

CONFIDENTIAL (FR)

**CURRENT
ECONOMIC COMMENT
BY DISTRICT**

**Prepared for the
Federal Open Market Committee
by the Staff**

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SUMMARY*

Overview. The economy is still entrenched in the recession, with District reports giving few indications of an imminent recovery. Lower interest rates and a slower rate of economic decline are cause for optimism, particularly in the North East, which has fared better than the rest of the country. Consumer spending, especially auto sales, remains weak in much of the country as consumers are cautious in the face of higher levels of unemployment. Manufacturing, mining and lumber industries are still experiencing widespread layoffs and plant closures, with no increase in orders to signal a recovery; defense-related industry remains strong. Lower mortgage rates are bringing optimism to the housing industry, but construction has yet to increase; commercial construction has turned down in many areas. Low prices, weak demand and bad weather are keeping farm income down, with only livestock producers benefiting from low feed prices. Corporations and households are taking advantage of the recent drop in rates to restructure their balance sheets rather than buying new capital equipment or homes. Many fear that a rise in interest rates will stall any recovery next year.

Retail Sales. Retail sales, especially sales of durables, remain weak throughout the country, and are being sustained in many areas only by promotional activity and aggressive pricing. Inventories, however, are now at acceptable levels. Retailers are optimistic about the holiday season in most Districts, but weak October sales are keeping some retailers cautious. In the North East and the St. Louis District, recent advances in retail sales are seen as encouraging. Auto sales, however, are still depressed, especially in the Atlanta District, where many dealers are failing. Lower interest rates

are generating some optimism among dealers, but high prices and high unemployment continue to deter buyers. Despite the declines in interest rates, consumer lending has not increased significantly.

Manufacturing and Mining. Though the view that the economy has hit bottom is widely expressed, signs of an imminent recovery remain scarce. Many of the Districts report further layoffs and plant closures, with expectations of more of the same, albeit at a slower pace. In the Chicago and Cleveland Districts, the capital goods industry is particularly distressed, with no upturn in new orders to signal a recovery. Low sales and imports continue to plague the auto and steel industries, and are now affecting truck manufacturers. Mining is down everywhere, and the lumber industry continues to experience very low demand, leading to further mill closures. Recent increases in drilling activity are attributed to tax motives, not to a recovery in the oil and gas industry.

With widespread excess capacity, weak prices and pared inventories, some believe the conditions are now ripe for recovery. Others, however, are afraid that higher interest rates next year will continue to curtail economic activity and prolong the recession. There appears to be more economic strength in the North East than elsewhere, with the Boston, New York and Philadelphia Districts reporting strength in the business of their defense contractors, high technology manufacturers, finance and other service companies. Though some weakening in the high technology industry is evident there and in other Districts, defense-related business is expanding everywhere. One positive sign is the pervasive weakening of prices, which indicates continued low levels of inflation. It remains to be seen whether the moderating decline of business activity is indeed a precursor of the long-expected recovery.

Construction and Real Estate. Lower mortgage rates have returned some life to the housing industry, with real estate agents, builders and lenders all reporting an increase in home-buyers' inquiries. Only in the Atlanta and Dallas Districts, however, is the improvement being translated into an increase in permits and construction. Elsewhere, the housing industry remains on hold till rates stabilize at this lower level and spring comes. Commercial construction is weakening, as there are few new projects to replace completed or cancelled projects. Excess office space in the San Francisco District is expected to slow the construction of office buildings. While many Districts report cutbacks in plans for commercial construction, demand for construction loans is up in the Kansas City District, and commercial construction improved in the St. Louis District in October.

Agriculture. Agricultural income continues to suffer from large stocks, weak domestic demand, poor export demand and bumper crops. Bad weather has caused problems in the San Francisco and Minneapolis Districts. Prices of many crops--such as cotton--are well below last year's. Cattle, hog, dairy and poultry producers are doing better because of lower feed costs. Low farm income is threatening some farmers with the loss of their farms, but widespread foreclosures are not expected. Values of farm land continue to fall. Lower interest rates will bring relief, but only in the future.

Financial Conditions. The recent drop in interest rates has spurred a restructuring of corporate balance sheets. In the Minneapolis and Philadelphia Districts, for example, many firms have issued new equities and long-term debt to replace bank loans. Mortgage borrowers are also restructuring their debt, particularly in the San Francisco District where creative financing and balloon payment loans have created large demands for

refinancing. Despite the length of this recession, delinquencies, foreclosures and problem loans do not appear to be causing unmanageable difficulties for most financial institutions.

Depository institutions appear to be retaining a large proportion of the funds that were in all savers certificates, and some deposit gains have come from new types of account. Most institutions are preparing to offer the new money market account, but express concern about the likely increase in their cost of funds.

*Prepared by the Federal Reserve Bank of San Francisco.

FIRST DISTRICT BOSTON

Retailers in the First District reported strong sales, which they hope are the beginnings of a consumer recovery. In previous months, good sales were achieved only through aggressive promotion. Manufacturers, on the other hand, do not see a pickup. However, for most of those contacted, orders and production are no longer declining. Defense is very strong. While retailers are satisfied with their inventories, manufacturers are divided on whether they will have to make further cutbacks.

Retailing

Retailers in the First District reported strong sales growth in October. Some said the sales pickup, which is not explained by special promotional activity, may hint at a consumer upturn. They cautioned, however, that the growth is somewhat overstated because October last year was weak.

The strength was widespread, appearing quite generally in all the New England stores of those contacted. No particular geographic areas or product groups were especially strong or weak. One big department store chain, which has been "upgrading" its merchandise to "address the demographics," reported "better goods" were strongest. A building materials specialty house and a discount department store detected no product shifts aside from the usual seasonal changes.

Those with related companies elsewhere in the nation said that New England appeared to be stronger than other regions.

The retailers reported that they are planning on continued solid

growth and a good holiday season. Although their plans do not project a continuation of October's "super" sales levels, their "lean and clean" inventory positions should translate good sales into reasonable profit levels.

Manufacturing

The dominant message from the manufacturing sector is that there is no evidence yet of any upturn, but that conditions are no longer deteriorating. Most of the firms contacted are in capital goods industries and do not look for a significant recovery in their own operations until the second half of 1983. However, the defense business is vigorous, and in non-defense areas some firms have been able to increase sales with new products and aggressive marketing.

Most respondents from the manufacturing sector have seen no significant increases or decreases in demand in the past two months. Among the products for which no change was reported were roofing and related housing products, milling machines, industrial hardware, printing equipment and tires. In a few areas - major appliances, consumer hardware, printing supplies and energy-related capital equipment - there seems to have been a very modest pickup in demand, but the increases are too small to be interpreted as evidence of a solid upturn. The increased orders for capital equipment are based upon capital spending plans which were cancelled in the early part of 1982 but which have now been revived. Products for which declining sales were reported were machine tools, aircraft equipment and building materials for commercial construction; the last had been holding up quite well until recently, based on sales in the western states. Respondents have been reporting for some time that exports

to Europe are very disappointing; but this month two high technology firms mentioned Japan as well and a third worried that the high value of the dollar relative to the yen might affect exports. Mexico is also creating problems, but for different reasons. A large company with a Mexican subsidiary says that, because the subsidiary is unable to pay dollars for its imports from the United States, the parent is having to pay. Other firms in a similar position are taking payments-in-kind from their subsidiaries, but in this case the subsidiary sells only to the Mexican market.

