SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

June 1986

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SUMMARY*

Moderate growth is being reported by most Federal Reserve Districts, although the regional variations in economic conditions are substantial. Retail sales are expanding slowly, but several Districts report an acceleration in sales in recent months. Automobile sales are declining from their year-earlier levels and inventories have grown, but remain within acceptable ranges. Manufacturing activity is weak, especially in energy-dependent industries and regions. Past reductions in oil prices have led to significant declines in drilling. Residential construction activity remains strong overall. Nonresidential building, while maintaining a high level, is beginning to decline. Loan demand has been stable in most Districts. Agriculture is still facing low prices.

Consumer Spending

Retail sales have been growing moderately in most Districts. Cleveland, New York, Chicago, and Philadelphia report accelerating rates of expansion, but Dallas and St. Louis note absolute declines from a year earlier. Little change is cited in inventories, which are generally said to be tightly managed. Prices are stable, although some Districts say that respondents expect price increases for imported goods.

Automobile sales are sluggish in most Districts. The exception is Chicago, where sales have been matching last year's levels. Respondents report that a significant portion of the decline was anticipated because of the exceptionally strong sales of preceding years. In the Atlanta,

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*Prepared at the Federal Reserve Bank of Dallas.

Minneapolis, and Cleveland Districts, sales have been increasing in the second quarter over the first quarter levels, but remain below a year earlier. Inventories are growing, but are still within acceptable levels. For some particularly popular models, however, inventories are lean.

Early reports on tourism support the outlook for increased domestic travel this summer. Respondents report that lower gasoline prices, the weaker dollar, and preference for domestic vacations are the contributing factors. New York reports that foreign tourism is buoying retail sales.

Manufacturing

Manufacturing remains weak overall. Although several Districts note growing manufacturing output and employment, Cleveland, Chicago, and Dallas all report that the slump in energy has markedly reduced demand for manufactured goods, particularly steel and machinery. A number of Districts, however, cite industries such as tire manufacturing and petrochemicals that are benefitting from lower energy costs. Increased construction activity nationally is buoying orders to lumber and wood products firms and paper goods producers in the Atlanta and Minneapolis Districts, but it is providing little impetus to these industries elsewhere. Richmond notes that furniture manufacturers have excessive inventories due to lower-than-expected orders, and that longer-than-normal plant closures are planned for this summer. Boston's respondents have noticed some increased prices for imported manufactured goods, but they have seen little effect on sales or output. San Francisco's comments on weak employment growth in the electronic equipment sector seem to reflect this industry's national experience, especially with regard to computer-related goods.

Construction

In general, the strongest construction sector is single-family residential building, but this strength is not uniform. New York, Cleveland, and San Francisco all describe booming residential construction, aided by falling mortgage interest rates. In the Boston and Chicago Districts, shortages of skilled construction labor are now providing a drag on residential building. In contrast, home building in the Dallas District, and in some states of the Minneapolis and Atlanta Districts, has been stymied by weak economic conditions in these areas. Atlanta, Kansas City, and Dallas all cite sluggishness in multifamily building.

Growth rates of nonresidential building activity are declining or negative in every District that mentions this indicator. Nevertheless, the pace of nonresidential construction remains high in some Districts, notably Chicago, Atlanta, and New York. Retail building is generally the most active nonresidential category. Office construction is the weakest category, with rent concessions resulting from overbuilding in many major cities nationwide. St. Louis and Dallas report absolutely declining commercial construction.

Mining

The oil and gas extraction industry continues to reel as a result of falling oil prices. Dallas, Atlanta, San Francisco, and Minneapolis note reduced exploration and development activity in their Districts. The number of drilling rigs in operation is dropping nationwide. Richmond and Cleveland say that competition from oil and gas is reducing output and employment among coal mining firms.

Agriculture

Favorable weather is facilitating crop planting in the Chicago, St. Louis, and Minneapolis Districts, while adverse weather has hindered such activities in the Richmond, Atlanta, and Kansas City Districts. Low crop prices are mentioned as a concern in most agricultural regions. Chicago and Minneapolis note that increased dairy herd slaughter is depressing prices for cattle. Despite their uncertainty about the effects of the federal program to buy out dairy herds, cattle feeders in the Kansas City District are marketing their livestock on schedule. Both beef and poultry producers are expected to benefit from reductions in feeding costs. A slowing rate of increase in overdue agricultural loans is cited by St. Louis.

Banking and Finance

Loan demand has been stable in most Districts. Continuing strong demand for mortgage refinancing is cited by San Francisco, Richmond, Chicago, and Kansas City. A result has been higher mortgage rates and delays in closing. Cleveland, Philadelphia, Atlanta, and Dallas note growth in real estate and construction lending. The demand for commercial and business loans has been soft in Cleveland, Minneapolis, and Dallas, while increasing in Philadelphia. Consumer lending has been rising with particular vigor. New York, Cleveland, Atlanta, and Philadelphia all report strong growth in this asset category.

FIRST DISTRICT -- BOSTON

The economic imbalance that has characterized the First District economy for over a year continues, with manufacturers experiencing little or no growth while other sectors expand. Once again manufacturing respondents report that business is flat. The decline in the dollar has not yet had a clearly discernible effect on the firms contacted. Inventories and employment levels are viewed as a little high given current order rates. Retailers report mixed results for April and May, but more respondents were above plan than below. Retail inventories are up but contacts do not view this as a serious concern. Prices remain stable; few respondents have seen much increase in import prices. Retailers, even those with less than satisfactory sales growth in recent months, expect the second half of the year to be good.

Retail

Retail results for April and May were mixed. Several department stores, both upscale and discount, were disappointed in their late spring sales, with sales in some stores and chains below those of a year earlier. (The year-earlier results, contacts noted, were unusually robust.) In one case, the month of May appears stronger than the preceding three months; in another, no pickup is yet evident. In contrast, other department stores, notably one targeted to low income consumers, reported sales "nicely" ahead of last year. Sales in hardware and home buildings supply outlets were uniformly buoyant.

Among product lines, results were similarly mixed. Hard lines, such as electronics and paint, are generally strong. Other items experiencing strong demand include outdoor footwear and expensive housewares such as crystal. Apparel has performed poorly.

Inventories are higher than last year, but are not, at present, a source of concern for the retailers contacted. In some stores, inventories have been intentionally increased to improve customer service or alter product mix. Although inventories are also high in stores with disappointing sales, most do not plan major price cuts or order slowdowns to reduce them.

Prices are rising very moderately, in the 1-2 percent range. Merchants expect retail prices to remain well-behaved, with the effects of oil price reductions offsetting the declining value of the dollar; however, few have yet seen either oil-related cost reductions or rising import prices.

