SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

June, 1983

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SUMMARY*

Overview

Economic conditions are improving. Reports of solid increases in retail sales are widespread; hard goods such as appliances and home furnishings are moving particularly well. In manufacturing, orders and shipments have increased for consumer products and for the materials and parts used to fabricate these products. Demand is also strong for construction materials. However, most capital goods industries are still waiting for the recovery. Housing sales and construction remain vigorous, but in some areas the pace has slowed from that set earlier in the year. Financial institutions continue to experience deposit growth; inflows to MMDAs have slowed but are still substantial. Loan demand remains sluggish.

Retailing

Retail sales are up in almost all Districts, with Boston, Philadelphia and San Francisco reporting year over year increases in double digits. Sales of appliances, furniture and other hard goods are generally stronger than sales of nondurables, although apparel is selling well in a few areas. Auto sales have picked up; bigger cars are in the greatest demand. Low interest rate programs are an important stimulus to car sales according to Dallas and San Francisco. Retailers are optimistic about prospects for the rest of the year. Inventories have increased, but for the most part are considered satisfactory.

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*Prepared at the Federal Reserve Bank of Boston.

Manufacturing and Mining

Manufacturing orders and shipments are increasing. The demand for lumber, gypsum and other building materials is especially strong. Atlanta reports that cement plants and lumber mills expect to operate near capacity in the next few months and Chicago finds gypsum board plants already at full capacity. Production of consumer products and inputs to consumer products has also strengthened. The improved outlook for auto sales is having a broad impact, with Boston, New York, Cleveland, Chicago, Minneapolis and San Francisco reporting increases in a variety of auto-related products. Defense is another source of strength in the St. Louis and San Francisco Districts, high technology products in New York and Dallas. The major area of weakness is the capital goods industries; Boston, New York, Cleveland, St. Louis and San Francisco all note that these industries have seen little evidence so far of a recovery. An important exception is Chicago which reports an upturn in capital goods production, mostly for replacements rather than expansions. Both Chicago and Boston note that the high value of the dollar is discouraging exports.

The increases in manufacturing activity have been achieved largely through increases in the workweek, but the Philadelphia, Cleveland, Richmond, Atlanta, Chicago and San Francisco Districts have also experienced increases in manufacturing employment.

Manufacturing inventories have fallen recently, according to Cleveland and Chicago. A large part of the decline observed by Chicago was involuntary, with sales exceeding expectations; rebuilding is now underway. Richmond and St. Louis find that a majority of firms are satisfied with current inventory levels.

Decreases in drilling costs have stimulated oil and gas exploration in the Minneapolis and Dallas Districts. Metals mining in the Minneapolis District remains depressed.

Construction and Real Estate

Housing sales and construction remain vigorous, well above 1982 levels; but Philadelphia, St. Louis and Cleveland report that the pace has slowed from that set earlier this year. Demand has shifted towards smaller less costly homes according to New York and San Francisco and to more expensive homes according to Cleveland and Atlanta. Realtors in several districts expressed concern about the effects of rising mortgage rates; however, Atlanta and Chicago speculate that the small rate increases so far may have spurred sales, as potential buyers sought to lock-in current low rates. Boston and Chicago note that buyers continue to show a strong preference for fixed rather than adjustable rate mortgages.

Those districts commenting on nonresidential building activity generally see a lot of work in progress but few new projects. An exception is San Francisco which reports that although construction activity is below year ago levels, nonresidential building permits are increasing.

Banking and Finance

Deposits continue to grow at financial institutions in all districts reporting on this subject. Inflows to MMDAs account for a large part of the deposit growth, but Philadelphia, Cleveland, Atlanta and San Francisco note that the growth in MMDAs has slowed. Loan demand remains sluggish, with only Philadelphia, Atlanta and Minneapolis reporting substantial growth overall. Commercial and industrial loan demand is especially weak. Faced with a shortage of attractive loan applications, financial institutions in the Dallas and San Francisco Districts are increasing their holdings of securities.

Agriculture

Cold and wet weather delayed plantings in most Districts. Crop development is back to or close to normal in the New York, St. Louis and San Francisco Districts, but still behind schedule in Chicago and Minneapolis. Kansas City notes that while plantings of row crops were delayed, the wet weather has produced an excellent wheat crop and good range conditions. The PIK (Payment-in-Kind) program is seen as having a positive effect on the incomes of wheat, corn and cotton farmers, but Atlanta warns that livestock farmers and agricultural suppliers will be adversely affected. Chicago and Minneapolis see abundant world supplies and weak export demand putting downward pressure on agricultural prices.

FIRST DISTRICT - BOSTON

Retailers in the First District are enjoying strong sales gains, with hard goods moving particularly well. However, many manufacturers have still not seen much evidence of a recovery. Sales of consumer and intermediate products have strengthened but orders for capital goods remain depressed. There is apparently considerable interest in capital goods, with a number of manufacturers reporting increases in the volume of inquiries and requests for proposals, but potential buyers are unwilling to make firm commitments. In both retailing and manufacturing, plans for price and wage increases in 1983 are moderate and are consistent with continued low rates of inflation. Most respondents are aggressively pursuing increases in productivity. In the banking sector, two of the largest banks in the District recently announced a merger.

Retailing

Retailers in the First District reported continued strong sales gains this year, and optimism for similar or greater strength through the third and fourth quarters. Prices are reasonably stable, so gains will be mostly real; vendor prices are also stable, so margins continue to be strong. Inventory positions are mixed, but none was considered to be grossly unsatisfactory.

Reported sales increases for May were generally above plan and ranged from 7 to 20 percent over May last year. Hard goods were selling substantially better than soft goods, although men's sport apparel was also said to be performing well. Those contacts able to make interregional comparisons said sales increases continue to be stronger in New England than elsewhere.

Firms with sales below plan or with slower sales growth in May than in April reported higher-than-desired inventory levels, but foresaw no serious problems in bringing inventories back into line. One contact noted that "lessons learned during recent hard times" allowed them to support a greater volume of business with leaner inventories than previously thought possible.

Manufacturing

Manufacturing respondents say that the rate of recovery so far has been modest at best. Capital goods producers, in particular, have seen little evidence of an upturn. Inquiries about capital products and requests for proposals have increased but potential buyers are unwilling to commit themselves. While some respondents attribute the weakness in capital spending to low capacity utilization and the buyers' lack of financial resources, others see a lack of confidence in the recovery as the primary problem. Capital goods sales to utilities and other energy-related industries are especially weak. Reports are more encouraging for consumer goods and intermediate products. The improved outlook for the domestic auto industry is beginning to have a positive effect, with sales increasing for a variety of automotive products.

Several respondents report that demand has picked up in Canada and Europe. For most, however, overseas markets are weaker than those at home; the strength of the U.S. dollar is seen as a substantial barrier to exports.

Prices, Wages and Productivity

Retailers and manufacturers expect the rate of inflation over the next two years to be moderate, and their own price and wage plans support this view. No one plans very large price increases and a substantial number will not increase prices at all in 1983. Buyer resistance to price increases and low capacity utilization are the most commonly cited reasons for restraint.

For high technology products, technological advances and competitive pressures will bring prices down. Wage increases in 1983 will generally be smaller than in 1982, and at some firms, merit will play a greater role in the awarding of increases. Although recent productivity gains are partly due to the current phase of the business cycle, most respondents have major programs to increase productivity over the long run. These programs involve greater use of performance goals, changing purchasing and other procedures, and automating where feasible.

