SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

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SUMMARY*

Most Federal Reserve Districts report moderate economic growth. Manufacturing orders and shipments continue to grow, with few reports of price increases or inventory buildup. Lumber production is operating near capacity, due in part to an expansion of exports. Housing construction continues at a steady pace despite the recent increase in mortgage rates. High vacancy rates and the new tax laws have reduced commercial construction.

Most agricultural sectors remain depressed. Although recent increases in beef and hog prices have generated short-term earnings gains for cattle and hog producers, crop farmers still face problems of oversupply and low prices. The energy sector also remains depressed. Oil and coal producers report that drilling and mining operations are below last year's levels. However, oil drilling has increased in some areas as domestic oil prices rise. Growth in retail and automobile sales appears to be slowing. Higher prices, increased consumer indebtedness, and higher interest rates are the major reasons cited. Loan activity is also weak. Strong demand for commercial and real estate loans has not been enough to offset the reduction in the volume of consumer loans.

RETAIL

Growth in retail sales appears to be slowing in many districts. Dallas and San Francisco continue to report generally sluggish sales,

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*Prepared at the Federal Reserve Bank of Cleveland from information gathered prior to June 15, 1987.

while Boston and Cleveland indicate wide variations in sales activities among various retail chains. Most Districts report increases in apparel prices, especially among imported goods. Boston's inquiries about the reasons for price increases reveal two primary sources: import quotas and the decline in the dollar. Strong demand for apparel is leading to increases in the prices at which quotas are bought and sold among overseas manufacturers.

Also, quotas provide the incentive for foreign producers to import more expensive lines of clothing. The decline in the value of the dollar has been felt most strongly on prices of imports from Japan and European countries, whose currencies have appreciated most against the dollar. Prices of domestically produced apparel have also risen but not as much as prices of imported apparel. Much of the domestic price increase is due to domestic textile mills running near capacity.

Automobile sales are sluggish in most Districts. Dealers in the Minneapolis District report that automobile sales were 20 percent lower in May than a year ago. Weak auto sales raise the prospect for more aggressive sales incentives and further production cutbacks by domestic auto producers. As yet, domestic auto dealers have not discounted prices, and current production schedules have stabilized inventories. The declining value of the dollar has significantly reduced import auto sales by raising prices. Import dealers report declining profits, and inventories increased considerably in May.

MANUFACTURING

Manufacturing continues to show signs of growth. Many Districts report increases in orders and shipments and moderate reductions in inventories. Boston reports that both high-technology and traditional industries are experiencing increases. Philadelphia indicates improvement in the durable-goods sectors, and Richmond finds increased activity in nondurables. Employment, however, has shown little gain. In many areas, employment is limited to replacement hiring. Other areas, such as Minneapolis and St. Louis, report employment losses over the past month or two.

The effect of the depreciation of the dollar on manufacturing is still mixed. Boston reports that none of its respondents attribute the gain in domestic orders to an easing of import competition. San Francisco, on the other hand, finds that manufacturers of some products that compete against low-cost imports report strengthening in sales and orders. In general, strong domestic demand appears to be the major force behind improvement in manufacturing. The increase in steel production, for example, appears to be attributable to increases in construction and in oil drilling operations, despite cutbacks in automobile production.

Most districts report that input prices are stable. There is some upward price pressure as certain products, especially steel products, continue to be in short supply.

Capital spending is reported to be moderately high by some Districts. Chicago reports sizable investments in upgrading facilities in the traditional, heavy-manufacturing industries.

ENERGY

The energy sector remains depressed, despite the increase in domestic crude oil prices. Atlanta and Kansas City report that exploration and development are below levels of a year ago. Dallas, however, reports that drilling continues to increase. In May, the rig count was only 4 percent below a year ago, and it was above the levels of earlier months in 1987. The recent increase in domestic oil prices is expected to sustain this trend.

Coal production has increased slightly in recent weeks, but both Atlanta and Richmond report that output is below last year's level. Some coal producers anticipate that the increase in oil prices may help to shore up demand.

AGRICULTURE AND FORESTRY

Although a few agricultural sectors have shown signs of improvement in recent months, conditions are still generally depressed. Increases in cattle and hog prices and lower feed costs have raised short-term earnings of cattle and hog producers. However, prospects for the future are mixed. Atlanta and Chicago report that hog and cattle herds are being rebuilt and that feedlots are presently full. Kansas City, on the other hand, indicates that while feedlots are near capacity, few feeders are expanding capacity and cow-calf and stocker-cattle operators do not appear to be adding to their herds.

Most Districts report favorable crop conditions. A relatively dry spring has allowed crop planting to be finished ahead of schedule. Crop development appears good, although St. Louis reports that its dry spring may reduce wheat yields by as much as 20 percent. Crop prices, although slightly higher in the past few months, are anticipated to fall back to around the government subsidy levels.

Lumber production in the Pacific Northwest is running near peak capacity, primarily due to strong demand from China, Japan, and Europe.

Recent interest-rate hikes temporarily reduced the volume of orders in April, but orders have picked up as mortgage rates have stabilized.

CONSTRUCTION AND REAL ESTATE

Residential construction remains strong in all Districts except for Dallas and St. Louis. The jump in mortgage rates during April and May has had little effect on housing activity. Housing starts in many Districts continue to run ahead of last year's numbers. New York reports that anticipation of further rate increases generated additional demand. High vacancy rates, higher interest rates, and the new tax laws have caused a slowdown in commercial construction in many Districts. However, the New York City area continues to experience brisk commercial construction activity.

FINANCE

Growth in loans and deposits is generally weak. Commercial and real estate loans remain strong, but the volume of consumer loans has fallen off substantially. Some bank contacts attribute the decline in consumer loan demand to the attractiveness of home equity loans, high consumer indebtedness, and competition from auto finance companies. To attract additional borrowers, several banks have pursued aggressive marketing strategies, which include increased advertising and proposals to offer loans with variable rates, similar to financing arrangements available from home equity loans. Some banks have lowered (or plan to lower) rates on their fixed-rate loans in order to be more competitive.

FIRST DISTRICT - BOSTON

Economic activity in the First District remains at a high level, although the composition of activity may have changed a little. The retail experience has been mixed, with some merchants facing flat sales and others enjoying large increases. Poor weather depressed sales in May; early June results have been stronger. Manufacturing respondents reported a fairly broad-based pickup in orders in the past couple of months. This increase is attributed to domestic demand, rather than an improving trade situation. While retailers are seeing rising import prices, manufacturers are not. Employers throughout the District are experiencing difficulty attracting and holding workers, particularly at the entry level.

Retail

Sales results continue to be mixed in the First District. Some chains report sales level with last year; others have seen increases of up to 22 percent in recent months. Several contacts mentioned a noticeable pickup in the first week or two of June after a lackluster May. Inventories have been kept in line with sales. Some prices, notably apparel and lumber, are rising; so are local labor costs.