Stores doing well expect the strength to continue through the balance of the year. Those with weak growth are not making major adjustments, confident that consumer demand will soon be back on track.

Manufacturing

Manufacturing respondents report that while orders are weakening in some areas and strengthening in others, the overall level of activity remains flat. General industrial demand for traditional machinery and fabricated metal products is slow and getting slower. Sales of a variety of automotive products, which had been strong, are also softening. One contact reports a slowing in sales to the industrial and commercial construction market. On the other hand, sales of appliances and home building supplies are doing well. The defense business remains very strong, with a couple of respondents experiencing increases. The commercial aerospace market is said to be strengthening.

Several respondents noted that sales are stronger in Europe than in the United States. These reports referred to sales of subsidiary operations rather than exports. None of the firms contacted has experienced an improvement in business that he would attribute to the decline in the value of the dollar. Respondents in the traditional machinery and metals industries said that Japanese competitors had increased prices 5 - 6 percent; however, they did not think this was enough to change the competitive situation.

One contact noted that prices for imported parts had increased. However, all respondents, including the one experiencing the increase in import prices, said that materials prices are not changing to any significant degree. Several commented on their inability to raise their own prices; one reported that an attempt to raise prices 2 percent on a commodity-type metal product was greeted with derision from customers. Respondents expect wage increases of 0 to 4 1/2 percent.

Respondents consider employment and inventory levels to be a little high and will be taking modest corrective action. Plans call for capital spending to be higher in 1986 than in 1985, but a couple of larger respondents have got off to unexpectedly slow starts on their capital projects.

While manufacturing respondents do not expect a downturn in the near future, they are concerned about a lack of vigor in the economy and they are puzzled by widespread forecasts of a strong second half of 1986 when they see no evidence of any change.

New England Economic Project Outlook

The New England Economic Project (NEEP), a non-profit corporation comprised of New England business firms, government agencies and educational institutions has just released its semi-annual forecast for the New England economy. The forecast is based on state models developed by a local-area consulting firm and managed by NEEP members from each state.

The NEEP forecast calls for employment growth in New England of just under 3 percent in 1986 - about the same as in 1985 - and 2 1/2 percent in 1987. Growth should be sufficient to maintain an average unemployment rate in the region of close to 4 percent.

New England's growth in 1986 will depend, as it did in 1985, on the nonmanufacturing sector, especially trade, services and the finance insurance and real estate group. Manufacturing employment, which declined throughout 1985, will stabilize in 1986.

The NEEP expects growth in 1987 to be more balanced. Nonmanufacturing employment will grow more slowly. Construction employment is projected to slip a little from very high levels. Manufacturing employment, on the other hand, is expected to increase moderately - in large part because of an improved trade situation. This pickup in manufacturing employment will be concentrated in high tech and in traditional metalworking and machinery.

SECOND DISTRICT--NEW YORK

The pace of the expansion in the Second District economy has varied among sectors since the last report. Most retailers experienced further growth in sales, and builders report increased buyer interest in new homes. The commercial real estate market showed little change, however, and business activity was somewhat weaker. Many small banks have experienced a moderate rise in the number of credit card accounts in recent months.

Consumer Spending

Most retailers in the Second District reported continued growth in sales, with May somewhat stronger than April. Medium and higher priced stores generally registered over-the-year sales increases of 10-15 percent, while discount stores reported smaller gains or losses in some cases. Consumer demand for household durables, especially furniture, showed a noticeable pickup after several months of weakness. One retailer reported that with the drop in interest rates, "Consumers seem to be starting to move on big-ticket purchases." Fashion apparel, particularly better sportswear, also sold well. In addition, more foreign tourists are shopping in area stores after a steady decline over the last few years. However, according to retailers, these recent gains do not yet mark a trend toward steady and strong growth.

In New York City, where sales had been slower, recent gains generally matched the pace in the rest of the District. Sales growth in western New York, however, continued to be erratic. One department store chain in that area experienced a 4 percent over-the-year decline in April, but then registered a strong gain of 9 percent in May. Recent sales growth was reportedly higher in Buffalo than in Rochester, where many residents are concerned about large-scale layoffs scheduled for this year at Kodak.

Business Activity

Economic activity in the Second District weakened slightly in recent weeks. Almost 25 percent of purchasing managers surveyed in Buffalo and Rochester reported a worsening of business conditions in April, up from 18 and 8 percent in March, respectively.

May unemployment rates rose in both New York and New Jersey to levels somewhat above a year earlier. While New Jersey's 5.5 percent rate remains well below the United States average, New York's 7.4 percent is now slightly higher. Employment in the nonmanufacturing sector continues to expand, but reports from several firms indicate that further layoffs may occur in manufacturing. In Rochester, for example, a 10 percent cutback is underway at Kodak, and a General Motors division there may soon reduce its workforce by several hundred. Downstate on Long Island there is concern that a recently cancelled Air Force contract could mean the loss of several thousand jobs at Fairchild Republic when existing contracts are completed.

On a more positive note, Smith-Corona will increase its workforce by 300-400 in upstate New York and two other firms plan large-scale expansions of their research and laboratory facilities. These expansions will result in additional employment in the pharmaceutical and optical equipment industries.

Construction and Real Estate

Homebuilders in the Second District are very busy; in fact, the biggest problem for many is keeping up with demand. Lower mortgage rates are cited as a primary factor behind the strong buyer interest at this time. A record year for housing starts is forecast in some New Jersey areas, and in western New York the biggest housing boom in 10 years is reportedly underway. However, upward pressure on prices is resulting in some areas from a growing shortage of suitable lots, and certain types of skilled labor remain in short supply.

The Second District commercial real estate market has stabilized in recent weeks. While rent concessions remain widespread and inventory levels continue high in some areas, no additional softening seems to have occurred. Vacancy rates have also shown little change recently. Observers anticipate some improvement, however, because the number of plans for new office space is declining in areas of excess supply such as northern New Jersey and Fairfield County.

Financial Developments

Many small banks in the Second District report that the number of their credit card accounts has grown somewhat in the past few months despite high rates and a large amount of consumer indebtedness. A few banks noted, however, that they had also raised their minimum payment requirements, and the volume of their outstanding credit card debt has not increased much as a result. The growth in the number of accounts is partly attributed to increased advertising and the development of cards targeted at specific occupations and income levels. Growth at some banks has also resulted partly from the acquisition of competitors' facilities. A few banks, in contrast, report that their share of the credit card market has been eroded by money center banks, and they have responded by lowering rates and fees and by lengthening grace periods.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District are generally stable, with indications of improvement in some sectors. In manufacturing, the majority of the companies participating in the June Business Outlook Survey report steady business for the second consecutive month. Retailers say that sales have picked up in May and June following a slower than anticipated April. Automobile sales, however, continue to be weak. Bankers report a recent upturn in commercial loan demand, but say that consumer lending is only growing moderately.

