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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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TABLE OF CONTENTS

SUMMARY*

Introduction. While economic conditions remain very depressed throughout the nation, there is a widespread view that a bottom was reached in the first quarter, possibly in January when severe weather hampered activity over a large portion of the nation. Allowing for weather effects, retail sales, manufacturing, employment, and construction have been about level since late last year. Despite deep pessimism, panic has been avoided. Sluggishness is expected to continue in the second quarter with some improvement about midyear, hopefully aided by lower interest rates. Price inflation continues to slow. With a downturn developing in oil and gas development, defense procurement becomes the principal expanding sector. Finished goods inventories are too high in some sectors, but most purchased materials are under close control. Capital spending plans generally are being reduced. Auto and appliance sales remain weak. Extreme caution holds back decisions on consumption and investment, especially on major items. Housing remains severely depressed everywhere, but some districts report incipient improvement. Office building construction is still vigorous in some large centers. Crop prices remain low partly because of large harvests projected for this year, but livestock prices have increased. Several districts report increased bankruptcies and more problem credits for consumers, business, and agriculture.

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*Prepared at Federal Reserve Bank of Chicago.

The financial condition of S&Ls continues to deteriorate and they probably will not be able to finance a resurgence in housing. Several districts report business loan demand as "flat," but outstandings are buoyed up by expanding energy loans, and loans that are not being paid on schedule because of financial problems afflicting various borrowers.

Regional differences. All of the district reports follow, in general, the outline described above, but there are noticeable differences. The Chicago and Cleveland districts with their emphasis on hard goods continue to present the blackest pictures. New York, on the other hand, finds that the Second District is "weathering the recession quite well." Philadelphia may be "on the verge of a turnaround." Minneapolis sees "hints of recovery." Dallas reports autos and housing "showing initial signs of recovery." At the other extreme, San Francisco (in the past one of the most vigorous growth regions) has "slipped deeper into recession," with homebuilding at the lowest level since World War II, and distress in housing replacing the fabulous boom of the late 1970s.

Inflation. Price increases clearly have slowed, with exceptions in some lines. Philadelphia reported, however, that increases in industrial prices were more prevalent in March. Cleveland and Chicago note substantial pressure by producers on labor and suppliers to cut costs. Goods and services are readily available, and price discounting is widespread. Chicago noted far-reaching ramifications of the declines in crude oil and oil product prices, as a result of the world-wide excess supply of oil.

Employment. Additional layoffs and reduced hours, affecting full-time and part-time workers in a wide variety of lines of business, were reported by most districts. New York characterized overall labor market conditions there as relatively strong. Dallas noted deterioration since December, due to layoffs and inmigration of the unemployed from other districts, but reported an unemployment rate in February of only 5.8%. Layoffs in the Fourth District included workers from the last auto passenger tire plant in Akron. San Francisco indicated that most of the boost to employment from rising defense spending will occur in 1983-1984, not this year. In response to widespread layoffs and reduced job opportunities, unionized workers have been increasingly willing to grant concessions.

Consumption. Retail sales reports are mixed, but generally indicate sluggish or weak spending. Lack of confidence and negative expectations were noted as restraining outlays. Those who commented on the outlook project a rise in consumer expenditures in the second half of this year. Minneapolis and Dallas noted signs of recovery in auto sales in response to rebates. Evidence of financial strains--consumer loan delinquencies, rising personal bankruptcies, and closing of retail stores--was reported.

Inventories. Reports on inventories are difficult to characterize because of a highly mixed picture by industry, by stage of fabrication and distribution, and by region. In general, raw materials and purchased components are low, while finished goods have become excessive when sales sagged. San Francisco tells of "involuntary" accumulation. Philadelphia reports retail inventories "pretty clean", in general. Richmond notes a rise in manufacturing inventories. Boston finds stocks generally too high, but packaging materials "very low." Cleveland says oil product inventories are being cut, but not crude oil. Aluminum is high at the producer level, and "extremely low" at the fabricator level. To sum up, except for particular imbalances, inventories are low relative to normal standards because of heavy finance charges and uncertain sales prospects. Chicago and Kansas City warn that a rise in final sales could quickly bring longer lead times and higher prices.

Capital spending. District reports suggest a significant decline in capital spending in 1982. Low business confidence is a major factor. San Francisco and Boston are affected by layoffs related to reduced demand for commercial aircraft. The drop in oil prices has brought a reduction in drilling in all producing regions. Demand for related equipment has dropped, and a proposed oil pipe mill has been canceled. New York and Cleveland report cancellations of orders for machine tools. The TVA has halted construction on three nuclear plants. Commercial construction is weak except for large office building in centers such as New York, Chicago, Cleveland, and Dallas.

Manufacturing. Defense procurement is vigorous, but these activities are most significant in a few districts: San Francisco, Dallas, St. Louis, and Boston. Steel and motor vehicle output are down sharply, but there are signs of improvement. Appliance output also is down currently. Textiles are down in Atlanta and apparel in Dallas. Petrochemical output is off in several districts. Richmond reports a rise in demand for cigarettes. Overall, manufacturing output remains depressed but may be past its low point.

Housing. The housing picture varies from bad to worse throughout the nation. Dallas and Minneapolis report a recent rise in home sales, but Richmond, San Francisco, St. Louis, Chicago and most other districts have observed no improvement in starts from an extremely low level. A backlog of demand for housing is building up with few unsold units, as reported by Kansas City. Lower interest rates are the only hope for home building this year and time is running out, at least for the northern states. More builders and subcontractors are leaving the field. "Creative financing" has not proved of much help.

Agriculture. Large crops are forecast for the South, the Midwest, and the Great Plains--especially wheat, soybeans, and corn. Production plans indicate large plantings, and subsoil moisture conditions are excellent. Large crops suggest further downward pressure on prices. Livestock prices have been rising, but most experts project a further decline in net farm income. Farm land prices are declining and delinquencies and bankruptcies are rising. Heavy debts at high interest rates, combined with lower income, could cause further deterioration in the financial condition of agriculture.

Finance. Uncertainty continues to characterize the financial markets. Business loan demand is described as weak or flat in most districts. Business credit ratings are being downgraded, and more loans require special attention. New York experts say business liquidity continues to deteriorate, and more ratings will be downgraded soon. Mortgage credit is very tight, both for housing and commercial projects. Usury rates are impeding credit use in some states, especially for credit cards and auto loans.

FIRST DISTRICT - BOSTON

There is no upturn yet in the First District. Retailers report that sales have been slow, although not much slower than expected. While a few manufacturers see signs of a pickup, the majority report no improvement or further declines. In both retailing and manufacturing, inventories have increased relative to desired levels. A lack of confidence in the future is depressing capital spending, even by firms with adequate funds for investment.

Retail

Retailing continues to be slow in the First District; but merchants reported no serious disappointments relative to plan, since they expected sales to be slow. The first quarter is traditionally weak for retailers, and weaker still so far this year. Those contacted reported February transactions were below last year; while dollar sales were slightly up for some retailers, others' sales were down as much as five percent in some New England states. Inventories are slightly above desired levels.

Several retailers mentioned considerable geographic variation in sales performance. Results for individual product lines were also mixed. One merchant said increasing fabric sales signaled that consumers are economizing through home sewing; another said better women's sportswear and "designer" housewares had moved strongly; another's declines were storewide.

All the retailers contacted are taking a "conservative" approach to the first half of the year, expecting the current slowness to continue. Several said promotional activity will remain at its usual seasonal levels. Ordering and buying for the second half of the year were said to anticipate an upturn.