The weather in New England was poor in May and sales generally suffered as a result. This was particularly true of seasonal items, which reportedly picked up markedly as the weather warmed at the end of the month. One store experienced a sudden drop in sales of major appliances in the middle of April which has not yet been reversed; another, however, said appliances advanced well while sales of homebuilding supplies declined.

A number of merchants reported difficulty in keeping stores and home offices fully staffed. Turnover is rising ("because it is so easy for employees to find new jobs") and it is difficult to hire new employees, especially at the lower-paid end of the market.

Forecasts for the remainder of the year are closely tied to recent performance. For stores performing poorly, this represents a more negative outlook compared with earlier this year.

<u>Apparel Prices</u>

Because of the sizable apparel price increase in the CPI, inquiries about the sources of this increase were made among First District retailers. These retailers report that apparel import prices are rising substantially (10-25 percent compared to a year earlier); they lay the blame for these increases on both the quota system and the decline in the value of the dollar. Prices of domestically produced apparel are increasing more gradually; these domestic price increases are attributed to rising textile prices.

Strong demand for apparel is leading to increases in the prices at which quotas are bought and sold among overseas manufacturers. Also, because the quotas limit the <u>quantity</u> (not value) of goods that foreign producers can send to the United States, the items now imported include fewer inexpensive goods. While the decline in the value of the dollar has had its strongest effects on the prices of imports from Japan and Europe, quotas also affect goods from countries with no currency appreciation relative to the dollar. In addition, the appreciation of the yen has contributed to price increases for Korean and Taiwanese apparel, because many producers in these countries buy their fabrics from Japan.

Both imported and domestic textile prices are rising. Prices for imported textiles are rising because of the decline in the value of the dollar (Japan and Europe) and because of quotas (Hong Kong, Korea, Taiwan). Domestic prices are rising because demand is up and domestic textile mills are running near capacity.

Manufacturing

Respondents from the manufacturing sector have seen an increase in orders in the past month or two. Most of these contacts are producers of capital goods, but within this group the increases have been broadly based. Manufacturers of both high technology products and more traditional capital goods have experienced increases. Domestic demand is responsible for the improvement. Reports on exports were mixed. One contact in the instruments industry reported that exports to Europe have been strong since 1986; however, another contact, from a firm that is very active in international markets, described exports as disappointing. None of the respondents attributed the pickup in domestic orders to an easing in import competition. Japanese competitors are said to be resisting raising prices and are holding on to market share tenaciously. Most respondents are also holding the line on prices and in a couple of cases prices are being reduced.

Because of the lag between orders and shipments, several contacts have quite low shipment volumes. A couple have had small layoffs recently. Hiring is limited to replacement hiring; none of the firms contacted is increasing the size of its workforce. Capital spending levels are considered to be fairly high, although not necessarily higher than last year. On balance, manufacturing respondents have become a little more positive about the outlook for the next six months to a year.

Outlook

The New England Economic Project (NEEP), a non-profit organization comprising businesses, government agencies and educational institutions, held its semi-annual outlook conference at the end of May. The NEEP forecasts for the six New England states, taken together, call for nonagricultural employment in the region to increase at a slightly faster rate in 1987 and 1988 than the 2.6 percent rate of growth experienced in 1986. Growth will be more balanced, with manufacturing employment stabilizing in 1987 and increasing slightly in 1988. Nonmanufacturing employment will grow strongly but not quite so strongly as in the past couple of years. The unemployment rate in the region will remain around 4 percent. Representatives from all six states spoke of the difficulties employers are having finding workers. All kinds of businesses, manufacturing and services, are experiencing difficulty attracting and holding on to staff, especially at the entry level.

SECOND DISTRICT—NEW YORK

The modest uptrend in the Second District economy continued in recent weeks. Most retailers had sales gains that were at or above plan, and residential construction remained strong. Business activity showed some improvement, and demand for office space was generally good. Small and mid-sized banks report that consumer loans continue weak, however, despite increasing attempts to attract borrowers.

Consumer Spending

Second District department store sales were relatively strong in recent weeks according to our contacts. Due to the late Easter this year, sizable over-the-year gains during April had been anticipated. However, the 13 to 16 percent increases actually posted were generally larger than had been targeted. May sales gains of 7 to 9 percent were for the most part in line with expectations. The major exception was a respondent whose May sales rise of 19 percent was even greater than his year-over-year April increase.

In line with the Easter holiday and spring season, the items mentioned as most heavily in demand were adult apparel and various items for children. Most respondents reported that, as a result of recent sales activity, inventories remain on or close to plan. However, one retailer, who noted a slowing of sales momentum in May, described his inventories as "a little heavier than desired".

Business Activity

A pickup occurred recently in District economic activity. Both the Buffalo and Rochester surveys of purchasing managers registered an increase in those reporting improved business conditions in May, and no respondents in

Rochester experienced a worsening. In April, both surveys had shown a decline in the percentage of firms with better conditions, though the percentage with either stable or better conditions was essentially unchanged. The May reports also showed a sharp drop in firms encountering higher commodity prices.

District unemployment rates of 4.2 percent in New Jersey and 4.8 percent in New York remain well below the United States average. However, some recent developments have elicited considerable concern about the District's employment outlook. A Labor Department study just released shows that from 1984 to 1987 manufacturing jobs declined much more rapidly here than nationwide. In addition, two major corporations announced plans to move their corporate headquarters and 6000 employees from the region over the next year or so. Much public discussion has ensued about what is needed to avoid the exodus of other major corporations as well as about the increased vulnerability of the District's economy due to its narrowing industry mix.

Construction and Real Estate

Residential construction activity is strong in the Second District and builders continue to anticipate that this year will see a high level of homebuilding. While some areas expect a slowing from last year's hectic pace, other newly developing areas look for an even higher rate of activity. The rise in mortgage rates has apparently not yet had much of a dampening effect and, in fact, may be prompting some additional demand in anticipation of further rate increases. However, a cautious note has been injected into the outlook in northern New Jersey where a shortage of affordable land has been an increasing problem. An 18-month moratorium has just been declared on building in the New Jersey wetlands and its impact on residential development is uncertain.

Office leasing activity in the Second District has continued at a good pace with reports of brisk demand in the midtown Manhattan market. Although the recently announced plans of Mobil and J.C. Penney to move their corporate headquarters from Manhattan mean the release of an additional three million square feet, the consensus seems to be that this can be accommodated with no real difficulty. A major new project getting underway is a $900 million complex of offices, condominiums, and stores in Jersey City. While the overall vacancy rate in northern New Jersey remains high, this project on the Hudson River is reportedly at a prime location because of its proximity to public transportation as well as New York City.

