parts, which were already depressed, fell further. One large Minneapolis-St. Paul manufacturer of building supplies indicated that its October new orders were 10 percent below the already depressed level that it had been forecasting. The general decline in orders for manufactured goods has spread to the district's high technology manufacturers, whose orders had been increasing until recently. According to local security analysts, the recent declines in new orders for computers and other high technology equipment were caused by sluggish capital spending and the high value of the dollar in foreign exchange. Despite the easing in orders, district manufacturers do not appear to be having any excessive inventory problems.

As manufacturing activity declined, so did activity in the depressed forest products and iron mining industries. According to directors, layoffs occurred at taconite plants in northeastern Minnesota and the Upper Peninsula of Michigan during October. These layoffs were in addition to the layoffs that were announced in September. In Minnesota, almost 20 percent of the state's iron ore workers are now unemployed. The lumber mills in western Montana that were closed last month remained closed, and several lumber mills in northeastern Minnesota and the Upper Peninsula of Michigan were also closed in October, according to directors.

Confirming this slowdown in industrial activity was the recent rise in initial claims for unemployment insurance. Minnesota's initial claims, seasonally adjusted, increased 20 percent between September and October.

### Agriculture Conditions

Agricultural producers have been hampered by poor weather and declining prices. Minnesota's harvest, according to the Minnesota Agricultural Statistics Service, is about two weeks behind its normal schedule due to wet weather. In addition, farmers experienced another month of price declines. In South St. Paul, the cash prices for slaughter steers and hogs declined 5 percent between September and October, and feeder cattle prices dropped 1.3 percent. In Minneapolis, the cash prices for corn and soybeans decreased 5.3 and 4.3 percent, respectively. Wheat prices, however, increased 1.7 percent between September and October.

One bright spot is that the district's farmers expect bumper crops. This year's corn harvest is estimated to be 22 percent larger than last year's, and the soybean crop is estimated to be 6 percent larger than it was last year.

### Financial Developments

Lending at district banks continued to reflect the sluggishness in the district's business activity. The amount of outstanding loans at Minneapolis-St. Paul area banks in October remained at the lackluster level it has been at since last spring. According to one Twin Cities banker, some of the demand for loans came from businesses that had to finance inventories that hadn't moved as fast as planned--if inventories had been moving, bank loans would have been even lower. Outside Minneapolis-St. Paul, bankers also continued to report weak loan demand in October.

## TENTH DISTRICT—KANSAS CITY

Summary. Economic activity in the Tenth District continues to soften, except where the energy and recreation industries are especially important. Retail sales, including new automobiles sales, are slow and retail inventories are somewhat higher than desired. Price increases are also moderating, however. Farm income remains under pressure from low prices for output. Loan demand at District banks is mixed, and deposit growth remains sluggish.

Retail Trade. The majority of Tenth District retailers report that nominal sales in the January-September 1981 period were only slightly higher than in the January-September 1980 period. In addition, most retailers report softness in October 1981 sales, relative to the first nine months of the year. Greatest weakness is in sales of big ticket items, such as appliances, furniture, and fine jewelry, while some strength exists in sales of women's apparel and winter clothing. Retailers note downward pressure on profit margins due to soft sales, despite only small increases in merchandise costs. All retailers indicate that current inventory levels are too high, due largely to weak sales. Excess stocks are expected to disappear by yearend, however, as most District retailers express optimism about sales in the coming holiday season.

Automobile Sales. Tenth District Automobile Dealers Associations report auto sales markedly below last year at this time, with the exception of Oklahoma where a strong economy is supporting an increase in sales of over 10 percent. High interest rates continue to plague the industry, forcing dealers to carry low inventories which may also be having a depressing effect on sales. While financing is available, fewer people are able to afford the high interest rates

and larger downpayments required by banks carrying auto loans. Auto sales for the remainder of the year are expected to be slow unless interest rates decline and the economy strengthens.

Agriculture. The agricultural situation in the Tenth District continues to appear depressed with little prospect for improvement by the end of the year. There is little prospect for improvement in farm income levels for 1981 as compared to 1980, given the continuing low prices received by farmers for both crops and livestock. Despite excellent pasture and range conditions throughout the District, most cattle producers do not intend to hold calves or feeder steers through the winter. Although cattle prices are expected to increase by spring, most ranchers are marketing their calves now in order to meet their current debt obligations.