Manufacturing

Manufacturing activity in the First District has fallen since the end of last year; and while a few firms report that recent business has been better than expected, most see no signs of improvement. For three consecutive months now, surveys of local purchasing managers have found more firms in which production and orders have fallen in the month than firms with increases.

The problems of the auto industry and the commercial airlines were of particular concern to this month's respondents. The commercial airlines continue to cut back orders for new engines and parts, causing substantial employment losses in the First District's aircraft industry. This decline has also affected manufacturers of electronic components and communications equipment. Among the areas recently affected by difficulties in the auto industry are tires and capital equipment. Again, there is concern that conditions will deteriorate further. Not all the products in which demand has softened are tied to particular problem industries. The demand for specialty industrial chemicals has weakened; the paper industry has seen a downturn.

Among the few positive developments was a report of a definite pickup in orders for packaging for consumer products and medical supplies; the demand for industrial packaging has not improved. The defense business continues to be a source of strength. Firms which were not previously active in defense work are now competing for contracts. In a few cases, bottlenecks have developed because inexperienced subcontractors and suppliers are having difficulty meeting defense specifications.

With respect to labor negotiations, manufacturers expect settlements to be more moderate than in the past; labor is more likely to be flexible on fringes than on take-home pay.

Inventories

Inventories have recently become higher than desired, according to several First District manufacturers; unless sales pick up in the next few weeks it will be necessary to make further production cuts. However, the manufacturer of packaging materials reports that both his inventories and those of his customers are very low; if demand were to improve quickly, he would have difficulty responding.

Capital Goods Spending

A December survey of the capital spending plans of New England manufacturers was just released. New England firms plan on increasing capital spending in 1982 by 12 percent; this is the same as the actual 1981 increase but less than originally planned. High technology firms account for most of the increase. Comments by industrial manufacturers are less encouraging, however. While few admit to actively cutting back capital spending, most are looking at projects more closely. According to one producer of capital goods, there are a lot of companies which should be investing and which have funds available for investment but which are not investing because they lack confidence that the economy will turn around any time soon.

Professors Eckstein, Houthakker, Samuelson, Solow, and Tobin were available for comment this month. Pointing to sharp declines in consumer and business confidence, Eckstein fears the economic upturn will be delayed and weak. He notes pervasive fear of a financial disaster and urges the Fed to give some weight to that contingency. He views widespread bankruptcies of the thrifts "not as a risk but a certainty" and calls for a public explanation of "the safety net against financial collapse." Whatever the long-run validity of monetarism, there is no present danger of overliquidity and lower interest rates are needed to mitigate financial distress and to help restore confidence.

Professor Houthakker feels monetary policy is "on the right track" and recommends moving back toward the top of the M1 range over the next few months. He fears the large Federal deficit but, like Eckstein, expects only token spending reduction and tax increases. With monetary growth of 5 percent, Houthakker sees the chances of a Depression as "very small."

Professor Samuelson notes that high nominal interest rates are partly due to less rationing of credit. With apprehension about prospective deficits and "hysteria" about the money growth targets, Samuelson speculates that macroeconomic policy may not be able to contrive a recovery. Fiscal stimulus creates fears of future deficits which discourages investment and monetary growth in excess of the targets creates credibility problems. Nevertheless, more years of stagnation are not satisfactory and will increase the "natural" unemployment rate. The crusade against inflation may not be consistent with the need to absorb the resources freed from the long-term decline of the auto industry and basic manufacturing due to changes in comparative costs.

Professor Solow sees the point of a tight monetary policy to encourage a shift toward a tighter fiscal policy but feels continuation of a tight policy now would "overdo it." He finds it implausible that the Congress will enact major spending cuts or tax increases with the unemployment rate above 9 percent. He rejects the notion of a "permanent monetary policy" that can be set once and for all. There is a clear need for a shift in the policy mix with a net move toward expansion. An expansionary policy in the early stages of an upturn would leave plenty of time to react to any excess demand pressures. A focus on the past three years of no growth, not a few months of an upturn, suggests that the marginal anti-inflation payoff of further restraint will be small relative to its costs.

Professor Tobin advocates "the Accord of 1982" -- a deal between the Fed, the Congress, and the Administration to reduce the Federal deficit and encourage economic recovery. The Congress would suspend the 1983 tax cut and indexing of spending programs and cut spending enough to hold the deficit to $80 billion in 1983 and 1984. The Fed would abandon its current procedure and follow instead a nominal GNP goal that would ensure a strong recovery. The nominal GNP goal would be reduced in succeeding years. This plan would allow the Fed to back away from an untenable monetarist policy that is losing credibility with the people that matter -- the business community that is so disenchanted with the current policy mix.

SECOND DISTRICT - NEW YORK

Economic activity in the Second District remained sluggish during February and early March. Among retailers, sales activity was uneven. Residential construction continued to be depressed, but nonresidential activity was still thriving. Conditions in the manufacturing sector were generally lackluster. Reports from upstate New York indicate that a number of small companies have abandoned their expansion plans while some machine tool companies have been hit by cancellations in backlogged orders. High technology firms, however, were the exception to the prevailing weakness in manufacturing, proving relatively resistant to the national downturn. Overall, labor market conditions were comparatively strong. New York State's unemployment rate has been less than the nation's and its unemployment insurance claims have been below those of a year ago. Looking ahead, respondents saw neither a turnaround nor a further decline in the nation's economy as imminent.

Consumer Spending

Retail activity in the Second District was uneven during February and the first half of March. Sales at both department stores and discount chains ranged from below plan to at or above plan. In upstate New York, there have been some store closings and earlier weather-related losses have not been recouped. Inventory levels were comfortable at most stores. Most of the merchants, even those who have had below-plan sales in recent months, tended to be cautiously optimistic in their outlook for spring.

Real Estate and Construction Activity

Conditions varied widely in the construction sector. Activity in the residential market continued to be minimal, as high financing costs and economic uncertainty discouraged potential buyers. Creative financing has done little to stimulate sales. Homebuilders noted that demand for high density housing remains strong, though zoning obstacles are preventing such construction in many areas. The building of high-priced homes by prior contract accounted for virtually all activity.

In contrast, the nonresidential construction boom has not abated and is expected to continue into 1983. In Manhattan, a shortage of office space has pushed vacancy rates to record lows, although office rental prices are now rising much more slowly than a few months ago. In suburban areas, earlier industrial and corporate growth has fueled a similar expansion in office space. Hotel and motel construction in the District was also strong, although, in Manhattan, this construction has been tapering off.

Labor Markets and Business Activity

The consensus of business leaders and government officials around the region was that New York State was weathering the recession quite well. All those contacted expressed surprise at how well the regional economy has held up, and mentioned the diversification in the state economy into high technology industries as one of the primary contributing factors. Despite some pockets of extreme joblessness, the unemployment rate was less that the nation's and unemployment insurance claims were below those of a year ago. According to a state labor official, much of the increase in unemployment which has occurred is the result of the difficulties which new entrants and reentrants to the labor force have had finding jobs rather than from what is commonly expected during a recession--increased separations of experienced workers.

Nevertheless, some industries have been deeply affected by the recession. As in the nation, layoffs and reduced hours are widespread among steel, automobile, automobile supply, and machine tool firms. As an example of the problems facing the machine tool industry, one upstate company was hit by a large number of cancellations of backlogged orders. In addition, a number of smaller firms were reported to have abandoned their spring expansion plans.

