

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
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by the Staff

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SUMMARY*

Overview: Economic activity remained mixed in April, according to the District reports. Sales at retail stores were up sharply in many areas. Manufacturing activity, however, was uneven although there were more positive signs this month than last. Loan demand generally was weak despite scattered strength in some sectors and in some geographic areas. While residential construction continued to be severely depressed, in a few Districts several large commercial and industrial projects were underway. Recent rains relieved drought conditions in many areas of the country, but Richmond, Atlanta, and Minneapolis still reported insufficient soil moisture. Economists boosted their forecasts for real GNP growth to the 2 - 3 percent range, but high interest rates were still anticipated. There is little evidence that expectations for inflation have been altered.

Consumer Spending: Retail sales picked up sharply in April in many areas of the country although Boston, St. Louis and Atlanta were exceptions to this pattern. In several Districts this degree of selling strength was unexpected; Chicago reported its best increase in years. Although "big ticket" items continued weak in Philadelphia and Kansas City, they contributed significantly to sales growth in Richmond. Inventories were not a problem. In contrast to the marked improvement of retail store sales, the demand for automobiles decreased in most Districts after rebate promotions ended. Nevertheless, Minneapolis and Richmond experienced modest recoveries after the post-rebate decline, and New York indicated some strength for foreign and high-priced

*Prepared at the Federal Reserve Bank of New York.

domestic models. In Dallas some improvement in automobile sales was expected this month as the removal of state usury ceilings could make more loan money available.

Manufacturing: While manufacturing activity continued to vary considerably from District to District and from industry to industry, a few new signs of strength have emerged. Cleveland, Richmond and Dallas reported growth in specific sectors; shipments in New York still were strong despite decreases in new orders. Energy-related industries continued to be a source of strength, and most steel plants were operating near capacity, with the exception of those supplying automobile manufacturers. However, overall activity in most Districts was generally flat, and levels remained especially depressed in Boston and Chicago. Further, demand for manufactured products by Japan and European countries was down in some areas, in part a result of the strong dollar and the slowdown in Europe.

Construction: Residential construction continued sluggish as a result of high interest rates. Kansas City reported that mortgage interest rates varied between 14 3/4 and 17 percent; several other Districts reported rates in the neighborhood of 16 percent. Housing starts weakened in Dallas and Chicago. Only Atlanta reported that homebuilding rebounded in March and April and even this recovery was attributed to mistaken expectations of lower interest rates. Philadelphia and Richmond indicated some pockets of residential demand, but housing construction generally remained at low levels. In contrast to the weakness in the residential sector, Richmond, St. Louis, and Dallas reported strong nonresidential construction activity, each with large commercial and

industrial projects boosting activity. Chicago's boom in downtown office construction, however, was believed to have peaked.

Financial Developments: Loan demand in most Districts continued to languish in April. Consumer loans were generally weak; Philadelphia reported levels 16 percent below last year. In Chicago there was no evidence that the recent easing of variable rate mortgage regulations had any significant effect on the home loan market. Loan demand remained depressed in Minneapolis with banks there reporting increases in federal funds sales. Commercial and industrial loan activity, however, was strong in Kansas City for energy-related activities and was strengthened in Dallas by attempts to borrow in advance of the raising of the state's usury ceilings. In San Francisco, financial institutions were coping with volatile interest rates by making almost all loans on a variable rate basis.

Agriculture: Further rainfall has ended soil moisture problems in several Districts, but Richmond, Atlanta and Minneapolis still need more rain in some areas. In Minneapolis, agricultural prices are rising, but still lie below last year's levels. Given current price levels farmers will have trouble repaying loans according to the Kansas City and Dallas reports. San Francisco projects a continuation of ample food supplies that will provide low prices for consumers.

Outlook: The generally strong showing in the first quarter has prompted economists to boost their estimates for real GNP growth in 1981 to the 2 - 3 percent range. Some weakening is anticipated in the second quarter, but growth is expected to resume by the end of the year. High interest rates have led some to fear further setbacks to housing demand, deferment of capital spend-

ing, and trimming of inventories. However, manufacturers in New York, Philadelphia, and Richmond anticipate improvement in coming months. Although there are reports of some abatement of inflation, there is little evidence that expectations have changed. The impact of the United Mine Workers strike so far has been limited to railroads. Utilities in the Atlanta area reportedly hold large stockpiles, but those near Philadelphia have only a 60-day supply of coal.

FIRST DISTRICT - BOSTON

The First District economy is in a holding pattern. Retail sales are flat. Loan demand is flat. Manufacturing activity is generally flat, except for exports sales which have softened. No one seems to be hiring now. While there has not been a noticeable increase in layoffs, neither are there any vacancies.

Manufacturers report that overall activity remains unchanged at levels generally described as depressed. There is, however, considerable variation from division to division and product to product. Thus, one large manufacturer of industrial machinery reports that backlogs for heavy capital equipment for the process industries are at their lowest levels in four years while special purpose machinery which increases productivity is selling very well. Manufacturers of aircraft and parts are enjoying a strong defense demand but are laying off in the commercial jet divisions. One important new development is a weakening in export sales; several firms reported that sales abroad, particularly in Europe, are now one of their greatest sources of concern. This weakness is attributed by some to the strong dollar and by others to the poor economic performance of the United Kingdom and West Germany.

Perceptions of the rate of inflation are highly varied. Some respondents claim to see signs that inflation is abating: prices are not actually falling but increases seem to be less frequent and/or more moderate. Others, however, see no evidence of a change. In an April survey of New England purchasing agents, the number of firms reporting higher prices for materials and supplies increased from the previous month

but was below the number reporting increases a year ago. Approximately two-thirds of those responding to the survey expect higher prices over the next three to six months; this is the lowest proportion reporting such expectations in more than a year of surveys.

The City of Boston faces a fiscal crisis. The problem is political rather than economic. The City has been enjoying a period of unprecedented economic development. However, Boston is now caught between (1) the need to raise substantial additional revenues to fund schools and court-ordered property tax refunds and (2) a major reduction in its revenue raising capacity. This reduction in revenue capacity is due to a state referendum limiting property taxes to 2-1/2 percent of the full value of a municipality's property. Boston and other communities above the limit must reduce their levies 15 percent each year until the limit is reached; overrides are very difficult. Various solutions have been proposed but a consensus has proved elusive.

Professors Eckstein, Houthakker, Samuelson, and Tobin were available for comment this month. Professor Eckstein feels the Fed has no choice--it must stick with its stated policy--because the Fed has a mandate from society to meet its long-run targets. He believes this policy will defer a housing recovery until 1982 and reduce this year's real growth to just over 2 percent and next year's to under 3 percent but that it will reduce next year's inflation .2 percentage points. He urges the Fed to get on with reforms such as contemporaneous reserve accounting and improvements in the discount window. He notes that fiscal policy is likely to be more restrictive than the President's proposals because tax cuts will be scaled back.