Looking ahead, the Third District business community is generally optimistic. More than half of the industrial firms covered by the June Business Outlook Survey expect better business conditions in the six months ahead, although they anticipate some weakening in the employment situation. Retailers believe the current healthy pace of sales will continue through the rest of the year. Automobile dealers, however, do not expect better sales any time soon. Lending officers at Third District banks predict that further strengthening of the regional economy will keep commercial loan demand high, while consumer lending is expected to grow at a relatively slower rate.

MANUFACTURING

Industrial activity in the Third District is running at a steady pace, according to the latest Business Outlook Survey. Fifty-nine percent of the area manufacturers responding to the June survey say business is unchanged from May, 17 percent note improvement, and 20 percent report slower business. Conditions in the nondurable goods sector appear to be somewhat better than they are in the durable goods sector.

Specific indicators of manufacturing activity show little change on the whole. New orders and shipments are up slightly, while order backlogs are off somewhat. Prices of industrial goods in the region are steady. Employment is down marginally; although two-thirds of the industrial firms polled in June report steady employment levels, 20 percent are reducing payrolls, while just 13 percent are adding workers.

Third District manufacturers are optimistic about the balance of 1986. More than half of the June survey respondents expect a pickup in business over the next six months, while only 16 percent anticipate weakening conditions. On balance, gains are forecast for new orders and shipments, while unfilled orders are expected to remain at current levels. Capital spending plans call for slight increases in the second half of the year. Local manufacturers do not predict improvement in employment, however.

RETAIL

Third District retailers report a pickup in sales after a slower than expected April. In late May and early June, general merchandise and department stores sales were 5-10 percent above the same period last year. Store officials say seasonal items are selling well, and that sales in all product lines are meeting expectations. Consumer response to promotions has been very good. The one drag on the retail sector is automobile sales, which have been disappointing for the past few months.

Third District retailers, with the exception of automobile dealers, are optimistic about the second half of the year. With a healthy regional economy, they expect sales in the June-December period to be nearly 10 percent greater than in the second half of last year.

FINANCE

Lending officers at major Third District banks say demand for commercial and industrial loans is rising and they expect outstanding volume at the end of the second quarter to be significantly higher than it was at the end of the first quarter. They attribute this growth to accelerating business activity in the region, and expect it to last through the rest of the year. Real estate and construction lending is also up strongly. Several banks report commercial construction loan volume in early June more than 50 percent above June 1985. Most of this financing is for office buildings nearing completion, however, rather than for new projects.

Consumer lending in the Third District is also moving up as the second quarter comes to a close, although at a significantly slower pace than early in the year. Bankers say they believe consumers are becoming more sensitive to interest rates, and that the recent growth is due largely to the promotion of low rate (9-10 percent) personal loans. Credit card balances are growing slowly, and for some banks are virtually flat. Bankers do not expect more than moderate growth in overall consumer lending in the second half of this year.

FOURTH DISTRICT - CLEVELAND

Summary.

The Fourth District economy continues its pattern of slow growth with weakness in manufacturing and energy and strength in housing. Retail sales are a bit better than last quarter. Unemployment remains above the national level despite employment growing faster than nationally during the last twelve months. Manufacturing activity continues to be sluggish, and the energy industry is depressed. Housing activity is robust. Real estate and consumer installment lending is strong but commercial and industrial lending is down.

Consumer Spending.

Retailers in the District report generally better sales in the second quarter than in the first quarter. Although two major department store chains differ in the amount of increase during the current quarter, they both agreed that first quarter sales were below plans and that sales in the past two months have improved. General merchandise inventories are reported to be at normal levels. Charge sales at department stores appear to be increasing as a percent of total sales and one firm noted a significant increase in delinquent accounts since the beginning of this year. Retailers reported that imported prices have increased very little in response to dollar depreciation, although one expects price increases in the third or fourth quarters.

Area auto dealers reported much the same story as other retailers. Sales in recent months have been better than the first quarter, but still well below levels of last year. Inventory levels at domestic auto dealers range from slightly above normal to "heavy," but only one dealer expressed any concern over inventories. None of the dealers contacted expected additional near-term price increases, but did mention that past increases have been completely passed on to the consumer.

Labor Market Conditions.

Relative to a year earlier, Ohio employment in May has risen by 2.55%, somewhat better than the national gain of 2.03%. Nevertheless, the unemployment rate in Ohio was unchanged from its year earlier level and at 8.1% (s.a.) remains well above the national rate.

Manufacturing.

Manufacturing activity continues to be sluggish. Manufacturers in this District report new orders continue to grow but at a substantially slower pace than in April. The pace of production was also slower than in April. Order backlogs are up slightly after several months of decline. Employment in manufacturing appears on balance to be flat. Inventories of raw materials and finished goods continue their slow decline. Prices paid by manufacturers for commodities, components and equipment rose much more rapidly in May than they have in the last year or so. A major steel producer in this District has laid off several hundred production workers, in large measure because of weak demand from the oil and gas industry. The firm expects the workers to be out of work at least throughout the summer.

Energy.

Coal, oil, and natural gas industries in this District are depressed. A major oil firm expects crude oil prices to fluctuate between $12 and $18 per barrel and to average $15 per barrel over the next three or four years. The firm has cut its exploration budget by almost 60% from last year and would cut it further except that active drilling projects can't be cancelled. Total capital expenditures are being cut by about one-third from last year.

Housing and Construction.

The pace of housing activity in the Fourth District is high and builders, real estate brokers, and mortgage lenders all expect that the strong first-half pace will persist for the balance of 1986. However, there is a general consensus among market participants that lower mortgage rates would probably be required for the high level of housing construction to be sustained into 1987.

Real estate brokers continue to complain that a typical mortgage loan application now requires more than 60 days to process. Apparently, mortgage lenders are understaffed but do not expect the high mortgage volume to last long enough to justify expanding staff. Mortgage lenders are accommodating the longer processing times by extending their loan commitments from the standard 30 days to 60 days. Long processing times are not causing a higher level of application cancellations. So far, the suspension of the FHA mortgage-insurance program has had no visible effect on mortgage markets in this region, and FHA lending still represents approximately 12%-15% of total mortgage applications.