While the overall demand for manufactured products has not picked up, two firms, producing test instruments, appliances and airplanes, report that they have been able to increase sales through new products or aggressive marketing. According to one executive, people and firms have the money to buy more but they have gotten out of the habit and must be persuaded. The defense business is strong and getting stronger as Reagan's policies are only now starting to take effect.

Most of the firms contacted believe that the demand for their products lags the business cycle and consequently, they do not expect a recovery in their own operations until the second half of 1983 and, in the case of machines tools, early 1984. Most executives seemed a little more reconciled to the slow recovery than they were several months ago - perhaps because orders have stabilized. Respondents split on the question of whether they can continue to operate at present rates without further cuts in inventories and employment. Some believe they have made all the necessary reductions; others are planning additional layoffs and extended plant closings. Layoffs in the computer and office automation industries

may be quite substantial in the next few months, according to one executive. Firms in these industries enjoyed rapid growth through 1980 and 1981 and when the slowdown finally came they thought it would be very brief and they did not react. However, the slowdown continues and they are now cutting back.

Professors Eckstein and Houthakker were available for comment this month. Eckstein believes the market has "overdiscounted" the demise of monetarism at the Fed, and it expects a further cut in the discount rate sometime soon. Although Eckstein is leery of overstimulating money growth, he believes some further decline in yields may be warranted. First, the growth of the higher order monetary aggregates must be decelerating, reflecting the lack of economic growth in October. Except for housing and defense, aggregate demand has no momentum. Second, Eckstein believes that the money growth guidelines should be raised perhaps as much as 1 percentage point in 1983. "We have learned that the guidelines in the past failed to supply enough credit to provide for growth." He believes that future velocity growth, like past velocity growth, will not be large enough to bail the economy out, so "unless we are wildly optimistic about inflation (you have to believe inflation is only 4 percent) the money growth targets will not accommodate even a mild recovery." Eckstein believes unit labor costs will rise 5 percent next year because "2 percent productivity growth is about all we can expect with 3 percent GNP growth in 1983." Price increases will then exceed 5 percent because of increasing social security taxes, rising excise taxes, natural gas deregulation, and a restoration of business markups.

Houthakker at first doubted that the Fed had abandoned monetarism

last month, and now he believes it "even less." He believes we have made substantial progress in reducing inflation, although we cannot declare victory yet. Raw materials prices are depressed, and he foresees 5 percent increases in new wage settlements. "With productivity increases of 2 or perhaps 3 percent next year, unit labor costs should increase much less than 5 percent," allowing inflation to decelerate further. Houthakker believes that growth will be very slow until the second or third quarter of 1983 and that capital spending may not recover until 1984.

SECOND DISTRICT--NEW YORK

Reports from business leaders throughout the Second District suggested that the region's economy has stopped declining though concrete signs of an upturn remained limited. Retail sales exhibited some sluggishness at the beginning of October but improved modestly in recent weeks. Although residential building was still at depressed levels, builders have turned more optimistic. Nonresidential construction activity continued strong. In manufacturing, further layoffs occurred but at a greatly reduced rate. Even with some emerging signs of stabilization in the District's economy, few of our business leaders foresaw an immediate upturn. Concern over the future course of interest rates was voiced by a wide range of our contacts.

Consumer Spending

Retail activity was sluggish at some stores at the beginning of October but improved modestly in more recent weeks. For the month as a whole sales generally ran above the year-earlier pace. Nevertheless sales volume did not meet expectations of some merchants. However, national retailers again reported that sales tended to be better in the Eastern region than elsewhere around the nation. Basic apparel and fashion goods were mentioned as strong items and one store noted a pickup in home furnishings. Inventories were generally in line for the holiday season, but a few merchants reported some excess, but not worrisome, accumulation. Most retailers expected sales to hold up for the remainder of the year, but only with continued heavy promotional activity and aggressive pricing.

Construction and Real Estate Activity

For the first time in several months, the residential construction market showed some signs of life. While actual starts and sales of new homes remained slow in many areas of the District, builders were generally more optimistic than they had been earlier. Real estate people noted a decided pickup in buyer inquiries which they attributed in part to the decline in mortgage rates. The continued high level of interest rates on construction loans, however, dampened builder enthusiasm for initiating new projects. Home prices in the region remained steady with sellers still offering concessions such as buy-downs.

Nonresidential construction activity continued strong as a result of projects currently underway, but announcements of major new projects were still scarce. Nevertheless, respondents felt that an upturn was closer at hand. Even though the office market in the suburbs remained soft, Manhattan experienced a small but definite increase in leasing activity, the first such increase in over six months. Moreover, office rents have stopped slipping and the amount of vacant space did not increase.

Business Activity

Reports from business leaders throughout the District reinforced the view that the region's economy may have hit bottom. Although layoffs continued, they occurred at a much reduced rate. Business activity for many defense contractors, high technology manufacturers, and finance and other service companies held strong. Unemployment rates in the region remained below the national rate, rising less rapidly here than nationwide since the beginning of the year. Initial claims for unemployment insurance have

basically held steady, in contrast to the recent sharp upturn at the national level. Many of our respondents had previously expressed fears that the current recession would eventually trigger a repeat of the greater-than-national decline of the District's economy as occurred in the early seventies. They now, however, feel more confident of the ability of the region to ride out the recession without a major collapse. Some areas of the region, including New York City, have even weathered the recession thus far without experiencing any year-over-year drop in employment.

Outlook

While the local economy appears to have stopped declining, few of our respondents saw signs of an immediate upturn. Indeed some respondents feared that the national economy had not permanently bottomed out but had merely paused before resuming its downward slide. Uncertainty over the outlook grew from concerns that 1) the large deficits projected for all levels of government would bring back high interest rates; 2) the recession would continue at the national level and begin to permeate the nonmanufacturing sector; and 3) increases in the number of workers exhausting their unemployment benefits would dampen consumer spending. Skepticism as to the likelihood of any quick rebound was reinforced by a New York State Department of Labor official who found no strengthening in the average number of hours worked per week, normally a precursor of any improvement in the economy. Nevertheless, manufacturing inventories remained lean and companies appeared ready to step up production in response to any strengthening in orders.

Financial Panel

This month we have comments from Irving Auerbach (Aubrey Lanston) and John Olcay (New York representative of London's W. Greenwell):*

Auerbach: Saw no prospects for a significant recovery unless interest rates fall much further. Even if that should happen soon, the impetus to greater output would not take effect before the second quarter of next year. So it is unlikely that 1983 will turn out to be strong.

Olcay: Echoed similar thoughts. An immediate cut in short-term interest rates of about 2 percentage points is both warranted and necessary for any recovery to begin. The risks in terms of inflationary expectations are minimal, because the European economies are very weak and will not snap back until a U.S. recovery is well underway (by which time the Federal Reserve can again safely target M1). So commodity markets will not tighten. Olcay put particular emphasis on the dollar's strength, which has severely eroded U.S. export competitiveness. It means that the domestic economy will have to grow by 1-2 percent just to keep overall GNP level.

*Their views of course are personal, not institutional.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District in November point to mixed local economic conditions. Manufacturing is showing signs of a hiatus after a short recovery in October, but retail sales have perked up somewhat. Mixed loan activity is reported by area bankers. Mortgage rates have dropped, giving the housing sector a boost.

Third District businessmen are very cautious about the prospects for improvement over the next six months. A weak recovery is expected in the manufacturing sector while a moderate pickup is expected in retailing. Bankers foresee lower interest rates and slipping business loan demand.