Real Estate

The residential real estate market is vigorous, although borrowers are said to be very sensitive to fluctuations in the mortgage rate. Borrowers also have a strong preference for fixed rather than variable rate mortgages. Substantial numbers of first time buyers are said to be entering the market and, at least in the Boston area, are choosing more modest single-family homes in more distant suburbs over similarly priced, more lavishly equipped condominiums downtown. Several developers expressed the view that condominiums have become much less attractive investments. Apartment construction remains an unattractive investment unless it is subsidized, but some lenders say that the purchase of existing properties run by professional managers can offer very good returns. There is great interest in real estate-based tax shelters.

Banking

In the past six months, Massachusetts, Rhode Island and Connecticut have passed interstate banking bills. These permit banks in New England states with reciprocal legislation to acquire or merge with local banks. In

New Hampshire similar legislation was tabled. Maine already had interstate banking legislation which is national in scope. With the passage of the Connecticut bill in early June, CBT, the largest bank in Connecticut, and Bank of New England, the third largest bank in Massachusetts, announced a merger. The new bank will be the second largest bank in the New England region and the largest in terms of domestic deposits.

Second District - New York

Introduction

The economic recovery continued at a steady pace in most of the Second District through May and June, but some industries and regions are not yet experiencing renewed economic growth. The most dynamic sectors of the District's economy were homebuilding, high technology industries, some automotive suppliers, and the financial and service industries. The regions in which these industries dominate--New York City, Northern New Jersey, Long Island, Syracuse, and Albany--are performing well. It also appears that the patrons of upscale retail establishments are spending much more than they were last year.

In the regions that specialize in the manufacturing of steel and producers' durables recovery has yet to begin, and some observers of these areas are not even sure that the recession has bottomed out. Unemployment rates remain above 13 percent in Buffalo and Elmira, for example. In general, the unemployed manufacturing workforce has not been called back in large numbers. Other weak spots include the agricultural sector and, possibly, the office construction industry as well.

Some local firms are beginning to increase their borrowing from banks as economic activity strengthens, but overall the pickup remains spotty. New inflows of deposits associated with the MMDAs have encouraged banks to be more aggressive in expanding loans to businesses, and demand has strengthened for construction loans, inventory financing, and loans to computer-related companies. Nevertheless, in the industries and regions where the economic recovery has not been felt, loan demand remains very sluggish.

On the price side, only a little immediate upward pressure has been felt on most prices. However, some shortages of construction materials have developed, and the increasing cost of medical insurance is raising widespread concern.

Manufacturing

With the exception of the heavy industrial plants of the Buffalo area, most District manufacturers are reporting increases in orders and shipments. The high technology sectors on Long Island and in the Albany area have done especially well, and the automotive suppliers near Jamestown and Syracuse are beginning to resupply the "Big Three." However, growth in output has not yet translated into decreases in unemployment in most places. Unemployment in all of the District's major labor market areas, except Poughkeepsie, remains higher than it was a year ago. Employers, for the most part, have been increasing the length of workweeks instead of recalling laid off workers.

Retailing

The District's major retail chains continue to compete intensely for market share. Sales to middle income households especially have been described as a "competitive blood bath". The stores serving high income clientele have enjoyed the largest sales increases over last year, while the lower priced chains have had substantially smaller gains.

The Financial Sector

The drop in interest rates since last summer continues to improve the earnings outlook for thrift institutions in the Second District. On average, quarterly losses at New York State mutual savings banks were considerably smaller in Q1 1983 than during 1982. Similarly, by the end of 1982 over half of the savings and loan associations in New York and New Jersey had turned profitable, and more recently this proportion has risen further.

Deposit inflows at thrifts have increased as a result of the MMDAs, particularly outside of New York City. New savings inflows to New York and New Jersey S&Ls have picked up in 1983, and recent inflows appear to have been the strongest in several years. At New York mutual savings banks, the rise in net deposits since last year has generally been more modest. In part this reflects the high degree of competition for funds in the New York City market. Moreover, some of the savings banks are not aggessively expanding their liabilities as a result of concern over their capital positions.

Public Finance

The continuing strong performance of the New York City economy--led by the finance and service industries--has improved local fiscal circumstances markedly. In January the City's financial analysts were predicting a large deficit and local leaders were planning large tax increases and the layoffs of some 4,000 school district employees. Since then, revenue collections have exceeded expectations in every month. The latest projections envision a substantial budget surplus, and plans are being considered for service improvements.

The stronger than expected performance of the City's economy and the improved condition of its treasury helped pave the way for New York's reentry into municipal bond markets. The City's first competitive bond issue since the fiscal crisis of the mid 1970s recently received a respectable welcome in the market, although still at a relatively low credit rating.

Agriculture

The wet weather this spring is not expected to reduce crop production in New York State. However, net farm income was flat in New York last year and is expected to remain so this year. Corn acreage has been reduced through the Payment in Kind program, but PIK does not apply to New York's large dairy and fruit industries. Agriculture should, therefore, remain a weak sector of the District economy.

Construction and Real Estate

Housing sales and construction continued to increase in May though they were curtailed somewhat by the bad weather. In recent weeks some signs have emerged that buying activity has spread to smaller, less expensive homes, in contrast to the first quarter when sales were largely confined to the more expensive end of the market.

In the northern and eastern suburbs of New York City and in Syracuse, commercial real estate and construction markets remained quite active. In other areas, the amount of new space about to come on market suggests that construction starts will be sluggish through 1983. However, most observers of commercial real estate in the District remain optimistic regarding the prospects for filling existing office space and expect new construction projects to follow before too long.

Wages and Prices

With two exceptions, major wage or price increases are not likely this year. Most wage settlements are calling for increases below six percent, and most industries apparently consider competition too strong to venture significant price increases.

One exception is building materials. Contractors are experiencing shortages of lumber and of skilled labor. However, increases in the prices of these inputs are typical during the early phase of an expansion of housing construction.

The second exception to the general picture of price stability is causing more concern. The costs of health care, and therefore of employee medical insurance, continue to increase quite rapidly. Employers are beginning to experiment with and even implement changes in their medical insurance programs aimed at reducing these costs. Some savings have been realized, but changes are meeting employee resistance.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District point to further improvement in regional economic conditions in June. The vigorous expansion in the manufacturing sector has continued this month, pushing industrial prices up slightly, and local retailers report double-digit sales growth at area department stores. Loan volume has picked up unexpectedly in June, but deposit growth at area banks has moderated. Real estate sales, however, have slipped and construction activity has levelled off.

Third District businessmen predict continued gains through December. Manufacturers expect the industrial recovery to carry on at a brisk pace at least through year-end. Retail sales are projected to finish the year on a strong note as well, and merchants are beginning to rebuild inventories in preparation for a December surge. Bankers foresee modest improvements in lending activity, with better growth in retail loans but only slowly developing commercial demand.

REAL ESTATE AND CONSTRUCTION

Activity in the Third District housing market has backed off a little in June. Overall sales are still in good shape on a year-over-year basis, about 25 percent ahead, but many real estate brokers fear that a recent rise in mortgage rates may have nipped rising demand in the bud. Rates have climbed 25 to 50 basis points since mid-May, and that rise has shown up in lighter traffic and slower sales, particularly of newly constructed units. Third District construction activity is flat in June and builders say new starts are not as numerous as earlier in the year.

