SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

May 1984

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SUMMARY*

The overall economic picture in the nation is fairly bright, according to reports from the twelve Federal Reserve Districts, although a few industries are still weak. Retail sales in many Districts bounced back in April from a March slump and are expected to continue their growth. Auto sales are very strong, with near-capacity production levels at many auto plants. Other manufacturing industries are also doing well, especially paper products and consumer durables. Residential construction remains strong, although some signs of slowing have appeared in recent weeks. Bankers in the Eastern and Southern parts of the nation report increases in both business and consumer loans, while borrowing in other areas has remained flat. Probably the weakest sector in the economy at this time is agriculture.

AGRICULTURE

The agricultural sector has suffered in recent months due to a combination of factors. Plantings in the Southeast and Midwest have been delayed by heavy rains, while Dallas and Minneapolis report that overly dry conditions have held down winter wheat production. Both Dallas and San Francisco, however, say cotton growers are having a good year.

Pork farmers in the Atlanta District have been reducing inventories in response to higher feed prices, but that cutback might be near an end. Dairy farmers in the northern Midwest continue to experience financial problems, and they do not expect much help from the new Federal diversion program. Contacts in Kansas City say this year's calf crop is about average. Poultry farmers in the Richmond District continue to be troubled by avian influenza outbreaks.

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Both Chicago and Kansas City report a further drop in farmland values. Kansas City also says farm credit problems are as bad this year as they were last year, and that farm asset liquidation is likely to increase unless debt is reduced.

MINING/ENERGY

Business activity in the mining and energy sector appears to be mixed in April. Both production and prices are up in the coal industry in the Midwest. Cleveland attributes some of the strength to utilities' stockpiling coal against the possibility of a strike by the United Mine Workers in September. San Francisco reports, however, that the coal companies in the West have been laying off workers.

The oil industry remains weak. The increase in drilling apparently stems from lower costs and more favorable leasing terms rather than from growth in demand. Dallas says these factors have accounted for a 38 percent increase in the number of offshore rigs since the first of the year.

CONSTRUCTION/REAL ESTATE

The underlying upward trend in the residential construction industry persists, according to most Districts, despite a recent slowdown and anxiety about the future course of interest rates. New York and Cleveland report brisk sales of homes, but indicate that buyers and builders are very conscious of mortgage rates. In most other Districts, residential sales slowed in recent weeks, the result of a combination of bad weather and higher mortgage rates. Higher rates have given a further boost to adjustable rate mortgages (ARMs). Kansas City reports that over 80 percent of new mortgage loans in that District are ARMs.

Nonresidential construction remains generally strong despite concern about overbuilding. In New York and Chicago the demand for office space continues to grow. The market for industrial space, however, is mixed.

MANUFACTURING

The nation's industrial sector is continuing along a path of expansion. Although capital goods industries are weak in some Districts, the overall picture is bright in virtually all areas. The paper industry is probably the strongest at this time, followed by consumer durables, primary and fabricated metals, and electronics. San Francisco indicates rapid gains in the production of missiles and space vehicles, and Cleveland and Chicago both report that many motor vehicle manufacturing plants are operating at capacity. Manufacturers' stock levels are generally stable, and there are no reported plans for significant inventory-building. Industrial prices are mixed. The only real weakness in manufacturing is in exports. Boston reports, however, that there has been a pickup in sales of foreign subsidiaries of domestic firms.

RETAIL/CONSUMER SPENDING

About half of the District report that retail sales have made a brisk comeback in April after a sluggish March. The strongest gains were posted in Philadelphia, where sales are running as much as 35 percent ahead of the same time last year; about half of that gain was due to the later Easter holiday this year. In other Districts reporting rebounds, gains range from 8 percent to 26 percent. Even in those areas which have not seen an increase in sales, retailers believe the underlying strength in consumer spending is still present. Consumer durables appear to be leading the surge in spending, bolstered by the strength of the housing market. Nondurables, however, are also doing quite well. Retail inventories in most Districts have increased relative to sales, but merchants are not concerned and are not planning any special moves to cut back. At least part of the inventory buildup is intentional and being undertaken in response to continued strength in demand.

Auto sales are also reported to be vigorous. Foreign cars and larger domestic autos seem to be leading the pack, although Atlanta reports healthy sales of compact vehicles as well. Some shortages of the more popular domestic models are reported, and delivery times for foreign cars are being stretched out. Recent increases in consumer loan rates in some parts of the country do not appear to have dampened the demand for cars.

BANKING AND FINANCE

Virtually all Districts in the Eastern and Southern parts of the nation report strong growth in loan demand this month. Business loans remain brisk in those areas, with both large and small companies borrowing for a variety of reasons. Consumer borrowing is also up, especially loans for autos. Deposit flows, however, are weak at many financial institutions, and loans are being made with borrowed funds. Districts in the Western part of the country say there has been little or no loan growth in March and April.

FIRST DISTRICT - BOSTON

Business activity in the First District continues to expand. Retailers report satisfactory sales, and manufacturers are seeing a pickup in orders. While the expansion is widespread, it is not uniform - some sectors continue to outpace others. A few supply problems have materialized, but price increases are quite moderate. Demand for bank loans is strong and increasing.

Retail

Retailers in the First District reported sales growth on or better than plan in recent months, although unseasonable weather combined with a later-than-usual Easter to shift March sales into April. All retailers contacted expect steady sales growth to continue through the year. Supply problems have caused inventories to be higher or lower than desired levels in some cases, but the deviations were not considered serious. Prices are rising very little because of strong price competition. 1984 capital spending by retailers contacted this month will probably mirror 1983.

Merchants expected low sales in March because of Easter's late arrival, but sales fell below even modest plans because of consistently bad weather in New England. However, April sales rebounded to bring year-to-date sales back to plan or better. Reported increases for April ranged from 8 to 15 percent on a comparable stores basis. Aside from items the stores were actively promoting or downgrading, no specific products were noticeably stronger or weaker than average, except that one chain sold more lumber and building materials than they expected.

Two retailers have lower inventories than desired because some of their suppliers are not providing promised merchandise. In contrast, one department store's high inventory levels were attributed to excessive ordering by divisions faced with shipping delays. These problems are not serious; none of the merchants contacted planned any significant changes in inventory practices.

Most retail respondents this month reported capital spending plans for 1984 similar to last year. New store openings and remodeling and expansion of existing stores reflect continued confidence in steady regional growth.

Manufacturing

Business is very good, according to most of the manufacturers contacted. Representatives of the metal working industry tend to be less positive than other manufacturers, but they also report that business has improved over the past several months. The strength is widespread, although appliances and other housing-related products and electronics are unusually strong and capital goods for the farm and construction equipment industries are unusually weak. In general, orders for capital equipment are picking up, but the rate of recovery is varied. Several capital goods manufacturers report that demand is behind schedule for this stage of the recovery; customers may have ambitious investment plans, but they seem unwilling to make large cash commitments. In contrast, a few firms report unexpectedly strong demand with very tight delivery dates; these firms are uncertain whether to gear up to accommodate what may be panic buying. Sales in Canada, the Far East and Europe are increasing, but because of the strong dollar, the pickup is more pronounced for sales of overseas subsidiaries than for exports.

