SUMMARY OF COMMENTARY ON ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

June 1985

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SUMMARY*

The pace of economic activity in all Districts seems to be slowing across most sectors. Retail sales generally continue to sag yet inventory levels appear satisfactory and the outlook remains optimistic. An important exception is auto sales which are strong in most areas and the strength is extending to suppliers. While primary metals manufacturing is improving in some areas, manufacturing growth in general seems to be modest or declining. Residential construction is a source of strength throughout the country, but signs of weakness exist in parts of some districts. Non-residential construction is mixed. Agricultural conditions remain difficult almost everywhere, but financial problems appear concentrated in the Plains states. Mining and drilling activity is declining throughout the country. Bank loan activity is mixed with most growth occurring in the consumer sector.

Consumer Spending

Consumer spending has slowed in recent weeks and continues to vary widely across the country. Six districts report generally weak sales; strong sales are reported by Richmond and St. Louis. Atlanta and San Francisco report a more mixed picture with significant growth in much of their districts but still some sluggishness in certain areas. In general, demand in the automotive sector appears strong, as a result of lower interest rates and promotions by manufacturers and dealers. Retailers' inventories were generally at satisfactory levels, but Chicago, Minneapolis, and Kansas City report that some actions have been taken to reduce stocks. Automobile dealers reported tight inventories, especially for imports, in three midwest Districts.

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*Prepared at the Federal Reserve Bank of New York.

The outlook for consumer spending was generally optimistic across the country; lower interest rates and increased mailings of tax refunds were commonly expected to boost demand. Only Dallas mentioned expectations of further slowing.

Industrial Activity

Manufacturing activity seems to have slowed in much of the country, but remains varied across districts and industries. Five districts reported weak or slowing industrial activity, and four reported stable levels or only modest growth. The only report of sharp improvement was for Missouri. The outlook generally is for little change, but Philadelphia and Cleveland report moderation of growth forecasts, Dallas reports an increase in optimism, and some observers in the Eighth District expect a slight improvement.

Business for primary metals producers was mixed. Continued distress for steelmakers was reported in the Cleveland district and in the Chicago area. Minneapolis noted that iron ore processing cutbacks are soon expected. However, steel and other metals producers report gains in the Dallas District as well as in New York, Alabama, and the Detroit area.

Two districts report slowing in high-tech industries. Boston and San Francisco both report weakness among semiconductor firms (with signs of recovery only in Arizona), attributed to weak domestic demand. Business for New England computer manufacturers was mixed. Suppliers to the auto industry have benefitted from that industry's strength, according to reports from Boston and Chicago. Energy-related producers in three districts report slack demand.

There were several reports of hardship caused by import competition and the strong dollar. Reports of adverse impacts come from steelmakers (Cleveland), manufacturers of home appliances and capital equipment (Chicago), paper producers (Atlanta and Dallas), the lumber industry (San Francisco), and apparel and textiles firms (Richmond and Atlanta).

Construction and Real Estate

Construction activity varied greatly across the United States. Residential construction has been proceeding at an exceptionally rapid pace according to New York, Boston, Minneapolis, and Richmond; but Atlanta, St. Louis and Kansas City report some areas with significant weakness. Non-residential construction slowed in the New York and St. Louis districts, and Cleveland indicates that no new construction contracts are expected for the next few years due to recent overbuilding. In contrast, absorption is "strong as ever" in Atlanta. The market was "vigorous" in the Chicago district but observers believe a glut may develop next year when a great deal of space comes on line. Industrial construction has been increasing according to reports from Richmond.

Agriculture and Mining

Weak prices across commodities continue to compound the difficult conditions in the farm sector. Dairy prices and output are weakening largely due to reduced federal support. St. Louis, Dallas, and San Francisco report attempts to reduce inventory in livestock. Good weather and early planting using full acreage should yield large harvests in the autumn in most areas except South Dakota and Montana, where dry conditions currently prevail. This may put additional price pressure on farmers. Vegetable, fruit, and poultry producers in the Mid-Atlantic and the West coast, however, seem to face a much better outlook than others.

Most natural resource industries seem to be hard hit. Dallas notes a continued slide in the number of drilling rigs, primarily due to declining petroleum prices. Richmond and San Francisco report employment declines in mining. Minneapolis contacts, however, observe a boom in the wood products industry as a result of strong construction activity. Forest fires in the Sixth District have created tremendous, and largely uninsured, timber losses.

Finance

Despite the sluggishness of retail spending, growth in total loans seems to be sustained primarily by consumer lending. St. Louis, for example, reports a retail lending increase of more than 30 percent over last year. Chicago notes, however, that the rapid rise in consumer credit is accompanied by a rising deliquency rate. For the most part, real estate lending remains strong, while weakness in commercial lending seems widespread and Dallas has even been experiencing a decline in business loan volume. Only Philadelphia and San Francisco report continued strength.

Financial pressures in agriculture seem to remain concentrated in the Plains states. Kansas City reports that agricultural bank closings have shut many farmers out of the credit markets due in part to higher credit standards of the remaining banks. Chicago adds that pressures seem to be increasing on the cooperative Farm Credit System.

FIRST DISTRICT - BOSTON

Economic activity in the First District remains sluggish. This sluggishness is particularly apparent in the manufacturing sector, where high technology companies continue to announce layoffs and furloughs. Firms in more traditional manufacturing industries report that employment is trending downward in response to fairly flat order rates; but, for most, layoffs are not required. Inventory-to-sales ratios are said to be higher than desired but coming down. The experience of the retail sector is more mixed, with some contacts enjoying strong sales increases and others seeing a slowing in growth. Retailers remain optimistic about the rest of the year and are currently ordering winter merchandise based on this optimism. Increases in both industrial and retail prices remain very moderate. In contrast to the sluggishness of the manufacturing sector and the confusing signals from retailing, the real estate market is booming.

Retail

Retail results continue to be mixed in the First District. Several retailers enjoyed a strong performance in May; others reported some softening in sales growth. On both sides of the performance scale, however, retailers with national affiliations felt First District results were at least as strong as those of their affiliates elsewhere.

Merchants with "upscale" customers appear to be faring somewhat better than discount stores, although the difference is not great. Several contacts mentioned especially strong sales of video-related merchandise, computers, and VCRs. Toys and women's apparel are also performing well.

Inventories are higher than last year in several cases, but are not a source of concern among the merchants contacted. In one case, inventories are high because sales did not meet expectations; another supplier, however, has intentionally increased inventories faster than sales so as to improve customer service.

Firms are currently ordering merchandise for next winter's holiday season and are building into those orders expectations for a good sales season - as good or better than year-over-year growth to date. A contributing factor, according to one contact, is that interest rate declines have reduced the costs of carrying this merchandise. Prices are steady. Fall prices for one merchant, for example, will be only 2 1/2 percent higher than last fall.