The availability of credit does not appear to be a significant problem at most District banks, and credit from agricultural merchants and dealers continues to be available in most areas. However, concern is being expressed over the creditworthiness of borrowers. Persistent low commodity prices, for both crops and livestock, coupled with the high cost of borrowing leads to continuing repayment difficulties for farmers. District bankers estimate that in 1982 the number of agricultural customers no longer creditworthy will be twice as large as in a normal year.

Financial Conditions. Reported loan demand at Tenth District banks is mixed this month. Commercial and industrial lending is strong where energy or recreation industries are important, but only stable or up slightly in other areas. Very little demand is reported for real estate loans, except for commercial real estate lending in those areas with healthy economic activity.

Agricultural and consumer loan demand remained essentially flat in recent weeks. Prime lending rates have dropped 150 to 200 basis points in the last month to the 17 1/2 to 18 percent level. Several banks report more stringent lending policies, with greater emphasis on the creditworthiness of the borrower.

Deposit growth at Tenth District banks remained sluggish in the past month, despite the introduction of the all-savers certificates. Volume on these certificates is reported as mixed. New money comprised 17 to 30 percent of the total, with the remainder of the funds for the all-savers certificates usually coming from a different account within the same bank. Demand deposits, and consumer time and savings deposits subject to fixed ceiling rates, declined in most areas. NOW accounts, money market certificates, and small saver certificates at most banks displayed stable growth. Large CD growth is up in most areas, particularly those where the level of economic activity is high.

## ELEVENTH DISTRICT--DALLAS

Economic expansion in the Eleventh District continues, although at a slower pace. Activity in energy and nonresidential construction industries is moderating at a high level. Output of oil field equipment and apparel is high, but demand for other manufactured goods is weakening. Department store sales are weakening, auto and truck sales are off substantially, and residential construction continues to decline. Heavy rains in North Central Texas are resulting in crop losses. Loans and deposits are rising more slowly than last month. The all-savers certificate is causing time deposits to be the fastest rising category of deposits at commercial banks and stemming deposit outflow at S&Ls.

The pace of oil field activity is moderating, but record drilling levels are forecast for next year. Recent wet weather has slowed drilling in Texas and Oklahoma. Tight supplies of tubular goods are easing as foreign pipe mills with spare capacity are increasing shipments to U.S. oil fields. Prices for used drilling equipment are showing signs of softening. High wages in the oil industry continue to attract labor from other industries. For example, a Midland apparel plant closed after much of its work force found higher paying jobs in the oil fields.

Nonresidential construction remains strong, but the number of new projects announced is declining. A surplus of office space is anticipated in some urban areas next year. New housing starts are declining, despite rises in the number of townhouses and condominiums being built. Apartment occupancy rates are very high. Rents are increasing at rates from 8 to 10 percent per year and faster increases are expected.

The pace of manufacturing output overall is steady, but demand varies widely from industry to industry. Producers of oil field equipment continue to operate at full capacity and expect demand to remain strong through next year. Apparel manufacturers report record orders for deliveries next spring. Production of defense-related electronics and aircraft remains high, but a slowdown in orders for commercial aircraft is resulting in some excess capacity and layoffs in the industry. Output in refining continues to decrease, and producers of petrochemicals are cutting production in response to the declines in orders from the auto and housing industries.

Department store executives report a slowing in sales and expect little improvement for Christmas. Inventories are above plan, as current sales are below expectations and Christmas merchandise is arriving. Apparel is selling well, but sales of appliances and home furnishings are low.

Automobile dealers describe the drop in vehicle sales as "dramatic" and expect no significant turnaround before spring. Light truck sales show the sharpest decline. Fleet sales and sales of imports and used cars are also down. Inventories are above desired levels, and dealers are cutting orders for the remaining months of this year.

Heavy rains and flooding have caused crop losses in North Central Texas. Preliminary estimates of damage to cotton and wheat crops total about \$25 million in a 13-county area. Slight damage in other areas appears to have been more than offset by the beneficial effects of increased moisture on pastures and crops.

The growth in loans at District banks and S&Ls is easing. Demand for business loans continues to be greatest in the energy and nonresidential construction industries and weakest in nondurable goods manufacturing and retail trade. The volume of consumer loans is declining, and the use of bank credit cards is below average for this time of year. Bankers anticipate widespread use of variable interest rates on consumer loans next year. Mortgage lending at S&Ls remains low.