Manufacturers are operating with lower inventory-to-sales ratios than in the past. Use of computerized inventory management techniques and, in some cases, simply more attention to inventories have made it possible to reduce inventory ratios without impairing customer service. Several respondents commented that because of lower inventory ratios, their need to borrow working capital was substantially below normal for this point in a recovery.

None of the firms contacted has seen evidence of widespread price increases. Pulp prices are said to be rising, but no other products were singled out. Semiconductors are in extremely short supply; but the problem is lead times not price increases. Wage increases are also reported to be moderate; several respondents expect increases in 1984 of about 5 percent.

Commercial Banking

Banking respondents report vigorous growth in loan demand. The expansion is broad-based. Smaller banks are seeing strong real estate and installment loan demand. At larger banks, business loan demand is increasing, with medium-sized and New England-based firms providing much of the strength. To a substantial degree, banks are financing the increased demand with purchased funds rather than deposit growth.

SECOND DISTRICT--NEW YORK

Introduction

The slowdown in the national economic recovery suggested by the leading indicators and unemployment rates was not reflected in reports from the Second District for March and April. Business activity continued to expand in most sectors throughout the District. Several purchasing managers report very favorable conditions and the unemployment rate in New York reached a four-year low. The demand for homes is very strong and builders expect to be busy until the end of the year. Nonresidential construction is also strong with especially tight space availability in some parts of the District. Consumer spending did slow in March, and despite a sharp recovery in April, several retailers report excess inventories. On the financial side, banks have begun offering two new types of consumer loans: variable rate installment loans and equity access accounts.

Consumer Spending

Retail sales in the Second District were weak in March but rebounded in April. Two retailers located in New Jersey registered sales lower in March than last year, and several store chains reported very small increases. In contrast, consumer spending rose sharply in April throughout the District, to amounts ranging from 11 to 26 percent higher than those of last year. Bad weather in March, good weather in April, and an Easter holiday three weeks later than last year were common explanations for this pattern.

The increase in April sales was not enough to prevent excess inventory build-up for a number of retailers in the course of the past few months. Several stores have accumulated merchandise 20 or 30 percent over last year's levels. While much of the inventory growth was intentional, levels at some stores were up to 10 percent higher than planned. Some retailers plan to reduce stocks by cutting back or cancelling orders, but others expect increased sales to absorb excess inventory.

Business Activity

The business expansion in the Second District maintained its pace in recent weeks. Purchasing managers in upstate areas reported quite favorable economic conditions, and the percentage of managers in the Buffalo area citing increases of new orders reached the highest level in six years. Downstate, improved economic conditions made possible a New York City budget proposal calling for substantially higher levels of public employment.

Further employment gains were registered in many areas of the District. March nonagricultural employment in New York State increased broadly to a record level for that month, and the unemployment rate fell below 7.0% for the first time in four years. The greatest improvements were in the construction, trade, service, and financial industries. Manufacturing employment also rose as a pickup in business capital outlays led to increased employment in the electrical and nonelectrical machinery industries.

Among major new construction projects in the District, two of the largest were the groundbreaking for a new 300-room hotel and convention center in the Albany area, and a planned office building and hotel near Giants Stadium in New Jersey. Other large expansions include an additional building at IBM's Kingston, New York complex, increased space at a dairy plant, and the enlargement of its headquarters building by a microwave firm.

Construction and Real Estate

Residential construction activity was brisk throughout the District despite occasional interruptions due to unseasonably wet weather. Demand is very strong and builders anticipate being booked through November. Because of anxiety over the future course of interest rates, New York and New Jersey builders are considering issuing "builders bonds" to finance mortgages themselves, in order to assure a stable flow of funds next year.

Nonresidential real estate activity also picked up a bit in recent months. The strength in the Manhattan office market, which has recently been confined to older buildings, is extending to new, higher-priced office space. Demand is also up in New Jersey and lower Connecticut, but remains fairly slow in the northern suburbs of New York. On Long Island, despite fears of large electricity rate hikes, the industrial market was especially tight. The amount of available industrial space fell by nearly 25 percent in the six months ending in March.

New office buildings are planned or starting both in New York City and in suburban areas. Construction of retail space, especially "strip centers" along major roads is up on Long Island.

Financial Developments

Small Second District banks are offering two relatively new consumer financial instruments, variable-rate consumer installment loans and equity access accounts. Most banks surveyed now offer variable-rate consumer loans. Monthly payments are generally fixed for the term of the loan, and quarterly rate adjustments are incorporated by changing the number of payments. The response to these loans has been quite good; the banks reported that up to 80 percent of consumer loans are now of the variable rate variety.

Equity access accounts are mortgage loans that can be accessed like lines of credit. They are are being offered by fewer banks and demand for these accounts appears to be fairly weak.

THIRD DISTRICT - PHILADELPHIA

Most Third District contacts report steady growth in the local economy during the past six weeks. The one exception is the real estate and home construction industry, which has experienced a recent slowdown in activity. In other industries, manufacturers report solid increases in activity since early March and, after an anticipated let up in March, retailers are enjoying handsome sales gains in April. Additionally, local bankers report very steady growth in both commercial and retail loan volume.

The outlook varies across industries. Manufacturers and retailers forecast continued growth, but at a slightly slower pace than during the recent quarter. Area bankers are confident that they will continue to see healthy loan growth during the next six months. On the other hand, real estate and construction executives express the concern that if mortgage rates continue to rise, their industry will experience a significant and sustained slump in activity.

MANUFACTURING

The Third District manufacturers responding to the most recent Business Outlook Survey report solid increases in activity during the past two months. Over 50 percent of the respondents indicate a pickup in activity, while only five percent report a decline. New orders and shipments continue to make significant, steady advances, and unfilled orders and delivery times are also up. Contrary to national figures, survey results indicate that local manufacturing inventories have been unchanged for the past six months. Also, April employment has made only slight gains over March levels.

The effect of the economic expansion is being felt in industrial prices at area firms according to the survey. In April, 51 percent of the respondents report paying higher prices for raw materials and 23 percent indicate that they are being paid more for their output. Looking ahead, the April price outlook marks the 12th consecutive month in which more than three-quarters of the respondents have forecast higher input prices. This month, 80 percent of those polled predict increased input costs by October, and 54 percent anticipate receiving higher prices for their final products.

The overall outlook for manufacturing during the next six months is positive, though to a slightly lesser degree than in past months. Two-thirds of the executives surveyed foresee continued expansion in manufacturing activity until at least October. Additionally, a large portion of respondents (47 percent) once again forecast a pickup in capital expenditures over the next two quarters.

RETAIL

Following an anticipated mediocre performance in March, retail sales in the Third District have been very healthy in April. Retailers report sales increases of 25 percent to 35 percent over April '83; they attribute about half of that gain to the late Easter holiday. Despite the reported declines in national retail sales for the months of February and March, contacts here have not sensed a reduction in either consumer confidence or willingness to spend. In fact, credit sales as a percent of total sales continue to rise. Inventories at local department stores are reported to be slightly on the heavy side, but retailers say they have no plans as yet to undertake markdowns. Merchants report that they promoted heavily during the Easter selling season, but that current promotions are normal for this time of year.