CONSTRUCTION AND REAL ESTATE

Spurred by a rapid decline in mortgage rates, the Third District housing market has revived substantially in the last six weeks according to industry contacts. Conventional mortgage rates have dropped into the 13 to 14.50 percent range, pushing housing activity above the disastrous levels of a year ago. Market conditions, however, are still described as soft by area real estate brokers. Sales are reportedly running somewhat behind those of a "normal" fall and contacts say that mortgage rates in the neighborhood of 12 percent are necessary to induce buyers to enter the market in force. Most of the sales activity is in pre-owned homes. With new home prices depressed, builders report little improvement in the market for new construction; housing starts remain at a virtual standstill.

MANUFACTURING

Manufacturers participating in the November Business Outlook Survey report that local industrial activity, which showed marked improvement in October, has slipped marginally this month. The gains indicated in the October survey were the most widespread in over a year and the only significant improvement noted thus far in 1982. It

is evident from the latest survey, however, that area industry continues to struggle. New orders have held steady in November, but shipments, after two months of steady growth, have fallen off slightly. Manufacturers continue to reduce industrial payrolls and have also cut back again on working hours. In addition, inventory liquidation is still pervasive.

Looking ahead, respondents are still very optimistic that expansion in the industrial sector will resume over the next six months. Almost four out of five participants project a strengthening in general activity between now and May, characterized by widespread gains in new orders and shipments, along with growing backlogs. But there is little feeling that inventory rebuilding is in the picture yet. Plans for capital spending remain weak, emphasizing respondents' caution regarding the recovery.

The prices firms charge for their own products dropped marginally in both October and November, the first price cuts in area manufacturing since the end of the 1973-75 recession. Input costs, on the other hand, remain largely unchanged from their September levels. Manufacturers predict that between now and May, as the industrial sector rebuilds, prices of both raw materials and finished goods will begin to rise again.

RETAIL

Sales at department stores in the Third District are beginning to show more life. Volume has improved since September and now ranges from zero to four percent above the levels of a year ago. Retailers say, however, that in light of the poor showing by area stores in 1981, sales activity is still very weak. Local merchants, who expected the upswing, indicate that much of the spending is for promotional items, lower-priced luxury goods, and less-expensive hardgoods such as kitchen appliances.

Retail contacts continue to be cautious about sales over the coming months. The present uptempo buying is expected to continue through mid-December, when a brisk holiday season should kick in. Gains for 1982 on the whole, however, are projected to be on the order of only three to four percent. Merchants foresee a slow pickup continuing into the second quarter of 1983, resulting in sales two to six percent above year-earlier volume by May.

Retail inventories have been kept trim in response to the slow activity prevalent through most of this year, and are now slightly below last year's levels. Retailers have no plans to alter stock levels in the near term.

FINANCE

Third District loan activity has turned mixed recently after increasing through early October. A swing to long-term corporate debt, facilitated by lower interest rates and declining inventory financing requirements, has slackened the demand for business borrowing. As a result, C&I loan volume has slipped since the last Redbook. Current estimates put commercial lending only four to five percentage points ahead of last November and a little below bankers' expectations. Consumer loans, as expected, are seeing more action again this month, due mainly to the drop in interest rates on consumer loans and an increased effort by local bankers. The volume of retail loans, however, remains well below year-ago figures.

Bankers are forecasting a continuation of present trends in area lending over the next six months, depending on the strength and timing of the expected recovery. Less distress borrowing and increased reliance on the corporate bond market should soften business loan demand even further. Consumer borrowing will probably grow strongly, according to contacts, as both lenders and borrowers find retail loans more attractive.

The prime rate at Third District banks has dropped to 12 percent from 13.50 percent in September. A downward trend is expected to pull the prime down as far as 10 percent sometime late in the second quarter of 1983 before it firms up. Other lending rates at area banks, including mortgage rates, are expected to follow suit.

Deposit flows in the Third District appear healthy in November. Demand deposits are up sharply since September; bankers attribute this jump to slow reinvestment of maturing All Savers' dollars. Time deposits have improved as well, especially the new 7-31 day time deposits, and are now as high as 14 percent above last year at this time.

FOURTH DISTRICT ← CLEVELAND

Overview

Forecasts of fourth quarter economic activity have been scaled down. Steel and automobile manufacturers plan inventory reductions this quarter. The housing outlook remains bearish. Personal consumption expenditure is expected to grow modestly. Manufacturers expect shipments, inventories, backlogs, employment, and hours worked to decline in November, while orders stabilize at the low October level. Automobile, steel, and capital goods producers face continuing weak sales. District unemployment rates exceed the national rate as additional plants are being shut down and workers laid off. Some firms are obtaining labor-cost concessions.

National Outlook

Economists who attended the Fourth District roundtable meeting on October 29 at this Bank scaled down their forecasts of economic activity from their June forecasts. The median of 30 forecasts now shows a 2.6 percent annual rate of increase in real GNP in the fourth quarter, 3.1 percent in the first quarter, 3.0 percent in the second quarter, and 4.0 percent in the second half of 1983. Only three of the forecasts show declines in the fourth quarter, and none show declines in the first and second quarters. However, several of the roundtable participants prepared their forecasts before third quarter preliminary GNP data were available, and some of those now expect a decline in the fourth quarter. The median forecast shows the Implicit Price Deflator accelerating to a rate of 6.1 percent in the fourth quarter and then moving to 5.6 percent in the first quarter and 5.9 percent in the second quarter. The

median forecast has unemployment averaging 10 percent in the fourth quarter, 9.8 percent in the first and 9.7 percent in the second.

Inventories

Additional inventory decumulation appears likely this quarter. A steel firm forecasts steel mill inventories will fall an additional 1 million tons by year-end, bringing to 4 million tons the total mill inventory reduction in 1982. The firm, however, expects no further decline in customer steel inventories. Automobile producers plan to reduce their inventories in the fourth quarter. A steel firm expects truck inventories to be reduced in the fourth and first quarters. However, a major producer of consumer electrical durables says inventories are not excessive at the manufacturer or retail level. Fourth District observers expect inventory liquidation to be complete by year-end.

Construction

Housing industry economists are quite bearish on prospects for starts. Interest rates are not yet down to attractive levels, consumers are cautious, the inventory of unsold houses is large, and houses have lost their appeal as an investment vehicle. One thrift industry economist forecasts 1.09 million (a.r.) housing starts in the fourth quarter and 1.33 million for 1983. A producer of insulation reports only a seasonal rise in orders and expects fewer than 1.3 million starts in 1983. A bank economist predicts that, because of the lag in their decline, mortgage interest rates will not be down to attractive levels until spring.

Consumer Spending

Personal consumption expenditure remains sluggish. Real PCE nationally will increase 3.5 percent (saar) in the fourth quarter, 2.5 percent in the first quarter, and 3.7 percent in the second quarter, according to the median forecast of economists at this District's roundtable meeting. Spending is retarded by high unemployment, sluggish growth of real disposable personal income, and declines in real house price, but encouraged by declines in inflation and consumer interest rates and the rally in stock and bond prices. Overwithholding of the July tax cut should result in larger tax refunds early next year, stimulating consumer spending in the second quarter.

A major producer of household consumables says their real sales were up in the third quarter and that the consumer is buying. A major producer of consumer electrical durables reports a sharp rise in early October orders compared with a year ago, following months of declines. An official with a large department store reports that recent improvement in sales has prompted officials to raise their near-term sales forecasts from September.