Financial Developments

Small and mid-sized banks in the Second District report that growth in consumer loans has remained weak in recent months, despite increasing attempts to attract borrowers. Banks indicated that originations of personal, automobile, and mortgage loans have all been considerably lower than their usual level for this time of year. Respondents attributed the decline to the attractiveness of other products such as home equity credit lines, high consumer indebtedness, and competition from the auto finance companies. Several banks emphasized the importance of home equity credit, and suggested its growth relative to more traditional consumer loans has been exerting pressure to lower rates in the problematic areas. Banks cited the desire for a more balanced portfolio between fixed rate consumer and variable rate home equity loans, as well as the higher profit margins on the fixed rate category as reasons underlying this pressure. Most surveyed banks indicated that they have begun to offer lower rates on several types of consumer credit or plan to do so in the near future. In addition, most of the banks are in the process of increasing advertising and marketing efforts to current and prospective bank customers.

THIRD DISTRICT - PHILADELPHIA

Moderate growth characterizes most sectors of the Third District economy as the summer begins. Manufacturing activity is expanding slightly in June, for the third month in a row; and, in a change from recent months, durable goods manufacturers are making greater gains than nondurable goods producers. Retailers report that May sales ran ahead of plans and that strong consumer demand is continuing into June. Automobile sales, however, are weak. Bankers note that real estate lending remains strong and that commercial and industrial lending picked up in May and June. Consumer loan demand, however, is growing at the same slow pace that has marked recent months.

The outlook in the Third District business community is generally optimistic. A slight majority of the manufacturers polled in June expect further expansion in the next two quarters. Area merchants are encouraged by the pace of sales this spring and they forecast a good summer. They also express confidence that sales will remain healthy for the rest of the year. In contrast, automobile dealers do not expect any improvement this year. Bankers expect business lending to grow modestly, but they do not foresee an acceleration in consumer loan demand. Although bankers say pressure on net interest margins has eased somewhat recently, slow growth in deposits has prompted concern about the cost and availability of funds later in the year.

MANUFACTURING

Industrial activity is up slightly this month, according to the most recent Business Outlook Survey. Nearly one-third of the companies covered by the June survey report increased business, while one-fifth say their business is off from May; about half are operating at a steady pace. Business is improving for durable goods producers, but is mostly stable for makers of nondurables. Although the difference is slight, it marks a reversal of the sectoral pattern observed in earlier months this year.

Most indicators of manufacturing activity in June reflect the trend of moderate growth experienced so far this year. Shipments by local manufacturers are rising and new orders are up, but not by a comparable amount. Consequently, order backlogs are slipping. Employment is steady, with most firms reporting no changes in either payrolls or working hours.

Industrial prices in the region are generally stable, although there is some upward movement in input costs. While most of the companies surveyed in June indicate steady prices for the goods they purchase, 40 percent reported higher charges compared to May. Most firms say they are holding the line on the prices of their own products.

Looking ahead, just over half of the survey respondents foresee continued growth this year. Overall, area manufacturers expect further gains in orders and shipments, and they expect declining order backlogs to stabilize. On balance, their capital spending plans call for higher outlays during the next six months. Nonetheless, employment is expected to decline slightly over the next two quarters.

RETAIL

Nearly all area retailers contacted in early June reported strong sales in May continuing into June. Sales at all types of stores are running ahead of last year, with increases ranging from 5 to 10 percent. Department store officials say quality apparel and upscale merchandise generally are their best performing product lines. They are emphasizing these goods in their product mix because of their relatively greater selling margins.

The strength of consumer demand this spring, following good first quarter results, is leading store officials to raise sales forecasts for the summer. Most merchants expect sales for this period to run nearly 10 percent above last summer, and they expect similar results for 1987 as a whole. However, some discount store executives are concerned that stepped-up promotions and price markdowns may become common later in the year as individual competitors attempt to maintain and enlarge their market shares.

Automobile sales in the Third District are running parallel with national trends. Unit sales vary from up slightly to down substantially at domestic franchises, and inventories exceed desired levels for nearly all makes. Nevertheless, dealers selling U.S.-made cars have not discounted prices yet, and this, combined with lower operating expenses, is limiting the current impact of slower sales on their profits. However, import dealers' profits are declining as gross sales fall. Dealers expect the pace of sales to slip a bit further before stabilizing for the balance of the year.

FINANCE

Loan growth at major Third District banks picked up somewhat in May after slowing in April. Total outstanding loan volume in late May was approximately 3 percent above year-end 1986, and 10 percent above last May. Most of the growth is attributable to real estate and commercial lending. Real estate lending has been strong for the past 12 months, and bankers say that active real estate markets and profitable land development projects in the region continue to provide opportunities to make sound loans.

Commercial and industrial loan growth increased in May. Bankers say that their marketing efforts are bringing in good loans from local businesses. They are putting relatively more floating-rate loans on the books, and they say that net interest margins, which had contracted recently, are now improving.

Some area banks are promoting consumer loans aggressively, and they report gaining substantial amounts of new business. Overall, however, the lower growth rate in consumer lending that local banks first noted last fall is continuing. Lending officers contacted in June said that credit card lending is flat and other installment lending is up only slightly. The rapid growth in home equity lending that followed the introduction of this product appears to have eased also.

Nearly all bankers say deposit growth has not met expectations. This is especially the case with long-term (one year or more) certificates of deposit. Bankers believe higher rates on alternatives to bank accounts have led to disintermediation in recent months. Several mentioned the possibility of declining liquidity in the banking system toward the end of the year. Anticipating this, asset/liability managers are attempting to lengthen the maturities of their liabilities, and some banks have introduced floating-rate CDs or raised rates to attract longer-term money.

FOURTH DISTRICT - CLEVELAND

Summary

The region's economy continued to show positive signs. Increases were reported in production, new orders, and employment, while inventories remained steady. Commodity prices continued to increase, and shortages were experienced in a number of areas, particularly specialty steels. Retail sales were mixed, with hard goods outselling soft goods. Housing permits continued to increase as the building season progressed. Consumer installment loans picked up once again, and the volume of real estate loans continued to grow, despite higher mortgage rates.

Retail Sales

Retailers reported mixed growth through April. Retail sales growth in Ohio was roughly on a par with the national growth rate of 6 percent in April. This growth was concentrated in a few regions and types of items. Retailers in the Cleveland area reported sales increases substantially below the national average, while Akron and Columbus reported the opposite. Some retailers reported strong hard goods sales, especially home furnishings. Meanwhile, sluggish sales were reported in soft goods, such as apparel, perhaps stemming from the double-digit price increases reported in the April CPI. Slow sales growth in consumer electronics has been attributed largely to foreign exchange rates and quotas.

Sales of domestic automobiles in Ohio grew at a slightly faster pace than those in the rest of the nation. Although dealers reported lower sales than last year, they have tried to avoid financial incentive programs, preferring to lure customers with package deals. Import dealers reported that sales in the area are keeping pace with the nation. Dealers indicated that modest price increases have reduced sales. They also have avoided financial incentive programs because they feel their profit margins are at the lowest acceptable levels.