Looking ahead, retailers foresee some easing in sales growth, but still forecast 5-15 percent increases over a year ago through September.

FINANCIAL

Bank contacts in the Third District report healthy growth in both commercial and retail loans since early March. C&I loan activity is maintaining the 10 percent to 15 percent rate of increase over 1983 levels which began in February. Contacts report that both large and small companies are borrowing money for capital expenditures, inventory financing, and working capital. Retail loan volume also has posted healthy advances during the past six weeks, and consumer loans outstanding now exceed last year's levels by 10 to 20 percent. Loan officers remark that the growth is attributable to automobile loans and credit card borrowing.

While most bankers foresee continued strength in loan growth for the remainder of 1984, some have cautioned that higher interest rates could discourage borrowing later in the year. On the retail side, local contacts unanimously forecast generally robust activity for at least the next two quarters.

The prime rate at Philadelphia banks is currently 12 percent, up from 11 percent six weeks ago. Bank economists are forecasting gradual upward movement in both short-term and long-term rates through the end of this year. They predict that continued GNP growth in the second quarter (3 percent to 4 percent), an increasing rate of inflation (5 percent to 7 percent), government borrowing demands, and a firm Fed policy will push rates gradually higher. Some local economists feel, however, that the FOMC will attempt to keep the federal funds rate at or below the 11 percent level for the remainder of this year. They believe that if second quarter growth appears to be within the 3-4 percent range and there are no unexpected jumps in the monetary aggregates in the near future, the Fed will be able to achieve that goal.

REAL ESTATE/CONSTRUCTION

Third District realtors and residential builders have begun to feel some effects of rising mortgage interest rates, which have climbed by 50 to 125 basis points over the last two months. Local rates for 30-year, 3-point fixed-rate conventional mortgages currently range from 13-1/2 to 14 percent. Although real estate sales firms report that sales have remained strong through early April, (15 to 20 percent higher than those of a year ago) some are now seeing a slowdown in activity. Local builders, however, report a more dramatic drop in sales over the last several weeks, which they say are now running 30 to 40 percent behind last April's strong pace. Both realtors and builders attribute the recent easing of activity exclusively to buyer nervousness over rising mortgage interest rates.

New housing starts also have slowed considerably as local builders express caution over the dangers of speculative construction during a period of rising interest rates. Builders also are concerned about the possible increase in the rate of buyer cancellations of contracts on houses already under construction. As a result, inventories of uncommitted homes are very slim. As for the future, industry contacts feel that if mortgage rates reach the "magic" level, somewhere between 14 percent and 15 percent, the industry will enter a sustained slump.

Fourth District - Cleveland

Summary.

Economic activity in the Fourth District continues to increase, but labor market conditions remain weaker than in the nation. Retail sales improved in April from March, but gains for the March-April period are smaller than for the previous two months. Output and prices in manufacturing continue to rise, and some primary metals and automotive production lines are operating at capacity. Housing construction and sales remain strong. Strike-hedge demand for coal is rising. Business loan demand remains strong at commercial banks.

District Labor Market Conditions.

Despite steady recovery, labor market conditions in this District remain weaker than in the nation. A banker estimates the unemployment rate for eastern Kentucky to be 16%. Ohio's unemployment rate in March was 3.1 percentage points below its year-earlier level but was still 2.4 percentage points above the national rate. Nevertheless, the average workweek in Ohio manufacturing increased 0.2 hours to 42.6 hours (n.s.a.) in March, after two months of declines, and the average workweek in automobile manufacturing increased to 46.2 hours, the highest since December 1978.

Unemployment rates in eleven major metropolitan areas in this District in February ranged from 7.6% in Columbus to 13.3% in Pittsburgh. An index of leading indicators for the Pittsburgh area has risen strongly in the last few months following a slowdown last autumn, suggesting substantial employment gains in the months ahead.

Retail Sales.

Retail sales recovered briskly in April from the previous month's slump. General merchandisers contacted, however, report less than 10% year-over-year gain for the March-April period as compared with increases of about 11% to 12% in the previous two months. Much of the April strength was concentrated in soft goods, especially apparel. New cars sales remained quite strong in April. Both domestic and import dealers report solid, across-the-board sales strength, which is expected to persist through the remainder of the quarter. Shortages were reported for some larger size models, and the waiting period for some import models has lengthened to about eight weeks.

Manufacturing.

Output and prices continue to rise. This Bank's survey of Fourth District manufacturers indicates that firms expected shipments to rise in April but at a slower pace than in March. A survey of northeastern Ohio purchasing managers indicates production and new orders rose again in April. Two-thirds of the respondents report prices paid are higher than a month ago, and none report lower prices. A survey of Cincinnati area purchasing managers indicates vendor performance is continuing to deteriorate while prices paid are rising. A major auto producer reports difficulty adding to production schedules that are at capacity for mid- and standard-size cars.

Primary Metals.

Demand for sheet steel and aluminum remains strong. A major steel producer reports that production is at capacity for sheet steel, which is used primarily in automobiles. The firm suggests demand for sheet steel may not increase further because automobile production has peaked and steel imports are readily available. Area steel producers report growing demand from the capital goods sector.

A major aluminum producer's fabricating facilities have been operating at capacity for a year. The firm is allocating supplies of aluminum sheet among customers for June and July deliveries because demand exceeds production capacity. The firm's smelters have been operating at capacity since autumn; however, some high cost smelters are closed and won't reopen unless aluminum prices increase by about two-thirds. World market prices of ingot aluminum have declined in the last three months despite apparent tight supplies, a phenomenon the firm cannot explain. World supplies of bauxite and alumina are reported to be ample.

Housing.

House construction and sales remain strong but are sensitive to interest rates. Builders of single-family homes report that construction activity during the first quarter of 1984 was up from a year ago, and barring a further rise in interest rates, construction in 1984 would match or possibly exceed last year's total. The "move-up" market remains strong and demand by first-time buyers is being bolstered by expectations that interest rates will edge up steadily as the year matures. Realtors, who reported record earnings in 1983, are currently experiencing a strong sales pace; even if interest rates rise slightly, they expect a fairly good housing market for the balance of 1984.

Lenders recently experienced a decline in mortgage applications. Applications for fixed-rate mortgages fell, but are being partially replaced by applications for adjustable rate mortgages (ARMs). Lenders say ARMs will keep the market buoyant until initial ARM rates reach the 13% - 13 1/2% range, which lenders now consider the "tolerance" rate.

Coal.

Coal prices are rising and demand and shipments are increasing in eastern Kentucky. Utilities are reported to be increasing stockpiles as a hedge against a strike when the United Mine Workers' contract expires on September 30.

Commercial Banking.

Loan demand remained strong at Fourth District banks in recent weeks. Business lending led the way and is expected to remain strong throughout the year. Consumer loans also increased, particularly auto loans. Bankers expect the pace of consumer lending to taper off somewhat, but expect overall loan demand to remain quite strong in the months ahead.

Net deposit inflows have been relatively flat with the lack of growth partly attributed to the April 15th tax deadline. Loans have been financed to a large extent with borrowed and purchased funds, and from the sale of government securities. Bankers expect deposit growth to pick up moderately in the next two months.

