# SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
# BY FEDERAL RESERVE DISTRICTS

October 1984

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# SUMMARY*

The economic expansion has slowed in most districts, but a resurgence in consumer spending suggests that the slowdown may only be a pause in a recovery that has not run its full course. With the exception of Boston, which reports a continuation of steady growth, the districts report moderating economic recoveries in the third quarter. Slower growth has been especially apparent in residential construction and manufacturing activities. Agricultural conditions are mixed. Generally, crop conditions continue to improve, but low prices are expected to keep most districts' farm income depressed. There is a very bright spot, though, in the economy. Consumer spending in September and early October was robust throughout the country. These developments in real economic activity are reflected in financial conditions: business loans have been somewhat weak, while consumer loans have been strong.

## Construction

Part of the recent slowdown in the recovery can be attributed to residential construction activity. While the reports are mixed, half the districts report that housing starts have weakened, even though they remain at a high level. Philadelphia, Cleveland, St. Louis, Minneapolis, Dallas, and San Francisco all report that either housing starts or home sales have slowed. New York and Atlanta are the only obvious exceptions; housing is reportedly doing quite well there. Several districts also report strength in commercial construction.

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*Prepared at the Federal Reserve Bank of Minneapolis.

Manufacturing and Industry

The slowdown in the recovery is also being caused by some slowing in manufacturing activity. Although manufacturing continues to expand in most districts, it is doing so at a modest pace. New York, for example, reports that upstate managers recently experienced a slower growth of new orders and a considerable number of actual declines. Similarly, Philadelphia, Cleveland, St. Louis, and Dallas--districts that specifically report on new orders--say that demand generally remained unchanged or declined somewhat in recent weeks.

Agriculture

Agricultural conditions are mixed. Most areas expect average to above average crop yields this year. For example, Minneapolis reports favorable crop conditions in its district, and St. Louis expects its crop production to be near the 1982 levels. However, crop prices remain low and continue to fall. Minneapolis reports that the farm price index for Minnesota fell 3 percent between July and August. With low and declining prices, districts expect cash receipts and farm income to be depressed this year. Only Richmond is optimistic for its farm sector. It expects production gains to outstrip falling prices, leaving farmers with higher cash receipts and income than last year.

Consumer Spending

Consumer spending is the clear bright spot in virtually all district reports. While somewhat restrained in most of July and August, consumers started to spend again in September and early October. Richmond reports that consumer activity is back on its earlier strong trend, with a significant rebound in durable good purchases. Atlanta reports that retail sales were generally robust in September, with department store sales in its metropolitan areas outpacing those in the nation. St. Louis points to retail sales as the greatest strength in its district economy. Only Chicago and San Francisco report that consumer spending has been mixed. Both see some weakness in durable good sales. San Francisco, however, notes a recent pickup in retail sales in the Pacific Northwest.

Overall, inventories appear to be satisfactory relative to sales.

Finance

Loans at commercial banks generally mirror the slowdown in the recovery and the recent strength in consumer spending. Business loan demand is reported to be sluggish and very soft in several districts. Yet most districts that report on consumer loans say these loans are quite strong and are expected to remain so. Philadelphia, for example, reports that over the past six weeks business loans in its area grew only between zero and 2.5 percent, while consumer loans grew from 4 to 10 percent.

# FIRST DISTRICT-BOSTON

Steady economic growth continues in the First District. Retailers report generally satisfactory sales gains. Manufacturers are experiencing good order rates, although a few sectors remain weak. Price increases remain moderate in both manufacturing and retail, although several contacts mentioned tight local labor markets. Deposit growth and demand for bank loans continue strong, although two nationally-oriented banking organizations reported some slackening in business loan demand. The outlook is optimistic, in spite of some concern that tax policy changes will occur after the elections, regardless of the outcome.

## Retail

Retailers in the First District continued to make reasonable sales gains in September, although performance relative to plan was mixed. Several merchants expressed mild concern with inventory levels. Price competition is widespread, and prices are holding steady or rising only slightly.

Sales reported for September ranged from 8 to 14 percent above September 1983 on a comparable stores basis. The department store chain with 8 percent growth was under plan, but forecasts improved results for the next several months. The 14 percent increase was "way over" that discount chain's plan. These two chains also reported wide sales variance across stores -- customers appear to be quite responsive to local promotions, upgraded store interiors, and local competition. Hard goods and toys continued to outpace sales of men's and ladies' clothing.

Inventories were generally "as usual," except when unanticipated sales changes left them above or below plan. Several merchants cited stiff competition in supplier and retail markets as explanations for stable or moderately increasing prices. However, markups have been maintained at normal levels. One chain had difficulty in finding new headquarters and warehouse space and faces an extremely tight local labor market.

Manufacturing

Manufacturing activity in the First District continues to expand. Some sectors report greater strength than others. Firms or divisions producing computers and semiconductors, automobile-related and (less uniformly) housing-related products report healthy growth. Products related to the commercial aircraft, utilities, and off-the-road equipment industries remain in the doldrums. Exporting continues to be dampened by the strong dollar while overseas plants are performing satisfactorily.

While order rates and sales are rising, one respondent said backlogs had fallen because the firm had geared up production. The Purchasing Management Association of Boston also reported an easing of backlogs in September. Inventories are generally at satisfactory levels relative to sales.

Prices are rising very moderately, perhaps 1-5 percent. Respondents mentioned strong domestic price competition as well as imports (or the threat of imports) benefiting from the strong dollar. When suppliers attempt to raise prices "too much" (more than 3-5 percent), firms take their business elsewhere. Very tight input market conditions reported by a high technology firm have moderated recently. Wage settlements have also been moderate recently, reducing cost pressures. However, two firms complained of increasing tightness in the New England labor market for professionals. One has reinstituted an in-house training program.

Capital spending is up. The reasons are varied. Some firms are combining productivity improvement with expanding physical capacity. Others are making only labor-saving replacement investments because of existing excess capacity. Purchasing managers also indicated increased capital spending in September, and expect continued higher levels over the next 3-6 months.

Commercial Banking

Larger regional banks, who have been experiencing very strong corporate loan demand since the beginning of the year, note a moderation in that demand within the last 30 days. Consumer loan demand continues to be strong, however. Smaller regional banks, particularly those located in areas dominated by high technology firms, report continued strength in both corporate and consumer lending. Two contacts noted a definite increase in commercial real estate investment and construction loan activity during the past 60 days.

No changes were reported on the liability side. Deposit growth continues to be strong. Intense competition for consumer time deposits has kept these interest rates high.

One large regional bank contact expected corporate lending to pick up in the next 30 days, while other respondents expected essentially unchanged conditions. Interest rates are expected to continue unchanged or to decline slightly over the next 30 days, but to rise slightly after the elections.

