SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

August 1985

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SUMMARY*

The economy remains sluggish. Retail sales have been disappointing, but some districts see signs of a pickup in July. Despite the weakness in retail sales, inventories remain under control. The manufacturing sector is stagnating; orders and shipments are flat and employment seems to be declining. Residential and nonresidential construction continues to be a source of strength; several districts report increased activity. Consumer lending continues to rise. Commercial lending is up in some districts and down in others. Agricultural prices are below year ago levels and decreasing. While harvests are expected to be good in general, some parts of the country are suffering from very dry weather and grasshopper infestations.

Consumer Spending

Retail conditions are mixed. Most districts report that recent sales have been disappointing. However, in about half the districts, July appears to be an improvement over June. Exceptions occur in the San Francisco district where sales are well ahead of a year ago but slowing and in Richmond where there has been a marked softening in recent weeks. Minneapolis cites especially slack sales in distressed agricultural areas. A majority of districts find soft goods performing better than durables. Prices are relatively stable, partly because of promotional markdowns. Inventories have generally been kept in check, even in areas with slackening sales growth.

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*Prepared at the Federal Reserve Bank of Boston.

Automobile and light truck sales are up in a number of districts but down in others. Foreign cars are said to be selling better than domestic, at least partly because the loosening of quotas for Japanese cars has increased availability. Economic activity in resort areas is stronger than last summer, although New York reports reduced foreign tourism.

Industrial Activity

The manufacturing sector continues to stagnate. While Philadelphia reports that new orders and shipments have picked up marginally, Cleveland and Richmond find that business is flat to down slightly. Industries cited as experiencing difficulty outnumber sources of strength. Both Cleveland and Chicago observe that orders for heavy trucks have fallen recently. The steel industry remains troubled as do a number of capital goods industries in the Chicago district. Semiconductor and related firms are a source of weakness in the San Francisco district, and in Dallas a weak energy sector is depressing sales in many industries.

Experience varies among districts, however. For example, while Richmond reports that textiles, apparel and furniture are losing market share to imports, Dallas observes that apparel orders are well above year ago levels and furniture makers in the Atlanta district are looking forward to increased sales.

Reductions in manufacturing employment are taking place in a number of Districts including some in which manufacturing activity is flat or up slightly. Chicago reports deep cutbacks in such industries as steel, capital goods and electronics.

The mining sector remains weak, with activity generally below year ago levels. There have been a few encouraging developments, however. In the

Richmond district coal production is expected to increase shortly because stocks have been drawn down sharply. Gold mining has strengthened in the San Francisco district. Dallas reports that the rate of decline in drilling appears to be slowing, with the seasonally adjusted rig count actually increasing in July.

Construction and Real Estate

The pace of residential construction differs across the country. New York, Richmond, Atlanta and San Francisco report continued strength in homebuilding. Construction activity has picked up in the Cleveland and Dallas districts. However, the level of activity in Dallas is said to be low relative to a year ago. Residential construction is also below year earlier levels in the Chicago, St. Louis and Kansas City districts.

Nonresidential construction activity is strong in a number of districts. Construction has increased substantially in the St. Louis district while Chicago and Dallas report small advances. Dallas observes that the city of Dallas is now said to lead the nation in vacant office space; New York also notes that vacancy rates remain high.

Finance

Consumer lending is continuing to increase, with several districts reporting substantial gains. Richmond, however, finds weakness in retail sales reflected in consumer loan demand. Commercial lending also appears to be increasing but rates of growth are generally smaller than for consumer loans. Dallas reports a decline in business loans, while at Kansas City banks commercial, industrial and agricultural loans are unchanged or down.

Agriculture

Agricultural prices continue to weaken. Corn, soybeans and cotton have been particularly hard hit, with prices down substantially from last year because of ample supplies and weak export demand. Drought conditions and grasshopper infestation pose severe problems in parts of several districts. Poor pastures have speeded up the sale and slaughter of livestock, causing prices to decline. Minneapolis reports live cattle prices at their lowest level since 1978.

Chicago reports continuing declines in farmland values; however, Dallas finds that the decline in land values in its district abated in the second quarter.

FIRST DISTRICT-BOSTON

Business conditions in the First District have improved slightly in the past month. While retailers reported that June sales results were just fair, preliminary results for July were more encouraging. Inventories have been kept in check. Plans for the second half of 1985 remain optimistic. Reports from the manufacturing sector are mixed, but more positive, on balance, than a month ago. Most of the manufacturers contacted expect small real sales increases for the rest of the year. Manufacturing inventories are said to be in good shape, even at firms that have experienced weak sales. In the financial sector, commercial and consumer lending activity has increased; the demand for mortgages is strong but expected to level off.

Retailing

First District retailers reported that June, like the preceding couple of months, was relatively slow. Although sales exceeded year earlier totals by 2 to 8 percent, they did not meet expectations. Sales have slowed across the board, with soft goods weaker than durables and, within the soft goods grouping, clothing weaker than home furnishings (such as bed and bath linens). However, the month of July, to date, has been an improvement over June. This is attributed, in part, to greater promotional activity.

Inventories are up only slightly as a result of the slowdown in sales growth. Merchants are keeping a careful watch on their inventory positions; one chain reported that substantial markdowns had been used to keep inventories lean.

First District merchants remain optimistic about the second half of the year. Despite several months of sales below plan, contacts have not lowered their plans for the remainder of 1985 because they have confidence in the New England economy's basic strength. Unemployment is low in the region and local retailers report that they continue to outperform many of their national affiliates.

Manufacturing

Reports from the manufacturing sector are somewhat more positive in tone than a month ago. Business is fairly flat, but respondents appear relieved that the situation is no worse. Most contacts expect slight positive growth for the rest of 1985.

While there has been little change in overall order rates, demand for housing related products such as appliances and lighting is picking up. The capital goods picture is mixed. Some products, such as factory automation systems and construction equipment, are doing reasonably well. However, a lot of capital goods spending is for imports. Especially weak at the present time is the demand for parts and components from industries, like machine tools, that are losing market share to imports.