FIFTH DISTRICT - RICHMOND

Overview

Although there are some indications that the rate of expansion of the District economy has slowed, activity continues to increase. Also, at least a portion of the perceived slowing is attributed to recent weather conditions. Construction and agriculture, especially, have been hampered. On other fronts, industrial activity, retail sales, and mining remain robust, as do the underlying trends in commercial and residential construction. District coal production also continues to run well ahead of year earlier levels. In general, loan demand is also growing, but financial institutions appear capable of absorbing significant additional loan growth, especially if deposit forecasts come close to the mark.

Manufacturing

After allowance for seasonal factors, manufacturing activity appears to be still expanding generally. Shipments, orders, and order backlogs all showed further growth over the past several weeks, although the improvement was more narrowly based than in the previous few months. Manufacturing employment also seems to have gained, and the length of the average work week may have risen sharply. Our information indicates little change in manufacturers' inventories over the past month or so, only some very modest accumulation in raw materials. Most of our respondents still find current stocks at comfortable levels, although a few report them excessive. There is some sentiment for expanding inventories if sales continue to rise, but little expectation of a significant accumulation in the near future.

In general, current plant and equipment capacity is considered about right. There is occasional mention, however, of plants or industries facing possible short-term constraints. In particular, the paper industry and some of its customers, such as the gypsum wall board industry, may be near capacity. Isolated plants in the textile, furniture, automobile, and printing industries are also cited as examples.

Consumer Spending

Sales of general merchandise lines have made further headway in recent weeks despite some purportedly seasonal weakness in apparel and related products. It is generally felt that subsequent periods will make up for this weakness. Automobiles may also have gone through a lull, but continued improvement is widely expected. Other consumer durables such as furniture and appliances continue to do quite well, perhaps even gaining a larger share of total sales.

Retailers do report some inventory accumulation recently, but are generally comfortable with current stocks, as they are with the present number and size of outlets. Also, employment by retailers appears to have expanded over the past four to six weeks.

Housing and Construction

Adverse weather conditions have undoubtedly resulted in lost production in the construction sector since mid-March, and measured activity will certainly reflect this. Underlying trends in the industry remain strongly positive, however, and widely-held expectations are that the recovery will continue when weather permits. Both commercial and residential construction appear very strong if gauged by projects in various stages: plans, announcements, permits, starts, in progress, etc. Nearly all the evidence points to continued strength in the industry. In addition, house sales are still quite strong.

Banking and Finance

Loan demand at District financial institutions has grown somewhat more rapidly in recent weeks than earlier in the year, particularly on the business side. Nonetheless, consumer installment and residential mortgage activity remain strong. Financial institutions have the capacity to accommodate further loan growth, and many project that deposit growth will outstrip the expansion of loan demand in coming months.

Agriculture

Unseasonably wet weather during March and April has delayed farmers' plantings, possibly causing a shift from corn to soybeans for some. Avian influenza, which inflicted heavy losses on Virginia's poultry industry in the Shenandoah Valley last winter is continuing to plague turkey growers with sporadic outbreaks, resulting in sizeable economic losses. On the input side, farm production expenses are expected to increase only 2-4 percent in the current year, which, coupled with stronger expected product prices, is causing some optimism concerning farmers' profit positions this year.

The Outlook

The outlook around the District certainly remains positive, but is somewhat less ebullient than in recent months. There is no sense of an impending contraction, but more observers seem to see less and less capacity and opportunity for further growth.

SIXTH DISTRICT - ATLANTA

The pace of economic growth is slowing in the Southeast. Labor markets continue to strengthen largely because of ongoing expansion in the industrial sector. However, most manufacturers, fearful that the recovery is near its peak, are not initiating plant expansions and are monitoring inventories carefully. Growth in consumer spending has decelerated, but retailers are satisfied with current inventory levels. Rising interest rates contributed to a decline in residential construction in the early spring, but commercial building remains on the rise. Consumer and mortgage lending has slackened. Even the growth rate of business lending, which was strong throughout the first quarter, fell in April. Southeastern thrifts are avoiding sharply discounted adjustable-rate mortgages. Conditions in the travel industry are healthy despite rapid expansion of lodging facilities and the lingering effects of intense airfare competition last year. Pork supplies should not fall as drastically in the Southeast as in the nation, and the outlook for profitability in this segment of the agricultural sector is positive.

Employment and Industry. The unemployment rate in March fell on a seasonally adjusted basis in five District states. Defense contracts, tourism, and construction are boosting employment in Florida. Florida's 5.5 percent jobless rate was the lowest in nearly a decade. Manufacturing is sustaining much of the employment growth rates of recent months. Steel and aluminum production in Alabama recently increased. The forest products industry is operating near capacity, according to a trade association spokesman. Recent unfavorable weather conditions have hampered some timber harvesting, causing mills to struggle to meet surging demand. However, lumber industry representatives are concerned about the effect of rising interest rates on demand for wood products. Strong backlogs reported by contacts with oil surveying crews and seismic operations in Louisiana portend renewed drilling activity.

Contacts in most industries stress that greater utilization of present facilities is a top priority; plant expansions are infrequent at this time. Many producers, fearing that the recent surge in economic growth cannot be sustained, are maintaining a close watch over inventories. The strong dollar and slow recovery abroad are retarding the growth of manufactured exports from Miami to Latin America and of grain and coal exports from New Orleans and thereby limiting the recovery of foreign trade activity in the District. Port officials throughout the region foresee a continuation of slow export growth.

Consumer Spending. District retailers report a slowdown in March-April sales growth from the year-over-year advance recorded in the January-February period. Easter holiday sales were below merchants' expectations, but they were above 1983 levels. Electronics, home furnishings, cosmetics, shoes, and sportswear were among the top selling items this Easter. Retailers also report that there have been no significant increases in suppliers' prices and inventories generally are at desired levels. The monthly growth rate of car sales in the region remained strong in the first four months of 1984 but, in contrast to the 1983 pattern, has fallen below the national rate. Compact and medium-sized models are showing particularly healthy sales growth here.

Construction. Contacts in major District cities report decreases in single- and multifamily building permits from March to April following increases from February to March. Orlando, with 26 and 52 percent decreases in single- and multifamily building permits, respectively, experienced the greatest slowdown from March to April. Most respondents attribute the decline to rising interest rates and rainy April weather. The Federal National Mortgage Corporation is discouraging sharply discounted adjustable-rate mortgages (ARMs), and some private mortgage insurers have become reluctant to insure such ARMs. As financial institutions respond to this trend, higher income requirements for ARMs may be shrinking the pool of potential home buyers.

Nonresidential construction, measured in square feet, increased 57 percent from February to March, surpassing the national rise of 39 percent. Overbuilding is a concern in Atlanta's office market. Fears of further materials price rises and interest rate escalation have caused builders in Orlando to decrease speculative building and purchase forward commitments to guarantee current rates. Population growth and corporate relocations are also fostering development, but increased building costs and rising interest rates have spurred builders in some areas to rush projects in progress in case the boom should end soon.