# SECOND DISTRICT--NEW YORK

## Introduction

Economic activity in the Second District grew moderately in recent weeks, but at a slightly slower pace than in late summer. Consumer spending continued to show improvement in September and early October, and generally met the expectations of retailers. Most purchasing managers report growth or stability of new orders but a growing minority reported actual decreases. Business loan demand was mixed across banks, and in the aggregate was essentially flat. The office market softened in some areas while remaining strong in New York City. Homebuilders will be busy through the remainder of 1984, and in parts of the District are optimistic about next year.

## Consumer Spending

The pace of consumer spending in the Second District shows continued improvement. According to area retailers, the strengthening in department store sales which began in late August has continued through the first week in October. September sales gains varied widely among respondents, averaging about 8 percent over levels of a year ago, and generally matching expectations. The region on average outperformed the nation's sales growth, but business in New York City was not as good as in the rest of the District. Inventories remained mostly on target, averaging 15 percent over last year, partly with the help of promotional markdowns. However, one higher-income department store chain reported inventories 22 percent over 1984 as a result of sluggish business since June.

## Business Activity

Economic activity continued to expand in recent weeks, but the pace is slowing. Reports by upstate purchasing managers indicated significantly slower growth of new orders and faster delivery times in September. While the majority of firms faced conditions that were unchanged from the prior month or still improving, the proportion reporting actual decreases of orders grew to nearly one-third in Buffalo. Major plant construction or expansion projects were announced by several firms across the state, such as manufacturers of electronics, chemicals, plastics, and furniture. The Army will station a new division in economically depressed Jefferson County, generating up to 20,000 construction jobs. The unemployment rate in New York state, seasonally adjusted, fell from 7.7 percent in August to 7.0 percent in September, while the New Jersey rate held steady at 6.2 percent.

The cost of electricity on Long Island is of growing concern. The state Commerce Department reports that 400 firms have threatened to close or relocate in response to recent and expected future rate hikes associated with the Shoreham nuclear plant.

## Financial Developments

Business loan demand at regional banks in the Second District has been mixed in recent weeks. Overall volume was essentially flat, as has been the case nationwide. Borrowing by car dealers is reported to be down, reflecting lower-than-usual inventories at the end of the model year. In contrast, service industry demand, particularly by advertising agencies, has been strong. Upstate bankers indicate that loan demand from the manufacturing sector was especially weak in Western New York, but was fairly strong in the Syracuse area. Borrowing by retailers also was geographically mixed.

Construction and Real Estate

Residential construction is operating at capacity in the District, and activity through the end of the year may be restrained only by unfavorable weather or shortages of skilled labor and subcontractors. Demand appears to be driven primarily by rising incomes, and current interest rates seem to have little downward effect. Planning for 1985 is unusually active for October in New York City's northern suburbs. Homebuilders generally expect a repeat of this year's strong performance.

The office leasing market softened considerably in parts of the Second District. High levels of speculative construction are still taking place despite sluggish demand in areas such as Fairfield County and northern New Jersey. On Long Island, in spite of electricity rate fears, demand is fairly strong but some observers question whether it will be sufficient to absorb the large amounts of space coming on line. The market in Midtown Manhattan continues to be very active, and the likelihood is increasing that prime space will be scarce and rents will rise by year-end. Downtown, concern about potential oversupply seems to have abated. Demand seems stable, and very large blocks of space are scarce. Still, observers predict longer phase-in periods for recently announced construction projects.

THIRD DISTRICT - PHILADELPHIA

Third District business contacts have given a mixed report on the economy in October. Manufacturers continue to see a deceleration in the growth of industrial activity and realtors indicate that sales are down about 15 percent compared to last year at this time. In contrast, retail sales remain very strong in the Third District and the financial sector is sailing along, but with some slight softness in the demand for commercial loans.

Looking ahead, a healthier business climate is anticipated in the manufacturing sector and realtors are looking for sales to pick up by about 5 percent by March. The growth rates of both consumer loans and retail sales may slow in early 1985 if interest rates rise, according to local business spokesmen.

MANUFACTURING

Third District manufacturers continue to see a slight deceleration in growth, according to the October Business Outlook Survey. This month, 35 percent of the manufacturers surveyed say industrial activity continues to increase, while 13 percent report a decline. A slight majority say there has been no change since September.

Specific indicators turned in a positive performance, although it was slightly less robust than last month. About half of the executives polled cited gains in new orders and shipments. Over two-thirds of the respondents, however, reported no change in producers' backlogs, delivery time, employee payrolls, and the length of the average workweek.

The six-month outlook for manufacturing is better this month than last. According to the survey, growth is expected to continue: 50 percent of the respondents anticipate a healthier business climate by March and only 13 percent expect worse conditions. Gains are expected in new orders, shipments, delivery times, employee payrolls, length of the average workweek, and capital expenditures.

Industrial prices for both raw materials and finished goods are relatively stable this month, as about three quarters of the executives polled report no change since September in either prices paid or prices received. The outlook, however, does show widespread expectations of price hikes within six months. Eighty-three percent of respondents anticipate higher costs by the end of the first quarter of 1985, while 54 percent foresee receiving more for the goods they sell.

RETAIL

Demand is still strong in the retail sector. After a little summer sluggishness, area retailers are meeting or exceeding their sales expectations, with gains of 10 to 20 percent over last year's receipts. Third District merchants project a strong ending for 1984, although sales may not match those of last year's exceptional holiday season. Over the next six months, the rate of growth in retail sales is expected to slow somewhat. Sales at the end of the first quarter are likely to stand at about 8 percent over a year earlier.

Inventories are up about 10 percent over last year and are heavier than usual, but are in line with sales expectations. The proportion of sales made on credit remains stable at about 60 percent at area department stores.

FINANCE

Loan demand in the Third District is softening slightly on the commercial side. Bankers report a range of 0 to 2.5 percent growth in C&I loans over the past six weeks, with most of that growth coming in the most recent 2 weeks. Bank executives anticipate a pickup in commercial loan demand within the next six months in conjunction with further maturation of the economic expansion.

In the consumer lending area, financial contacts report 4 to 10 percent growth over the past six weeks. On a year-over-year basis, consumer loans are still running about 20 percent ahead. One local bank reports an increase of 50 percent in retail loan volume over a year ago, principally due to intensified development of credit card operations. Area bankers look for continued growth in the consumer area but at a slower pace.

The prime lending rate dropped from 12.75 to 12.50 percent on October 17 at most large banks in the area. Third District bank economists predict another 25 basis point cut within the next few weeks. Their six-month projections, however, show a prime rate of about 15 percent as a result of increased credit demand.