Manufacturing

A number of First District high technology companies have announced layoffs and furloughs in the past two months. Layoffs have been especially prevalent among manufacturers of semiconductor test and production equipment; most of these layoffs have been fairly small, affecting a couple of hundred people each. The largest individual layoffs have been at computer companies; in one case, 1,000 workers in the First District have been dismissed. However, the employment situation in the computer industry appears to be more varied than for firms selling to the semiconductor industry: some computer companies have avoided layoffs but are shrinking staff through attrition; others are still hiring. A slowing in domestic orders is said to be the primary reason for the high tech companies' difficulties. The effect of the slowdown has been magnified by the rapid expansion that preceded it; during this expansion firms added to capacity and built up staff in anticipation of continued rapid growth. Despite current difficulties, however, the high tech firms contacted are not curtailing their capital spending plans; these expenditures are seen as necessary to bring out new products and remain cost competitive.

Firms in more traditional manufacturing industries report only small changes in aggregate order rates. Although one contact reported that overall business was down and would require layoffs, most manufacturing respondents have seen order decreases in some divisions offset by gains in others. Sales to the auto industry are good. Sales of housing related products are mixed. Sales of capital goods depend very much on the condition of the customer's industry, but appear to be holding steady overall. As in the case of high tech companies, traditional manufacturers have not changed their capital spending plans. For the firms contacted, planned expenditures are about the same as or less than expenditures in 1984; however, spending in 1984 is said to have been unusually high. The emphasis in capital spending is on increasing productivity rather than adding to capacity. In particular, there seems to be little need for additional floor space; according to one respondent, today's machinery is much more compact for the same power and value.

Inventory-to-sales ratios are a little higher than desired but coming down. Industrial prices remain very well behaved. All respondents report that price increases for materials and supplies continue to be very modest; several commented that they are encountering greater resistance to increases in their own prices.

Real Estate

The real estate market is booming, especially in the Boston area. Realtors report a low number of listings while demand, said to be fueled by declining mortgage interest rates, is running very high. Many realtors report that it is a "sellers" market. They expect this situation to continue in the near future and intensify if mortgage interest rates decline further.

New residential construction centers on condominium developments and higher-priced homes. Realtors report that very few moderately priced housing units are being constructed. Also, condominium conversions are continuing at a rapid pace.

SECOND DISTRICT--NEW YORK

Activity in most sectors of the Second District economy slowed in recent weeks. Sluggishness of consumer spending has continued for the last few months, although many stores in the area were still doing somewhat better than for the nation as a whole. Fewer firms reported improving business conditions than did earlier in the year. Commercial real estate brokers indicated growing concern that their "boom" may be over. A major bright spot was in residential construction, where homebuilders reported the best market conditions in years. On the financial side, consumer loan rates began to decline, reflecting the trend in general market interest rates.

Consumer Spending

The pace of consumer spending in the Second District continued to slow over the last two months. Although several retailers reported that business in the metropolitan area was slightly better than in other parts of the nation, gains over 1984 averaged only about 2 percent for April and 4 percent for May. Sales for some merchants continued to fall short of expectations by significant margins. Nevertheless, inventories were generally close to planned levels, and promotions continued at a normal pace with few special price markdowns. One department store chain, however, reported especially weak sales even with extensive promotions, and was returning some unsold summer merchandise to suppliers.

Business Activity

The erratic business expansion seems to have slowed recently in the District. While the majority of purchasing agents still reported improved or stable business conditions, fewer firms reported improvements in May. In

Buffalo, moreover, more firms indicated that new orders had fallen. In line with this moderation of economic activity, firms have been undertaking inventory reductions in recent weeks.

Major capital investment projects continued to be announced, however, including two joint ventures involving foreign investors. Toshiba and Westinghouse will retool and restaff an Elmira plant (which had been closed for nine years) to produce TV tubes and computer display screens. In addition, the government of Yugoslavia will participate in a project to convert part of Bethlehem Steel's abandoned Lackawana plant to an aluminum mill. These undertakings would add several hundred jobs to areas facing persistently high unemployment rates.

Other large projects recently begun or announced in the District include the construction of a new shopping mall and the expansion of two existing ones in Niagara County, as well as a new financial center and corporate headquarters in downtown Albany.

Construction and Real Estate

Residential construction activity remained robust, with builders and suppliers reporting the best market conditions in many years. Lower mortgage rates have added an additional stimulus in recent weeks, according to our contacts. Home prices have risen above year-earlier levels, sharply in some areas. The outlook for the rest of the year is for continued strength, and some homebuilders already are optimistic about 1986. Skilled labor remained scarce in some areas, and some construction schedules have been delayed. Observers in various parts of the District also reported price increases for developed lots, lumber, or other materials.

The New York City government has proposed major zoning revisions to reduce the construction costs for apartment houses. The changes could encourage the construction of up to 5,000 new units annually, at 25 percent below current costs, according to the City's estimates.

Real estate brokers are becoming concerned that the "boom" in the region's office market may be over. Availability rates remain very high, over 20 percent in some areas, yet net absorption is not increasing. The outlook is uncertain, with the strength of commercial construction depending on the performance of the general economy in the coming months.

Our contacts also expressed uncertainty regarding the impact of the President's tax proposals. Most agreed that real estate would be a less attractive investment, especially to small investors and syndications. A slower pace of investment could depress property values, at least in the short run, but one observer was optimistic about the longer-term stimulus of the tax plan. Some brokers also believed that investment in Manhattan and Long Island might be discouraged to some extent by the elimination of state and local tax deductibility. Fairfield County (Connecticut) and northern New Jersey might derive some relative benefit.

Financial Developments

Consumer lending rates began to recede from their recent high levels, reflecting the downward trend in market interest rates. Some commercial banks in the District already have cut consumer rates, and our contacts all agreed that the spread between consumer and market rates will narrow soon. Auto loan rates appeared to have fallen the most sharply, and bankers expect this downward trend to continue. Rates on personal loans have fallen only slightly and remain very high, but are expected to decline further. In contrast, credit card rates have not declined and are not expected to fall in the near future. Bankers attributed the reluctance to lower finance charges to high operating costs.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District are mixed. Manufacturing activity is basically unchanged in June for the third consecutive month. Retail sales are flat and, for some major stores, below expectations for this time of the year. The financial and real estate sectors are more positive. Both commercial and consumer loan volume at area banks in June is greater than it was at this time last year, but the rate of increase is slowing. Mortgage lending is increasing rapidly, reflecting increased real estate sales. In the agricultural sector, some area farmers are under financial pressure, but overall conditions appear to be better than in other parts of the nation.

On balance, the outlook for the Third District economy, although weaker than it was a few months ago, is still positive. In manufacturing, about 40 percent of the industrial establishments participating in the June Business Outlook Survey anticipate improvement over the next six months. Retail merchants expect a slight improvement in sales between now and the start of the holiday shopping season, despite the present slowdown. Area bankers forecast slower but sustainable growth in commercial lending and a slackening in the growth of consumer credit from its rapid pace earlier this year. Real estate sales and mortgage lending are expected to accelerate as long as interest rates do not rise.

