SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

AUGUST 1987

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SUMMARY*

Regional reports filed in late July show little change from those filed in mid-June and indicate continued moderate economic growth. Manufacturing activity is rising in most of the country, and the energy sector shows some signs of revival. Retail sales are still increasing. Price increases are more common at producer and consumer levels. Construction activity appears somewhat weaker than reported six weeks ago, primarily because of declines in homebuilding. Bank loan and deposit activities are mixed to slightly weaker than reported in June. The financial outlook for farmers has brightened.

CONSUMER SPENDING

Most of the Reserve Banks report moderate growth in retail sales in their districts. Philadelphia and Chicago say that the hot weather has helped move summer goods. The New York district's retailers are selling more housewares, furniture, and rugs, but retailers in the Philadelphia, Cleveland, and Richmond districts say that demand for big ticket items is low. Retail store executives across the country are generally optimistic about prospects for sales in the coming months.

The prices of apparel and certain other goods such as imported electronics continue to rise, and retail inventories are higher. Large stocks of goods in department stores have retailers somewhat concerned in the Boston and Dallas districts. Dealer inventories of new cars are up in Cleveland, Atlanta, and Minneapolis, but they are lower in Richmond and tight in Kansas City.

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*Prepared at the Federal Reserve Bank of Richmond from information gathered prior to July 28, 1987.

Three Reserve Banks see signs of a good summer tourist season. Atlanta notes increases in hotel occupancy rates, and both Minneapolis and San Francisco report heavy highway traffic.

MANUFACTURING

Districts generally report modest increases in shipments and new orders, although activity within particular manufacturing sectors varies by district. Atlanta indicates that oil price increases have encouraged drilling and stimulated the oil equipment industry. In the Kansas City and Dallas districts, however, the energy sector has responded only slightly to higher oil prices. Steel production fell in Cleveland, but steel mills in the Chicago district are producing sheet products at capacity. In the Boston area, sharp output gains are evident in specialty textiles and in computers and other nonelectrical machinery, while product lines dependent on the automobile, housing, and utility industries are slow. Chicago and Cleveland note declines in big-three automobile production, some of which is being offset by increases in truck production and by increases in domestic automobile production by foreign manufacturers.

Input prices may be rising faster. Reports from Boston, New York, Philadelphia, Cleveland, Richmond, Chicago, and Kansas City all include references to price increases.

CONSTRUCTION

A slowing in residential activity is indicated by the Boston, New York, Richmond, Atlanta, Chicago, and St. Louis Reserve Banks, while Kansas City notes mixed activity. Cleveland, Minneapolis, and Dallas, however, report increases in housing activity.

Nonresidential activity is mixed. St. Louis reports strong growth, but the San Francisco district is experiencing a severe downturn. Relatively stable activity is reported by New York, Atlanta, Chicago, and Dallas. Within these and other districts, however, are pockets of strength and weakness. New York indicates that commercial and industrial leasing activity is generally good but is threatened by overbuilding.

AGRICULTURE

Farm income prospects have improved. Higher prices for hogs and cattle are helping, and crops are in generally good condition in most districts. On the negative side, Atlanta notes that poultry prices have fallen, San Francisco says that labor shortages are cutting harvests, and Atlanta Richmond, and Minneapolis report some weather-related crop damage.

The financial position of agriculture is looking better in other ways. Richmond and Chicago observe upward pressure on farmland prices. The volume of farm operating loans is reported to be falling by St. Louis. Richmond reports lower interest rates for agricultural loans, and both Richmond and St. Louis are witnessing stronger loan repayment rates.

FINANCE

Loan and deposit activity at banks remains at the generally weak pace reported in mid-June. Cleveland reports a decline in total loans, Richmond and Kansas City report little change, and Philadelphia and Atlanta report slowing growth. St. Louis, however, indicates faster growth in total loans. Deposits are reported to be down by Dallas, unchanged by Kansas City, and growing slowly by Philadelphia. Continuing strength in the demand for home equity loans is mentioned by New York, Philadelphia, and Richmond.

FIRST DISTRICT - BOSTON

The pace of economic activity in the First District picked up in early summer. Recent retail sales results have been well ahead of year-earlier levels and equal to or better than plan. Manufacturers are experiencing encouraging increases in orders and shipments, although they remain cautious about the future. Reports of price increases are more common. Several retail contacts expect rising input costs to lead to higher prices next year. Manufacturers are seeing modest rises in materials prices and are encountering less resistance to increases in their own prices. Reports from the housing market contrast with the more positive tone from the retail and manufacturing sectors: in many areas in the region the residential market is slower than normal for this time of year.

Retail

Retail sales in the First District were equal to or better than plan in the early summer. For the merchants contacted, sales through June ranged from 6 to 40 percent ahead of a year earlier, with early returns for July suggesting a continuation of current trends. These results are on plan or 3 to 4 percent higher than planned. The strength is fairly general across product lines and geographic areas within New England.

Two retail respondents have purposely built up inventories in recent months. Although the buildup has successfully bolstered sales, they are nervous about the costs and risks involved in heavy inventory investment and, therefore, are reexamining their inventory policies.

Pricing remains very competitive, especially at the low end of the market. However, several contacts expressed concern with increases in vendor prices. Although retail price increases remain in the 2 to 3 percent range, this pace shows signs of accelerating during the coming year.

New England retailers are optimistic about the coming year. They expect the positive results to date to continue through the close of the year and are budgeting for comparable or slightly more conservative increases next year.

Manufacturing

First District manufacturers report moderately encouraging increases in orders and shipments. However, they are not convinced that the recent pickup will last. Producers of specialty textiles and computers and other nonelectrical machinery cite some of the sharpest gains. Paper and appliance manufacturers are experiencing more modest increases, while product lines dependent on the auto, housing, and utility industries are "slow." Firms serving the aerospace industry give mixed reports.