In late May, mortgage lenders increased their mortgage charges slightly by increasing closing points by 1 point and adding 1/4 to 1/2 percentage point to the mortgage rate. The 15-year mortgage is becoming less popular as borrowers return to the 30-year mortgage. The adjustable rate mortgage also continues to lose favor, falling to less than 10% of new loans by many lenders in this District.

Commercial Banking.

Overall loan demand continues to be flat at District banks. Total loans outstanding at large banks fell slightly over the last month even though real estate and consumer installment loans rose at a double-digit pace. Commercial and industrial loans outstanding contracted somewhat, reflecting softness in the demand for business loans. Other types of loans also fell at large District banks. Lenders do not anticipate any significant pickup in business loan demand over the next few months, but they do expect relatively good growth in consumer installment and real estate loans.

FIFTH DISTRICT - RICHMOND

Overview

Directors report a generally strong regional economy which includes depressed pockets such as the coal fields in West Virginia as well as booming areas such as those around Washington, D.C., and Charlotte, North Carolina. Production and final sales of goods have been about flat in recent weeks, but most service industries, especially those tied to tourism, are doing very well. New orders for manufactured goods are up, and most manufacturers are optimistic about where the economy will be in six months. At S&Ls, mortgage applications are still heavy, despite a rise in rates, while depositors are shifting funds to shorter maturities. In the agricultural sector, drought conditions exist in several areas.

Consumer Spending

Major department stores report only a slight increase in activity in recent weeks as compared with the surge in sales they reported several weeks ago. Sales of nondurable goods continue strong, but sales of big ticket durable goods, such as video and stereo components, are down somewhat. Most of the respondents expect increases in real retail sales in the months ahead.

Manufacturing and Mining

Manufacturing and mining activity are little changed from a month ago, according to our survey of business conditions. In coal mining, however, one large firm has just closed down some mines. In manufacturing, 58 percent of the respondents report no change in employment, and 65 percent report no change in the workweek. The remaining percentages are fairly evenly split between those reporting increases and those reporting decreases. Forty percent of the manufacturers report increases in new orders, but an even larger percentage report increases in shipments. Consequently, unfilled orders are reported as down by 30 percent of manufacturers, as compared with the 20 percent who report increases. Manufacturers report prices of both materials and finished goods are about the same as a month ago. Looking ahead six months, 70 percent of manufacturers expect general business conditions to improve. By then, 37 percent expect capital expenditures to be above current levels, as compared to 14 percent who foresee reductions.

Within the manufacturing sector, textile activity remains mostly unchanged while apparel shipments and new orders have increased over a month ago. Import competition remains the main concern of apparel manufacturers. Furniture manufacturers report heavier-than-normal inventories for this time of year, so they plan to close down for two weeks instead of one week in early July. According to furniture manufacturers, their excess inventories are due to lower-than-expected sales, and to retailers holding less in stock. Manufacturers of machinery report an average capacity utilization rate of 51 percent, the lowest of the industries surveyed. On the brighter side, manufacturers of stone, clay and glass products, fabricated metals, and transportation equipment all report increased shipments, orders, and levels of employment.

Financial

Deposit activity at savings and loans is generally reported to be normal. There are, however, many reports of depositors shifting funds from longer term accounts to 6-to-12 month accounts. Most respondents feel the shift reflects their depositors' impressions that interest rates are likely to move up in the near future. Meanwhile, mortgage rates are rising, with several reports of increases from bottoms of around 9-3/4 percent a few weeks ago to current rates of around 11 percent on 30-year fixed-rate mortgages.

Mortgage loan applicants continue to experience long delays in obtaining approvals. The delays--often 60 to 90 days, or twice the time it took a year ago--are attributable in part to the time required to obtain appraisals, credit reports, and title searches. Much of the heavy volume is due to applications for refinancing mortgages, but first-time mortgage demand also continues very strong.

Agriculture

Below normal rainfall remains a major problem facing crop producers around the District. Although precipitation over the last few weeks has brought relief to some areas, soil moisture levels remain well below normal. Small grain harvests, already well underway, are producing below normal yields. Hay and pasture conditions are generally fair to poor. Recent rains have kept most of the corn crop in good condition and tobacco is also reportedly not experiencing significant drought stress in most of the District at this time, although some corn and tobacco areas are very dry.

Livestock producers continue to face low prices. Beef and pork prices have been held down by large supplies. Poultry prices on the other hand, although also experiencing some downward pressure, should be sufficiently high to yield adequate profit margins, given the lower costs of grain.

SIXTH DISTRICT - ATLANTA

Growth of the southeastern economy slowed since the last reporting period, as indicated by rising unemployment. However, consumption accelerated with strength evident in consumer lending, merchandise and auto sales, and tourism. Activity in single-family residential housing remains robust, but multi-family construction is weakening, and commercial building is generally slower across the region. Dry weather continues to damage farm revenue prospects in parts of the region.

Employment and Industry. Labor markets weakened for District states except Florida and Georgia from March to April. The region's unemployment rate edged up to 7.9 percent, the third consecutive monthly increase. Textile and apparel employment continued to fall concurrent with the nation's record breaking April $1.4 billion textile and apparel trade deficit. Foreign competition continues to push down domestic textile goods prices; however, contacts report that mill operating rates have recently turned up in reaction to favorable retail inventory positions. Louisiana's oil industry has shown little improvement, and the state's drilling rig count has reached the lowest level since 1949. Oil field service companies continue to scale down operations; industry spokesmen see little prospect for near-term improvement.

More positively, low oil prices are benefiting the region's many tire producers by stimulating auto usage and holding down prices of petroleum-based raw materials. A trade organization reported that regional paper producers recently increased prices in reaction to strong domestic demand for corrugated products. The Southeast's lumber industry is being bolstered by increased demand for residential housing. Lumber prices and domestic output have increased in spite of the growing volume of Canadian imports, according to industry sources.

Consumer Spending. Department store sales rose 3.7 percent in the first quarter of 1986 over the level a year earlier in metropolitan areas of both the Southeast and the nation. Except for Louisiana and parts of Florida, most metro areas around the

District posted gains over year-earlier levels, with Birmingham, Mobile, Nashville, West Palm Beach, and Atlanta registering above-average increases. More recently, a poll of District merchants suggested favorable growth in May, led by strong apparel sales. District merchants are optimistic about the sales outlook for the rest of the summer. District car sales improved substantially in May from weak levels earlier this year, helped by cheaper gas and by dealer special financing and marketing efforts. Even so, year-to-date car sales remain below year-ago levels when sales were brisk.