MANUFACTURING

Manufacturing activity in the Third District remains generally stable in June for the third month in a row, according to the most recent Business Outlook

Survey. Seventy percent of this month's survey respondents say there has been no change from May in their rate of operations; however, the portion reporting a decline (18 percent) exceeded the portion indicating an increase (11 percent) for the first time since September 1982. The rate of shipments in June was the same as in May, but new orders dropped marginally, pulling down producers' backlogs and delivery times. Although workforces were reduced at one-fifth of the industrial plants surveyed in June, most survey respondents said their employment was stable.

In reply to questions about general business activity during the rest of the year, 40 percent of the June survey respondents said they expect present conditions to persist, more than one-third look for improvement, and nearly a quarter expect further deterioration. The outlook for increased employment and capital investment is growing dimmer. The portion of manufacturers scheduling increases in expenditures on new plant and equipment fell to 20 percent of those participating in the survey this month, the lowest level yet this year. Little change in factory employment is likely in the near future. Less than 20 percent of the June survey respondents plan increases in either payrolls or the length of the workweek over the next six months.

RETAIL

Retail sales have been flat in the Third District over the past two months. Local merchants say there has been no increase in sales in either May or June compared to April. Sales volume is also unchanged compared to the same period last year. Sales of home goods and higher priced items have been particularly weak.

Cautiously optimistic is the term store managers use to describe their short-term outlook. For the months remaining until the Christmas shopping season, retail sales are generally expected to post gains of 5 percent or more above year-earlier periods, with the most optimistic retailer forecasting a 10 percent increase. Lower interest rates and the faster pace of income tax refunds are cited as factors tending to boost consumer spending.

FINANCE

Borrowing in the Third District remains strong, with both business and consumer loans up substantially from a year ago. Consumer loan volume is approximately 25-30 percent higher than it was in June 1984, with credit card and automobile loans accounting for most of the increase. Commercial and industrial loan volume at Third District banks in early June is approximately 17 percent higher than it was twelve months ago. Business borrowing is likely to ease off in coming months, however; many borrowers have been able to improve their balance sheets recently and are likely to have less need for borrowed funds. Lending officers see economic growth tapering off further over the summer, resulting in year-over-year increases of about 10 percent in commercial loan volume.

Mortgage lenders report large increases in the demand for housing finance in recent weeks, with outstanding mortgage volume up 14-20 percent from last year at commercial banks. A major thrift institution in the Third District is receiving one-third more mortgage applications this spring than last, and reports the dollar volume of new mortgages made this April to be three times greater than that in April 1984. The average rate on conventional, fixed-rate 30-year mortgages is 12 percent in mid-June. Falling mortgage rates appear to be the major force behind the boom in housing demand, offsetting any downward pressure stemming from concern over the effect of proposed tax changes on the cost of home ownership.

Third District banks lowered their prime rate to 9.5 percent on June 18. Some local bank economists feel interest rates in general will drop further in the short-run, but they expect higher interest rates later in the year. The consensus of their forecasts is a prime rate of 11 percent by December, federal funds above 8 percent, and Treasury bills and bonds at about 8 and 11 percent, respectively. Consumer loan rates are expected to fall in the immediate future and then parallel the movement of other rates.

AGRICULTURE

The financial and market conditions of the Third District agricultural sector are not as critical as in other areas of the country. Farms in the Third District are not as highly leveraged as farms elsewhere, and farmland prices have not declined substantially.

Dairy farming is the weakest of the District's agricultural industries, as the end of the federal diversion program and reduction of the milk price support have contributed to lower dairy prices and incomes. Other important farm products face better markets. Poultry sales are expected to increase during the rest of the year, with prices remaining stable. Income from fruit and vegetable products in the region this year should meet or exceed the level of last year if prices hold at current levels.

FOURTH DISTRICT - CLEVELAND

The pattern of economic activity in the Fourth District has changed little since the last Beigebook. District employment rose slightly in May, although manufacturing employment was unchanged. Cars and soft goods continue to sell well, while big ticket department store hardgoods are beginning to recover from weak sales in mid-spring. Manufacturing production remains flat, with output strong in automobiles and weak in steel. Firms continue emphasis on cost-cutting modernization rather than expansion. Multi-family residential construction remains volatile because of tax law uncertainty while office construction is being reduced because of excess space. Business loan demand has been flat while real estate and consumer installment loan demand has been good.

Labor Market Conditions.

Ohio's unemployment rate fell from 9.0% sa to 7.7% sa in May. A slight rise in employment was accompanied by a large drop in the labor force, which is a phenomenon not witnessed in ten years of data. Therefore, some analysts agree with the direction but not with the magnitude reported. Pockets of high unemployment in the District in many cases are attributable to continuing weakness in mining and agriculture.

Retail Sales.

Fourth District retailers report continued sales growth, although most mention brief periods of weakness in early May. Car sales remain strong. Dealers continue to have problems stocking popular domestic models and report no excess inventories. Import dealers have had an especially difficult time obtaining cars. Some dealers feel the market is becoming more competitive, but most think little additional discounting is possible. Although some consumers purchased new cars in April and May specifically because of below-market interest rates that recently ended, dealers expect strong sales to continue as long as rates in general do not rise and personal income does not falter.

In contrast to auto dealers, department stores report that sales of big-ticket items like furniture and appliances have been weak since mid-April. These items are beginning to recover and retailers believe this may be due to the arrival of tax refunds. Apparel and other soft goods continued to move exceedingly well and sellers expect this trend to continue. Retailers are optimistic about the rest of 1985. Inventories are at desired levels and most stores do not expect to cut prices further. They hope to recover some of their margins lost to earlier discounting by a continued drop in their costs for some goods.

Manufacturing and Investment.

A survey of manufacturing firms in the midwest indicates new orders are increasing slightly faster than in the first quarter but inventories are being decreased. Planned capital spending in 1985 exceeds the amount spent in 1984 but by a substantially smaller margin than in the March survey. Surveys of manufacturing firms in the Cincinnati and Cleveland areas show little change in production, new orders and inventories. The consensus of the three surveys is that prices paid and received are changing very little.

Manufacturers of automobiles and automobile and truck parts report that their capital spending is almost entirely for modernization rather than expansion of capacity. Even when a new plant is built it is usually to replace an old, inefficient plant. One manufacturer of truck parts reports that orders are being stretched out but not cancelled. The firm's cash flow is weakening, so the firm may cut back its spending on plant and equipment. Despite a sharp increase in imports, an auto producer will not cut prices because it is operating at full capacity. Major steel producers continue in distress. Prices remain soft, imports high, and profits low or negative. Most major steel producers are reducing their costs but the benefits seem to go into lower prices rather than higher profit margins.