As for the future, local business leaders and government officials saw no imminent signs of an economic turnaround but neither did they think that conditions were going to get much worse. Respondents were uncertain about the direction of interest rates, the impact of personal income tax cuts, and the effects of safe-harbor leasing provisions.

Financial Panel

This month we have comments from Henry Kaufman (Solomon Bros.), Donald Maude (Merrill Lynch) and Robert Stone (Irving Trust):*

Kaufman: The economy will begin to experience real economic growth sometime this spring but the recovery will be of sub-cyclical proportion. The financial backdrop will not support a strong and sustained business recovery. Business liquidity continues to deteriorate; profits will remain under extreme pressure, while no balance sheet restructuring has materialized during this recession. Many additional downgradings of business credit

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*Their views of course are personal, not institutional.

ratings are likely to be announced in the forthcoming months. Interest rates will continue to be highly volatile. The long-term bond markets in particular will be challenged by a lack of liquidity in business, the huge Treasury cash needs, and a firm monetary policy.

Maude: Most likely developments over the spring and early summer months should place renewed severe upward pressure on interest rates with long-term yields retesting their 1981 highs in a financial crisis type environment. These developments should manifest themselves in the form of a highly anemic economic recovery, some modest pick-up in private credit demands, a cash flow squeeze in the nonfinancial corporate sector, continued strains on financial intermediaries, credit quality concerns and a reluctance on the part of investors to make long-term fixed income commitments. The underlying causes of these difficulties should be an April and July surge in money growth, a resulting monetary tightening, huge actual Treasury financing (especially during the third quarter) and continued apprehension over the out-year budgetary deficits.

Stone: It is our view that the economy has probably touched bottom and that a few months of relatively slow growth lies ahead. While lower interest rates are urgently needed, it would be a mistake for the System to take overt action to reduce them until MI has remained within the target range for several weeks. Accordingly, it seems to me that in the period ahead the Fed should continue to provide non-borrowed reserves such that "basic borrowings" (borrowings net of seasonal and extended credit) come out in the general range of $800 to $1200 million.

THIRD DISTRICT - PHILADELPHIA

Indications from the Third District in March are that the economic slump is bottoming out for some industries, and that the economy may be on the verge of a turnaround. District manufacturers say the pace of industrial activity held steady this month, bolstered mainly by nondurables. Retail merchants say things are just about where they were a year ago as well, but hope for a push as they enter the Spring selling season. Bankers report that business borrowing is flat. The only real sour note comes from the homebuilding industry where things are simply described as "worse—not better".

Third District businessmen are reasonably optimistic, but not overly so. Manufacturers predict a pickup soon, but are a little less enthusiastic than they were a month ago. Retailers, likewise see some strength, but not a lot. Bankers anticipate little in the way of loan growth, but are forecasting healthy deposit flows and lower interest rates, at least for the near term.

CONSTRUCTION AND REAL ESTATE

Area homebuilders continue to suffer as high mortgage rates and other factors are keeping away buyers in droves. "Other factors," according to one contact in New Jersey, include uncertainty about interest rates, inflation, and jobs. Although traffic is up slightly through new homes, few people are buying. If January and February are any indication of things to come, New Jersey housing starts may fall below 10,000 in 1982, or less than half of the 1973-75 recession level. There is some feeling that unless there is some improvement within 30 to 60 days, many subcontractors will have to fold.

MANUFACTURING

Respondents to the most recent Business Outlook Survey say the six month slump in area industrial activity seems to be bottoming out. Although business in the durable goods industries continues to sag, a pickup in nondurables has given a rosier complexion to the overall industrial outlook. Specific indications of a levelling off of the downturn include higher levels of new orders and shipments, both of which have rebounded from their winter trough, and less prevalent reports of payroll cuts. Inventories, on the other hand, are still being drawn down, paced by sharp reductions in the durables sector.

Looking ahead, manufacturing executives polled this month are still optimistic, but, in spite of the apparent turnaround, their outlook has softened. While general business conditions are expected to improve by September at over 50 percent of the firms sampled, a small but significant number of respondents now foresee a drop in activity. Strong growth in new orders and shipments is still widely expected, although not as widely as in recent surveys. Producers remain very cautious, and are planning little expansion of either inventories or capital expenditures before late summer. Any increased demand for their goods will be satisfied by hiring new workers and lengthening hours.

Industrial price hikes are more prevalent in March. Over one-third of the manufacturers responding to the survey this month report higher costs, and nearly one-fourth say they are charging more for the goods they sell. There are widespread expectations of further price inflation over the next six months as well. More than 75 percent of those polled are predicting higher prices for raw materials by September, and over 50 percent are planning to raise the price of their finished goods.

RETAIL

March department store sales are looking fairly grim at this point, especially so as they come on the heels of a disasterous January and barely adequate February. Sales volume is running just about even with year-ago levels. Sales analysts say consumers are now receiving their winter fuel bills, and are spending their money on oil, gas, and electricity rather than spring clothing. An early Easter this year should give a boost to sales in late March though, and the month could turn in an overall performance 6 to 7 percent better than a year ago. Retail inventories are a little heavy at some stores, but, in general, are pretty clean.

Looking ahead to the next six months, retailers seem to be planning for a fairly tough second quarter and only a modest third quarter. Summer sales are expected to run 2 to 5 percent ahead of year-earlier volume. Many merchants are less than optimistic simply because they see nothing in the near term to turn the consumer around.

FINANCIAL

Third District banking contacts says business loan volume is up between 3 and 10 percent from a year ago, but has flattened out in recent months. Consumer loans are off substantially, but mostly by design. As for the future, area bankers foresee continued steadiness for C&I loans, now that inventories have been worked off in many industries. A change in the mix of funding over the next six months, away from bank loans and into bonds, could also keep the lid on business borrowing at banks. The outlook for consumer loans is actually a little brighter this month. Many Philadelphia banks are setting up card operations in Delaware, where usury laws were abolished last year. Those banks hope to pick up new retail business later this year, thereby giving consumer borrowing in this area a shot in the arm.

Third District bankers are in agreement that a weak economy, dropping inflation, and a moderation of private credit demands will continue to draw interest rates down, with the prime rate, currently at 16 1/2 percent, dropping another 200 to 250 basis points. Estimates of the timing of a trough in interest rates range from June to September. As the economy turns the corner, rates are expected to start climbing again, unless a solution to the Federal budget dilemma becomes apparent. The recent bulge in M1 is expected to work itself out with little permanent effect on interest rates.

Deposit flows at area banks have held up surprisingly well in 1982, despite weakness in the economy and market rates still running well above passbook and statement savings yields. Demand deposits have dropped only slightly from high year-end levels, while total time and savings have grown. The only explanation offered for the apparent insensitivity of savings to interest rates has been that the precautionary demand for money has increased in the last few months.

FOURTH DISTRICT - CLEVELAND

Summary. Economists have scaled down their forecasts of economic activity for 1982. The steel industry is being squeezed between weak demand and strong imports. Business construction is mixed. Steel and petroleum product inventories are falling. Home appliance production has been curtailed. Bankers are lending cautiously as their customers' financial positions weaken. Usury laws are limiting bank automobile financing. Pressures on labor and parts suppliers for cost reductions are substantial. Unemployment rates are high and rising amidst a rapid pace of plant shutdowns.

