

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

June 23, 1982

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SUMMARY*

Overview: Reports from the twelve Districts suggest that on balance the economy may have reached its trough but few signs of recovery are seen. Only Atlanta, St. Louis, and Kansas City report signs of improvement. Other Districts report either flat or deteriorating conditions. Retail sales improved in May but were mixed in June, and retailers remain very cautious. Manufacturing activity remains depressed with new production cutbacks seeming to outweigh the few production increases. Additional, although slower, inventory liquidation seems likely. Construction, mining, and agriculture remain weak. There are some signs that inflation continues to abate. Consumer and real estate lending is weak, while business loan demand is mixed. Bankers are concerned about delinquencies and loan quality.

Retail Sales: Retail sales improved in May but were mixed in June and retailers are cautious about the second half. The May improvement reported by most Districts was mostly in non-durable goods. Sales of household durable goods generally are weak, except in San Francisco. Several Districts report sales gains were achieved only because of strong promotions and large markdowns. Discount stores are doing better than full-price stores. San Francisco, St. Louis and Minneapolis report improvement in car and/or light truck sales, but Dallas reports car sales fell after GM's low interest rate promotion ended. Some Districts report continued improvement in early June while others report retail sales falling back from their May levels. Retailers are at best cautiously optimistic about sales for the second half. They are reported to be conservative about ordering goods and keeping a tight

*Prepared at the Federal Reserve Bank of Cleveland.

rein on inventories. While some look for sales to increase in response to the tax cut and social security increase, others expect consumers to emphasize saving and paying down debt.

Manufacturing and Mining: Manufacturing activity generally remains depressed, with new production cutbacks seeming to outweigh the few production gains. Most Districts report either declining or flat orders, shipments and backlogs. Some increases in motor vehicle production are reported, but production of steel and machinery is depressed. Dallas reports firms selling to the petroleum industry are making particularly large cutbacks. Paper production is still being cut but lumber production has stabilized at a depressed level. San Francisco reports cutbacks in commercial aircraft and electronic equipment production more than offset gains in aerospace defense equipment.

Reductions in mining activity are widespread. Minneapolis reports sharp curtailment of iron and copper output, a modest reduction in coal production, and oil and gas drilling activity at less than half the year-ago level. Dallas reports oil drilling rates are low, but increased slightly at the beginning of June. San Francisco reports copper and silver mine production at 50 percent of capacity.

Inventories: Many firms have reduced their inventories to desired levels, but there are widespread reports of continued liquidation, and few reports of plans to build inventories. Most Districts report retail inventories are at desired levels but some suggest inventories are still on the high side. Retailers are reported to be extremely cautious about building inventories. Cleveland reports that liquidation of inventories of consumer goods and some industrial products "has probably run its course" but further liquidation of inventories is likely in primary metals and capital goods.

Other Districts generally report significant proportions of manufacturers still planning further reduction of inventories. Richmond reports nearly one-third of manufacturers still view inventories as excessive, and Boston reports many manufacturers plan to reduce inventories over the next three to six months. Dallas reports many firms have excess inventories, particularly those selling to the petroleum industry. Philadelphia reports the pace of inventory liquidation is tapering off from May's peak rate of reduction.

Construction: Most Districts that commented on residential construction report very low levels of activity with no indications of improvement. Two exceptions are Dallas, where starts are "up strongly from April," and San Francisco, where homebuilding "appears to be picking up," albeit from a post-World War II low.

The outlook for commercial construction is weakening. New York and Chicago report postponements of new projects and Dallas reports a decline in the number of new project announcements. Softening in office rental markets is reported by New York, Atlanta, Chicago, and San Francisco.

Agriculture: The situation in agriculture is generally gloomy. Grain prices are depressed while input prices continue to rise. Low farm income, high interest rates, and falling land prices make financing difficult. Financial strains are reported by Atlanta, St. Louis, Dallas, and San Francisco. Several Districts report spring planting delayed by wet weather. A bright spot for farmers is livestock prices, reported up by St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.

Inflation: There are some signs that inflation continues to abate. Prices in department stores are reported to be sharply discounted in most Districts. San Francisco reports food supermarket price wars. Commercial property rental markets are soft in some Districts. Chicago reports

construction project bids "10 to 20 percent below estimates," and sharp price discounts in building materials and paper prices. Prices for basic metals and grains also are weak. Manufacturers in the Richmond District report declines in prices paid and received in the past month. Chicago reports "unilateral cuts" in salaries of nonunion employees and negotiations with unions to adjust compensation and work rules. Philadelphia reports industrial prices stabilized in May and June. However, prices of livestock and crude oil are rising.

Financial Conditions: Consumer loan demand is generally weak and business loan demand is mixed. Bankers are concerned about delinquencies and loan quality. Little, if any, growth is reported in bank consumer lending. Loans to finance purchases of automobiles are reported to be constrained by usury laws. No strength is reported in real estate lending.

Business loan demand is reported strong in some Districts and weak in others. Where strong, it is variously described as distress borrowing and as a substitute for tapping the bond market, but there is little indication of borrowing for plant expansion. Several Districts report bankers are concerned with the quality of existing loans and are very cautious about the quality of new credits. Delinquencies have risen, and San Francisco reports concern about the "level of nonperforming business loans, particularly to the construction, forest products and aerospace industries."

FIRST DISTRICT - BOSTON

There is a sharp dichotomy between the recent experience of retailers in the First District and that of manufacturers. Retail sales in the past month have been good and compare favorably with sales a year ago. The firms contacted are looking forward to the widely predicted pickup in consumer spending in the second half of the year. Manufacturers, on the other hand, have become more pessimistic. Business continues to be very poor. The rate of decline seems to be slowing, but there are no signs yet of an upturn.

Retail

Retailers in the First District have become more bullish. The firms contacted reported that, in spite of the recession, sales growth over the year exceeded the rate of inflation and either matched or exceeded the growth projected in their business plans. One firm, which had run an extra circular promotion, achieved an increase in New England sales in May of 19 percent over May last year. Another experienced growth over the year "in the high single digits"; sales were particularly strong in New Hampshire and Rhode Island. Persistent rains have not hurt overall sales much, but have reduced sales of swimwear and other items traditionally sold at the beginning of the summer. Most of the firms contacted are cautiously basing business plans on the widely reported forecast of a pickup in consumer spending in the second half of the year.

A representative of a major department store said that prices of purchased stock are becoming more attractive. Since the store maintains a

constant markup, prices to the consumer will improve. Another retailer expects price increases to slow over the next several months, as earlier reductions in energy prices filter into the transportation component of retail costs.

Manufacturing

Gloom pervades the manufacturing sector. The firms contacted were almost unanimous in describing business as very poor. Several expressed great concern about the deterioration in corporate balance sheets, with the chief economist of one large firm suggesting that today's high interest rates are justified to a significant degree by the decline in business coverage ratios and the resulting increased risk to the lender.

The rate of decline in manufacturing appears to be slowing, however. In a May survey of New England purchasing managers the percentage of firms reporting decreases in orders and backlogs was lower and the percentage reporting no change was higher than in the March and April surveys. However, more firms still reported that orders and backlogs declined than reported increases. Among the firms contacted directly, a group including firms in the rubber, chemicals, appliance, electronics and aircraft industries, most thought that orders and shipments had stabilized. However, almost no one saw signs of a pickup and a few firms continued to suffer decreases. A designer and manufacturer of process industry control systems, which had not felt the recession as recently as March, has now seen a definite slowing in orders and a rise in cancellations. These systems reduce costs at existing facilities, rather than add to capacity; so the cancellations suggest that firms in the process industries are having difficulty justifying even cost-saving

investments.