Most of the firms contacted are proceeding as planned with their capital spending programs. One contact, that had previously reduced its capital plans in response to weak demand, has made a substantial upward revision. Inventories are said to be in good shape - even at firms facing sluggish demand. A close watch is also being kept on employment levels. A couple of contacts have had small layoffs. One firm, enjoying strong sales, is relying on temporary help rather than permanent hires to meet the increased demand.

Financial

Financial institutions in the First District report that consumer lending activity has either remained at the same level as last month or increased slightly. However, all the institutions contacted report an increase in automobile loans. These lenders expect demand to remain at its present high level.

Commercial lenders report that demand for commercial loans has increased. Some attribute the increase to the decrease in the prime rate. Lenders expect the demand for commercial loans to continue at the present rate or possibly increase further.

Demand for mortgages is high, but the lenders contacted expect it to level off. Some lenders are predicting an increase in mortgage rates soon.

SECOND DISTRICT--NEW YORK

Introduction

The economic expansion in the Second District continues to be uneven. Consumer spending remains sluggish, but there is some evidence of improvement in July. Levels of business activity vary across the District, with signs of strength in Rochester and weakness in Buffalo. Two large automotive projects will bolster the otherwise difficult conditions in regional manufacturing sectors. Office markets are generally quiet as is usual at this time of year, but extensive inventories are prompting landlord concessions and contacts are uncertain about the fall outlook. The District's housing market continues to boom, however, and real estate portfolios of regional banks reflect this strength.

Retail Sales

The prolonged softness of District retail sales has continued in recent weeks, with average spending only 2 percent above last year. The weakness persists despite intensive promotions and heavy price markdowns at many stores. Sales fell short of expectations by as much as 8 percent in June even though some merchants lowered their forecasts as recently as May. New York City sales are especially weak, and one store reports a decline to 4 percent below 1984 sales levels. Suburban outlets report modest gains, but still smaller than anticipated. While most merchants are satisfied with inventory levels, one store reports stocks 10 percent above plan and little success in moving its merchandise.

Explanations for this spending slump include uncertainties concerning tax proposals, increased travel (and shopping) abroad, and reduced foreign tourism here. Additionally, some retailers think that consumers are waiting for further price cuts. Many report that early July figures suggest substantial improvement, but the data are too sketchy for them to call it a turning point.

Business Activity

As was the case last month, the pace of the business expansion varies widely across the region. Rochester's economy continues to pick up, with growing numbers of purchasing managers reporting sales gains and very few reporting declines. In contrast, fewer Buffalo firms report improvement in June, and more indicate a drop in business. Syracuse's gain from Empire Airlines' recent decision to consolidate operations there may be, to some extent, Utica's loss. Some suburban areas such as Long Island and Fairfield County, Connecticut report scarcity of low-skilled labor. In fact, McDonalds restaurants in Stamford are busing 150 workers daily from The Bronx. Overall, the District's unemployment rate remains below the national average.

Two major projects announced by General Motors were welcome news to regional manufacturing sectors. General Motors will spend nearly $500 million to modernize and retool its Linden, New Jersey facility and to rebuild a plant in Tarrytown, New York. Meanwhile, ground was broken in Rochester for a complex of offices, small businesses, and a hotel: about 1,000 jobs will eventually be located there.

Construction and Real Estate

Vacancy rates in the District's office markets remain high. Across the District, a buyers' market has developed, and landlord concessions such as a period of free rent and leasehold improvements are common. In northern New Jersey demand has been flat for the last six months, and vacancy rates are as high as one third. Around the District, observers are unsure whether the autumn's normal seasonal upturn in demand will materialize, due to questions about the economy, tax reform, and the value of the dollar.

Investment banks have been important in real estate recently. Dean Witter will rent one million square feet in the World Trade Center that the New York State government will be vacating. Prompt leasing of such a large block has relieved some realtor concern over the generally weak demand for space in new buildings. Morgan Stanley plans to lease 220,000 square feet in Brooklyn, pending special State subsidies. The Midtown Manhattan core of office space has been widening in recent years, but this is the first major office project across the East River.

The District's housing markets continue to boom. Homebuilding in Rochester has been especially active, and the Syracuse builder's association canceled its annual home show as unnecessary. Prices continue to rise in many areas, and land, skilled labor, and some materials remain in short supply. Delayed completions have resulted, prolonging the period of heavy demand. Many builders expect this strong pace to continue at least through year-end.

Financial Developments

The region's stronger-than-average housing market is also benefiting area banks. Our contacts in the District observe none of the real estate problems reported in the national press. Delinquencies on their real estate loans are not rising nor is the value of their mortgage collateral falling. Area banks expect the solvency of borrowers to improve as variable rate mortgages adjust downward and high-cost fixed rate loans are refinanced at lower rates.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District appear to have improved slightly in July. Manufacturing activity has picked up marginally after a flat three months and retail sales have rebounded from an unexpected dip in June. Both commercial and consumer loan volume continue to grow at area banks, although somewhat more slowly than in the first half. Early indications are that tourism business in the Third District this summer is better than it was in the disappointing 1984 season.

The outlook for the Third District economy is positive. Manufacturers generally expect business conditions to remain stable or to improve over the next six months and anticipate increased capital spending. Area retailers are pleased with the recently regained strength of sales and expect a good third quarter. Bankers predict renewed economic growth and foresee demand for commercial credit increasing near the end of the year.

MANUFACTURING

Manufacturing activity in the Third District is moving up marginally after a 3-month lull, according to the July Business Outlook Survey. Twenty-eight percent of the local companies answering this month's survey report a pickup in business since June, versus 18 percent reporting a slowdown. Slightly less than half indicate no change. The rate of both new orders and shipments in July increased fractionally over June and inventories continued to be worked down. Negative indicators in July were manufacturers' backlogs of unfilled orders and employment, both of which edged lower.

In their outlook for the next six months, most area manufacturers are optimistic. Over 85 percent of the July survey respondents believe business conditions during the next six months will be the same or better than they are now, and more than 40 percent forecast gains in both new orders and shipments. Prospects for greater capital expenditures have improved slightly. Twenty-nine percent of the companies contacted in July plan increased outlays for plant and equipment over the next six months, up from 20 percent in June. The employment situation is not likely to improve, however; more than half of the industrial establishments surveyed this month plan no changes in either employment levels or working hours, and more than one-fourth expect to make workforce reductions between now and January 1986.