Manufacturing

Preliminary results from the November survey of Fourth District manufacturers indicate continued weakening in that sector. Shipments and inventories are expected to decline more in November than in October, while employment and hours worked are expected to decline slightly. New orders are expected to stabilize after falling in October. Backlogs fell in October and are expected to fall again in November.

Automobile and capital goods sales are weak. A major auto manufacturer reports domestic producers have reduced their fourth quarter planned output to a 4-3/4 million unit annual rate. According to a major capital goods producer, orders are weak, and no pickup is expected until the second quarter.

He says output of capital goods is falling more than capital spending because export sales are falling more sharply, in response to strong appreciation of the dollar. A diversified producer of capital goods expects his real sales to decline 8.7 percent (a.r.) in the fourth quarter and rise 14.4 percent (a.r.) in the first quarter, after which they will still be 25 percent below the level of four years ago.

The steel industry is in great distress. A major steel firm asserts that falling auto production and extreme weakness in capital goods output are undermining steel consumption and extending the period of customer inventory liquidation. Steel mills are closing plants to cut costs and lengthen the time span before huge operating losses produce financial collapse. An early cyclical recovery in the economy is essential to preserve the viability of the U.S. steel industry. Another steel firm expects no increase in steel consumption in 1983, but thinks shipments will improve because steel user inventories will stop falling.

Labor Market Conditions

Labor markets in the District remain weak. Unemployment rates are higher than the national rate, as temporary and permanent layoffs and plant shutdowns continue. A major steel firm is shutting down a seamless pipe mill for three weeks, idling 500 workers. At one steel plant, 40 percent of the hourly employees have been reduced to a four-day work week. Another steel firm has suspended all operations at a plant for an expected three months, laying off 450 workers. Another steel firm is shutting down two blast furnaces and other facilities indefinitely and laying off 900 more workers. A foundry that has been operating at 25 percent of capacity is closing for six weeks. A duplicating-machine-parts plant that employs 300 workers closed permanently after union members rejected a three-year package of concessions.

Some firms are obtaining labor cost concessions. A major manufacturer of aircraft and automotive components obtained givebacks worth \$1.77 per hour in a new three-year contract. A large producer of machine tools obtained substantial givebacks in a three-year contract for one plant and gave no pledges of job security. Workers at another automotive parts manufacturer recently authorized union leaders to open concessions negotiations with the company. Most major steel firms in the Fourth District have imposed 5 percent to 10 percent pay reductions on non-union, salaried workers.

FIFTH DISTRICT - RICHMOND

Overview

There are several indications that the level of business activity in the Fifth District has stabilized somewhat over the past few weeks. Reports from manufacturers continue negative, on balance, but most industries appear to have arrested the decline or even made some gains in new orders. Overall, labor market trends are also mixed, recalls and longer workweeks in some areas and industries largely offset by shorter weeks and further layoffs in others. The retail sector remains weak by nearly all accounts. There is virtually no evidence that seasonal fall buying has materialized. Mixed reports come, as well, from the construction and housing sectors. There has clearly been no decisive move by either. Loan demand remains generally soft, including commercial and industrial, consumer installment, and real estate.

The Manufacturing Sector

Our latest survey of manufacturers suggests minor declines in shipments, new orders, and order backlogs in recent weeks. In addition, inventories shrank further, particularly materials, and employment was down noticeably. Nearly all of this observed weakness, however, was concentrated in the paper, primary metals, and shipbuilding industries. The textile industry appears to have made some significant gains while most other manufacturing groups at least held their own over the month. A respondent in the paper industry attributed the weakness at his establishment to a growing displacement of paper bags by plastic. He does not see the weakness as a cyclical phenomenon.

It does appear that manufacturing employment declined further in October despite several isolated reports of recalls from temporary layoff. Shorter workweeks and further temporary layoffs predominate in the manufacturing sector. Coal mining areas of the District continue to report weakness in mining employment. What support the labor markets are getting is coming from government, services, and some isolated manufacturing sectors or concerns.

Manufacturers' inventories remain generally above desired levels, as does current plant and equipment capacity. Prices received at the manufacturing level are reported to have declined in the latest survey period, while prices paid were essentially unchanged and employee compensation rose, although narrowly.

Retail Sales

Our information suggests that retail sales deteriorated further in October, at least after allowing for seasonal factors. The failure of the expected fall buying surge to develop may be the principal element here. Retail inventories appear to have declined modestly and remain generally within acceptable limits. Prices at the retail level showed no change according to respondents.

Housing and Construction

There have been scattered reports of recent gains in construction activity, particularly in the residential sector. It would clearly be premature to pronounce this a recovery, however. There are indications that the stock of houses on the market, both new and older, has declined somewhat. There is a sense among the financial community, however, that the expectation

of even lower mortgages rates in the near future is now a mild deterrent to some prospective buyers.

The Financial Sector

There is little indication that loan demand is recovering. Further inventory reduction in the manufacturing and retail sectors is moderating business loan activity. Consumers continue to pay down installment debt. Mortgage activity, although showing signs of life in some areas, remains very weak. Delinquencies do not seem to be a problem, although there is continuing concern over the rising number of personal bankruptcies.

Our information suggests that banks are generally retaining 50% or more of the maturing "all-savers" funds and most of that is being rolled into CDs, many of them of 30 months or longer maturities.

Expectations

Manufacturers remain among the most optimistic of respondents. A substantial majority expects improvement in the level of activity nationally, locally, and in their respective firms over the next six months. Retailers are much more cautious, anticipating little change at all over that period. Bankers, also, are very cautious. Most respondents in this sector see loan demand increasing little, if at all, in the near future.

Agriculture

The District's prospective crop output as of October 1 continued to point to significantly smaller crops of tobacco, peanuts, and cotton than last year. Record corn and soybean crops are anticipated, however.

The 1982 flue-cured tobacco marketing season was marked by record average prices and better quality leaf than in 1981. Total volume of sales

was down 12 percent from last season, however, and total value of marketings was almost \$100 million or 6 percent below a year ago. Loan receipts were up sharply in all flue-cured belts.

SIXTH DISTRICT - ATLANTA

Autumn economic conditions in the Sixth District remain weak. Most sectors of the labor market continue to deteriorate. Consumer spending has risen only slightly, and the outlook for the Christmas season is mixed. Falling crop prices continue to augur lower farm income, but poultry prospects have improved. Tourism is still off in many areas, but EPCOT is generating widespread optimism. With sustained improvements in residential building and real estate, construction remains the brightest spot in the southeastern economy.

Employment and Industry. Labor market conditions in the Southeast remain grim. The District's September unemployment rate has returned to the April level of 9.9 percent, the highest rate of the current recession and the peak of the 1973-75 recession. Tennessee's unemployment benefits fund is reported near bankruptcy. However, media reports of sharply increased unemployment in Knoxville after the closing of the World's Fair seem exaggerated. The local Office of Employment Security expects only 1,500-2,000 of the Fair's 6,700 employees to apply for unemployment benefits.

Nonfarm employment is still declining. Even in "growth" sectors, including services, trade, finance, and transportation, job expansion is decelerating. Expressions of concern over the shutdown of the Woolco chain are widespread. Most retailers polled plan to increase hours of part-time employees rather than hire more workers for the Christmas season. Public sector employment, although still declining, is not falling as rapidly as earlier, but some of our contacts expect more reductions at the state level. Construction employment has yet to reflect lower mortgage rates. Anecdotes of applicants far outnumbering positions typically accompany reports of job openings.