Reports of increased sales were very few and were usually contradicted. Thus, one manufacturer of specialized printing equipment and supplies reported a pickup in demand, while a firm in a closely related industry reported a decline. A third manufacturer of printing equipment said that there had been a slight upturn earlier but business was now levelling off, still well below plan. Also, one very large manufacturer of electrical equipment saw the beginnings of a recovery in Europe; however, another firm described Europe as "dead and getting deader". The defense business is the only area about which reports are consistently positive.

The manufacturers contacted directly were generally satisfied with recent inventory levels. However, the survey of local purchasing managers showed a substantial fraction of firms planning to reduce inventories over the next three to six months.

Professors Eckstein, Solow, Samuelson, and Houthakker were available for comment this month. They all believe that a weak recovery will begin soon, although Eckstein and Samuelson emphasized the downside risks to their forecasts. They differed, however, on whether the Fed should nurture the recovery by permitting the monetary aggregates to grow outside their target ranges.

Eckstein and Solow both believe that the Fed should not apply the monetary brake because interest rates are remaining at unacceptably high levels. Eckstein emphasized that continued high interest rates could neutralize the stimulative effects of the July tax cut, thereby aborting the recovery and dragging the economy into a deeper recession. He is especially alarmed by the devastating impact of high rates on business

fixed investment. In his view capital spending will be considerably weaker during the remainder of the year than indicated by the Commerce Department's most recent plant and equipment expenditure survey.

Solow agrees that, given current economic conditions, the Board should "intelligently lean against the wind" by easing monetary policy. He cautioned that a decline in interest rates per se would not necessarily indicate that the appropriate degree of easing had taken place. Monetary policy could still be too tight if the decline in rates were caused merely by prolonged economic weakness. At the same time, he acknowledged that a dramatic return to rapid monetary expansion would risk rekindling inflationary expectations.

Samuelson, although sympathetic to Eckstein's and Solow's position, nevertheless urged the Board to "make some semblance of an attempt" to attain the high end of its targets. He argued that "monetarists have so mesmerized Wall Street" that failure to do so would raise fears of a new round of inflation and therefore keep real interest rates from falling. Nevertheless, if economic conditions continue to deteriorate through the summer, which he believes is a distinct possibility, then he would consider abandoning the targets.

Houthakker recommended that the Board stay at the upper limits of its target ranges in order to preserve its gains against inflation. However, he urged a cautious approach to the targets, given the probable weakness of the recovery and the randomness of movements in the aggregates. He believes that adherence to the targets would keep pressure on Congress to reduce proposed budget deficits. Solow believes that for political reasons "Congress has gone about as far as it can go" in trimming the deficit for fiscal year 1983.

SECOND DISTRICT--NEW YORK

After holding up fairly well earlier in the recession, the economy of the Second District appeared to be weakening in May and early June. The unemployment rate for the region remained below the nation's, but there were signs of deterioration in many sectors and localities. Indeed, we were unable to find any concrete indications that an upturn had begun. Many of the gains scored by retailers in May could prove short-lived as early reports for June showed a decrease at some stores. Poor conditions generally prevailed in the residential construction sector. Nonresidential building was still brisk, but the outlook was uncertain as softness in the office rental market persisted. There was no letup in layoffs in the manufacturing sector and some producers noted sharp declines in their business. It was therefore not surprising to find business leaders generally more pessimistic than last month with few looking for any recovery before year-end.

Consumer Spending

Retail activity increased in May, as many department stores finished the month above plan. The improvement could be short-lived, however, as some firms reported a weakening of sales in early June. Promotional activity was heavy throughout this period. Overall, nondurable goods generally sold well despite a softening in apparel sales at a few stores; sales of big ticket items like home furnishings stagnated. While inventories did not pose serious problems, stocks at some stores tended to the high side. Some retailers continued to expect the tax cut and social security increase to spur sales during the second half of the year.

Construction and Real Estate Activity

Residential construction remained depressed with sales and starts substantially below year-ago levels. As in our last report, observers noted some positive signs. In New York City, sales of existing homes were still brisk in Queens, and sales of cooperative apartments in small buildings improved in Brooklyn. In suburban areas, condominium construction increased modestly, and "buy downs" stimulated some homebuying.

The outlook for nonresidential construction weakened. Many developers throughout the District postponed groundbreakings for new buildings, but ongoing projects, like Battery Park City, are likely to sustain a high level of construction for the next few years. The office rental market was soft again this month in both city and suburban areas, enabling lessees to negotiate more favorable terms. Possibly foreshadowing further weakening of the midtown market, two firms--one in advertising and one in publishing--resisted large rent hikes by moving from prime space to less costly parts of Manhattan. Nonetheless, most respondents believed the office market was fundamentally sound. Demand for space was expected to grow rapidly as banking and the international sector in general expand further.

Business Activity

Business conditions varied widely across the region. Some previously strong areas, such as Syracuse, reported a softening and those already hard hit, such as Buffalo, deteriorated further. Although the rate of unemployment was essentially unchanged and still below the nation's, announcements of new workforce reductions continued. In

industries such as oil and steel, firms shut down plants, some permanently. Companies postponed or even cancelled capital expenditure plans, as capacity utilization fell and interest rates stayed high. For many producers business distinctly worsened. For example, a ball bearing manufacturer reported that new orders fell to only 10 percent of the level of a few weeks previous and were running below cancellations. Similarly, a furniture producer which had been prospering at the previously resilient luxury end of the market found that the demand for its goods had collapsed.

Outlook

Business leaders, except for retailers, turned more pessimistic, and few looked for any upturn before the end of the year. As economic conditions have weakened across the region, hopes for an early turnaround have faded. Respondents from such previously strong areas as Rochester and Long Island are voicing much more concern than before, although their gloom does not approach that reported in Buffalo.

The price slowdown continued, but contacts expressed little confidence in its permanency. Once demand picks up, prices are expected to rebound as firms restore profit margins. A more encouraging sign on the price front was the apparent moderation in wage settlements, with reports of increases in the 6 percent range not uncommon.

Financial Panel

This month we have comments from David Jones (Aubrey G. Lanston & Co.), James O'Leary (U.S. Trust Co.) and Robert Stone (Irving Trust Co.):*

Jones: Three factors are tending to prop up interest rates, despite still pronounced recessionary tendencies. First, a commendably tight monetary policy. Second, heavy Federal government credit demands associated with an excessively loose fiscal policy. Third, large "desperation" business borrowing as profits-strained business competes with the Federal Government for funds to finance excessive inventory stocks, interest payments, wages and salaries and other necessities. The upshot is likely to be continued high interest rates through most, if not all, the remainder of 1982. Also, there could be mounting business failures, and major financial strains in the commercial paper and Eurodollar markets which could operate to virtually cut off financing to less credit worthy borrowers. Paradoxically, it may be that significant interest rate relief will not come until sustained economic recovery gets under way in 1983. Only then will business (those that survive the recession are likely to be lean, cost efficient, and highly productive) be able to generate sufficient profits to be able to pay off short-term debt.