Professor Houthakker urges the Fed to hold firm in its pursuit of lower monetary growth and not to worry about the foreign reaction or the market's "overreaction" to high interest rates. He acknowledges that interest rates will remain high for some time but sees some progress in reducing inflation and no collapse in the real economy and no extraordinary difficulties in the financial sector. He does feel that the current level of the dollar is sufficient to expect a deterioration in the trade balance after 1981.

Professor Samuelson doubts that a supply-side miracle could resolve the overly optimistic assumption about money demand implicit in the Administration's forecast. Given the Fed's desire to continue to make progress in reducing inflation, the Fed must act on the basis of the strength in the economy rather than what a priori reasoning suggests high interest rates will do. The Fed's task is to convince the markets that its tolerance for high rates is not simply the politically opportune thing to do now but a willingness to move in the Thatcher direction. However, he cites the recent French elections as evidence of the need to consider carefully how weak the economy can be expected to be.

Professor Tobin feels the important issues are larger than the decisions at this meeting. The Federal Reserve has locked itself into a broader, inconsistent economic program. It is being "set up as the scapegoat for the eventual failure of that program." Even though the immediate situation seems to require no hard choices, the difficult decisions will arise when either strong loan demand forces interest rates to 30 percent or a "crunch" is avoided only at the cost of unemployment rising to 9 percent. Tobin believes missing the long-run money growth targets for two consecutive months is not an important issue.

SECOND DISTRICT -- NEW YORK

Economic activity in the Second District continued to be mixed in April, with marked improvement particularly evident in the consumer sector. Several retailers experienced exceptionally large sales gains, and there was strength in some parts of the automobile market. While new orders for capital goods remained weak, the backlog of unfilled orders has sustained production levels. Inventories were at acceptable levels in all sectors. Unexpectedly strong growth in first quarter GNP prompted business economists to revise upward their forecasts of real activity in 1981. Slower growth is still expected for the second quarter, however, followed by a general pickup in the latter half of the year. On the financial side, activity in the home mortgage market is far below year-earlier levels.

Consumer Spending

Retail store sales strengthened significantly in April, without unusually heavy promotional activity. Growth generally was higher than expected at a wide variety of stores throughout the Second District. One retailer reported that sales grew at twice the rate indicated in the store's plan. While year-to-year comparisons are especially difficult to interpret this month due to last year's credit controls, transit strike and earlier Easter season, the 15 to 25 percent gains reported over last April by several stores reflect unusually strong growth. Apparel merchandise has moved particularly well. Inventories are somewhat above anticipated levels, but are well in line with the higher volume. While respondents anticipate continued real growth in sales, a repetition of April's surprising showing seems unlikely.

The demand for higher-priced domestic automobiles continued strong while sales of less-expensive American models remained sluggish. Dealers attributed weakness of the latter to high prices and high costs of financing. Meanwhile, a dealer of relatively expensive domestic cars reported his third consecutive month of record sales. Foreign car sales improved, but remained weaker than a year ago. No inventory problems were indicated.

Manufacturing Sector

Manufacturing activity continued mixed in the Second District. Capital goods manufacturers reported a softening of sales, but the backlog of unfilled orders helped to maintain production. Moreover, many firms expected orders to pick up later in the year, in part because of anticipated changes in business taxation and increases in subcontracts from defense firms. Activity related to primary and secondary metals appeared to be fairly strong. In general, inventories were not seen as being out of line, although some firms are making adjustments to accommodate anticipated changes in demand. For the most part, capital spending is proceeding on schedule, but some concern over interest rates was voiced.

Financial Developments

An informal survey of 15 of the larger savings and loan associations in New York and New Jersey shows that activity in the home mortgage markets is far below year-earlier levels. Only two of the 15 S&L's report an active market, secured mainly through aggressive advertising and pricing campaigns. Most associations indicate that many of the customers who apply for mortgages at the average rate of 15 1/2 percent (plus 2 1/2 to 3 points) on fixed rate

mortgages do not meet the thrifts' income qualifications. While rates are slightly lower on flexible rate mortgages, they are not as low as the 14 1/2 percent rate that one organization cited as the threshold level for an active market. Approximately one-half of the S&L's surveyed offer both fixed rate and variable rate mortgages; one-fourth offer only fixed rates and the remaining one-fourth offer only variable rates.

Economic Outlook

Several business economists have increased their real GNP growth forecasts for 1981 by about a percentage point, to 2 - 2 1/2 percent. Nonetheless, doubt was expressed that real GNP growth in the first quarter was as high as the preliminary estimate of 6 1/2 percent. For the second quarter, slower or no real growth is forecast with gradual improvement to follow. Proposed tax cuts may boost consumer sales, but there was concern that continued volatility and high levels of interest rates may depress credit sales.

Financial Panel

Comments this month are from James J. O'Leary (United States Trust Company of New York), Francis H. Schott (Equitable Life Assurance Company), and Albert M. Wojnilower (First Boston Corporation).*

O'Leary: With a clash between forces toward a stronger expansion in real output, with continued high inflation, and monetary policy aimed at squeezing down the expansion of money supply, both short-term interest rates and long-term rates are likely to remain very high through 1982. The expectation that inflation will remain high, and that interest rates will remain high and volatile, is drying up the availability of funds for the purchase of long-term,

*Their views are personal, not institutional.

fixed-rate bonds and mortgages. Borrowers are thus forced to continue to borrow short-term, much of it in the commercial banks, with the effect of giving an upward bias to the expansion of the money supply. Should interest rates, on average, remain high and credit tight for an extended period -- say through 1982 -- there will be a severe crisis for many thrift institutions and probably for some life insurance companies. The need to place greater weight on fiscal restraint to help the monetary authorities is great.

Schott: The financial market reaction to the strength of the economy and the run-up in the money supply figures is exaggerated and likely to be short lived although it is understandable. Borrowers and investors alike are uncertain how much additional interest rate fluctuation is going to be induced by strict emphasis on monetary aggregates. Hence, there is precautionary borrowing, and great reluctance to lend in the face of possible further major disintermediation.

The level of interest rates is excessive relative to business conditions and underlying inflation. There will be a correction as soon as the money aggregates return to roughly target levels.

Wojnilower: The current business situation appears flat and slightly up. Businessmen, except in the housing and auto industries, are virtually unanimous in their optimism about the short and long run business outlook. Financial markets are more than ever preoccupied with day to day swings in security prices.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District in May are that business remains sluggish to mixed. In the industrial sector, area manufacturers report a few signs of expansion this month but, for the most part, overall manufacturing activity has remained basically unchanged. Local manufacturers anticipate widespread pick-ups in general activity within the next six months, though. Area retailers report sales up over year-ago figures, rebounding in May from the losses suffered last month owing to a mass transit strike in Philadelphia. Contacts forecast marginal increases in their sale volumes within the next six months but no "boom" in sales is expected. Third District bankers report mixed loan activity in May as C&I loan volume is up but consumer loans are off by as much as 16 percent. Looking ahead to the next six months, business loans are expected to increase slightly and retail loans to remain flat. On the residential construction scene, sales are mixed. New residential sales are running about even with May '80 levels, while resale volumes have dropped as much as 50 percent.