RETAIL

Retail trade in July appears to be picking up a bit after a lackluster June. Major department stores in the Third District had flat or slightly lower sales in June, on both a month-to-month and year-to-year basis; but increased sales in July should put them back on the path to 1985 sales at least 5 percent above 1984. Apparel and seasonal items remain popular with shoppers while sales of hard goods lag. Exceptions are electronic equipment, which has been strongly promoted by some stores, and air conditioners.

Retailers are optimistic about the third quarter, anticipating an increase in sales of approximately 6 percent over the same period last year on a same-store basis. New stores opened in the Third District by major chains in recent months are doing well, and, despite a slower than expected spring, inventories have been kept under control.

FINANCE

Loan volume continues to grow at Third District banks, but the pace is moderating. Consumer loan volume is increasing at an annual rate of approximately 15 percent in July, substantially slower than the 25 percent year-to-year increase reported last month by major banks in the Third District. Tighter credit qualifications and stepped-up collection efforts in response to a rising delinquency rate are mentioned as factors in the slackening pace of consumer loan growth. Commercial and industrial loan volume in July is approximately 14 percent higher than it was in July 1984, a slight easing from the June year-to-year increase of 17 percent. According to local bankers, business borrowing has been limited by retrenchment in long-term foreign lending and by large corporations' reliance on bond and money markets.

Third District bankers expect loan growth in most categories to continue at the present pace for the next several months, then pick up at the end of the year. Some believe that commercial lending, especially to middle market companies, may move up sharply as economic growth accelerates into 1986. Agreeing with this outlook, local bank economists expect credit conditions to become tighter near the end of the year. They say that interest rates may be driven up by federal government borrowing requirements and increased private sector credit demand, coupled with greater restraint by the Fed. They place the prime rate at 10 percent or more by year-end, the federal funds rate near 9 percent, and long-term Treasury bond rates at 11 percent.

TOURISM

Tourist-related business has improved over last year at mountain and seashore resorts in the Third District, although the vacation home rental market is soft in some locations. Chamber of Commerce and local government officials report more visitors to recreational attractions this year. They attribute the increase primarily to better weather than in the 1984 season, but also cite improved economic conditions and greater promotional efforts. Delaware officials say the Memorial Day weekend broke records for attendance at the beaches. By mid-July, tourism-related revenues at Pennsylvania mountain resorts were estimated to be 4 percent above 1984. In New Jersey, tourism revenues are up about 10 percent from 1984, although shorter vacation stays and an increased supply of summer homes have resulted in lower rental income this year at some of the state's resort communities.

FOURTH DISTRICT - CLEVELAND

Summary.

The District's economy remains lackluster, with no signs of pickup. Unemployment remains high and manufacturing employment soft. Retailers report lower sales of autos, other durables, and nondurables. Major manufacturing industries report production and sales are flat or slightly down. The housing industry remains cautious despite recent strenthening in sales. Consumer loan demand is strong but business loan demand continues soft.

Labor Market Conditions.

Unemployment remains high and manufacturing employment remains soft. Ohio's civilian unemployment rate rose from 7.7% (sa) in May to 8.6% in June, but analysts believe much of the increase is a reversal of inaccurate seasonal adjustment in May. Employment showed only marginal gain in June. A survey of Cleveland-area manufacturing firms indicates employment is growing slowly. Firms reporting increases stated that people were being hired to reduce overtime, which employers have kept at higher-than-usual levels during this recovery. Manufacturing employment in Cincinnati was down for the second straight month in June and weakness in order activity revealed by a survey of Cincinnati-area firms suggests employment declines are likely to continue in July. An outlook survey projects that the Midwest's third quarter hiring will be healthy relative to the rest of the nation, despite continued deterioration in the manufacturing sector.

Retail Sales.

Fourth District retailers report mixed signals in recent sales patterns. For the first time this year, car dealers' sales were below expectations for more than a brief period. Domestic dealers especially report lower sales, although they note that this decline occurred in comparison to very strong sales through May. They remain optimistic about car sales for the rest of the year and are not planning to decrease inventories, which are slightly above previously desired levels. Dealers of Japanese cars report quickening sales as the number of vehicles allowed under voluntary quotas increases. Even with the higher quotas, some popular models remain in extremely short supply.

Other durable-goods sales appear to be weakening. Department stores report weakness in furniture and appliance sales, confounding earlier expectations that sales of these goods would strengthen as late tax refunds were spent. Nondurables sales were also soft at major retailers, although this decline was described as marginal. Because sales generally came in below forecasts, inventories at department stores are now moderately above desired levels. Nevertheless, all stores maintain that profit margins remain too thin to allow for much discounting. They expect strong sales for the rest of the year and so feel little pressure to cut stocks.

Manufacturing.

Manufacturing activity remains flat in the District while new orders, backlogs, and inventories of raw materials and finished goods are declining. Workers at a major steel producer went on strike for the first time in 26 years when the firm, operating under Chapter 11, demanded an 18% reduction in wages and benefits. Another major steel producer has offered to sell its specialty-steel division to reduce its debt. One major steel firm expects that shipments in the second half will be about the same as in the first half of 1985. Shipments of steel to auto manufacturers may be down while shipments to appliance makers may be up a bit in the second half.

A major tire manufacturer reports that original equipment sales remain strong but replacement tire sales have been weak since February and continued disappointing in July. Tire prices remain soft because of import competition. Employment has been flat but is likely to decline as the big three Akron-based rubber companies are implementing special programs to reduce salaried workforce to prepare for the next squeeze on profits.

A major supplier of parts to truck manufacturers reports that orders for both light and heavy trucks are softening, apparently reflecting a reduced pace in capital spending. The firm continues to operate at effective capacity but expects to cut production as orders weaken.

A supplier of construction materials reports demand from the commercial-building industry has been flat at a low level for six months. Demand from the residential building industry remains at a high level but has not grown for four or five months.

Housing and Construction.