Deposit growth, in general, has remained flat with the exception of savings certificates with a maturity of eighteen months or more. This may reflect consumers' expectations of further drops in interest rates and an attempt to lock in higher rates now.

REAL ESTATE

Residential real estate sales have been flat over the past six weeks and contacts say sales are down by about 15 percent compared to year-ago levels. They attribute this almost entirely to high mortgage interest rates. Thirty-year fixed-rate conventional mortgages are available at 13.9 percent. Adjustable rate loans, negotiable after one year with 20 percent down, stand at 11.5 to 12 percent. Inventories of unsold houses have been a little heavy lately as a result of the mini-slump in sales and continued new construction, mostly of townhouse and condominium complexes. Realtors are optimistic for the future, however. Unit sales are expected to grow by about 5 percent from their current levels by March 1985.

Commercial real estate is reported to be experiencing a boomlet. Building permits are up and office occupancy rates are around 90 percent in both the city and suburbs.

# FOURTH DISTRICT - CLEVELAND

## Summary

Reports from this District indicate moderation of economic growth. Employment is growing slowly and pressures to avoid price increases are intense. Retail sales gains are moderating. Manufacturers report either smaller order increases or declines in orders. Inventories are near desired levels. Housing activity continues to fall, but banks report business and consumer lending remains strong.

## District Labor Market Conditions

Labor market conditions in the District improved in September. Employment increased and unemployment declined in Ohio, reducing the unemployment rate to 9.2% (s.a.), 2.3 percentage points below its year-earlier level. Manufacturing employment continues to rise slowly.

## Prices

Firms report substantial competitive pressure on prices. A survey of manufacturing firms in the region reveals fewer firms are raising prices and more are cutting prices than three months ago, while most are holding prices steady. Those firms also report a substantial slowing of increases in prices paid for commodities and services. Capital goods producers anticipate using productivity gains primarily to moderate increases of prices charged rather than to widen profit margins, despite their view that profit margins are very narrow for this stage of an economic expansion.

## Retail Sales

General merchandisers in this District report double-digit sales gains from year-earlier levels for September. The increases, however, were concentrated in the first part of the month. Gains dropped back to a single-digit pace by month-end and remained there through early October. Retailers expect this more moderate pace to continue through yearend, with one analyst anticipating a 7% - 8 1/2% gain for the year as a whole. Cutbacks in orders have kept inventories at acceptable levels.

Area auto dealers report an easing in early-October sales. Low inventory rather than a lack of demand continues to be cited as the major cause of slower sales.

Manufacturing

Firms in this District generally report new orders continue to rise but at a reduced pace, although several capital goods producers report order declines. Weakness in capital goods orders is generally attributed to inventory adjustment, growth of imports, and slowing of business fixed investment to a more normal pace for this stage of the business cycle. One capital goods producer, noting the strength of new appropriations for capital spending, expects orders to rebound soon, and capital spending to decline in late 1985 at the earliest. Firms experiencing declines in orders expect to use order backlogs to avoid reducing output, but only for a few months. A producer of truck parts notes that there was a decline in orders for large trucks in the third quarter because orders had been bunched into the first half to avoid tax increases effective July 1. He expects truck orders to rebound in the fourth quarter.

Steel producers report soaring imports and customer inventory liquidation have caused a reduction of orders and production. Together with excess capacity, this weakness in demand has kept transaction prices well below published prices. A major producer estimates it will be late in the first quarter of 1985 before customer inventory targets are reached.

A tire producer reports orders from original equipment manufacturers continue very strong but orders for replacement tires have softened in the last two months. Despite their having operated at capacity for many months, domestic tire producers generally plan no increases in production capacity.

Inventories

Inventories generally appear to be near desired levels. Most manufacturers report inventories of materials and finished goods are being kept level, while roughly equal numbers of firms report inventory increases and decreases. Excessive inventories are reported in the steel industry, especially at steel service centers, and in the farm machinery industry. Inventories of truck and automobile tires are very low for this stage of the business cycle but manufacturers, distributors, and retailers seem satisfied with current inventory levels. General mechandisers report inventory levels are satisfactory, and automobile dealers complain that inventories are too low.

Housing

After an unusual one-time surge in August funded by proceeds of State of Ohio mortgage revenue bonds, housing activity in September resumed its downward trend of recent months. Despite signs of further weakening during the fourth quarter, market participants are expecting better-than-normal sales and profits for this stage of an economic expansion. Nevertheless, builders and realtors are undertaking significant steps, including reducing building on speculation and lowering employment through attrition, to weather the slowdown that they forecast will continue through mid-1985.

Mortgage lenders report considerably fewer applications in the third quarter than in the second, with applications in September ranging from 20-40% below expected levels. Lenders indicate that high mortgage rates have softened demand considerably, and a recent slight drop in mortgage rates had no effect on borrowing. Unlike in many other parts of the country, mortgage borrowers in this area seem to be particularly cautious about adjustable rate mortgages.

Commercial Banking

Loan outstandings in all major categories increased at Fourth District banks during September. Business lending increased significantly, after being relatively flat in July and August. Consumer loan demand continues to be strong although the pace of lending has tapered off somewhat. Bankers expect business and consumer loan demand to remain quite good in the next few months.

Evidence suggests that district banks used borrowed funds to accommodate much of the recent loan growth. Although savings deposits increased, banks experienced a greater decline in transaction deposits.

# FIFTH DISTRICT - RICHMOND

## Overview

A confluence of special factors is making it very difficult to evaluate the underlying condition of economic activity in the Fifth District. Seasonal factors, weather, labor negotiations, and especially rising imports appear to be masking more general trends. The manufacturing sector, for instance, seems to be making further headway, although losses in the apparel and textile group are continuing. The weakness earlier reported in the retail sector now appears to have been less than uniform, and the earlier momentum of retail sales has been recaptured in any event. There have clearly been production losses in several areas, notably coal, textiles, and automobile related manufacturing, as a result of labor negotiations. In the auto-related sectors, these losses should be made up rather quickly. Coal production continues very strong, with a record year virtually assured. Construction activity remains strong, but somewhat less uniform than in early summer. Loan demand is essentially stable, with consumer installment loans back on trend, and there have been modest inflows of consumer deposits into District financial institutions.

## Manufacturing

Most evidence suggests that further gains in employment and output have occurred in District manufacturing in recent weeks. It is almost certain that the machinery and equipment and electrical equipment industries have expanded employment. Also, seasonal strength in food processing and tobacco manufacturing is boosting employment and output. On the other hand, textile and apparel producers have not exhibited their normal seasonal strength. Most other industries have shown little change of late, and some, such as paper producers, continue to operate at extremely high levels of capacity utilization.

Manufacturers' inventories have been essentially flat recently, and there appears to be only scattered concern that they might be excessive. Plant and equipment is largely in line with perceived needs, although there is decidedly less optimism among District manufacturers than in recent months. Prices at the manufacturing level are practically flat.