MANUFACTURING

Manufacturers responding to the June Business Outlook Survey say local industrial activity has grown sharply again this month as the recovery in the manufacturing sector maintains its brisk pace. Overall business conditions have shown consistently widespread improvement in each of the last five months, which, according to survey results, is the most sustained strength exhibited by area industry in well over five years. Both new orders and shipments have increased substantially in June and employers have been hiring additional workers and lengthening their average workweeks. Stock levels, however, have been reduced again at area plants.

General activity is expected to show further improvement over the next two quarters. Respondents predict that new orders will play the lead role by climbing considerably, and producer backlogs are likely to increase. Manufacturers also expect to bolster factory payrolls and working hours by December. In addition, increases in capital expenditures are planned by nearly one third of participating businessmen.

Reports of industrial price hikes in June, though still not as widespread as in the late 1970s or early 1980s, are more prevalent than they have been in over a year. Whereas in mid-1982 very few Third District businessmen reported rising prices, one-fourth say they are paying more for raw materials in June than they did in May, and one-sixth report a boost in their own products' prices since last month. Survey results indicate that further increases are likely by the end of the year.

RETAIL

Department store sales in the Third District have surged ahead in June, according to retail contacts. Gains in current dollar sales over a year ago are surprisingly strong this month, hitting double digits at many retail outlets. In the last six weeks, household furnishings and other durable goods have been moving especially well. Merchants cite improved consumer attitudes and favorable weather conditions as contributing factors in the better-than-anticipated business. Promotional activity, however, also continues to play an important role in generating sales.

Area retailers are getting bullish in their forecasts and foresee big sales gains in the next six months. Rapidly growing sales are expected to push December volume 8 percent to 10 percent over fairly strong year-earlier levels. Store operators predict that consumers will spend at least part of their July tax cut and expect rising employment to loosen purse strings even more. By most accounts, a banner Christmas season is in the making and the rosy outlook has prompted many merchants to add to stock levels, albeit cautiously. Inventories are now ahead on a year-over-year basis, and carefully controlled growth is planned for the rest of the year.

FINANCIAL

Third District bankers say loan activity edged upward in June. Commercial lending bounced back after dipping in May but volume is still only slightly ahead of a year ago. Although demand for traditional business loans for working capital and inventory financing remains weak, demand for short-term operating loans has been strong enough to result in the small and unexpected increase in overall C&I loan volume. Retail lending has picked up again this month as well and, according to contacts, volume is now as much as 10 percent above last June. Consistent economic recovery apparently has buoyed consumer sentiment and increased retail credit demand. Interest rates, however, remain high relative to historical standards, keeping consumer lending activity below the levels most bankers had been hoping for.

Area bankers do not foresee any major changes in present lending trends between now and the end of the year. Modest improvement in consumer loan activity is anticipated as the economy builds steam, but the recovery still has a long way to go before C&I loan demand picks up significantly, lenders say. Corporate capital spending plans are expected to stay soft well into the fourth quarter.

The prime rate at major banks in the Third District is unchanged at 10.5 percent in June. The stickiness in interest rates over the last several months has led local seers to revise their forecasts and most now believe that rates have reached the trough of their cycle. Analysts predict that rates will average slightly higher in the third quarter than in the second quarter, and, by late in the year, expanding credit demands and large deficits are expected to exert further upward pressure.

Deposit flows in the Third District are still healthy but they have softened in June as they did last month. Demand deposits slipped again and now only range from unchanged to 4 percent ahead of last June. Time and savings deposits remain well ahead on a year-over-year basis despite slower growth resulting from reduced activity in MMDAs.

FOURTH DISTRICT - CLEVELAND

Summary. Economic conditions in the Fourth District continue to improve. Employment is rising steadily and unemployment rates, although very high, are falling. Manufacturers remain optimistic about the near-term outlook for price and wage inflation. Retailers report improving sales. Manufacturing orders and production are mixed. Automobile-related production continues to improve, while capital goods orders and production remain flat at a low level. Steel sales and prices are weak, as last winter's spurt in orders has ended. Housing construction shows signs of weakening recently, but office construction remains strong. Commercial banks are very liquid, as deposit growth is strong and loan demand is weak.

District Labor Market Conditions. Employment is rising steadily in this District. Total employment in Ohio edged up in May for the fourth consecutive month and manufacturing employment has risen for five consecutive months. Average weekly hours of manufacturing production workers increased slightly in May for the fourth consecutive month. Local indexes of leading indicators point to continued improvement in Pittsburgh and Cleveland. Indexes for both areas have risen for six consecutive months.

Unemployment rates in the District are falling but remain well above the national average. Unemployment rates have fallen in each of the District's eleven largest SMSAs and averaged 13.3% (nsa) in April, down from 15.4% in January. However, the unemployment rate for Ohio edged up from 12.8% (nsa) in April to 12.9% in May, as labor force growth exceeded the gain in employment.

Prices and Labor Compensation. Fourth District manufacturers remain optimistic regarding the near-term path of price and wage inflation. List prices for their own product lines have generally remained stable since January, and although discounts are still common, they are gradually narrowing as market conditions improve. They do not expect to have a significant degree of pricing flexibility until the fourth quarter, at the earliest. With a few exceptions, including natural rubber, natural gas, and inputs for specialty steels, material input prices have also been stable over the past several months. Labor cost increases have been moderate because of a series of concessionary labor contracts, reductions in fringe benefits, easing of work rules, and business cycle-related productivity gains.

Retail Sales. Major retailers report improving sales. Sales gains have been good for several months and especially good in the first half of June. Retailers report higher priced goods selling especially well, while also noting that customers continue to place strong emphasis on price and price promotions. Inventory levels are satisfactory and firms plan to expand them cautiously in line with sales gains. Retailers are optimistic about the sales outlook for summer.

Manufacturing. Manufacturing activity in the District is mixed, with some producers expanding output and others showing no change. However, few firms report declining output.

This Bank's June survey of Fourth District manufacturers shows little progress in manufacturing activity in May and June. Employment, hours worked, shipments, new orders, and order backlogs are flat. Inventories continue to fall and about 20% of firms report increases in prices they pay for materials, components, and services.

A survey of purchasing managers in the Cincinnati area indicates a steady slowing in April and May in the rate of gain in production, new orders, and order backlogs. Inventories of raw materials and finished goods are falling. Firms report a decline in employment in May after two months of increases.

Manufacturing of light trucks and automobiles, especially large autos, is strong. Producers of these vehicles and their components report expanding hours and employment, but remain cautious about building inventories. Production of parts for the auto after-market, which remained fairly steady during the recession, is rising slowly.

Tire manufacturing is improving mildly. Tire manufacturers report shipments of original equipment auto tires up substantially over last year in line with improved new car sales, while replacement tire shipments are up only slightly. Production is up only moderately over last year because original equipment sales account for only a small share of the business. Manufacturers have stopped inventory drawdown but are taking a cautious approach to inventory building.

The machine tool industry is depressed but deterioration apparently has ended. Orders, production, and shipments are flat, and order backlogs are very low. Employment is stable, with firms reporting neither layoffs nor recalls or increases in hours. The low capacity utilization levels of customers may increase the customary lag between general economic recovery and improved demand for machine tools.