Most contacts stress the continuing need to cut costs, improve quality, and avoid becoming overextended. Accordingly, inventories, which have been slim for some time, are being squeezed even further. While capital spending is generally running above last year's level, its primary purpose remains improving efficiency and quality control. Some spending is the result of plant closings and consolidation. However, a small part represents bricks-and-mortar expansion within New England - a relatively new development.

First District manufacturers are reluctant to hire additional workers. Two contacts indicated that they would prefer to invest in more productive equipment, while another is only hiring on a temporary basis. While one respondent is planning a large layoff, for the most part employment levels are stable or rising slightly.

Most contacts report modest increases in materials prices, particularly pulp, paper, aluminum, lead, copper, and steel. In contrast with the recent past, respondents are now finding it easier to pass these costs on to customers and to make small (2 to 4 percent), "selective" price increases stick.

On the whole, First District manufacturers expect a reasonably good year, with improvements in profits ranging from small to significant. In general, they attribute this improvement to their own strict attention to costs and to the effect of the dollar's depreciation on reported profits rather than to any marked increase in economic growth.

Residential Real Estate

The residential real estate market in most parts of the First District has experienced a slower than traditional summer season. Business has been picking up recently in some sections, however. The market is said to be flooded with over-priced, lesser-quality properties and, as a result, selling times have increased. Buyers have become better informed and are resisting over-inflated prices. Many property owners are reluctant to lower asking prices on properties that are not selling, but others are becoming more responsive to the market and reducing prices accordingly. Properties that have sold recently have often had their prices cut.

SECOND DISTRICT--NEW YORK

Developments in the Second District economy varied somewhat among sectors during recent weeks. General business conditions continued to be stable or improved and office leasing remained good in most areas. Some slowing in residential construction activity occurred, however, and consumer spending was not uniformly on or above plan. Small and mid-sized banks reported a decline in primary mortgage rates during June and July.

Consumer Spending

The pattern of sales at District department stores was mixed during June, but for the most part respondents reported results that were on or above plan. One retailer with lower-than-targeted June sales noted that its stores ran a special promotional in May with very strong sales, and this detracted from some of their usual Father's Day business in June. Consequently, the chain is viewing the two months as a single unit this year, the combined results for which were slightly above plan. Overall, June sales among respondents ranged from 4 percent to 12 percent above year-earlier levels.

Items for which there was good demand in June were apparel of all types, not just for Father's Day, and housewares, furniture and rugs. Inventories continue to be monitored closely and generally are on or slightly above target. One retailer whose chain has had higher-than-desired stocks in recent months plans an additional promotional in the near future to try to pare inventories.

Business Activity

The improved tone in the District's economic activity continued in recent weeks. The Buffalo survey of purchasing managers registered a sizable increase in the percentage reporting better conditions while in Rochester, for the second consecutive month, no respondents experienced a worsening. Both area surveys, however, found an increase during June in the percentage of firms reporting higher commodity costs following a decline in May.

Several recent developments point to a positive impact on the District's economy. The New York Times announced plans to spend $400 million, its largest capital investment ever, on a new printing plant in New Jersey. Estimated to be the size of 20 football fields, the plant will ease production constraints at existing sites and permit growth of the Sunday edition. Also in New Jersey, Governor Kean has just presented plans for a $200 million state center for the performing arts to be erected in Newark, plus expenditures of about $50 million on other performance facilities in the District. In another development, ground was recently broken in Manhattan for Shearson Lehman's new office tower which, upon completion, will house 1500 new employees together with 5000 workers currently employed by the firm.

Construction and Real Estate

A slackening in the pace of District residential construction occurred in recent weeks which was described in terms ranging from "negligible" to "definitely slower". The main reasons cited for the slowdown were a two percentage point rise in mortgage rates in some areas and the high level to which land and home prices have risen in others. Responses were also mixed as to the near-term outlook. Some homebuilders reported a pickup had already begun while others anticipated that the slower pace would continue. For the most part, however, District builders still expect this year's activity to run at or close to the rate in 1986, which for many was a record.

Leasing activity in the District's commercial and industrial markets generally remains good. Among new undertakings, construction has begun on a large mixed-use office, residential and commercial complex at a four-acre site in mid-Manhattan which for many years had served as a parking lot. A major tenant has already been announced for the office skyscraper to be built there. While conditions have generally been good, some concern has been voiced recently regarding developments in Westchester County and northern New Jersey where office vacancy rates remain at 20% or above. Leasing activity in much of Westchester has been slow in recent months, and while northern New Jersey continues to attract new tenants, a spate of newly announced large office projects has raised the possibility of increasing vacancy rates.

Financial Developments

Small and mid-sized banks in the Second District report that primary mortgage rates have mirrored the national pattern, rising during April and May and declining by a smaller amount since then. The banks attributed the recent decline to consumer resistance to higher rates and competitive pressures from other banks. Most banks expected that the reduced demand for primary mortgages would put additional downward pressure on rates in the near future. However, a few respondents thought that rates had stabilized. As interest rates rose earlier in the year, the demand for adjustable rate mortgages relative to fixed rate loans increased dramatically. This trend has reversed itself since interest rates turned down, and the portfolio mix now is very close to that at the beginning of the year. Despite the lower demand for primary mortgages, banks do not expect that home equity loans will be negatively affected because of the low rates and tax advantages associated with them.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District is growing at a moderate pace, as indicated by information obtained in July. Manufacturers reported that business is improving at about the first half's modest rate. A reversal of the first half's downward trend in orders and a slight pickup in employment in July are encouraging signs for the industrial sector. Retailers contacted in July said the healthy pace of sales they have experienced for the past few months is continuing, with warm weather bolstering sales of summer clothes and seasonal goods. Growth in total bank lending in the region has slackened a bit since the beginning of the year, but Third District bankers report that business and real estate lending has been growing steadily for the past four months. Consumer lending, as classified for reporting purposes, appears to have fallen off, but some bankers say a drop in credit card lending has been offset by home equity loans. Deposit growth, however, has slowed, largely due to a run off in long-term certificates of deposit.