INDUSTRIAL

Third District manufacturers responding to the May Business Outlook Survey say that although the local industrial sector showed a few signs of expansion this month, manufacturing activity remained basically unchanged, continuing a trend that started in January. Shipments are up slightly in May and inventories, after six months of holding steady, have increased marginally this month as well. New order levels, on the other hand, are about where they were in April. On the employment front, the situation remains unchanged from last month with no expansion in either payrolls or the average workweek reported.

As for the future, survey respondents are predicting widespread pick-ups in general industrial activity within the next six months. New orders and shipments are expected to take off between now and November, and, as production picks-up, area

manufacturers plan to make some additions to inventories. Labor stands to gain from such optimism, as survey respondents plan to lengthen the average workweek and hire new employees within the next six months. Increased capital expenditures are also forecast.

Area industrial prices are up again in May as 70 percent of the survey respondents report paying more for raw materials than they did last month, and about one-half say they are charging more for their finished products. Local manufacturers expect inflation to continue over the next six months as nearly 9 out of 10 respondents anticipate higher input costs by November and nearly 8 out of 10 are planning price hikes for the goods they sell.

RETAIL

Retail sales have bounced back in the Third District in May from the losses suffered last month owing to a mass transit strike in Philadelphia. A new contract agreement for the Transport Workers Union was ratified on April 10, ending a 26-day walkout. According to area merchants, May sales are doing well compared to year-ago figures, up 10 to 20 percent. The Easter shopping season was longer this year and big promotional campaigns helped to bring in more business. Credit card sales in May are 3 to 4 percent above year-ago figures, accounting for over one-half of total sales this month. One major area retail chain is starting to accept VISA and Master Charge, thus giving their credit sales an added boost. Sales of soft goods—apparel and small household items—continue to be strong, with big ticket items remaining sluggish.

Looking ahead to the next six months, local merchants expect the current trend of strong sales to continue but are planning cautiously. Contacts project sales over the period to run only slightly ahead of last year's levels, about 4 to 7 percent. According to one spokesman, the first quarter of 1981 was strong and the second quarter should be better, but no "boom" in sales is expected. Inventories remain in-line with no changes in stock levels planned, as retailers hope to keep inventory-sales ratios healthy.

FINANCIAL

Area bankers report mixed loan activity in May. C&I loan volume is up 1 to 6 percent over year-ago figures, slightly off budget for the most part. Consumer loans, however, are off as much as 16 percent in May, generally below budget. Local bankers say they are holding off pushing consumers loans until the rates come down a bit and their marketing efforts might prove fruitful. For the longer term, area bankers say they are not too optimistic about the next six months. Their forecasts, therefore, are on the conservative side. Commercial loans are projected to increase slightly, 3 to 4 percent, by November and consumer loans to remain flat.

Reports of deposit flows in the Third District are mixed. Demand deposit levels range between 4 percent below to 2 percent above year-ago levels, savings and time deposits 4 percent below to 5 percent above May '80 figures. Contacts blame the lackluster performance on the fact that many customers are putting their money into 26-week certificates and money-market funds in order to get a higher return on their money.

Third District bankers are currently quoting a prime rate of 19 percent. Projections of the prime indicate an expected drop in the rate, leaving it about 200 basis points below the current level by November.

HOUSING

Housing sales in the Third District remain sluggish in May. New residential sales are running about even with last year's levels, while resale volumes are off by as much as 50 percent. In downtown Philadelphia, though, condominiums and townhouses appear to be doing well. Prices are reported to have been stable over the last few months, but as construction costs rise many brokers expect the price of new homes to go up as well. Mortgage money is available if, as one contact put it, "the borrower is willing to pay the price." Current mortgage rates are running 15 3/4 to 16 1/2 percent. Area

brokers say if mortgage rates drop to 13 1/2 percent, their sales would increase by almost one-half of their current volume and starts would pick up as well.

MINING

The United Mine Workers (UMW) walked out on March 27 after their old contract with the Bituminous Coal Operators Association expired. So far, railroad transportation is the only major industry of the economy to feel the strike's pinch. Steady declines in coal traffic have resulted in employee layoffs at Conrail, the highly publicized Philadelphia-based railroad. Coal represents about one-fifth of Conrail's total shipments. Since the UMW strike began, Conrail has furloughed 1,400 workers throughout the system.

In New Jersey, residents could face power blackouts this summer if the UMW strike continues into July. Electric utilities there report having only a 60-day supply of coal remaining. South Jersey's power problems have been compounded by increased tourism in the Atlantic City area, since casino gambling was legalized in 1978. Officials are predicting a record-breaking number of visitors to the shore this summer, requiring a large amount of electrical power. Spokesmen for the utilities say they will face some supply difficulties even if the strike ends soon. To prevent blackouts, utility officials are urging customers to conserve energy and industrial users to cut down on non-essential use.

FOURTH DISTRICT - CLEVELAND

Summary. Respondents in the Fourth District have generally revised their forecasts of real GNP upward for 1981 in response to first quarter strength, but still expect slow growth over the remainder of the year. Inflation may continue to moderate over the year, but the underlying rate is unlikely to change much. Capital goods producers still report a mixture of strengths and weaknesses. The steel industry continues to operate at a high level, but recent softening in orders suggests a typical summer slump ahead. Consumer spending in the first quarter was buoyed by auto rebates, and some economists expect a decline in the second quarter. The housing industry remains at a standstill, despite scattered reports of increased lending activity. Bankers expect continued strength in loans, accompanied by still higher interest rates.

Outlook. Several participants from the Fourth District Roundtable, held last March, have raised their fourth quarter 1980 to fourth quarter 1981 forecast of real GNP from about a 2% gain to about 3% as a result of a stronger-than-expected first quarter. A participant, who had expected a negative second quarter, now doubts that real GNP will show much change at all. A bank economist is now more optimistic than early last spring, because he believes that relatively rapid growth in the first quarter reflected earlier momentum in the economy and that auto and housing are still in serious trouble. Rising interest rates should not be a deterrent to economic activity, according to a bank economist, unless record interest rates are reached. Overall manufacturing activity, as measured by the Fourth District's Survey of Manufacturing, is expected to continue to expand into the second quarter, based on strength in new orders, shipments and employment. However, a loss of momentum is also suggested by the reduction in

the number of firms expecting increases in each of these indexes, except shipments, during April.