Manufacturing shows virtually no evidence of a turnaround. The rate of year-to-year declines increased in September, and our directors and others report additional layoffs in October in chemicals, primary and fabricated metals, transportation equipment, and machinery, including computers and other electronics. The number of new manufacturing facilities over \$0.5 million declined 40 percent through August compared to the first eight months of last year. Factory expansions were down over 45 percent. Contacts at state economic development agencies report that low utilization rates have prompted manufacturers to do only maintenance and efficiency construction and to shelve new construction plans until solid signs of recovery appear.

Consumer Spending. Taxable retail sales through September are slightly above last year in real terms in Florida, Tennessee, and Alabama but down in Mississippi, Louisiana, and Georgia. One new encouraging sign is the slight increase in sales of big-ticket home furnishings in certain areas. Purchases of men's apparel, cosmetics, auto supplies, and electronic games remain strong. District retailers report that consumers are still wary because of high unemployment. Although optimistic about the Christmas season, retailers continue to hold inventories taut. District auto sales are running far below depressed 1981 levels and behind those of the rest of the nation. Lower interest rates and new models have yet to spur sales in the Southeast. Reduced sales have resulted in a high rate of dealership attrition, particularly in rural areas.

Construction and Real Estate. Most municipal and county governments contacted report that single- and multifamily building permits remain seasonally strong, but slower growth regions, especially blue-collar areas, still show little improvement. Realtors report more traffic and sales during October. The lower FHA rate has helped attract buyers outside high-income brackets. Still, since home buyers are making much use of seller financing, thrift officers find mortgage closings less strong than hoped. Housing industry spokesmen worry that lower mortgage rates may be the result of

election engineering and thus only temporary. Realtors expect modest improvement in 1983 but only if mortgage rates drop further or stabilize. Despite improved housing sales, apartment occupancy rates remain high. The office and industrial building market is slow. Recession and high interest rates have substantially curtailed relocation and expansion.

Tourism. Our survey of over 50 tourist industry representatives reveals little change in conditions since last month. Local and less expensive tourism appears to be holding steady or improving, whereas out-of-state and international tourism is down. Respondents state that fewer delegates are attending conventions in Georgia and Louisiana; international tourists in Florida are reportedly lodging with friends and relatives and spending less, thereby depressing hotel/motel occupancy rates, attendance at attractions, and retail sales, especially in South Florida. One bright spot is the October 1 opening of EPCOT (Experimental Prototype Community of Tomorrow), which has already exceeded its own attendance projections and is expected by many to boost local tourism more than the Knoxville World's Fair, which closed on October 31. That exposition met its self-designated break-even point of 11 million visitors, but some of those polled dispute the profitability of its economic impact.

Agriculture. Available evidence does not support the widespread pessimism and expectations of large-scale farm failures. Farm lenders suggest that a higher-than-normal liquidation rate is occurring, but the percentage of farmers affected is quite small and is likely to remain low. Interest rates are declining at farm lending institutions, providing some relief to farmers renewing loans. However, this decline will not affect farmers' cash flows until at least 1983 when loans become due.

Except for poultry, conditions in the livestock industry have changed little in recent weeks. Both egg and broiler prices have increased although egg prices remain 27 percent below year-ago levels. Lower feed costs and higher prices have improved

the outlook for poultry farmers. Large supplies of corn and soybeans now being harvested continue to depress prices of these crops. Without high yields or low costs the prospect for breaking even on these two crops looks doubtful. Tobacco, sugarcane, and peanuts appear to offer the greatest opportunity for profit.

Finance. Telephone interviews with District bankers indicate that many are making advance preparations for the new money market accounts to be authorized by the DIDC before mid-December. Bankers currently offering sweep accounts have a headstart because the mechanics of setting up the two accounts are the same. Although our contacts view the new money market account as necessary and desirable, they voiced two major concerns. First, they expect the new account to drive up the cost of funds and to put banks under greater pressure to price individual services. Second, banks' reporting and compliance burden could increase since the new account becomes reservable if the three non-preauthorized, third-party transactions limit is exceeded.

Panel of Economists. Our panel of economists believes that the Fed has eased monetary policy in recent months. Nearly all approve of this perceived change as a means of fueling recovery without reigniting inflation, although one urged a more straightforward acknowledgment by the Fed of its shift in policy. Our respondents detect much internal restructuring in lending activity since the drop in interest rates. Businesses are lengthening their debt maturity; builders are lining up construction loans; homeowners are refinancing mortgages. Other borrowing has not increased substantially. Most of those surveyed believe interest rates will continue to fall at least through Spring, 1983. Except for some improvement in construction, economists see no signs of incipient recovery in their states. There was no consensus regarding the timing and strength of recovery. A slight majority anticipates less than normal Christmas spending, but opinion varies widely on this issue.

SEVENTH DISTRICT--CHICAGO

Summary. The region of the Seventh District continues in a deep recession. The expected "turn" in general activity has not occurred. On the contrary, most indicators are still declining. However, morale has been boosted by recent strength in both the equity and debt capital markets. The election results are not expected to significantly affect the near-term economic outlook. Easier mortgage credit has increased sales of residential properties, but from a very low level. Nonresidential construction is heading down. Output of durable goods has declined further, but there are signs of a leveling in nondurables, such as paper. More plants are being closed, some permanently. Layoffs and terminations of workers are causing widespread distress. State and local governments are cutting programs, reflecting financial strain. Retail sales remain weak, but some merchants are encouraged by trends in recent weeks. Large harvests and weak demand for grain are placing additional downward pressure on crop prices and income. District farmland values declined 5 percent in the third quarter, and 16 percent in the past 12 months.

Purchasing Managers Pessimistic. October reports of purchasing managers associations in both Chicago and Milwaukee show further substantial declines in employment, output, new orders, and backlogs. Rapid deterioration was first evident in these reports in the fourth quarter of 1981. Since then the downtrend appeared to be losing momentum at times, thereby raising hopes for a turnaround. But recent months have shown no glimmer of improvement. Inventories continue to be reduced generally, but are still viewed as excessive in some companies. Order backlogs have virtually evaporated for many. Starting last February, prices paid have averaged lower every month, an

unprecedented development since World War II. (A year ago price increases substantially exceeded decreases.) An interesting but disturbing development in October was a moderate deterioration in vendor performance, attributed to suppliers that have contracted or closed operations.

Financial Pressures. Most District manufacturers and retailers are reporting either reduced profits or losses for the third quarter. Losses are cutting deeply into net worth in some cases, and, along with heavy debts, are causing reductions in credit ratings, and associated increases in interest costs. Some companies are reporting losses and reducing dividends for the first time in decades--since the depths of the Great Depression in some cases. Managements stressing "survival strategy" are reducing corporate staff, and contracting operations by selling or closing divisions. The used equipment market has been hit by auctions of items from closed plants, especially in the farm and construction equipment sector. Capital expenditure programs commonly are being cut back, even when acquisitions would greatly increase efficiency--e.g. automated office systems.

Price Cutting. Widespread price cutting prevails to an extent unknown since the 1930s. Discounting is especially "horrendous" in steel, nonferrous metals, and building materials. Railroads and truckers are engaged in "rate wars" now possible under deregulation. Retailers are offering sharp cuts from list on "designer" apparel, appliances, and current books. There are also numerous retail bankruptcy or "liquidation" sales, some of which seem to be on a sustaining basis. Meanwhile, costs of utility services, local taxes, insurance, and medical care continue to advance at a rapid pace.