Manufacturing

A survey of purchasing agents in Ohio continued to show positive signs of growth in manufacturing. An increasing percentage of firms indicated that production was higher than the previous month. New orders continued to improve, and inventories remained low. Purchasers expressed concern about increases in commodity prices growing faster than productivity. Prices of steel products were most often mentioned as being higher and in short supply. Also mentioned was the steady increase in the price of services.

Raw steel production in the region was up 26 percent in May from the previous month. This marks an increase of 12 percent since the beginning of 1987. With employment increasing by only 3 percent and average weekly hours roughly constant, much of the increase in output is attibutable to higher labor productivity.

Labor Markets

The employment picture in the region has improved from previous months. In April, Ohio gained 22,000 jobs, while the number of unemployed fell 14,000. These changes resulted in an unemployment rate of 7.2 percent. Most of the employment increase occurred in nonmanufacturing. Construction, retail trade, and services (notably business and amusement and recreation services) registered the largest gains. Manufacturing employment remained unchanged from the previous month.

Regional employment projections for the third quarter of 1987 are generally optimistic. A greater number of employers expect to add workers than to reduce employment. Employment opportunities are predicted by durable and nondurable manufacturers, wholesalers and retailers, the construction industry, and services. Staff reductions are forecasted in finance/insurance/real estate. Columbus, Dayton, and Akron report the most positive employment forecasts; Pittsburgh and Youngstown report the least positive.

Factory production workers in Ohio worked an average of 42.1 hours per week in April, down .4 hours from March. Their average weekly earnings dropped $5.12 to $493.41. Reduced overtime lowered earnings significantly in many industrial sectors. A notable exception occurred in blast furnace and basic steel products in which average weekly earnings rose $22, due primarily to an increase in the average workweek of 1.3 hours.

Housing

Housing starts in Ohio during March were up 39 percent over a year ago. Sales of existing homes continued to rise as we move into the traditional house-buying season. Average house sales for the first quarter this year over last year rose 7.5 percent in Cleveland and 60.8 percent in Pittsburgh. Although interest rates have risen one percentage point since March, loan officers felt that the panic over expected large future rate increases has subsided.

Banking

District loan demand has been soft. Total loans outstanding at large banks fell at an annual rate of 6 percent from mid-April to the end of May. Commercial and industrial loans accounted for the vast majority of the recent contraction in loan volume, at least partly because of the higher cost of borrowing. In contrast, consumer lending picked up. Installment loans outstanding grew at an annual rate of nearly 30 percent over the last six months. Real estate lending also continued to increase at an annual pace of over 20 percent.

FIFTH DISTRICT - RICHMOND

Summary

Growth in the Fifth District economy is slowing, and business optimism, although still relatively strong, has waned somewhat. Most retailers and producers, however, report increased activity in June and expect further slow improvement in coming months. District crops are off to a good start, but higher grain prices are starting to pinch the profits of poultry producers. Executives of depository institutions report increases in mortgage loans, and they expect loan demand for business capital expansion and modernization to rise in the months ahead.

Consumer Spending

Major department stores throughout the District report increased sales in early June. Most retailers expect their sales to rise in coming months, but only about one-fourth plan to add employees. The use of credit cards in many of these stores continues to decline although discount chains report little change in credit card use.

Manufacturing and Mining

Manufacturing activity in the District remained on an upward trend in early June. Over one-third of the producers who responded to our June survey experienced May-to-June increases in shipments and new orders, while one-fourth recorded declines. Employment, the workweek, and raw material prices increased, the backlog of orders was generally unchanged, and inventories declined slightly. Although the survey indicates continued growth in the manufacturing sector, comparisons with responses earlier this year show that this growth is slowing.

Nondurable manufacturing seems to be improving more briskly than durable manufacturing. Among nondurable firms, those in textile and apparel manufacturing have recorded strong sales gains in recent months and expect further increases in coming months. Production and sales are strengthening in large chemical corporations, in some instances due to increased export orders. In the durable goods sector, nonelectrical machinery manufacturers report increased activity and a rise in their capacity utilization rate to 64 percent, the highest in some time. Furniture industry representatives, however, report a decline in shipments, which they attribute to reduced home and office building activity. In the stone, clay, and glass industry, where the capacity utilization rate is 86 percent, business has improved slightly this past month. Plant managers expect lower production in the months ahead, however, as higher interest rates begin to affect homebuilding, which accounts for a large portion of their sales.

District coal production has increased in recent weeks and is now near its level a year ago, but coal employment is at an all-time low. There are indications that much of the recent production is being stockpiled in anticipation of a strike later this year.

Wages

In the building trades, collective bargaining now in progress suggests little change in the moderate rate of wage gain recorded in recent years. In the Washington metropolitan area, however, and certain other District cities where labor markets are very tight, there are reports of gouging by construction workers and builders.

In the suburban areas around Washington and elsewhere in the District where the unemployment rate is very low, it has become increasingly difficult to fill service jobs. Higher wages and other inducements are being offered to attract workers.

Agriculture

Plantings of most major crops across the District have progressed to a normal level after falling behind earlier in the spring due to cool temperatures and heavy rainfall. Growing conditions have been excellent in all but a few parts of the District.

The production of hardwood lumber has been booming in West Virginia. Demand has prompted mills to build more kilns to dry the lumber.

Financial

Executives of District financial institutions report little change from a month ago in commercial and industrial loan activity. Loans secured by real estate, however, including home equity lines, continue to rise. These financial executives are optimistic that the economy will continue to grow, but are fearful that inflation may accelerate. They project increases in coming months in loans to consumers and loans to businesses for plant and equipment expenditures, but they anticipate declines in loans secured by office buildings.

A slowdown in home sales may be creating problems for institutions that specialize in originating and selling mortgages. At least one of these institutions finds itself unable to meet its contract commitment to mortgage buyers.

SIXTH DISTRICT - ATLANTA

The Southeast continues to show moderately increasing employment and falling unemployment rates, even in Louisiana and Mississippi where rates have been in double digits. Manufacturing employment has been increasing, especially in textiles. Construction of office buildings and homes has slowed, although warehouse and industrial construction is still strong. Production of oil and gas seems to have bottomed out.

Employment and Industry. The employment picture improved moderately in the region for the latest reporting period. Notably, the unemployment rate in Louisiana fell by over one percentage point from March to April, and total employment expanded. Transportation equipment employment increased in the state due to more activity in ship building and repair. Increased activity in the lumber and wood sector also accounted for some of the state's employment gains. The employment declines in the energy-producing sector appear to have bottomed out.

District chemical producers supplying the apparel and textile industry have been prospering as a result of the rebound in textiles. The tire industry is strong as a result of lower prices for petrochemical raw products and growing demand attributable to increased auto travel. Food manufacturing is getting a strong lift from the expansion in poultry and fish processing industries. Spokesmen from the furniture manufacturing industry are optimistic, at least for the near term. The machinery industry, however, suffers from excess capacity and weak demand.