Outlook. Economists who attended the Fourth District Roundtable Meeting on March 12 at this Bank scaled down their forecasts of economic activity for 1982 from their late-October forecasts. The median of 33 forecasts now shows a 3.3% annual rate of decline in real GNP this quarter, a small upturn next quarter, and growth rates between 4 and 4 1/2% (a.r.) in the final two quarters. All but three forecasters expect positive growth in the second quarter. The median forecast shows the GNP implicit price deflator rising at a 6.6% rate in the first half and a 7.0% rate in the second half. The unemployment rate is expected to peak at 9.2% next quarter and ease to 8.7% in the fourth quarter.

Capital Goods. A major steel company reports "the first glimmers" of improvement in orders for a few products, but total orders are still damped by users' inventory liquidation. That firm's profit margins are being squeezed between rising costs and the decline in product prices that was aggravated by the January jump in steel imports. Another steel firm reports that imports are "demoralizing" markets, and prices are "extremely weak and unstable." Both firms expect their inventories and employment to decline again in March. Another steel firm reports orders have recovered almost to their December level following a decline prompted by the early-year increase in interest rates. Three major steel firms' forecasts of 1982 domestic steel shipments range from 82.5 to 89.0 million tons, compared to 87.0 million in 1981.

A major producer of machine tools reports order cancellation rates are high and sales of consumable cutting tools and supplies are down. He has furloughed workers in the last month, expects to lay-off more, and foresees no upturn this year.

Construction. A fabricator of aluminum cans and a producer of polymers both recently announced major expansions of their production facilities. Cleveland and Pittsburgh are experiencing booms in office building construction. Oil and gas drilling activity in southern Ohio is down 12% from "a fantastic level" in 1981. A petroleum company economist expects no increase in total domestic drilling this year. A major steel firm announced deferral of plans to double its capacity to produce pipe for the oil and gas drilling industry.

Inventories. A petroleum industry economist reports that petroleum product inventories are being liquidated but crude inventories are not being liquidated. Two major steel firms report their inventories fell in February and will fall again in March. An aluminum producer reports that fabricator inventories are extremely low while producer inventories are high.

Durable Consumer Goods. A major manufacturer of home appliances reports appliance production has been sharply curtailed in the last three months in a lagged response to the decline in house construction. He expects more layoffs of appliance workers and notes these may be permanent because appliances are no longer a growth industry. Nevertheless, he expects retail sales of appliances to be better in the second half.

Commercial Bank Lending. A banker in a small city expects many failures in agriculture, construction, and automobile agencies and sees weak markets for resale of property acquired from bankrupt clients. His bank will have to curtail loans to firms whose net equity has disappeared. Banks will no longer extend credit to tenant farmers without a signature from the land owner. Some farmers are selling their cattle to finance their spring planting. A Pittsburgh banker reports that Ford and Chrysler captive credit companies are no longer extending credit in Pittsburgh. Local bankers do not want to make automobile loans because the state usury law ceiling is too low, so the automobile dealers are having great difficulty financing sales. An auto producer estimates that with a prime rate of 16.5%, usury laws make bank lending for automobile loans unattractive in 21 states accounting for 37% of the U.S. car market.

Cost of Production. A petroleum company economist expects the cost of drilling oil and gas wells to rise by 10% this year after rising between 20% and 30% annually in the last two years. A food industry economist expects sizeable commodity price increases in 1982.

Pressures on labor and parts suppliers for cost reductions are substantial. A meat packer in Cincinnati is threatening to move unless labor concessions are granted. An auto industry economist reports that because of recent union concessions, his firm's labor costs will rise by 15%-18% instead of 25%-30% over the life of the contract. A truck parts manufacturer has eliminated COLA for all non-union employees. A tire manufacturer has eliminated COLA for white collar workers. A Pittsburgh electrical contractor reports electricians' union acquiesence to time and one-half pay for overtime instead of the area tradition of double time. A bearing manufacturer has received demands from six Fortune 100 customers in the last 30 days for price reductions ranging from 2% to 7 1/2%, and believes his competitor is yielding to similar demands.

Unemployment and Plant Closings. Recession effects have spread and deepened throughout the Fourth District. Unemployment rates are higher in the Fourth District than national average. For the top 11 SMSAs in this District, the January NSA unemployment rates range from 8.8% in Columbus to 13.8% in Toledo and 15.7% in Youngstown.

The rapid pace of plant shutdowns continues in the District. The most recent is the closing of a 65 year old rubber plant in Akron that will result in a permanent job loss for nearly 1,300 salaried and hourly workers. The plant was the sole surviving producer of auto passenger tires in Akron, once the tire-producing capital of the U.S. (Since 1979, 14 tire plants in U.S. have closed.) Also, in mid-February, GMC announced the closing of a stamping plant in Cleveland that employs 1,200 workers. The announcement that a second Cleveland plant, employing 1,700 workers, would be closed apparently will be rescinded as part of the recent GM-UAW agreement.

FIFTH DISTRICT - RICHMOND

Overview

Pessimism pervades recent reports on Fifth District business activity and there appear to be very few bright spots to help this outlook. Other than the tobacco industries and some energy related activities such as coal mining and gas drilling, economic and business activity seems almost uniformly weak. Manufacturers report further declines in shipments, new orders, and order backlogs in the past month. Retailers report little change from the low levels of sales in recent months. Residential construction has shown no signs of recovery. Automobiles and other consumer durables are not moving. As a result, large segments of some industries; stone, clay, and glass; textiles; and major appliances; are operating at severely reduced levels.

The Manufacturing Sector

Although the rate of decline may have moderated over the past month, District manufacturers report continued weakness in most measures of activity. New orders and order backlogs were down broadly and over half our respondents report reductions in employment and in the length of the average work week since last month. Inventories are generally higher with stocks of finished goods up substantially. Current plant and equipment capacity is considered excessive by most respondents. Over one-third of the manufacturers surveyed report declines in prices received and several report paying lower prices than last month. Employee compensation, on balance, appears unchanged recently.

Consumer Spending

Retail trade has shown few signs of any recovery. Automobiles and other big ticket items, in particular, are not moving at all and large inventories are causing trouble among dealers. Furniture and major appliances are in a holding pattern awaiting some pickup in housing construction and sales, but there is little expectation of any significant improvement over the next few months. There are scattered reports that we may be seeing some stirrings in the general merchandise lines, but the evidence is far from conclusive. There is a widely held view that negative expectations are, and will continue to be, a severely depressing factor with consumers.

Housing and Construction

The construction industry continues spotty with the housing sector almost uniformly weak. At this point even pockets of strength in housing seem non-existent. Commercial and industrial construction continues to lend some strength, but even here the situation seems to have deteriorated in recent weeks. Projects already underway are continuing, but there are few indications that much new activity is appearing. The outlook for construction is little more positive than current conditions. Despite a generally perceived backlog of demand for housing units financing terms and uncertainty about the prospects for long term financing have created a block against any turnaround in construction activity.

Agriculture

Comments of Richmond directors suggest that prospects for agricultural output are generally favorable around the District. Moisture conditions in some areas are reported to be the best in four years. With cigarette production at current high levels tobacco prices have been favorable to farmers. Other farm prices are generally weak and several of our directors see serious problems for District farmers under the circumstances.

The Financial Sector

Business loan demand is very weak but generally stable according to our directors in the financial sector. Mortgage lending is also soft across the District. Response to the expanded IRA eligibility has apparently been somewhat weaker than expected, at least to date.

The Outlook

The outlook of manufacturers surveyed continued to improve over the past several weeks. Nearly a third of the respondents expect the level of activity nationally to improve over the next six months and almost half expect improvement for their respective firms. Retailers are even less pessimistic. As noted above, the outlook for housing remains very uncertain. There is some concern that home buyers must adapt to the new types of financing and that this factor will further delay a full blown recovery. On the other hand, the backlog of housing demand is expected by some to make activity extremely responsive to a decline in interest rates.