Financial Services. Loan demand at banks has been strong through the first quarter. Business and real estate lending has grown most rapidly, although business lending slowed somewhat in early April. Consumer lending softened in the March-April period. Deposits, especially demand deposits, at large commercial banks declined in March. Contacts believe withdrawals for income tax payments caused the shrinkage. Savings and loan associations in Louisiana and Mississippi registered large increases in mortgage commitments, but higher mortgage interest rates dampened this activity somewhat in April. A poll of southeastern savings and loan associations revealed little usage of deep-discount (5-7 percent range) adjustable-rate mortgages. S&Ls have taken steps such as raising minimum income requirements to protect themselves from the heightened risk of such loans.

Regional interstate banking is gaining legislative momentum in the Southeast. Georgia has enacted a law permitting interstate banking, and Florida, South Carolina, and North Carolina have bills at varying stages of the legislative process. Meanwhile, banks outside the Southeast are taking advantage of a provision in federal banking statutes allowing out-of-state banks to operate consumer loan and deposit-taking facilities provided they refrain from offering either business loans or checking accounts. Over 30 institutions have applied to operate these consumer banks in Florida and Georgia.

Tourism. Most sectors of the tourism industry posted increases at the beginning of the spring season. Visitor center registrations were generally up in March, although the rate of growth in Florida was a narrow 2 percent, a reflection of both a deceleration in visitor growth and a later Easter. Respondents report that convention business is healthy, especially in Nashville and Orlando. Lodging tax revenues showed a double-digit percent increase over year-earlier levels in every state. Hotel occupancy rates, however, have softened from last year because of the large number of new rooms available. The 1984 World's Fair in New Orleans should help hotels in Louisiana, Mississippi, and Alabama. Reservations managers report strong bookings through the spring. Advance ticket sales to the Fair had been below expectations but have spurted in recent weeks.

Air traffic continued to rise in most smaller cities in March, but the Atlanta and Miami airports reported a drop in passenger volume of 2 percent and 3 percent, respectively. These declines reflect the elimination of sharply discounted fares, which inflated air travel a year ago. Cruise ship bookings are still slow but on the rise. Anticipating growth, several lines have launched new luxury ships from Florida ports.

Agriculture. In response to rising feed costs, pork farmers began to reduce inventories last year by marketing hogs earlier and breeding fewer sows. A recent survey suggests that reductions are continuing and this summer's farrowings at the national level will be the lowest since 1975. However, partial data for the Southeast imply that inventories here will remain at approximately 90 percent of 1983 levels. If normal crops are produced in 1984, feeding costs should decline in the fourth quarter and hog prices should rise, prompting an increase in production that will reach the consumer next year. Declining costs and rising revenues should improve the profits of pork producers. The pork industry generates over $800 million in annual farm revenue in the Sixth District.

SEVENTH DISTRICT--CHICAGO

Summary. The business improvement in the Seventh District continues, but the uptrend in retail sales slowed in the early spring and housing activity ebbed, allowing for seasonal trends. Employment has increased further, but gains are still concentrated in manufacturing. Despite sharply higher profits, cost reduction programs are still being pressed vigorously. Output of motor vehicles, paper products, gypsum board, and household appliances is high, often at or near full capacity. Nonresidential construction is showing new life, both private and public. Demand for most mechanical capital equipment has improved, but only moderately. Two major public utilities have serious financial problems, with no resolution in sight. Although leadtimes on deliveries of goods have stretched out further and price increases are more frequent, most items continue to be readily available. Inventory building is underway on a broad front, but appears to be voluntary and in line with plans. Despite evidence of slower growth, most District executives anticipate further gains in a highly competitive environment. Pressures to restrict imports are building, supported by business and labor groups. Farmland values declined again in the first quarter.

Cost-Cutting. Various companies whose sales and profits have increased sharply since the low point of the recession continue to press cost-cutting programs--eliminating marginal and replacing better-paid employees, consolidating functions, selling or closing less profitable operations, etc. In past expansions such efforts often were relaxed. New hirings require special approval, and early retirements are encouraged. Staff reductions through attrition are difficult because, reflecting slack labor demand, quit rates are a small fraction of the postwar average, and the lowest since the 1930s. Also cutting staff are banks, insurance companies, and other financial service companies facing intense competition. The medical field--hospitals, laboratories, and medical supply firms--has been laying off workers, after expanding rapidly for many years, because of pressures for "cost containment."

Business Climate. Interested groups are much concerned about publicity given to recent studies indicating that Midwest states are "inhospitable" to business. Problems cited include high wages and benefits, restrictive work rules, energy costs, taxes, unemployment insurance and workers' compensation, government regulation, and lack of special incentives to locate, expand, or remain in the region. Some charge that evaluation methods of the surveys are unfair and inaccurate, but there is general recognition that unfavorable "scores" have foundation in fact.

Job Markets. Increases in manufacturing employment in the District since the low point in late 1982 compare favorably with increases in the nation, mainly because of callbacks in the motor industry. Nonmanufacturing employment, however, has increased less than in the nation. For both manufacturing and nonmanufacturing the District experience compares unfavorably with the nation relative to the 1981 peak or to earlier years. Nevertheless, many factories are working long hours--seven-day weeks, heavy daily overtime, and extra shifts. Major food chains in the District have cut compensation of union workers substantially despite existing contracts. Executives say these moves were necessitated by growing competition from food discounters. Cuts in labor costs have been reflected in lower food prices.

Retail Sales. Merchants were somewhat disappointed by April sales, at least of soft goods. However, it is not believed that the underlying strength of the upturn has deteriorated. Sales of appliances, led by microwaves, have been "phenomenal". Other hard goods also have done well. Inventories, overall, are now slightly higher than had been budgeted, especially when goods on order are included, but not a cause of concern. General merchandise prices, up 2 percent in 1983, are expected to rise 3 percent this year.

Capital Equipment. Orders for capital equipment are rising, but with wide variations by category. Farm equipment remains very weak. Light construction equipment has improved, but not heavy types. Freight car orders are somewhat higher, but only specialized types, including piggy-back flatcars, auto carriers, and some bulk carriers. Machine tool orders have exceeded shipments this year, but the industry remains in "dire straits" because of sharply reduced cash flow. The paper industry is starting a new wave of expansion. There is no activity in new chemical plants, oil refineries, electric utilities, ore processing, cement, and gypsum board. A leading steel producer may build a large, modern cold-rolled sheet mill. Output of heavy trucks and trailers is at full capacity, and this is expected to continue into the second half. Traffic handled has increased sharply, and the trucking fleet aged and deteriorated in the past several years of low investment.

Housing. For the first quarter, housing permits were one-third above 1983, and four times the pitiful level of 1982, but less than half that of early 1977 or 1978. Sales of new and used homes slowed in the past month, except in particularly "hot" markets. The housing slowdown is attributed to a reduction in the overhang of deferred purchases, and concern over the soundness of ARMs that involve artificially low starting rates.

Nonresidential Construction. The uptrend in office building construction has gathered strength, but mainly in the Chicago area. Additional large buildings are getting underway. (Factory work is up, from almost zero, but still very low.) Leasing activity is up substantially and rents have firmed, belying "expert" forecasts early last year that the overhang of space would take several years to absorb. Highway construction projects are moving forward at a very rapid pace, after lagging earlier in the year.