Prices. Moderation in the first quarter GNP implicit price deflator has not altered inflation expectations. Decelerating prices, anticipated by several Roundtable economists, have been enhanced by rebate programs in the auto industry and declining demand for gasoline. While most items except energy increased at a reduced rate in the first quarter of 1981, the underlying inflation rate remains about 9%-10%, according to an auto economist. A producer of consumer nondurables expects meat prices to increase during the summer, following the stepped-up slaughtering of cattle in recent weeks. Food prices in general may be helped by expected good weather, but rising costs could lead to upward pressures on prices by year-end. A trade economist expects inflation to move below double-digit rates by the end of the year, but he also expects slower progress over the longer term because of the insensitivity of wage costs.

Capital Goods. Production of producer durable goods continues to strengthen, but rising interest rates and a softening economy are likely to curtail capital spending this year. A producer of metal-cutting machines reports that orders are strong, but a producer of consumer-related electronic equipment reports that orders are softening. A manufacturer of automatic controls reports strong sales and has expanded his production facilities. However, area construction activity so far this year is at best 10% below depressed levels last year, according to a materials supplier, partly as a result of state and local government cutbacks in building and road maintenance. Heavy-duty truck sales have been set back by rising interest rates, and the market now needs a strong economic recovery over the rest of the year to exceed 1980 levels, according to a major parts supplier.

Steel. Second quarter steel shipments should be stronger than the first, but several steel economists report a definite slowing in new orders in recent weeks. The industry's relative strength continues to be associated with inventory building, with little gain in steel consumption, according to an industry economist. Also, a shift from imports to domestic steel has resulted from higher second quarter trigger prices. Therefore, steel production is currently moving toward full capacity, according to one industry economist. However, the third quarter should experience the usual summer slump in orders and shipments, because of a slow-growth economy which stalls steel usage, a sharp drop in auto sales, and a reversal of the favorable import trend as the value of the dollar continues to rise.

Consumer Spending. Consumer spending, aided by auto rebates, was greater-than-expected in the first quarter, according to an economist for a national department store chain. Real spending should decline in the second quarter, but with a tax cut, spending should recover by the end of the year.

Autos. Total auto sales dropped to an 8.1 million rate in April, according to an industry economist. Area sales in April and early May have lagged national sales. A local auto dealer reports that auto sales are off over 50% from a poor level a year-ago, and 75% from 1979 levels. Area sales should benefit from the introduction of "J" cars, but an area dealer questions whether production will be high enough to make a significant difference in overall sales. An import dealer reports a 5% increase in area sales from year-ago levels. Waiting lists for imported cars may reappear because of the new import quotas, but one import dealer is skeptical that consumers will switch to domestic cars. The import dealer doubts that the 7% reduction in the volume of car imports is enough to benefit the ailing domestic industry.

Housing. Area loan commitments for single-family housing in March showed less than nominal seasonal gains, according to area S&L officials. Recent increases in mortgage rates, now averaging about 16% for an 80% loan, and a substantial outflow of funds from S&Ls have slowed activity further in recent weeks. However, one S&L official reports success in lending to area builders with borrowed funds. Also, second mortgages are now being offered to existing customers at a variable rate, starting 25 basis points below the market rate of 18%. However, another S&L spokesman states that available funds are being arbitrated into higher yield short-term assets. Hopes for a turn-around soon are fading in the housing industry, according to an economist with a regional FHLB, because mortgage rates are not expected to fall below 13% by year-end.

Banking. Loan demand should remain firm at least through the second quarter because of substitution of bank loans for new bond issues and because some narrowing of the yield spread between commercial paper and the prime rate has made bank credit more competitive. First quarter weakness in loans may have been partly associated with overborrowing late in 1980, when fears of a credit crunch developed, according to a bank official. With those inventories depleted, businesses are now back in the market. A bank economist expects interest rates to rise further in the weeks ahead, before falling back by late spring or early summer.

FIFTH DISTRICT - RICHMOND

Overview

The latest survey of Fifth District business conditions provides some evidence that activity has rebounded somewhat over the past month. Both manufacturers and retailers report stronger conditions as compared with a month earlier. In the manufacturing sector the volume of new orders jumped sharply, shipments rose slightly, and order backlogs were unchanged. Retailers report fairly widespread gains in total sales and further relative gains in sales of big ticket items. Retail inventories and manufacturers' stocks of finished goods were up generally, while materials on hand held steady. Price increases, while still widespread, appear to have moderated over the month. In general, the tone of expectations is positive. Few survey respondents expect activity to decline in coming months.

Consumer Spending

Survey respondents from the retail sector report a decided pick up in sales over the past month. Sales of big ticket items appear to have contributed significantly. Auto sales, in general, have improved in recent weeks, but from severely depressed levels, and continue abnormally soft. Richmond directors, however, are not at all optimistic about the near term future of consumer spending. Citing such reasons as consumers being generally spent out and over-extended, they expect and in some cases already perceive a slowdown in spending. Retailers, on the other hand are generally optimistic. Most expect activity, nationally, locally, and in their respective firms to improve in coming months. Among retailers surveyed inventories rose over the past month while employment was unchanged. Inventories are basically in line with desired levels and there is no sentiment for increasing the number or size of outlets.

The Manufacturing Sector

Over one-third of our manufacturing respondents experienced increased order volume in the past month. Shipments were also up, on balance, and order backlogs were steady. Finished goods on hand increased but there was no change in stocks of materials. Overall, inventories remain about right to somewhat higher than desired. There is a growing feeling that current plant and equipment capacity is greater than required under the circumstances. Current expansion plans are characterized as about right. The recent pickup in activity appears to be fairly evenly distributed among industries. Performance at textile manufacturers was perhaps somewhat stronger than average, while the furniture industry continues weak. The pattern does seem to vary geographically according to responses of our directors. In some areas industrial activity appears surprisingly strong, particularly those areas where textile production predominates. Neither employment nor the length of the average workweek showed any significant change over the latest survey period. Nearly half of the manufacturers responding expect activity to improve over the next two quarters. Very few anticipate any worsening of activity nationally, locally or at their individual establishments.

Housing and Construction

Conditions in the housing sector, and in construction generally, remain mixed. Reports from several areas suggest some recent improvement in sales of houses and in residential construction. One Branch director finds real estate volume to have increased dramatically in the last few weeks. Other areas continue to experience a dearth of activity in both sectors. Commercial and industrial construction appears quite strong, but much of this strength is

attributable to a small number of sizeable projects in various stages of completion. The impression remains, however, that, on balance, the construction industry in the District is doing moderately well.

The Financial Sector

In general, loan activity appears to be firming moderately although, as in the real sector, activity is spotty and individual reports are not all consistent. Commercial and industrial loans are reported to be expanding at a very moderate, but steady pace. Consumer loan demand is spotty, but most indications are that installment loans are also expanding generally. Auto loans appear to be up in most, but by no means all, areas. Much the same is true of the real estate sector. On balance, residential real estate lending is up, but there remain pockets of virtually no activity. There is some acknowledgement that private financing is displacing traditional mortgage lending so that the level of the latter understates sales activity in the real estate sector.