SIXTH DISTRICT - ATLANTA

Business conditions remain weak throughout the Sixth District, with no significant evidence of recovery. However, there is a general feeling of optimism that business conditions will improve around mid-year. Retail and home sales are sluggish. Unemployment is a major problem and additional layoffs are occurring in many southeastern industries. Tourism is behind last year's level in the region's major tourist areas.

Consumer Spending. Retail sales have exceeded expectations in many parts of the District. Sales of high-quality merchandise showed relative strength, with home appliances and home improvement products showing increases over last year. However, retailers expect nondurable goods sales to remain soft until about mid-year, when economic recovery is expected. In the meantime, merchants are holding a tight rein on inventories.

Auto sales continue to be poor in the District. Reports of weakness have surfaced even in Florida, where sales, income and employment have held up well compared to other parts of the region. Large cars are selling more briskly, due in part to falling gasoline prices; however, high interest rates continue to limit sales and squeeze profit margins. Unless rates stabilize at lower levels soon, more dealer closings can be expected. Even so, auto dealers are cautiously optimistic for a mid-year turnaround.

Financial and Construction: Throughout the region, residential home sales continue to be weak. The value of single and multi-family permits has been running 50 percent below last year's level. Construction is most depressed in northern areas of Alabama and Mississippi. The halting of construction on three of TVA's nuclear power plants will compound this area's employment and income problems.

Lending activity at savings and loan associations continues to decline. However, net deposit flow has improved slightly since year-end.

Employment and Industry. Unemployment continues to spread across the region. Four of the six states in our District now have jobless rates above the national average. Conditions are most serious in Alabama, where the statewide unemployment rate is nearly 14 percent. There are also reports of unemployment rates as high as 22 percent in some rural counties in the region. Although Georgia's rate remained below that of the U. S., an 8.2 percent rate in January marks a six-year high.

Textile employment has perhaps been affected most severely. A large North Georgia carpet manufacturer recently went bankrupt, eliminating 1,200 jobs. More plant closings are predicted due to the industry's linkages to the stagnant new housing market.

Energy and related industries have been the primary sources of strength to the Mississippi and Louisiana economies over the past year. However, declining oil prices and reduced exploration are now affecting these areas adversely. Oil refineries and offshore drilling rigs are operating at rates well below those of last year, forcing temporary layoffs. Drilling permits in Louisiana are down 6 percent from a year ago. There are as many as 2,000 workers on temporary layoffs in the petro-chemical industry around Baton Rouge. Industry experts predict that this number will more than double in the next month.

Repercussions of the recession on the region's important tourism industry vary widely among major resort areas. Although activity is slow in South Florida, there are signs of improvement in Central Florida. Attendance at Disney World has been affected little by the recession. So far in 1982, occupancy rates at lodging places have been up as compared to last year.

By contrast, Atlanta and New Orleans are experiencing lower hotel occupancy rates, declining convention business activity, and lower visitors' expenditures. While tourist activity in South Florida is expected to improve by mid-year, industry analysts in Atlanta and New Orleans are concerned that recovery may take longer than previously expected.

Agriculture. Low farm product prices and high costs continue to weaken farm financial conditions in the region. Indebtedness exceeds assets for many farmers in the Southeast, but few lenders are foreclosing. Land prices are soft and lenders feel that a rash of foreclosure sales would probably drop prices to the extent that they would have to buy farms to protect their interests. In most cases, lenders feel that their chances of recovering on loans are much better if the property remains in the hands of current owners.

Views of Outside Experts. Several widely respected economists addressed a conference in Atlanta last week. Remarks by Milton Friedman, Lawrence R. Klein, and Martin Feldstein are of particular interest.

Friedman warned of 25 percent inflation in three years if the Administration yields to growing pressure to support an increase in federal taxes or delay scheduled reductions in personal income tax rates. On the other hand, he predicted that inflation could drop as low as 3-5 percent within three years if President Reagan sticks by his supply-side policies of lower taxes and reduced spending. He warned that reducing the size of government is absolutely essential if the economy's ills are to be cured. This, Friedman emphasized, is even more important than reducing the budget deficit.

Klein favors incomes-based policies if the fight against inflation is not successful and labeled Friedman and others "a lot of sob sisters blaming the Federal Reserve" for the nation's economic distress. He argued that economic events of 1981 provide extraordinary evidence that certain popular renditions of supply-side economics are false.

Martin Feldstein warned that the hardships of the current recession, particularly rising unemployment, could scuttle the administration's effort to achieve fundamental economic reform. He also said that "if Congress focuses on rising unemployment and falling profits, it could revert to its old ways and call for a Keynesian stimulus to demand." In Feldstein's view, this would mean increases in government spending and would pressure the Federal Reserve to expand the growth of credit. The result would be a return to higher inflation rates and an even harder time controlling inflation in the future.

A panel of bank and business economists within the region is in general agreement that monetary policy is correct provided the Fed adheres to its announced monetary growth targets. The consensus view concerning the prospective 1982 deficit is that it will limit, but not abort, economic growth after mid-year; however, some "crowding out" of housing and business investment will occur.

Early signs of economic recovery in the region are not yet visible to any of the respondents on the panel, but most expect recovery to begin sometime this summer.

SEVENTH DISTRICT--CHICAGO

Summary. Seventh District economic activity continues very depressed. However, better weather conditions after mid-February aided a revival in some sectors. Retail trade continues slow. Further layoffs have occurred in a wide variety of employment categories. Equipment manufacturers report further weakness in orders. Construction industry prospects have deteriorated further. High interest rates, heavy debt burdens, and reduced cash flow have placed many business and financial enterprises in precarious positions. State and local governments are budgeting severe restrictions on spending. It appears that the general economic decline has moderated. A few sectors report gains in recent weeks, including steel, light trucks, office equipment, and airline travel. All types of goods and services are readily available, and price discounting is widespread. Pressures are strong to cut production costs, especially labor costs. Agriculture faces another year of depressed income, especially if crops are as large as expected. Bank loans to business remain strong, but more doubtful credits are requiring special attention.

Confidence Weakens. Recent surveys of business and consumer attitudes in district centers show a further erosion of confidence. The region has been plagued by a three-year recession which has seriously depressed morale, especially for those who have never experienced an extended period of trouble. For the general public the main concern is loss of income and scarce job opportunities. Executives, in addition to worrying over their own companies' problems, are disturbed over huge prospective federal deficits and high interest rates. Low morale, even fear, is deep and widespread.

The Oil Glut. Price declines for crude oil and most oil products, especially gasoline, have surprised many analysts. Ramifications have been profound. Pressures to develop alternative fuels have subsided. More refineries are being closed. A growing surplus is noted for line pipe and oil field equipment. Demand for diesel-powered vehicles has eased, EPA-MPG may be deemphasized, and the RV industry's prospects have improved.

Employment. In January, payroll employment was 3 percent below a year earlier in the district, while the nation was about even. Compared with January 1979, when this region was relatively prosperous, district employment was down 5 percent, while employment in the nation was up 3 percent. All the district states compare unfavorably with the nation, but the hardest hit are Michigan, Indiana, and Iowa. The principal sectors accounting for the plight of district states are motor vehicles and agriculture. State jobless pay funds in Michigan and Illinois are heavily indebted to the federal government. Wisconsin borrowed recently and Iowa expects to do so.