O'Leary: During the balance of the year the political and public pressures on the Fed will intensify to an alarming level: (1) the current increase in interest rates, if it continues and is sustained, may deepen the recession or at least postpone any significant recovery; (2) the financial side of the economy is a minefield and "crowding out" is a serious danger; (3) the Fed does not have much room to maneuver before it begins to lose its credibility; (4) the widely expected bulge in money supply in July will present

*Their views of course are personal, not institutional.

a very difficult problem for the Fed; (5) the fear remains high the huge Federal deficits and excessively easy credit will sooner or later lead to a new upward ratcheting of inflation; (6) the long-term capital market is especially vulnerable--due in part to the changed position of the life insurance companies it has lost much of its stability and is much more susceptible to wide swings in psychology.

Unfortunately, the Fed has very little option and must adhere quite closely to its targets even if in the near term they contribute to a rise of short-term rates, prolongation of the recession, and intense political pressure. If instead the Fed permits the monetary base to expand at the rate it has increased so far this year or even higher, the result will be a sharp increase in interest rates in any event, especially long-term rates. Adherence to the monetary targets will keep the heat on the Administration and Congress to hold down the Federal deficit, which is where the real policy problem lies, not with Federal Reserve policy.

Stone: The economy has reached bottom and activity has begun to turn up or will soon do so. Recovery is likely to be moderate however, and should interest rates not decline it may abort in late 1982 or early 1983. The market's focus is currently on the possibility of another bulge in the aggregates in July and on the large Treasury financing needs that loom ahead--all against the background of the heightened state of uncertainty in the aftermath of Drysdale. With all of this, it seems to me the appropriate course for the Fed is to hold to its present nonborrowed reserves path and to let borrowings rise to meet the increase in reserve requirements associated with the July bulge in the aggregates should it occur. But in view of the very fragile state of the market I believe the Fed should temporarily speed up the provision of nonborrowed reserves if the rate increases that would accompany such a rise in borrowings should seem disorderly or excessive.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District are mixed in June. Reports from the industrial sector continue to point to a bottoming out, but signs of growth are few and far between. Industrial prices continue to reflect that sluggishness. Retail business is sporadic, with large gains in May being offset by a weak June. In the financial sector, bankers say business borrowing is strong and deposit flows are reasonably good.

As for the future, Third District businessmen are optimistic but cautious. Manufacturers anticipate a pickup over the next six months, but not one strong enough to warrant increased capital spending or significant inventory building. Retailers seem to agree. They project some gains, but none large enough to really signal a recovery. They, too, plan to keep the lid on inventories. Area bankers have mixed views about business over the next six months, mostly as a result of widely variant interest rate forecasts.

MANUFACTURING

Manufacturers responding to the June Business Outlook Survey say their industry is still in a lull. Industrial activity has remained virtually unchanged for four consecutive months now. A note of encouragement comes from the durables sector, however, which appears finally to have stabilized. Specific indicators show that new orders and factory shipments both posted small gains in June. As a result, the pace of inventory liquidation, although still significant, has tapered off somewhat after reaching a two-year peak in May. Labor's situation has not improved, however, with cutbacks in payrolls and working hours still being reported.

The dampness of the current business climate seems to have only slightly affected survey participants' outlooks; about 70 percent still see clear sailing ahead. There is widespread anticipation of gains in shipments and new orders between now and year-end, and manufacturers are planning to expand both their work forces and the length of the average workweek to some degree. Respondents also predict an end to the

inventory run off, but are not projecting a recovery strong enough to warrant a serious increase in plant and equipment spending.

Industrial prices, which were stable in May, are holding steady in June too. And, while some area manufacturers foresee some renewal of inflation over the next two quarters, at least some of the present price sluggishness is expected to persist. In June, a larger portion of respondents than at any other time since the last months of the 1973-75 recession say that both raw material costs and finished good prices will remain steady through the balance of 1982.

RETAIL

Area department stores turned in a strong showing in May, but primarily as a result of heavy promotion. Sales through the first half of June have been fairly slack, and May gains, some as high as 12 percent, are being partially offset. Even so, year-over-year gains for the May-June period are expected to be in the neighborhood of five percent. Reasons for the current dampness in department store sales include unseasonably wet weather and a "DON'T buy now" consumer psychology, a sharp contrast to a few years ago when the public believed in "buy now" to avoid price hikes. With the inflation rate down, consumers now tend to put off purchases and wait for price markdowns. As a result, retail margins are under the gun.

Looking ahead to the balance of 1982, retailers are very cautious. Although some small sales gains are anticipated, merchants generally don't predict a strong surge until at least the fourth quarter. The tax cut and Social Security increase are expected to go into further rebuilding of balance sheets. As a result, retailers are keeping very tight stocks, to the point of causing some spot shortages of certain goods. No plans for inventory building are evident.

BANKING

Third District bankers say retail borrowing is still off substantially from a year ago, but business loan volume is strong. Reports this month put current C&I loan volume from 8.5 to 12.5 percent ahead of June 1981 levels. Much of that strength, according to contacts, comes from businesses barred from the bond market by the high cost of long-term capital.

Bankers' views on interest rates have turned mixed since the last Redbook, and some now believe we've already seen the trough of the current interest rate cycle. Forecasts of the prime, which now stands at 16.5 percent, range from a 250 basis point drop between now and year-end to a 200 basis point increase by that time. Uncertainty over whether the Fed will bring monetary aggregates into line with targets seems to be the source of the variance in the forecasts.

Loan demand forecasts for the next six months depend heavily on the direction of interest rate movements. With slack demand for retail inventory financing expected and a possible end to stress borrowing, some bankers believe that a further decline in rates, drawing customers to the bond market, would cause the bottom to drop out of the commercial loan market. Without that decline in interest rates, though, loan volume will probably hold up, they say.

Deposit flows in the Third District are mixed but improving. Demand deposits have been picking up at major banks recently, but are still about 3 percent off on a year-to-year basis. Time and savings deposits are ahead of year-ago levels by about 11 percent. Sales of both 91-day money market certificates and 42-month ceiling-free deposits have been less than dramatic.

FOURTH DISTRICT - CLEVELAND

Summary. Economists have scaled down their forecasts of economic activity for 1982. Unemployment rates in the Fourth District are higher than the national rate and more layoffs are expected. Manufacturers report little sign of recovery in orders and sales, although declines appear to have bottomed, except in capital goods. Inventory liquidation probably is complete in consumer goods and some industrial products but further liquidation is expected in primary metals and capital goods. Little recovery in housing is expected. A variety of financial strains are reported.

Outlook. Economists who attended the Fourth District Roundtable Meeting on June 11 at this Bank scaled down their forecasts of economic activity for 1982 from their March forecasts. The median of 29 forecasts now shows a 0.5% annual rate of increase in real GNP in the second quarter, 3.5% in the third quarter, and 3.3% in the fourth quarter. Twelve of 29 forecasts show declines in the second quarter, while none expects a negative third or fourth quarter. The median forecast shows the implicit price deflator accelerating from a rate of 5.0% in the second quarter to 6.4% in the third quarter and 6.7% in the fourth quarter, and the unemployment rate gradually receding from a peak at 9.5% in the second to 8.6% in fourth quarter. They expect fourth quarter 1982 to fourth quarter 1983 increases of 3.7% in real GNP and 6.4% in the implicit price deflator.

Employment. Labor markets in the District remain weak, and unemployment rates are generally much higher than the national rate despite a

decline in May. Most of the major metropolitan centers in the District have double-digit rates of unemployment. The Cleveland Press, an afternoon daily, failed in June idling 900 workers. Our latest monthly survey of manufacturers suggests employment will decline again in June, particularly in the District's steel industry where the drop in orders has resulted in the banking of numerous blast furnaces in Cleveland and Pittsburgh.