Primary Metals. Demand for steel is weak. The spurt in orders that occurred in February and March has ended. Orders have been weak and flat since then, causing order backlogs to shrink. Steel prices remain very weak, putting great pressure on profit margins. Production in the industry currently is only about 55% of capacity. The industry expects to ship about 69 million tons this year, little better than last year's very low 62 million tons. Advance orders for the third quarter are so weak that production, employment, and hours may decline in July and August. Producer inventory liquidation has ended except for oil pipe, for which liquidation is likely to continue through yearend.

Construction. Construction activity is one of the stronger sectors of the District's economy. Housing construction activity is much greater than a year ago, although recently its improvement appears to have slowed substantially. Most houses are being built on contract, rather than on speculation. The mix of demand is shifting toward higher-priced homes. Prospective buyers are reported to be very sensitive to interest rates and are shopping for small rate advantages. The recent increase in mortgage interest rates is reported to have slowed or stopped the rise of, but not decreased, sales of new and used houses. Office construction is likely to remain strong in the District for another year or two as major projects already underway are carried to completion, but few new projects are being planned.

Commercial Banks. Banks are very liquid as deposits growth is strong and loan demand is weak. Money market demand accounts continue to grow extremely rapidly, although not nearly as fast as earlier in the year. Total deposits are showing solid growth. Business loan demand is flat or down. Consumer credit demand is generally flat except for some strength in credit card credit and variable rate loans. Automobile loan demand is reported strong in Pittsburgh in response to rate competition.

COMMENTARY ON ECONOMIC CONDITIONS

FIFTH DISTRICT - RICHMOND

Overview

Business activity is expanding across a broad front in the Fifth District, yet the pace of expansion appears moderate. Manufacturing firms, generally, report recent gains in shipments, new orders, and order backlogs, but little change in inventories. Retail activity also appears to be improving as both total sales and relative sales of big ticket items are reported to have risen in recent weeks. Inventories at the retail level apparently rose sharply, however. Construction activity has also firmed substantially in most areas. Total employment has made only very modest gains, although the employed are working longer hours, and earning higher wages then earlier in the year. Expectations in most sectors are strongly positive. Loan demand at District banks and thrifts is also on the rise, but remains spotty in most areas, lacking solid support from any particular sector.

Manufacturing

Rising levels of shipments, new orders, and order backlogs continue widespread in the manufacturing sector. Recent leaders, such as the textile and apparel groups, have been joined by building materials, especially lumber and wood products where some extraordinary gains have recently been reported. On the other hand, primary metals and paper continue to lag somewhat. Manufacturers inventories were nearly unchanged over the past month as a slight rise in finished goods was nearly offset by a very minor reduction in materials on hand. Inventories appear to exceed desired levels on balance, although a majority of firms seem to be satisfied with current levels.

Manufacturing employment appears to have eked out a modest gain in recent weeks. Employment was actually reduced at some plants, however. Most of the recent pickup in activity has been accomplished by increasing the length of the workweek, in some cases by as much as 25% (32 hours to 40 hours per week). It appears that this process still has a way to go before output gains begin to lead directly to higher levels of employment. Current plant and equipment remains somewhat in excess of desired levels, but much more narrowly so than in most recent months.

Consumer Spending

Consumer activity continues to be a positive factor in the bigger picture, but now appears less robust than was thought to be the case one or two months ago. District retailers continue to report increases in sales, however, and are selling an increased proportion of big ticket items. Scattered strength in consumer installment lending further supports this conclusion. Available evidence suggests that furniture, appliances, and autos continue to provide considerable strength to the overall sales picture.

Inventories were up over the past few weeks at the retail level, but generally remain in line with desired levels. Most retailers also appear comfortable with existing numbers and sizes of outlets.

Housing and Construction

The situation in the construction sector appears to have changed little in recent weeks. Housing construction, overall, remains much improved, but the improvement is very spotty. Much of it continues to be concentrated in or near metropolitan areas. Most rural areas continue to lag. There appears to be growing concern over the prospects for housing in coming months.

This concern seems to center on the future direction of mortgage interest rates. How the housing recovery will progress is generally felt to hinge on mortgage rate developments. For now, however, available housing continues to sell very well in most areas.

Commercial and industrial construction activity continues to be buoyed by work in progress. New work and prospects for new work are sparse at present.

Banking and Finance

Overall, loan demand at banks and thrifts appears to be rising very modestly, and there is no readily apparent pattern, either geographic or for types of loans. Gains in consumer installment lending are among the most widespread, although in some areas mortgages or business loans are leading the way.

SIXTH DISTRICT - ATLANTA

Consumer spending, especially for durables, offers the strongest evidence of recovery in the Southeast, and retailers surveyed expect sustained growth through the summer. The uptrend in construction persists despite a recent increase in mortgage rates and an earlier drop in building permits. Business loans at large commercial banks have risen for the first time since February. Manufacturers report increased sales, some firming of prices, and more recalls than layoffs. The pickup in tourism is gaining momentum, but this acceleration has yet to reach south Florida and Tennessee. Florida's citrus industry is one of the few bright spots in the troubled agricultural sector.

Employment and Industry. The southeastern labor market shows signs of strengthening despite the increase in Florida's unemployment rate from 8.6 percent in April to 9.1 percent in May. The recent volatility in the state's jobless rate is attributable to changes in seasonality patterns. Alabama's unemployment rate fell from 14.3 percent in April to 13.1 percent in May. Even in depressed industries, recalls have exceeded layoffs. Steel fabricators in Alabama have begun rehiring furloughed workers. Building supply firms, particularly in Florida, report increasing sales and firming prices because of expanded housing demand. Executives at cement plants and lumber mills expect to operate near capacity in the next few months in response to burgeoning construction activity. Higher prices in Louisiana's farm chemical industry, mainly the result of cutbacks in plant capacity and reduced supplies, are probably more temporary. However, industry leaders remain concerned that low-priced, imported ammonia will exacerbate their problems. Louisiana produces 30-40 percent of the nation's ammonia, a chief source of nitrogen fertilizer for crops.

Consumer Spending. The May performance of consumer sales exceeded retailers' expectations; southeastern taxable sales in May rose 6.8 percent from 1982 levels in spite of declines of 5.9 percent in Louisiana and 0.3 percent in Mississippi. Most retailers polled now anticipate sales throughout the summer to run 10 to 35 percent ahead of last year, even though nearly all predict the impact of the July 1 tax cut will be negligible. Merchants attribute these increases to renewed consumer confidence in the economy and, in Florida, to a growing momentum in tourism. Appliances and other durables, such as stereos, televisions, and lawn mowers, are moving especially well. New motor vehicle sales in the Southeast continued to strengthen in May. Dealers indicate that a number of popular full-size car lines were in short supply regionally as well as nationally at the end of May. Consumers are using credit to pay for a large portion of these durable purchases, according to retailers and credit reporting agencies polled.

Construction. The June 8 increase in the FHA/VA rate from 11.5 percent to 12.0 percent may spur home sales, according to realtors in the District. A fall in discount points accompanied the rate hike and lowered "cash-in-hand" requirements for many home buyers. The rise in rates also spurred prospective buyers to sign contracts in order to lock in current interest rates. Lenders expect no major changes in mortgage rates in the near future, but they believe increases are quite possible within a year.