Construction. Single-family sales volume and permits issued are up in most of the region except Louisiana since the last reporting period. Realtors in the Miami area reported record-breaking sales during April, while sales in Nashville are slowing slightly. However, multi-family developers throughout the region reported increasing weakness and voiced concern that passage of pending federal tax legislation might lead to construction of fewer apartments and a substantial rise in rents.

Commercial construction generally has slowed since early this year, but its strength varies widely across the District. In major office markets such as Atlanta and Tampa, vacancy rates, while still high, are beginning to rise more slowly. Retail construction is reported strong in the Birmingham and Nashville areas. Developers believe pending tax legislation, if passed, will slow commercial construction throughout the region.

Financial Services. April total loan growth at large banks in the Southeast reversed its year-long decline with business, real estate, and consumer credit all registering an upturn. The most dramatic increase came in consumer loans where the rate of growth increased from 14 to 20 percent. Personal loans and second mortgages appear to be spurring the rise in consumer loan growth; the consensus of bankers throughout the District is that auto loans are down because of lower rates being offered by the major U.S. auto manufacturers. A few banks in the Southeast have cut credit card interest rates, but contacts at large regional banks expressed intentions not to follow suit.

Tourism. Hotel occupancy in Florida is up sharply, and travel agents believe the state will benefit from a dramatic decline in travel to Mediterranean destinations. Georgia's contacts expect double-digit travel revenue increases this summer over 1985. Respondents in Atlanta are especially optimistic as cities are becoming more competitive vis-a-vis ocean beaches in luring vacationers. Tennessee tourist industry representatives expect record-breaking volume as the favorable economic and political environment coincides with that state's bicentennial celebration. Expectations are not as high in Alabama, Louisiana, and Mississippi as in the rest of the District.

Agriculture. Planting delays and slow growth due to low soil moisture in portions of the Sixth District will likely reduce yields of crops such as corn, soybeans, and peanuts, although recent rainfall has provided relief in the Mississippi Valley. With southeastern farmers planting less acreage, coupled with the prospect for below-average yields, production should be substantially lower this year than last. Moderate declines in the volume of livestock marketing suggest revenue in this sector will also fall below that of 1985. Production of poultry and eggs, on the other hand, has increased, and profits are growing with the rise in market prices and the decline in feed costs.

SEVENTH DISTRICT -- CHICAGO

Summary. Expansion in activity in the District apparently is continuing, but still trails the nation. Respondents report consumer products doing better, but industrial markets disappointing. The strongest sector is housing, which is booming in most areas. Sales of related consumer goods, including appliances and home furnishings, are also strong. Auto sales are at a high level but not growing, and imports have made further inroads into auto markets. Office and retail construction continue vigorous. Contracts for nonresidential building are about even with last year. Demand for gypsum board, cement, and other building materials is very strong. Capital goods generally remain weak. Steel shipments are about flat. Crop planting conditions were favorable, and abundant moisture will get crops off to a good start, suggesting continued downward pressure on grain prices.

Housing. Residential construction, both homes and apartments, remains strong. Housing starts are sharply higher than last year. Resales of existing homes continue at very high levels, but the rise may be slowing. The surge in new loan applications and refinancings, in response to the lower mortgage rates, has caused major processing problems for area lenders and appraisers, and substantial delays in closings. The rise in mortgage interest rates in the past month appears to have accelerated refinancings by those who think they may have "missed the bottom." Fixed-rate, 30-year mortgages commonly are around 10.5 percent, compared with under 10 percent earlier this year. Some lenders are quoting several sets of rates and points, with higher rates corresponding to lower points and vice versa. Strong demand has pushed housing prices significantly higher in some favored areas. Realtors report instances of two or more buyers bidding for a house above its list price. Production of mobile homes has been higher than a year ago in the District, mainly in Indiana, in contrast with a decline for the U.S.

Nonresidential Construction. Additional office buildings continue to be announced for the Chicago area, despite substantial vacancies and large concessions to new tenants. Office construction activity remains at a high level, especially in Chicago and Indianapolis. Scattered strikes have disrupted work in Chicago. (Strikes have been uncommon in recent years.) Retail construction is vigorous in suburban areas where population has been rising. Concessions are offered on retail leases. Some expect the pace of leasing to slow by year-end. Demand for small to medium-sized industrial buildings, particularly multi-use structures, is strong in some Chicago suburbs readily accessible to major highways. Contracts for nonresidential construction, District-wide, are about flat. Highway and public works activity are expected to be up this year from an improved level. Skilled building trade workers are in short supply. Many such workers retired or left the District in recent bleak years. Some are said to be returning in response to contractor appeals. A major supplier to ready-mix cement, which cut capacity a few years ago, reports shortages of trucks and drivers.

Steel. Orders for steel have slipped recently, and output appears likely to remain flat, slightly above last year. Strongest markets are galvanized sheet, especially for motor vehicles; structurals and other contractors' products; and a variety of consumer goods. But "one-third of the economy is missing," meaning most heavy capital goods, utilities, and oil and gas development. Steel imports are lower than last year but still substantial. Part of the decline in imports reflects the collapse of oil country tubular goods. Steel producers are still losing money. Efforts to raise prices have failed. Cost-cutting continues, including labor costs. One producer is transferring production of structural steel to Chicago from Pittsburgh. The same company has started a new continuous caster at a Chicago-area plant with 3.3 million tons of annual capacity. Inventories are under control, with managements determined to keep them under control.

Motor Vehicles. The pace of auto sales this year has been near last year's level, with imports accounting for a larger share. More aggressive incentive programs and modest production cutbacks by auto makers appear to have brought domestic inventories back into overall balance. Stocks of imports are generally lean. Sales of light trucks also have been boosted recently by incentive programs. Heavy truck sales remain soft, and will be 15 percent lower this year than in 1985, according to one industry observer.

Capital Goods. Demand for most mechanical capital goods remains weak. Consolidation of facilities and firms continues. A District manufacturer of heavy cranes sold that division to another heavy equipment maker. Another firm is selling a majority interest in its construction equipment business to a Japanese competitor, which will close the division's headquarters in the District and a manufacturing plant elsewhere. Railroad and farm equipment are down from last year's dismal levels. Additional layoffs, extended summer shutdowns, and plant closings in 3 District states have been announced by farm machinery makers. Oil and gas development equipment has fallen very sharply. Diesel engine demand is below expectations. Buying of lighter construction equipment has risen with home building. Food processing machinery also is higher.