Manufacturing Activity. A variety of manufacturers in the District report little sign of recovery in orders and sales, although the declines appear to have bottomed except for the typically lagging capital goods industries. Producers of personal safety equipment for industrial uses, basic chemicals and reinforcement fiber glass report orders and sales have flattened in recent months but no improvement has yet occurred. Sales of residential glass are flat to down a little but sales of commercial building glass continue strong. Coatings and glass sales to the automotive industry apparently bottomed in April, but sales of house paint continued to decline in May. A producer of corrugated boxes (sales of which apparently closely parallel industrial production) reports a small sales increase in May over April, and a petroleum refiner reports gasoline sales in May were the best in the last two years. Capital goods producers generally report further deterioration in orders and shipments. Orders for bearings from the construction, agricultural and railroad equipment industries weakened further in May, and a producer of electrical capital goods reports that their orders deteriorated in June. A producer of pneumatic and hydraulic parts reports orders from industrial machinery manufacturers have dropped severely recently. Machine tool orders remain very weak, even for robotic equipment, and no turnaround is expected until well after an economic recovery because of weakened balance sheets and cash flows of capital intensive industries.

Inventories. Most respondents in the District report that inventory liquidation of consumer goods and select products in industrial markets has probably run its course but further liquidation remains in primary metals and capital goods. A producer of major home appliances has cut inventories "below the bare minimum" and could not respond quickly to an upturn in orders. A diversified producer of industrial materials reports that their inventories have been reduced from a 5 to 6 month supply to 30 days and are down "as far as they can go." Dealer inventories of tires for agricultural implements are also reported to be extremely low. Crude oil inventories are expected to decline more in the second quarter than in the first, according to a petroleum economist. Refined product inventories are expected to grow in the third quarter. An auto manufacturer reports their inventory reduction in the second quarter was much less than in the first. There are still some inventories that are high. A pneumatic and hydraulic parts producer reports inventories of construction and agricultural machinery and some non-electrical machinery are high. Steel producers expect inventory liquidation again in the third quarter, although not as severe as in the second quarter. One expects no improvement in steel production until the fourth quarter, which should be the best of the year as users begin to rebuild inventories.

Housing. Neither lenders not suppliers to the housing industry expect much of a recovery in housing, at least in the near term. A producer of major home appliances forecasts little recovery in house construction in 1982-1983 as an increase in the number of units is offset by reductions in house size. A housing industry economist projects a weak recovery in housing because mortgage rates are not expected to fall much, consumer income is constrained by the sluggish economic recovery, and savings institutions are weak. He reports there is not yet any pickup in S&L loan commitments in this

region. House sale closings are at one-third the level of 1978, delinquencies are up sharply in the last 18 months, and foreclosures are also rising.

Financial Conditions. Bank officials in Cleveland and Pittsburgh report business loans are still strong, although banks in some smaller metropolitan centers report all kinds of loans, business and consumer, are weak. One banker reports delinquencies on consumer loans have not yet been a problem despite widespread layoffs in his area, but another predicts mortgage foreclosures and bankruptcies will increase unless economic conditions improve next half.

A variety of financial strains are reported. A major public accounting firm reports that many client firms are in severe financial difficulty. One auto producer reports that their credit company is not encouraging new business and has been advising dealers to seek credit from local banks. Another reports that an estimated one-third of the new car market is unattractive to lenders because of usury law limits on interest rates. He estimates that the prime rate would have to fall to 12% for new car financing to be attractive to lenders in all 50 states. Thrifts in the District are preoccupied with their continued deterioration in net worth and are concentrating on merger plans rather than making mortgage loans, according to an economist in this District. Thrifts generally report very little loan activity.

FIFTH DISTRICT - RICHMOND

Overview

Fifth District business and economic activity continues very weak and by many measures has deteriorated further in recent weeks. Generally, activity in the manufacturing sector has continued to decline. Manufacturers surveyed report further declines in shipments, new orders, and order backlogs in the past month. Inventory liquidation has apparently moderated but continues. Retail sales began to show some life but big ticket items were not helped. Sales and construction in the housing sector have made no appreciable recovery from the very low levels of recent months. Business and mortgage lending activity is generally quite slow. Consumer lending continues spotty and basically weak, but may have picked up slightly from former levels. Expectations continue to improve and are quite strong among survey respondents.

The Manufacturing Sector

Sales, shipments, and order backlogs all declined further during the latest survey period according to our manufacturing respondents. Once again, stocks of materials declined while finished goods were basically unchanged. Nearly a third of the respondents, however, still view current inventories as excessive. Manufacturing employment among respondents also continued to fall during the mid-May to mid-June period, as did the length of the average work week. Official reports just becoming available, however, indicate that manufacturing employment, as well as total employment, began rising in the early spring in most areas of the District. Unemployment rates remain high but have dropped back from the record levels reached in March. Respondents further report no change in employee compensation and actual declines in other prices paid and received over the past month.

Optimism continues to spread among these manufacturers as about three quarters expect business conditions to improve shortly.

Consumer Spending

Survey responses suggest a modest improvement in the retail sector in recent weeks. This improvement has been narrow, however, and there is some evidence that it may mask a decline in sales of big ticket items. Retailers surveyed and Richmond directors believe that sales of durable goods have been reduced to those absolutely necessary. Any improvement, in this view, will be dependent upon a change in consumer attitudes. They do not see such a change as imminent, however. Our information further suggests a continuation of consumers paying down debt and increasing savings.

Housing and Construction

Little change is evident in this sector. Sales of houses and construction generally remain very slow, and there is no apparent expectation of significant near term improvement.

The Financial Sector

Richmond directors generally expect little or no increase in business or consumer loan demand over the next few months. They find that businesses have reduced their loan requirements through inventory liquidation but that the process may still have a way to run. While some business sectors like autos and wholesalers are thought to be near the minimum levels for inventories, other industries are seen as likely to reduce stocks further. Generally, business borrowing is being restricted to the absolute minimum.

The outlook for consumer lending is no better. There is little expectation that consumers' purchases of durable goods will show any sustained improvement in the next few months. Here too, purchases are being made only in near emergency cases.

The Outlook

Manufacturers responding to our survey have become even more optimistic than last month. Nearly three fourths of them expect the level of business activity nationally, locally and in their respective market areas to improve over the next two quarters. Retailers, on the other hand, still expect little or no change in the level of activity over the remainder of the year.

SIXTH DISTRICT - ATLANTA

Growing evidence suggests the District economy is in a moderate upturn. Employment is edging higher, although some sectors remain weak. Unemployment rates have declined slightly in most areas. Consumer spending is up moderately. However, high long-term interest rates are depressing the housing and housing-related industries as well as the farm sector.

Consumer Spending. Retail sales are reported to be up moderately in the District compared to recent months and this time last year. Soft goods sales continue to outperform hard goods sales. Sales of home entertainment products are also good, while sales of quality goods generally are outperforming lower priced items. Widespread sales promotions and markdowns contributed to the sales gain but also narrowed margins and strained liquidity of financially weak stores. Although many retailers believe that sales erosion has stopped, they are reported to be lowering their sales estimates for the remainder of the year. For example, many clothing retailers expect fall 1982 sales to be flat compared to fall 1981 and are thus now buying cautiously at trade shows in Atlanta and Miami.

Auto sales in May in the District were generally off from May of last year but up from levels of mid-1981 and early 1982. The geographic pattern of sales within the District is consistent with geographic differences in the severity of the recession; Atlanta car sales are strong compared to agriculturally-depressed South Georgia. Full-size cars continue their recent gain of market share at the expense of compact cars; however, the recent increase in the price of gasoline may soon reverse this trend. Auto dealers are fearful that high interest rates will limit future sales levels.