Steel. Shipments of steel are expected to continue to rise through the year with a less than seasonal decline in the summer. Demand is strong for lighter steels to be used in vehicles, appliances, and housing, with output at virtual capacity. Inventories are building, on a voluntary basis, but remain low by past standards. Structurals are improving, but demand for heavy plates used in capital goods remains weak.

Agriculture. Our survey of agricultural bankers indicates that farmland values in the District declined nearly 3 percent in the first quarter, ranging from virtually no change in Indiana and Michigan to an unusually large decline of 6 percent in Iowa. Overall, farmland values were 5 percent below the year-ago level and 18 percent below the 1981 peak. Weakness in farmland values partly reflects asset adjustments by a small number of farmers. The major cause of forced sales has been debt-financed investments in the boom of the late 1970s, at high prices and high interest rates.

EIGHTH DISTRICT - ST. LOUIS

Economic activity in the Eighth District continued to increase in March and April, but the pace of the expansion slowed. Retail sales were moderately strong, but year-over-year comparisons were less favorable than during the winter. Industrial production rose moderately, construction remained vigorous, and employment increased. Farmers have been hampered by wet weather, but expectations of large plantings have stimulated seed, fertilizer and implement sales.

Outlook

Employers generally are optimistic about the near term outlook. In a recent survey of St. Louis area business firms, 32 percent planned to hire more workers in the second quarter of 1984, while only 7 percent planned staff reductions in the quarter. In a similar survey taken a year ago, 23 percent of the employers said they planned to hire more workers and 8 percent expected to trim their staffs.

Consumer Spending

Department store sales in the District continued to be above year ago levels in March and April. At six stores, sales during the two months averaged 5 percent above the same two months in 1983. Clothing items moved well, but appliance sales slowed. Inventories are higher than in January, but retailers do not judge them burdensome.

Auto sales have been strong. Several dealers report that March and April sales were 16 percent or more above year ago levels.

Dealers claim that sales would have been larger if popular models had been available. Sales of used cars and trucks also have been vigorous.

Rainy weather in March and April adversely affected home sales in the District; they were about the same as in the comparable months a year ago. Industry spokesmen, however, expect total home sales for 1984 to be at least 10 percent higher than in 1983. This year's growth in the sales of multifamily homes has been offset by a decline in single family home sales. Prices of homes are rising, but not out-of-line with general inflation. Construction costs have increased with a recent 5 percent wage boost, rising land prices and higher material costs. Builders and realtors expressed concern over increases in the mortgage interest rate: if it rises much more, sales are expected to decline greatly.

Manufacturing

Industrial activity in the District continued to expand moderately during March and April. Expenditures for capital equipment were strong, but most of the outlays were for replacement and modernization rather than for increased capacity. Inventories are higher than last fall, but with sales also up, they are generally still within the desired range. A few firms, however, reduced their production growth rates in order to prevent an unwanted buildup of inventories. A large firm in Arkansas cut back its operations significantly and laid off 450 workers because of slower sales.

Employment

Total employment in the District rose slightly in March and April with gains recorded in the manufacturing, construction and service industries. This increase, however, about matched the growth in the labor force, and the unemployment rate was little changed. Respondents indicate that summer jobs will be somewhat more plentiful this year than last.

Agriculture

Farmers plan to plant substantially more acres this year than last, when the PIK program caused a marked reduction in crops. As a result, implement, seed and fertilizer sales have been much improved. The amount of land planted in April, nevertheless, was negligible because the ground was too wet to work. This delay will not become critical, however, for another two weeks or so.

Finance

Banking data indicate little net change in credit and deposits in March and only a moderate expansion in the first three weeks of April. Commercial and industrial loans increased $120 million at 12 relatively large District banks from the end of February to late April. Real estate loans rose only $10 million, while consumer installment credit was up $50 million. Time deposits climbed by $70 million, while demand deposits expanded by nearly $300 million.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District's growth prospects, while still good, have moderated somewhat over the past few months. Consumer spending has been slowed a bit by bad weather and a slack farm economy. Employment, however, has continued its usual seasonal improvement. Also, though the agricultural sector is still suffering from a general malaise, some scattered signs of improvement have appeared. Resource-related industries have improved as well, with the production of taconite, coal, oil, and wood products all firming. Meanwhile, loans and deposits haven't appreciably changed.

Consumer Spending

Primarily due to bad weather and a slack farm economy, spending for general merchandise has been at a little lower rate than usual in the district. One large district retailer reports that its sales this March were only 5 percent greater than its sales last March. A chain of department stores reports that its February and March sales in the Twin Cities were "disappointing." While bad weather has kept some rural residents shopping in local stores rather than in urban malls, rural shopping throughout the district has been restrained by the generally slack farm economy. Reflecting this, Bank directors report spotty sales figures in Montana, South Dakota, and parts of Minnesota outside of the Minneapolis-St. Paul area. However, according to the limited data available, consumer spending improved throughout the district in April, thanks to better weather and Easter sales.

Regional auto sales have continued to show the strength evident in previous months. Large domestic automakers report that monthly vehicle sales increased 50 percent between February and April. One large automaker reports that both auto and truck sales were up substantially from comparable 1983 levels and that current inventories are low. Corroborating this, Bank directors report good to strong sales in the cities within Montana, the Dakotas, and western Wisconsin.

While home buying increased in the first quarter of 1984, March sales failed to match the very high level of March 1983. In the Twin Cities, both unit and dollar sales were between 10 and 20 percent below year-ago levels in March, whereas in January and February sales had been between 10 and 20 percent above year-ago levels. Scattered reports indicate, though, that home sales remained good in other parts of the district, including Fargo, North Dakota, and western Wisconsin.

Employment

Labor market conditions have continued to improve. The seasonally unadjusted unemployment rate in Minnesota fell from 7.9 percent in January to 7.1 percent in March, despite an increase in the labor force. Employment growth has been particularly robust in the Twin Cities area, which has now regained the jobs lost during the recession. Also, initial unemployment claims in Minnesota were 28 percent lower this March than last. In Minneapolis, the help wanted advertising index for February was more than double its level last February. Improvement was also noted in other parts of the district. The unemployment rate in west central Wisconsin fell from 10.7 percent in January to 10.1 percent in February. The unemployment rate in the Fargo, North Dakota, area also fell between those months, from 5.1 percent to 4.6 percent. Meanwhile, the unemployment rate in the Upper Peninsula of Michigan remained over 20 percent, but the recently announced construction of a large paper mill should help in the future.

Agriculture

The generally gloomy agriculture picture described in our last report has brightened only a little lately. Dairy farmers are still having problems in Minnesota and western Wisconsin, and the federal dairy diversion program is not expected to help much. Farm auctions and loan delinquencies are prevalent. Cropland values continue to fall in South Dakota. Moisture conditions are below normal in parts of Montana, hurting the prospects for the winter wheat harvest. Farm equipment sales continue to be slow. Some comfort can be taken from the recent 1 percent rise in Minnesota's farm price index, from scattered reports of increased land prices, and from the continuing strength in livestock markets.