Consumer Spending. During May, southeastern retailers generally posted slight increases over last May's sales. While overall sales fulfilled merchants' expectations, activity continued to be sluggish in Mississippi and Louisiana. Retailers do not plan to increase inventory levels in anticipation of higher prices, and they seem content with their present inventory as they head into the summer months. Although profit margins on foreign goods are decreasing for some, retailers generally have not yet raised prices on imported merchandise.

Car sales in the District were disappointing in May as major U.S. and Japanese manufacturers posted sharp declines in sales from levels a year earlier. Dealers' hopes for the traditionally strong pre-summer months were dashed despite attractive car-maker incentive programs to lure new buyers. Meanwhile, minivan, utility vehicle, and light truck sales are still growing.

Construction. Single-family building permits held steady in April for the Sixth District and the nation (three-month average, seasonally adjusted). Contacts in Birmingham, Atlanta, and Nashville report an oversupply of homes priced over $200,000 but note that the sale of medium-priced homes is still strong. Additions and renovations to existing buildings make up the bulk of construction in New Orleans. The mortgage rate increase has dampened sales and led to closing delays, say realtors.

Orlando builders report a decrease in office vacancy rates, although contacts in Atlanta and Birmingham say the construction pace has yet to slow enough to see significant rate declines. Office vacancy rates in the central business districts of Ft. Lauderdale and Memphis rank among the nation's highest. Contacts say the concentration of new office space in the suburbs of these cities is largely to blame.

District builders are more optimistic about development of industrial distribution and warehouse space. Atlanta's strong absorption rate has spurred assemblage of large land tracts for industrial development despite falling rental rates. Orlando contacts expect strong demand this year and steadily declining vacancy rates.

Financial Services. Total loan growth at the District's larger commercial banks edged downward in April, caused largely by a steep drop in the growth rate of consumer loans. Contacts speculate that reductions in outstanding credit card debt, along with weak auto sales and uncertainty about the economy, may have dampened consumer lending growth this year.

Tourism and Port Activity. With visitor registrations in May up strongly from last year, there are expectations throughout the Southeast of a strong summer season for tourism. Cities throughout the District are posting increases in air travel well above the national average, which is partially a result of more airlines selecting southern cities as hubs for their operations.

The lower dollar appears to be slowly fueling export growth in the District. Miami port officials report gradual improvements in exports to Latin America. Even so, exports and total port tonnage were both 10 percent below year-earlier levels for the first seven months of the fiscal year beginning in August 1986. In New Orleans, a rise in exports of pulp and paper and other manufactured products has substantially boosted port employment and revenues. Rebounding foreign sales of phosphates in the first four months this year pushed Tampa's export tonnage up by about 5 percent from the depressed level in the same period last year.

Agriculture, Forestry, and Mining. District oil rig activity remained stable in May for the third consecutive month. Even so, the number of rigs in operation is still 30 percent below last year's depressed figures. Although two-thirds of the ocean rigs in the Gulf of Mexico are idle at present, one source predicts active rig numbers will double by 1988 because of the improving price outlook. Coal production in Alabama and Tennessee experienced more than a seasonal decline in April and May; output fell short of year-ago levels by 12 percent. With higher prices for petroleum products, demand for coal should improve during the balance of 1987.

On balance, crop prospects currently appear favorable. There is some concern over low rainfall totals in the eastern half of the District. The poultry industry, suffering from production-induced price declines, is experiencing shrinking profits. Pork and cattle herds are apparently being rebuilt.

SEVENTH DISTRICT--CHICAGO

Summary. Economic activity continues to expand in the Seventh District, at a stronger pace than in 1985 and 1986 despite lagging demand for autos. From December 1986 through April 1987, payroll employment in District states rose faster than in the U.S. Chicago purchasing managers reported another month of continued growth in May, accompanied by further increases in prices and slowing of deliveries. Sources contacted regarding capital spending in various industries noted several sizable projects and numerous smaller ones, some announced earlier and already under construction, others to be started next year. Signs of improvement are reported in demand for some types of machinery which had been weak. Slowing auto sales have led to production cuts and layoffs, particularly affecting southeast Michigan. Steel continues to show surprising strength, with some products in short supply and prices rising. A large retail chain reports a pickup in sales in early June, after a slow May. There are indications that would-be home buyers are adjusting to higher mortgage interest rates, though one knowledgeable source sees continued hesitancy in hopes that rates will fall. Livestock farmers' earnings have been boosted by higher prices. Allaying earlier concerns about a lack of precipitation, prospects appear good for high crop yields per acre in most areas of the District.

Capital Spending. Contacts surveyed recently noted numerous capital investment projects underway or expected, some not until next year. These include several auto assembly plants, parts plants, and other facilities--Japanese, American, and joint venture--being built, expanded, or improved in District and nearby states. A large steel mill, a joint venture American-Japanese plant, is to be built in northern Indiana. Other steelmakers are expected to make sizable investments in upgrading facilities in the District and elsewhere. Rehab projects are going ahead at refineries and electric utilities, including conversion of a Michigan plant from nuclear to gas expected to start next year. A producer of building and industrial products expects to increase its capital spending substantially in 1988 and 1989. A furniture maker is building a computer furniture manufacturing plant in Michigan.

Machinery. Some markets for equipment show an upturn, but reports on current conditions are mixed. A capital goods producer, bearish in recent years, sees significant improvement in some lines, including basic food processing machinery and specialized machinery, but not in petroleum equipment. On the other hand, a steelmaker reports improved demand from the petroleum industry, particularly for offshore drilling, as well as from makers of farm equipment, construction equipment, and railcars. In contrast, a large farm equipment producer forecasts retail demand in 1987 below 1986's low volume. To an unknown but apparently significant extent, strength of steel demand from these sectors reflects rebuilding of low inventories and filling of order backlogs built up during prolonged work stoppages which ended early this year in steel, farm equipment, and construction equipment.

Motor Vehicles. Auto sales have continued to trail year ago. Auto makers have reduced their forecasts of sales for the year. Production cuts and layoffs, temporary and indefinite, at assembly and parts plants have been particularly significant in southeast Michigan. A contact expects unemployment in the Flint area to rise to around 14% by year-end, as a result of auto industry cuts and their effects on other businesses. In contrast, truck sales so far this year have been above last year's strong pace. An industry source expects production of heavy trucks to exceed 1986's output by 16% or more, returning to around the 1985 level.

Steel. Production cuts in the auto industry have not been reflected in reduced output of sheet steel. Order backlogs, built up because of the USX work stoppage, have been reduced. Third quarter output of sheet and other steel products is expected to be unseasonably strong, partly because of reduced imports, and partly because of increased usage in some industries. The reduction in imports is thought to be mainly a result of the lower dollar, rather than bilateral import restraint agreements. Hot rolled sheet and plate were reported in short supply. A large amount of structural steel is under contract or out for bid, part of which is for auto and parts facilities under construction in this country. Steel prices are up with further increases expected later in 1987 and into 1988.