Housing market participants remain cautious despite recent strengthening activity. A regional builder in the Fourth District had exceptional months in May, June and July bringing new orders for the first half above last year's first half. Builders anticipate that the second half will be equally strong. However, there is little speculative building, as builders remain cautious and uncertain about how long the current uptrend will last. Real estate firms had an exceptional second quarter. The volume of contract closings at one realty firm was the highest in two years, and its forecast for closings in the second half has been revised upward, but the firm will remain in a wait-and-see posture until August before deciding whether to increase its staff. More move-up buyers are reentering housing markets. Mortgage lending volume is picking up with the 15-year mortgage becoming popular and the adjustable rate mortgage losing favor among borrowers. In the second half of the year, mortgage markets in Ohio will receive a boost from recently approved state-subsidized mortgage money that amounts to $346 million and that will be available to qualifying home buyers at 9.8%.

Commercial Banking.

District loan demand continues to be mixed. Loans outstanding in all major categories at large banks increased over the past month. Consumer installment loans registered the largest gain, and contacts expect consumer loan demand to remain strong, particularly with lower and declining interest rates. In contrast, business loan volume increased only moderately, and most of the growth apparently was due to seasonal factors. Contacts do not expect business loans to pick-up significantly in the next few months.

FIFTH DISTRICT - RICHMOND

Overview

Business and economic conditions in the Fifth District continue to reflect somewhat disparate performance across sectors. On balance, activity seems flat to rising slightly. Some of the areas of earlier strength continue to lend support, while others, notably the retail sector, have softened markedly. Construction activity and house sales remain upbeat. Manufacturing is flat to down slightly, although there is some indication that the slide in manufacturing employment has been arrested. Coal production remains below year earlier, although stocks have been drawn down significantly since year-end. The service sector remains the primary source of employment growth. The outlook for agriculture has improved somewhat of late because of much improved weather conditions.

Manufacturing

There is little evidence of any significant turnaround in the manufacturing sector despite a modestly improved employment situation. According to our reports, manufacturing shipments stabilized over the past month, although new orders and order backlogs both declined. Month to month changes continue to be dominated by such sectors as textiles, apparel, and furniture where imports continue to gain market share. Some of this weakness has been offset recently by very modest gains in primary and fabricated metals, food products, and segments of the chemicals industry.

Coal production continues to run slightly below year ago levels, but recent employment losses appear to have been stemmed in this industry as well. Nonetheless, mining employment remains well below the levels of a year ago. There is generally widespread feeling that output of coal will be on the rise shortly. Consumption, particularly by electric utilities, is running strong, and stocks on hand are down sharply from only a few months ago.

Consumer Activity

After providing major support to the District economy for quite some time, the consumer has retrenched significantly in recent weeks. The slowing of sales appears to cut across most product lines, and is by most accounts widespread geographically as well. It has been noted also that many of the aggressive promotions of late 1984 and early 1985 have come to an end. Retailers have responded to the weakness in sales by cutting orders, despite already lean inventory positions.

The reported weakness in sales of goods has not spread to tourist related services, however. Most reports are that tourist areas are doing quite well, so well, in fact, that they are exhibiting more general economic strength, such as in commercial and residential construction.

Housing and Construction

Both residential and commercial construction retain much of the strength they have shown for more than a year now. Gains in housing starts and sales have slowed in some areas, but there is no indication that levels have fallen. Activity remains quite strong by historical standards. Commercial activity also continues apace in most metropolitan areas, as well as in several large tourism centers. Outside these areas there are several areas showing substantial strength in industrial building. There is little indication that activity in any of these sectors is likely to slow any time soon.

Financial Sector

District financial institutions are reporting a mixed situation with respect to loans. Commercial and industrial lending is growing somewhat, but consumer lending reflects the weakness reported in the retail sector. Residential mortgage activity remains buoyant in most areas. Financial institutions do not appear to anticipate any difficulty in supporting continued loan expansion.

The Outlook

On balance, the outlook among District businesses has deteriorated in recent weeks. Surprisingly, however, retailers have become slightly more optimistic regarding the near term outlook for sales. Otherwise, there is very little optimism in evidence around the District. There is some feeling, nonetheless, that recent movements in interest rates, the dollar exchange rate, and overall business inventories bode well for future economic activity. To date, however, that feeling has not been incorporated into the outlook of District businesses and consumers.

General Motors Corporation's recent selection of a site in central Tennessee for its Saturn automobile production project bodes well for continued growth in the sector. The project will eventually employ 6,000 people.

Consumer Spending. June sales behavior was mixed, according to District merchants, with over half of the retailers reporting volume slightly below year-ago levels due to somewhat sluggish consumer demand and cooler than normal temperatures during the month. More recent activity in early July was reported to be better than the same period in 1984. Inventories are at desired levels and merchants project fall sales to be 3 to 8 percent above last fall.

Car sales activity in the District through mid-July remained strong despite a sluggish performance in some localities. Some recent weakness is blamed on the ending of manufacturers' incentive programs in June and an insufficient supply of best-selling models. Overall, the region's sales volume continues to run above 1984's high levels.

Construction. Robust residential construction and sales activity characterize the region. The Jacksonville and Atlanta markets continue strong with manageable inventories, while Nashville contacts report that demand for single-family homes exceeds the supply. Multi-family construction is also strong in major District cities with the exception of New Orleans.

Office construction shows no signs of slowing as of late July, even though office vacancy rates increased from the first to second quarter. Atlanta is the only major District city with a lower-than-national-average metropolitan vacancy rate.

Financial Services. All three major lending segments--business, consumer, and real estate--experienced an acceleration in total loan growth in June. Real estate lending is the most vibrant of the major lending segments, with refinancing comprising a significant portion of recent real estate lending. Bank contacts report the lending upturn continued in July, although concern is growing that high debt levels will eventually soften consumer loan demand.

With announced plans to acquire a small Atlanta bank, a North Carolina-based bank holding company became the first with announced holdings in all states from North Carolina to Florida.

Tourism. The tourist industry shows signs of strengthening as the summer season reaches its midway point. Except in Georgia, attraction attendance showed healthy increases over year-ago levels. State parks showed mixed attendance patterns, but most national park sites report positive growth.

Major District-based air carriers show record-breaking increases in passenger traffic. Deplanements are substantially up in almost all Southeastern airports.

Agriculture. Favorable growing conditions throughout the District indicate crop yields should be normal this season. The prospect of ample supplies and uncertainty over government farm programs pushed most District crop prices lower, with corn, cotton, and soybean prices down by one-fifth since a year ago.