Motor Vehicles. October auto sales declined substantially from September after seasonal adjustment. After several reductions in plans, fourth quarter auto output will be well below last year's poor level. Truck output will be

about even. U.S. output is even weaker than sales because of increased net imports of "domestic" vehicles from Canada--about four times last year's rate. Independent suppliers of parts are in deep trouble. Major captive finance companies recently reduced finance charges substantially. Some banks also advertise lower charges, but most banks are not vigorously seeking auto loans. Although auto dealers attack high interest charges as the main impediment to sales, many potential customers are deterred by high prices and concern over reliability of new domestic models.

Capital Goods. The District's important capital goods industries are in a crisis. Some large, diversified firms are drastically contracting operations. Some have stopped making certain parts in favor of purchases from outside. Plant closings appear to be accelerating. Almost without exception, demand for capital goods is weak with no sign of improvement, not even for parts and operating supplies which usually signal the early stages of an uptrend. Some capital goods producers anticipate no significant change for the better until well into 1983--perhaps into 1984.

Steel. Demand for steel has declined further against normal seasonal trends. Chicago-area steel plants are operating at 50-55 percent of capacity compared to 38 percent for the industry. Chicago and Detroit have been producing 40 percent of the nation's new steel, up from 31 percent a year ago. Partly this reflects less import penetration in the Midwest, but also relatively more efficient plants. Motor vehicle demand for steel, counted upon earlier to boost total output in the current quarter, is being reduced further. Oil and gas industry demand, insatiable a year ago, is now the weakest sector.

Housing. Home builders report an increase in both traffic and confirmed sales in the past six weeks. Mortgage rates have declined about three points

since last spring. Because of cold weather housing starts in the District will not be helped by easier mortgage credit until next spring. The recent expansion of S&L powers to make consumer instalment loans and business loans may direct a substantial portion of any savings inflows away from housing. Officials of some very large S&Ls have vowed never to get "into that fix again"--i.e. total reliance on long-term assets funded by short-term liabilities.

Agriculture. Progress of the District's large crop harvests varies widely. Illinois, Indiana, and Michigan harvesting is well ahead of normal. In Iowa and Wisconsin, however, harvesting is behind schedule. Crop prices are seriously depressed, reflecting the record harvest and reduced projections of both domestic utilization and export demand. Depressed conditions in agriculture continue to exert downward pressure on farmland values. District agricultural bankers report that farmland values declined 5 percent in the third quarter, and 16 percent in the year ending in September. Further declines are expected, in part reflecting financial pressures that are forcing some farmers to liquidate capital assets.

VIII-I

EIGHTH DISTRICT - ST. LOUIS

Although economic activity in the Eighth District remained depressed in October, increased consumer outlays point to a developing recovery. Respondents noted that inventories are near desired levels and that prices have been more stable in recent months, providing a better climate for an economic rebound. Production and employment, however, changed little in October, and many respondents in the manufacturing sector expect no improvement before spring. Respondents believe that long term interest rates will decline only slightly if at all over the next six months or year.

Retail sales in the District, adjusted for both seasonal differences and price changes, were moderately higher in October than in the summer and early fall. Sales strength at department stores was centered in apparel and other soft goods. Furniture dealers sold more higher quality merchandise while cheaper lines continued to move slowly. Merchants are becoming moderately optimistic about sales during the Christmas season, in part because of the increased after-tax incomes of consumers, the greater wealth brought about by higher stock and bond prices, and the lower level of interest rates. Retailers, nevertheless, have been holding a tight rein on stocks of merchandise.

Two of the most depressed sectors of the District's economy, autos and homes, also improved slightly during October. Automobile dealers reported sales increases for both new and used cars; one Ford dealer claimed sales were 10 percent above October 1981. Price concessions, heavy promotion and lower interest rates contributed to the sales gains.

Sales of new homes in the St. Louis area were about 15 percent greater in October than in the corresponding month last year, according to the St. Louis Homebuilders Association. Sales, nevertheless, remained nearly 70 percent below what the Association terms normal for the month. Proceeds from county revenue and state housing development bonds, which lower the effective interest rates for qualified home buyers, contributed to greater sales. Builders' inventories of unsold homes declined slightly during the month. Commercial construction in the District also improved in October.

Industrial activity in the Eighth District was unchanged on balance from September to October. Firms supplying goods for national defense continued to expand. Food, livestock feed and apparel production remained roughly unchanged. Orders and output at most other manufacturing concerns, however, were slightly lower. Inventories remained near desired levels at most firms as production was adjusted closely to the flow of incoming orders. In response to the prolonged recession and a rather bleak outlook, a few industrial firms trimmed their plans for capital expansion in 1983. On the other hand, a company dealing in motivational programs for businesses reported an increase in new accounts recently, usually an indicator that business activity will improve.

Total employment in the District was changed little in October. Some industrial firms continued to reduce their work force, largely through attrition. These declines were offset, however, by a continued expansion of jobs in the service sector and a recall of workers at an auto plant.

Agricultural output in the District was exceptionally large in 1982. In some areas, there are shortages of grain storage capacity. Also, selling prices for crops have been depressed. As a result, many farmers are in financial difficulty, especially those that began the year with sizable indebtedness. Some banks serving rural areas have been forced to extend the maturities on advances to farmers unable to repay at this time, and the quality of outstanding loans at these banks has deteriorated. Farm equipment dealers continue to report few sales, and the price of farm land drifted lower. High selling prices and low feed costs, however, have generated large profits for hog raisers. Cattle, dairy and poultry producers have also benefited from relatively favorable feeding margins.

NINTH DISTRICT - MINNEAPOLIS

Since July, open market interest rates have declined substantially and equity values have made record gains. So far, the effects of these national developments on the Ninth District have been restricted primarily to financial variables. District commercial, consumer, and mortgage loan rates have fallen, and some local corporations have begun taking advantage of improved market conditions to clean up their balance sheets.

Some sketchy evidence has emerged, however, that interest rate and wealth effects have started to carry over into the real sector. In particular, auto sales have shown some responsiveness to improved financing terms, and more would-be home buyers have been actively shopping (if not buying, as yet). Nevertheless, October home, auto, and general merchandise sales remained weak by historical standards. District manufacturing, metal mining, and lumbering continued in the same depressed condition reported in the last several Redbooks. On district farms, falling commodity prices and poor weather still were causing distress.

Financial Developments

Borrowing costs for district businesses and consumers have declined this fall, and the well-publicized reductions in the prime rate have been matched by most district banks. Local mortgage bankers and officials of the district's two largest banks and its largest S&L indicate that their rates on mortgage and consumer installment loans dropped 200 to 300 basis points in the last three months. In addition, one of the district's largest bank holding companies reduced its interest rate on outstanding credit card balances from 22 to 19.8 percent in October. Not all local firms have cut their loan rates,

though. For example, at a consumer finance company, headquartered in the district and with operations in 31 states, rates are still at usury ceilings in most of the states in which it operates.

Interest rate declines have not increased business borrowing from district banks, but rather, district corporations have stepped up their borrowing in primary securities markets. The lackluster business borrowing from banks reported in recent Redbooks seems to have continued in October. However, representatives of two major investment banking firms say that local firms have recently increased their offerings of debt and equity. A large district leasing and rental company, for example, floated a \$100 million debt issue, and equity issues were made by a large retailer and by a food processing company. The investment bankers indicate that the proceeds of these issues will be used primarily to refinance short-term debt, not to fund new plant and equipment expenditures. Furthermore, they say that many other local firms are planning to offer more debt and equity if market conditions remain favorable.