Specific Areas of Interest

The effects of the coal strike, significant because of the size of the industry in the District, have so far been confined to the coal industry itself. At some point it is expected that those effects will spread. The duration of the strike is a major question at this time. Agricultural areas are still in dire need of rain. Rains of the past few days have helped, but much more is needed to restore necessary soil moisture levels.

SIXTH DISTRICT - ATLANTA

Recent economic activity in the Sixth District appears sluggish. Retail sales have been mixed with scattered areas of strength; retail stocks have not built up excessively. The recent rise in interest rates has put a damper on mortgage lending, and builders are predicting a substantial drop-off in housing permits in May. Strong industrial expansion continues in the energy production areas of the District, but other industries registered little growth. Bank lending has been sluggish. The prospects for agriculture are heavily dependent on abundant rainfall in the District.

Consumer Spending and Inventories. Retail sales in March appeared strong; however, caution should be exercised in interpreting the trend. Year-to-year comparisons, generally used by merchants, can be misleading for two reasons: (1) March 1980 sales were unseasonally weak due to the credit controls and the sharp recession, and (2) Easter came two weeks early last year; some of March's sales reflected pre-Easter buying.

In view of these precautions, our general impression suggests softness in retail sales. Sources mentioned lofty interest rates, hesitancy in credit use, and general uncertainty about future business conditions as reasons for caution. Automobile sales are in a post-rebate lull throughout the District, and no-frill buying is quite prevalent at this time. Interest-rate-sensitive items were noticeably weak, but there were no indications of excessive inventories. Catalog sales were about even with last year.

Recent good news from the Atlanta area was that wholesale gasoline prices declined for the second month in a row. The current glut of oil on the

world market and increased use of public transportation appear to be causing companies to lower their prices somewhat.

Financial and Construction. General uncertainty best characterizes the financial industry. Mortgage lenders report that demand is slowing down in response to the recent surge in interest rates. The hike to 16 percent equaled the record level for a large Atlanta savings and loan in April and May of last year. In south Florida, there has been a slight softening of prices in the used home and condominium markets due to high mortgage rates. Creative financing is a must if a home is to be sold there.

Home building rebounded in parts of the District in March and April; however, the increases were most likely due to builders incorrectly guessing that interest rates were headed downward. Some undesirable inventory overhang is probable and most builders predict a substantial drop-off of housing permits in May. Some consumers are willing to pay the high interest rates, evidenced by a still strong market for luxury housing in south Florida.

Loan demand has stabilized, with large banks reporting manufacturers and wholesalers holding inventories at low levels to avoid high financing charges. A notable exception is that energy-related lending is advancing at a strong pace. Money market certificates continue to attract funds to time deposits.

Employment and Industry. Although the number of factory jobs has risen substantially in the District since July 1980, not all industry divisions have fully recovered from the 1980 recession. Employment in the primary metals and building material industries (lumber, wood, stone, clay, and glass) is still well below last year. The United Mine Workers, who have 13,000 active coal miner members in Alabama, continue their strike. Area utilities are heavily

dependent on coal for generating electricity but are apparently well stockpiled and could withstand a lengthy strike. Favorable news from Alabama was that U.S. Steel will expand, adding 1,000 jobs to the northern area of the state. The continuous cast pipe plant will produce a product much in demand by oil drilling operations.

Industrial expansion is continuing strong in Louisiana, mainly due to the capital-intensive petroleum and chemical industries. Marine construction is registering substantial vitality as offshore oil fleets are enlarged. Oil and gas exploration remains strong in south Alabama and south Mississippi.

Attendance at central Florida tourist attractions rebounded in late March and early April. The Kennedy Space Center led the pack--about one million visitors came to witness the historic launch of the Space Shuttle Columbia. In contrast, south Florida reports the worst tourist season since the 1974-75 recession. Advance bookings for the Easter season were off almost 28 percent from last year. Weakness is also evident along I-75, the main corridor travelled by Florida visitors. High air fares, high gas prices, high motel rates, and reduced discretionary income were reasons given for the unusual number of vacancy signs.

Agriculture. The prospects for agriculture rest heavily on rainfall in the District. Not enough rain has been received thus far to replace the subsoil moisture evaporated by last year's drought. Although showers have been sufficient to provide a good winter wheat crop, the development of summer crops will be severely restricted without abundant rainfall. Livestock producers continue under heavy economic pressure that will be accentuated if another dry summer is experienced in the Southeast.

SEVENTH DISTRICT - CHICAGO

Summary. Economic activity in the Seventh District remains depressed relative to the nation. Nevertheless, year-to-year comparisons in sales and orders for April and May will appear favorable because of the sharp "free fall" declines that occurred last year. Employment in all five district states is running below last year's level, with no significant near-term improvement anticipated. The recent rise in interest rates cut-off a very modest, incipient improvement in housing. More businesses and state-local governments are experiencing financial problems. Demand for capital goods is generally weak. Steel orders continue to be strong. Although sales of autos and trucks remain disappointing, general merchandise has been surprisingly good. With improved moisture conditions crop prospects are good, but farm income estimates for 1981 have been reduced because of depressed prices.

Inflation. Price inflation has moderated in highly competitive sectors. Retailers report a general slowing of the rise in prices. Concrete and lumber are down. Over 70 percent of Chicago area firms reported paying higher prices in April, compared to 90 percent a year ago, but none paid lower prices. All transportation costs are up sharply. Utilities insist that large boosts are needed to prevent insolvency. Overall there has been no improvement in inflationary psychology.

Employment. Demand for workers continues slow throughout the district. Help-wanted ads in Chicago papers are about one-third below last year. A number of permanent plant closings involving farm and construction equipment, motor vehicles, oil refining, and meat packing have been announced in the past two months.

Hirings by state and local governments are curtailed by budget constraints. Many business firms are pushing wage cost reduction programs. These efforts are complicated by pressure to meet EEO quotas. Attempts to get unions to accept concessions are seldom successful.

Retail sales. Large national general merchandise retailers headquartered in the district reported increases in sales averaging 20 percent over last year in April. This was the best showing in years, and was surprising to merchants who had noted some improvement in March. Part of the surge is attributed to depressed sales of homes and motor vehicles, and to reduced vacation travel.

Capital spending. Demand for capital goods is generally disappointing. Foreign orders are up, however. Machine tool orders are off by one-third and cancellations are up sharply. Demand for heavy trucks and trailers, freight cars, mining equipment, and construction equipment is weak. Farm equipment is mixed. The oil and gas development sector is very vigorous, but the district has only a limited participation. Utilities are slowing capital expenditure programs, partly because of financial problems, and partly because of reduced estimates of demand. The auto industry is postponing major projects because of inadequate sales and reduced cash flow.