Weak crop prices mean lower feed costs for the animal products industry, enhancing the possibility of profit. While livestock and poultry prices are moderately lower than last year, prices of eggs, pork, and broilers increased in recent weeks as production declined.

SEVENTH DISTRICT--CHICAGO

Summary. Business conditions in the Seventh District continue sluggish, with no sign of significant improvement in the months ahead. Forecasts have been revised down. While analysts and executives are cautious and uneasy, few anticipate a general decline. Total payroll employment has increased modestly in the five-state area in recent months, but manufacturing employment has declined. Indiana and Michigan, aided by the recovery in motor vehicle output, have paced the District, while Iowa and Illinois, more associated with the depressed agricultural sector, have enjoyed very little improvement. Demand for most capital goods produced in the District has shown only partial recovery, and in some cases none at all. Heavy trucks and trailers, which were strong early this year, have weakened in recent months. Steel output has declined since last spring, contrary to earlier expectations. Construction activity has been helped by lower interest rates. Retail sales of general merchandise have been below forecast, and credit delinquencies have increased. However, retail inventories, generally, have been brought into line. There are no problems in procurement, and order leadtimes have shortened on many items. Prices in wholesale markets have been soft, especially steel, nonferrous metals, and paperboard.

Layoffs. A number of large District firms are in the midst of painful staff reduction programs to reduce financial deficits. Deep cuts sometimes involve veterans with 30 or more years service. Included are railroads, airlines, steel, capital goods, electronics, utilities, finanicial institutions, and conglomerates. Staff reductions take the form of attrition, retirement incentives, and outright discharge. Mergers and acquisitions, a large factor among firms headquartered in the District, typically result in elimination of employees deemed redundant.

Motor Vehicles. Total auto deliveries have remained at a high level, but slipped in June and early July, at least partly because of the expiration or reduction of incentive programs for domestics. Imports have increased as Japanese cars have become more available. Some popular domestic models are in short supply, a situation that should be eased by strong third quarter production schedules. The largest auto manufacturers were pleased by the plan to amend the CAFE requirement penalizing production of full-size cars. Sales of light trucks have remained vigorous. However, orders for heavy trucks fell well below production in the first half, and backlogs are lowest in 2 years. Second half output is expected to be 25 percent lower than in the first half.

Steel. With orders disappointing, raw steel output has declined, and overall operations have remained below break-even levels. Producers continue strenuous cost-cutting efforts. Industry analysts view the effectiveness of the Administration's import restraint program as doubtful. Auto industry needs are the main support of steel order books. Light construction steel also is in good demand. Steel for heavy construction and capital goods remains soft.

Capital Goods. Demand is down from last year for various lines of equipment, including oil and gas development, food processing, and materials handling. Construction equipment remains very depressed. Farm equipment sales have been below last year's miserable level. Rail equipment orders are still in driblets. Two computer and semiconductor manufacturers headquartered in the Seventh District are reducing staff in response to the weakening in that industry, but most production is outside the District.

Construction--Nonresidential. Nonresidential building in the District showed a small advance in the first half of 1985, after two years of vigorous growth. Nevertheless, activity remains well short of good levels of the late 1970s. Michigan, which was most depressed, has had the sharpest gain over the past 3 years. Commercial construction has been strongest in the District--new office and retail buidings and substantial rehabilitation work. Additional large office buildings are planned to be started in downtown Chicago and strategic suburban centers, despite a "substantially overbuilt" market. Proposed tax changes would reduce incentives for developers. Concessions on leases are large and widespread. New space is constantly coming on the market as new buildings are completed.

Construction--Residential. Residential building in District states, except Michigan, has been somewhat below a year ago. Construction has improved in all states from 1984's second half. Activity, overall, is only about half the level of 7-8 years ago. New work is severely depressed in communities dependent on agriculture or hard hit manufacturing firms. Mortgage interest rates, recently at the lowest levels since the late 1970s, continue to support sales of new and used homes.

Highway Work. Highway construction is a source of strength in the District. Most of the new federal highway money is being used for small, urgent projects, usually involving asphalt resurfacing. Government authorities are said to be reluctant to start big projects because the flow of federal funds could halt again this fall.

Consumer Spending. Major general merchandise retailers found sales to be disappointing in May, June, and early July. Moreover, credit delinquencies have been rising. However, inventories have been reduced from somewhat excessive levels several months ago, through tight restraints on ordering. An industry analyst notes the possibility of shortages in the pre-Christmas buying season. Home appliance shipments were at record levels in the second quarter. (Appliance manufacturing is important in the District.) Most lines were strong, but the leader has been microwave ovens, the majority of which are imported.

Agricultural Distress. District farmers continue under pressure from weaker crop prices and declining farmland values. Our survey of District agricultural banks shows that farmland values at mid-year were down nearly 5 percent from March, down 20 percent from a year ago, and down 40 percent from the peak in 1981. Most bankers expect further declines. Prospective crop yields in Iowa and some other areas of the District have been reduced somewhat because of dry weather in recent weeks. Overall harvest prospects, however, remain favorable. Corn and soybean prices, already down about 20 percent from year-earlier levels, are drifting lower, reflecting expectations that this year's harvest will substantially exceed requirements. Farm loan portfolios continue to deteriorate. In our mid-year survey, agricultural bankers reported "major or severe" repayment problems with about 17 percent of their farm loans, up from 13 percent a year ago.

EIGHTH DISTRICT - ST. LOUIS

Summary

District indicators suggest a mixed economic outlook for the region, which represents some improvement from the last report. Employment growth and construction activity have both lagged national trends while retail sales have improved recently and are expected to remain strong, particularly in the automobile sector. Consumer lending has continued vigorously while commercial lending has maintained a weak pace. Prices of District agricultural commodities are expected to remain weak.

Employment and Business Activity

District payroll employment has increased at a 2.1 percent annual rate through the first five months of 1985, compared with a 3.3 percent rate nationally. Employment growth has been particularly strong in Kentucky (6.1 percent), but decreased at a .5 percent rate in Arkansas. Kentucky's employment strength was attributed to job gains in the construction, service, and trade sectors by an official from the state's Office of Economic Security. Indices of general business activity show Kentucky growing at a 3.9 percent annual rate in 1985, while the Arkansas index has fallen at a 0.7 percent rate; the indices for Missouri and Tennessee rose at 1.8 and 2.4 percent rates, respectively.