The decline in interest rates also seems to have increased consumer borrowing somewhat. An official of the nation's third largest mortgage banker, headquartered in this district, says that its residential mortgage applications rose 6 percent between July and August and 16 percent between August and September. The district's largest S&L reports that, in the week ending October 25, it received 54 applications for fixed rate mortgage loans as compared to 16 in the week ending a month earlier. This S&L has been heavily advertising for consumer loans and reports a doubling in the number of such loans extended over the last 30 days. The district's two largest banks report that consumer lending has not risen much in the last month or so, but that inquiries are up significantly.

Consumer Spending

Home and auto sales have remained weak in the district, although better financing terms have produced some hints that sales will pick up soon. Our contacts indicate that much of the recent increase in mortgage lending has been to refinance existing mortgages and contracts for deed; home sales, they say, have yet to improve. The Minneapolis Board of Realtors, for example, says that October home sales in Minneapolis and surrounding suburbs matched the weak sales reported in recent Redbooks. But future sales seem likely to be stronger because more people were reportedly shopping for homes in October than in earlier months. Similarly, regional sales managers for the nation's two largest auto manufacturers call recent auto sales "weak." But one has been more aggressive than the other in improving terms of financing and has been doing relatively better here.

General merchandise sales also have remained weak in the Ninth District, according to this Bank's directors and Minneapolis-St. Paul retailers. However, two Twin Cities retailers indicate that furniture and appliances (reported weak in previous Redbooks) showed some signs of improvement in October. This improvement is attributed to price cutting and heavy advertising, though, not to reduced finance charges.

Industrial Activity

Recent layoffs and plant closings suggest that district manufacturers have continued to retrench. In computer manufacturing, a large Minneapolis company recently announced that its work force will be reduced by 1,850, and another plans temporary fourth quarter shutdowns affecting 9,000 workers. In heavy equipment manufacturing, a construction equipment firm permanently

closed a plant in Minnesota, and a North Dakota tractor manufacturer laid off 80 people. In consumer products manufacturing, an apparel firm permanently closed a plant in Minnesota, and a major microwave oven manufacturer recently shut down its South Dakota plant for three or four weeks.

The metal mining and lumbering industries generally have continued to operate at low production levels. Minnesota's largest taconite plant, shut down in June, was supposed to resume operations later this year. It recently announced, however, that it will not reopen until "sometime in 1983." Reflecting the continuing weakness in lumbering, a large district railroad reports that in September, forest product shipments were 31 percent below those a year ago. One hopeful sign for the lumber industry is a Minnesota director's report that the state's production of wafer board (an inexpensive substitute for plywood) increased in September and October.

Agricultural Conditions

Declining commodity prices and poor weather conditions have continued to plague district farmers. Due to declines in both crop and livestock prices, the index of prices received by Minnesota farmers dropped in October-- 2 percent from September and 3 percent from a year ago. While the threat of early frost reported in our last Redbook did not materialize, farmers worry that wet weather may interfere with the harvest, which is late already. In Minnesota, for example, only 25 percent of the corn had been picked by November 1, less than half the 63 percent usually picked by that date.

TENTH DISTRICT—KANSAS CITY

Overview. While business conditions in the Tenth District remain very weak, there are some indications that the recession has bottomed out. Although retail sales deteriorated in October, the upcoming holiday season is producing cautious optimism. Purchasing agents indicate that they are no longer reducing inventories, and auto dealers seem to expect increasing demand as interest rates continue to fall. Although interest rates on farm loans are declining, bleak income prospects are producing financial stress among Tenth District farmers. Prime rates charged by commercial banks are falling and total loan demand is flat, as is overall deposit growth.

Retail Trade. Most retailers in the Tenth District report only modest sales gains in the first 10 months of 1982 compared to last year. Sales deteriorated substantially in October with sales of recreation and leisure merchandise remaining the only bright spot. Merchandise costs have not changed appreciably for retailers in recent months, but most are heavily involved in promotional price cutting. Inventories of merchandise are adequate for the coming holiday buying season, but are high relative to the rest of 1982. Most retailers remain cautiously optimistic about sales in November and December of this year.

Auto Dealers. Auto sales are somewhat weaker than at this time last year but have picked up recently. Large cars are selling to the more affluent clientele, but small car demand is quite weak. Recent interest rate declines have yet to affect automobile dealers. Rates on consumer loans have begun to ease; however, they have lagged behind declines in the prime and other market rates. Floorplan financing costs remain high. Except for 1982-model carryover,

dealer inventories are either stable, at a minimum level, or are declining. Each respondent indicated optimism about the outlook for sales and expressed the belief that declines in interest rates should free some pent-up auto demand.

Purchasing Agents. Almost all purchasing agents report input prices have fallen relative to a year ago. The amount of the decline varies from industry to industry with a precipitous drop (10-25 percent) occurring in the cost of metals, polyethylene film and wood products. The outlook for the next few months indicates a bottoming out of the downward trend in input prices. All firms forecast inputs to remain accessible into the first quarter. Clouding the horizon, though, is the possibility of further declines in the number of suppliers for a few inputs. While a few companies continue to reduce their inventory levels, the majority are satisfied with existing stocks. Plant utilization varies widely, with some plants operating at less than two-thirds of capacity.

Agriculture. Harvest progress in the Tenth District varies widely from state to state, with little damage reported as a result of frost occurring in some areas. The corn harvest is almost 75 percent complete in most states while soybeans and sorghum are lagging behind. Corn and bean production is expected to be above last year's, and sorghum production will likely be less than a year ago. Grain storage capacity appears adequate throughout the District, but when harvest is over all available storage facilities will have been utilized. The planting and growth of winter wheat is lagging slightly behind normal, except in Oklahoma where the wheat is in urgent need of rainfall. District bankers continue to be receptive to farm loan requests backed by positive cash flows. Interest rates on farm loans have recently declined throughout the District

and are averaging between 14 and 15 percent with further declines expected. The interest rate reductions are welcomed by hard pressed farmers and rural businessmen. However, bleak income prospects continue to add to the financial stress experienced by Tenth District farmers.

Banking Developments. Reported loan demand is generally characterized as flat throughout the Tenth District. Demand for construction loans is up somewhat, while energy-related demand is down. Demand for other commercial and industrial loans, consumer loans, real estate loans, and agricultural loans appears steady. Most bankers report continuing modest deterioration of loan quality. Prime rates charged by the banks surveyed range from 12 to 13 percent. Rates have fallen as much as 150 basis points from last month. Virtually all the bankers questioned expect future declines. Overall deposit growth is flat, or slightly up. NOW accounts, large CD's, and smaller saver accounts have experienced some growth. Demand deposits have continued to decline somewhat at most banks. Banks in which All-Savers deposits are a significant fraction of total deposits report that a large portion of the maturing All-Savers has been retained, either through rollover or through transfer to other types of deposits. Virtually all the banks surveyed intend to offer, and aggressively market, the new money market account being formulated by the DIDC. Opinions vary as to the expected sources of funds for this new account.

ELEVENTH DISTRICT--DALLAS

The District economy shows continued weakness in a number of areas, including manufacturing, commercial construction, agriculture, and department store and auto sales. However, the economic picture is not all bad. Residential construction appears poised for a significant upturn and auto dealers are expressing hope that declining interest rates will help revive their sales. Also, the rig count has been climbing, although seasonal factors may explain much of this reversal. Nevertheless, the economy is not yet showing clear signs of significant recovery.