Financial and Construction. The housing industry remains sluggish. Real estate sales and issuance of building permits are basically unchanged since May. Realtors

do not expect much improvement for the summer. Realtors and S&Ls report that housing is definitely a buyers' market—price concessions are causing a decline in housing prices in some areas. The much-feared overbuilding of commercial office space may have been exaggerated. In many areas of the District, downtown office space is attracting occupants, but often as a result of the lowering of rents.

Strength in bank lending is reported to be largely distress borrowing related to the recession. Firms are avoiding the long-term credit market because of high interest rates and are using short-term bank credit to finance operating costs. In Florida, some firms are continuing to borrow to relocate businesses to the region. The Mississippi area had little strength in bank loans from any source.

Employment and Industry. There are recent indications that the region is experiencing a moderate upturn in employment. Florida is behaving as usual, with a slowdown beginning six to nine months after the national recession. Employment there is declining and the state's unemployment rate is over 8 percent. Construction remains weak throughout the District, but based on employment figures through April and impressions from those close to the industry in June, construction jobs have improved somewhat. Service-related employment continues to climb, but recent increases have been below trend as recessions elsewhere have slowed the inflow of northerners to Florida. Unlike the private sector, however, government jobs are still declining.

A slight upturn in employment is also evident in slightly lower unemployment rates in the region. Unemployment rates declined in April in five of the six states in the District, with Georgia experiencing the largest decline. Although Alabama's unemployment rate edged up, the increase was marginal when compared to previous months. Florida's jobless rate fell in April despite a decline in employment as labor force growth slowed in response to the reduced inflow of people from outside the state. Florida and Georgia are the only two states in the six-state region with single-digit

unemployment rates. These two states, however, comprise a large portion of the area's population and labor force. Thus movement in their rates has an important influence on the region's job picture.

There are signs of a turnaround in the south Louisiana petroleum industry due to higher crude oil prices and the potential for greater demand. Well financed oil drillers and related operations see opportunities to expand as the surplus is consumed. Streamlined regulations regarding offshore drilling have stimulated drilling activity, particularly in the Mobile Bay area.

The textile industry, a major portion of which is based in the Southeast, has been affected by the recession. However, production has bottomed out and a very gradual revival is expected to begin in August after normal July plant closings. Products tied to autos and housing have been doing more poorly than other segments of the industry and are expected to recover more slowly. Personal consumer products are considered most likely to lead the rest of the textile industry out of the recession.

Tourism. Attendance at the World's Fair through June 17 was 3,427,096 compared to the original projection of 2,271,000. After a slow start, May attendance was considerably heavier than expected. Due to physical site limitations, promoters are still sticking with original projections of 11 million total attendance. Still, overall attendance should exceed 11 million. People driving to the World's Fair are taking in other Tennessee attractions as well. Tourists are reportedly arriving in Memphis and Nashville in record numbers. The Fair's so-called "spinoff effects" appear limited to the state. Tourist activity in north Florida is down from the same time last year, and in New Orleans, hotel occupancy rates are lower than usual.

Agriculture. The farm financial picture for the Sixth District remains unfavorable. From a low rate of 26 percent in Tennessee to a high of 60 percent in Georgia as of June 2, delinquencies on farm loans represent a continuing problem. The

40 percent delinquency rate for the District demonstrates the high proportion of FmHA farm borrowers who are in economic difficulty. Completed and pending foreclosures, nevertheless, comprise less than 2 percent of delinquencies. Recent legal decisions would also appear to forestall any foreclosure activity in the near future.

With few exceptions, acreage for the major crops is down 10 to 15 percent from last year's. Peanut acreage is down even more, 20 to 30 percent. But these acreage reductions do not necessarily portend a drop in production. The highly favorable weather and soil moisture conditions which exist throughout the District may result in production near that of last year. Clearly, if such is the case, there will be less upward pressure on farm prices.

SEVENTH DISTRICT - CHICAGO

Summary. Developments in the Seventh District provide little hope for near-term improvement. It is unlikely that the region will participate in the uptrend widely expected for the nation in the second half of 1982. Machinery and equipment output and bookings have been declining sharply this year in virtually all lines. Sales and output of motor vehicles improved in the second quarter, but remained at depressed levels. Increases in defense outlays have not been a significant factor here. Retail sales of nondurables rose somewhat in May, but remained relatively soft. Construction activity showed less than seasonal gains. Most employers have been reducing or, at best, maintaining staff. Unilateral cuts in nonunion compensation are common. Renegotiations of labor contracts continue, not always successfully. Some large corporations are shrinking or restructuring operations. Price reductions are still common, but may be moderating. Oil product prices have rebounded. Seventh District farmers are completing crop plantings, after a slow start in Iowa. Livestock prices continue at favorable levels, but corn and soybean prices remain depressed. Farm equipment sales remain poor.

Declines Spread. Few economic sectors in the District have remained untouched by the recession. Meat packing has been going through a painful adjustment. Electrical component manufacturers report substantial declines in orders, for some the worst in their history. Demand for office furniture, which remained strong through the first quarter, softened in the spring. Service industries also report reduced demand, including engineering, technical consulting, public relations, commodities trading, and recreation.

Inflation. Some companies now expect a 5 percent rise in average prices of purchased materials in 1982, only half as much as in 1980 or 1981. But in some sectors prices are down dramatically. Bids on construction projects are running 10 to 20 percent below estimates. Sharp price discounts also are noted for steel products, nonferrous metals, cement and other building materials, and paper products. Many of these depressed prices would rebound rapidly if demand improved, partly because capacity has been reduced by retirement of older facilities.

Corporate Restructuring. Financial problems and reduced estimates of future demand have caused various District corporations to take steps to restructure their operations. Drastic actions are required in some cases to "ensure survival", and to get into position for the eventual upturn. Divisions are being closed or sold--some because they are unprofitable, others because they are readily marketable. Substantial reductions in corporate staff and unilateral cuts in nonunion salaries--up to 10 percent--are common. Negotiations with unions to adjust compensation and work rules in order to control labor costs continue, often without publicity. However, substantial increases in compensation continue to be announced in many fields.

Employment. Labor markets continue soft in all portions of the District. In April, payroll employment in the five District states was down 5 percent from the prosperous level of April 1978 and manufacturing down 18 percent, a much worse performance than the nation. Unemployment averaged 12 percent in the District in April, compared to 5.6 percent four years earlier (when it was lower than for the nation). In addition to those unemployed, many workers are on short hours. Complete shutdowns for a week or more

at a time are common. New hirings are at a low ebb as indicated by help-wanted ads and reports from job-finding agencies. Summer work for students is less available than at any time since the 1930s. New college graduates with technical degrees are having unusual difficulty finding work.

Capital Expenditures. Evidence from District companies suggests a much larger decline in capital spending than was indicated by the recent Commerce Department survey, both for projects to be located here, and for equipment produced here. Business equipment orders are off sharply this year, frequently by 20 to 30 percent or more. Components such as castings are off as much as 50 percent.

Motor Vehicles. Auto production was off 31 percent from last year in the first quarter, and 22 percent in the second quarter, but the third quarter is expected to be up 7 percent. Light truck output has been running well ahead of last year since February, but heavy trucks remain weak. Vehicle inventories are at comfortable levels and imports are under restraint. Industry leaders expect a continuing moderate improvement in sales and output of both cars and trucks, but not enough to return the auto centers to prosperity.