Consumer Spending

Reports from the District indicate generally strong levels of retail sales in June after more mixed results in earlier months. The

Memphis area reported a 2 percent increase in sales from May to June after declines in consumer spending earlier in the year. A local respondent projects continued sales strength in the Memphis area through the 3rd quarter due to the currently low interest rates.

Automobile dealer associations in the District report first-half 1985 sales to be up 5 to 10 percent over first-half 1984 levels. Most dealers feel the sales strength will continue through the second half of 1985, although one large St. Louis domestic car dealer believes second half sales will fall from current levels. The strong sales are reported to be evenly distributed among car and truck sales; foreign car dealers are posting 10 to 20 percent sales increases over last year's levels.

Construction

Total construction contracts in the District through the first half of 1985 were down 1 percent from the first half of 1984. Total construction contracts in the U.S., however, were up slightly by 0.1 percent over the same period. District nonresidential construction in the first half of 1985 grew by 12 percent from last year while residential construction fell by 9 percent. Reports from Memphis suggest that nonresidential construction will be 30 percent higher this year. Respondents from the city's banking and insurance communities feel there may be overbuilding, especially in hotels, apartments and commercial space. The St. Louis area, on the other hand, reports nonresidential construction to be down by 13 percent from year-ago levels.

Banking and Finance

The lending experience among Eighth District banks has closely paralleled the national trends of strong consumer loan growth and declining overall loan demand, especially among commercial lending. Total loans at large District banks grew at a 13.6 percent rate in the first half of this year, compared with a much faster rate of 28.3 percent over the first half of last year. This slowdown is largely the result of the 5.9 percent growth rate in commercial and industrial loans. Consumer loans, however, continue to exhibit strength, posting a 27.9 percent growth rate in the first half of this year, compared with a 16.5 percent rate in the first half of 1984.

Agriculture

Cash prices for most crops are at least 20 percent lower than a year ago and the best option for many producers appears to be the placement of their harvests under CCC loan. Expected large domestic crops and continued weak export demand are responsible for the ongoing decline in prices. Cotton is particularly affected by weak export demand with USDA projections for 1984-86 showing a two million bale decline in exports and a four million bale increase in stocks. Red meat prices also should continue to decline over the next several months as both cattle and hog supplies increase; deteriorating pasture conditions and poor calf prices are encouraging cow slaughter while larger slaughter of heavier hogs has increased pork supplies by 2-3 percent.

NINTH DISTRICT - MINNEAPOLIS

District labor market conditions haven't worsened lately, despite the deepening agricultural crisis. Consumer spending appears to have slackened, though, particularly in drought-plagued agricultural areas. Summer construction and tourist spending have helped many district states weather the lack of storms.

Employment

Labor market conditions have continued to show general improvement. Minnesota's seasonally adjusted unemployment rate declined further, reaching 5.1 percent in June. Between May and June, initial unemployment claims in Minnesota fell 4.8 percent. In June, for the first time in four months, that state's economy created more manufacturing jobs than were seasonally expected. This brought Minnesota's total employment growth over the previous 12 months to 3.4 percent, the same as the nation's. Furthermore, despite agricultural sector woes, North Dakota's unemployment rate has been around 6 percent, while Montana's fell to an estimated 6.7 percent in June, despite an increase in its Billings area rate. Large retail chains opened new stores in St. Cloud, Minnesota; Brooklyn Center, Minnesota; and Bismarck, North Dakota. But in late June another taconite plant, employing 450 people, closed in the hard-pressed area of northeastern Minnesota.

Consumer Spending

Retail sales of general merchandise have slowed in the district. A retail chain reports that June sales have been not up to its expectations, although its July sales have been pretty much on target. Its inventories aren't excessive. A grocery chain also experienced somewhat lower sales recently. This Bank's directors generally report flat sales, due in large part to agricultural woes throughout the district.

Sales of motor vehicles have been seasonally slow, as consumers wait for new models to come out. Reflecting this, one domestic manufacturer reports that both car and truck sales were off in July. Another manufacturer reports higher June truck sales, though. Both manufacturers have more than adequate inventories.

Home sales have been strong lately in the Minneapolis-St. Paul area. There home sales in June were 20.7 percent above their high levels of a year earlier. At the same time, though, in North Dakota new housing starts were up only about 2 percent, and district Bank directors haven't reported much home building activity in agricultural areas.

Tourist expenditures have been generally up. Through June, inquiries at Minnesota state tourism offices were 27 percent ahead of last year. The big, multipurpose resorts are doing better than the small fishing resorts. A Bank director reports that a national park in North Dakota was busy in June, being visited by more people this year than last. A director from Montana notes that tourism to Yellowstone Park was up 18 percent this year. Finally, a bakery which serves northwestern Wisconsin and parts of the Upper Peninsula of Michigan reports that its sales were up, a good indicator of overall tourist expenditures in its service area.

Construction

Construction activity has helped buoy employment levels throughout the district. Ground was broken for yet another large office/retail complex in downtown Minneapolis, which is to add 1.25 million square feet of office space to the city's 14 million square feet of existing space. Twin Cities area commercial contractors now believe that activity will stay high into 1986. Public construction projects have provided jobs in Duluth, Minnesota; Rapid City, South Dakota; and parts of North Dakota and Montana.

Agriculture

Due to extreme dryness, the agricultural scene in Montana is a "total disaster," according to a Montana director, and is analogous to problems in the western Dakotas. Grasshoppers have been destroying whatever the drought has weakened. (According to experts, an average of eight grasshoppers per square yard on a 10-acre plot will eat the same amount of forage as one cow.) Crop insurance should be of some help to the stricken farmers, though. Also, the resulting lack of pasture land (due to both the drought and the grasshoppers) has hurt livestock operations, which have had to sell a lot of cattle as a result. A director reports that live cattle prices are now at their lowest levels since 1978, in part due to slack meat demand.