The outlook in the Third District business community is for continued growth but at a somewhat slower pace. Manufacturers expect improving business for the rest of the year, although they are not planning significant increases in hiring or capital spending. Retailers expect the current growth of sales to slacken, but still forecast a good second half. Bankers expect slower growth in economic activity in the region in the next several quarters to result in smaller increases in loan volume than were booked in the first half of the year. Nevertheless, they express some concern that they may not be able to fund planned loan growth without raising interest rates paid on deposits.

MANUFACTURING

The modest growth that the region's industrial sector experienced in the first half of the year is continuing, according to the latest Business Outlook Survey. Just over one-fourth of the firms participating in the July survey stepped up production from June's pace, while 16 percent cut back; around half were operating at a steady rate. Conditions appear to be slightly better for durable goods producers than for nondurables makers. Reflecting the overall trend of slow growth, most measures of industrial activity made only fractional gains in July. New orders and shipments rose slightly, continuing the first half's pace. Showing more improvement, order backlogs turned up after declining for five months in a row, and employment rose fractionally for the third time this year. Although three-fourths of the companies surveyed in July reported steady payrolls, 17 percent added workers, while only 8 percent made cuts. Industrial prices in the region remain generally stable, although input costs are showing some upward movement.

Looking to the future, area manufacturers contacted in July are mostly optimistic, but remain conservative in their planning. On balance, survey participants forecast gains for new orders and shipments, and larger order backlogs by the end of the year. However, local manufacturers do not expect the recent improvement in employment to continue, and they are planning only modest increases in capital spending. Price expectations are mixed. Half of the firms polled in July intend to hold the line on the prices of their own products, but one-third plan increases in the next six months; 60 percent anticipate higher prices for purchased goods in the next six months, while one-third expect no change.

RETAIL

Merchants contacted in late July reported healthy rates of sales continuing from June. Store officials say sales for their fiscal second quarter (May-July) will probably meet or exceed plans, with increases from the year-ago period around 10 percent in dollar terms. Retailers say a long spell of hot weather has resulted in greater than expected sales of summer apparel and seasonal items. Less robust performance has been turned in by home furnishings and major appliances.

Looking past the usual summer lull to the fall, retailers expect sales growth to slow from its current pace and to run about "average." They do not believe that business can continue to increase substantially unless overall economic growth accelerates.

FINANCE

Total loan volume outstanding at major Third District banks in early July was about 5 percent above the level at the beginning of the year. Loan volume appeared to be increasing at about a 10 percent annual rate in July, consistent with the second quarter's rate but slower than the first quarter's pace. Bankers contacted in July say that commercial and industrial lending and real estate lending are growing, but that consumer lending has fallen off. However, some commercial bank credit officers have analyzed the shift from credit card borrowing to home equity loans by their customers, and they conclude that total lending for personal expenditures is still increasing at about the same rate as it has grown over the past twelve months, around 10 percent annually for large Third District banks as a group.

Third District bankers generally expect a period of sluggish economic growth ahead, resulting in a smaller increase in overall loan demand in the second half of the year than in the first half. With slower loan growth, some bankers say gains from the purchase and sale of securities will account for an increasing share of revenues, and that this will increase the variability of their earnings.

Most large banks contacted in July reported that deposit growth has been slower than expected since May. Long-term certificates of deposit are not being rolled over and bankers believe these funds are being reinvested outside the banking industry. However, total deposits continue to rise as a result of strong growth in other accounts, especially interest-bearing checkable deposits. Nevertheless, bank asset/liability managers say they may have to raise rates on money market deposits and other short-term accounts later in the year in order to maintain deposit growth in line with planned asset growth.

FOURTH DISTRICT - CLEVELAND

Summary

Economic activity in the Fourth District has changed only slightly from the last report. The region's economy continues to grow at a very conservative pace. Increases are reported in production and new orders, but employment is down and inventories are up. Retail sales continue to grow but at a slower pace than during the previous month. New housing starts are higher, even though mortgage rates continue to rise. Demand for consumer and commercial loans has weakened.

Retail Sales

Retail sales grew at a slower pace in June than in the previous month. Most of the sluggishness appears to be in hard goods, which is partly attributable to a drop in housing sales earlier in the year. Another factor is that consumers appear to be reaching the limit of their debt capacity. Some retailers report an increase in deliquency rates, while others note a leveling of credit use. Sales of soft goods continue to expand. Some retailers note that inventories are starting to build. However, due to the initially low inventory levels, few retailers foresee any need to liquidate inventory in the near future. Price increases are generally expected to be modest (2 to 3 percent per annum), although import quotas could provide additional upward pressure on prices.

Domestic auto sales in June are reported to be as much as 40 percent below sales a year ago. Dealers blame sluggish sales on confusing incentive programs, weak real income growth, and the prospect of better deals to come. Foreign auto dealers also report slow sales.

The slowed pace of import sales combined with added production capacity in the U.S. has pushed inventory levels well above those of previous years.

Labor Markets

Total employment in Ohio increased by 44,100 in May. However, an increase in the civilian labor force of 71,000 over the month pushed the unemployment rate from 7.2 percent in April to 7.9 percent in May. The national rate was unchanged at 6.3 percent.

Increases in nonmanufacturing sectors offset continued losses in manufacturing. Retail trade and services accounted for over half the total increase in employment. Much of this increase was seasonal as vacation-related businesses prepared for the summer months. For instance, eating and drinking establishments and amusement and recreation services registered the largest increases.

Manufacturing lost 2,600 jobs over the month, half of which were in primary metals. Electrical and electronics equipment and transportation equipment also experienced sizable job losses. The average workweek edged up slightly to 42.5 hours, helping to raise average earnings of production workers by $4.69 over April's earnings.

