SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

September, 1983

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SUMMARY*

Overview

The economic expansion continued through August and the early part of September in all 12 Federal Reserve districts. Retail sales continued to be strong, and both factory orders and production rose. The level of employment has increased, and the rate of unemployment has fallen from its peak in the early part of this year.

Manufacturing output is increasing at a slow pace relative to most other sectors of the economy. The demand for heavy capital equipment, which had been particularly sluggish, is showing signs of improvement. Auto sales continue to be brisk and would have been even stronger were it not for short inventories of larger domestic and Japanese models. Housing sales have declined recently throughout the nation, and the hot dry weather that has persisted over much of the Midwest has severely damaged many crops.

Retail Sales

Consumer products have been selling well for some time now. Chicago and St. Louis report that demand has been particularly strong in the areas of autos, furniture, appliances and floor coverings. Boston reported smaller-than-expected sales increases in July and August.

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*Prepared at the Federal Reserve Bank of St. Louis.

However, retailers expect a return to the levels established earlier in the year, and merchants generally expect the Christmas season to be particularly good.

Manufacturing

On the whole, moderate increases in manufacturing production have continued. Dallas reports unusually large orders during July and August. Backlogs of orders have developed at electronics firms which have been producing at near capacity. Minneapolis, San Francisco and Boston report increased orders at high technology and electronic companies.

Sales of heavy capital equipment, on the other hand, continue to be sluggish. Many plants in the Chicago District remain closed or are operating at less than 50 percent capacity. However, the manufacture of tandem trailers, permitted under the new federal law, has been particularly strong.

Employment

Employment in most districts is responding to the turnaround in economic activity. Dallas indicates that job growth has been particularly strong in durable goods manufacturing and primary metals. New claims for unemployment compensation are down sharply in the Chicago District, and St. Louis notes that many construction, manufacturing and service firms expanded their work forces during August. Employment has increased modestly in the Boston District, with job opportunities in the professional and technical areas particularly strong.

Construction and Real Estate

Housing starts, construction and the sales of new and older homes were mixed during July and August. San Francisco reports that sales of new homes fell by 14 percent in August, and many respondents expected sales to slow further. Atlanta, Philadelphia, Dallas and Chicago indicate that residential construction slowed in July. In each case, the reductions were attributed to higher interest rates.

However, New York, Richmond and Kansas City indicate that construction activity remains at relatively high levels. Construction activity in New York has been so brisk that shortages of supplies and labor have developed.

Finance

Commercial and industrial loan activity at banks has been soft over much of the nation. Any increases in loan activity have been concentrated in the areas of consumer installment credit and auto loans. San Francisco indicates that these loans have increased at a 12 percent rate over the past three months.

Demand for mortgage loans continued at the relatively high levels established earlier in the year. However, a number of districts, indicating that this is a result of previous commitments, report a drop in applications for new mortgage loans.

Agriculture

The hot and dry weather that has continued over much of the nation has severely damaged the corn and soybean crops. Kansas City and

Chicago estimate the yields of these crops to be roughly 50 percent below normal. Crop prices have risen in anticipation of the poor yields. The marketing of livestock has increased due to higher feed cost and poor pasture conditions, and the price of livestock has fallen as a result.

San Francisco reports that unseasonable rains in Southern California have damaged a number of crops. However, farm income in this District is expected to be relatively high this year due to the combined effects of the drought experienced in the rest of the nation and large PIK transfers.

Tourism

The tourist trade continued to be strong in July and August and this is expected to continue into the early fall. Occupancy rates at hotels and motels in the St. Louis, Atlanta and Minneapolis districts were generally higher than year-ago levels. Respondents attribute the brisk trade to lower room rates, discounted airfares, and reduced gasoline prices.

FIRST DISTRICT - BOSTON

Manufacturers in the First District report that business conditions are looking up. Demand has improved for electronics, computers, original equipment automotive products, and components related to the general level of industrial production. Demand remains weak for many capital goods, although the level of inquiries is high. Basic industries, such as autos and farm equipment, are said to be interested in making capital expenditures but unwilling to make major commitments. Manufacturing inventories are in good shape for the most part. In the retail sector, First District department stores report that the pace of recovery seems to have slowed. Sales gains in July and August were both smaller than expected and smaller than the gains enjoyed earlier in the year; as a consequence, inventories are slightly higher than desired. The slowdown was attributed to the unusually hot weather which caused an exodus from the metropolitan areas. Reports of a very good tourist season in more rural areas seem to confirm this hypothesis.

Manufacturing

More and more First District manufacturers are seeing an upturn in orders, but perceptions as to the strength of the recovery vary considerably. The defense business is good. Consumer products like appliances have been selling well for some time now. Demand has increased for original equipment automotive products and for components and supplies related to the general level of industrial activity. Various high technology companies report increased orders; the electronics industry is doing particularly well. However, demand is still weak for many investment goods - especially those purchased by the auto, off-the-road equipment, and energy industries. Many capital goods producers say inquiries have increased substantially and sales people are very busy, but so far, these inquiries have produced few new orders. Customers are not willing to make major committments. This reluctance to commit is attributed to low capacity utilization and low, although improved, profits. However, one manufacturer noted that high real interest rates make it more difficult to justify capital expenditures and another said that, in the area of industrial automation, firms are taking time to study and analyze different alternatives. The recovery in the capital goods industries is thought to be slower than in 1975-76.

Several firms report that exports are improving, but one very large exporter which had enjoyed fairly good sales during the recession has seen a sharp dropoff in the past couple of months. The competition from European producers is said to be fierce, as Europe tries to export its way out of the recession.

Employment is increasing modestly at most of the manufacturing firms contacted, but one firm which has already drastically reduced its workforce is contemplating still another major layoff. Two high technology companies are aggressively recruiting in the professional and technical areas; they say professional manpower is scarce and expensive.

Inventories are in good shape except in some segments of the machine tool industry where they are still much too high. Prices continue to be well behaved, but are no longer declining. One respondent reports that he sees more attempts to increase prices, but these are rarely successful.

Retail

Retailers in the First District reported smaller than expected sales increases in July and August. Compared to sales volumes in the previous year, sales gains were smaller than in the first half of 1983. As a result, inventories are slightly above desired levels. However, most merchants expressed confidence that sales gains would again be strong this fall.

Two department store chains, centered in major cities, cited the unusually hot weather as a possible explanation for the slack sales, hypothesizing that local residents left town more frequently this summer than last. This view seems to be supported by reports of a strong tourist season in northern and western New England. Also consistent with this hypothesis were reports that the weakness occurred across the board -- no specific product lines were especially strong or weak. Since they see no reason to expect the unseasonal weather to continue long into the fall, the merchants are optimistic about a return to the strength shown earlier in the year. However, one retailer with affiliated stores in other regions doubts that First District stores will hold the sales lead they have enjoyed in recent months, not because of local weakness, but because the other regions' previous year's sales were so weak.

Somewhat excessive inventories have resulted from two factors. First, slower-than-expected sales gains left more merchandise in inventory than planned. Second, several retailers said the strong spring recovery had encouraged them to buy more aggressively and bring goods in earlier than usual.