Job Opportunities. Demand for workers is very soft. Information that a company is hiring brings a flood of applicants. State unemployment compensation offices open to long lines and operate at capacity. Help-wanted ad lineage in Chicago papers is running about 25 percent below last year, and more than 50 percent below two years ago. State and local governments are cutting staff, including employment service offices. Labor management negotiations similar to those publicized in the auto and trucking industries are widespread. Various companies have reduced compensation for white collar workers and executives, hoping to achieve the same changes in union contracts in upcoming negotiations.

Inflation. Price inflation has slowed significantly. Trucking rates have been reduced, and the advance in rail rates has slowed. Auto companies have demanded 2 percent, across-the-board price reductions from suppliers who, in turn, passed similar demands on to their suppliers. Purchasing managers are asking price concessions and threatening to change sources, instead of accepting price increases passively. However, costs of shoes, medical care, tuition, and utility services have continued to rise at a very rapid pace.

Inventories. Inventories of oil, paper, general merchandise (at retail), farm and construction equipment, and some autos are excessive because of poor sales. Holdings of steel, nonferrous metals, building materials, and components are quite low. Buying is hand-to-mouth, to a degree unknown in recent years. A pickup in final demand could quickly tighten the lines of supply, increase orders to factories, and moderate intense competition.

Capital Spending. Construction contracts, orders for producer goods, and announcements by various companies suggest a sharper reduction in capital spending than the one percent drop projected by the government survey. Various projects have been shelved in the steel, vehicle, and utility industries. Producers of pipelayers and bulldozers are protesting the ban on sales to Russia.

Motor Vehicles. Auto sales were very weak in recent weeks, despite rebates. Light truck sales responded to rebates and were up 20 percent in February, but heavy truck sales were down 17 percent. Production of vehicles has declined more than sales and schedules appear somewhat firmer. The third quarter schedule is above last year's.

Steel. March saw a slight improvement in steel shipments from the very depressed level of February. April is expected to continue this trend. Inventories of steel users are very low relative to usage. Normal lead times of 6-10 weeks are down to one week in some cases.

Retail Sales. Consumers have been holding back on spending, either because of reduced income or increased caution as to future income. Instalment credit use is below normal. Among the few lines selling well are video games, video recorders, auto supplies, and children's merchandise.

Construction. Permits for new residential units have been close to zero. There is much concern over problems of rolling over short-term home mortgage financing. While nonresidential prospects also are generally poor, at least three large new office buildings have been cleared for construction in downtown Chicago. Rehab work on older buildings has been stimulated by tax benefits. The public sector outlook is very bleak, for two years ahead.

Agriculture. Pessimism in the farm sector is deep and widespread. This year's rise in farm production costs will be modest, but net farm income probably will decline significantly from the depressed levels of the past two years. Farmers are holding back on all types of outlays. Most farm lenders are confronted with loan collection problems, but these are generally considered to be manageable.

EIGHTH DISTRICT - ST. LOUIS

During February and early March, economic activity in the Eighth District changed little from its earlier depressed level. Retailers and most manufacturers report that sales continue to be disappointing; and housing sales declined even further. Production schedules at a number of manufacturing firms were trimmed again to avoid an inventory build-up, and employment declined slightly. Farm land prices also weakened. There were, however, bright spots, most notably in auto sales.

Consumer spending has remained weak since January, in part as a result of heavy snows which hindered shopping in February. Seasonally adjusted sales at several major District department stores have been unchanged since January. Retail volume at several smaller Arkansas stores also has remained flat. Apparel, furniture and appliance sales declined in both St. Louis and Memphis, and farm equipment dealers report few sales.

On the other hand, many smaller retailers, such as food processors, repair shops and professional services, continue to thrive. Reports from seven auto dealers indicate an improvement in sales during February and early March. One large Ford dealer sold 25 percent more cars and trucks in February than in the corresponding month a year ago and has added 16 employees since January. A distributor of earth-moving equipment states that business remains good, reflecting both continued road construction and increased coal mining. A major brewer reports rising beer sales.

Manufacturing activity in the District also has been mixed since January. Orders continued to decrease at oil refineries and at firms producing consumer durables, aluminum, and industrial machinery. On the other hand, the demand for defense goods, replacement parts for autos, farm equipment, and fibers has strengthened. A manufacturer of valves, fittings, boilers and heat exchangers stated that production remains at a high level.

Inventories at most manufacturers and retailers are at or near desired levels. In order to avoid excessive inventories, production has been trimmed further at several plants since January. A few companies report that additional employees were laid off, and one large apparel firm closed a plant for a week in February. Several firms report that they have reduced the length of work schedules. In Arkansas, the unemployment rate rose to 12 percent in February.

Construction activity generally remains unchanged from the late-1981 level, with residential construction, particularly depressed. Some builders, however, report heavier traffic through their subdivisions, and one builder has had a sales pickup. According to the St. Louis Home Builder's Association, there were 36 housing starts in the area this February compared with 81 in February last year and 280 in a "normal" February. The Association estimates that there will be 150 housing starts in March compared with 500 for a typical March. Commercial and other nonresidential construction continues to be stronger than residential.

Depressed farm income, which will probably continue in the near term, combined with large farm debt and high interest rates, is causing weakness in District farmland prices. Although prices in some locations have declined only slightly, they reportedly have fallen $250 per acre in parts of northern Mississippi. Farm debt is larger than usual for March, and agricultural banks have renewed a number of farm loans, though at times reluctantly. In some instances, farmers have liquidated a portion of their assets to obtain working capital and it is anticipated that there will be few big purchases of farm equipment this year.

Commercial banks report a moderate increase in both outstanding loans and savings deposits since the end of January. Savings and loan associations, on the other hand, are continuing to experience an outflow of deposits, and most are operating at a loss. The new IRA accounts have drawn funds into financial intermediaries, but in most cases the amounts are relatively small.

NINTH DISTRICT - MINNEAPOLIS

Economic conditions in the Ninth District looked generally the same in February and early March as they have for quite a while: several indicators hinted at recovery, but most remained weak. This time the positive hints came from spending on cars and homes, which picked up a little; spending on winter sports, which remained strong; the costs of manufacturing, which seemed to have eased; and the prices farmers receive for livestock, which increased. The negative indicators still dominated the positives, however. Spending on general merchandise was still sluggish. Manufacturing orders and production declined further. The forestry and mining industries were depressed again. And low grain prices did not improve. Reflecting the economy's general weakness was the continued weakness in bank lending.

Consumer Spending

General merchandise sales have been depressed in the district since last summer, and they did not recover this winter. Three large Minneapolis-St. Paul retailers reported that their sales did increase between January and February, but this increase was only temporary. It merely represented spending which consumers had postponed in January because of bad weather. In early March, sales slumped again. Because of their long sales slump, these metropolitan area retailers said they have been watching their inventories very closely, and lately they have been cutting back on their part-time help, both the number of workers and the hours they work. Outside the Minneapolis-St. Paul metropolitan area, meanwhile, retail sales continued to be very weak, according to this Bank's directors.

Home and auto sales also continued to be very weak this winter, but they showed some signs of recovery. The president of the Greater Minneapolis-St. Paul Area Board of Retailers said that home sales climbed steadily from 125 in the last week of January to 294 in the first week of March--they more than doubled in about a month. Regional sales managers for domestic auto manufacturers said their sales improved between January and February too, partly because of rebate programs.