Manufacturing

A survey of purchasing agents in Ohio indicates that business continues to improve at a conservative pace. Positive signs include increases in production and new orders. Of particular note are increases in the production of heavy trucks and military orders and in the outsourcing of machinery work. On the negative side, inventories and prices are higher, employment lower, and the backlog of orders has fallen off.

Raw steel production in Ohio fell by 8 percent last month. Despite this recent downturn in production, several major steel producers in the area have reported positive quarterly profits for the first time in several years. They attribute their healthier financial standing to the gains in productivity from reducing employment, closing inefficient facilities, and upgrading more efficient ones.

Domestic automobile production in the region is substantially lower this period, compared to the same period a year ago. Among the Big Three producers, scheduled output will drop by 15.3 percent at GM, 4.3 percent at Ford, and 17.5 percent at Chrysler. Since transportation equipment production is heavily concentrated in Ohio, these cutbacks should have a large impact in the region. Somewhat offsetting domestic cutbacks is the continued expansion of production facilities of foreign manufacturers in the area. For instance, Honda recently announced a $450 million plant expansion project at its Anna, Ohio plant, which will enable Honda to produce 360,000 motorcyle and auto engines a year.

Housing

Housing starts in the region were 14 percent higher in May than in the previous month. Home mortgage rates have edged up slightly over the past month to close to 10 percent for 30-year fixed-rate loans. Nonetheless, many developers are optimistic that housing starts in the region will continue to grow as the major urban areas continue to recover and relatively inexpensive land remains available.

Banking

District loan demand has weakened in the last month. Total loans outstanding at large banks fell at an annual rate of 15 percent over the last five weeks, following a slight decline in May. Commercial and industrial loans continued to account for the majority of the loan contraction. In addition to the softness in business loan demand, consumer and real estate lending have tapered off considerably. After increasing at a rapid clip in May, consumer installment and real estate loans outstanding fell at annual rates of 14 percent and 6 percent, respectively, over the last five weeks.

FIFTH DISTRICT - RICHMOND

Overview

Broadly speaking, economic conditions in the District have not changed much in recent weeks. Directors and respondents to our regular mail and special telephone surveys reported generally positive current conditions and widespread optimism about prospects for the economy. Manufacturing activity continued to increase moderately from June to July, while retail sales were unchanged. Wage and price pressures intensified at producer and consumer levels. Homebuilding and sales of single family homes were steady. Large banks reported strength in consumer and home equity loans, no clear change in commercial and industrial loans, and extraordinary additions to loan-loss reserves. Reports from agricultural bankers indicate that farmers are under less financial stress than a year ago, although July's hot and dry weather has probably reduced prospective crop yields.

Retail Activity

Retailers responding to our regular survey reported that their sales through the first part of July were about even with those in late June. Forty percent of the survey respondents reported increases in sales, as compared with 33 percent who reported declines. Weakness in sales of big ticket items was noted by one-fourth of the respondents, as compared with one-sixth who reported strength in this category. Retail inventories, except of automobiles, were reported to be higher. Retail employment showed little change.

Upturns were evident in retail prices and wages from June to July. One-third of the retailers reported increases in the prices they charge and in employee compensation, as compared with negligible percentages reporting declines. Retailers were about evenly split between those reporting increases and those reporting no change in the prices they pay for goods at wholesale.

Retailers remain optimistic about sales in the months ahead, with almost two-thirds anticipating increases. Most expect wholesale and retail prices to rise further. Few, however, expect an increase in their employee numbers, even though over half currently report job openings. Evidently retailers are doubtful that they will be able to fill these positions, given the tightness of markets for service workers.

Manufacturing and Mining

Manufacturing activity continued to grow at a moderate rate in July. Shipments, new orders, employment, and the workweek increased. The backlog of orders has been generally unchanged in our last two regular surveys. Inventories of materials increased slightly, while inventories of finished goods were unchanged. Manufacturers again reported increases in the prices of raw materials and finished products, and over one-third of the respondents reported that they had raised wages in the past month. Manufacturers believe their business activity will improve further in coming months.

Coal production is above its year-ago level, but below the level predicted a few months ago. Export demand is weaker than had been anticipated, and electrical generating utilities are not buying at the expected rate.

Housing

Homebuilders in most of the District report July activity was about even with June, but down from a year ago. Builders believe that many prospective buyers are staying out of the market, waiting for mortgage rates to decline. Meanwhile, current buyers of new homes are seeking more amenities, including higher ceilings and larger rooms. In the Washington, D.C., area, homebuilding activity -- particularly condominium construction -- continues to increase.

Realtors in the District report that their sales of single family homes were unchanged in July from June. They expect mortgage interest rates to remain steady for three months, and then to rise.

Financial

Large District banks report that consumer loan demand is strong this summer compared to last, and home equity loan demand is also strong. Commercial and industrial loan demand is mixed. Residential mortgage activity other than home equity loans is lower this summer. Variable rate mortgages that allow conversion to a fixed rate mortgage at the borrower's option -- the so-called convertible ARMs -- are being offered by only a few District banks, and only one bank reported strong customer interest.

Almost half of the banks surveyed reported out-of-the-ordinary additions to their loan-loss reserves. The increases were mostly due to foreign debt exposure and were expected to be one-time adjustments.

Agriculture

Preliminary results from our recent survey of District agricultural banks suggest a lessening in the financial stress facing District farmers. Agricultural loan repayment rates are improving and bankers are more optimistic that farmland values will rise. Further, interest rates across all loan categories eased somewhat in the second quarter. Hot, dry weather is the predominant problem now facing District farmers. If it doesn't rain soon, corn and soybean yields will suffer, which would reduce prospective revenues from crop sales at harvest and the ability of some farmers to service debt.