Housing and Construction.

Housing market participants expect a moderate rebound in housing activity in this District during the second and third quarters. As a result of a substantial recovery in listings and closings, realtors have cancelled previous plans to scale down operations. Although builders expect at least a two-quarter housing rebound, they have positioned themselves to minimize downside risk and thus will forego potential profits if the housing reversal is stronger or longer than anticipated. Mortgage lenders are less optimistic than realtors about the duration and strength of the rebound. Builders expect volatility in multi-family housing to continue in this District until there is less uncertainty over tax-reform legislation.

Office construction in the District's major cities has been robust since 1980, resulting in an oversupply of office space. Consequently, all of this District's major cities are currently experiencing a substantial downtrending or complete stoppage in new contracts for office construction, which is expected to persist over the next three to four years. Generally speaking, the office construction market is best characterized as an "orderly buyers' market," inasmuch as prices are being discounted 10% to 20% but suppliers are not panicky.

Commercial Banking.

District loan demand has been mixed with loan outstandings at large banks registering a slight decline over the past month. Business loan demand has been flat, and contacts anticipate continued softness for commercial and industrial credit into the Summer. On the other hand, the demand for real estate and consumer installment loans has been quite good, and contacts expect consumer loan demand to remain relatively strong, particularly with lower and falling interest rates.

FIFTH DISTRICT - RICHMOND

Two distinct pictures emerge from the District economy at this time. Most areas and sectors are offering very upbeat reports. Activity is generally rising, and in many cases, from already record or near record levels. Such reports come from the retail sector, the construction and housing sectors, and the service sector. On the other hand, the manufacturing and agricultural sectors are giving off very negative signals. The manufacturing sector, in particular, is reporting declining sales, production, and employment. Manufacturers continue to cite foreign competition as a major factor in the current situation, and quite a few are apparently relying more heavily on offshore production themselves, either by moving production facilities or by importing parts or materials. In agriculture, recent rain has ameliorated difficulties in some areas, but crop outlooks remain less than satisfactory.

Manufacturing

Once again, as earlier in the year, manufacturing activity has slowed. Our respondents report declines in shipments, new orders, and order backlogs during the past several weeks. In addition, manufacturing employment has fallen in most areas, and several industries are generally on reduced workweeks. Most indications are that while these conditions may be concentrated in the textile, apparel, and furniture industries, they are by no means peculiar to those segments of manufacturing. There appear to be very few, if any, industry groups actually showing growth at this time, although several related to commercial and residential construction activity remain above year earlier levels of activity.

Coal production remains slightly below the record levels of last year, but is still quite strong. Mining employment, on the other hand, is not holding up so well. During April coal mining employment in West Virginia was more than 5 percent below the year earlier level.

Consumer Activity

Consumer activity in the District appears quite different from manufacturing. Sales are strong and rising very nearly across the board. Non-durables, durables, automobiles, and services are all doing well in most areas. Despite the general perception of strong sales, automobile dealers are aggressively promoting attractive financing arrangements. Tourism is also an area of strength, although some areas report slight declines from the extraordinary levels of activity a year ago. Tourist activity, in fact, is prompting quite a bit of development activity in several tourist oriented areas of the District.

Housing and Construction

Construction activity in the District remains almost uniformly strong, with both residential and commercial building contributing heavily. Also, there is little indication that any slowing of activity is in prospect. Most industry observers and participants expect continued buoyancy in construction activity and adequate absorption of new space. Housing sales are generally robust, and are even reported to be breaking records in some areas. There are even pockets of strength in industrial type building, particularly around industrial and office parks where new facilities make up most or all of the activity.

Financial Sector

District financial institutions are still reporting moderate to strong growth in loan demand. Business loan demand is rated as flat to up slightly, since although business needs are expanding, businesses are perceived as having quite a bit of cash on hand. Consumer demand for credit is generally strong, and mortgage credit, of course, reflects the strength of the residential real estate market. The financial institutions seem able to continue financing this loan growth, since deposit growth is also holding up very well.

The Outlook

The outlook around the District reflects the state of business activity. Manufacturers, as a group, do not expect to see any improvement in business activity over the next six months or so, although few envision any further actual deterioration of the economy. In most other sectors the outlook is much more positive. Clearly, there is some uncertainty stemming from the debate on taxes, but there appears to be general agreement that business investment will continue on a strong upward path for at least the rest of the year. Plans for construction activity and purchases of producers' goods are largely in place, and there does not seem to be any general tendency to cancel or otherwise reduce planned investment. Consumer confidence remains strong, as job and income growth continue despite the lull in manufacturing activity.

SIXTH DISTRICT - ATLANTA

Indications have surfaced that southeastern economic activity has begun to slow but areas of strength still outweigh weaker sectors. Labor markets have shown little overall employment growth. Conditions have not improved for the region's import sensitive industries such as textiles and apparel where employment rolls continue to shrink. Consumer spending has been strong for seasonal goods and the outlook for new car sales is positive. Real estate activity has been diverse in recent months with real estate loan growth strengthening in parts of the region. Commerical building remains strong. However, total loan growth has begun to weaken at the region's large banks. Tourism is lackluster in some areas and the summer outlook is mixed. Despite continuing financial stress in agriculture, little acreage is being idled this year.

Employment and Industry. Labor market conditions have basically remained unchanged from the last reporting period with the District unemployment rate hovering around 8 percent. A notable exception was that Alabama's unemployment rate moved to the single digit range for the first time since June of 1981.

Alabama's recent employment growth is mainly attributable to job recalls in the steel industry and a booming construction sector. Construction employment is up over seven percent from last year. Shipbuilding has revived in the state; new defense related contracts portend still more job growth in the sector.

Imports continue to batter the region's textile and apparel industry. In Georgia alone, textile and apparel employment is down by 9,000 workers from a year ago. Spokesmen for the forest products industry note that market prices are stable and builders are buying. The strong dollar has slowed exports of the region's pulp and paper mills. Foreign imports have impacted coated paper products and new orders for packaging material have contracted resulting in excessive inventory accumulations.

The chemical industry is producing at a constant level, however, industry officials note a recent softening of product prices. Uncertainty about the terms of the new federal tax policy has held down oil and gas drilling activity in Louisiana.

Consumer Spending. Retailers in Alabama, Florida, Georgia and Tennessee reported sales growth through May to be up approximately 10 percent over the comparable period a year ago. Retailers in Mississippi reported mixed sales activity while Louisiana reported activity below its year-ago level. Strong sales of seasonal goods such as summer apparel, home furnishings and gardening supplies were reported throughout the region.

The outlook for car and truck sales remains bright in most parts of the region. Manufacturers' incentive programs aimed at both consumers and dealers also have been instrumental in boosting sales activity.