Farmers in less heat-stressed parts of the district are still suffering from low prices. The Minnesota farm price index finally steadied in July, but still remained 14 percent below last July's level. A recent decrease in federal milk price supports is expected to cost Minnesota dairy farmers around $50 million a year. Milk prices in Minnesota in July were the lowest in five years.

TENTH DISTRICT--KANSAS CITY

Overview. Recent modest economic growth in the Tenth District is expected to continue through the rest of the year. Retail sales have improved and are expected to continue to outpace last year's sales. Retail inventories have been reduced to satisfactory levels, while some further trimming of producers' input stocks is expected. Housing starts are lower than a year ago, but falling mortgage loan demand is expected to stabilize soon. District banks report mixed loan conditions and essentially unchanged deposits overall. The winter wheat harvest is nearly complete with yields in most district states at or below average compared to other years.

Retail Trade. Most retailers report improving current dollar sales after a weak showing in May, with sales of apparel and accessories especially strong. Overall, sales in the first half of 1985 are slightly above the first half of last year. Sales are expected to continue to run slightly ahead of last year. Retail prices have been stable during the past three months and are expected to remain stable throughout the rest of the year. Most retailers have been trimming inventories, but are now satisfied with their levels and no significant further change is anticipated.

Automobile Dealers. Automobile dealers report sales very close to year-ago levels. Financing is readily available for both dealer floorplanning and customer purchases. Dealers are trimming inventories to make room for the 1986 models. Most dealers expect that total 1985 sales will be about as strong as 1984 sales.

Purchasing Agents. Purchasing agents report input prices not much different from a year ago. Falling semiconductor prices have benefited some firms and falling crude oil prices have helped others. Little further change is expected for the remainder of the year. Input availability is excellent and is expected to remain so. Materials inventory levels range from satisfactory to somewhat high. Inventories are expected to be trimmed in coming months for reasons ranging from normal seasonal behavior to decreased sales projections.

Housing Activity and Finance. Most homebuilders report sharply lower housing starts, both single-family and multi-family, relative to a year ago. Expectations about starts for the remainder of the current year vary widely. Sales of new homes also vary considerably as a number of builders report sharply lower sales. New home prices have remained stable; inventories are described as good to slightly high. Prices of materials are generally reported as steady and material availability is described as good. Savings and loans institutions report savings inflows slightly higher than a year ago. No dramatic change is expected in the near future. Most respondents report lower mortgage demand and commitments but expect both to stabilize shortly. Mortgage rates have remained constant to slightly lower, with a slight decline or no change expected in the months ahead.

Banking. Tenth District banks report mixed loan behavior and largely unchanged deposit behavior. Half of the banks surveyed had increased consumer loan demand, with the other half reporting unchanged or decreased consumer demand. Real estate loan demand was fairly evenly divided among increases, decreases, and no changes last month. Commercial, industrial, and agricultural loans were either unchanged or down. The prime rate has fallen 0.5 percentage points at most banks surveyed, with many banks expecting further declines in the near term. Consumer lending rates, however, are largely unchanged. Deposit behavior last month was, on average, unchanged. Deposits in NOW accounts, Super-NOW accounts, money market deposit accounts, and small time deposits tended to either increase or remain constant, while large CD's and passbook savings tended either to decline or remain constant. Demand deposit behavior was more mixed, with about equal numbers of respondents reporting increases, decreases, and no change.

Agriculture. The winter wheat harvest is nearly complete, with yields in Missouri, Kansas, and eastern Nebraska about average. Bad weather led to disappointingly low yields in Oklahoma, and low yields are also expected in Wyoming and western Nebraska due to dry conditions and grasshopper damage. Colorado's wheat harvest produced almost twice the normal yield.

Conditions of spring crops and ranges generally are good across the district. Corn and soybean conditions are reported good to excellent in Missouri, Kansas, and eastern Nebraska. However, corn and soybeans in western Nebraska are suffering from extreme dryness and grasshopper infestations, while the condition of the Colorado corn crop is reported to be spotty. Adequate moisture has provided good range conditions in the eastern portion of the Tenth District. However, the western part of the district is experiencing extremely dry range conditions. Due to poor range conditions, ranchers in Wyoming are moving their cattle to market and selling at discounted prices. Cattle are also moving to market in western Nebraska, but to a lesser degree.

Agricultural lenders throughout the district report that land acquired by financial institutions through foreclosure or liquidation is being moved onto the market with little or no delay. Moreover, banks in all district states report that they are taking market price for farm real estate, and often setting no minimum at auction.

Many farm equipment dealers in the district remain in financial difficulty. Producers and sellers of farm equipment continue to cut back on inventories and number of employees. Farm equipment sales in Oklahoma have declined dramatically from the already low levels of a year ago.

ELEVENTH DISTRICT--DALLAS

Economic growth in the Eleventh District remains slow, although signs of strengthening are discernible. Overall manufacturing activity is flat, although some sectors have benefitted from increased demand. The fall of energy prices continues to depress drilling activity and energy-related manufacturing. Growth in retail sales has been modest but auto sales remain brisk. Nonresidential construction activity continues to expand, and the pace of residential building is up modestly in response to lower interest rates. Prices of farm products generally remain below year-earlier levels.

Eleventh District manufacturing activity has stabilized, but overall performance is flat. Some sectors show signs of rebounding, but the weak energy sector continues to hinder sales in many industries. Primary metals and nonelectrical machinery manufacturers report increased sales to food processors and defense contractors, but this rise barely offsets lower demand from firms catering to energy. Excess inventories of construction-related goods, in addition to weak energy demand, are hindering production of fabricated metal products. Manufacturers of stone, clay and glass and of lumber and wood products note that competition from foreign producers has reduced their sales to the construction sector. A rise in home-improvement sales is offsetting reduced sales to contract construction firms for the latter group. Apparel manufacturers report substantial increases in orders compared with last year. Electrical machinery producers note modestly higher sales, although semiconductor makers attribute continued weak demand to excess inventories held by buyers.

Eleventh District drilling activity remains depressed, but the rate of decline appears to be slowing. Despite expectations of a continued slide in oil prices, the year-over-year rate of reduction in the number of active drilling rigs in Texas eased in June. After seasonal adjustment, the rig count increased from June to July. Recent changes in proposals concerning drilling-related tax provisions may have contributed to the rise. The number of well permit applications in Texas and the U.S. seismic crew count, which are leading indicators of drilling, remain below year-earlier levels.