Consumer Spending. A leading general merchandise retailer reported that sales in May showed the largest gain over a year earlier in 1 1/2 years. Other chains' results also are improved. Inventory levels are about normal. Delinquency rates on credit sales are high but stable. Major home appliance shipments continue to set records, and industry observers expect continued strength. Airline travel is above last year's level but by a smaller margin than earlier in the year. Michigan sources note increased construction activity to meet demands related to increase travel and tourism. An industry analyst projects a 10 percent rise this year in auto miles driven, which would boost demand for a wide range of travel-related products and services.

Agriculture. Spring crop plantings in the District are winding down on schedule. A favorable planting season and abundant moisture reserves will get crops off to a good start for the critical summer growing months. Despite less acreage, the consensus is that the 1986 crop harvest is again likely to exceed commercial market needs and add to already burdensome (price-depressing) stocks of grain. District pork producers have benefited from a rise in hog prices in recent weeks. Cattle prices remain at depressed levels, in part because of the heavy movement of animals to slaughter following the start of the whole-herd dairy buy-out program in April.

EIGHTH DISTRICT -- ST. LOUIS

Summary

Despite stronger employment growth, other sectors expanded more slowly in the District than in the nation. This is a reversal of the stronger District growth indicated in the last report. A survey of small District businesses, however, indicated a generally optimistic outlook for the second and third quarters of the year. Bank data show commercial lending expanding more rapidly and consumer lending growing more slowly than in the same period last year. District farmers are enjoying nearly ideal early growing conditions. Farm lending by commercial banks has declined sharply while the deterioration of farm loan portfolios has slowed.

Outlook

A recent survey of 236 small businesses in the District found a generally favorable outlook on business conditions through September. They judged the second quarter of this year to be a more favorable time to expand operations than they had previously judged the first quarter. The more favorable outlook was due primarily to declining interest rates. Pricing plans appear more restrained as 17 percent of the respondents anticipated price increases in the second quarter versus 25 percent who planned to increase prices in the previous survey last quarter.

Employment

Although growth in District nonagricultural employment showed some signs of slowing in April, the District's 5.6 percent growth rate exceeded the nation's 2.5 percent rate over the three month period ending in April.

The District growth was spurred by a particularly strong expansion of Missouri's nonmanufacturing industries. Employment in the District's manufacturing sector expanded at a 0.8 percent rate in the February through April period. The District unemployment rate declined from 7.9 in March to 7.6 percent in April.

Construction

Both residential and nonresidential construction activity grew more slowly in the District than in the nation in recent months. District residential building contracts expanded by 1.5 percent during the February-April period, and were 2.3 percent above the year-ago level while the corresponding national figures were 9.1 and 11.1 percent. The pace of residential construction in Missouri was similar to the nation's, but was substantially weaker in Arkansas and Tennessee.

Nonresidential building contracts declined by 2.4 percent in the three months through April in the District, but increased by 2.2 percent nationally. Strong growth in Tennessee was offset by declines in Arkansas, Kentucky and Missouri. District nonresidential building contracts were 6.7 percent below year-ago levels compared with a 4.5 percent national decline.

Consumer Spending

Despite strong growth in Missouri, first quarter retail sales decreased at a 0.5 percent rate in the District compared with a 4.3 percent national rate of increase. First quarter consumer spending in the District was 5.4 percent above the year-ago level, however.

Banking

Total loans outstanding at large weekly-reporting District banks grew at a 7.0 percent annual rate for the three months ending May. This rate of growth is approximately half that for the same period last year due primarily to sluggish growth in both consumer and real estate lending. In particular, consumer loans grew at a 7.4 percent rate over the three months compared with a 30.2 percent rate for the same period last year. Commercial loans, on the other hand, expanded at a 16.8 percent rate against a 10.3 percent rate over the same three months last year.

Agriculture

As a result of favorable planting weather followed by timely rains, most District crops have developed at a pace ahead of last year's. Normal weather patterns for the remainder of the crop season would produce near-record harvests of corn, soybeans and other major crops in spite of acreage cutbacks related to the price support programs.

At the end of the first quarter, District banks had reduced their agricultural loan volumes by 9.2 percent from a year earlier. The sharpest reductions were made by banks in Missouri where volumes fell by 18.3 percent. Kentucky banks, however, posted a slight increase in agricultural loans. Overdue farm loans at District agricultural banks continued to grow as a percentage of all agricultural loans but did so at a slower pace than last year. While net chargeoffs at agricultural banks in the U.S. continued to increase, chargeoffs were unchanged for District agricultural banks.

NINTH DISTRICT -- MINNEAPOLIS

Ninth District conditions appear to have improved somewhat during the second quarter. Some employment indicators moved favorably in April. Some components of consumer spending may have softened a bit during May, but big-ticket durables remained strong. Some hard-pressed nonmetro areas are being helped by increased tourist spending. Resource-related industry performance remained mixed: extractive sectors suffered while wood products sectors prospered. And while both crop and export conditions improved in the agriculture sector, little else did.

Employment

Labor market indicators picked up a bit in April. The district's seasonally adjusted unemployment rate fell to 6.2 percent in April, from 6.6 percent in March. The Minneapolis-St. Paul metropolitan area experienced a larger-than-seasonal decline in its unemployment rate, too. Unadjusted figures from state employment services show large, albeit partially seasonal, employment gains and unemployment rate declines in all district states. Only the Upper Peninsula of Michigan exhibited little improvement.

Some good news is finally evident in the manufacturing sector. Both of the Dakotas logged small increases in manufacturing employment during April. And while one computer company announced another layoff in Minnesota, it was more than compensated for by a callback issued by another computer firm.

Consumer Spending

Retail sales of general merchandise may have softened a bit between April and May, according to two large district retailers. Still, one of them recorded a 9 percent year-over-year increase this May and notes that the falling dollar is helping to stimulate substitution of American-made goods for Japanese goods. A spate of home sales has stimulated heavy purchasing of home items. A chain of department stores reports that Father's Day sales of menswear were good. Another chain reports that neither its inventories nor its credit sales are excessive. Bank directors again note the slack retail conditions in small cities and towns, particularly in western agricultural and energy-producing regions.

Auto sales appear to have improved in May. One large domestic manufacturer has had particular success selling trucks in this district. Its truck sales were 13 percent higher this May than last. Currently, neither its truck nor its car inventories are excessive, and the firm is optimistic about third quarter sales. As in the case of retail sales, Bank directors note slack auto sales in some nonmetro areas, including Miles City, Montana, and parts of western Wisconsin.

Outside of North Dakota and Montana, housing activity appears to have stayed fairly strong. In both Minneapolis and St. Paul, home sales during April and May were way above their levels a year earlier. Low interest rates, economic growth, and good weather have all helped there. Realtors in South Dakota also have found much buyer interest, particularly in the eastern half of the state and its Sioux Falls metro area. New homebuilding is down from last year in Fargo, North Dakota. Residential construction in the oil and gas producing western part of the state has declined substantially.