Consumer Activity

At present, consumer activity is back on the strong trend established earlier in the year, despite some isolated spots of weakness in mid-summer. Current indicators are that the earlier weakness was less widespread than earlier indicated, and was concentrated in durable goods. Some areas are now reporting a significant rebound in those goods more recently. Thus, year over year gains are once again in double digits almost across the board. As an aside, some respondents seemed surprised by the suggestion that August may have been an off month for retail sales. One other factor, however, has been unusual weather. In particular, a hurricane significantly disrupted business activity in a sizeable part of the District in the past month.

Construction

Commercial construction continues to lead the way for the District, especially in the metropolitan areas. The pipeline for these projects remains full, as new plans and announcements are still keeping up with completions.

Housing activity is by most indications, making a comeback after a brief respite. Once again, major strength seems to be concentrated in and around the metropolitan areas, but that has been the case, more or less, throughout the recovery. All in all, housing construction and sales are at or near the levels reached earlier in the year.

## Agriculture

Agricultural cash receipts in the Fifth District are expected to rebound sharply from the drought dominated levels of a year ago. Preliminary estimates call for District cash receipts rising 12 to 17 percent over 1983 levels. Larger crop production as well as increased livestock production have fueled the cash receipts increase, more than outweighing lower crop prices experienced this season. Production cost increases were modest in 1984, indicating that agricultural net cash receipts levels will also show improvement.

## The Outlook

Expectations around the District are very mixed at present. Manufacturers, as noted, are considerably less optimistic than in recent months, perhaps even pessimistic. Quite a few now seem to feel that current levels of activity are unsustainable. Much of this lack of optimism is related to import competition, however. Textile and apparel producers are very concerned and 1984 imports to date could easily justify that concern.

Consumers and retailers, on the other hand, are seen as confident and still holding to positive expectations, at least for the remainder of the year. Retailers are described as cautious with regard to inventories, but indications are that inventories are adequate to support continued strength in sales. Retailers are not, apparently, inclined to risk losing sales on this account.

There is little sense that inflation poses any near term threat. Prices are expected to rise only very little in coming months.

## SIXTH DISTRICT - ATLANTA

The Southeast's economy continues to progress in spite of nagging difficulties in several areas. The strong dollar and high mortgage interest rates have retarded manufacturing employment growth and dampened somewhat the region's usually dynamic housing industry. Inadequate dealer stocks of popular automobile models and drought-reduced crop yields have countered the general expansion. On the positive side, steady consumer spending continues to be the principal impetus behind the region's growth, followed by swelling defense-related payrolls, strong commercial construction and a rebound in housing, and improving tourism.

Employment and Industry. In August, the District unemployment rate of 8 percent continued near the level that has prevailed since last April. Florida and Georgia posted unemployment rates slightly over 6 percent, contrasting sharply with Alabama and Mississippi at 11.2 and 11.3 percent, respectively. Weakness in some industries has been offset by strength in others. Expectations for forest products have been revised downward as a result of slackening demand for housing and Canadian competition. In spite of productivity-enhancing investments by domestic textile and apparel firms, foreign producers continue to increase market share due to the strong dollar. Chemical companies are reacting to foreign competitive pressures by reducing production costs and shunning large projects that could result in excess capacity.

In contrast, defense and related industries are boosting payrolls throughout the region. Shipyards doing Navy work, high-tech electronic firms and aerospace companies are all experiencing rapid growth. Appliance producers expect their record-breaking sales to continue through year-end. Oil and gas drilling activity should remain strong in the months ahead and show signs of increasing stability. Carpet manufacturers report strong sales, especially for commercial use.

Consumer Spending. Retail spending through September exceeded its year-ago level by a substantial margin. Retailers in the Southeast reported varying sales gains for August, but generally robust September sales. The Atlanta, Orlando, Jacksonville, and Miami metropolitan areas continue to outpace the nation in department store sales. Clothing, electronic items, and housewares are early fall best sellers.

A low inventory of popular models weakened auto sales during August and September, according to car dealers throughout the region. Although August car and truck registrations in the Southeast fell sharply from previous months, year-to-date figures were 19 percent ahead of the same period last year. A major auto producer's sales in the region and the nation advanced 10 and 18 percent, respectively, in the first nine months of 1984 compared to 1983.

Construction. Residential construction in the Southeast remained surprisingly buoyant through early October, particularly in central Florida and the Nashville area. However, single- and multifamily building permits are down from their year-ago levels. Builders believe that uncertainty about the overall state of the economy and the impact of government deficits, in particular, is keeping interest rates high and limiting housing activity. The downward creep in mortgage rates over the past three months has increased the popularity of fixed-rate contracts. Mississippi's housing market got an infusion of new money from the state's $175-million housing bond issue designated for below-market-rate home mortgages. Commercial construction continues to surge, with office construction leading the way.

Financial Services. Total loans by large commercial banks were up in September over August. Both commercial and residential real estate loans showed continued strength in August and September, while some leveling off occurred in business loans. Contacts attribute slower business lending to corporations reaching desired inventory levels and moderating economic growth. They also report that a large share of commercial real estate loans in September was for the building of office parks, strip shopping centers, and hotels. August mortgage commitments at S&Ls dropped 9 percent from July and were 11 percent below commitments for the same month last year.

Tourism. Early fall activity in the tourism industry exceeded its year-earlier performance. Visitor center registrations were up in every state except Tennessee. Many attractions posted double-digit increases in attendance. Boosted by strong business and improved convention travel, hotels seemed to have filled more rooms without lowering rates. Despite poor average daily attendance of 38,000 at the World's Fair, New Orleans hotels have enjoyed a 12 percent increase in occupancy and a $10 average increase in room rates.

Air traffic remains strong at most District airports. Contacts cite renewed travel interest following the Olympics and ideal weather as two main factors contributing to the overall high level of tourism activity in the District. The start of the school year has not dampened travel to the extent expected.

Agriculture. Significant changes have occurred in the prospects for soybeans and cotton in the region over the last month. A late summer drought in Georgia has caused projected soybean production to fall by 12 million bushels for an approximately $75-million decline in revenue. On the other hand, weather has favored cotton production, causing estimated yields to approach or surpass record yields of previous years. The net effect of these changes is likely to be a modest decline in net revenue to the region's producers of major crops.

The U.S. Department of Agriculture projects a larger domestic supply of orange juice this year than in the 1983-84 season. The Florida crop is expected to be about 30 percent smaller than in 1980-81, the last year without freeze damage. Citrus canker has not yet been found in bearing groves but was discovered in a seventh Florida nursery.