Resource-Related Industries

Signs of improvement have been visible in several resource-related industries. Due to increased demand, all taconite plants in Minnesota are now operating, albeit at an average of only 53 percent of capacity. Two plants are running at 75 percent of capacity in the Upper Peninsula of Michigan. Coal production is up in Montana, but no new mines are foreseen there or in North Dakota. Oil production is picking up in Montana and may be picking up in North Dakota. Oil lease prices are higher in Montana now than a year ago. Wood product sales are continuing to build throughout the district. Waferboard plants are running constantly, and prices have firmed. Paper production is still high in the district, and a large new mill is being built in the Upper Peninsula of Michigan.

Finance

Neither total loans nor total deposits appear to have changed much early this year. Commercial and industrial loans at banks in the Ninth District rose a bit in February and fell a bit in March, leaving the level about the same. Deposits at savings and loan associations in Minnesota fell slightly in February. Deposits have been fairly stable in rural areas recently. Still, both loans and deposits were around 10 percent higher than a year ago in the first quarter.

Variation is seen among other loan categories. Consumer loans have reportedly increased a bit in North Dakota and southern Minnesota. However, agricultural lending has been fairly flat, partly because of the higher cost of money in rural areas where incomes are depressed. Banks are keeping fairly liquid in most rural areas of Montana, where few good lending opportunities exist.

TENTH DISTRICT -- KANSAS CITY

Overview. The current moderate improvement in Tenth District economic conditions is expected to continue. Retail sales in early 1984 have been well above a year earlier, except in rural communities. A gradual slowdown in sales growth is expected, however. Prices are expected to be stable to slightly rising, both at retail and for materials inputs. Lead times on materials inputs are increasing, leading to some inventory expansion. New car sales are good in most district states. Housing starts are strong, but builders expect a slight decline as the year progresses. Demand for mortgage funds is down somewhat at savings and loan associations, which report making over 80 percent of new loans on an adjustable rate basis. District commercial banks report modest deposit growth and weak loan demand, with demand strongest for consumer loans. Winter wheat conditions vary widely across the District, depending on local disease and moisture conditions. Spring crop planting has been delayed in much of the district by excessive rain.

Purchasing agents. Most Tenth District purchasing agents contacted report input price increases of 5 to 10 percent since April of last year, but few report significant increases during the last three months. A majority expect further increases of 5 to 10 percent during the remainder of the year. Nearly all respondents report increasing lead times and some problems with availability of inputs, with little improvement expected over the course of the year. In general, materials inventories are at satisfactory levels after recent expansion in response to increasing sales and worsening lead times.

Retail trade. Most retailers report sales for the first three months of 1984 well above a year earlier, except in rural communities where there has been little or no improvement. Because of extremely competitive conditions, retailers have not raised prices. Furthermore, aside from increases to maintain markups if costs rise, prices are expected to remain stable through 1984. Many retailers report high inventories which they intend to trim. A gradual slowdown in sales growth is expected for the rest of 1984, but sales are expected to stay above year earlier levels.

Automobile sales. Automobile dealers in the Tenth District report generally improved sales in 1984 relative to a year ago although some areas of weak sales still exist, particularly in rural areas. Gains were strongest in Missouri and New Mexico, and weakest in Colorado. Domestic inventories are being expanded where possible in expectation of continued strong sales, while very low inventories continue to suppress the sales of imports. Most dealers report that funds are available both for floorplanning and for customer loans. All dealers contacted are optimistic about the outlook for sales through 1984.

Housing activity and finance. Home builders report housing starts are up from a year ago despite recent bad weather, but are expected to fall slightly as the year progresses. Sales of new homes are lagging slightly behind year-ago levels. New home prices are up 5-10 percent over a year ago. Home builders report no problems in obtaining materials. Savings inflows at savings and loan associations are generally unchanged from last year but are expected to increase slightly through the rest of 1984. Increased mortgage rates have slightly reduced the demand for mortgage funds. Further rate increases are expected to weaken demand the remainder of the year. Savings and loan associations are aggressively marketing adjustable rate mortgages with 80-100 percent of all new loans made in this form. Because the rates on most ARM's are tied to an index which lags market rate changes, recent increases in market rates have not yet resulted in significant collection problems.

Banking. Bankers' reports on both loan growth and deposit growth differ widely, ranging from slightly stronger to weak. Only in Colorado and Northern New Mexico do conditions seem uniformly good. Surveyed bankers report a slight increase in loan demand during the past month. Demand is strongest for consumer loans, especially auto loans, and for commercial real estate loans. A few bankers report a slight increase in residential real estate loans. Demand for commercial, industrial, and agricultural loans is flat Districtwide, however. The prime rate has increased to a range of 12 to 13 1/2 percent from a range of 11 to 12 1/2 percent last month. Most Tenth District banks report a slight increase in deposits from last month, nearly all due to MMDAs, IRAs, and Keogh accounts. Conventional NOW accounts and demand deposits increased slightly in the last month while Super-NOWs and passbook savings accounts remained constant. Large CDs also remained constant Districtwide, reflecting weak loan demand and modest deposit growth.

Agriculture. Winter wheat conditions throughout the Tenth District range from poor, due to disease or lack of moisture, to good. District bankers report that farmers' sign-up for the government's revised 1984 wheat program thus far has been high. The planting of spring crops in all but the southwest area of the District has been delayed by at least two weeks due to excessive rain. The calf crop in most of the District is above average with calving rates as high as 95 percent in some areas. Some yearling cattle are being sold this spring; others will be pastured until fall. Ample funds are available for farm operating loans this spring. Farm credit problems, however, are at least equal to those of last year, with some farmers wholly or partially liquidating assets to reduce farm debt. Unless farmers can substantially reduce their debt this year, farm liquidations will likely rise. Farm real estate values continue to decline as the supply of land on the market increases, but relatively few sales are being reported.

ELEVENTH DISTRICT--DALLAS

The Eleventh District recovery continues strong despite the sluggish energy sector. Manufacturing employment increased for the second consecutive month in March and overall production was 13 percent above its low during the fall of 1982. Brisk auto and retail sales are ahead of the strong pace set last year. Residential and commercial construction maintained their overall strength, but, a decline in multifamily starts may suggest further weakness in that area.

District manufacturing activity is healthy. Manufacturing related to construction, consumer goods, and electronics account for almost all of the gains. Strong consumer spending and high levels of residential and commercial construction led to increases in the demand for nonelectrical machinery used to produce electrical goods and consumer durables. The demand for fabricated and primary metals is greater than one year ago and this strength can also be traced to construction and consumer expenditures. Mills for manufacturing paper products and materials for residential construction are running at or near capacity. Strong consumer spending is also buoying the demand for apparel with the increases being reflected in higher employment and output. The economic recovery is finally impacting the production of chemicals and plastics. Some firms have responded to the strong demand by running multiple shifts. Primary metals and chemical manufacturers indicate that intense domestic and foreign competition is squeezing profits and reducing market shares. Domestic firms hope to counter this pressure by using their technological advantage to develop new products and improve their competitive position. Manufacturing firms in the District are continuing to implement controls to maintain lower levels of inventory without hindering their ability to meet demand.