Housing. Potential residential mortgage borrowers experienced "sticker shock" in May after interest rates jumped up sharply, but are said by one contact to be returning to lenders. Another source, however, thinks talk that interest rates will decline is causing some potential home buyers to wait. Chicago-area lenders typically are quoting 10.5-10.75% for 30-year fixed-rate loans, with a few as low as 9.9-10% seeing strong demand. Lenders' cost of funds has risen less than yields on home loans, resulting in attractive spreads. New home construction in the Chicago area this year has been above a year earlier, largely as a result of the mild winter. Home resales have been active but below excellent levels in 1986. Rental housing units in certain parts of the Chicago area are in excess supply.

Consumer Spending. A large general merchandise retailer reports that sales were somewhat slow in May, but have been strong so far in June, helped by warm weather. Women's apparel has been selling well, despite price increases resulting from the lower dollar. Credit delinquencies, concentrated in energy and farm states, have declined after rising earlier. Inventories are low.

Agriculture. Earnings of District livestock farmers have been buoyed recently by a large rise in cattle and hog prices. Because of strong earnings, cattle feeding activities have expanded, particularly in Iowa. During the first four months of this year, Iowa farmers placed 30% more cattle in feedlots than a year earlier. Some observers view the increase as a sign that the long, steep downturn in cattle feeding in Iowa has ended. Spring crop plantings in District states are virtually complete, one of the earliest planting seasons on record. Early stands of corn are rated mostly "good". Rains have tempered earlier concerns about drought in most District areas.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District's economy slowed in the most recent period as indicated by employment and construction data. Dry agricultural conditions have allowed rapid planting progress but threaten further crop development.

Outlook

A recent survey of 261 small businesses in the Eighth District suggests that respondents' expectations of economic conditions in the near future were less optimistic than a year ago. Compared with first quarter 1986, a smaller proportion felt general business conditions would improve, that it was a good time to expand and that their sales volume would increase in the near future.

Employment

Total District employment declined slightly in April, but a larger decrease in the number looking for work allowed the region's unemployment rate to fall slightly in April to 7.4 percent. District nonfarm employment expanded at a 2.8 percent annual rate in the three months through April. Although this pace approaches the national average, it represents a considerable slowing from the last report. Most of the slowdown was concentrated in manufacturing, construction and the health and business services sector. Regional manufacturing employment fell at a 1.4 percent rate in the February-April period with most major industries posting losses. Auto assembly plants laid off workers in April and May, and temporary shutdowns are planned for portions of June and July. In Missouri, auto industry employment in April was a third lower than one year earlier. District mining employment, concentrated in Kentucky coal mining, fell in March and April after four successive months of gains.

Construction and Real Estate

Construction slowed recently due to a sluggish residential sector. The value of District residential contracts was up 2.1 percent during the three months through April, trailing the nation's 6.4 percent growth. Permits for both multi- and single-family dwellings dropped in April after first quarter gains.

New home sales jumped in April as buyers attempted to close deals before anticipated higher mortgage rates. In St. Louis and Memphis, sales were strong in April, but were expected to flatten in May. Single-family starts in Louisville were more than 30 percent above year-ago levels in April and May, although one real estate contact expects slowing in future months.

District nonresidential construction accelerated in recent months; nonresidential contracts issued in the three months through April grew 15.3 percent, outpacing the nation's 7.2 percent expansion. Extremely rapid growth in Arkansas offset declines in Tennessee.

Banking

A recent survey of the largest District banks indicated a slowing in participations and sales of commercial and industrial (C&I)

loans. All of the respondents indicated a slackening in the demand for C&I loans and as a result, are reducing their involvement in sales and participations in order to build their own portfolio. Most respondents emphasized sales and participations were viewed as a means of limiting risk rather than as money-making vehicles.

Most of the loans sold or participated were sold to affiliate banks or U.S.-chartered banks with assets greater than $1 billion. The average maturity of these loan participations is approximately one year. District banks typically average a spread of 50 to 100 basis points as the "lead" bank in a participation transaction.

Agriculture

Current weather conditions are a source of both good and bad news. Due to dry weather, planting progress on all major District crops is well ahead of average. To date, crop development has been favorable. The bad news is that the dry spring leaves crops vulnerable to damage during the normally dry months of July and August. Most states report that wheat yields will be reduced by as much as 20 percent due to the dry spring.

The volume of farm products shipped on the middle Mississippi River in the first four months of this year was 19 percent above the level of the same period last year.

NINTH DISTRICT-- MINNEAPOLIS

In the second quarter the Ninth District's economy showed signs of continued improvement. Employment conditions strengthened early in the quarter. Consumer spending didn't grow by much, but neither did it weaken. Other improvements were noted in agriculture and resource-related industries--both of which have been weak spots in the district's economy.

Employment

The district's labor market continued to improve. In Minnesota, seasonal job growth helped lower the unemployment rate to 4.6 percent in April. In the Minneapolis-St. Paul metro area, the unemployment rate fell to 3.7 percent--its lowest April rate since 1979. Increases in nonmanufacturing jobs in the Twin Cities offset continued layoffs in manufacturing there. Also indicative of continuing strength in Minnesota labor markets, initial unemployment claims during May fell 8 percentage points below year-earlier levels. In addition, the Minneapolis help-wanted advertising index rose in April to a level 18 percentage points higher than a year earlier, corroborating the view of Bank directors that the Twin Cities labor market is tight.

Other district states also experienced heightened job growth. During April, employment rose and unemployment rates fell in the Dakotas and Montana. In South Dakota, durable goods manufacturing increased, and the April unemployment rate in the Sioux Falls metro area fell to only 2.7 percent.

Despite firm labor markets, relations between labor and management have been a concern at some major companies. A number of strikes have troubled the meatpacking industry and have affected 6,700 workers in South Dakota, Minnesota, Iowa, and Nebraska. One such strike is reported at a large meatpacking plant in Sioux Falls.

Consumer Spending

Retail spending on general merchandise grew moderately in recent months. One large retailer reports that its combined sales for March and April reached levels 10 percentage points higher than a year ago. Another diversified chain reports a slightly larger increase over the same months and notes that its sales promotions during May were also well received by consumers. Although inventory levels haven't been too low, a few retailers mention that offshore deliveries from Asia have been slow. One Bank director notes that the rate of retail price inflation has been low. Bank directors continue to report lackluster retail sales in smaller cities and towns dependent on agriculture and oil extraction.

Motor vehicles sales have recently slowed. One large domestic manufacturer reports that its district sales were about 20 percent lower this May compared to May 1986. However, last May's sales were unusually high, so the recent decline wasn't overly severe. Another manufacturer says its late-May sales picked up and have been particularly strong in the Dakotas. Both manufacturers report that district inventories are normal for this time of year. Bank directors report that sales were slow in western parts of both Montana and Wisconsin.

Housing markets continued to be quite active in the district. In the Minneapolis-St. Paul metro area, housing permits were 17 percent higher during this year's warm April than in April 1986. Multifamily home construction was particularly strong. One Bank director notes that housing still remains affordable. But realtors are worried about future sales in light of recent increases in mortgage rates.