## SEVENTH DISTRICT--CHICAGO

Summary. Developments of recent weeks suggest that economic activity in the Seventh District has plateaued, but few observers are apprehensive over an imminent general recession. Total employment in the five-state area has shown very little improvement since early in the year and job seekers are abundant. However, surveys by consultants indicate increases in salaries of over 6 percent in 1985. Apparent settlement of the threatened auto strike removes a shadow over many District centers, but the terms of the agreement perpetuate the region's competitive disadvantage of high labor costs. Except for new cars, small trucks and vans, retail sales were disappointing in the third quarter. Steel output appears to have started up again, after a sharp slump, and steel executives here anticipate effective government actions to curb imports. Mechanical capital goods demand remains weak with new disappointments in farm and construction equipment, and slower sales of heavy trucks. Housing activity is slipping while most nonresidential construction has upward momentum. Delivery leadtimes on goods have shortened. Most inventories are under close control, but stocks of general merchandise are described as "high." Prices are fairly stable with competition restraining increases in most markets. Many District farmers are hard-pressed by heavy debts, unprofitable prices, and declining values of farmland and used equipment.

General Outlook. Despite vexing problems, quite serious in some sectors, business and consumer confidence in the Seventh District remains generally sound--but not ebullient. It is now recognized that the national expansion has been slowing since last spring, but only a few isolated voices are apprehensive that a general recession is at hand. Relatively stable prices and lack of speculative buying by consumers and businesses have been welcome surprises. Recent easing of interest rates has allayed fears voiced earlier of a new credit crunch. Apparent settlement of the auto negotiations removes a storm cloud. However, there is widespread worry over huge federal deficits, enormous foreign trade deficits, and the shaky state of some financial institutions and some foreign debtors. Serious imbalances, in short, are seen to be financial rather than physical.

Employment Growth Slow. Through August 1984, the rise in payroll employment since December 1982 in the five District states was only half as great as in the nation. District employment has remained well below the level of the late 1970s. Since February, a large portion of the District including the entire states of Illinois and Iowa have witnessed no growth at all in employment. Hiring surveys and projections of activity by industry indicate no significant improvement in the months ahead. Job seekers are abundant, although many are said to be poorly trained and qualified. Despite slack labor markets, private surveys indicate Chicago area employers plan average increases in salaries in excess of 6 percent for 1985, slightly more than in 1984, and close to the national average. Employers are making intense efforts to curtail soaring costs of medical benefits, but have had only limited success so far. The new UAW pact retains medical benefits intact. Chicago teachers threaten a strike if their medical plan is made contributory. Strike threats loom in the trucking and airline industries where employers are trying to force substantial compensation concessions to get labor costs more in line with those of non-union competitors.

Evaluating the Auto Settlement. Rank-and-file approval of the three-year UAW-GM pact and the tentative Ford settlement seem to remove the threat of a major work stoppage that had been overhanging the District economy all year. Unlike earlier years of auto contract renewals, there are no near-term contract expirations of importance to be faced in the farm and construction equipment industries. Thus, the durable goods industries of the Midwest appear to be entering an extended period of labor peace. The new auto agreements, valued at roughly

25 percent over three years (depending on actual costs of COLA, medical benefits, job security provisions, retirement improvements, etc.) have been greeted by some as "modest" and noninflationary, but other observers point out that they extend and reinforce the heavy labor cost differential that has been a major factor in the competitive disadvantage of the region relative to other regions and abroad. At the end of the contract, the average annual labor cost per active production worker in the auto industry will substantially exceed $50,000. Pressures for investments in labor-saving equipment and foreign sourcing can be expected to intensify.

Steel Slump Over? Raw steel production in the Chicago and Detroit districts dropped by more than a third from mid-May to late September before turning up in early October. The accompanying decline in steel shipments in the third quarter was more than seasonal, in contrast to earlier expectations. Except for the hard-hit farm sector, steel consumption has held at, or near, expected levels. Therefore, the decline is attributed to increased imports and inventory liquidation. The fourth quarter is expected to see improvement, bringing industry shipments for the year to about 75 million tons, well above 1983, but several million tons less than expected earlier in the year. Higher mill shipments in the fourth quarter will reflect greater consumption in the motor vehicle industry and nonresidential construction, stabilization of inventories, and reduced imports. Industry leaders have been assured that the Administration "means business" in restricting imports from third-world countries, up till now uninhibited by restraints. Imports are expected to return gradually to 20 percent of domestic usage, down from the 26 percent ratio for the first 8 months of 1984.

Capital Goods. Producers of mechanical capital goods still report general weakness. Defense orders continue to expand, but are of relatively small importance in the District. Orders for oilfield apparatus and materials handling equipment have improved, but from a very low base. Light construction equipment is improved, but heavy items, such as outdoor cranes, remain severely depressed. Farm equipment sales are running well below last year's sad level. Orders for heavy trucks dropped in the third quarter, but demand for medium trucks and truck trailers remains vigorous.

Construction. Homebuilding has declined from last spring, but remains near last year's level. Sales of new and used homes have held up better than expected, partly because the public has accepted the view that high rates are here to stay. Conventional mortgage interest rates quoted range from 13.5 to over 14 percent, plus 3 to 5 points, about 100 basis points below the peak of last spring. Almost 70 percent of new home mortgages are ARMs, with initial rates ranging up to 12 percent. Nonresidential construction of virtually all types, with office buildings leading, continues to increase with a steady stream of sizable new projects announced.

Retail Sales. Some major retailers express disappointment over volume in recent months. The two-year boom in appliances, furniture and other home furnishings appears to have peaked out. Soft goods have strengthened somewhat. General merchandise inventories are generally excessive. This has led to widespread price cutting to keep inventories from rising further.

Prices Fairly Stable. Competition, including a wide range of imported goods, is keeping inflation in check. A retail analyst estimates general merchandise prices average less than 1 percent above last year, the smallest rise in many years. In the wholesale markets, prices of many metals have declined in recent months. Increases in prices of paper products, gypsum board, and electronic components have been substantial, but may have levelled.

# EIGHTH DISTRICT - ST. LOUIS

Consumer spending continued at a brisk pace during September and early October in the Eighth District, but home sales were down and most other sectors of the economy experienced little change. Expectations by most respondents are that consumer spending will remain strong for the remainder of the year and that manufacturing, transportation and employment will rise moderately, while construction is likely to drift lower.

## Consumer Spending

The greatest strength in District economic activity during September and early October was in retail sales. At six department stores, sales were 8 percent higher than the comparable period a year ago, which was then considered a relatively good sales period. Better quality apparel, sports wear, cosmetics and consumer electronics moved particularly well, while sales of furniture and carpeting were below year-ago levels. At each of three discount stores, sales increases were more than 14 percent above the year-ago pace. Promotions combined with price markdowns were successful in moving merchandise.