Deposits at commercial banks are rising at a slower pace than in September. Growth is strongest in IPC time deposits and is attributed to the all-savers certificate. S&L's report continued loss of deposits to money market mutual funds. The all-savers certificate is described as mitigating the pace of deposit outflows at S&L's but is expected to have little impact on mortgage lending. Respondents at both types of financial institutions say the moderate growth in deposits in all-savers certificates is meeting their expectations and attribute about one-quarter of the growth to new funds.

## TWELFTH DISTRICT - SAN FRANCISCO

Twelfth District respondents report that economic activity has slowed considerably over the past month. Consumer spending has dropped, particularly for durable goods. In the manufacturing and mining sectors, layoffs and production cutbacks have increased and spread to more industries. The slump in District homebuilding activity and home sales has deepened. Farmers are experiencing financial strain as a result of rising costs and declining commodity prices. Commercial and consumer loan demand has slowed due to the shelving of capital investment programs and reduced consumer spending. Mortgage lending activity at financial institutions is still extremely slow. Banks face intense competitive pressures from higher-interest bearing market instruments.

Consumer Spending

Respondants report a further slowdown in retail sales, with most of the decline occurring in durables. Sales of new automobiles have dropped sharply from the September pace and are running far below the year-ago level. Respondants attribute the drop to the price-sensitivity of consumers and their uncertainty with regard to the future. Now that dealer rebates have been eliminated and higher-priced 1982-models introduced, new cars sales have once again slumped. Sales of lower-priced used cars in contrast are strong. Purchases of other expensive durable goods, such as furniture and appliances, also have slowed and are running below year-earlier levels in real terms. Sales of apparel and other nondurable goods are reported to be holding up better than durable goods. Retailers generally expect a slow Christmas season.

### Manufacturing and Mining

Respondants report further cutbacks in production and employment among industries that already were depressed--such as construction, lumber and metals. They trace this growing weakness to the deepening slump in the homebuilding, automobile and appliance industries which comprise the major national markets for these regional products. Western lumber production continues to drop and is currently running about 40 percent below the 1978-peak. Copper producers in Arizona and Utah are cutting production. The aerospace equipment manufacturing industry has been cutting employment as a result of a further slowdown in commercial orders. New orders for jet transports have slowed to a trickle due to the poor financial performance of the nation's airlines. Semiconductor firms in California are planning extended shutdowns during the Thanksgiving and Christmas holiday periods to reduce excess inventories accumulated as a result of cutbacks in business equipment spending. Industries that had been expanding--for example, the paper industry--have begun to cut back production, indicating that weakness in demand is spreading.

### Real Estate

Respondants report a further slowdown in homebuilding activity and home sales, from already severely-depressed levels. They cite numerous indications of the financial distress being experienced by builders and realtors as a result of the depressed residential market. These include a growing number of incomplete projects, foreclosures and business failures. Homes are not moving, despite reduction in prices and the "buying down" of market mortgage rates by builders. As a result, a growing number of builders are resorting to auctioning to dispose of property. Non-residential construction also is reported to be slowing as firms shelve planned capital investment programs.

### Agriculture

Twelfth District farmers and ranchers are finding it difficult to keep up with inflation. Harvests of nearly all major crops are up sharply from 1980-levels. But prices for a wide range of farm products--including cattle, wheat, cotton, nuts and certain fruits and vegetables--have been declining and in some cases are running below year-ago levels. Faced with higher than year-earlier production and interest costs and lower commodity prices, farmers are experiencing a severe cost-price squeeze. Bountiful harvests and declining export demand--resulting from weakness in overseas economies and the strength of the dollar--have been responsible for the erosion in prices for some products. In the case of fruits and vegetables, fears about possible Medfly infestation continue to reduce demand and prices for California products.

### Financial Institutions

Bankers report a slowdown in overall loan growth in October. Commercial and industrial loan demand for capital spending purposes has been decreasing due to growing excess capacity. Real estate borrowing has picked up slightly but is still very low compared with previous years. Consumer borrowing from banks is reported to be extremely slow due to tight credit terms and cautious consumer buying patterns. The money market mutual funds continue to siphon off bank deposits. A few large banks have been attempting to retain deposits by offering cash management services to large commercial customers. But these innovations are not yet a widespread phenomenon among various sized banks and customer groups. The All Savers Certificate is believed to have merely transferred low-cost savings balances to higher-cost instruments within the same institutions.