SIXTH DISTRICT - ATLANTA

The Sixth District's economy shows signs of moderate strengthening in a number of sectors. Unemployment in the Southeast continues its downward trend assisted by sizable job gains in services and a slow rebound in manufacturing. Retail sales are rising moderately, and tourism is also providing a positive impact. Construction presents a mixed picture with pockets of brisk activity interspersed among slowing areas. Prospects in agriculture appeared generally favorable at mid-July although hot, dry weather again threatened crop yields.

Employment and Industry. Unemployment rates continue to decline in the Sixth District. The May rate of 6.8 percent was the lowest in seven years for the region, and the downward trend apparently continued according to preliminary June reports. The largest employment gains have been posted in the service-producing sectors; however, manufacturing employment has improved steadily since the first of the year.

The chemical industry is rebounding, aided by the weak dollar and low raw material costs. The recent upturn in oil prices has encouraged drilling activity, which has stimulated the oil equipment industry. Bank directors report that orders and shipments for furniture manufacturers remain strong, and consumer purchases of furniture are accelerating. Textile inventories are reported to be at acceptable levels, and many plants in the region are operating near capacity at present.

Consumer Spending. Retailers in the District report sales are matching modest national gains, on balance. Atlanta sales, according to some retailers, show signs of picking up. Florida is the Southeast's best performer, while Mississippi and Louisiana are the worst. Georgia, Alabama, and Tennessee are performing about on par with the nation.

District car dealers report mixed trends for June and July as foreign car sales outperformed the sluggish movements of domestic cars. As in recent months, most dealers handling GM models report weak sales and unwanted inventory accumulation.

One surprising bright spot emerged in New Orleans, where the stabilization of oil prices and renewed drilling activity spurred the best June car sales performance in that location in four years. Overall, the Southeast's new car registrations this year through the end of May were off by 1 percent compared to the first five months of 1986, while the nation's rate dropped by 9 percent.

Construction. Single-family building permits in the Sixth District (three-month average, seasonally adjusted) declined in May after holding steady for three months. However, District realtors anticipate that the softening of mortgage rates in recent weeks will boost housing activity. The spring uptick in rates discouraged residential builders and apparently priced many first-time buyers out of the market for new homes. Some have turned to lower-priced existing homes, which, contacts report, are generally selling well.

Market performance varies throughout the District. Jacksonville reports strong sales, and new residential construction continues at a healthy pace in the suburbs of Jackson, Mississippi. The worst performance is reported in New Orleans, where sales are slow and prices are stagnant.

The Southeast's prolonged slowdown of commercial construction has enabled markets to firm slightly. Orlando reports a decline in vacancy rates for commercial space, and prices for industrial space in Atlanta are strong. Montgomery contacts note active commercial construction.

Financial Services. Total loan growth at the largest commercial banks edged downward in June. Growth of both business and real estate loans slowed, while consumer loans grew only slightly. Around 50 percent of the total credit available through home equity lines is currently in use, say District bankers. While many line holders are using the credit to pay off consumer debt, many are also using it to make major purchases.

Tourism. Tourism throughout the Southeast is matching last year's performance. Florida leads the District as it benefits from Disney's anniversary publicity. The state's hotel occupancy rates have increased from last year. There is positive news for Mississippi in the revival of tourism in Natchez and Vicksburg and for Louisiana in the planning of the Pope's visit in September. Alabama, Georgia, and Tennessee are realizing earlier expectations of a good summer tourism season.

Port Activity. Rising exports are gradually offsetting the volume lost from the sluggish pace of imports at several District ports. In Miami, for example, increased exports to Latin America are more than compensating for reduced imports. In New Orleans, port revenues are up from last year, and the prospects for continuing gains in export cargo and employment are quite promising. In Savannah, exports are also gradually rising, led by higher shipments of kaolin to Europe, machinery to Brazil, and forest products to many countries.

Mining. The number of active oil and gas drilling rigs in the District rose sharply in early July to reach the highest level since April 1986. Most of the increase occurred in Louisiana and Alabama. The upsurge is in response to higher petroleum prices and expectations of improvement in the price of natural gas. Substantial drilling activity is occurring in the Gulf of Mexico with plans for further exploration and development. Because almost one-third of the nation's natural gas supply is located in the Gulf, this area will continue to be developed, which bodes well for southeastern seaports.

For the first half of 1987, District coal production was 11 percent less than the same period of 1986, and coal prices averaged 6 percent lower.

Agriculture. Crop conditions in the Southeast are favorable at present, but if recent hot, dry weather continues, yields could deteriorate. The broiler industry may experience losses as prices have fallen 20 percent below a year ago in the face of slowing demand and large supplies.

SEVENTH DISTRICT--CHICAGO

Summary. Business activity in the Seventh District continues to expand. Contacts appear more optimistic about the near-term outlook. Purchasing managers in Chicago and Milwaukee reported further improvement in June. Total employment growth in District states from the end of 1986 to May about equaled that in the U.S., seasonally adjusted. District steel mills are operating at capacity for some products and at high levels for others. In response to slower car sales and high inventories, auto makers have cut production, but truck sales and output are strong. Contacts continue to report rising demand for some types of business equipment. Nonresidential construction is slowing in some areas, including Chicago suburbs, but continues strong in downtown Chicago and in Michigan. Residential construction has trailed 1986 since the strong first quarter, and the rest of 1987 is projected at a high level but below last year. Retail sales of seasonal merchandise have been boosted by hot weather, and home improvement products are also reported selling well. Farmland values are edging upward, reversing a six-year decline.

Purchasing Managers. Chicago and Milwaukee purchasing managers' reports show continued expansion in activity through June. Both groups report further increases in output, orders, and inventories, accompanied by rising prices. The Chicago report indicates slower growth of orders than earlier in the year with backlogs and employment unchanged after earlier increases. Milwaukee, in contrast, saw faster growth of orders and backlogs, and rising employment. Both reports have been more favorable this year than in 1985 and 1986, with the improvement particularly sharp in Milwaukee.