Tourism

Many nonmetro areas in this district are hoping that more summer tourism will help stimulate their economies. Early reports indicate that this is happening. A branch Bank director from Montana says that reservations at Yellowstone Park are already up 20 percent from last year. Campgrounds overflowed during the fishing opener in the Indianhead region of northwestern Wisconsin, where inquiries about summer travel are running far ahead of last year's pace. In anticipation of a good season, there has been a lot of resort expansion in the Upper Peninsula of Michigan, where inquiries are also up from a year ago.

Resource-Related Industries

Performance in large resource-related sectors has continued to be mixed. Wood products--including pulp, paper, and lumber--are all fairly strong. The new paper mill at Quinnesec, in Michigan's Upper Peninsula, is very busy. The high level of building activity nationwide has created demand for lumber and other building products, such as waferboard. A director does report timber industry concerns about a Forest Service plan to restrict the allowable harvest in northwestern Montana, though. Falling energy prices have greatly reduced prospects for oil and gas exploration in Montana and western North Dakota. A Bank director notes that only 9 rigs are operating in Montana now, whereas 23 were operating last year--and that was way below the peak number. Coal prices and production are not being helped by low oil prices. One bright mining spot is noted, though: A platinum mine is opening in Montana.

Agriculture

Recent news in the agricultural sector has been mixed. The Minnesota farm price index rose 3 percent between April and May, yet was still 6 percent below its level a year earlier. The fall of both farm prices and the U.S. dollar should help stimulate export sales; soybean exports are already up over last year. Exports are particularly important to Minnesota and North Dakota, which ranked seventh and eighth, respectively, among farm exporting states last year. Good weather has allowed timely planting and development of District crops. Ground moisture levels in Montana were the best in five years. Overall field conditions are noted as above average in both Montana and North Dakota. The much-publicized dairy herd buyout program has yet to cut milk production much. Cattle producers are reported to be displeased with the buyout's attendant herd slaughter, which is believed to have put downward pressure on already low cattle prices. Previously declining dairy land values are said to be likely to have bottomed out.

TENTH DISTRICT -- KANSAS CITY

Overview. Other than continued weakness in the energy and agricultural sectors, some recent improvement is reported in Tenth District economic conditions. Retail sales are at or above levels established last year. Retailers are generally satisfied with inventory levels, although manufacturers' purchasing agents continue trimming their materials inventories. The automobile market, however, is characterized by low sales, high inventories, and an uncertain future. Housing activity is expected to remain strong, and low mortgage rates continue to stimulate refinancing activity. Loan demand and interest rates at commercial banks are generally unchanged. Crop prospects are uncertain, but farmland prices may be stabilizing.

Retail trade. Retailers report year-to-date sales equal to or above levels established last year. They are optimistic that this will remain the case the rest of the year. Sales of apparel and accessories, cosmetics and fashion jewelry, and sportswear are strong. Sales of home furnishings and electronics are somewhat sluggish. Prices have moved slightly downward, but retailers expect to hold them stable through the end of the year. Retailers are generally satisfied with inventory levels, and they are attempting to keep them generally steady at levels slightly below last year's.

Automobile sales. Low sales, generally high inventories, and an uncertain future characterize district auto dealers' conditions. Favorable credit conditions have not stimulated sales, which are lagging behind 1985 levels. Moreover, with inventory levels already high in most areas, continued slow sales could have a magnified future adverse effect on dealers' new car orders from manufacturers.

Purchasing agents. Most purchasing agents report prices of their major inputs about 2 percent higher than year-ago levels, with most of this increase occurring in the last three months. Prices are expected to remain at current levels for the remainder of the year. Most firms have been trimming their materials inventory levels and plan to continue this process for the remainder of the year.

Housing activity and finance. Area homebuilders report that year-to-date starts of single family dwellings have increased over last year's pace, while multifamily starts have varied widely. Sales of new homes are near last year's levels, and new home prices have remained steady. Most homebuilders expect housing starts to remain steady during the remainder of the year. Builders report good availability of housing materials and no delivery problems. Materials prices are generally steady, though most builders continue to encounter higher lumber costs. Savings and loan institutions have experienced reduced savings inflows relative to a year earlier and have mixed expectations for the months ahead. Mortgage activity continues to be strong because of demand for refinancing. Mortgage rates have been holding steady, and most respondents expect them to remain so for the rest of this year.

Banking. Total loan demand was generally unchanged and total deposit activity has been mixed at Tenth District banks during the past month. Most bankers surveyed indicate a continuation in strong refinancing activity in residential real estate loans while commercial and industrial loans, consumer loans, commercial real estate loans, and agricultural loans were mostly unchanged or down from one month ago. No respondents have changed their prime rate or consumer loan rates during the last month. Mixed total deposit activity reflects variation mostly in demand deposits and large CD's. Other deposit categories were generally unchanged.

Agriculture. The wheat harvest in Oklahoma is about 50 percent complete, with yields ranging widely from below average to exceptional. In Kansas, the harvest has been delayed by wet weather. Agricultural lenders report that a large proportion of the wheat crop will be put in storage under CCC loans. A severe storage shortage, however, may force some farmers to market some of their wheat.

The corn crop is rated good to excellent throughout the tenth district, with some planting completed ahead of schedule. Except in Nebraska, soybean and sorghum planting is slightly behind schedule due to wet weather, but bankers are optimistic about prospects for these crops nonetheless.

Despite uncertainty about the effects of the dairy herd buy-out program, cattle feeders in the tenth district are marketing their livestock on schedule. Although some cattle feeders held back livestock initially, very few are sticking to that strategy now. Those cattle feedlots making wide use of forward contracts and/or hedging strategies have been able to keep marketings on schedule better than others.

Agricultural lenders in some parts of the Tenth District report that the long sought stabilization in farm land values may be under way, although, in many cases, not enough land has been traded to determine which direction prices are moving.

Falling oil prices have created additional financial hardships for ranchers who earn income by leasing their oil-bearing property. Such ranchers are faced with either reduced income from their oil leases, or with termination of the leases. The loss of oil income may contribute to business failure for some ranchers.

ELEVENTH DISTRICT--DALLAS

The Eleventh District economy is still reeling from the declines in energy prices. The drilling rig count has plummeted and oil and gas extraction employment has also dropped sharply. Although construction contract values rebounded slightly in April, their trend has been downward this year. Manufacturers' orders continue to fall in response to ebbing activity in construction and the energy industry. Retail and auto sales are declining. Assets at large banks are unchanged from a year earlier, as a result of sluggishness in loan demand. District agricultural prices remain below those of last year.