Continuing weakness in the energy sector is mirrored in the District's rig count which is down 12 percent from the first of the year and is only 9 percent above year-earlier levels. The lack of a significant increase in drilling means the dismal picture for this sector is likely to continue. Despite the overall weakness, the Texas offshore rig count has registered a 38 percent increase since January. This can be attributed to reduced drilling costs and recent leasing of favorable tracts offshore. Some oil field suppliers reported reductions in inventories and spot shortages of certain products used in drilling. This may portend an upturn for manufacturers and suppliers of oil field equipment later this year.

Auto sales are outpacing their increases of the previous year. Higher interest rates have not had noticeable effects on consumer attitudes or purchases. Sales would have been even higher but for shortages of the more popular models. Increased car production is mitigating inventory constraints, pointing to a strong 1984.

Retail sales maintain their strength. Some respondents reported declines in March but these were more than offset by mid-April sales and both months were well above the same period a year ago. Demand for durable goods in particular is benefitting from homebuilding and continued consumer optimism. Inventories are being increased because of retailers' bright outlook for the economy and a fear of shortages.

The boom in office and commercial construction is continuing with the exception of Houston, where the depressed energy industry has dampened demand for office space. Vacancy rates there have reached record levels. Industry analysts are predicting higher vacancy rates in Dallas but, to date, these expectations have not prevented marked increases in office construction. The value of new office and commercial development for the first quarter in Dallas is 43 percent above the level for the same period in 1983.

After leading the recovery with a stellar performance, residential construction growth is beginning to slow. Permits and starts of single family homes are still increasing but the number of new multifamily units has dropped significantly, reflecting fears of overbuilding. In Dallas alone, permits dropped 42 percent in March.

Total loans increased at savings and loans and the District's large banks. The rate of growth in real estate loans has slowed while remaining significantly above last year's March figures. Overbuilding in multifamily units has induced caution among lenders.

Farmers are benefitting from increasing commodity prices. Drought continues to plague about one-third of the District. Most cotton producers are not affected by the current drought and sales should increase because of brisk export demand and moderate growth in domestic consumption.

TWELFTH DISTRICT -- SAN FRANCISCO

The Twelfth District economy appears to be growing at a slower rate than earlier this year but still to be outperforming the nation. Consumer spending strengthened in April, with rising interest rates reported to have had no dampening effect on durable goods sales. Western homebuilding activity has slowed since January, but remains far stronger relative to a year ago than nationally. Nonresidential construction activity continues to pick up, but there is some concern that vacancy rates in office and commercial buildings are rising. In the manufacturing sector, employment and output generally continue to grow but at a slower rate, partly due to the effects of the housing slowdown on such industries as lumber and the near full capacity operations reached in a few industries such as aluminum and paper. In California, agricultural crop growing and demand conditions generally are considerably better than a year ago, but wheat farmers in the Pacific Northwest are experiencing another difficult year. Loan demand at Twelfth District banks has continued at a strong pace despite higher interest rates.

Consumer Spending

Consumer spending appears to have increased more than seasonally during April. Major department stores in Southern California, for example, experienced an average 11 percent year-to-year gain in sales during the first half of April compared with a 10 percent rate of growth for all of March. In other Western states, sales also increased, although the year-to-year gain was not as large. Sales of apparel have been especially strong -- up 25 percent at Southern California department stores. But furniture, appliances and other durable goods also are selling well and have not been adversely affected by higher interest rates. Auto dealerships have been experiencing much larger sales gains than department stores, even in rural areas, and sales would be even higher were it not for shortages of some larger-size vehicles. Auto financing charges to consumers have risen only slightly due to competition created by captive automobile financing companies. Except for autos, retail inventories are reported to be somewhat heavy.

Manufacturing and Mining

Manufacturing employment continues to expand among a wide spectrum of industries but at a slower rate overall than during the fourth quarter. The most rapid gains continue to occur in the electronic equipment and missiles and space vehicles industries located in California, Oregon, Arizona and Utah. Electronic firms have been benefiting not only from rising defense and consumer demand but business capital spending to enhance efficiency. Other capital goods industries adding to their payrolls include nonelectrical machinery, trucks and aircraft. In Washington, the nation's leading manufacturer of commercial transport planes has been adding workers since October but recently reduced its sales forecast for the 1985-87 period. The Pacific Northwest lumber industry has been experiencing a decline in orders and prices recently due to the slowdown in national homebuilding. Two other Pacific Northwest industries -- aluminum and paper -- are reported to be operating at near full capacity, as is the California semiconductor industry. Apart from these industries, the manufacturing sector throughout the West generally still has ample unused production potential. After a period of stability in payrolls, the copper and coal industries have been laying off workers.

Construction and Real Estate

Homebuilding activity in the West has slowed since January in response to the rise in mortgage interest rates. But as of March, Western starts still remained 22 percent higher than a year earlier compared with only a 3 percent year-to-year gain nationally. Housing sales remained strong through March, but are reported to have dropped 10-20 percent in April. This slowdown in sales, combined with the large number of new homes recently completed, has resulted in an increase in the inventory of unsold homes which suggests that Western housing starts could fall in the next few months. Respondents point to several factors which indicate that any such decline could be moderate however. These factors include the rapid increase expected in personal income in the West, the increased public acceptance of adjustable rate mortgage packages -- which offer initial rates as much as 3 percentage points below conventional fixed rate mortgages -- and the increased offerings of "buy-down" programs by builders. While respondents report a sharp increase in nonresidential construction activity, they express concern that the supply of new office and commercial space is already beginning to outstrip demand. Firms continue to be cautious about investing in new industrial structures, except for electronic equipment manufacturers, especially semiconductor firms.

Agriculture

Agricultural conditions and prospects vary among the District states. In California, crop conditions generally are considerably more favorable than a year ago. Prices for most fruit and vegetable crops produced in the state are up sharply from those of a year ago, partly as a result of the winter freeze in Florida and Texas. Planting and growing conditions are far better due to improved weather. For example, planting of cotton is in full swing under excellent weather conditons. Tree crops are budding early, suggesting that yields of tree fruits and grapes will be moderate and prices higher. In the Pacific Northwest, farmers are experiencing another difficult year however. In Idaho, over 50 percent of last year's wheat crop is in storage. Prices for the Fall wheat crop are expected to be only slightly above the break-even point for most farmers in Washington and Idaho. Farm property values are declining in the Pacific Northwest and a few scattered areas of California. Bankers estimate that around 5-7 percent of California's farmers are in extreme financial difficulty but that the percentage is considerably higher elsewhere in the District.

Financial Institutions

Rising interest rates over the last two months have been reflected in loan rates, but have not yet had a significant impact on loan demand in the Twelfth

District. Commercial loan rates have shown the largest increase because they float in accordance with market rates. Consumer loan rates at the major banks in the region generally have risen by a smaller amount -- 25 to 100 basis points on most fixed-rate loan products. Qualification standards, and other loan pricing terms at most institutions, generally have remained unchanged. The increase in rates has had mixed effects on loan demand among institutions. In some cases, the strengthening economy has overcome rising rates; other institutions report weaker loan demand. For the District as a whole, large banks continue to report rapid growth in commercial and consumer loans, and moderate growth in mortgage lending. Banks anticipate continued strength in demand for commercial loans, especially as borrowers accelerate their takedowns of the large loan commitments used to finance merger activity. However, institutions are concerned that further interest rate pressure could begin to have a significant dampening impact on real estate loan demand.