Steel. Chicago-area steel mills are operating at capacity for sheet products used in the automotive, appliance, and construction industries. Production of structural steel has slowed but by less than usual in the third quarter. The market for steel plate has tightened. Steel service centers have been setting sales records. Price increases have continued to be reported for various steel products, reflecting improved demand from some sectors, rebuilding of low inventories, lower imports in response to higher prices for foreign steel and the Administration's trade restraint program, and cuts in domestic steelmaking capacity due to plants being closed in recent years and not reopened.

Motor Vehicles. As expected, extended shutdowns for model changeovers are being scheduled in the auto industry to cut inventories. Car sales have continued to trail last year's levels. Permanent as well as temporary cutbacks in auto production are having a particularly sharp impact on industrial activity in southeast Michigan, where the industry is heavily concentrated. However, a knowledgeable contact thinks forecasts of a Michigan recession with double-digit unemployment in 1987 or 1988 are unduly pessimistic. Buyers continue to substitute vans and other light trucks for cars. Sales of heavy trucks are strong. A supplier projects a 16 percent rise in production of heavy trucks this year, to 4 percent above 1985. In contrast with cutbacks in car output, an Indiana truck plant is adding a second shift and 1,100 workers. Unions are expected to emphasize job security in negotiations on new contracts in the industry; management is expected to prefer bonus or profit-sharing plans over increases in base pay.

Equipment. Reports indicate rising demand for various types of equipment, but continued weakness in other lines. A producer of diesel engines is working overtime to fill orders from truck makers, and backlogs have increased. Demand for diesels from other sectors is a little stronger, except from makers of farm equipment. A steel supplier is seeing increased orders from makers of railcars (up from a very low level), construction equipment, and pressure vessels used in the chemical process industry. Buying of machine tools, volatile from month to month, remains weak, hurt by auto industry cutbacks.

Nonresidential Construction. Contracts for construction of nonresidential buildings in the District, in square feet, during the first half of 1987 were about even with last year. A further sizable rise in Michigan was about offset by a large decline in Illinois. Commercial construction continues strong in downtown Chicago. New large buildings continue to be announced, additional structures are being planned, and more announcements are expected. Commercial building has slowed substantially in Chicago suburbs. A steelmaker notes an upturn in buying of pipe for use in oil and gas well drilling, and strength in construction of gas pipelines.

Residential Construction and Sales. Construction contracts for residences in the District states during the first half were above a year earlier, in contrast with the U.S. which was lower. However, the rise in the District was entirely in the first quarter, helped by unusually mild weather. Higher mortgage interest rates since late March and uncertainties over possible future rate declines have caused potential home buyers to wait. Mortgage rates have eased since May, to 10 percent or a little lower for 30-year fixed-rate loans. Inventories of used homes for sale in the Chicago area are low, and lending activity has slowed. A number of housing projects are expected to start soon in this area. Residential building for the rest of the year is expected to stay at a high level but below 1986.

Retail Chain Store Sales. Exceptionally hot weather has encouraged buying of seasonal merchandise, according to a contact at a large retailer. Sales of home improvement items have been doing well. Higher prices, particularly for women's and other apparel, have added to the dollar volume of sales. These higher prices are attributed less to the fall in the dollar than to bilateral trade agreements sharply limiting growth of U.S. apparel imports from Asian countries.

Agriculture. Preliminary results from our latest survey of agricultural banks show that, on average, District farmland values rose about 1.5 percent in the second quarter. Banks from each of the five District states reported an increase. This marks the second consecutive quarter of modest increases, reversing the six-year slide that extended through 1986.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District's economy continued to weaken in the most recent period. Employment and construction slowed since the last report. The outlook for consumer spending, however, was positive. Favorable farming conditions suggest large harvests of District crops.

Employment

District employment has stagnated in recent months after rapid growth in early 1987. Nonfarm employment grew at a 0.4 percent annual rate in the three months through May compared with the nation's 2.6 percent pace. Kentucky and Missouri posted declines during the period. The District labor force dropped in May for the fourth consecutive month.

District manufacturing employment declined at a 3.3 percent rate in the March-May period with losses concentrated in Missouri auto production. It was recently announced that $563 million will be invested to expand a Louisville assembly plant and produce a new line of light trucks. The expansion will directly create several hundred jobs.

Reports indicate that price increases for imported goods have allowed expanded sales of regionally produced textiles and apparel, electronic parts and metal-cutting equipment. Continued cost-cutting and automation, however, are expected to slow employment increases in these industries. Employment in the region's textile and apparel sector leveled off in recent months following gains since last fall. Jobs in electrical and non-electrical equipment have declined since 1985.

Consumer Spending

Reports from District retailers suggest that sales were quite strong in April and May but weakened in June. Most report that sales of durables were recovering from first quarter softness. Several respondents reported sharply higher clothing prices for both foreign and domestically produced clothing. There was a general feeling of cautious optimism among retailers regarding third quarter sales because consumers have been readily accepting fall clothing in early July and consumer debt levels have dropped lately. Of 67 small retail businesses in the District surveyed in April and May, 60 percent expected an increase in their real volume in the near future.

Construction

Despite strong growth of nonresidential building, overall building activity slowed in the region as residential construction activity declined. The value of District residential building contracts dropped 10 percent in the second quarter, following a moderate first quarter gain. Residential activity remained strong in the Louisville and St. Louis areas, however. District nonresidential contracts grew 20.6 percent in the second quarter. Nonresidential building was particularly vigorous in Arkansas and Missouri.

Despite the recent slowing, general construction activity remained stronger in the District than in the nation in the second quarter, due to the strength of the region's nonresidential sector.