The pace of residential construction is quickening. New single-family home sales and starts are up substantially, as are condominium sales. One Dallas area builder reported 52 new start orders in one week. Respondents point to the recent mortgage rate declines and the consequent increase in the number of qualified buyers as the reason for the surge in sales. Increases in new home prices are expected to be moderate for the next few months due to stable material and labor costs and declines in closing costs. Apartment construction continues to expand rapidly as new investors enter the market.

Commercial construction appears to be falling off faster than anticipated. The number of nonresidential building projects in Texas fell 42 percent from August to September, as more projects were completed than were begun. Office building vacancy rates in both the Dallas and Houston markets increased during the third quarter, indicating a growing softness in these markets. A vice president from a large Dallas bank reports that

loan request volume for office projects is off 50 percent from last year as a result of the softening.

The employment picture in Texas darkened considerably during September. The seasonally adjusted unemployment rate jumped from 6.7 to 8.4 percent as employment in the durable goods manufacturing sector fell for the seventh consecutive month. A large part of the employment decline was concentrated in Houston where it is estimated that an additional 20,000 workers became jobless. The Border region also contributed to the increase in unemployment as 23.2 percent (unadjusted) of the Laredo work force was unemployed. In October, the Texas unemployment rate fell to 8.3 percent as employment and the labor force both grew. On a seasonally adjusted basis, the number of unemployed workers was unchanged.

Drilling activity may be starting to pick up, but it's too early to tell for sure. Both the Texas and U.S. rig counts increased the past few weeks, but it is unclear whether this is a result of recent increases in domestic crude prices or normal seasonal factors. The rig count usually picks up toward year-end as firms take advantage of the fast turnaround on tax writeoffs. Since the seismic crew count has not begun to increase yet, it's likely that the drilling increase is seasonal, and hence, may not last past the end of the year.

Manufacturing production levels are essentially unchanged. Refinery output is up slightly due to the normal seasonal increase in heating oil production. Steel firm executives indicate that the industry is running at roughly one-half capacity and expect this to continue through the fourth quarter. Electronics firms report some growth in semiconductor

and consumer product demand. The latter is attributed primarily to increases in home computer sales.

Deposits at commercial banks increased a healthy 2.5 percent in September. Demand deposits jumped 4.9 percent and time deposits were up 1.6 percent. Both increases were above the seasonal norm. Member bank loans grew by 1.0 percent as business and real estate loans at large weekly reporters rose 1.7 and 2.1 percent.

Department store sales were slow throughout September and October. Dollar sales volume for the year-to-date is 2 percent ahead of last year, down from 4 percent on September 4. Profit margins are down as a result of increased promotional costs and price discounts. Respondents' expectations for the Christmas season are mixed, with some looking for a good season and others anticipating continued slow sales. Border sales are still depressed.

New auto sales have remained roughly constant since August. Sales have been slow since early summer. Inventories are up due to the addition of 1983 models to dealers' floor plans, even though orders are lower than normal. As a result, GMAC is offering 10.9-percent financing on all 1982 models, and Ford Motor Credit Company is offering 10.75-percent financing.

Texas farm income for 1982 will probably fall short of the 1981 level. Cotton production is expected to be 57 percent less than last year. At the same time, cotton and other major crop prices are well below 1981 levels due to large stocks, lower export demand and bumper crops nationwide. Livestock producers are faring a little better due to falling feed costs, but recent declines in beef and hog prices have erased much of the gain.

TWELFTH DISTRICT--SAN FRANCISCO

The Twelfth District economy remains entrenched in recession. Consumer spending is not leading the recovery, despite the tax cut, while unemployment is rising. Residential construction is still depressed, and non-residential construction is now slowing down in many areas of the District. The lumber industry continues to suffer from mill closures, layoffs, low prices, and foreign competition. Metal prices are still too low to reopen any closed mines. In agriculture, low crop prices are contributing to low farm incomes, and unseasonable rains recently caused large losses for some California crops. Depository institutions appear to be gaining funds with new types of deposit accounts, but the large amount of funds coming due in balloon-payment mortgages is a major concern among financial institutions. A survey of Twelfth District Directors indicates that unemployment is almost universally expected to increase further on both a national and regional basis, but the recent rise in bond and stock prices are seen by some as an optimistic sign.

Consumer Spending

Continuing high levels of unemployment appear to be holding back any recovery in consumer spending. Despite the recent tax cut, retail sales continued to be weak in August and September, as retail stores failed to benefit from back-to-school buying. Weak sales in early October are threatening even the holiday season's upturn. In many parts of the District, auto sales continue to be slow, despite a wide variety of sales pitches. With high consumer loan rates, consumer credit is not increasing in southern California or Utah. One bright spot, tourism in Oregon, is estimated to be up 10 percent this year over last year.

Manufacturing and Mining

Manufacturing and mining continue to be depressed in the Twelfth District. In the lumber industry, at least four more major plants and mills have closed recently in Oregon and Washington, and more are expected to close before the end of the year. In Idaho, the wood products industry is still operating at a very low level of activity. Prices of some major lumber items are now half what they were in 1979. As a consequence, prices on federal timber contracts made several years ago are well above market. To avoid defaults and further curtailment of activity, the cancelling of some contracts has been proposed. It is believed that wood pulp and paper producers are losing 20-25 percent of their business to foreign imports. While silver prices are up from a recent low, they are not high enough or firm enough to reopen any of the closed mining operations in Idaho. Unemployment in the mining areas is very high, and many workers face the expiration of their benefits in early 1983. The copper and steel industries existence in Utah are threatened by continued low prices for these products. In the Seattle area, Boeing continues to eliminate several hundred jobs each month; employment at Boeing is expected to fall from 85,000 last year to 70,000 by the end of this year.

Construction and Real Estate

Late summer brought no signs of recovery for the housing industry, though recent declines in mortgage rates have been cause for some optimism. By the end of 1982, the number of new residential permits issued in Utah will have fallen by 70 percent from the 1977 all-time high, making this housing recession the longest and most severe on record. New permits in Oregon so far this year are at less than a tenth of 1979 levels. The nonresidential construction picture is mixed. In Oregon, this activity dropped 30 percent in

August from July. In Los Angeles, nonresidential construction has slowed down; some projects have been cancelled, including a few that were underway, because long-term financing could not be found. In Washington, however, commercial construction remains strong, although office vacancies are rising; and, in Utah, nonresidential construction was up 153 percent in August from a year ago. Signs that inflationary expectations are coming down are to be found in the low bids for various large highway construction projects in Washington State; these bids were half the previously estimated cost.

Agriculture

Cold and wet weather in late August and September has caused some dramatic crop losses in California, which have been estimated to amount to between \$150 million and \$300 million. Raisins, wine grapes, and almonds all suffered losses. Low prices and rain have combined to cut farmers' income from this year's harvest of alfalfa, tomatoes, and lima beans. Low prices and weak demand continue to keep farm income low, and are threatening farmers in some areas with the loss of their farms.

Financial Institutions

The drop in interest rates appears to have generated demand for restructuring debt, rather than much new investment. Increased inquiries about home loans may signal a real estate market improvement, but may also result from borrowers' desire to refinance balloon payment loans amounting to an estimated several billion dollars. The new variable rate account is attracting funds to depository institutions, and there has been some recovery in core deposits recently. Delinquencies and bankruptcies are not causing noticeable problems, though some financial institutions are having to take over real estate. A

survey of Twelfth District Directors indicates that recent declines in interest rates have not reduced the number of problem loans and a substantial reduction will not occur until the economy improves.