Agriculture

Agriculture conditions have continued to improve somewhat in recent months. Crop conditions have been generally excellent, with early growth stimulated by warm weather and recent rains. A Bank director from North Dakota observes that conditions have been good through much of that state--even in the usually dry area around Bismarck. In Minnesota, most of the earlier moisture deficiency has been remedied by recent rains. A Bank director from South Dakota notes that more rain is needed in some parts of that state, though. Crop prices, while still relatively low, have risen recently. Wheat prices have increased particularly sharply, and corn prices have also increased. These increases will save the federal government some money on its farm payments programs.

Compared with major crop production, conditions for meat-animal production continue to be more favorable. In Minnesota, prices for May lambs were the highest on record. A Bank director reports that cattle prices were still good. And members of this Bank's Advisory Council on Small Business, Labor, and Agriculture report that the hog market looks promising through August, and that farm income generally is on the rise. In fact, a big hog production facility is planned for the area around Pierre, South Dakota.

Resources-Related Industries

Some good news is reported in most major resource-related industries. Higher copper prices have helped the important White Pine copper mine on Michigan's Upper Peninsula. Bank directors say the gold mine there is also doing well and that two new gold mines may open in South Dakota. Coal producers in Montana may be helped by a cut in severance taxes. While the oil industry is still in the doldrums, permits for oil-drilling increased a bit in North Dakota. Finally, demand for many district wood products remains solid.

TENTH DISTRICT - KANSAS CITY

Overview. Little change is apparent in overall Tenth District economic activity. Retail sales generally are increasing slightly, but auto sales are sluggish. Retailers report little change in prices while manufacturers' purchasing agents report stable to moderately higher input prices. Inventory levels are satisfactory. Housing starts remain near last year's levels, and mortgage loan demand at savings institutions has declined. The district's energy industry remains generally depressed. Loan demand and deposits at district banks are essentially unchanged. Winter wheat harvest is under way and yields are expected to be about average.

Retail Sales. Tenth District retailers generally report that sales are about the same as or above year-ago levels and have been improving during the last three months. Most retailers report little change in prices during the past three months, although one retailer reports dramatic increases in the prices of imported goods. Inventory levels are satisfactory. Retailers are generally optimistic that sales will be solid during the rest of 1987.

Automobile Sales. Automobile dealers report that sales in May were below a year earlier and a month earlier. Because of sluggish sales, inventories are larger than desired. Financing is generally available for both dealer inventories and consumer purchases. Dealers hope that sales have bottomed out, and most are cautiously optimistic in their outlook.

Purchasing Agents. Purchasing agents report that major input prices are stable to moderately higher relative to a year earlier and that they expect input prices to increase only moderately during the remainder of 1987. Some problems with materials availability were reported. The Canadian lumber strike was blamed for a shortage of lumber, for example. Few problems with material availability are expected for the remainder of the year, however. Inventory levels are viewed as generally satisfactory.

Housing Activity and Finance. Homebuilders report that housing starts remain at or slightly below last year's levels. Single-family home construction remains stronger than multifamily construction. Builders expect overall 1987 housing starts to be near 1986 levels. Sales of new homes are up slightly, with prices moderately higher than a year ago. New homes inventories are not causing undue concern. No problems are reported with either the availability or delivery of housing materials. Materials prices are relatively stable.

Many savings institutions in the Tenth District have experienced weak deposit growth during the last year. Negative publicity about the FSLIC has dampened deposit inflows. Loan demand has fallen off since the April runup in mortgage rates. Mortgage rates leveled off after their April increase, and most respondents believe that rates will remain near current levels in the near future.

Energy. The district's energy industry remains generally depressed despite the fact that prices of domestic crude oil have remained near $20 for several weeks. Although OPEC is committed to keeping prices stable, recent events in the Persian Gulf have made the outlook for oil prices more uncertain. Exploration and development activity in the district remains flat. The average weekly number of operating drilling rigs in the Tenth District fell from 248 in April to 238 in May, still about two-thirds of the number recorded a year earlier and only 16 percent of the peak number reached in 1982.

Agriculture. Wheat harvest in the Tenth District is under way in Oklahoma and parts of southern Missouri and Kansas. Although wheat acreage is down in areas where a wet fall prevented some winter wheat planting, yields across most of the district have not been adversely affected by the weather.

Wheat yields appear average in most parts of the district. Grain storage capacity in the district should be adequate for this year's wheat crop.

Spring crop planting was generally finished ahead of schedule due to favorable weather across most of the district. Most areas report that 80 to 100 percent of the corn, milo and soybean crops are planted, and many fields are showing good early growth.

Feedlots in the Tenth District are generally full, reflecting strong returns to cattle production over the last year and the renewed rise in beef prices since the first of the year. Few feeders are expanding their feeding capacity, however, and cow-calf and stocker-cattle operations do not appear to be adding to their herds. Growers appear reluctant to expand herds at the current high cattle prices and some bankers, fearing a drop in the market, are loaning less on the collateral value of the cattle purchased. District hog producers have reacted to strong market conditions much the same as cattle producers. Hog prices have been favorable over the past year and particularly strong in 1987, but there is little evidence of expansion in hog operations. Though some bankers report a moderate increase in hog inventories in their areas, there has been no sign of investment in new facilities.

Banking. Total loan demand and total deposits at Tenth District banks were essentially unchanged during the past month. Demand weakened slightly for consumer loans, but was constant for other types of loans. About two-thirds of the respondents reported raising their prime rates slightly, while the rest expect their prime rates to increase slightly in the near term. Half the respondents report raising consumer loan rates slightly, and about a third expect their consumer rates to rise slightly in the near term. Half the respondents report no change in large CDs, while the other half report an increase. Balances in other accounts remained constant.

ELEVENTH DISTRICT--DALLAS

The District economy remains weak overall. Nevertheless, the number of industries that appear to have reached their troughs has increased since the April survey. Respondents from most manufacturing industries report that sales have stabilized or are increasing. Energy industry indicators point to slow improvement. Construction remains weak, but declines in contract values have ceased for now. Liabilities of District banks continue to decline, but at a decelerating pace. Average prices paid to District farmers are increasing.

Although most District manufacturers report that their orders are either rising or have ceased to fall, industries linked to the construction sector note continued declines. Manufacturers of energy-related durable goods say that past reductions in their sales and employment appear to be over, but they do not expect marked increases in sales soon. Orders to steel producers continue to rise. Respondents from the electronic equipment and chemicals industries say that the falling dollar has led to continued increases in marketings of their products. Demand for oil refinery output is very strong. Apparel industry sales are up over a year earlier.

District drilling continues to increase. In May the rig count was only 4 percent below a year earlier and it was above the levels of earlier months in 1987. Leading indicators of drilling activity in the District point to continued slow improvement in the rig count. Both the seismic crew count and well permit applications increased in April and May. The price of West Texas intermediate crude oil has remained near $19 per barrel.