SECOND DISTRICT--NEW YORK

An uneven economic recovery in the Second District continued in August. Consumer spending appeared to be slowing from the extraordinary pace of early summer, though gains over 1982 were still substantial at some stores. Residential construction was strong; homebuilders are booked up for the next few months. Nonresidential construction improved further, with some industrial and commercial projects getting underway. Most manufacturers saw a pickup in activity, but heavy goods producers saw little improvement. In the agricultural sector, a summer drought damaged corn and hay crops, but harvests of fruit are expected to be high. On the financial side, business lending was flat and automobile loans picked up.

Consumer Spending

Retail activity continued to slacken in recent weeks. Although some department stores still achieved healthy double-digit gains over a year ago, the volume of sales in August was generally lower than in May and June. The pace appeared to be slowing further in early September. One middle-income chain experienced four straight weeks of declining sales and reported that by early September, volume was less than last year. Some merchants felt that hot weather was a key factor in depressing sales, especially those of autumn apparel. Retailers are hopeful that business will pick up when the weather cools.

Construction and Real Estate

Residential construction continued at a rapid pace. Builders of custom homes are fully booked through the next few months, and speculative projects, mostly condominiums, are increasing. This activity has caused shortages of supplies and labor to become more severe. Despite the current activity, builders are anxious about next spring. Traffic has fallen recently. While such a slowdown is normal around Labor Day, there is concern that higher interest rates may be discouraging buyers. If the normal pickup in October fails to materialize, construction will fall off during the first half of next year.

The nonresidential real estate market continued to improve throughout most of the District. Leasing activity increased further in downtown New York, New Jersey, and on Long Island. Although new starts of office construction remained rare, our contacts reported that some buildings are being planned. Furthermore, several industrial and commercial development projects are planned or underway in New York City's outer boroughs, with a good deal of public sector participation. And plans for major retail mall projects have been reported in Manhattan, Long Island, and the Albany area.

Business Activity

Manufacturing activity continued to pick up throughout the District, but the extent of the upturn was uneven. High technology companies, including producers of computers, semiconductors, defense electronics, and medical equipment, experienced the sharpest gains, and several of these firms announced expansion plans. In other industries, such as plastics and instruments, sales gains were modest. In heavy goods industries, however, no significant pickup has been reported. While steel production rose marginally in Western New York, almost half of the industry's capacity remained idle. And although capital goods producers were finding more projects on which to bid, they had still not observed any significant rise in solid orders.

As for employment, a state labor official felt the job market was just beginning to turn up, with the strongest relative improvement in the services and construction sectors. By contrast, some major insurance companies reported efforts to cut costs by reducing employment levels or by moving jobs outside Manhattan. Unemployment District-wide remained below the national level, but in some areas, re-entrants to the labor force were expected to keep rates high even as employment levels rise. In New York City in particular, the rapid increase in the labor force pushed the unemployment to 10.6 percent in July and August.

<u>Agriculture</u>

In the agricultural sector, bad weather has damaged some crops but has had little effect on others. The drought during July and August depressed yields per acre for corn and hay. In contrast, wheat was harvested early during the dry spell, and yields were high. The fruit-growing regions had adequate rain, and good crops are expected. The apple harvest may be one of the largest on record. High yields and low demand for New York wines have combined to depress the price of grapes, however. In the dairy industry, high production has limited price increases, and profits are expected to be squeezed as feed costs climb.

<u>Financial Developments</u>

Banks surveyed in early September reported that business lending showed little improvement. Any increase at individual institutions, moreover, was attributed to their marketing efforts rather than any improvement in overall loan demand. Most institutions in the region have taken an unaggressive approach to mortgage lending as rates have backed up and demand for loans has dropped off. In contrast, the volume of both direct auto loans and dealer paper has picked up during the summer as auto sales have surged. Further, the competitive position of banks is expected to improve as many interest rate promotions of auto finance companies end. With the deregulation of most types of consumer time deposits beginning October 1, some institutions have begun extensive promotional campaigns, in some cases offering retail repurchase agreements at high rates until October 1 when the funds will be converted into longer term time deposits.

THIRD DISTRICT - PHILADELPHIA

Reports from the Third District point to mixed economic conditions in September. The strength in activity remains centered in the manufacturing and retail sectors, where surprisingly robust growth has continued this month. Loan volume at area financial institutions, however, has weakened recently and is mixed. Activity in the housing market continues to nose downward as mortgage rates rise.

Third District contacts foresee general improvement in business activity over the next six months. Both retail and manufacturing executives project healthy gains into 1984, although a slowdown in growth is anticipated. Local bankers are forecasting a sluggish upturn in lending activity and interest rates by next March. The outlook for housing is not bright, however, especially if mortgage rates continue to rise.

REAL ESTATE AND CONSTRUCTION

Third District housing activity has slowed again in the last six weeks, but business is still well above last September's depressed levels. Housing sales and new starts are reported to be off by between 25 percent and 75 percent from their spring and early-summer highs, and traffic of prospective buyers has also fallen significantly. Builders and realtors contacted attribute the slide to a combination of seasonal pressure and the continued escalation of mortgage rates, which have risen about 50 basis points since early August. Many real estate brokers indicate that a drop of between 50 basis points and 200 basis points is needed to restore strength to the market.

MANUFACTURING

Respondents to the September Business Outlook Survey indicate that Third District industrial activity has picked up the pace of its upward advance this month. September returns reveal the most widespread improvement in general business conditions this year. Both new orders and shipments are up significantly over August levels, and producers' backlogs have increased at many factories, as well. Production activity has increased enough to prompt many employers to add to payrolls and to lengthen the average workweek.

Despite the vigorous expansion currently underway in the manufacturing sector, survey respondents' outlooks have mellowed somewhat this month. Two-thirds of the participating businessmen expect further improvement in industrial activity over the next six months, fewer than at anytime in the last year. Climbing levels of new orders and shipments are still forecast, although not as strongly as in recent months, and further expansion of the factory workforce and working hours are planned. Capital expenditure plans are still fairly weak, but solid growth in inventories by the end of the first quarter is projected. Overall, survey respondents obviously expect the recovery to continue, but they seem to be indicating a slower rate of expansion over the next six months.

Prices in the manufacturing sector continue to drift upward, but survey results indicate that, on average, the pace remains slower than in the past. Roughly one-third of the participating businessmen report paying higher input prices since August, and another sixth have raised their final products' prices this month. Further increases in industrial prices are likely by March.

RETAIL

Sales activity at Philadelphia area department stores has remained in excellent shape through August and into September. In fact, the growth in the dollar volume of sales over year-earlier figures has once again pushed into the double digit range, much higher than merchants had anticipated. Very dry weather, rising consumer optimism, and timely promotional offerings have combined to step up the pace of retail spending. According to retailers, "back-to-school" and other seasonal soft goods are moving especially well, and most other lines are not far behind.