State and local government. Financial stringencies on state and local governments are worse than at any time since the 1930s. Officials in all five states have commented that programs are being constrained by shortages of funds caused by shortfalls in revenues and reduced federal grants. Medical care costs are up. Wisconsin, which had led other district states in economic performance, has been hurt by layoffs in capital goods, motor vehicles and recreational products. Its governor recently said the state was in a "deepening depression." The Chicago

area has been warned of a possible shutdown of its vital rapid transit service.

Motor vehicles. Auto assemblies in the second quarter will be about 20 percent above last year, following a decline in the first quarter. Long model change-over periods at some plants to convert to Front Wheel Drive cars and will hold output at last year's level in the third quarter. Sales dropped off sharply in late March and April after the rebates were withdrawn. Sales of heavy trucks dropped back in the first quarter instead of increasing as expected.

Steel. Demand for steel from Chicago area mills has been strong, partly because of inventory building. A leading firm is operating at effective capacity and expects this to continue into the third quarter. Detroit mills, heavily dependent on autos, are operating at lower rates.

Housing. Improvement in home sales noted in March was wiped out in April and May as credit tightened. Some lenders are quoting mortgage rates as high as 17¼ percent, but with few takers. Some S&Ls are not making any new commitments, probably an unprecedented situation at this time of year. Many sales involve loan assumptions or seller subsidies. There is no evidence that recent easing of regulations in VRMs is having a significant effect. There are reports of cuts in asking prices for new and used homes, but there is no reliable quantification.

Non-residential construction. Growing deficits have caused state and local bodies to cut back on bridge and highway work and other public facilities. A major boom in office buildings is in progress in Chicago's downtown area, but some analysts believe the wave is "over the top."

Agriculture. District farmland prices rose two percent in the first quarter according to our survey, but only half as fast as in the second half of

1980. Liquidity at district agricultural banks is ample, but loan demand is held back by high interest rates, low farm earnings, and by use of non-bank lenders.

Recent rains have ended drought fears, but have slowed field work which had been ahead of schedule. The outlook for good crops is still favorable. Hope for high grain prices have been dimmed by smaller than expected exports and large harvests abroad. Both cattle and hog farmers report that selling prices remain below costs of production. Overall, these developments have caused analysts to reduce estimates of the extent of the rebound in farm income this year.

EIGHTH DISTRICT - ST. LOUIS

Overall, recent economic activity in the Eighth District has exhibited no marked change from earlier in the year, according to area businessmen. Retail sales apparently are keeping pace with inflation. Manufacturing activity is mixed: appliances, automobiles, metals and paper are among the weaker sectors; chemicals, military equipment, and oil and gas equipment are among the stronger one's. Homebuilding remains at a low level, and, with higher mortgage interest rates, builders fear even further declines. Loan demand at District banks is stable. Prospects for this year's crops continue to improve with the recent rainfall in drought areas of Missouri and Arkansas.

Consumer spending has remained constant in real terms in recent weeks. However, department store representatives report that sales in nominal terms are running well ahead of last year's level and that sales in April were above those in March. A weakness in sales of automobiles and appliances was reported; automobile sales were down 15 percent or more in April from March. This weakness, however, was partly attributed to the end of the rebates. Truck sales, on the other hand, have remained stable.

Several manufacturing industries have shown little strength in activity in recent weeks. Demand was described as unchanged for steel and declining for aluminum. The drop in the demand for aluminum began last fall, in large part as a reflection of reduced orders from Japan and Western Europe. Moreover, an upturn in demand for steel or aluminum is not expected

until later this year or early next year. One representative of an appliance manufacturer reported that production has been adjusted at his firm by so-called "tuning days," whereby plants are closed for extended weekends or holidays. Automobile manufacturing in the District remains at the low level of a year ago. A representative of the paper and boxboard industry reported no change in sales in recent weeks, although the shipments in units are below a year ago.

Manufacturing sectors exhibiting some strength include chemicals, military equipment, and oil and gas equipment. A representative of a major chemical firm noted that sales this year have been better than expected. Demand for industrial chemicals and plastics has picked up, and demand for agricultural chemicals remains at a high level. Increased government spending on military equipment has resulted in increased activity for military hardware producers in the District and further increases are expected on the basis of the current military budget. Commercial aircraft manufacturing activity is currently remaining at a high level, based on sizable backlogs of orders built up in 1980; new orders, however, have begun to decline and are expected to continue declining for the rest of this year. Demand for equipment for the oil and gas industries continues to be a source of strength for producers of such products as pipes, pipe coatings, regulators and valves.

No substantial inventory problems were reported by either retailers or manufacturers. Automobile inventories were trimmed by the rebate

program, and appliance manufacturers report that they have kept inventories at desired levels by curtailing days worked, despite weakness in demand.

Housing activity remains far below normal levels throughout the District, although seasonal gains were registered in March and April. Builders' expectations about home sales this year were jolted by recent increases in interest rates which were counter to earlier expectations. Some observers note that many residential builders are in considerable financial difficulty and may be unable to survive another year of "low" housing sales. Commercial construction, on the other hand, continues at a high level in the District, particularly in the St. Louis metropolitan area where a number of large projects are under way.

Loan demand is reported by District bankers to be unchanged. However, the prime interest rate on bank loans has been increased along with those in the national money markets, while interest rates on home mortgages have risen to around 16 percent in the St. Louis area. With no increase in loan demand, many banks--especially those in rural areas--are investing funds in money market instruments. Officials of savings and loan associations report little growth in their deposits, and most associations report that they are not actively seeking mortgage loans. Rather, they are restricting loans to present customers and building liquidity by investing in bank CDs and other short-term liquid assets. S&L officials reacted favorably to the recent regulatory change allowing federally chartered associations to offer variable rate mortgages. One official predicted that such mortgages would be available at his institution within 30 days.

Low moisture conditions over the eastern portion of the District have about disappeared with the rainfall in recent weeks. Farmers in the region plan to expand rice acreage somewhat, while keeping their cotton and soybean acreage about the same. In Missouri, which was hard hit by last summer's drought, farmers are planning to decrease corn acreage, but increase acreage of grain sorghum, which is more drought-resistant. Planting of corn, cotton and rice is proceeding at a rapid pace, and land preparation for soybeans is well under way.

NINTH DISTRICT - MINNEAPOLIS

Although there are a few signs that the Ninth District's business activity improved in April and early May, the sluggishness noted in our last report has generally persisted. The signs of improvement came in consumer spending and agricultural conditions. General merchandise sales increased modestly, and auto sales surpassed their low prerebate levels. Also, farm prices rose and part of the district received some much-needed rain. The other components of the district's economy, however, continued to be sluggish. Manufacturing activity remained sluggish as gains in some industries' orders were offset by declines in others', and iron ore, lumber, and home sales continued in the doldrums. In addition, construction activity has recently been disrupted by strikes. These weaknesses were reflected in sluggish bank lending.