Financial and Construction. Housing markets in the Southeast have been mixed, in contrast to the fairly consistent growth of only six months ago. While the Atlanta and Nashville markets may have been stimulated by the continued decline in mortgage rates, New Orleans, and Baton Rouge markets remain depressed. A factor favoring residential activity has been the intense rate competition between local mortgage lenders. Miami's housing market has been slowing down and overbuilding is apparent. New home prices in parts of the metropolitan area have been declining. The condominium market continues to look bleak, with unsold inventory at an all-time high of around 13,000 units.

Jacksonville, Fort Lauderdale, and Nashville are experiencing a further upswing in nonresidential building activity.

The Atlanta office space absorption figures are keeping up with their corresponding levels of a year ago, and demand is seen to be as strong as ever. Rents are rising in most markets despite falling occupancy rates, reflecting expectations of continued strong demand.

Large banks in the district have reported weakening growth in total loans for the past four consecutive months, relative to the same months of last year. Business lending, which showed virtually no increase from April to May, contributed significantly to the moderating growth of total lending.

Real estate lending, the strongest component of total loan growth, is responsible for much of the expansion of total loans from April to May.

Tourism. Conditions in the tourist industry are mixed. Most major vacation destinations appear to be faring well, but other locations more dependent on local visitors have experienced little or no growth, especially in areas where local economic conditions are weak. Lodging tax receipts for April showed healthy increases.

Attraction attendance has also shown disparate signs. State and national parks report excellent visitations thus far and, along with some private mountain attractions and resorts, are expecting healthy growth this summer. However, attraction attendance to date in Florida has been lackluster.

Agriculture. Abnormally dry spring weather in Florida has resulted in almost 150,000 acres of woodland being destroyed by fire. Most forests were uninsured and the loss to owners will amount to several million dollars. Despite earlier concerns about farmers obtaining operating credit, reports throughout the District indicate little acreage is being idled. Various farm lenders have noted no substantive increases in rejections of farm loan applications.

SEVENTH DISTRICT--CHICAGO

Observers of economic developments in the Seventh District generally view the current situation and outlook with caution. No recession is anticipated, but neither does an upturn appear in prospect from the sluggish overall trend, and weakening manufacturing sector, of recent months. Construction of office buildings and stores, rehabilitation of older structures, and highway and bridge work continue vigorous. Residential sales and building are rising in response to lower mortgage interest rates. Auto and truck sales are at high levels, and a large rise in auto output over last year is planned for the third quarter. Major home appliance sales are at record levels, but the recent rise is centered in microwave ovens, many imported. Other areas of consumer spending for goods have flattened or declined. Consumer debt levels are high, and delinquencies are up significantly for some lenders. Manufacturing jobs in the Seventh District have declined since January, adjusted for seasonal patterns. Employers trying to force down labor costs in air transport, auto production, trucking, and food retailing have been met with work stoppages and costly litigation. Most District capital goods producers have experienced only limited recovery, at best, from reduced operating rates of 1982. Some lines, including heavy construction equipment, railcars, and farm machinery, have remained at very low levels, with numerous plant closings. Steel orders are rising, chiefly due to auto industry buying, but demand and pricing remain short of satisfactory levels, and vigorous cost cutting continues. The recent weakening in personal computers and semiconductors has had relatively little impact in this region. Continued declines in agricultural commodity prices have added to strains on farmers, suppliers, and rural communities. Strains on farm lenders apparently have also intensified. Business executives are studying and commenting on the Administration's tax reform plan, with mixed reactions.

<u>Tax Plan Reaction</u>. Most District executives recognize the merits of the Administration's goal of simplifing the federal income tax system and reducing marginal rates. However,

equipment producers strongly oppose elimination of the investment tax credit, and many are concerned about the effect on future cash flow of tighter depreciation rules and "recapture" of so-called windfalls from past accelerated depreciation. Builders decry the proposal to end tax credits on renovations of older commercial structures, which have been accounting for a substantial share of current construction activity. There is also concern over the proposed requirement that equipment and buildings must be in service on January 1, 1986, to qualify for existing incentives. However, many believe that the abrupt cutoff will be modified to permit a more gradual transition. Home builders will strongly oppose elimination of deductibility on personal returns of state and local taxes and interest on second homes. Attitudes of state and local governments on deductibility of taxes are mixed. In Illinois, there is sentiment that existing rules comprise a subsidy to other states with heavier taxes. Despite these apprehensions, the proposed tax legislation does not play a large role in projections of demand or profits for the remainder of 1985.

Import Competition. Heavy import competition, attributable largely to the strong dollar and lower labor costs abroad, is gradually squeezing down manufacturing activity in the District in a broad variety of industries. It is widely believed that the growth of imports is understated because of lags in "documentation" at ports of entry. Meanwhile, more and more operations are being shifted abroad--to Europe, Latin America (especially Mexico), and the Far East. Examples include electrical apparatus, auto parts, household appliances, and farm and construction equipment. Pressures to seek lower costs abroad are so strong that changes in tax laws, or even significant weakening of the dollar, are unlikely to arrest the trend.

Capital Goods. Seventh District capital equipment producers continue to be battered by the strong dollar. A more sluggish domestic economy apparently also has cut growth of capital spending plans and reduced orders. Demand is generally weak for various types of heavy capital equipment. Railcar orders are down from very low levels last year.

Motor Vehicles. Sales of cars and trucks continued strong through May, helped by cut-rate financing, dealer incentive programs, and easing of shortages. However, inventories of some models are still tight. Planned third quarter auto production would be highest for the quarter since 1977, and 16 percent above year ago. Truck sales in May were highest ever for the month. Sales of medium and heavy trucks are expected to rise 3-5 percent in 1985, with only small gains in the second half. Truck trailer orders and shipments have fallen substantially, following the surge in production of larger and tandem trailers last year in response to changed Federal regulations. A small Midwestern auto producer has given notice that it plans to end car production in the U.S. unless labor agrees to sizable concessions.

Steel. Steel production at Chicago area mills has declined somewhat since spring, but output has increased in the Detroit area. Third quarter bookings indicate a smaller than seasonal decline in output, mainly because of auto industry needs. Construction fabricators' backlogs are rising, especially for bridges and commercial buildings. Demand for steel remains very weak for heavy industrial projects, oil and gas, and farm and construction equipment. With continued losses, steel companies are still drastically cutting costs, eliminating marginal facilities and workers and contracting out additional functions.

Construction. Office and retail construction, renovation, and highway work continue vigorous in the Chicago area. The market for large blocks of office space in and near the Loop is tight, but a substantial amount of space is available in smaller blocks. A large volume of new space will hit the market in Chicago next year and may cause a serious glut. A record volume of highway contracts will be let by the State of Illinois in June. No shortages of materials are anticipated.

Mortgage Rates. Lower interest rates are boosting housing sales and construction. Residential building has strengthened, with midrise suburban rental apartments up strongly, perhaps in part to "grandfather" current tax treatment. Home resales have also improved. Fixed-rate 30-year mortgages are being quoted by Chicago area lenders at contract rates as low as 11.5 percent. First-year rates on adjustable rate loans are quoted by numerous lenders at rates under 10 percent, with some being offered at 9 percent or less. Lower rates are encouraging a shift toward fixed-rate loans.