Auto demand remained strong in most parts of the District during September and early October. In the last week of September, however, sales became somewhat sluggish. Seven dealers reported sales 11 percent higher in September than in the same month a year ago, and early October was nearly as good. Reflecting the strong demand and a continued shortage of popular models, effective new car prices increased at the retail level.

Realtors and developers reported that single-family housing sales in September and early October were about 25 percent below the comparable period of 1983, and new housing starts declined further. In some smaller towns, the real estate market was virtually dormant. The volume of construction activity, both residential and nonresidential, however, remained on a high plateau although some softness is beginning to appear. A building material business continued to operate at capacity, which its owner expected would continue through the end of the year.

## Industrial Production and Employment

Output of manufacturing firms generally continued to be strong in September and early October, but the flow of new orders remained relatively unchanged. Some customers trimmed orders temporarily in order to reduce inventories, and auto assembly was interrupted by a strike. Price changes have been modest, with declines nearly matching increases. Employment in manufacturing changed little on balance, but retailers, service firms and government increased their employment moderately.

## Transportation

A railroad reported that business had been drifting lower since a peak reached in early summer, but activity in September was still 6 percent larger than a year ago. Grain moved well in September because of the Russian purchases. Railroads are increasing their orders for new cars. A Memphis-based truck line is still enjoying excellent business.

Barge traffic on the Mississippi remained flat at a rather depressed level, and there are still a large number of excess barges.

Finance

Total loans and leases outstanding at large weekly reporting banks decreased at a 3 percent annual rate in September. This decrease comes after a 22 percent growth rate during the previous month. A falling volume of loans to financial institutions was primarily responsible for the September loan contraction. Commercial and industrial loans and consumer credit rose at slower rates, while real estate loans increased at a slightly faster rate than in the previous month. While total loans were down, total deposits were growing at an annual rate of 26 percent, reversing the previous month's decrease at a rate of 19 percent.

Agriculture

Early fall cold weather has effectively stopped any further crop maturation and shifted attention to the completion of harvest. The lack of rain during September also has diminished soybean yields 3-4 bushels per acre in the southern portion of the District. Despite these recent setbacks, harvests for most crops are expected to be very good, near 1982 levels.

The availability of hogs for slaughter continues to surprise the market and should dampen what were expected to be sharp increases in red meat prices during the fourth quarter. Higher numbers of hogs for slaughter, however, also are responsible for low prices to farmers; recent prices for feeder pigs were only 1 percent above the 1983 average.

# NINTH DISTRICT - MINNEAPOLIS

Modest growth continues in the Ninth District. Unemployment rates and other labor market indicators seem to have improved lately. Some growth in consumer spending is reported, but not for homes. Also reported are scattered signs of commercial and industrial expansion. Indicators of recent financial activity are mixed--strong in the Minneapolis-St. Paul area, but weak in the rural areas, where farmers are facing low prices.

## Employment

The latest available data indicate that labor market conditions have strengthened a bit. Minnesota's unemployment rate fell 0.1 percent to 6.3 percent in August, reversing two months of slight increases. Also in August, employment in Minnesota reached an all-time high. Improvement was particularly notable in the Twin Cities metropolitan area, where the unemployment rate dropped to 4.5 percent in August. Indicative of continuing strong labor demand, in August the Minneapolis-St. Paul help-wanted advertising index was still about 47 percent above its level a year earlier and in September Minnesota's initial unemployment claims fell again. This Bank's directors continue to report that unemployment rates in southern Minnesota and the Dakotas are low and that rates in parts of Wisconsin and Montana have fallen somewhat.

## Consumer Spending

With the exception of sales in agriculturally dependent cities and towns, retail sales of general merchandise appear to be following the trend of modest growth reported last month. One large retailer in the Twin Cities reports that its back-to-school promotion went well, particularly in September. Its sales figures are still running ahead of plan. It and another large retailer in the Twin Cities say that apparel sold particularly well. Bank directors from diversified cities around the district report similar findings. Large chain stores in Rochester, Minnesota, report a good September, although smaller stores weren't doing as well. Mall business was up considerably in September in Sioux Falls, South Dakota, but only modestly in Bismarck, North Dakota.

Mirroring reports for the nation, motor vehicle sales in the district seem to have picked up a bit since August. In September, a domestic manufacturer was surprised to find both its car and truck sales in this region up substantially over year-earlier levels. District inventories of vehicles are still low. Some Bank directors in agriculturally dependent areas report that cars and trucks have been moving well there, too.

Home purchases, while still up from levels of a year ago, appear to be falling off. Both Bank directors and district realtors indicate that housing affordability has deteriorated, with high financing costs, prices, and taxes mentioned as factors. Mortgage revenue bonds are helping to prop up sales in parts of western Wisconsin, though.

Tourist spending in the district, which may have been somewhat more restrained this summer than last, picked up with the arrival of the fall color season. In the Upper Peninsula of Michigan, the season started early and is lasting longer than expected. Travel to parks in Montana and the Dakotas has been lower this year than last. While some attribute this to exchange rates inducing Canadians to stay home, in fact more Canadians appear to be crossing the border this year. Canadian tourist dollars appear to be flowing elsewhere than parks.

Commerce and Industry

Scattered reports have been appearing lately about commercial and industrial production and expansion in the Ninth District. Plans to build a $100 million office-hotel complex in Minneapolis have been announced. Some energy production facilities are being built in North Dakota, where petroleum-related activity is running at a record rate. However, construction permits are down in Bismarck, North Dakota. While an auto parts distribution center is being built in South Dakota, little other new expansion is reported there. Building products plants, which are benefiting from low lumber prices, are producing at high levels to meet building demand. While pulp and paper plants are still very busy, no expansion plans have been announced recently.

Agriculture

Most of the agricultural sector continues to be plagued by low prices, low land values, and high debt service, none of which is likely to improve soon. In Minnesota alone, the farm price index fell 3 percent between July and August. Despite Soviet purchases, generally favorable crop conditions may push production up enough to lower prices further. For example, recent estimates indicate that the nation's corn harvest will be the fourth largest on record, and both soybean and wheat production are up substantially over the drought- and PIK-reduced levels of 1983. Corroborating this, district Bank directors report favorable crop conditions in the district, except in the dry areas of the western Dakotas and northeastern Montana. They also continue to report severe farm debt-service loads. The only ag producers with some reason for optimism seem to be those selling meat animals. Lower feed prices are improving the profitability of hog and livestock operations, and cattle prices have picked up a bit recently.