Banking

Total loans outstanding at large District banks grew at a 9.7 percent annual rate for the second quarter compared with a 7.4 percent rate for the same period last year. Second quarter loan activity saw an acceleration in real estate lending being partially offset by slower commercial loan growth. Real estate loan volume grew at a 21.6 percent annual rate in the second quarter versus a 0.6 percent rate for the same period in 1986. In contrast, commercial loans grew at a 7.3 percent rate during the second quarter compared to an 11.6 percent rate over the same period last year.

Agriculture

District crop development is as much as two weeks ahead of average due to early planting and recent widespread rains. The District's corn crop has already passed its critical stage which guarantees a large crop even with dry weather in the future. The soybean crop's critical growth period falls in early August when additional rains will be needed.

The volume of farm operating loans continued to fall both at commercial banks and at Production Credit Associations during the first quarter of the year. Overdue farm loans at agricultural banks improved from 10.4 percent in the first quarter of 1986 to 9.0 percent one year later. Net loan losses at agricultural banks also improved from .28 percent to .20 percent over the same period.

NINTH DISTRICT--MINNEAPOLIS

The district economy has continued to improve this summer. Strong seasonal employment growth has helped many parts of the district, causing a general decline in state unemployment rates. Consumer spending has grown modestly, while housing activity may be starting to pick up a bit again. The tourist industry, a major summer employer, has done well so far this summer. The agricultural sector has at least done better than last year, thanks to warm weather, high livestock prices, and income from government farm programs.

Employment

Labor market conditions have improved in early summer. Most district states report good seasonal employment growth and unemployment rate declines during May. In South Dakota, the unemployment rate fell from 4.1 percent in April to 3.5 percent in May, while in North Dakota, the rate dropped from 5.2 percent to a historically low 4 percent. Preliminary May estimates from Montana also indicate a healthy decline in its unemployment rate, down more than a full percentage point from April and down two percentage points from May 1986. Statistics from the Upper Peninsula of Michigan are particularly heartening; they show a three percentage point drop in its unemployment rate between April and May coupled with a sizable increase of 3,300 jobs over the last year. And while both Minnesota's nonfarm employment and its unemployment rate deteriorated a bit during May, its Minneapolis-St.Paul metro area continued to register improvement in both statistics.

Consumer Spending

Retail sales of general merchandise have continued to grow moderately. One retail chain reports sales 4 percent higher this June than last. Its recent sales promotions did quite well. Its inventories are at acceptable levels, and management is optimistic about fall business. Scattered reports from cities around the district indicate that retail sales are holding up in Sioux Falls, South Dakota, as well as in Missoula, Montana, where a new large discount store is slated to open this August.

Motor vehicle sales seem to be picking up. One domestic manufacturer experienced its best June sales ever in this district. While its inventories are still a bit high, its dealer profits have been good. A large Twin Cities dealer of another domestic manufacturer reports that its recent sales have been quite good, too. Directors of this Bank's branch in Montana give mixed reports about auto sales in their hometowns.

Housing activity may have rebounded a bit recently. After a 22 percent drop in May, Minneapolis-St.Paul home sales posted a 9.5 percent gain in June over the level of June 1986. Sales for the second quarter were still around 20 percent lower than a year earlier, though.

Tourism

The tourist industry, a major contributor to the summer economy throughout the district, has done well so far. Despite a few incidents with grizzly bears, the number of visits to major tourist attractions in Montana was 4 percent higher this June than last, leaving the year-to-date number up 6 percent. Reservations for the rest of the year are also ahead of a year ago. Attractions in the Black Hills area of South Dakota report 15 to 20 percent increases over last year. During one week in June, a caravan of Airstream homes brought 7,000 people to that area. Industry representatives in western North Dakota report activity up about 10 percent this June. Good reports also come from most areas in the Upper Peninsula of Michigan. Traffic into the Upper Peninsula over the Mackinac bridge this July is running ahead of last year's record level.

Agriculture

Agricultural conditions have continued to improve. Prices of farm commodities have continued to rise. The Minnesota farm price index rose in June to a level 3 percent higher than in May and 4 percent higher than in June 1986. Meat prices account for much of the increase, as beef cattle prices reached their highest level in eight years. Government land idling programs have helped lower plantings of major crops currently in excess supply. For example, corn acreage in Minnesota is now at its lowest level since 1983. Income from livestock sales and a variety of government agricultural programs led to an increase in district farm income during the second quarter, according to this Bank's survey of agricultural bankers. This survey also shows that the higher farm income helped farmers service their bank debt, which has improved the portfolios of agricultural banks. Unseasonable warmth has helped row crops to develop very rapidly, but it has also led to moisture stress in some parts of the district. And some areas are having problems with grasshoppers and hail.

TENTH DISTRICT - KANSAS CITY

Overview. Economic activity in the Tenth District is continuing at a sluggish pace. Retail sales have stabilized over the past three months, but a few retailers report declines. Auto sales are steady to slightly stronger in July. Retail prices have remained steady, although manufacturers' purchasing agents continue to report moderate increases in input prices and continue to expect further slight increases. The housing industry in Oklahoma and Colorado is depressed, while other parts of the district report that housing starts are near last year's levels. The energy sector has responded only slightly to higher oil prices. Deposits and loan demand at district banks show little change. Winter wheat yields in the district were about average. Strong prices have brought little expansion in the livestock sector.

Retail Sales. District retailers report mixed sales, with half the respondents reporting sales above year-ago levels and half reporting sales below year-ago levels. Sales have mostly stabilized over the past three months, but a few retailers report declines. Prices have been generally constant over the past three months, and retailers expect this trend to continue for the near future. After some recent trimming, inventories are considered to be satisfactory. Most respondents express optimism for future sales.

Automobile Sales. Automobile dealers generally report that auto sales are steady or slightly stronger in July. Inventories are generally considered tight, and some dealers report difficulty obtaining automobiles due to end-of-model-year conditions. Dealers expect auto sales to remain constant or improve during the remainder of 1987.