Consumer Spending. Major chain stores in the Seventh District report weaker sales growth in recent months, for both durables and nondurables. Distribution of delayed tax refunds did not discernibly boost spending, according to a large retailer. Consumer buying on credit has been heavy, and delinquencies have been rising. With inventories somewhat heavy, retailers have been scaling back orders. Total shipments of major home appliances have been at an all-time high.

Agriculture. Low commodity prices continue to plague District corn and soybean farmers. Average farm commodity prices fell further in May, to 11 percent below a year earlier and lowest for the month since 1980. Unexpected weakness in livestock prices has paced the decline in recent months. Hog prices are down 14 percent from a year ago, in part reflecting large increases in competing supplies of poultry and escalating imports from Canada. Crop plantings progressed well ahead of normal. Early plantings usually enhance yield prospects. Without a large rise in crop exports, not now anticipated, a big harvest would add to stocks and hold prices at support levels.

Recent developments are reportedly adding to the pressures on the cooperative Farm Credit System. Stock requirements of several PCAs in Iowa were frozen. In addition, the Omaha FLB raised its farm mortgage rates 75 basis points. These developments reportedly triggered a "flight" of good borrowers from PCAs and FLBs to other lenders. In some cases, the flight has been encouraged by heavy advertising of lower rate loans on the part of competitive lenders.

EIGHTH DISTRICT - ST. LOUIS

Most District economic indicators have declined recently. Retailers, however, reported single-digit sales increases in May over year-ago levels. District employment declined slightly in April, though the unemployment rate remained unchanged. Both residential and nonresidential construction contracts declined from the year-ago level in April. District respondents expect very little change in business conditions over the next three months. Total loan growth at large District banks has slowed from last year's pace. Only consumer loan growth has outpaced the year-ago growth rate. In the agricultural sector, the prospect of large harvests has lowered futures prices for most major crops to new life-of-contract lows.

Outlook

A majority of District respondents surveyed early in the second quarter expects business conditions to be about the same through September of this year. Half of those surveyed expect the real volume of business to increase slightly, while one fourth of respondents expect no change. Prices near current levels over the next three months are planned by about 60 percent of respondents, while almost 20 percent plan to raise prices and only 2 percent expect to lower prices. Survey respondents also indicate that no work force changes are planned in the near future. Most respondents are comfortable with current inventory levels and plan no change in those levels in the next three to six months.

Consumer Spending

All indications suggest that retail sales in the District have been fairly good, a condition unchanged since the last report. Some District department and discount stores reported sales gains of 5 to 10 percent in May over last year's level.

Employment

Eighth District payroll employment declined at a 3 percent annualized rate in April, bringing the year-to-date rate of growth to just over 1 percent. The District unemployment rate remained unchanged in April at 7.5 percent despite the small decline in employment. The unemployment rate declined slightly in Arkansas and Kentucky while Missouri's unemployment rate remained unchanged and Tennessee experienced a small increase.

Business Activity

Business activity in April, as measured by an index of seven indicators, rose sharply in Missouri at an 11 percent rate. Arkansas business activity also increased in April, but only at a 1 percent rate. The business activity index was 1.5 percent above the year-ago level in both states in April.

Construction

Total construction contracts in April declined 14 percent from the April 1984 figure. Both residential and nonresidential construction contracts fell from their year-ago levels, at 18 and 7 percent rates, respectively. Reports from the District suggest, however, that interest in new homes and home improvements has increased recently.

Banking and Finance

The most recent bank data indicate a continuation of lending trends that have been evident since the beginning of this year. Total loans at large weekly-reporting District banks grew at a 12 percent annualized rate (not seasonally adjusted) over the three month period ending in May. This is considerably slower than the 24 percent rate of loan growth for the same period of the previous year. Slower growth in both commercial and real estate lending were the most important factors contributing to the slower overall loan growth. Commercial loans grew at a 10 percent pace this year compared to a 15 percent rate last year while real estate loans grew at only a 5 percent rate as compared to a 17 percent rate over the three month period last year.

Consistent with recent experience, consumer lending has grown more rapidly over the past 3 months of this year (33 percent) than for the same period last year (12 percent). Over the last three months, however, the month to month growth rates have been declining, suggesting a slowing in consumer borrowing.

Agriculture

Early planting and timely rains have lowered futures prices for most major crops to new lows. With export demand weak, it appears as if grain, soybean, and cotton prices will stay near current levels unless yields are below average. Cattle supplies remain abundant with producers still attempting to market a large number of overfinished animals. Hog prices have increased somewhat recently, partially in response to widening restrictions on the importation of hogs from Canada.

NINTH DISTRICT - MINNEAPOLIS

Mixed signals have recently been received from key indicators of the Ninth District economy. While labor market conditions have continued to improve generally, most of the improvement has been seasonal. Some slackening of the pace of consumer spending has been noted throughout the district, although car sales and housing activity rose in some parts. The wood products sector is the only resource-related industry reporting good news, while bad news is still the norm for agriculture.

Employment

Labor market conditions have continued to show improvement, although most improvement has been seasonal. The Ninth District's seasonally adjusted unemployment rate fell a bit in April to just under 6 percent, despite a slight drop in seasonally adjusted employment. Also, the increase in April employment was less than normal in the Minneapolis-St. Paul metro area. But April's unemployment rate in the Twin Cities dropped a little more than seasonally to only 4.2 percent, and teenage unemployment there, at around 10 percent, is about as low as in any metro area in the nation. Normal seasonal employment increases were noted in South Dakota, dropping the state's unemployment rate to 5.1 percent and the Sioux Falls MSA's rate to 4.4 percent. This April's unemployment rate in North Dakota remained unchanged from last April's, at 6.4 percent. A Bank director notes that North Dakota's stagnation was primarily in the state's western part, which has been adversely affected by a curtailment of energy production projects. Bank directors report that Montana has been suffering from deteriorating conditions in its agricultural and resource-related sectors; the state's unemployment fell between March and April at less than the seasonal norm.

Consumer Spending

Some softening in the district's consumer purchases of general merchandise was noted in May and early June. One large retailer, noting that its April sales were better than expected, speculated that some of its normal May business may have instead come in April this year. By May's end, the retailer's year-to-date sales were up 10 percent over last year's. Another large retailer found that large discounts were the only way to keep business brisk in May, curbing store profits. Furthermore, this retailer's inventories are still high and will have to be brought back in line by more discounts. Recreational clothing--particularly jogging togs--has been an excellent seller thanks to the unusually warm weather in the district's population centers. Bank directors concur that retail sales are generally flat-to-slowing throughout the district, with the possible exception of eastern South Dakota.