Finance

The financial sector reflects the continuing trend of urban economic growth outstripping rural growth. Both deposits and loans at large Twin Cities banks have been growing faster than their national counterparts. From mid-August to mid-September in the Twin Cities, large bank deposits and loans grew 1.7 percent and 2.8 percent, respectively. The comparable national figures were only -0.1 percent and 1.1 percent. Consumer loan growth has been particularly strong in the Twin Cities. Financial activity in the rest of the district seems to be slower, though, according to this Bank's directors.

TENTH DISTRICT--KANSAS CITY

Overview. Some moderation continues to be apparent in Tenth District economic activity. While retail sales continue to improve, housing activity and mortgage demand have generally slowed. Inventories of retail goods are slightly larger than desired, while inventories of materials inputs are at satisfactory levels. Price increases have been small, and are expected to continue so. Loan demand is increasing slightly at district banks, while deposits remain unchanged. Yields of fall-harvested crops varied across the district while the newly-planted winter wheat crop is in good condition.

Retail Trade. Retailers report that year-to-date retail sales are up significantly over a year ago, and that sales continued to improve in the past three months. Inventories are slightly larger than desired for some retailers. However, no major trimming is intended, because most retailers are optimistic about sales through the remainder of the year. Prices remained generally flat in recent months, and no significant increases are anticipated through the remainder of the year.

Automobile Sales. Automobile dealers throughout the Tenth District continue to report improved sales in 1984 relative to last year. Credit market conditions are satisfactory, and financing is available both for floorplanning and car buyers. Most dealers report smaller inventories due mainly to the 1985 model introductions and partially to the GM strike. Dealers are optimistic about sales for the balance of 1984 and early 1985.

Purchasing Agents. Purchasing agents report input price increases of 5 to 10 percent over the last 12 months, with virtually no price increases during the last three months. Although metals prices are expected to continue to fall, prices for other inputs are generally expected to remain stable through the end of the year. No problems with availability were reported and none are expected. Most purchasing agents report inventories at satisfactory levels, and no substantial changes in inventory levels are planned.

Housing Activity and Finance. Residential construction activity is softening. Single-family starts are generally down, particularly since August. Starts in multi-family units range from below year-ago levels to about the same levels. Housing starts are expected to slow through yearend if interest rates remain at, or rise above, their current level. Sales of new homes are generally down from last year (except in Colorado where sales have been steady). Building materials are in good supply and are expected to remain so. Prices for materials are generally steady. Demand for mortgage funds and mortgage commitments at savings and loan associations is slowing because of slight increases in mortgage rates over the past months, and also because of seasonal declines. Most respondents expect mortgage demand to continue decreasing, although rates are expected to stabilize. Savings inflows range from much higher to much lower than last year. Increased competition was cited as a contributor to the declines at certain institutions. Respondents, however, generally anticipate only very moderate changes in savings flows for the remainder of 1984.

Banking. Total loan demand increased slightly last month at Tenth district banks. The gains were distributed unevenly throughout the district, however, reflecting the diversity of economic conditions. Commercial real estate loans and commercial and industrial loans increased where strong construction activity is underway. The slight increase in consumer loans was also concentrated in the economically more active areas of the district. Residential real estate loans declined district-wide, however, as did agricultural loans. Following money center banks, Tenth District banks reduced their prime lending rates by three-quarters of a percent early in

October to rates ranging from 12 3/4 to 13 3/4 percent. Most bankers expect the prime to decline slightly further, although they expect a lower prime to have little effect on consumer lending rates. Consumer lending rates were generally unchanged from last month. Total deposits remained unchanged last month at Tenth District banks, reflecting the general lack of strong loan demand and the slow pace of the district economy. A slight increase in MMDA's and IRA and Keogh accounts offset a slight decrease in demand deposits and passbook savings accounts, while other deposits remained constant.

Agriculture. Fall harvest is underway in district states. Corn yields in New Mexico, Oklahoma, and parts of Colorado and Nebraska are average to above average this year. Other parts of the district have not harvested corn yet due to wet conditions, and yields in Kansas and Missouri may be below average. Below average soybean yields in most district states are partly attributed to late planting in the spring and to an early frost. Reports on sorghum yields are mixed. Planting of the winter wheat crop is underway throughout the district. Though just starting in Kansas, planting is finished in Oklahoma, Colorado and parts of Nebraska, while other states report 50 to 75 percent of the crop planted. The crop is in good condition, and moisture conditions are generally favorable. Very little wheat acreage will be used as pasture this fall, but range conditions in the district are generally good. Bankers are generally pessimistic about debt repayment by farmers this year. Production loans will be repaid, but little reduction of intermediate and long-term debt is expected. Some bankers expect problems in receiving full payment of interest on outstanding loans. Reports of foreclosures and partial liquidations are mixed. With some exceptions, most bankers believe that agriculture's financial stress will worsen during the year ahead.

# ECONOMIC COMMENTARY

## ELEVENTH DISTRICT--DALLAS

The Eleventh District's recovery continues at the slow pace that has characterized it since mid-summer. This pace represents a reduction from the growth experienced in the District during much of 1983 and the early portions of 1984. Overall demand for District manufactured goods is rising very sluggishly. Oil and gas drilling currently shows no appreciable growth. Retail sales exhibit an irregular pattern of modest expansion across product lines. Nonresidential construction is declining slowly, but the level of activity remains strong. Residential construction continues to slide, due to large declines in multifamily building. Improved weather has boosted prospects for the District's agricultural sector.

District manufacturing sales growth is unchanged and slow. Demand for paper and allied products and electrical machinery is rising steadily. Stone clay and glass firms report flat demand, with the decline in housing-related demand being offset by strong sales of cement for use in public works projects. Some lumber and wood products firms report increased sales. Primary metal manufacturers report weak demand and low prices. Sales of chemical and allied products remain unchanged, while there is evidence of weakness in the purchase of refined petroleum from District producers. Fabricated metal products and nonelectrical machinery manufacturers report that growth is slowing, with the increased demand coming primarily from energy firms that are replenishing depleted equipment inventories. Demand faced by District apparel manufacturers remains low primarily due to continued strong competition from imports.

The District's rate of oil and gas drilling remains unchanged. The number of active drilling rigs in Texas is declining, while the total for the three District states (including Louisiana and New Mexico) was virtually the same in September as in August. Britain's October oil price cut, together with attendant movements in spot prices, represents a significant contribution to the down-side risk faced by District drillers and may further discourage drilling in the District, even if OPEC countries do not also cut prices.

Retail sales growth continues at a moderate pace, owing chiefly to increased promotional activity by stores. Demand for consumer durables remains low, but sales of men's and women's apparel are strong. Major deparment stores are building inventories in anticipation of a good Christmas.

After a summer of brisk sales, a seasonal downturn has begun to affect automobile dealers. The strike has had no appreciable effect so far on product availability. The recent strike settlement has offered hope to dealers that supply problems will not occur for domestic autos, but import dealers report inventory shortages. Prices are expected to remain stable through the first of the year.