Area merchants predict that consumer spending will be healthy in early 1984 but that sales growth will settle down to more modest levels near year-end. Following a "reasonable" holiday season, gains of four percent to five percent over a year-earlier are expected for the first quarter of 1984. The cheery forecast has encouraged store operators to be less cautious about inventories, and stock levels, which are currently a little higher than a year ago, have notched some growth since August. Contacts indicate, however, that any further inventory growth will be carefully controlled.

FINANCIAL

Local bankers say loan activity at major banks in the Third District is mixed again this month. C&I loan activity has been "unexpectedly quiet" since early August. Current reports on business loan volume range from 11 percent below to 14 percent above a year ago, much the same as they were six weeks ago. According to contacts, increased corporate profits have sufficiently improved cash flow at many companies, permitting more internal financing and preventing any real firming of commercial loan demand. Loan activity on the retail side continues to improve, but recent gains are not as strong as earlier in the year. Although consumer lending is now as much as 11 percent ahead of last September, lenders say rising interest rates have taken some of the edge off the demand for consumer loans.

Area banking officials foresee gradual improvement in overall lending activity over the next six months. C&I loan demand is expected to gain strength slowly through next March as commercial investment expands beyond the funds available internally. Most bankers also predict that consumer demand for credit will expand further despite the likelihood of slightly higher interest rates. Many lenders plan to maintain their aggressive marketing posture.

The prime rate charged by major Third District banks has risen to 11 percent in September from 10.5 percent in early August. Local seers are predicting that, because of positive reports on inflation and the money supply, upward movement in interest rates over the next six months will remain sluggish. They are forecasting an increase in the prime and most other rates of between 50 basis points and 75 basis points by the end of the first quarter as both private and government borrowing expand.

Deposit flows have weakened somewhat in September, but bankers attribute most of the decline to seasonal factors. Demand deposits have slipped slightly, and are now only one percent to two percent ahead on a year-over-year basis. Growth in time and savings deposits has slowed as well, but deposit levels have maintained their sizable spreads over pre-MMDA levels.

FOURTH DISTRICT - CLEVELAND

Summary. The District economy continues its mild improvement. Employment is rising and unemployment falling. However, weekly earnings in manufacturing declined along with the average work week. Consumer prices are rising slowly in Cincinnati and Pittsburgh but rapidly in Cleveland. Retail sales are well above year-ago levels but down from June and July. Manufacturing activity continues to expand, but steel and machine tool orders and output remain very weak. Productivity is rising briskly in many firms as output rises. Investment in plant and equipment is weak. Coal inventories remain too high while output is stable. Commercial banks remain liquid as savings deposit growth is strong. Real estate and consumer loan demand has increased in recent weeks but commercial loan demand remains flat.

District Labor Market Conditions. Employment continues to rise in this District while unemployment falls. In Ohio, total employment continued its uptrend in July, despite a small decline in manufacturing and a larger decline in nonmanufacturing wage and salary employment. The overall employment gain outpaced labor force growth causing the unemployment rate to fall from 12.8% in June to 10.9% in July (nsa). Unemployment rates among ten of the District's largest SMSAs ranged from 8.5% to 14.3% (nsa) in July and averaged 11.6%, down from 13.3% in June. Local indexes of leading indicators for Pittsburgh and Cleveland point to continued improvement in those industrial centers.

Prices, Wages, and Earnings. Average weekly earnings of Ohio manufacturing production workers fell in July as both average weekly hours worked and average hourly earnings declined. The decline in hours was the first since January and the decline in hourly earnings was the first since October.

The Consumer Price Index for all urban consumers in Cincinnati rose 6.5% in the last twelve months and at a 1.8% annual rate in the last two months. For Cleveland, the index advanced 9.3% and 9.0% and for Pittsburgh 7.1% and 0.4% in the same two periods.

Retail Sales. Fourth District retailers are showing significant sales gains from year-ago levels, although spending for most goods has moderated further from June highs. General merchandise sales by major retailers in August were roughly 14 to 15 percent above last year, but somewhat lower than in either June or July. Sales strength is reported for most expenditure types, with softgoods and home furnishings registering the strongest gains. Auto dealers are reporting moderate-to-strong sales across the District. New domestic car sales are generally above year-ago levels, but decidely slower than in June or July. Domestic new-car sellers indicate a mounting inventory shortage, which should ease as 1984 models arrive. Lean inventory positions more seriously restrained new import-car sales in August and early September, but import showroom traffic is still heavy.

Manufacturing. District manufacturing activity continued to expand in August. A survey of purchasing managers in the Cleveland area reveals production, employment, and new orders rose in August more rapidly than in July. Inventories were little changed from July, but prices accelerated from July.

A survey of purchasing managers in the Cincinnati area shows production and new orders rose briskly in August, albeit not as rapidly as in July. Employment and prices rose more rapidly than in July while inventories of finished goods continued to fall.

This Bank's survey of Fourth District manufacturers shows shipments, new orders, backlogs, inventories, and employment rose in August and are expected to rise, albeit somewhat less rapidly, in September. Prices are rising slowly. Several firms report productivity rising rapidly, limiting their need to expand employment and hours as output increases.

Producers of defense and aerospace equipment report continued increases in orders, production, employment, and investment. Suppliers of parts for cars report sales continuing good. Orders for truck components are rising.

New orders for machine tools have been rising slowly this year but remain weak as customers' capacity utilization is low. A major producer reports backlogs rose slightly in July for the first time in 30 months. Production is down from last year. Employment remains stable with no layoffs and no recalls. Prices remain soft.

Orders for steel have begun to rise slowly from very low levels. Capacity utilization remains near 55% and below the break-even point. Several producers report that orders and production for flat rolled products have been at or near current effective capacity. Nevertheless, prices remain soft and are heavily discounted from list, and currently idle capacity is unlikely to be brought back into production soon. Employment is stable, but one major firm is reported to be planning further layoffs of management personnel.

Investment in plant and equipment by major firms in this district remains weak and cautious. Most of current activity involves completion of long-lead-time projects, and replacment, which includes some upgrading of technology. A very few firms are initiating projects to expand capacity; these are in industries where product demand is currently stong, including aerospace, defense electronics, and road construction materials.

Coal. A major coal producer reports inventories remain too high. Sales improved in August because hot weather induced greater use of electricity. Production, employment and hours worked remain stable as the firm is matching production to sales but is not building inventory.

Commercial Banking. Savings deposit growth continues to be strong at district banks. Banks remain liquid and are apparently using these funds to replace maturing large denomination CDs. They have added to their holdings of U.S. Treasury securities with maturities of less than five years, and increased sales of federal funds even though loan demand has picked up in recent weeks. The increase in loan demand appears to be concentrated in the real estate and consumer areas. Commercial loan demand continues to be flat.

COMMENTARY ON ECONOMIC CONDITIONS

FIFTH DISTRICT - RICHMOND

Overview

The economic expansion continues apace in the Fifth District. Manufacturing activity generally is still improving, and the effects are beginning to spread across more industries, notably primary metals. Retail sales have also made further gains in recent weeks with big ticket lines still increasing their share of the total. In the construction sector, housing activity remains strong in most areas despite some recent slippage in sales. In addition, a resurgence of commercial and industrial activity seems to be getting underway, at least in the metropolitan areas. Unemployment seems to have stabilized somewhat over the past month. Business lending by District financial institutions has been essentially flat. Principal areas of concern continue to be the export and farm sectors.