Building permit activity remains strong despite the drop in April. Single-family building permits issued fell 1.1 percent from March to April. Many industry analysts attribute the decrease to aberrations from normal seasonal patterns earlier this year when lower interest rates catalyzed an unusual winter surge in building. Permit offices report that June housing activity remains stable. Atlanta housing sales are especially strong. The market now consists of individual transfers from other regions and a larger share of local buyers seeking to upgrade the value of their housing; last year corporate relocations accounted for most sales. Although fairly stable to date, housing prices may begin to rise by the fourth quarter because of inventory absorption and increasing land costs, according to industry representatives.

Commercial real estate brokers surveyed have become more buoyant in their outlook despite rising rental rates and ongoing problems of excess supply in many regional cities such as Orlando, Atlanta, and New Orleans. Commercial realtors are not worried that vacancy rates are not diminishing because they expect a 6-8 month lag between the onset of recovery and office relocation decisions. However, suburban markets in the Southeast are faring better than their downtown counterparts. The vacancy rate in Atlanta's central business district approaches 20 percent compared to a metro-wide rate of 15 percent.

Financial Services. Total loans at large District banks rose considerably from April to May. The first growth of business loans since February sparked this overall increase. Total bank deposits were off slightly in May. Some respondents believe the slowdown in income tax refunds has reduced the influx of most deposits except time deposits and large-denomination certificates of deposit. Money Market Deposit Accounts showed more strength at S&Ls than at large banks in May. However, their earlier impetus has slowed to a monthly growth rate of less than 3 percent at both institutions. Substantial funds flowed out of Negotiable-Order-of-Withdrawal (NOW) accounts at large banks although super-NOWs at thrifts rose slightly from April to May. After shelving a proposal to allow interstate banking, the Tennessee legislature recently passed several bills to make the state's financial institutions more competitive. Most notably, banks may now acquire other banks across county lines.

Tourism. Attendance at most attractions is more than 5 percent over last year's levels, and state visitor center registrations, except in Alabama and Tennessee, were up in May relative to last year. Central Florida remains the leader of this upsurge. Respondents in Tennessee and south Florida are pessimistic about travel this summer. May lodging tax receipts in most states exceeded year-ago figures, but many properties still suffered lower occupancy rates because of the lingering effects of recession and because of the expansion in hotel rooms. Hotels in cities such as New Orleans and Atlanta, which rely on convention trade, have begun to discount rates to offset reduced occupancy. This practice is likely to generate considerable uncertainty and adverse results, particularly among smaller hotels, in the opinion of those polled.

Agriculture. Conditions in agriculture remain troubled, although certain markets show encouraging signs. Valencia orange production has rebounded from last year's crippling freeze with an estimated harvest of 72 million boxes (20 million more than in 1982). Overall revenue projections for oranges portend a 20 percent rise to $804 million. In contrast, large stocks of grapefruit juice carried over from 1982 and poor marketing practices have resulted in excess supplies, lower prices, and a $40 million decline in projected revenues. Estimated revenue in 1983 from Sixth District peach production will be approximately half of 1982 revenue because late frosts and freezes severely reduced crops in Georgia, Alabama, Tennessee, as well as South Carolina. Despite these regional crop losses, California's above-average peach crop has held nationwide prices below 1982 levels. Adverse weather throughout the South and widespread flooding in Louisiana and Mississippi lowered the District yield for winter wheat from 36 bushels per acre in 1982 to 32 bushels in 1983. Nevertheless, wheat farmers' net income should be substantially higher this year because approximately one-fifth of the projected revenue of $530 million will come from sales of Payment-in-Kind (PIK) wheat, for which there are no offsetting costs. PIK, however, continues to have an adverse impact on agricultural suppliers and livestock farmers, who face higher feed costs.

SEVENTH DISTRICT--CHICAGO

Summary. Things continue to look up in the Seventh District with prospects favorable for a recovery through the year. Even so, operating levels in durable goods manufacturing will remain low relative to prosperous levels. Summer declines in steel and autos will be smaller than usual. Hiring intentions are significantly stronger than last year at this time, and claims for unemployment compensation are lower. Increases in worker compensation will be smaller this year, but price inflation is accelerating slightly. Productivity gains have been large this year, but are likely to slow down. Retail sales continue to improve, helped by a heat wave since mid-June. Demand for capital goods is showing some life, but mainly for replacements. Closings of marginal manufacturing plants continue. Housing remains vigorous, but rising loan rates cause concern. Some new large office buildings have been announced. Contracts for highway work have surged. The high value of the dollar has sharply curtailed exports of some producer goods. Farm crops are coming along after a slow start, but are still behind normal development. Farm prices are weaker than had been expected, partly because of reduced export demand.

Foreign Trade. The high value of the dollar is the principal cause of a "drying up" of some export markets. Exports of construction equipment and heavy trucks are 80 percent below the levels of two years ago. There is concern that foreign producers will capture these markets permanently. The high dollar also encourages imports of capital goods such as machine tools, medium trucks, and aircraft components. Reduced airline traffic to the U.S. and smaller foreign tourist business also reflect current exchange rates as well as restrictions on conversion of Latin American currencies to dollars.

Employment. Surveys show that companies planning to increase hirings now outnumber those planning reductions, reversing the pattern of a year ago. Most of the change reflects fewer planned reductions. No new major layoffs are foreseen. However, most of the companies that cut staff drastically in the past two years do not plan to reverse these policies. Middle management has been most affected by cutbacks. Job opportunities remain very limited except for well-trained specialists such as data processors. The weak job market continues to hold down increases in compensation. Many companies are continuing "freezes" for exempt workers. Unions face tough bargaining in upcoming negotiations.

Inflation. Prices are strengthening somewhat, overall, but no significant upsurge is expected this year. Cost structures have benefitted from excellent productivity gains, but this trend will slow as activity rises further. Most firms strongly desire to widen profit margins, which are far below the level of the late 1970s.

Housing. The uptrend in residential construction continues. Fixed rate home mortgages, on average, have increased from about 12.5 percent to 13 percent. This rise may have stimulated demand from borrowers who fear further increases. (Lenders continue to experiment, with varying success, with innovative adjustable rate mortgages, which still lack general acceptance.) A further increase in rates to 14 to 15 percent could seriously dampen the market. Meanwhile, demand for building materials is excellent, with most gypsum board plants operating at full capacity. Gypsum board is on allocation in some areas, but this is not restricting construction activity.

Nonresidential. Work on new factory buildings is at a very low level, and no improvement is foreseen. The office building sector is still declining, but some large new downtown projects in Chicago are being unveiled for an early start. The market is overbuilt, but developers believe that space will be needed in three or four years when these projects are completed. Moreover, some developers wish to take advantage of the temporary willingness of "hungry" contractors to enter bids that may seem cheap later on. There is a large volume of rehab work, often handled at wages below union scale. Bridge and road work will be up sharply in the second half.

Capital Goods. Demand for equipment produced in the District is picking up, but not as rapidly as the national aggregates on orders and output indicate. Producers of steel plates and castings report some rise in demand from equipment producers. Mainly this is for replacement needs, either parts or whole machines. Few industries have large new facilities underway or in the planning stages. Sales of truck trailers are booming because of new regulations. Orders for heavy trucks have improved enough to raise output schedules from very depressed levels. Freight car orders also are up slightly from near zero. Business communications equipment, which held up during the recession, remains strong. Machine tool orders remain very weak, but press orders have increased slightly. Heavy construction equipment remains very depressed with large stocks in the field, including those of leasing companies. Farm equipment inventories represent a whole year's sales, and new layoffs have been announced. Foreign demand for U.S. equipment is very low.