Indicators of District construction activity have shown some recent strength, but the belief that these increases signal a building recovery is not widespread. The value of construction contracts in March and April showed improvements compared with previous months. Year-over-year declines persist, but at a much slower rate than earlier in 1987. The drop in multifamily building permits is still occurring at a fast pace. Despite the recent upturns in overall contract construction values, the lagged effects of past declines have resulted in continued dropoffs in construction employment.

Retail sales in the District remain sluggish, with respondents reporting no recent significant changes in sales or employment. Sales tax receipts in Texas remain below a year earlier. Sales of home furnishings and of some apparel lines are weak, but sales of women's accessories are growing. Respondents generally express guarded optimism with respect to sales increases in the second half of 1987.

District auto dealers say that their sales rose in April and held steady in May, but that volume is below a year earlier. Prices of domestic models have remained constant, while those of many imported models have risen substantially. Respondents expect that sales in the second half of 1987 will be higher than during the first half of the year but that sales will be relatively slow by historical standards.

The balance sheets of large District banks continue to show a reduction of deposits, but the rate of decline in deposits has slowed somewhat in recent months. Total deposits were down 8.7 percent in May from a year earlier with large time deposits down 14.4 percent. Borrowings by large banks continued to increase, although at a decreasing rate.

Business and real estate loans declined in April and May. Deposits at thrifts remain above a year earlier, but their rates of growth have been falling. Although the rate of decline in large time deposits has increased in recent months, strong growth in small time deposits has offset this reduction. Some savers are said to be redistributing their deposits among various S&Ls to maintain deposit balances below the maximum level covered by FSLIC insurance.

District farmers and ranchers show signs of increasing their incomes compared with a year earlier. For livestock producers, margins between feed costs and slaughter prices have widened markedly over the last twelve months. Demand for old-crop cotton remains strong and relatively high futures market prices have led to some increases in forward contracting for the new crop. The 1987 cotton crop is in excellent condition along the Rio Grande but cotton farmers face moisture shortfalls and low seed supplies elsewhere. Farmers' credit conditions seem to be stabililizing but the fallout among their lenders continues. From the beginning of 1987 through the end of May, six Texas agricultural banks closed, compared with the same number of closings for all of 1986.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

Economic conditions are healthy in most parts of the Twelfth District, although weakness persists in the intermountain area and in Alaska. Spending on consumer products, including automobiles, has slackened in recent months, but the pace of manufacturing activity has improved. Forest products activity continues at a strong pace, while higher prices for many western agricultural products bode well for mining and farming enterprises. The recent upturn in oil prices has sparked optimism among California oil producers, but oil-related problems in Alaska continue to mount. Higher interest rates have had little impact on construction activity in most areas, as residential markets continue generally healthy and nonresidential activity already had been slowed by high vacancy rates and tax reform. Financial institutions have experienced sharp reductions in home mortgage refinancing applications, and many report a renewed interest in adjustable rate instruments. However, few bankers report significant declines in mortgage applications for home purchase.

Consumer Spending

In many parts of the District, the pace of consumer spending has slowed in recent months. Sales of both domestic and imported cars are reported to be lack-luster in several areas, including the otherwise economically healthy San Francisco and Seattle areas. In the San Francisco area, auto sales reportedly are down 21 percent from last year, with inventories rising. Several respondents noted that although new car sales are down, used cars are selling very well. In the Eugene, Oregon area, one auto dealer estimates that he sells two used cars for every new car sold.

More generally, respondents in Arizona and Washington report moderating of the previously robust activity in those two states. In Idaho, sales tax receipts for April were higher than they were in March, but remained substantially lower than their year-earlier level. Import-dependent retailers and distributors are being hurt by the reduction in imports that has taken hold in recent months.

Manufacturing

Manufacturers of some products that compete against low-cost imports report strengthening sales and orders which they attribute to the reduced value of the U.S. dollar. Sectors reporting improvement include apparel, semiconductors, and computers. One large semiconductor maker has announced that it intends to complete two Oregon facilities which were put on hold in 1985 due to the semiconductor industry slump.

Agriculture and Resource Related Industries

Lumber production continues to be strong, and many mills are running at peak levels. China is becoming an increasingly important market for these products. Already this year, 8.5 million tons of railroad ties have been exported through Portland to China, and shipment of 10.5 million board-feet of lumber to China will begin in August. Demand in Japan and Europe also has been bolstered, by the reduced value of the dollar. Overall, lumber exports are 28 percent higher than they were a year ago. The volume of orders declined in April and early May due to the increase in mortgage interest rates, but as rates stabilized later in the month orders picked up again.

The prospects for many western farmers have improved. Cattle producers are enjoying higher prices and lower feed costs, while potato and fruit growers benefit from a mild winter and increased production. California cotton commands prices double the level of last year, as strong foreign markets, notably in China, buoy demand. However, dry weather in some parts of the District has raised concerns about summer yields. Wheat farmers, among others, continue to experience low prices. Despite high participation rates in government acreage-reduction programs that should reduce the current oversupply problem, they see little prospect of improvement. These problems are particularly apparent in eastern Washington and Oregon, in southern Idaho, and Utah.

In Kern County, California, oil industry prospects have improved modestly since the price of local oil rose to $13 per barrel from less than $10 a year ago. In contrast, Alaska's economy continues to founder. One company reports that the volume of freight it ships to Prudhoe Bay is down 70 percent from last year's level.

Construction and Real Estate

Most respondents reported that the increase in interest rates this spring has had little effect on the volume of real estate activity in their areas. In the San Francisco Bay Area, for example, the real estate market has been healthy through May. One East Bay developer placed forty-seven "spec" lots on the market, at prices of $75,000 and up, and sold forty of them on the first weekend. Although residential construction activity remains largely unaffected at this point, some builders reportedly are scaling back plans for residential units in 1987, and generally are taking a more cautious attitude. Moreover, some building materials dealers have reported a sharp drop in low-end housing starts, since low income buyers are particularly sensitive to higher interest rates.

High vacancy rates and changes in the tax law caused a slowdown in commercial construction activity earlier in the year, and higher interest rates appear to have had little additional impact. A few projects which do not pencil out at the higher rates have been squeezed out. One banker argues that some developers have withdrawn loan applications, hoping that rates will fall later in the year.

Financial Sector

The initial jump in mortgage interest rates caused a flurry of activity in April, apparently due to concern about the possibility of further rate increases. Several bankers report that the increase in interest rates has reduced demand for mortgage refinancing and renewed interest in adjustable-rate instruments. For example, one banker reports that refinancing applications have fallen to thirty percent of their previous level. The same banker notes that while fixed-rate mortgages previously comprised about 85 percent of his bank's mortgages closings, they now account for only 60 percent of its total. Most bankers report little change in the number of mortgage applications for housing purchases, but one claims that the number of applications has dropped to a third of the level seen several months ago.