Manufacturing

In the manufacturing sector, shipments, new orders, and order backlogs continue to make broad month to month gains which are also continuing to spread across industry groups. Such industries as primary metals and electrical machinery and equipment have joined the early leaders of the expansion. Despite this continuation of rising levels of activity, manufacturing employment gains were modest over the past month, significantly less than in the previous few months. The length of the average work week, however, continued to increase generally.

Manufacturers' inventories particularly of finished goods, continued to decline according to our respondents. There are now scattered reports of shortages of finished goods on hand and total stocks are now essentially in line with desired levels. In addition, there are beginning to be reports of inadequate plant and equipment capacity and, in a few cases, of inadequate plans for expansion of that capacity.

Price increases are also becoming more common among manufacturers. Nonetheless, a majority of respondents continue to report stable prices for goods bought and sold. A larger majority continues to report stable employee compensation in terms of average hourly earnings. District manufacturers remain optimistic with a large majority expecting further gains in business activity, nationally, locally, and in their respective markets over the next six months.

Consumer Spending

There is almost no evidence of a loss of momentum in the consumer sector. Retailers continue to report widespread gains in sales and further, although modest, increases in relative sales of big ticket items. It appears that more of the recent gains are occurring in the non-durable lines which, until recently, had experienced only modest gains. In addition, there appears to have been some further inventory accumulation at the retail level over the past month, and total stocks on hand remain at or above desired levels despite the continued sales gains. Prices at the retail level continued to hold essentially flat over the month, although reports of increases in wages paid were fairly common.

District retailers remain basically optimistic, but their outlook for the next six months has become significantly less ebullient in recent weeks. Although none expects any decline in activity, many apparently feel that the potential gains in activity have, for the most part, been achieved.

Housing and Construction

Residential construction is apparently holding up very well in those parts of the District that showed recent strength, i.e., most areas. Furthermore, there is almost no evidence, to date, that it will slow in the immediate future. It is evident, however, that sales of residential properties have slowed. Mortgage rates appear to have stabilized after the run up of mid-summer.

Reports of a resurgence in commercial and industrial, particularly commercial, construction plans and activity have become much more widespread the last few weeks. Several of the District's major metropolitan areas are reporting major projects in various stages. These reports clearly suggest that the commercial construction pipeline is filling up. It is probably too early to tell, however, when the process will become more widespread.

Banking and Finance

Mortgage activity is down somewhat and consumer installment credit is growing less rapidly than earlier in the summer. Business loan demand is also soft and, for the most part, is expected to stay that way. In some quarters, however, lenders are expecting an inventory buildup and increases in sales generally to begin to pump up loan demand in the near future.

Nonetheless, as a result of generally soft loan activity competition for consumer deposits like MMDAs has not been particularly aggressive and rates on those deposits have risen only about one-quarter to one-half as far as money rates generally.

SIXTH DISTRICT - ATLANTA

The pace of recovery in the Southeast is showing signs of slowing, but most sectors continue to expand. Consumer spending remains strong although unseasonably hot weather resulted in lower-than-anticipated back-to-school clothing sales. Industrial employment and orders are generally rising, but some reversals appear imminent especially in the forest products industry. Higher mortgage rates have reduced sales of new homes from levels attained earlier this summer. In the financial sector deposit and loan growth is weaker than in June. The surge in central Florida tourism shows further indications of ebbing. Drought-induced crop shortages are likely to increase food prices and lower revenues for crop and livestock farmers.

Employment and Industry. Employment has been expanding, but some setbacks seem likely. Tire and automotive glass manufacturers report markedly increased activity. At least one large tire plant is operating seven days a week. Major government contracts for defense and the space shuttle will soon create new jobs in Alabama and Louisiana, respectively. In contrast, representatives of the forest products industry indicate that the jump in interest rates has diminished orders for and production of lumber. Building material inventories are increasing beyond desired levels. Moreover, reduced demand for coal has prompted layoffs in Alabama's mines. Contacts at industrial development agencies remark that recent capital expansion plans are designed more to improve productivity and efficiency than to meet additional demand. For example, many petrochemical firms in Louisiana are planning cogeneration projects that would produce electricity from wasted heat, thereby reducing fuel requirements by 10 to 13 percent.

Consumer Spending. Retailers report that consumer spending in August and September continued to exceed 1982 levels. Southeastern taxable sales rose 7.0 percent in July over 1982 levels. Florida's 21.0 percent increase offset a 28.1 percent decrease in Mississippi and a smaller decline in Louisiana. New car sales are well ahead of the depressed levels of August 1982. Home entertainment and personal computer items continue selling well. Sales of fall clothing are strong but less vigorous than anticipated by merchants. Nearly all of those polled had stocked back-to-school inventories earlier and on a larger scale than last year. However, sparked by the prolonged heat spell, purchases of summer clearance items accounted for an unusually large portion of consumer expenditures during the back-to-school season. Notwithstanding less-than-expected sales of fall apparel, most retailers plan to maintain higher inventories in anticipation of a good fourth quarter.

Construction. After three months of rising mortgage rates, housing sales fell during August and early September and have yet to revive even though the FHA/VA mortgage rate fell 50 basis points to 13 percent as of August 22. Miami and north metro-Atlanta realtors report little change from the strong sales activity earlier this summer, whereas Birmingham, New Orleans, Macon, Knoxville, and Chattanooga have experienced significant drops in single-family housing sales. In areas of Birmingham, sales fell by 30 to 40 percent. However, lenders generally believe early September mortgage rates will hold steady through autumn, and realtors expect improved sales in the fall.

Commercial real estate, especially suburban office space and shopping center developments, continues to improve in spite of the recent rise in interest rates. Markets in most central business districts, including Atlanta's, are also tightening. However, gluts in office space continue in Orlando and New Orleans. Because of expected ongoing improvement in the economy, industry contacts foresee a spurt of commercial construction contracts throughout the region within the next six months.

Financial Services. Deposits at thrifts and large banks continued the slow growth of July into August, according to preliminary, unadjusted data. S&L money market deposit accounts have been declining since spring, whereas two other interest sensitive categories—jumbo savings accounts and six-month money market certificates—have shown strength. The savings gains by southeastern S&Ls are attributable to larger investors who can afford the minimum deposits required to open these accounts, not to smaller savers whom the S&Ls have taken pains to attract. Loan activity, particularly business lending, grew more slowly in August than in July.

Regional bank executives have proposed the creation of a southeastern banking zone, whereby southeastern state banking laws would allow mergers and acquisitions only by financial institutions headquartered in the region. This arrangement would allow southeastern financial institutions to consolidate their competitive positions before large-scale interstate banking becomes a reality. Several major, money center banks recently applied to Florida banking authorities to establish industrial savings banks.