Inventories. Liquidation of inventories continued into the second quarter for many companies, but in large part this was involuntary as sales exceeded expectations. Rebuilding is apparently underway now, and will contribute to second half strength. Inventories of most cars, trucks (including heavy trucks), recreational vehicles, steel, nonferrous metals, capital goods components, and building materials are quite low. Oil products are in good balance. Retail stocks of finished farm tractors and heavy construction equipment are far in excess of current needs. General merchandise inventories at retail are lean, but additional supplies are readily available.

Motor Vehicles. Sales of autos (especially large models) and light trucks (especially compacts) are running well above last year. Orders for heavy trucks, many of which are custom built, have increased. (Because of downsizing of the heavy truck industry, there is concern that a surge in demand would strain capacity.) In contrast to last year when car output schedules were reduced several times, they have been increased successively this year. Third quarter output is now expected to be the highest for the period since 1978. The improvement in autos has reverberations throughout the region for companies making seals, locks, electric components, frames etc.

Retail Trade. General merchandise chains have been reporting improvement in sales for several months, both hard and soft goods, with the Midwest lagging the nation. The uptrend had continued in the face of an abnormally cold spring. A heat wave after mid-June brought a spurt in sales of air conditioners, dehumidifiers, light apparel, and recreational goods, which had been slow. Other lines benefitted from this increased "traffic."

EIGHTH DISTRICT - ST. LOUIS

Sales and production in the Eighth District continued to expand during May and early June, and prices were nearly stable. Residential home sales, however, declined from the pace attained earlier in the year, and many manufacturing plants continue operating substantially below capacity. Although there have been net employment gains, unemployment rose from its already high level, as the labor force was bolstered by graduates and students seeking summer jobs. Most respondents anticipate that economic activity will continue to expand during the summer and fall.

Tourism and Conventions

Tourist and convention business in the St. Louis area was more than 10 percent greater in May and early June than in the same period of 1982. Continued gains are expected during the rest of the summer. Downtown hotels already are booked to near capacity for most of July. The Convention and Visitors Bureau has received twice the number of inquiries about St. Louis attractions in the past six weeks as in the same period last year. This summer, 65 conventions-- more than during any other three-month period in history-- will be held in the area.

Sales

Sales at six department stores in the District were 7 percent higher in May and early June than in the same period of 1982. The gains occurred despite unseasonally wet weather in many areas of the District. Furniture, appliances, rugs and "Father's Day" merchandise showed strength. Apparel did less well, allegedly because the weather in May was too cool for customers to be interested in summer fashions.

Automobile sales improved in May and early June at four dealers but slipped back at two dealers. One large dealer, with sales of both new and used cars about 25 percent ahead of last year, noted that he had difficulty maintaining adequate inventories for both autos and trucks. A dealer of foreign cars said he was readily selling all the cars allocated to him and could sell many more of the popular models if available.

Home sales in the Eighth District, which had been strong earlier in the year, decreased in May and early June. The unseasonally wet weather in May and some inching up of mortgage rates in early June contributed to the slowdown. Industry spokesmen, however, remained optimistic about future sales. Residential construction continued at a relatively high level.

Manufacturing Activity

Most industrial firms in the District reported an increase in orders and shipments since April. The gains continued to be largest for consumer-type goods and defense items. Firms producing business equipment and metals reported little change in sales. Capital spending plans of most firms remain unchanged and are not likely to increase until current facilities are more fully utilized. Inventories at most firms are near desired levels.

Employment

Total Eighth District employment crept up in May and early June. Because of productivity gains, however, the rise in employment was less than the increase in production. Moreover, a few firms still are trimming their workforces, primarily through early retirements and attrition, in order to improve efficiency. Despite the net increase in total employment, the number of unemployed also rose moderately as the work force was enlarged by graduates and students seeking summer jobs.

Finance

Consumer loans rose during May and early June at large Eighth District banks, but commercial and industrial loans declined. Real estate loans changed little. Bank deposits increased, with both money market deposit accounts and super-NOW accounts rising rapidly. Savings and loan associations, also continuing to have an inflow of new funds, were able to increase their lending and improve their liquidity. The financial condition of savings and loans also has been strengthened by a slightly lower cost of funds and a higher average yield on assets.

Price and wages

Prices have changed little, and wages have risen only moderately so far this year in the District. In general, expectations are that prices and wages will rise moderately during the rest of 1983. Projections through 1984, however, are more diverse: some analysts focusing on excess capacity believe wages and prices will accelerate only modestly; others, concerned about the huge Federal deficits and rapid monetary expansion, anticipate marked accelerations in wages and prices.

Agricultural Conditions

Planting of many District crops was delayed because of rains and flooding. A few fields were left idle, and some farmers shifted from corn or cotton to soybeans, which does not require as long a growing season. Weather turned more favorable in June, however, and much of the crops are now planted, and at this stage, most crops are doing well.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District economy is still on the mend. Gains in sales of homes, general merchandise, and autos and increased interest in tourism suggest that consumer spending has continued to strengthen. Manufacturing and oil and gas exploration have been improving as well. But metal mining has remained in the doldrums, and signs of recovery have been mixed in agriculture. So far, the recovery has been strong enough to halt employment declines, but not strong enough to stimulate considerable hiring. Bank lending, however, has recently picked up.

Consumer Spending

Consumer spending has continued to show the most convincing signs of recovery. The most spectacular sign has been the continuing sharp resurgence in home building and sales. In Fargo, North Dakota, for example, building permits for 574 residences were issued in the two-month period April-May, more than five times as many as in that period last year. In Minneapolis-St. Paul, home sales in May were up 35 percent from a year earlier. Improved home sales seem to have helped boost home furnishings sales at two large Twin Cities department stores this spring. These stores report that other items have been selling very well too and that many consumers are no longer waiting for sales to purchase. Outside Minneapolis-St. Paul, recent general merchandise sales have been good as well, according to Bank directors.

Another sign of recovery is that the April rebound in auto sales has continued through May and early June. A sales manager for one of the nation's largest auto manufacturers, for example, says that his firm's auto sales in the district have in recent weeks been up about 25 percent from a year ago. Verifying this gain are Bank directors' comments about strong auto sales this spring in their communities.

A further sign of recovery is that district consumers appear to have become more willing to spend on travel and recreation. The number of tourism inquiries in the Upper Peninsula of Michigan this spring has been five times greater than normal. And the tourism association in northeastern Minnesota reports that it has distributed just about all its brochures; it had expected the supply to last through August. Businesses also have seemed more interested in travel and recreation lately. A major Minnesota resort reports that its recent reservations for business meetings have been up substantially from a year ago.

Industrial Activity

District industrial production has been manifesting signs of recovery too. The pickup in homebuilding, according to our last report, accounted for much of the pickup in district manufacturing through early spring, but in May and early June, auto sales have been providing impetus to manufacturing as well. A radial tire factory in Wisconsin has been having trouble keeping up with orders, and an auto parts manufacturer in the Upper Peninsula recently recalled a substantial number of workers. The district's one auto assembly plant has been working two shifts and plans to hire additional workers this summer if sales remain at present levels. Gas and oil exploration has also started to revive. In mid-June, 63 rigs were active in Montana and North Dakota, compared to 47 in mid-March. A North Dakota director attributes this increase to a sizable drop in drilling costs. Some district industrial activities are still suffering, however--particularly iron mining. The only Minnesota taconite plant to remain open throughout 1982 just announced that it is shutting down for two months and laying off 1,000 workers.