Manufacturing firms in the District are reducing output and laying off workers. Paper and allied products manufacturers, particularly those that supply packaging, say their orders are down. Chemical companies report fairly strong demand for products sold as intermediate inputs to firms serving national markets, but respondents note that demand is weak for final products marketed in the District. Among stone, clay and glass producers, orders from drillers and oilfield service companies have plummeted, and construction-related demand is also off. Ebbing construction activity in much of the District has stopped sales growth for lumber and wood producers, but few report absolute declines in orders. Both primary metals and nonelectrical machinery manufacturers are retrenching sharply in the face of falling demand from the energy sector. Fabricated metals orders are also down, particularly those from construction and electronics firms. Electronic equipment makers report slowly growing semiconductor sales, but orders for other computer-linked products are slipping.

Although District construction contract values rebounded slightly in April, the general trend since the start of the year has been down. Nonresidential construction activity remains significantly below a year earlier. Office vacancy rates in the District continue to climb. Residential contract values are also well below a year earlier and multifamily permits fell hard in April. There is much evidence of overbuilding in multifamily housing.

Most energy industries are curtailing their activities in response to the fall in oil prices. The drilling rig count in the District states has declined 65 percent since June 1985 and extraction employment has dropped sharply. Leading indicators of future drilling are also off, with drilling permits 63 percent below last year's level and the seismic crew count down 50 percent.

Automobile sales are slipping throughout the District. The largest declines are in the energy-dependent portions of the region, where year-to-year decreases are as high as 30 percent. Dealers link some of the decline to what they perceive as a normal cycle in automobile sales, but they believe most of the downturn is tied to the weakness of the regional economy. Inventories are up but, as yet, they are not at undesired levels.

Retail sales also are declining in the District, with revenues turning down even in areas with only limited direct ties to the energy industry. Retailers report that inventories are being held at desired levels, despite sluggish sales, because of effective monitoring and control. Price increases of some imported goods are expected in the third quarter but, so far, the prices of Japanese and European goods have been fairly stable.

Weakness in loan demand has induced large District banks to shift their asset portfolios toward treasury securities. In May, treasury securities grew significantly over their year-earlier level while the volume of business loans declined absolutely. Real estate loans continued to expand, but at a slower rate than last year. Deposits have been falling at large banks, led by declines in holdings of large certificates of deposit. In response to declining deposits, District banks have increased their reliance on borrowings. Deposits have continued to rise rapidly at thrifts.

In District agriculture, livestock and crop prices are down from the levels of last year, but they have remained steady in recent weeks. Grain and cotton prices are expected to fall. The reduction in grain prices, however, will reduce costs for livestock producers. Income prospects in District agriculture are more uncertain than usual because of unresolved questions about the extent to which government payments will offset the expected decline in grain and cotton prices.

TWELFTH DISTRICT - SAN FRANCISCO

The Twelfth District economy continues to be generally prosperous, although some problems remain. The volume of retail sales, while no longer spectacular, is still healthy and is benefiting from increased tourist traffic. Most manufacturing industries continue their weak performances, although lumber sales are benefiting from the boom in housing construction and commercial airplane orders continue strong. Similarly, problems continue to plague most agricultural producers, although some are doing quite well, including growers of apples, berries, and citrus fruits. While low interest rates have created a boom in construction of single family homes, weakness in most commercial real estate markets has caused the pace of office and apartment construction to slow. Reflecting these trends, banks report strong mortgage activity but few closings in commercial real estate loans.

Consumer Spending

Overall, consumer spending continues to provide a boost to the Twelfth District economy. However, in some areas with troubled economies, including for example Idaho, sales are relatively weak. Moreover, auto sales are flat or down in many areas, and imported cars remain popular despite the price increases of recent months.

Throughout the District, preliminary evidence suggests that high expectations for this summer's tourist traffic will not be disappointed. Washington and Oregon should post particularly strong performances, due to Expo '86 in Vancouver. In Seattle, hotel occupancy currently stands 13 percent above its year-ago level. The Portland airport has experienced strong passenger traffic this spring and ticket sales for the Shakespeare

Festival in Ashland, Oregon are currently outpacing last year's record level.

Manufacturing and Mining

Manufacturing continues to be a relatively weak sector in the West. Although the outlook for electronics firms has brightened during the past few months, investment and hiring activity remain sluggish. Moreover, the prospect of cuts in the defense budget, together with lingering uncertainties about the future of the space program, have put a damper on the previously brisk pace of government contract activity in the aerospace industry. At the same time, the continuing large number of orders for commercial airplanes benefits aerospace firms, which provides a boost to the Seattle area economy.

Forest products companies are enjoying a burst of activity associated with the current surge in homebuilding. Nevertheless, profit margins remain thin, particularly after the sharp drop in prices during the past month, so few firms are expanding and cost cutting efforts continue.

Low oil prices have slowed oil activity in the Twelfth District, although less so than in other regions of the country. In Alaska, the rig count is little changed from the beginning of the year, but exploration activity has fallen substantially. In southern California, one company has put back on line about half of the rigs it closed last month.

Agriculture

In most parts of the Twelfth District, agricultural problems continue. Weaknesses in the markets for wheat, beef cattle, and cotton are particularly persistent, and most respondents agree that the lower foreign exchange value of the dollar, lower interest rates, and lower oil prices are insufficient to turn those sectors around.

Some major crops are quite profitable this year, including apples in Washington and berries in Oregon. However, high prices and low inventories for both products are partly the result of crop damage in some parts of those states. In California, citrus and fresh fruit farmers are doing well, and the lower value of the dollar continues to benefit wine and almond producers. Crop damage to almonds in northern California should further benefit those producers that have good crops.

Construction and Real Estate

Construction of single family homes, stimulated by low interest rates, is strong in most parts of the Twelfth District. With the exception of retail building in some fast growing areas such as San Diego, commercial construction is much less robust than is homebuilding. High vacancy rates have combined with uncertainties about tax reform to slow office, apartment, and hotel building activity in most areas.

Financial Sector

Strength in mortgage lending and refinancing activity has created serious appraisal and mortgage evaluation backlogs for some lenders. Partly as a result of these backlogs, mortgage interest rates have risen about a percentage point during the past month.

Refinancing activity is strong for commercial real estate as well, but in most areas there is little demand for new commercial real estate loans. Lenders are scrutinizing closely the applications they do receive because they are concerned about the high vacancy rates and the potential for unprofitable projects.