Tourism. The boom in central Florida tourism shows further signs of slowing since earlier this summer. The number of visitors registering at Florida Welcome Centers in August declined slightly from 1982 levels, whereas the margin of growth in the previous three months had ranged from 12 to 17 percent. Lodging receipts are up statewide, but occupancy in many areas is even with or below last summer's levels. The addition of 850 rooms in the next six months should cause further softening in the Miami market, where established hotels are sharply discounting room rates to boost occupancy enough to cover fixed costs.

Tourist trade appears strong in Alabama and Georgia, where late summer attraction attendance, lodgings tax receipts, and visitor center registrations rose above year-ago levels. Georgia's tourism industry representatives attribute much of this year-over-year improvement to an increase in auto travel relative to air travel as a consequence of cutbacks in discount airfares. Prospects for the 1984 World's Fair in New Orleans improved in the late summer: a number of exhibitors firmed commitments, and several auto and bus associations purchased a total of 500,000 Fair tickets. However, Fair construction is hampering access to New Orleans' tourist district and thereby exacerbating already depressed conditions in that sector of the local economy. Mississippi tourism spokesmen blame the rather lackluster level of business this summer on the Fair, which, they say, is causing travelers to defer trips to Mississippi until next year.

Agriculture. The first widespread rainfall in weeks relieved the drought across the eastern portion of the region during the Labor Day weekend. Although rains arrived too late to reverse the damage to most crops, late-planted soybeans and pasture grasses should achieve additional growth. Louisiana and Georgia experienced less crop damage than Mississippi and Tennessee. Corn in southern Georgia achieved acceptable yields, whereas north Georgia corn was extensively damaged. Prospects of sharply reduced supplies have caused substantial increases in soybean and corn prices. By early September average prices of both important livestock feed commodities had increased about 65 percent from year-ago levels. Facing severe losses, livestock farmers have hastened animals to market. Calf prices, having declined 14 percent since June, are well below last year's levels. Reductions in poultry and egg output, partially a result of heat stress and death losses, have already produced substantial retail price increases for these food items.

Georgia and South Carolina growers, who lost much of their crop to a late spring freeze, will now find it difficult to sell their smaller, drought-stricken apples in the retail market and will have to divert such fruit to lower revenue outlets, such as processing or juice.

SEVENTH DISTRICT--CHICAGO

Summary. The economic recovery in most Seventh District centers continues to lag the national pattern, except for areas concentrating on automotive products. Even in that industry, operations are far short of the peak levels of the late 1970s. Major Midwest companies are still engaged in far-reaching cost-reduction programs to restore or improve profitability and to counter the high value of the dollar. Employment improvement, overall, is slower than in the U.S., but few new layoffs of importance are imminent. Retail sales were at favorable levels in August, aided by hot weather. Demand for capital goods produced in the region has shown only slight improvement, except for a surge in orders for truck trailers. Steel demand remains concentrated in lighter products, and has been disappointing in total. Single-family home sales and permits slowed in the summer as a result of higher interest rates, but leasing of office space has accelerated in downtown Chicago. State governments now anticipate surpluses rather than deficits because of increased taxes and tight budgets, but some local governments remain under severe strain. Corn and soybean crops have been severely damaged by hot weather and drought. Higher crop prices will boost income for many farmers.

Autos. Sales of cars would be even stronger if more large, rear-wheel-drive domestic models and more Japanese cars were available. Supplies of popular domestic models have been limited by capacity, which had been reduced, while the Japanese export quota has determined the level of U.S. sales of their cars. U. S. production schedules have been raised for the remainder of the year and appear firm. Measures are being taken to increase large car production capacity even though government penalties for failure to meet CAFE standards could be imposed under existing regulations.

Cost Cutting. Various Seventh District companies have announced ongoing programs to reduce costs substantially relative to the general price level over the next two or three years. The main reason for urgency is the substantial advantage foreign competitors have because of the high value of the dollar. Steps include drastic reductions in overhead staff; pressure on unions to accept concessions on compensation and work rules; closing of high-cost facilities (usually in the Midwest) and consolidation in more efficient units; pressure on suppliers to cut prices; and "outsourcing" components, previously made "in house", if cheaper supplies can be obtained from others, either in the U.S. or abroad.

Employment. Substantial increases in employment in the District since last December have been concentrated in the automotive industry and residential construction. The bulk of the expected automotive callbacks probably already have occurred. New claims for unemployment compensation are down sharply. While few important new layoffs are in immediate prospect, announcements of closings of long-established facilities continue. Where closings involve major, older facilities, the announcement is merely the coup de grace following a long period of attrition. Other plant closings follow failures of labor and management to agree on concessions. On the other hand, some closed plants have been reopened following successful concession negotiations.

Consumer Purchases. General merchandise retailers reported strong August sales, with air conditioners and other warm weather merchandise leading the uptrend. However, virtually all classes of goods have sold well, including furniture, appliances, and carpeting, which tend to be associated with house sales. The pickup in furniture was too late to save a number of well known stores, which went out of business--casualties of high interest rates according to managers. Recreational vehicles have had a very good year. Airline travel continues to show large gains in volume with promotional fares still a factor.

Capital Goods. As reported in the last Commentary, the important capital goods producers of the District have not participated proportionately in the uptrend in the national aggregates. Many plants remain closed and others are operating at less than 50 percent of capacity. Imports and loss of foreign markets have reinforced sluggish domestic demand. Some say that the high value of the dollar also makes investments in production facilities abroad more attractive. In most cases where increases in orders have been reported--for example, machine tools and heavy trucks--the rise has been modest and from a very low base. One sector that is going strong is tandem trailers, permitted under the new federal law.

Housing Slows. Higher interest rates slowed housing activity in July and August. In the District, July home permits were down sharply from June. Conventional mortgage rates in the Chicago area had moved up to the 14 percent range in the summer, but have been reduced since late August by nearly half of the lenders surveyed by one-eight to one-half percentage points. The state of Illinois recently provided $70 million obtained by sales of tax-exempt bonds for mortgage loans at 10.55 percent--3 to 3-1/2 percent below the market. The money was all spoken for at participating lending institutions in an hour or two, with some rancor evidenced by disappointed applicants.

Commercial Building. Factory construction and new utility projects are at a very low level. However, a number of large new office buildings have been announced for downtown Chicago, and more announcements are expected. (Downtown Chicago has been the only strong area in the District for office buildings.) Earlier this year, some experts predicted that the glut of office space in the Loop would last for years. Recently, however, leasing activity accelerated markedly, rents firmed, and concessions to lessees were cut back.

State and Local Governments. In the last legislative sessions, all five states of the District enacted tax increases to eliminate current or potential deficits. Higher taxes, tighter expenditure control, and the pickup in the general economy now are expected to produce budget surpluses in all five states in the new fiscal year. Increased rates were levied on corporate and personal incomes, retail sales, and gasoline. Rarely have the states moved in unison with such vigor to increase revenues, but the need was urgent because state deficits are illegal. Meanwhile major cities are wrestling with revenue shortfalls and demands for higher salaries for public employees, including teachers, police and fire personnel who have called strikes in some cases. Some layoffs and short weeks have been ordered.