Agricultural Conditions

In agriculture, signs of recovery have been mixed. Bank directors continue to report that the Payment-In-Kind program is having a positive impact on agriculture, but several who are in the industry are concerned that excess worldwide supplies will put downward pressure on prices. This mixed outlook is perhaps reflected in the Minneapolis cash prices for corn, wheat, and soybeans; they remained essentially unchanged between April and May, after increasing markedly between January and April. Cold, damp weather in May and early June is another worry. The height of Minnesota corn in mid-June averaged only 7 inches, which is 3 inches below normal, while soybeans averaged just half their normal 4-inch height.

Employment

The recovery in consumer spending and industrial production seems to have arrested the decline in district employment. District wage and salary employment, seasonally adjusted, has been essentially unchanged since the fourth quarter, and in April it was 1.5 percent below its level a year earlier. (National wage and salary employment increased 0.4 percent between the fourth quarter and April and in that month was down 1.1 percent from a year ago.) District employment has stopped falling because employers have reduced the number of workers they have been laying off. Minnesota's initial claims for unemployment insurance in April and May were 20 percent below their year-ago level. But employment has not risen because most employers have yet to significantly step up their hiring. The Minnesota Job Service currently lists 2,891 job openings in the Minneapolis-St. Paul area, for example. Although this is up considerably from last year's 1,780 openings, it is down considerably from the approximately 8,000 openings listed in both 1978 and 1979. Conversations with several large district employers corroborate these figures; none has done extensive hiring lately. The district's largest manufacturer has not added any workers nationwide for several months.

Employment conditions vary considerably among the district's four complete states, however. In Minnesota, wage and salary employment in April was down about 2 percent from a year ago, and this can be attributed largely to job declines of 4 percent in manufacturing and 29 percent in mining. Montana had a comparable mining decline, along with a 17 percent decline in construction jobs. That state's wage and salary employment was down roughly 1.5 percent. In South Dakota, payroll employment was unchanged from a year ago, mostly because trade and services employment held steady. In North Dakota, wage and salary employment was up 1.5 percent from a year ago. This stemmed from a 26 percent increase in construction employment that can be attributed primarily to a huge coal gasification project.

Financial Developments

As some industries have revived and employment declines have leveled off, bank lending has increased in the district. Between late April and mid-June, loans at country member banks rose 2 percent, the first rise in many months. This rise is confirmed by Bank directors' comments that loan demand has picked up in their areas. But directors also indicate that the quality of many recent loan applications has been poor.

TENTH DISTRICT—KANSAS CITY

Overview. Business activity in the Tenth District continues to strengthen. Growing sales are expected to bring moderate additions to retail inventories, but materials inventories are expected to stay near current levels. Small but broad-based increases in auto sales are expected to continue. The winter wheat crop is in excellent condition as harvesting begins in Oklahoma. Farmland values are stabilizing after recent declines. Loan demand at Tenth District banks is showing very little growth, and deposit growth remains limited primarily to money market deposit accounts. The prime rate remains generally stable, and no change is anticipated in the near term.

Retail Trade. Respondents report nominal sales gains of up to 10 percent in the first five months of 1983 compared with the same period of 1982, with most responses falling in the 5 to 10 percent growth range. Sales in all product lines have been growing steadily, with sales of women's apparel particularly strong. Most retailers indicate that inventory levels are satisfactory although about one-third of respondents are still reducing stocks. For the remainder of 1983, retailers throughout the Tenth District expect a continued steady growth in sales that would prompt about a 5 percent expansion in inventories by yearend.

Purchasing Agents. Prices of major inputs are currently 3 to 5 percent higher than in June of last year, according to purchasing agents contacted, with virtually all of the increase in the past three months. For 1983 as a whole, agents foresee prices rising 3 to 6 percent. Purchasing agents report attempts to manage inventories extremely closely in the recovery.

Thus, over the course of the year, they intend either to trim inventories or to maintain them at current low levels. At the present time, inputs are readily available, lead times are short, and there are no reported bottlenecks of either labor or capacity.

Automobile Dealers. Most respondents report a small but broad-based increase in auto sales compared with sales in the same period of last year. The growth in auto sales is attributed to low interest rates offered by manufacturers' finance companies. While some dealers report lower-than-desired inventories due to difficulties in obtaining large cars, most stated that inventories are being held constant or trimmed slightly in preparation for the new model year. For the rest of the year, auto dealers expect continued moderate growth in sales.

Agriculture. The winter wheat crop throughout the Tenth District is in excellent condition, as a result of early spring rains. Harvest is starting this week in parts of Oklahoma. District bankers report that the majority of wheat farmers plan to remain in the PIK (Payment-In-Kind) program. The planting of row crops is slightly behind normal but the recent dry weather has aided planting progress. Range conditions have also benefited from adequate moisture and are reported excellent for livestock pasturing. Many cattle that have been grazing on PIK acres have gone to market after attaining desired weight, while the rest have moved to grass pasture where available or to feedlots. According to District bankers, farmland values appear to be stabilizing after declining for two consecutive years. Not much land is selling, but almost all of the land that is changing hands is being purchased by farmers. Outside investor activity in land sales is currently reported to be minimal. Farm implement dealers are faring poorly with sales similar to 1982's depressed levels. Sales of large items such as tractors and combines have been particularly depressed. Tenth District bankers expect little increase in sales before the end of the year.

Banking. Loan demand at Tenth District banks has shown very little growth during the last month. A number of respondents report that real estate lending has increased, and a smaller number report an increase in consumer loan activity. Commercial and industrial loan demand as well as agricultural loan demand remain constant. Most respondents report deposit growth. Demand deposits, conventional NOW accounts, and Super-NOW accounts have shown no growth, on average. Continued steady growth of money market deposit accounts (MMDA's) was reported, with most of these funds coming from outside the reporting institutions. Reported growth in money market certificates, small saver certificates, and large CD's is quite variable but, on average, unchanged. With few exceptions, the prime rate of responding institutions was 10.5 percent for the past two months. No change in the prime rate is anticipated. Automobile loan rates have declined within the last month at a number of respondent institutions. Otherwise, consumer rates show little change, and little change is anticipated during the next month.

ELEVENTH DISTRICT—DALLAS

The economic recovery in the Eleventh District is strengthening. Increases in consumer and construction spending are leading the recovery. Department store sales are rising, and auto sales are above year-earlier levels. Construction is robust. Manufacturers' shipments have picked up as a result of stronger demand for housing, autos and other consumer goods. Mortgage and construction lending at S&Ls remains strong. Loan growth at commercial banks continues to slow. Banks have shifted to real estate lending partly to offset sluggish business loan demand. Growth in deposits at all financial institutions slowed sharply in May. The District drilling rig count is slowly rising after hitting a low for the year in May. Trends in the agricultural sector are mixed. Rising feed costs are helping grain farmers but are hurting livestock producers.

The pace of construction activity in the District is brisk. Construction of single-family homes and retail shopping space continues to rise. Apartment construction is beginning to slow but the level of activity is still very high. Two-thirds of the permits for residential construction this year have been for apartments. Office space under construction remains strong but the pace of new project announcements is slowing. Increases in retail construction are partly offsetting the slowing in the office sector.