Low-cost financing deals have propped up car sales into June. Two large domestic manufacturers have been left with low current inventories of trucks and cars. Both manufacturers have experienced year-to-date vehicle sales--especially truck sales--in excess of last year's good results. Sales were off in Montana, though, and also slowed in Sioux Falls, South Dakota.

Aided by falling interest rates, housing activity generally has grown. Sales of Minneapolis homes are up a whopping 31 percent this April, compared with last April. A major home builder association reports that its members had a record number of homes in the planning and building stages. Apartment construction has also taken off in the Twin Cities metro area, due to a combination of low interest and vacancy rates as well as to attempts to beat the possible enactment of federal tax laws unfavorable to real estate investment.

Early reports from tourist centers indicate that the pace of tourist spending--an important contributor to the district's economy in summer--is above last year's level in several spots in Minnesota. But tourist spending in North Dakota and Montana has been slowed by the strong U.S. dollar, which has kept Canadian visitors away.

Resource-Related Industries

District Bank directors report mixed conditions across several key resource sectors. Imports, input substitution, and scrap iron processing have all hurt the iron ore business in northeastern Minnesota. As a result, extended shutdowns in ore processing later this summer have been announced. Oil and gas exploration is way down in North Dakota and Montana, with the recent cut in British oil prices boding ill for future exploration in these states. Indicative of this, a Bank director notes that only 30 rigs were operating in North Dakota last month, compared with 70 in operation a year earlier. In contrast, high demand for housing and paper is spurring the wood products sector. A Bank director reports that a new wood-products plant is opening in the Upper Peninsula of Michigan.

Agriculture

Bad news continues to crop up in the district's agriculture sector. Farm prices continue to fall: The Minnesota farm price index was down 14 percent in mid-May from its level a year earlier. Crop prices declined even more precipitously than livestock prices did. In Minnesota, the average price for all milk was the lowest in almost five years. While warm, wet weather has aided crop development in Minnesota and North Dakota, crop development in western South Dakota and Montana has been hurt by a lack of moisture.

TENTH DISTRICT--KANSAS CITY

Economic activity in the Tenth District appears to be relatively sluggish. Retail sales are down slightly from a year ago, although auto sales remain comparable to sales a year earlier. Prices remain generally stable, at retail and for manufacturers' inputs. Housing starts are also off from a year ago, though sales of new homes are generally up. Future mortgage demand is expected to be stronger, as rates are expected to decline further. Agricultural lenders and borrowers in the district are both facing continuing difficulties. A good winter wheat harvest is well under way in Tenth District states. Bank loan demand is flat while deposits are generally higher.

Retail trade. Most retailers report that sales are down slightly from year-ago levels. Clothing, home furnishings, appliances, and electronic items are all selling more slowly. As a result, some retailers are trimming their inventories. Most retailers expect sales to pick up before yearend, however, and plan no major cutbacks in inventories. Retail prices remained stable during the past three months and are expected to remain stable in the near future.

Automobile dealers. Automobile dealers report that sales are comparable with year-ago levels. Sales are being spurred by manufacturers' low financing rates and, to a less extent, by recent declines in other interest rates. Inventory levels are largely satisfactory, and caution rules out inventory building in the near future. Most dealers, however, are optimistic that 1985 sales will be as good or slightly better than strong 1984 sales.

Purchasing agents. Purchasing agents report that input prices remained constant during the past three months. Most expect constant input prices through the end of the year. No difficulties in obtaining materials are reported, and none are anticipated. Satisfaction with current materials inventories is mixed. Most agents report some trimming of inventories due to seasonal and firm-specific factors.

Housing activity and finance. Homebuilders report that housing starts are down slightly to sharply from a year ago. Starts are expected to remain steady or increase slightly through the end of the year. Building materials are readily available, and materials prices are stable or rising slowly. Sales of new homes are generally up, as are new home prices. Savings and loans report that mortgage demand and commitments are up except in Colorado and Wyoming. Future mortgage demand is expected to be strong, since mortgage rates have declined recently and are expected to decline further. Savings and loans report larger savings inflows than a year ago but expect inflows to slow in the near future.

Agriculture. Agricultural lenders throughout the Tenth District are continuing to write down the value of farm assets, both because examiners are pressing banks to keep up with declining asset values, and for closer monitoring of loans. Some lenders in Missouri and Oklahoma report that their banks have already written farm asset values down to market levels. Aggressive writing down of asset values may cause these banks to reconsider the creditworthiness of some borrowers. Agencies of the farm credit system -- Production Credit Associations (PCAs) and Federal Land Bank Associations (FLBAs) -- appear to be writing down farm asset values as well. Bankers in Nebraska and Colorado report that some farm credit system borrowers are looking for new lenders due in part to rising interest rates on farm credit loans, and to perceived risk associated with capital stock in the PCA's and FLBA's.

Nebraska and Colorado have been especially hard hit by agricultural bank closings this year. In both states, farm borrowers at closed banks are having difficulty finding alternative sources of credit. Agricultural lenders in these states report that successor banks have applied higher credit standards, and other banks generally are not picking up customers of failed banks. As many as half of these customers may be unable to find new sources of credit.

The wheat crop in the Tenth District is expected to be very good. Until interrupted by recent rains, the harvest in Oklahoma and southern Kansas was running a week to ten days ahead of schedule, and is 95 percent complete in southwest Oklahoma.

Spring planting of corn, soybeans, and sorghum in the Tenth District is generally on schedule, and in some cases well ahead of the usual date. Successful spring planting has produced optimism about crop production prospects for the 1985 season, with crop conditions overall reported as good to excellent.

Banking. Tenth District banks report total loan demand was constant during the last month. Commercial and industrial loans were steady, but consumer loan demand grew somewhat. Residential and commercial real estate lending were stable, although the strength of real estate loan demand varied widely by locality. Several bankers note that the level of agricultural lending remains low and that loan quality problems persist. All surveyed banks reduced their prime rate during the last month, but only half lowered consumer loan rates. Total deposits were generally higher with widespread growth in demand deposits, Super NOW's, and MMDA's. Although inflows subsided after the April 15 tax deadline, IRA and Keogh accounts still rose slightly over the month.

ELEVENTH DISTRICT--DALLAS

The economic expansion in the Eleventh District remains slow. Manufacturing respondents, overall, report little change in output. The rate of decline in drilling activity is accelerating. Auto sales have slipped below last year's spectacular performance, but remain quite strong. Retail sales are expanding less vigorously than a year earlier. Nonresidential construction maintains its pattern of strong increases, while residential construction is in decline. Loan growth at District banks continues to slow overall. Agricultural production is expected to equal record levels, but prices are sharply lower than last year.