Consumer Spending

Consumers became less hesitant to spend. General merchandise sales increased somewhat more than seasonally in April, after being very sluggish in March, and recent sales were better than expected, according to three major district retailers. One large retailer with stores throughout the Upper Midwest, for example, reports that 37 out of his firm's 40 stores had sales increases in April. Directors from southern Minnesota and Montana also report that retail sales recently have strengthened.

Accompanying the pickup in general merchandise sales has been a modest revival in auto sales. District car sales did decline in early April after being boosted by the rebates in March. But a regional sales manager for a domestic auto manufacturer states that sales in late April and early May exceed-

ed their low prerebate levels and that in the Minneapolis-St. Paul metropolitan area April sales were large enough to give most dealers a profit.

While general merchandise and auto sales, although still quite weak, showed signs of improvement, home sales have not picked up. Mortgage loan applications at Minneapolis-St. Paul S&Ls in April were unchanged from March's depressed level.

Agricultural Conditions

Agricultural prices and the weather both improved modestly in April and early May. Cash grain and livestock prices at the Minneapolis and South St. Paul markets were all up 1 to 6 percent between March and April, but most prices were still well below the highs attained late last year. According to an economist with a large international grain trading firm, part of the increase in grain prices came from the markets anticipating that the administration would lift the embargo in late April. The weather has also improved. A month ago, the entire district needed rain, and drought or near-drought conditions still persist in western Minnesota and North and South Dakota. But in April sufficient rains came to eastern Minnesota and western Montana.

Industrial Activity and Inventories

In contrast to the slight improvement in consumer spending and agricultural conditions, industrial activity in April and early May was essentially unchanged from March's sluggish level. Gains in some manufacturing sectors were offset by declines in others. An economist with a national manufacturer of medical and office products indicates that his firm's orders picked up in April and that his firm's inventories are now lean. Similar comments also are voiced

by an economist with a large national manufacturer of consumer products. On the other hand, an economist for a national manufacturer of building supplies indicates that his firm's orders declined in April, and a director associated with the paper industry reports a recent softening in his firm's new orders. In addition, in April and early May, taconite plants and lumber mills continued to operate well below their capacity.

Not only have manufacturing and mining failed to pick up, but construction activity has been disrupted by strikes. On May 1, 2,800 Minneapolis-St. Paul bricklayers, roofers, and sheet metal workers went on strike. With pickets out at most major construction sites, these strikes have disrupted much of the construction activity in the Minneapolis-St. Paul metropolitan area.

Financial Development

Despite the improvement in consumer spending and agricultural conditions, the continuing weaknesses in the economy resulted in sluggish bank lending. In April and early May, directors report little change in bank lending from March's low level. They indicate that banks have increased their federal funds sales, because their customers have been reducing their loan requests. These reductions are attributed both to the sluggishness in the regional economy and to high interest rates.

TENTH DISTRICT—KANSAS CITY

Overview. The District economy is displaying little vigor, except in energy-related categories. Department store sales picked up a bit in April, but sales of new cars plunged. Outflows of funds at S&L's suggest further declines in homebuilding. Manufacturing activity remains depressed despite some improvement. Purchasing agents report fewer and smaller increases in input prices, and ample supplies of materials. Recent rains have improved pasture and crop conditions, but bankers believe that many farmers face bleak economic prospects. In banking, loan demand and deposit growth are lack-luster outside energy-strong areas.

Automobile Sales. Sales of new cars continue depressed in early May, following sharp declines in April. Dealers do not expect business to improve much soon, and are holding inventories at very low levels. In some states, relief is being sought from usury ceilings that have made auto loans unprofitable for banks.

Retail Sales and Inventories. Department store managers report improved sales in April. Lawn, garden, and automotive goods have sold particularly well in recent weeks, but big ticket items are still selling slowly. Retail profit margins, already reduced, are being cut further by the increase in the minimum wage. Retailers say their inventories are a bit high, but not worrisome, unless sales unexpectedly decline.

Home Finance. Savings and loan difficulties continue, with most associations reporting significant net outflows of funds. Rates on new mortgages range from 14 3/4 to 17 per cent. Some S&L's now will finance the purchase of

a house only if they already hold the existing mortgage. Mortgage lenders say that not many individuals qualify at current interest rates. Few thrifts have implemented variable rate mortgages although all are planning to do so.

Manufacturers' Input Prices and Inventories. Purchasing agents note a trend toward more stable prices in recent months. Most raw materials are readily available. The major exception is lumber, which is in short supply due to some mill shutdowns. About half the companies contacted report excessive inventories and excess plant capacity. About one-third have workers on layoff, a smaller portion than in recent months.

Agriculture. The winter wheat crop in the Tenth District is in fairly good shape due to recent rainfall. Winter wheat is approximately 2 to 3 weeks ahead of normal for this time of year and harvesting will begin in Oklahoma around the end of May. Spring planting is underway, although farmers in some areas are using irrigation at this time to pre-water their fields to allow the plantings to get an adequate start. Depressed cattle prices continue to cause difficulties for ranchers and cattle feeders. Many ranchers were intending to sell off cattle within the next few weeks due to lack of pasture growth. However, recent rains have improved pasture conditions, allowing many ranchers to continue to hold these cattle.

Agricultural loan demand remains low throughout the District while fund availability at agricultural banks appears to be more than adequate. Many farmers and ranchers have begun the year in a lower equity position than at this time a year earlier. In some parts of the Tenth District, agricultural producers have been able to pay only the interest on last year's loans and requests for renewals or extensions are higher than normal. District bankers

estimate that the number of agricultural borrowers who will have repayment difficulties by the end of 1981 may be twice as many as in a normal year. Although many bankers are recommending the Farmers Home Administration as an alternative source of credit to their borrowers this spring, most are not concerned over proposed cutbacks in this program.

Banking Developments. Loan demand is mixed at Tenth District banks. Several banks in Oklahoma and Colorado report strong increases in commercial, industrial, and commercial real estate loans—all related to the robust growth of energy-related industries. Elsewhere, commercial and industrial loans show moderate increases, but real estate loan demand is generally flat. Agricultural loans are flat, with most lending activity confined to carryovers. Consumer loan demand is also flat throughout the District, largely in response to the recent rise in lending rates. Most of the metropolitan banks have recently raised prime rates to 19 per cent. Base lending fees at some country banks have recently been increased to 19 1/2 per cent, but some banks in Nebraska are holding base fees below 18 per cent.

Deposit growth was generally stable this past month. Most bankers report moderate growth in NOW accounts, and expect further small shifts from demand deposits to NOW's. Demand deposits are mixed, with the strongest growth in Oklahoma and Colorado. Time deposits other than MMC's and savings deposits other than NOW's are either stable or declining at most banks. Some banks with strong loan demand are continuing to attract funds by marketing large CD's.