Steel. Although steel demand is running well below forecasts made earlier this year, District producers have increased their share of the total. Primarily, this is because auto industry demand for steel, an important market for these mills, is "less bad" than the total. Demand for heavy steel products for structures and equipment is "weak and getting weaker." Steel executives are pleased that the Administration has decided to take

action to curtail steel imports, although imports are less of a factor here than nationally.

Retail Sales. Sales of general merchandise improved in May according to major District retail chains, but no strong further advance is anticipated. Auto parts and apparel are moving well, but big ticket items, including household appliances and floor coverings, remain slow. While use of instalment credit has increased somewhat, delinquency experience has been favorable, reflecting tighter standards.

Construction. Construction contracts for new commercial and industrial structures in the Midwest are running well below last year's depressed level. Work continues on large new office buildings for Chicago's downtown area, but new starts are being delayed because major tenants have not been signed and permanent financing has not been arranged. Rehabilitation work is relatively strong.

Agriculture. Crop planting is nearly complete throughout the District. Even west of the Mississippi, where rains caused delays, substantial progress has been made. As of June 20, soybean planting in Iowa was 88 percent complete (compared to a five-year average of 100 percent), and corn planting was 98 percent complete. Despite heavy rains in some local areas, crop conditions are quite good.

EIGHTH DISTRICT - ST. LOUIS

Although economic conditions in the St. Louis District generally changed little during May and early June, there were some indications of improvement. Increases in retail sales and total employment provide the most encouraging news. Also, farmers have benefited from relatively high livestock prices and a favorable planting season. Manufacturing orders, however, have not picked up, and the unemployment rate remains essentially unchanged as the labor force has swelled with students seeking summer jobs.

Retail sales rose in the District during May and early June, with discount outlets outperforming regular department stores. St. Louis' largest department store reported May sales 4 percent above a year ago, while a major discount chain experienced a 21 percent jump in sales. Sales of nondurable goods gained the most, reflecting large promotions and price concessions. One shoe store chain reported excellent sales in May--over 25 percent above last May. As a result of the increased sales, retail inventories declined.

Automobile sales, although still below normal, increased again in May. Rebates to customers and factory sales incentives offered to dealers have stimulated sales. A major Ford dealer quickly moved a sizable number of cars slightly damaged by a hail storm by passing on to the purchasers, in cash, the insurance adjustment.

Most service firms report that business has remained steady. Auto and TV repair shops have kept busy. One restaurant chain reports a

significant gain in volume. Gasoline sales have improved moderately, and a motel chain noted fewer vacancies. Air travel was especially heavy over the Memorial Day weekend. A firm that provides business promotional activities reported a 27 percent increase in sales during May.

Industrial activity, on the other hand, has changed little in recent months. Defense procurement remains strong, a garment factory reports a backlog of orders despite capacity operations, and sales by food processors are about normal. However, firms producing consumer durables, chemicals, industrial equipment, paper and paper products, and wood products still face depressed orders. Manufacturing inventories are at desired levels as production schedules have been closely adjusted to the flow of incoming orders. Capital spending plans have changed little since April. A Louisville industrial collection agency reports both an increased volume of business and a smaller percentage finally collected.

Employment in the District has increased slightly since April, with gains centering in smaller firms engaged in service activities. Most larger industrial firms have had little change in employment; some have permitted employment to drift lower with attrition. Despite an increase in the number of people working, unemployment continued at a high level as high school and college students sought summer jobs. Even though unemployment is high, a sizable number of job vacancies exist. The St. Louis Post-Dispatch carried about 11 pages of "help wanted" ads in its Sunday editions in early June covering a wide variety of jobs from

those requiring much skill, training or education to those with less rigid requirements.

Throughout the District, the demand for commercial and residential construction remains weak. According to the Home Builders Association, residential construction in the St. Louis area was only 15 percent of normal in May. Prices of existing homes are drifting lower, with discounts often reflected in liberal financing terms accepted by the seller to close the contract.

Outstanding loans have risen moderately at both large and small District banks since April. Advances to business firms, particularly food, liquor and tobacco manufacturers and companies providing services, have expanded. Real estate loans also have increased. Delinquencies, although still not large, have risen, and some bankers feel that the financial condition of smaller commercial customers has deteriorated. More attention is being given to managing loan portfolios.

Many District farmers remain in financial difficulty. The average ratio of debts to book value of farm assets has reportedly changed only slightly over the past year. With high interest rates, low grain prices and rising costs of operation, the debts have become more burdensome. On the other hand, livestock producers have benefited from wide profit margins, and weather conditions have been favorable for planting.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District's economy entered the month of June in essentially the same weak condition that we have reported for the last several months. In some areas the situation has actually taken a turn for the worse. Recent shutdowns have devastated the district's metal mining. Cold and wet weather have delayed field work and crop development, thereby furthering the woes of district agriculture. Moreover, manufacturing remains depressed and consumers are still reluctant to purchase homes and durables. The only bright spots in our gloomy economic assessment are improved prices for some kinds of livestock and stronger vehicle sales.

Metal Mining

District iron production has been sharply curtailed in recent months because of weak demand for steel, and district copper output has been cut back severely as a result of sagging copper prices.

Most district iron mining companies announced shutdowns this spring or lengthened previously-announced shutdowns. In northeastern Minnesota, seven out of eight companies have or will be shutting down operations. Announced closures range from two weeks to 5 1/2 months and may, of course, be extended. In the Upper Peninsula of Michigan, all four iron mines have temporarily or indefinitely stopped production. According to a Department of Interior official, if the mines, which produce 90 percent of the nation's iron ore, adhere to announced schedules, 1982 production will decline 25 percent from 1981 levels and will be down 35 percent from 1979 levels when production hit its peak. District copper mines have also shortened production hours.

The Upper Peninsula's one large copper mine went from a four- to a three-day work week in early June, and is planning a six-week closure beginning around July 1. In Anaconda/Butte, Montana, where copper production has been declining since 1974, the state's largest copper mine was permanently closed earlier this year. There are rumors that the remaining mine will be closed if prices continue to weaken. According to company and Department of Interior officials, if the firms, which mine 7 percent of the nation's copper, adhere to their announced shutdowns, district copper production in 1982 could decline by as much as one-third from 1981 levels, and 42 percent from 1979, the industry's last good year.

These cutbacks in district metal production have caused serious local unemployment problems. District metal mining employment was 17,500 in March, down 18 percent from a year ago and 24 percent from the peak attained in 1979. Moreover, given recent shutdowns, unemployment in these industries is undoubtedly higher than indicated by the March data. Overall unemployment rates in the Upper Peninsula, northeastern Minnesota, and Anaconda/Butte this spring were 19 percent, 14 percent, and 11 percent, respectively. According to labor market analysts, many unemployed miners have almost exhausted their benefits, and Minnesota state leaders are considering a special program for laid-off workers in the northeastern part of the state.

Energy Mining

The district's energy mining sector has also felt some adverse impact from the nation's soft economy, but it has been relatively mild compared to metal mining.

In recent years, gas and oil drilling has been one of the fastest growing segments of the district's economy. Exploration and production

employment in Montana and North Dakota increased from 6,900 in 1979 to a current level of 16,900, and these two states currently account for 2 percent of all U.S. crude petroleum production. In 1982, however, exploration activity is expected to be down from a year ago, in part due to the past decline in crude oil prices. In May, for example, there were only 85 active rigs in these states as compared to 198 a year earlier.