Demand growth for District manufacturing firms remains modest, but respondents have lately become more optimistic about the prospects for future expansion. The recent mild resurgence in overall construction activity has boosted purchases of lumber and wood products and primary and fabricated metals. Nonelectrical machinery manufacturers, especially those serving the energy industry, report slack demand. Sales of electrical machinery are sluggish and inventories in the industry are undesirably high. Paper and allied products makers complain of weakness in their markets and say it is because of import competition and ebbing general economic activity. Apparel firms report that their customers are buying substantially more than in the recent past. Refiners have been expanding output and accumulating inventories in expectation of the usual summer increase in demand.

The number of active drilling rigs in the Eleventh District states continues to slide, in part, because of currently weak energy prices and of expected price reductions. Another reason cited for falling rig usage is that some firms find takeover activity offers a higher rate of return than does exploration and development. Respondents say that some firms have taken funds formerly committed to drilling and exploration and redirected them to takeover-related expenditures.

While retail sales growth is sluggish overall, spending for some lines remains strong. Consumer purchases of apparel are climbing at a particularly rapid rate. Demand for durable goods is low, however. Many respondents expect further deceleration of overall sales expansion. Retailers indicate that they are monitoring inventories with unusual caution. Some stores are now contemplating employment reductions.

Auto sales remain brisk, although they are down slightly from last year's exceptionally strong levels. Dealers report that they are optimistic about the future, as a result of recent declines in interest rates and of indications that the demand for high-priced luxury and sports models will remain unabated. Their optimism is tempered by concerns that overall economic conditions may weaken.

Nonresidential construction activity in the District continues to advance very substantially, despite increasing vacancy rates, rent discounting, and other evidence of overbuilding. Both non-residential building and nonbuilding construction contracts are growing rapidly. Contracts for streets and roads are expanding at a particularly high rate.

The value of residential construction contracts continues to slip from its year-earlier level, but the rate of reduction has slowed. The number of building permits also continues to fall. Multifamily permits have accounted for the bulk of recent declines.

At District large banks and Texas savings and loans, growth in assets and liabilities has lately decreased somewhat. At large District banks, the pace of expansion in total loans and securities subsided during the first quarter and again in May. Business loan volume has been falling absolutely since March. The pace of real estate loan lending has been slipping lately, but it still remains very high. At Texas savings and loans, both mortgage and construction loans have been expanding at rapid rates. Large banks are funding their asset growth primarily with increases in large time deposits and MMDAs. Both categories have been registering strong year-over-year gains. Borrowings at large banks have been declining since the fourth quarter of last year. Asset expansion at S&Ls has been funded chiefly by large increases in Jumbo CDs, other time deposits and borrowings.

Eleventh District agricultural production is surging because of good weather. Winter wheat yields are likely to match record levels. Increased world crop output, however, has led to significant declines in crop prices from its year-earlier level. Livestock prices have also declined over the last year, although somewhat less than crop prices. Texas cattlemen continue to liquidate their herds. In April, placements on feed were the lowest for that month since 1982 and the number of Texas cattle slaughtered was the highest April total in many years. Overall, Texas farm income is expected to be lower this year than in 1984.

TWELFTH DISTRICT — SAN FRANCISCO

The economy of the Twelfth District, in general, continues to be healthy. Activity weakened by the continued strength of the dollar appears to have been partly offset by the stimulus provided by recent declines in interest rates. The semiconductor industry, for example, has weakened considerably since last year but home construction activity is proceeding at long-term trend levels. Retail sales activity also has been generally vigorous, although there is considerable variation in retail sales growth reported within the District. The agricultural sector, although still struggling to overcome the problems of the high value of the dollar and extensive debt obligations, does not appear to be losing ground. The forest products industry and the mining industry also continue to be weakened by the strength of the dollar and by local production cost problems. Fortunately, in those states in which these industries are important, growth in the service sector or in manufacturing activity has helped to avoid the more serious implications of continued weakness in these industries.

Consumer Spending

The available data on retail sales activity presents a mixed picture. In the far west, recent retail sales activity is up comfortably from last year. Department stores in southern California, for example, report an increase of 10 percent over last year. In the intermountain states, however, retail sales activity has been less healthy. Idaho, for example, reports a sharp decline in retail sales over the past two months.

Automobile sales also are reported as being up from last year due in part to consumer awareness of increased price competition as the result of elimination of Japanese import restrictions. In California last month, the import share of the automobile market was above 50 percent.

Manufacturing and Construction

Manufacturing activity in the Twelfth District generally has experienced the slowdown exhibited nationwide and employment has been maintained primarily by growth in the service sector. The most important development has been in the regionally significant high-technology industries which are now displaying considerable weakness. In California, Idaho, and Utah, significant layoffs and decreases in earnings have been reported. The "book-to-bill" ratio, an important indicator of the prospects for future activity in the semiconductor industry, continues to be disappointingly low. Only the Arizona semiconductor industry reports a significant recovery in this leading indicator.

Construction activity generally is strong. In California, housing starts are running at the rate of 230,000 units per year, up 4 percent from the first quarter of 1984. In Utah, housing starts are down from last year, but non-residential construction activity is up nearly 40 percent. Generally speaking, vacancy rates in manufacturing facilities appear to be drifting upward, whereas vacancy rates in commercial structures are declining. This has been particularly important in the overbuilt Wilshire corridor in Los Angeles.

Despite relatively healthy construction activity, the forest products industry in the Pacific Northwest continues to be plagued by local labor problems, strong competition for plywood products from Japanese imports and competition for other wood products from Canada. Lumber exports out of the Port of Portland decreased by 58 percent between the first quarters of 1984 and 1985.

Agriculture and Mining

Although western farmers continue to face difficulties because of weak export markets and high debt burdens, recent modest increases in potato, bean, and livestock prices have been helpful. In addition, smaller cattle and hog inventories in the District suggest that there may be future improvement in prices. Wheat farmers, however, continue to have faced serious difficulties in world markets despite some recent slight improvements in price. The reduction in interest rates that has occurred recently, however, is seen as providing some assistance to farmers until world product prices strengthen. In California, vegetable and other row crop farmers have been facing less severe difficulutíes than their midwest counterparts, but have complained recently of sharp increases in transportation costs.

Mining and smelting activity in the district continues to be weak, again largely because of the strength of the dollar and competitiveness of foreign supply. In Utah, the recent closure of a major copper mining complex was a serious blow to the industry, but was offset in the aggregate by growth elsewhere in the Utah economy. The unemployment rate in Utah actually fell between April and May from 6.5 to 6.2 percent.

Financial Sector

The recent decline in interest rates has spurred commercial and mortage loan demand at district financial institutions. The increase in demand has been most marked in the consumer loan and mortgage sector, where some institutions are now offering adjustable rate mortgages with initial rates below 10 percent. Commercial loan demand had grown extremely rapidly in the latter half of 1984 so that the 6 percent increase in 1985 over 1984 thus far seems modest in contrast. Nevertheless, the decline in interest rates is a sign of optimism for many lenders, except those with undiversified loan portfolios in the agriculture and forest products sectors.