ELEVENTH DISTRICT--DALLAS

The economy of the Eleventh District continues to grow moderately. Manufacturing output is rising, and loan volumes at commercial banks are increasing slowly. The strength of nonresidential construction shows no signs of weakening. Department stores sales significantly exceed last year's levels. However, higher interest rates are curtailing mortgage loan demand, and the pace of housing starts is slowing. New car sales were high in the first quarter but have fallen since March. The probability of widespread defaults on agricultural loans is increasing.

Most District department stores are reporting outstanding sales gains for April, which were aided by a late Easter and good weather. Dollar sales for the first four months of the year are 16 percent above year-ago levels, but respondents expect May sales to decline slightly. Most product lines, including appliances and home furnishings, are selling well. Inventories are lean at most stores, and discounts and promotions are at normal levels. Credit sales as a proportion of total sales remain below last year's percentages.

New car sales are down from their March levels. The decline reflects the termination of manufacturers' rebate programs and commercial banks' continued retreat from financing auto purchases. However, dealers expect prospects for bank financing to improve since the Texas usury ceiling was lifted to 24 percent on May 8. The number of used car sales is the same as in the last survey period. Auto inventories may shrink from current levels as respondents do not plan to replace all units sold.

Total loan volume at commercial banks is up from March. Lending to the energy industries and for interim construction financing are the sources of strongest loan demand. The volume of consumer lending is up slightly as borrowers sought to avoid higher interest charges before the increase in the Texas usury ceiling. Bankers report increased competition from money-center banks offering loans priced under prime. Respondents are concerned that medium-sized and small companies without alternative sources of financing will be severely squeezed by higher interest rates.

The growth of deposits at commercial banks is slowing. Savings deposits and NOW accounts are still rising rapidly but at a slower pace than in March.

It is becoming increasingly likely that those banks that make primarily agricultural loans will experience a serious decline in quality of their loan portfolios. A growing number of bankers in the western half of the District, as well as contacts within the Farmers' Home Administration and Federal Intermediate Credit Bank, express concern about the poor financial condition of farmers and ranchers. Heavy borrowers are reportedly having problems servicing their debts and are said to be in desperate need of profitable grain and/or livestock sales. But current prices for major grains and livestock are below average break-even levels in many areas of the District.

Liquidity remains relatively high at S&Ls, even though the pace of deposit outflows is up from March. Restrictive lending policies are being instituted to offset the loss of deposits. Respondents reported

that savers withdrew funds for income tax payments and to invest in money market mutual funds. S&L officials anticipate further declines in loans and deposits.

The rate of new housing starts is falling, and no turnaround is anticipated until interest rates decline. Inventories of unsold homes are not exceptional but could cause problems for builders if interest rates continue to rise.

Nonresidential construction remains active because of the continued flow of foreign capital and new firms to the Southwest. Plans to build two 70-story buildings in Dallas were recently announced by a Canadian firm. Local government agencies and construction contractors report builders headquartered in the Midwest are bidding on an increased number of projects in Texas. That development is expected to keep cost increases down. Increases in prices of construction materials are at low to moderate rates.

Manufacturing output continues to expand steadily. Suppliers of nonelectrical machinery and fabricated metals report expanding production and employment, which they attribute primarily to increases in orders from customers in the energy industries. Manufacturers of building materials report no change in new orders, but expect purchases from residential builders to decline. Apparel output is declining slightly and manufacturers expect retailers to place few follow-up orders for this season's merchandise. Due to high carrying costs, manufacturers and wholesale distributors are paring inventories, resulting in longer order lead times but shortages of few products. Materials costs are generally stable or rising moderately.

TWELFTH DISTRICT - SAN FRANCISCO

The strong performance of the economy in the first quarter surprised many in the Twelfth District. Previously, gloomy expectations had been reported for economic conditions. Presently, most are expressing slightly more optimistic forecasts for economic conditions for the rest of the year. Inventory positions are reported to be low as firms are trying to cope with the high cost of financing. Housing related industries are still depressed and with mortgage rates in the 16 percent range little change is anticipated. Agriculture continues strong in the region and a water shortage no longer appears to be a serious problem. Financial institutions are dealing with volatile interest rates by making greater use of variable rate loans. Intense lobbying efforts are underway against recent rulings that remove "due-on-sale" clauses in mortgage contracts. The unemployment picture remains unchanged.

CONSUMER SPENDING, after a surprisingly strong first quarter, is reported to be weakening somewhat in the Twelfth District. Automobile sales rose briskly in response to the manufacturers' rebate program during February and March. However, sales are said to have substantially slowed down during April. Retail sales in general are reported to have been strong in April and many expect continued strength in the upcoming months. There is some concern that the recent rise in interest rates may lessen durable sales.

INVENTORY positions are reported to be very low compared to sales. Firms are still cautious to expand, given the high level of economic uncertainty and the high cost of financing. There is some evidence to suggest that automobile manufactures are replenishing inventories as a

result of the depletion of stocks due to strong sales during the first quarter. Some indicate that the inventory position should benefit the economic recovery as any pickup in sales will require a significant increase in inventories.

HOUSING related industries remain depressed. With mortgage rates in the 16 percent range little optimism is being expressed. There remains a large inventory of unsold homes and little new home construction is under way. The lumber industry remains in a slump and layoffs and shutdowns continue. The industry is also being hurt by a weakening in the export market. Concern is being expressed that many builders and construction labor that is being forced out of the market at this time will not return to the housing industry when it recovers.

AGRICULTURE in the district remains strong. Unseasonably heavy rains have raised the water table and the snow pack in the mountains and so reduced concern over a potential water crisis. The fruit fly still remains a potential major problem in parts of the district. Agricultural interests are on guard against any possible outbreak and have proposed the use of widespread spraying if the policies undertaken in the past months do not appear to have worked. The Texas quarantine of California produce has been rescinded as the fruit fly has not spread to the major agricultural areas. Agricultural sales for California totaled over \$14 billion for 1980 according to recently released figures. Projections are for an ample supply of agricultural products so that consumers will be seeing relatively low prices.

FINANCIAL INSTITUTIONS are trying to cope with volatile interest rates. Almost all loans that are being made are on a variable basis.

Institutions are trying to reduce the maturity of their loan portfolios. A major concern in a number of areas are rulings that remove "due-on-sale" clauses in mortgage contracts. Some contend that these rulings will hurt both financial institutions and the housing market. Some California Savings and Loan Associations are changing their charters so as to circumvent a ruling in the state prohibiting "due-on-sale" clauses. The recent authorization by the Federal Home Loan Bank Board of a new adjustable rate mortgage instrument which allows for greater variability in rate has received a favorable response from Savings and Loan Associations.

The UNEMPLOYMENT situation in the District remains mostly unchanged. The unemployment rate in a number of areas is still at very high levels. Fewer jobs are available and any news of possible hirings brings a flood of applicants. The electronics and computer industries continue to thrive and are constantly looking for skilled help. However, in general reports are not very optimistic for employment possibilities for the rest of the year.