Department store sales increased steadily in May. Respondents are optimistic about consumer spending during the rest of the year. Sales in the hard-hit Gulf and Mexican border regions were up slightly from April's level, but they are still well below the year-ago figure. Consumer durables are selling well, but apparel sales are uneven. Inventories are slightly above planned levels.

New car sales remained steady in May at levels above year-earlier volumes, but shortages of popular models are still curtailing sales. Dealers expect manufacturers' low interest-rate programs and a stronger economy to keep new car sales at current or higher levels. Sales of used cars are sluggish.

Manufacturing production in this District continues to respond to growth from consumer spending. Shipments of electronics, steel, chemicals, and lumber and wood products has picked up in response to increased demand for consumer durable goods, autos, and housing. Manufacturers of lumber and wood products are still rehiring workers. Employment at a number of other manufacturing firms is still declining but reductions are being accomplished mainly through attrition. Most firms are augmenting programs to increase productivity. Respondents expect little increase in wages and prices this year.

S&Ls again report that mortgage and construction lending is strong. Respondents are concerned, however, that interest rates may turn up sharply in the near term. They anticipate that borrowing demand would dry up if mortgage rates go to 14 percent or higher. Most expect mortgage rates to return to the 12- to 13-percent range by year-end. Given this interest rate outlook, efforts to lengthen the average maturity of jumbo CD holdings have been made. Consumer demand for longer-term deposits, however, has declined during the last 30 days.

At District member banks a slight decline in loan growth in May was offset by increased security holdings. Outstanding bank credit was 16 percent above the year-earlier level. Loan growth at large banks slowed in all major categories except real estate lending. Business loan demand remains sluggish and outstanding consumer loans were unchanged. On a year-over-year basis, deposit growth at all financial institutions in this District was 12 percent in May.

The number of drilling rigs operating in the District states turned up slightly in early June after declining in May to its lowest level this year. The outlook is favorable for a pickup in petroleum drilling. Drilling costs are well below historical levels because of excess supplies of equipment. In May, the dollar value of bids for lease sales of drilling sites in the Gulf of Mexico set an all-time high.

Conditions in the agricultural sector are generally improved except for cattle producers. Recent declines in cattle prices coupled with higher feed costs have reduced profits. Texas cattle producers, nevertheless, put more cattle on feed in May than a year ago, because they anticipate lower prices for feed grain later this year. Cotton producers' incomes are rising. Cotton prices moved upward on the strength of the recovery and better export prospects. Corn and sorghum farmers continue to benefit from rising prices, but income gains may be temporary if rising corn prices trigger the release of government-controlled corn reserves.

TWELFTH DISTRICT -- SAN FRANCISCO

The recovery in Twelfth District economic activity is gaining momentum, extending to a greater number of industries. Retail sales at department stores have been rising at an accelerated pace recently, while the recovery in Western homebuilding and sales activity has been even stronger than the upturn nationally. In the manufacturing and mining sectors, employment gains are becoming more widespread. Moreover, although the capital goods industries are not yet expanding their payrolls, employment has stabilized. The net inflow of funds into MMDAs at District banks has slowed but still remains substantial. Banks have been investing most of their excess funds in short-term Treasury securities since business and consumer loan demand remains weak despite promotional efforts.

Consumer Spending

Respondents report that consumers are imbued with a renewed sense of confidence and that retail sales have been increasing widely throughout the Twelfth District. Major department store chains in Southern California reported that sales rose sharply in May and ran nearly 13 percent above the year-earlier level, representing a solid gain in real terms. The only weakness is occurring in Utah where flooding, attributable to a record spring snow melt, is adversely affecting shopping. Competition for sales is reported to be extremely intense with department stores engaged in heavy discounting of list prices. These promotional efforts are being successful, however, and seasonal inventory is moving well. Sales of durable goods, severely depressed during the recession, are rising even faster than nondurables. In particular, the upturn in home sales is helping to spur sales of household goods, including furniture, appliances, and other big ticket items. Interest rate concessions by manufacturers have stimulated sales of automobiles. Retail credit delinquencies are returning to pre-recession levels.

Manufacturing and Mining

The recovery in Twelfth District manufacturing activity is becoming broader based. Until recently, gains in employment and prices were confined mainly to the important lumber industry which benefited early in the recovery from the pickup in national homebuilding activity. But in the past two months, employment also has begun to rise in a number of other important regional industries including primary metals, chemicals, apparel and food processing. Recent labor agreements in the aluminum and copper industries have removed the threat of strikes. The pickup in orders for those metals therefore is attributable to a fundamental increase in consumption by the automobile, appliance, container and housing industries, rather than to strike hedge buying. The West's major capital goods producing industries--including those that manufacture machinery, electronic equipment, trucks, aircraft and rail cars--have not yet experienced an overall pickup in orders. Although the defense and consumer markets for some of those products is growing, business demand for capital goods remains weak. Nevertheless, except for aircraft, where low commercial airline orders are still causing cutbacks, employment in most of those industries has stabilized.

Construction and Real Estate

The West is experiencing an even stronger recovery in homebuilding and sales activity than the nation as a whole. Housing starts in the West currently are running at double the level of a year ago and permit activity points to still further gains in the months ahead. Sales of new homes throughout the District apparently are rising at a strong enough pace to prevent an excess accumulation of unsold inventory. Sales of lower-priced homes have picked up especially rapidly. But in the Los Angeles area, single-family residences in the $200,000-$300,000 price range also are selling well. A large portion of the new homes are being financed through subsidized FHA/VA or state government mortgages. Although nonresidential construction activity remains below the year-ago level, respondents report a pickup in certain geographical areas for such non-office projects as shopping malls, hotels and hospitals. Moreover, the rising value of nonresidential construction permits issued suggests that spending will increase in the months ahead, provided interest rates do not rise sharply.

Agriculture

The return of clear weather in the past two months has permitted California farmers to plant lettuce, tomatoes, onions and other vegetable crops, which had been delayed by flooding. As a result, vegetable prices have begun to moderate after rising sharply earlier this year. Similiarly, fruit prices also are coming down. Prices for fruits and vegetables are still well above levels of a year ago, however, and California farmers are expected to experience a year-to-year increase in net income from those products. California farmers also are expected to benefit from the Federal payment-in-kind (PIK) program. In fact, cotton prices have been rising sharply recently and production costs for grains are down generally. Elsewhere throughout the District, smaller gains in net farm income are anticipated. One potential threat is the record snowpack which could damage California agriculture this summer.

Financial Institutions

The net flow of funds into MMDAs at Twelfth District banks has fallen off considerably in recent weeks in keeping with the national pattern, partly due to interest rate competition from thrifts. Still, the inflows represent a significant source of funds, which has allowed banks to reduce their reliance on purchased funds, especially large CD's, and to actively promote both business and consumer loan products. Business loan demand remains flat to weak, however. Thus, most institutions are heavily promoting their consumer loan products--i.e., auto loans, installment loans, and credit card plans--to stimulate consumers' demand for shorterterm or variable rate credit. Aggressive advertising campaigns and lower loan rates are the most common efforts being employed by banks to attract borrowers. Despite these efforts, consumer loan growth has not accelerated rapidly because of competition from captive finance companies offering discount loan rates and increasing competition from other nonbank lenders. Since the volume of banks' mortgage loans outstanding has not been growing, these institutions have been investing excess funds in short-term U.S. government securities.