Agriculture. Continuing searing drought through August caused the USDA to reduce its estimate for the corn crop of the District states by a further 20 percent. With large acreage cuts, the corn crop is now expected to be 53 percent below last year. The soybean crop, also badly damaged, is now expected to be down 28 percent. The extent of the drought damage varies widely and is most severe in Illinois and Indiana. Because of higher prices, earnings of farmers who were least affected by the drought, and those receiving PIK grain, will improve significantly.

EIGHTH DISTRICT - ST. LOUIS

The broadly based economic expansion continued during August and early September in the Eighth District, and most respondents expected further gains during the fall and winter. Retail sales continued strong, factory orders and production rose, and employment increased. Orders for business equipment, however, remained depressed, housing and auto sales slipped, and the hot dry weather destroyed many crops.

Outlook

A research organization recently projected that real economic growth in Arkansas and Missouri would be slightly greater in the last half of 1983 than in the first half. It anticipates that real growth in 1984 will be over 5 percent in Arkansas and 4 percent in Missouri.

Hotels and Motels

Since May there has been a pronounced increase in District hotel and motel occupancy rates. A manager for a chain of motels operating throughout the district noted a marked rise in occupancy rates. Summer conventions, increased tourism and more business travel have kept downtown St. Louis hotels nearly full for the first time in years. With large fall and winter bookings, hotel and motel managers are optimistic about the future. In the St. Louis area, two new major hotels are now under construction, one hotel has just completed a substantial renovation, and at least three others are planning sizable redecorations or enlargements this fall.

Sales

Department stores, discount houses and small shops throughout the District report relatively favorable sales in August and early

September. Back-to-school promotions were successful and furniture, floor coverings, appliances, jewelry and toys moved briskly. One large store is stocking shelves for an expected "spectacular" Christmas season.

Automobile sales continued to be lively, but were down from peaks reached in June and July. Inventories are low at a number of dealers, and several said they could have sold more if the cars had been available. Demand for used cars remains good, and prices of late models have risen.

Home sales remained below the pace reached in the spring, but were still up substantially from a comparable period a year ago. Higher interest rates and the hot weather contributed to the slowdown. Housing construction, however, continued to rise.

Manufacturing

Orders and production at most industrial firms in the District rose in August and early September. Orders for appliances and other consumer durables were particularly large, but equipment sales to businesses are still depressed. Inventories are at desired levels at most firms, but reports have been received of an abundance of gasoline stocks which has softened prices somewhat. Several firms are increasing their outlays on research and development.

Transportation

A major railroad reported that traffic was recently running 9 percent above year ago levels. Grain shipments were sufficiently strong to eliminate the surplus of covered hoppers. Several trucking companies also reported an increase in tonnage hauled.

Employment

Employment in the District rose in August, as many service, construction, transportation and manufacturing firms slowly increased their work forces as the need became clear. The unemployment rate, however, changed only slightly because the labor force grew and because of some offsetting reductions in employment, primarily through attrition. Three large District employers have scheduled rehirings, totaling 5,000, over the next two months. It was announced, however, that a plant employing 500 would be phased out this fall.

Agriculture

Crop damage in the District from the hot dry weather was the largest in years. Many crops were completely wiped out; farmers in most counties sustained some damage, and in a number of counties output will be less than half of last year. Corn, soybeans, tobacco, alfalfa, cotton, fruits and vegetables were all hurt, and many chickens and some hogs died. Financial losses to many individual farmers and rural communities have been severe. Meat and other food prices are likely to rise over the next year because of the reduced supplies. The lower yields, reinforcing the PIK program acreage cuts, are reducing the large overhang of inventories. Commodity prices have risen, bolstering total farm income. A few farm equipment dealers report improved sales, and farmland prices, which have declined for about two years, reportedly have stabilized and even risen in recent months.

NINTH DISTRICT - MINNEAPOLIS

With the exception of a dip in real estate and related activities, the economic recovery continues despite higher interest rates. Consumer spending for general merchandise and autos has not declined much from the torrid pace reported in our last report. Tourism has finished the summer on a good note. Some bright spots continue to turn up in manufacturing. The outlook for district crops has improved, due to favorable changes in local weather, the federal Payment-In-Kind (PIK) program, and higher prices. However, higher corn prices have hurt livestock profits. Financial activity appears normal. The weakest spot in our economy continues to be raw material extraction and processing. Due to the rise in interest rates, though, real estate and related activities have begun to weaken somewhat as well.

Consumer Spending: Retail sales of general merchandise apparently have continued at a healthy rate. One large Twin Cities retailer reports an "excellent" August, posting a sales increase of more than 20 percent. Sales of home and office furnishings were strong for that retailer. The back-to-school promotion went well for another large local retailer. The fall outlook is good for a diversified retailer, with big-ticket items buoying sales that were somewhat slowed by the hot August weather. Higher interest rates notwithstanding, retail credit sales are showing substantial strength over comparable periods a year ago. Southern Minnesota and North Dakota retailers have reported good sales to our Bank's directors, although some retailers in South Dakota and parts of Wisconsin have reported flat or lagging sales, due to local conditions.

Van and recreational sales led the way in producing healthy automotive sales figures. District managers for domestic auto producers report good increases in both truck and passenger car sales over last July and August. Vehicle inventories are lean. This good news was corroborated by our Bank's directors, who reported good auto sales in southern Minnesota, in parts of Wisconsin and the Dakotas, and even in economically troubled northern Minnesota.

Tourism: Tourism continued to show the strength evident in our last report. One senior tourism official in Minnesota says that August was excellent. He feels that the outlook for fall is good also. The economically depressed Upper Peninsula of Michigan had a good summer, with Mackinac Bridge traffic higher than last summer. Inquiries about the "fall color season" are also up. Similar sentiments are reported in the 26-county Indianhead region of Wisconsin, which expects to finish the season with tourism up 10 to 12 percent over last year.

Manufacturing: Manufacturing activity is generally good throughout the district. A recently released survey of our largest manufacturers shows that twelve of them posted a second-quarter increase in earnings, while only five suffered a decline. Two district paper companies are very busy. One of them just hired 50 more workers, and the other is contemplating an expansion. Two large computer industry manufacturers recently announced lucrative new contracts. An aluminum pot line was added to a plant in Montana, the first such expansion at that plant in several years.

Agriculture: Recent increases in corn and soybean prices are combining with the federal PIK program and better weather to spur farm income in this district. The Minnesota farm price index rose 8 percent, reaching its highest level in two years. Corn and soybean production is looking pretty good in Minnesota, where favorable weather is expected to produce yields well above the national average. However, these crops are not doing as well in southeastern and east central South Dakota, where bad weather and woolly worms are taking their toll. Wheat production is generally good in South Dakota and Montana, and wheat prices are running from 10 to 20 cents higher than last year. Livestock profitability is being gutted by high corn prices, though, and some wheat is being substituted for corn in cattle feed. Also, a recently implemented federal dairy production assessment is hurting dairy farmers.