However, this slowdown may only be temporary. At least, that is the view of an official for a Minneapolis company doing oil exploration in Montana and North Dakota. He expects activity to pick up, particularly if recent increases in petroleum prices continue. Moreover, because of the considerable lead time between exploration and actual production, the slowdown in exploration has not had a marked effect on oil and gas production.

District coal production, which employs 3,500 workers in Montana and North Dakota and accounts for 9 percent of the nation's output, has also been reduced somewhat. An analyst for a St. Paul-based railroad that hauls western coal indicated that the recession has slowed the growth in coal usage. Even so, he predicts that total 1982 western coal tonnage will still show an increase over 1981 levels.

Manufacturing

Manufacturing remains weak. Forty-nine percent of the manufacturers responding to a University of Minnesota survey said their new orders declined in the three months ending in May, and nearly as many (44 percent) said production declined also. The forest products industry continued depressed. A Montana director, for example, stated that Montana sawmills are currently operating at 60 percent of capacity or less, and paper mills at about 75 percent of capacity.

Agriculture

District agricultural conditions remain gloomy. Grain prices have not improved and remain well below prices of a year ago. Furthermore, due to wet and cold weather in May, field work and crop development in the district have been delayed. These delays are expected to reduce yields somewhat, even though the weather improved significantly in June. One encouraging development has been the strengthening in some livestock prices. Between April and May cash prices at South St. Paul for slaughter steers and hogs rose 7.3 percent and 13.5 percent, respectively. Feeder cattle prices, however, were essentially unchanged.

Transportation

A strike against a trunk airline carrier took place in May and June; however, it did not constitute a major disruption of air service. On May 21, 3,600 members of the International Association of Machinists struck Northwest Airlines over wages and work rules. On June 8, the striking workers overwhelmingly rejected a company offer and a prolonged strike seemed likely. However, a tentative agreement was reached on June 14 and ratified by over 90 percent of the union members on June 16. Although the strike did not appear to significantly disrupt area air transportation, Northwest Airlines did lay off about 1,700 workers.

Consumer Spending

Consumer spending has shown very limited signs of recovery. Large Minneapolis/St. Paul retailers and bank directors continue to characterize general merchandise sales as "soft," particularly for consumer durables. Directors also indicate that home sales remain depressed. However, retail

sales have improved somewhat from April's weather-depressed levels. In addition, motor vehicle sales are showing signs of life. In early April, regional sales managers reported improved domestic motor vehicle sales, primarily of light trucks; and in early June, one of these managers reported further strengthening. His view is that we are well past the bottom for motor vehicle sales in this area.

Finance

Reflecting the softness in the district economy, directors continue to report weak loan demand and deteriorating loan quality at district banks.

TENTH DISTRICT—KANSAS CITY

Overview. Business conditions in the Tenth District appear to be firming somewhat, and attitudes about the future appear to be slightly more optimistic. Retail sales gains have been stronger recently, and are expected to improve further in the months ahead. Inventories are well under control, with the possibility of some additions to retail stocks in the third quarter. Input prices are generally stable. Housing activity continues to be weak, as are savings inflows to thrift institutions. If excessive moisture conditions continue, it would have the potential of harming the winter wheat crop and hindering the planting of other crops. Loan demand at Tenth District commercial banks is generally flat. Deposit growth is mixed, with NOW accounts the primary source of growth beyond seasonal patterns.

Retail Trade. Most retailers in the Tenth District report sales increases in the 2-9 percent range between the first five months of last year and the first five months of this year. Sales improved substantially in April and May of 1982, especially apparel and softgoods; durable goods sales remained weak. Merchandise costs have stabilized in recent months, resulting in few price increases at retail. Tight controls and improved sales have brought inventories well within desired levels. Some slight inventory buildup is anticipated in the third quarter of 1982, as purchases of merchandise increase to accommodate expected sales gains in the last half of the year.

Purchasing Agents. The majority of purchasing agents contacted in the Tenth District report input prices have remained stable or decreased slightly compared to a year ago. Prices are expected to remain stable for the rest of this year. All firms contacted are continuing to trim their inventories and

plan to maintain very low inventory levels for the remainder of the year. Input availability is not a current problem in the District, but could become one if more suppliers go out of business or, in light of current capacity utilization, the economic recovery occurs at a greater pace than expected.

Housing Activity. Realtors and builders in the Tenth District report generally weak sales and stable prices. Second quarter housing starts have dropped 25 percent in Kansas City from last year, but they have risen moderately in other areas—with an increase of over 20 percent in Oklahoma City. Prices are stable or up moderately—3 or 4 percent at most. Sales are generally moderately weaker than last year, varying from down 10 percent in Kansas City to up marginally in Oklahoma City. Sales are weakest in the \$95,000 to \$185,000 price range. Supplies of building materials are adequate and inexpensive. Builders warn, however, that a sudden rise in construction activity will cause severe supply bottlenecks.

Housing Finance. Officers at Tenth District Savings and Loan Associations lament the continuing decline of savings inflows—down as much as 50 percent from last year. The 30-month CD has proven an effective vehicle, however, propelling modest boosts for competitive institutions. Officers fear that the recent upsurge in interest rates forebodes a renewed exodus to money market funds. Most associations are sticking to portfolio loans, but some report an unexpected but modest pickup in market rate mortgages from very low levels. One officer, however, dismissed the upswing as a mere seasonal flurry, and most associations are unwilling to commit funds past 30 days. Loans made at market rates are at interest levels of 16 1/2 to 17 percent, with little anticipation of a near-term decline.

Agriculture. Some areas in the Tenth District have received an excessive amount of moisture from the heavy rains occurring over the past several weeks. This situation has delayed both the harvesting of the winter wheat crop and, in turn, the planting of some fall crops, particularly in southern Oklahoma. In northern Oklahoma and Kansas the harvesting of winter wheat is soon to begin. No adverse effects on the quality of the wheat are reported. Some hail damage has been reported, but overall wheat conditions are estimated from fair to good at this time. Bankers in Nebraska report favorable progress being made in the planting of spring crops despite the cool weather. Recent improvement in cattle and hog prices has had a positive impact on the income of livestock producers in the Tenth District. However, bankers report no signs of livestock producers increasing their production capability.

Banking Developments. Reported loan demand is generally characterized as flat throughout the Tenth District. Several banks in Oklahoma indicate that commercial and industrial loan demand has recently increased. However, in contrast to 1981 and the first quarter of 1982, the source of this strength is in nonenergy related businesses. Real estate lending is down throughout the District, as is agricultural lending. Consumer loan demand is mixed with most activity arising from credit cards. Several bankers note that the overall quality of their outstanding loans has deteriorated, and some are obtaining additional collateral and restructuring loan terms. Deposit growth at Tenth District banks is mixed. Most bankers contacted report some growth in NOW accounts, but few new accounts are being opened. Those banks expanding loans are also generally issuing large CD's. Virtually no growth is reported in all saver certificates, and most other categories of deposits are following their typical seasonal pattern.

ELEVENTH DISTRICT--DALLAS

Manufacturers are cutting production and employment in the Eleventh District. Inventories of oil field equipment are excessive and imbalances are expected to persist, although the number of active drilling rigs recently increased. Growth in business loans, which had been rapid, tapered off in May. Savings and loan associations report slower deposit outflows and increases in mortgage loan closings. The pace of commercial construction continues strong and housing starts are increasing. Department stores report moderate increases in sales, but sales at auto dealerships are down. Farm incomes remain depressed.