Spending on winter sports in the district has been strong this season, and it generally remained so in February and early March. At the eastern end of the district, unusually cold weather in January and early February disrupted the good business that ski operators had enjoyed in November and December. However, according to one large Minnesota operator, business picked up again in late February, and he expected his March business to be 50 percent better than a year ago. At the western end of the district, ski area operators enjoyed uninterrupted good business.

Industrial Activity

Manufacturers were not in such good shape this winter: their orders and production continued to decline. As many as 50 percent of the manufacturers responding to a University of Minnesota survey said their new orders declined in the three months ending in February, and nearly that many, 47 percent, said their production declined. These were larger percentages than the 37 and 24 percent that had reported declines in the previous survey. These surveys confirm the declines we have reported in the last few Redbooks as well as Bank directors' comments about current weak manufacturing activity in their areas. Directors said the general weakness stemmed mostly from poor demand for building supplies, consumer durables, and automobiles.

The University's surveys do reveal two developments which indicate that manufacturers' costs may have eased lately and so firms may be better able to recover lost orders and production. One is that the prices manufacturers pay for raw materials and intermediate goods don't seem to have been increasing as fast as they were; the number of manufacturers reporting such price increases decreased between surveys. The other development is that manufacturers appear to have brought their inventories of these inputs (and so the costs of holding them) under better control; in the latest survey, only 25 percent of the respondents said their inventories of purchased goods had increased, whereas 37 percent had said that in the previous survey.

Activity in the district's mining industries also declined this winter, while the forest products industry simply remained depressed. Iron mining, which had showed some signs of recovery in early January, recently weakened again. Although one large iron mining company recalled about 1,800 workers in early March, another laid off 2,100 workers for eight weeks. Besides that, energy production, which had long been a source of strength for the district, weakened recently. Due to the glut in petroleum supplies, oil exploration slowed at the western end of the district. A Montana director said that in early March 100 oil rigs were idle in eastern Montana and western North Dakota. Directors also said that the forest products industry at both ends of the district remained very depressed.

<u>Agricultural Conditions</u>

Recent changes in the prices of farm products indicate possible recovery for about half the district's farmers--those who produce livestock--but *not* for the other half. Between January and early March, the prices farmers receive for hogs and cattle at South St. Paul rose about 7 percent. One director attributed part of the rise to unusually harsh winter weather restricting the flow of livestock to market. But the price rise may not be as temporary as that explanation would indicate: an economist associated with the livestock industry attributed part of the rise to livestock herds being smaller than anticipated. Crop farmers haven't had to face this ambiguity about their price situation. Cash crop prices at Minneapolis were essentially unchanged between January and early March, and they were considerably below their year-earlier levels. Weak demand seemed to be keeping these prices down, for the largest railroad in the district reported that its grain shipments so far this year were 20 percent behind those a year ago.

Financial Conditions

Bank lending continued to reflect the lack of any significant recovery in the district economy. Loan demand at banks in the Minneapolis-St. Paul metropolitan area was weak in late 1981, and it apparently remained so in early 1982. Loans outstanding at these banks did not change much between January and early March. Loan demand was also weak at banks outside the Twin Cities area, according to Bank directors.

TENTH DISTRICT—KANSAS CITY

Overview. Generally weak business conditions in the Tenth District are reflected in generally flat loan demand at commercial banks. Retail sales show little real growth. Inventories remain at low but satisfactory levels. Depressed conditions in the housing sector are reflected in continued weakness in the savings and loan industry. A large winter wheat crop is anticipated, but farmers continue to experience financial difficulties. Deposit growth at commercial banks varies widely across the District, with loan demand being funded primarily through the sale of large CD's.

Retail Trade. Retailers in the Tenth District report that current dollar sales in the first two months of 1982 about equalled sales in the first two months of last year. They also expect sales in the second quarter of 1982 to be about unchanged from the second quarter of 1981, but anticipate a slight pick-up in sales in the fall. Despite some levelling of merchandise costs, profit margins remain slim because of low volume, clearance sales, and the rising costs of utilities and labor. Store executives are satisfied with their current stocks of goods.

Industry Activity. The majority of purchasing agents contacted in the Tenth District report input prices have increased from 5 to 10 percent over the past year. Most firms are experiencing normal lead times in obtaining materials. Rising prices and lengthening lead times are expected when business conditions improve. But inventories continue to be maintained at low levels because of uncertainties regarding the economic outlook and the level of interest rates.

<u>Housing and Housing Finance</u>. Homebuilders' Associations report a continuation of depressed conditions. Inventories of unsold houses are very low. Among Tenth District homebuilders, the consensus is that the demand for new houses won't increase significantly until late this year, at which time shortages of materials could develop quickly.

Savings and loan association officers express increasing dismay over the rising cost of funds and the dismal growth of savings inflows. Most foresee no long-run relief, but many expect a short-lived drop in interest rates to bolster deposits temporarily. Few are making mortgage loans at market rates of 17 percent to 18 percent, and even "blended rate" mortgages ranging from 12 percent to 16 percent are up only marginally over last year.

<u>Agriculture</u>. Winter wheat throughout the Tenth District is currently in excellent shape, and a large crop is anticipated. Many farmers are waiting to decide whether to comply with the 1982 Farm Program acreage limitations, necessary if farmers wish to be eligible for price support loans and deficiency payments. That decision must be made before the April deadline. To comply, many farmers will have to plow under a portion of their crop or use it for pasture. Banks and Production Credit Associations report more difficulties in qualifying farm and ranch borrowers for credit this spring. In some cases, borrowers are having to sell some assets to improve their cash flow situation or to reduce debt loads. Established farmers are using their own cash reserves to keep their businesses in operation, and some borrowers are turning to the Farmers Home Administration for financing. Bankruptcies have not increased drastically this year according to District bankers. More farm real estate is being offered for sale this spring, than a year ago. However, very little land is being sold.

Banking Developments. Reported loan demand at Tenth District banks is generally flat with the exception of some strength in those areas serving the energy industry. Commercial and industrial lending is the only source of strength in loan demand Districtwide. Prime rates range from 16 to 16 1/2 percent, up slightly from the previous survey. Deposit growth varies widely across the District. Loan demand continues to be funded primarily through the sale of large CD's, as most banks report little growth in other deposit categories with the exception of some seasonal strength in transactions deposits.

Tenth District banks are moving cautiously in the area of deposit sweeping arrangements. Although a few of the banks contacted are considering offering deposit sweeps in the future, none are presently offering these arrangements. Most plans presently under consideration involve a tie-in arrangement with a mutual fund, while one bank indicates that excess balances might be placed in the RP markets. While no automated deposit sweeping arrangements are being offered, some cash management arrangements have been made on an individual basis for corporate customers.

ELEVENTH DISTRICT--DALLAS

There is some indication that the recession is bottoming out in the Eleventh District, but the decline in crude oil prices has begun to dampen oil field related activities. Auto and housing sales and new housing starts are showing the initial signs of recovery. Commercial construction remains strong, but builders are becoming more cautious. A slowdown in new orders for drilling equipment may work against a revival of manufacturing output. Department store sales are keeping up with inflation, and business loans continue to outpace slumping consumer loans. Low commodity prices continue to depress farm incomes.

Domestic auto sales have increased significantly since January in response to manufacturers rebates. Dealers expect domestic models to continue to sell as long as rebates are in effect. In addition, gasoline prices, which have fallen as much as 15 cents per gallon since the first of the year, have helped improve sales of larger models. On the other hand, unit sales of imports have shown no growth. Inventories are down from the record highs of December and January, and additions to current stocks will closely follow sales in coming months.