Financial: District bank lending and deposits both increased last month. Deposits and loans in Twin Cities banks grew by 3.5 percent and 5.2 percent, respectively. Comparable country bank growth figures are smaller. One bank director thinks that there may be some slack in country bank lending, due to recent interest rate increases.

Raw Material Extraction and Processing: These industries are still lagging behind the economic recovery, primarily because of structural problems. One director reports that delivered iron ore pellets from Brazil, for example, are cheaper than pellets from district plants. Two more large taconite plants in northern Minnesota announced closings this month. At around 15 percent, the unemployment rate in the Duluth-Superior area of northeastern Minnesota is the highest among all metropolitan areas in the five state Upper Midwest. Oil drilling is still down in North Dakota and Montana. In fact, the Williston Basin now has only about 40 active rigs; it had about 60 last spring. Demand for lumber was also down somewhat. Recent price declines for wood products illustrate this weakness. One sawmill operator thinks that demand would be stronger if interest rates fell, and stimulated more construction activity.

Real Estate: Recent interest rate increases have begun to slow real estate activity. Single-family home sales have fallen off in the Twin Cities. The condominium market also slipped. Builders, realtors and mortgage lenders all attributed this to recent increases in interest rates. Some scattered bright spots in residential construction are noted, though, with Billings, Montana, Sioux Falls, South Dakota and Rochester, Minnesota not being much affected by higher interest rates yet. While commercial construction has also been slack, one Twin Cities contractor notes that overcapacity may still be contributing to this.

TENTH DISTRICT--KANSAS CITY

Overview. Business activity in the Tenth District continues to grow, with sales and inventories both expanding. Prices at retail and for industrial inputs are increasing only moderately. Housing activity is beginning to slow, although savings inflows are expected to improve through yearend. Crop prices are up and livestock prices down, both in reaction to drought conditions. Bank loan demand has increased slightly, as have deposits.

Retail Trade. Total dollar sales volume has increased by as much as 12 percent in the first eight months of 1983 compared with the same period last year. Retail price increases have been moderate this year and are expected to remain so through the end of the year. In general, respondents are satisfied with inventory levels and are expanding stocks only to meet the pickup in sales. The outlook for sales for the rest of the year is promising due to an improved economy, increased advertising, and changes in marketing strategy.

Purchasing Agents. The majority of purchasing agents contacted in the Tenth District report input price increases of 2 to 5 percent since September of last year, with most of the increase occurring during the past three months. Prices are generally expected to remain stable or increase slightly through the end of the year. All purchasing agents report inventories at very low levels. Most report recent inventory expansion in response to increased sales, although a few note continued trimming of stocks. Purchasing agents are nearly unanimous in having no significant problems in obtaining inputs.

Housing Activity and Finance. Housing starts remain at about double last year's rate, despite recent moderation in housing activity. Most of this year's improvement in housing has been concentrated in single-family starts. Inventories are low although there are some indications that they are beginning to rise again. Demand for housing has weakened significantly because of the recent increase in interest rates and uncertainty about future rates. Most savings and loan associations report an improvement in savings inflows and continued improvement is expected through yearend. Mortgage rates range from 11 3/4 percent for variable rate mortgages to 14 percent on fixed rate mortgages. Mortgage rates are expected to remain steady until near the end of 1983 and then decline slightly.

Agriculture. Crop conditions are mixed throughout the Tenth District. Irrigated crops are likely to produce record yields, while nonirrigated crops have been severely affected by the drought. Crop yields for corn and soybeans of 50 to 75 percent below normal are likely in Kansas, Missouri, and Oklahoma, according to District bankers. Little of the corn crop will be salvageable for silage, while soybeans are more likely to be harvested but at reduced yields. Colorado, New Mexico, and parts of Nebraska are experiencing high yields on their irrigated corn, soybean, dry edible beans, hay, and sugar beet crops. While crop prices have risen in anticipation of poor yields, livestock prices have fallen as marketings have increased due to rising feed costs and poor pasture conditions. District bankers anticipate an even larger increase in marketing of livestock later in the year. Farm equipment and supply sales activity is very slow. Sales of big-ticket items, such as tractors and combines, are being postponed until next year. Some increase in loan repayments is reported by bankers, as some farmers have been selling corn recently released from the Farmer Owned Reserve program. Tenth District farmers are showing little if any interest in the 1984 PIK (Payment-In-Kind) program for wheat.

Banking. Loan demand at Tenth District banks has increased slightly over the past month, mostly due to increases in commercial and industrial loans. Consumer loan and commercial real estate loan activity was quite variable with a very slight increase on average, while agricultural loans decreased slightly. Total deposits have risen at the respondent banks. The growth in demand deposits was quite variable, with a slight decrease overall. Some bankers experiencing a decrease in demand deposits feel that interest-sensitive consumers are switching to interest-bearing deposits. Growth in money market deposit accounts and in money market and small saver certificates was also variable, but with little change on average. Conventional NOW accounts and Super-NOW accounts were up, as were IRA and Keogh accounts and large CD's. Some respondents indicate that they are deemphasizing large CD's. The prime rate ranged between 11 percent and 14.6 percent with three-quarters of the banks charging 12 percent or less. Over half the respondents report a half-percent increase in their prime rate over the last month, while a large fraction report no change. Consumer lending rates have not changed on average during the past month and most respondents do not expect any change in the near term.

ECONOMIC COMMENTARY

ELEVENTH DISTRICT—DALLAS

The Eleventh District economy continues its recovery. Production of oilfield equipment remains depressed, but other manufacturing industries showed further signs of strength. Growth in retail, government, and industrial construction, coupled with announcements of several large office projects, generated an unexpected upturn in commercial construction. There is some evidence that residential construction has started to slow. Retailers and auto dealers throughout the District are optimistic about sales in the third and fourth quarters. Loan demand at District member banks is still sluggish, but large banks expect business loan demand to be moderately stronger through year-end.

Moderate increases in manufacturing production continued. Unusually high orders in July and August boosted order backlogs at electronics firms, which have been producing at or near capacity. Despite price declines and cutbacks in distributors' orders, the rate of production of lumber and wood products remains high. Apparel production turned up sharply during the last six weeks as gains in national retail sales worked through to the manufacturing level. The large volume of new orders at the wholesale apparel market in August indicates that the near-term outlook for apparel production remains strong. Steady increases in the demand for chemical products have been matched with output gains. Production of oilfield goods is roughly stable at low levels although small increases in drill bit manufacturing were reported. Further gains in demand from auto producers and construction contractors pushed up steel production slightly in August. Prices and profit margins for steel producers are still below year-earlier levels.

Employment in the District is responding to the turnaround in economic activity. The seasonally-adjusted unemployment rate for Texas was 7.3 percent in August, down from a 9.0-percent peak last March. Job growth in the durable goods sector reversed the decline in manufacturing employment. Employment gains in the electronics and construction materials industries more than offset slowing declines in oil-related industries. Continued strength in auto sales and housing construction led to further employment increases in the primary metals sector.