Nonresidential construction value is declining in Texas, although it remains high and is showing little evidence of abatement in the other District states. The number of nonresidential construction projects is increasing in all District states, including Texas. Rising office vacancy rates have discouraged new office construction in some District cities, but retail construction continues at a high rate.

Residential construction is slowing throughout the District, owing to a rapidly weakening multifamily activity. Declines in builders' inventories have lately reversed the fall in single-family building, but the recovery has not proven very strong. Builders speculate that home buyers are waiting to see if mortgage rates will fall further.

Growth in deposits at member banks has remained flat since the end of the second quarter. At large District banks, year-over-year rates of deposit growth are slowing markedly. Deposits at these banks fell absolutely on a month-over-month basis in August and September. Growth in loans and securities at large banks also is declining. The rate of increase in real estate loans is ebbing and respondents indicate that a significant portion of these loans is being used to finance development projects outside the District. Business loans outstanding have shown almost no change since mid-summer. While consumer loan volume at large banks is well above a year earlier, it has also remained flat since mid-summer.

September and October rains have significantly reduced drought problems for Texas farmers and ranchers. September cattle prices are generally higher than a year ago and third quarter sales are estimated at 40 percent above the third quarter of 1983. Large harvests, growing surpluses, and falling prices characterize the outlook for feed, food grain, and cotton producers.

TWELFTH DISTRICT -- SAN FRANCISCO

The Twelfth District economic expansion has cooled dramatically. In September and early October, retail sales at department stores and automobile dealerships are reported to have shown no significant improvement from August's reduced pace. Nonresidential construction activity is reaching boom proportions in key metropolitan areas. But the recent slight reduction in mortgage interest rates has been insufficient to prevent both the construction and sale of new homes from falling further. The strong U.S. dollar, and consequent increase in lower-priced foreign imports, is hurting such key Western industries as lumber and primary metals, reducing the overall growth of manufacturing employment to a crawl. Prices for important Western agricultural products continue to fall, increasing the debt position of many farmers. Business loan demand at many District banks sagged during the third quarter, and only large banks expect a pickup in coming months.

Consumer Spending

Retail sales results were mixed throughout the Twelfth District states in September and early October. But overall, sales at major department stores appear to have shown little or no increase from August's reduced pace. The four major department stores in Southern California described back-to-school and early fall business as "disappointing". In September, their year-to-year gain in sales narrowed to 8 percent compared with 13 percent in August and 17 percent in July. Retailers attributed this weaker performance in part to unusually warm weather which hindered sales of autumn apparel. But the fact that sales of furniture, housewares and appliances fell indicates that the housing slowdown is taking a toll on consumer purchases of durable household items. Retail sales also were disappointing in Utah and Idaho. In contrast, retailers in the Pacific Northwest apparently experienced a pickup in sales after the mid-summer slowing. Throughout the District, automobile and recreational vehicle sales were reported to have declined in September, but mainly due to supply problems. Retailers generally have lowered their expectations for Christmas business. But department stores still expect an average year-to-year sales gain of 8-10 percent.

Manufacturing and Mining

The growth of manufacturing employment in most Twelfth District states has slowed dramatically recently, both because the growth of consumption of many key products manufactured in the area has slowed but also because lower-priced foreign imports are supplying on increased share of U.S. markets. The influx of imports has forced further cutbacks in employment in the metals and lumber industries and recently has begun to undermine domestic paper orders and prices as well. Moreover, the fact that inventories of such internationally-traded commodities as copper, aluminum and paper have continued to rise suggests that domestic producers may be forced to cut output further. If the Administration approves legislation recently passed by Congress, Pacific Northwest forest products firms could receive substantial relief from the burden of high-cost federal timber under contract. Still, lumber market conditions are so weak that many companies are expected to operate at a loss in 1984. Rising federal expenditures for defense and space programs and increased business investment continue to boost employment in such industries as electronic equipment, aircraft and missiles and nonelectrical machinery. But even in those industries, employment growth is slowing.

Construction and Real Estate

Housing starts in the West have shown further weakness recently, despite a slight reduction in mortgage interest rates. Western starts have held up somewhat better than those nationally but still are currently running about 27 percent below this year's peak reached in January. Because builders have reduced the construction of new homes about in line with the decline in sales, their inventory of unsold new homes has not risen to excessive levels. Nevertheless, builders expect Western housing starts to fall further in 1984 and 1985, even if mortgage rates remain at current levels. Falling permits reinforce the likelihood of a further slowdown in regional homebuilding. High interest rates have not impeded the virtual boom underway in nonresidential construction activity in the West. Portland is doing particularly well in attracting investment in high-technology manufacturing plants. Office vacancy rates are reaching disturbing levels in major metropolitan areas, however, reducing rents below year-ago levels.

Agriculture

In general, the Twelfth District agricultural sector continues to be in a difficult period financially, especially those farms which are highly leveraged. The strength of the dollar is reducing exports, while putting downward pressure on prices through a large influx of imports. Summer and fall crops in the region have been especially abundant, further reducing prices. Even in California where total net farm income may be up in 1984, the return on equity generally will be unsatisfactory. In California, above-normal production this year has combined with a carryover of surplus inventory to depress prices for such commodities as grapes, nuts, and tree fruits to or below the break-even point for many growers. California's cotton crop is progressing well, but the strong U.S. dollar and prospect of record world production continue to push prices lower. The situation of rice growers is especially troublesome, since such countries as Taiwan and Thailand have stepped up their exports. In California, Utah and other Intermountain states, the livestock sector has not experienced significant year-to-year improvement in prices. Farm land values are still falling, while highly-leveraged farmers are further increasing their debt position. In Utah, foreclosures on farm loans are reported to be rising sharply.

## Financial Institutions

Commercial and industrial loans at many Twelfth District banks sagged during the third quarter, and bankers report mixed prospects for the coming months. At large banks, business loans (not seasonally adjusted) declined at a 3 percent annual rate over the third quarter, in contrast to increases of 7 and 23 percent respectively during the first and second quarters. Still, most of the larger banks reported continued strong demand from certain borrowers, especially high technology firms, retailers, builders, and the service industries. Moreover, these banks expect improved retail sales, strong capital spending, and a slowdown in the growth of corporate profits to boost overall business loan demand in the near future, although lower inventory financing requirements will offset some of this expansion. Smaller banks -- especially those located in regions dominated by the mining, lumber, and energy industries -- also have experienced weaker demand for credit in recent months. But these banks generally do not expect business loan demand to pick up, due to the effects of continued high interest rates and import penetration in depressing their local economies. Moreover, an increasing number of firms in their market areas are trying to limit their investment to an amount that can be financed with internally generated funds.