Residential construction has perked up over the past two months with most of the increase centered on starts of apartments and condominiums. Sales of both new and existing homes are rising but remain well below year-ago levels.

Commercial construction is still robust, although the number of announcements of new projects is on the decline. The recession has tempered the demand for office space somewhat, and there is growing concern that many areas may become overbuilt. Securing permanent financing continues to be a problem, and lenders are demanding an equity share of a project as part of the lending agreement.

The drop in crude oil prices is contributing to declines in oil field related activities. At last count 2,596 drilling rigs were operating in the District states. That is down from a peak of 2,976 rigs in December, and 201 units fewer than a year ago. A decline is normal for this time of year, but the current setback is greater than had been expected. Nevertheless, industry analysts predict a turnaround this spring and the average number of active rigs this year will exceed the average count for last year.

Manufacturing output continued to trend downward slowly. Orders for oil field equipment are slipping. A number of refineries and petrochemical plants have shut down, and those still in operation are running at near record low levels. Downtimes for annual maintenance are being extended, and further plant closings are contemplated. Other manufacturers with national markets face weak demand for their products. Cutbacks in apparel manufacturing are causing many smaller contract plants to close down. However, the strength in commercial construction and the defense industry is holding up output in the steel and electronics industries.

The District labor market has deteriorated since December. Increased layoffs, plant shutdowns, and the in-migration of unemployed workers are contributing to the rise in unemployment. Still, the unemployment rate in Texas was only 5.8 percent for February.

Department store sales show no real gains. Sales of soft goods, especially men's wear and cosmetics, are doing better than sales of "big ticket" items. Tighter controls have reduced inventory levels since January. Credit sales are about even with last year, although payments are slower. The devaluation of the Mexican peso sharply reduced sales along the Border. Retailers expect higher sales in the second half of the year.

The dollar value of loans by commercial banks is increasing at a moderate rate. Energy production and exploration account for much of the gain. Both consumer and construction loans show net declines so far this year. Demand deposits have fallen since January, but time deposits have risen. IRA deposits have not grown as fast as expected, and respondents suspect that funds transferred from other accounts are a significant portion of the increase. Restrictions on the issuance of bank credit cards continue to be tightened, and bankers are considering instituting variable rates on these cards.

Mortgage lending at S&L's has picked up with the small gains in housing sales. "Builder buydowns" are helping to reduce interest rates on mortgage contracts. Lower prices for apartments and condominiums relative to prices for single-family homes has also stimulated loan demand. Delinquencies are up but are not considered high enough to be a problem.

Farm incomes continue to be plagued by depressed grain and cotton prices. Beef prices, however, are rising since the supply of feeder cattle has been cut to rebuild herds. Delinquencies on farm loans have climbed to dramatically high levels, and farm liquidations are above average. Set-aside programs have begun, but little near-term relief for farmers is foreseen.

TWELFTH DISTRICT - SAN FRANCISCO

The Twelfth District economy has slipped deeper into recession since the last report. Consumer spending has remained at the slow post-Christmas holiday level reached in January and is running below the year-ago level in real terms. In the manufacturing and mining industries, further cutbacks and layoffs are occurring in a number of industries, although the pace of the overall decline appears to be decelerating. Homebuilding activity has dropped recently, in contrast to the national pattern, and nonresidential construction also is slowing. Agricultural commodity prices have risen slightly during the past month but remain well below the level of a year ago. Respondants expect little or no improvement in net farm income in 1982, following 1981's decline. Bank credit at Twelfth District banks rose sharply in February, but as a result of weakness rather than strength in the regional economy.

Consumer Spending

Respondants report little change in retail sales from the slow post-Christmas holiday pace reached in January. Spending remains weak, running below the level of a year ago in real terms. Consumers continue to exhibit cautious spending behavior, staying away from costly durable goods such as furniture and appliances and confining their purchases to apparel and other necessities. Large department stores are doing better than smaller retail outlets which are reported to be going out of business in increasing number, especially in rural communities. While most retail outlets are no longer liquidating excess inventory, they are reported to be holding stocks at "bare-bone" levels, buying much less spring and summer merchandise than a year ago. This conservative inventory pattern reflects not only high interest rates but their belief that consumer spending probably will remain sluggish for the next few months. Automobile sales did pick up somewhat in February, in response to the domestic car rebate program, but still remained depressed relative to a year ago. Moreover, respondants are concerned that these purchases are being "borrowed" from subsequent periods and that auto sales will drop sharply when the rebates are eliminated.

Mining and Manufacturing

Respondants report further cutbacks in production and employment, but at a decelerating rate. Employment in the lumber and mining industries has stabilized at a very depressed level, with these industries operating at about 60 percent of capacity or less. But layoffs continue in the construction, commercial aircraft, aluminum and automobile industries. For example, the Boeing Company in Seattle recently announced plans to layoff as many as 5,000 workers this year because of slow demand for commercial aircraft by foreign and domestic airlines. General Motors Corporation recently closed its assembly plant at Fremont, California, and will shut down its plant at South Gate, California on April 1. These closures will layoff 2,500 and 500 workers at those respective locations and will have ripple effects on other industries. While rising defense spending is having some positive impact on regional employment, most of the stimulus is expected in 1983-84 when programs such as the B-1 bomber move into the production phase.

Real Estate

The Twelfth District has failed to experience the pickup in either new home sales or homebuilding reported elsewhere. On the contrary, sales of new homes remain so depressed that builders are still trying to dispose of unsold inventory. As a result, homebuilding activity has dropped to a new post-World War II low. Buyers are purchasing only when essential and only when extraordinary financing is provided by sellers. The slump in sales is eroding selling prices for both new and older single-family homes and condominiums, causing prices to drop below year-ago levels in real terms. Moreover, realized prices are lower than selling prices because of seller-financed transactions at below market interest rates. Distress among builders, brokers and property owners is especially great in areas of higher than average unemployment. Nonresidential construction activity also has been dropping recently as business firms have scaled back capital spending programs. Even the boom in office building construction has subsided as a glut of space has begun to appear in metropolitan areas.

Agriculture

Twelfth District farmers and ranchers experienced a decline in both gross and net farm income in 1981 as bumper crops combined with lagging demand to reduce commodity prices. Prices for a large number of commodities have risen recently but remain well below the level of a year ago. Thus, unless farmers produce significantly less in 1982 than in 1981, little or no improvement in farm income is likely this year. So far, agricultural sources are pessamistic that farmers will carry out that production cutback. Although the Department of Agriculture has reinstated several set-aside programs to reduce planted acreage, Twelfth District farmers generally are not expected to take advantage of those programs. Meanwhile, farmers and ranchers already are heavily in debt and finding it increasingly difficult to meet loan payments.

Financial Institutions

Bank credit at Twelfth District banks rose sharply in February as a result of a strong increase in business loans. However, as in recent months, the increase appeared to stem from the economy's weakness rather than from strength. Businesses are borrowing to finance involuntary inventory accumulation and to meet short-term working capital needs. Bankers also report an across-the-board deterioriation in the financial condition of many prospective business borrowers. In other areas, real estate loans continued to expand at a sluggish pace. Demand for new mortgage loans continued to be weak, with a slowdown in liquidation of old loans helping to account for the increase. Consumer loans dropped for the second consecutive month. Loans for automobiles and consumer durables were especially weak as rising unemployment caused further weakness in household borrowing. Bankers also report an upward drift in consumer loan delinquency rates and personal bankruptcies.