Drilling activity in Texas has shown some additional signs of recovery. Despite stable crude prices, the seasonally-adjusted rotary rig count in Texas has increased for two consecutive months. Lower labor and capital leasing costs are cited as factors contributing to the turnaround. Inventories of unused rigs remain high. Poor market conditions have made contractors unusually reluctant to sell the components of unused rigs. As a result, the number of idled rigs may not fall by as much as had been expected.

Growth in residential construction slowed in July as sales expectations were revised downward in response to higher interest rates. The volume of single-family permits in July was off sharply from the near-record June level, but it was still sufficiently high to maintain a moderate rate of growth during the next few months. Multi-family permits also fell. Given the volatility of this series, it is not clear whether the drop marks a reversal of the strong upward growth in this sector.

Texas farm income remains mixed. Livestock producers face losses, while crop farmers generally anticipate higher income. The price of cattle coming out of feedlots is roughly $5 less per hundredweight than the cost of production. Corn and sorghum grain growers in the District are anticipating higher incomes. The drought in the Midwest Cornbelt pushed down yield estimates there and raised prices nationally. The West Texas drought has caused nearly $13 million in losses to cattle ranchers, but this is small relative to the $4 billion statewide cattle industry. In addition, cotton farmers in West Texas face losses above $100 million. The income of Texas cotton farmers as a group, however, will be above last year's depressed level because of higher prices.

Loan demand at District member banks is still sluggish. Year-over-year gains remain in the 15-percent range. At large banks, business loan growth picked up modestly in August and further gains are expected. Real estate lending remains strong. Growth in deposits at member banks has slowed somewhat faster than credit growth due to greater reliance on borrowed funds.

TWELFTH DISTRICT -- SAN FRANCISCO

The Twelfth District economic recovery is continuing, but at a slower pace, due largely to the decline in residential construction and its ripple effects on such key industries as lumber. Apart from a shortage-induced decline in automobile sales, consumer spending remains strong, with department stores experiencing a widening year-to-year gain in sales in August. Western homebuilding activity has been falling off moderately since June, however, and an even sharper decline in home sales suggests a further slowdown in starts in coming months. In the manufacturing sector, overall employment growth has clearly slowed. Some capital goods industries -- especially electronic equipment -- are experiencing an increased order inflow, however. Consumer lending at Twelfth District banks has been especially strong, due mainly to increased consumer spending but also due to banks' promotional efforts. Applications for mortgage loans have dropped dramatically.

Consumer Spending

Respondent's throughout the Twelfth District report that retail sales continue to rise at department stores and other outlets and that these stores experienced a widening year-to-year margin of gain in sales in August. Major department store chains in Southern California, for example, report that sales in August ran nearly 16 percent above the year-earlier level. Double-digit increases also were recorded at major stores elsewhere. Retail outlets not only experienced strong sales of apparel and other back-to-school necessities but more costly personal luxury items and home furnishings. Respondents attribute these buoyant spending patterns mainly to pent-up demand, rising consumer incomes, and increased job security. Retailers have been increasing their inventory, but due to high real interest rates have held the buildup below the normal relationship to sales. Automobile sales declined in August, but respondents attributed the slowdown to a shortgage of 1983-models rather than to a decline in demand.

Manufacturing and Mining

Growth in both total employment and manufacturing employment has slowed recently. In some states -- notably, California and Oregon -- unemployment rates actually have risen. Part of the slowdown has been due to renewed weakness in residential construction activity and its adverse effects on the important lumber industry. Since June, prices for some key homebuilding lumber products have fallen as much as 25 percent, and lumber mills have been cutting production. Fortunately, the pulp and paper segment of the forest products industry has continued to experience further improvement in orders and employment. In the metal mining and manufacturing sectors, the Pacific Northwest aluminum industry has been raising its capacity utilization rate, but the copper industry in the Intermountain states has remained depressed as prices have continued to fall despite a labor strike against the nation's second largest producer. The West's major capital goods producing industries -- including those that manufacture machinery, electronic equipment, trucks and aircraft -- are experiencing a pickup in orders. Not only has consumer and defense demand for these goods increased, but business demand has risen, especially for electronic equipment. In the case of commercial transport planes, increased orders have not translated into increased employment, however, due to an even greater increase in shipments and consequent decline in unfilled orders. Employment has stabilized but not yet increased in such energy industries as coal mining and oil production.

Construction and Real Estate

Although housing starts in the West have held up relatively well compared with the national pattern in recent months, the rise in mortgage interest rates has had a dampening effect on starts since June. Moreover, sales of new and older homes have dropped much more dramatically, suggesting that the pace of homebuilding will fall further in the months ahead. In fact, in July, the West experienced a 14 percent decline in sales of new homes, and respondents report that sales slowed further in August. One large real estate firm in Southern California reports that it is doing 40 percent less business than it was doing two months ago. Another reports that sales of new and existing homes have fallen 25 percent in the last 60 days. As a result, the inventory of unsold homes has risen sharply. The climb in mortgage rates has disqualified large numbers of buyers in the high-priced California market. Builders in Southern California report that cancellations of new tract-home sales are running at a 40-50 percent rate in August, twice the cancellation rate earlier in the year when FHA rates were in the 12 percent range. Some builders who had previously committed to a "buy-down" arrangement to keep effective interest rates affordable are now facing a large number of discount points, thus shutting off this avenue of financing in the future. Most respondents feel that housing has clearly passed its cyclical peak for this year and that the recent drop in FHA and VA rates from 13.5 to 13 percent will only slow the rate of decline. In the nonresidential construction sector, activity continues to lag behind the year-earlier pace. Vacancy rates are declining for office and other commercial buildings, but no significant increase in construction is expected until 1984.

Agriculture

Unseasonable rains in Southern California caused damage to certain farm products in August, including alfalfa hay, cotton, tomatoes, grapes and almonds. Nevertheless, net farm income is expected to be up in most District states this year, partly because the farm sector is expected to benefit greatly from the combined effects of the Federal payment-in-kind (PIK) program and the Midwestern drought in boosting prices for cotton and grains. The positive effects of the PIK program for California and Arizona cotton growers will be reduced by their need to put part of their 1983 crop on loan with the Commodity Credit Corporation, reducing the amount available for sale at higher prices. Nevertheless, these farmers still will benefit significantly from the program, while farmers in Washington, Oregon and Idaho will benefit in general from higher grain prices. Livestock producers, on the other hand, will suffer rising feed costs and a further drop in already weak cattle prices.

Financial Institutions

The volume of consumer loans outstanding at large Twelfth District banks has grown at an annual rate of 12 percent over the past three months. Increased consumer spending resulting from rising real incomes, employment and confidence has been largely responsible for the increased borrowing. Households' purchasing power also has been enhanced by the effects of the stock market rally in increasing wealth. In addition, banks are actively promoting consumer lending, although this is taking place through new loan products and publicity about availability rather than by lowering rates significantly to meet competition from captive finance companies. Mortgage lending continued to increase through August on the basis of previous commitments, but it is likely to deteriorate in coming months as a result of higher rates. Bankers report a sharp drop in applications for new mortgage loans. Commercial lending activity remains very weak, partly because corporations are using increased profits to pay down short-term debt.