Texas employment increased in May, but the number unemployed continues to rise because of layoffs in transportation equipment, and energy-related manufacturing and in mining. Job losses in these industries are partially offset by employment gains in nonmanufacturing industries, particularly services. The number of inquiries from other states concerning employment possibilities is down from recent months.

The layoffs in mining reflect low drilling rates that have characterized the oil and gas industry for several months. But the number of drilling rigs operating in Texas increased slightly at the beginning of June, the first uptick since last year. Industry sources say that more time is needed to establish a trend. If drilling does increase, it is not expected to rise rapidly.

Faced with low sales and excessive inventories, District manufacturers are cutting output. Producers whose chief market is the

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petroleum industry have made particularly large cutbacks. Some of these firms anticipate that their inventory problems will last all year. Suppliers of commercial transportation equipment are also reducing production. Output of petrochemicals, apparel, and commercial electronics remains low. Petroleum refineries report rising production and capacity utilization. Firms that produce electronics for defense have large order backlogs but report a decline in the pace of new orders.

Commercial bank loans to businesses increased at a slower pace in May than in April, but the cumulative rise in loans this year to date is twice the average increase in the past five years. Loans increased for mining, services, petroleum refining, apparel manufacturing, and commodity dealers. The increases in loans to apparel manufacturers and commodity wholesalers were unseasonally large. Respondents at commercial banks attribute the rise in loans for mining to the takeout of previously committed funds by drilling companies responding to rises in gasoline prices. Loans to all other industries declined in May. The largest percentage decreases were for loans for construction and chemical manufacturing.

Deposits at commercial banks increased faster in May than in April. The cumulative rise in deposits this year is more than twice that of the past five years. A rise in time deposits more than offset a continued runoff in demand deposits and a fall in savings deposits in May.

The rate of decline in deposits at savings and loan associations has slowed since April. Mortgage loan closings are up moderately but remain below last year's levels.

The pace of commercial construction continues at a high level, and there are sufficient projects underway to sustain this pace for some time. But the cumulative square footage of new, additions, and major alteration projects for this year is well below last year's cumulative total, and the number of announcements of new projects is declining.

Housing starts are up strongly from April, but remain 14 percent below year-ago levels. Builders describe the current level of activity in some areas as a "profitless boom" because they are providing reduced interest rates and other incentives to buyers.

Department stores report moderate increases in sales from year-ago levels. Because of the unusual number of layoffs in Texas, they expect the pace of sales to change little this summer. Apparel sales are holding up well, but sales of home furnishings and appliances are slow. Inventories are trim, and price discounting and promotions proceed at seasonally normal levels.

New car dealers report that sales declined after General Motors' low interest rate finance program ended in May. Foreign car dealers said that this program stimulated comparison shopping at their stores. The last of this year's models will soon be delivered, and dealers expect inventories to be sufficient for a moderate pace of sales this summer.

Farm incomes remain low, in spite of rises in livestock profit margins. Prices for feed grains are 23 percent below year-ago levels, and heavy rains in May will further cut net revenues as farmers replant or absorb crop losses. Cattle prices are up as ranchers have cut back on the quantity of beef supplied to market.

TWELFTH DISTRICT - SAN FRANCISCO

The preponderance of evidence suggests that the Twelfth District economic recession still has not ended. Consumer spending picked up in May and early June at both department stores and new car dealerships. Homebuilding also showed welcome improvement. But the large inventory of unsold homes--aggravated by the growing number of foreclosures--suggests that the homebuilding recovery may not be sustained. Meanwhile, commercial construction is slowing. In the manufacturing and mining sectors, a number of industries are undergoing a new wave of production cutbacks. In the agricultural sector, crop and livestock prices have increased recently, but net farm income still is expected to be down again in 1982. At Twelfth District banks, business borrowing has been increasing in June due to corporate cash flow problems, and bankers are seriously concerned over the growing number of nonperforming loans.

Consumer Spending

Respondants report a pickup in retail sales in May and early June. This improvement is noted for both department stores and automobile dealerships selling new cars. Sales of used cars, on the other hand, are reported to be slowing, perhaps reflecting consumer willingness to make more expensive new car purchases. Even furniture sales are reported to have improved modestly. Department stores have had to engage in heavy promotional efforts and sharp price discounting to bolster sales, however, and profit margins are reported to be extremely slim. Moreover, although inventories have been reduced, stocks are still reported to be higher than desired and retailers are being very cautious about placing orders for replacement and new-season merchandise. Even large supermarket chains are

reported to be engaging in food "price wars," another indication of the highly competitive price environment existent throughout the consumer sector.

Manufacturing and Mining

Orders and prices in many basic Twelfth District manufacturing and mining industries have continued to decline in recent weeks, forcing further production cutbacks and layoffs. Especially hard hit have been the mining and primary metals industries--such as aluminum, steel, copper and silver--where prices have dropped to new recession lows. The copper and silver industries in Arizona, Utah and Idaho are estimated to have cut mine production to only about 50 percent of capacity. While employment in the lumber segment of the forest products industry has stabilized, the paper industry continues to cut back production. In both California and Washington, the aerospace equipment manufacturing industry has continued to register further overall declines in employment as growth in defense-related payrolls has been insufficient to offset continued layoffs in commercial aircraft and electronic equipment programs. The Boeing Company in Seattle has experienced a new wave of order cancellations from domestic and foreign airlines and still further cancellations are threatened. If those cancellations materialize, another 15,000 aerospace workers could be laid off in that state by year-end. On a favorable note, the recent strengthening of world oil prices is expected to arrest any further cutbacks in such energy programs as oil drilling and oil shale development.

Construction and Real Estate

Homebuilding in the Twelfth District finally appears to be picking up. But regional housing starts had dropped to a post-World War II low in

April, and residential construction remains extremely depressed. Moreover, sales of new and existing homes also reached a post-World War II low in April, and respondents report no subsequent pickup. On the contrary, they describe the residential sales market as "completely dead." They also report a sharp increase in foreclosures. Until the large inventory of unsold homes is reduced, respondents are doubtful that a significant homebuilding recovery can be sustained. Meanwhile, developers of commercial properties are now experiencing the same kind of serious financial distress experienced earlier by home builders. Developers are finding it increasingly difficult to sell or rent new projects, given rising vacancy rates and the growing unwillingness of pension funds and insurance companies to invest in commercial property.

Agriculture

Prices for such important Twelfth District agricultural crops and livestock products as citrus fruit, apples, hay, rice, potatoes and cattle have risen recently. But despite this increase--resulting in part from some pickup in export demand--agricultural prices generally continue to lag behind the level of a year ago, while farm input costs are up sharply. As a result, the agriculture industry expects to experience its third consecutive annual decline in net income in 1982. Bankers report that numerous farmers, who already are heavily in debt, are finding it increasingly difficult to obtain additional financing. Adding to their cash flow problems, equity in agricultural real estate--which usually supports agricultural production financing--has not been appreciating owing to the high cost of financing and poor commodity prices. As a result, a growing number of farm properties are for sale at distressed prices.

Financial Institutions

Data for the first two weeks of June indicate that bank credit growth in the Twelfth District has picked up substantially relative to growth reported in April and May. Most of this growth can be attributed to a resumption in business loan demand, with only very modest growth in consumer and real estate lending. Banks report strong business loan demand despite borrowers efforts to reduce reliance on debt by postponing and scaling back projects, reducing inventories and selling assets. Bankers appear very concerned about the level of nonperforming business loans, particularly to the construction, forest products and aerospace industries. They are reviewing new credits very carefully and are particularly cautious regarding repurchase transactions following the Drysdale default.