Retail sales continue to grow weakly, particularly for consumer durable goods. Although overall sales have been sluggish, respondents indicate that total inventories are not excessive. Apparel purchases have shown noticeable strength. Promotional markdowns are keeping retail prices near year-earlier levels. Employment levels are unchanged but respondents are still concerned that continued weak sales may force some layoffs.

Strong growth in auto sales continued throughout the second quarter with several respondents reporting increases over last year's exceptionally strong pace. Manufacturers' interest rate discounts and other promotions have stimulated sales, while prices have remained flat. Dealers report that inventories of imports and some large domestic models are fairly low, but small domestic models are in good supply. Some respondents, noting a slowdown in recent weeks, expressed concern that sales may level off in the next few months.

The value of nonresidential construction contracts continues to rise, but the year-over-year increase in May was the lowest in the last twelve months. Analysts have noted recently that Dallas now leads the nation in vacant office space. Although Houston's vacancy rate is falling, vacancies in some other Texas cities are rising. Rent discounts and other leasing inducements are being used throughout the District.

The value of residential construction contracts has been rising in the District since the beginning of 1985, as has the number of building permits issued. The levels relative to one year earlier remain low, however. Recent declines in mortgage interest rates have helped stimulate single family building, while the absorption of excess units has revived building of multifamily dwellings somewhat.

Asset growth at District large banks remained modest in June. Declines in business loans were offset by increases in real estate lending and holdings of government securities. Loan growth at Texas savings and loans remains high, although the rate of gain has ebbed somewhat in recent months. Deposit expansion at large banks continues to decelerate because of slower increases in large time deposits. New issues of jumbo CD's account for most of the deposit growth at savings and loans.

Eleventh District agriculture continues to face flat or declining prices, but the slide in land values abated during the second quarter. In a normal seasonal downturn, Texas feed grain prices fell in June from May, while livestock prices held steady. Prices of most Texas crop and livestock items have been below last year's levels for seven consecutive months. Meat production in the state is also lower than year-earlier levels.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

The economy of the Twelfth District continues to present a mixed picture. In general, consumer spending and growth in service industries have remained strong enough to offset problems in manufacturing and resource sectors. However, available data suggest that consumer spending is weakening. Semiconductor and related industries continue weak, and some agricultural sectors now bear additional burdens of bad weather, pests, and product recall problems.

Nevertheless, only one state, Arizona, reported higher unemployment in May than in April, and the 6.2 percent rate there remains well below the national rate of 7.3 percent.

Consumer Spending

Year over year consumer spending shows healthy increases in most sectors, although the limited available data on changes from month-earlier figures indicate possible recent softening. One exception is the central valley of California, where year over year retail sales comparisons show an inconsistent pattern of gains and losses, and auto sales fell 10 percent from June 1984 to June 1985. Sales tax receipts in Nevada and in the San Francisco Bay Area increased 12 percent and 13.5 percent, respectively, between May 1984 and May 1985. In Utah and Idaho, credit card sales and auto loan originations in June were well above those in June 1984 but below the levels seen in April and May, suggesting continued softening in retail sectors in the intermountain states. Sales at eating and drinking establishments, however, show particularly strong growth both in Oregon and in the San Francisco area. Auto sales in the Bay Area have improved from May 1984 but are unchanged from May to June of this year.

Manufacturing and Mining

The main bright spot in Western manufacturing is in defense and aerospace, in which there is little competition from abroad, particularly for government contracts. Continued weakness in manufacturing is felt particularly strongly in the western region by semiconductor and related firms. In the Northwest however, and particularly in Washington State, some high technology electronics firms, which rely less on personal computers for demand, are relatively insulated from the national slump. Throughout the Twelfth District, several firms have announced first quarter losses, layoffs, and mandatory unpaid holidays. Others have delayed or cancelled plant construction projects, although most construction projects in progress are continuing.

The wood products sector presents a mixed picture. While stronger than in the recent past, problems remain with competition from Canada and the strong U.S. dollar. Some firms continue layoffs and wage freezes, but others are returning laid off employees to work. In general, Oregon appears to be healthier than Washington. For example, one Oregon firm had strong paper earnings and orders in June, and expects a strong summer. In contrast, a Washington paper firm reports weakness in paper related to lower prices which now barely cover costs. One potential source of optimism in Washington is the weakening dollar, which has slowed the price decline. However, pressure on costs is sufficiently severe that production increases do not result necessarily in more jobs.

Mining sectors remain weak, with low prices and reduced employment in petroleum. With the exception of major gold mining and refining operations which have realized recent strength, there is no sign of improvement in the beleaguered mineral mining sector.

Construction and Real Estate

In general, building has been strong, although high vacancy rates in commercial and residential property in most parts of the district portend reduced construction activity in the future. While building permits remain strong in Phoenix, for example, many issued permits are not being used. Much of the residential building is focused on multifamily dwellings.

In some markets, signals are mixed. For example, in Idaho, May residential permits were 28 percent below May 1984, but the value of commercial construction was 45 percent above May 1984.

Agriculture

Natural and human misfortunes have combined with longer run problems to make this a bad time for most western agriculture. Cotton, almonds, and winegrapes, among others, continue to suffer from low world prices. The grape harvest again appears to be a bumper crop, raising the prospect of further declines in price. In addition, hot, dry weather has ruined some winter wheat in Oregon. Grasshoppers in southern Idaho and a recall of California watermelons because of pesticide poisoning have added to agricultural problems.

Nevertheless, there are some bright spots (lamb prices, for example, are up substantially), and western agriculture's ability to switch acreage to more profitable crops remains a source of long run optimism.

Financial Sector

Interest rates continue to fall, with 15-year fixed-rate mortgages now offered at rates as low as 11¼ percent, and variable rate mortgages with initial rates of 9 percent. Many financial institutions report reductions in problem loans, improved loan quality and higher earnings, suggesting that most problems in the financial sector have already surfaced. Lower interest rates have improved the outlook for many financial institutions where rates on liabilities have declined faster than rates on assets. However, institutions which hold substantial assets in variable rate instruments are seeing their spreads squeezed.