Purchasing Agents. Purchasing agents report that input prices are moderately higher than last year and are expected to increase slightly during the remainder of 1987. Most agents report that materials are readily available, although one purchasing agent reports problems obtaining steel. Steel will likely become easier to obtain during the remainder of the year, and few other problems obtaining materials are expected during 1987. Inventory levels are satisfactory.

Energy. Firming oil prices have brought some stability to the district's energy industry. A strong rebound in activity remains elusive, however, despite recent domestic spot prices in excess of $22 per barrel. Exploration and development activity in the district remains generally flat. The average weekly number of operating drilling rigs in the Tenth District fell slightly from 238 in May to 232 in June. This number compares favorably with the 200 drilling rigs operating in the district a year earlier, but remains less than one-sixth of the record set in 1982.

Housing Activity and Finance. Strength in the homebuilding industry varies widely across the district. Conditions in Oklahoma and Colorado are particularly depressed; other parts of the district report that housing starts are near last year's levels. Builders expect that the trends already established this year will continue. New home sales are generally steady, except for sluggishness in Colorado. Prices are generally stable. No problems are reported with either the availability or delivery of housing materials. Materials prices are stable, or up only slightly.

Deposit growth at Tenth District savings institutions is reported weak for the first six months of 1987. More recently, there has been a slight improvement in savings inflows at institutions that have increased rates to levels comparable with commercial banks. Demand for mortgage funds is down, but respondents hope for slight improvement over the remainder of 1987. Mortgages rates have fallen off a little due to slack demand. Rates are expected to remain at about their current levels for the rest of 1987.

Agriculture. The wheat harvest is nearly complete in Oklahoma, Missouri, and Kansas and is well under way in the northern areas of the district. Yields appear to be about average, except for disappointing yields in some areas of Kansas and Oklahoma. There appears to be sufficient storage for this year's wheat crop.

The corn, milo, and soybean crops are doing well throughout the district. Most district states have received good moisture and expect excellent harvests this year. There is some concern that the fall harvest may meet with isolated storage problems.

Feedlots generally remain full in the Tenth District as beef prices remain strong, but no expansion in capacity is reported. There are only scattered reports of herd expansion, as operators are generally holding steady. Hog prices remain high, but bankers report continuing fear of a downturn. Consequently, operators are somewhat hesitant to expand and bankers are reluctant to finance new facilities or large increases in inventories. There are, however, a few reports of small inventory increases.

Banking. Reports of total loan demand and total deposits at Tenth District banks are evenly divided: one-third of the respondents report that loan demand and deposits are down, one-third report they are unchanged, and one-third report they are up. This pattern is consistent for all categories of loans except for some general decline in commercial real estate loans. As with loan demand, there are scattered reports of changes, both up and down, in each category of deposit, but the consensus clearly reflects no change in deposits. Respondents report no change in their prime rates, and none expect any change in the near term. Virtually all the respondents report no change in their consumer loan rates, and, again, no change is expected.

ELEVENTH DISTRICT--DALLAS

Although the District economy remains weak overall, several of its most important sectors are showing some growth. Most manufacturing industries report slow output growth, but industries tied to construction remain weak. The energy sector is expanding very mildly. Construction contracts have registered recent gains. Retail sales remain sluggish, but respondents are guardedly optimistic about the fall season. Auto sales have picked up slightly. Outflows of large time deposits continue to occur at District financial institutions.

District manufacturers report mixed business conditions, but overall manufacturing activity has picked up since the beginning of the year. Only manufacturers of durable goods tied to the construction industry note a continued decline in business conditions. Producers of steel and military durables continue to show strength, with respondents in both industries reporting continued strong sales and expressing a favorable outlook for the coming months. Respondents in the chemical industry also report strong sales but note that increasing oil prices could make it harder to compete overseas. Producers of electric and electronic equipment report steady sales growth, with some recent gains reported in computer equipment. Manufacturers of energy-related durable goods report that their industry has bottomed out, but they do not expect much increase in the next few months. Apparel producers note a mild year-over-year improvement in sales.

The District drilling rig count has continued to climb on a seasonally adjusted basis in response to higher oil prices. In June the rig count finally rose above year-earlier levels, and it subsequently surged in the first two weeks of July. Well permit applications rose strongly in June, portending additional increases in drilling.

Indicators of new construction activity in the District have shown some recent gains. After reaching a trough in the fourth quarter of 1986, the value of construction contracts increased mildly in the first quarter of 1987 and rose again in April and May. Moreover, new activity has recently been near or above year-earlier levels. Recent increases have been fueled by small improvements in the residential and nonbuilding sectors, while new nonresidential construction has been fairly stable. Single-family housing permits have strengthened, but multifamily permits remain at extremely low levels. Despite these increases in new construction activity, the lagged effects of last year's declines in contract values have resulted in continued reductions in construction employment.

Despite some reports of modest sales increases, District retailers generally say their sales are sluggish across all lines and that their inventories are somewhat higher than planned. In cases where sales growth was reported, it was linked to special promotions. Most respondents expressed guarded optimism concerning the upcoming fall season. Rising prices were cited for electronics items and were linked to the increased value of the yen. Some retailers expect apparel prices to rise this fall as a result of new import quotas.

District auto dealers report a slight upswing in sales, with volume increasing above year-earlier levels. The gain came as a surprise to dealers, and they are cautious about extrapolating this growth into future months. An upturn in domestic auto sales more than offset continued weakness in sales of foreign models. Foreign auto sales have been stifled by rising prices stemming from the higher value of the yen and the deutchmark.

Deposits at the District financial institutions have slipped in recent months and are now only slightly above year-earlier levels. Commercial bank deposits were below a year earlier in June, with declines coming in demand and large time deposits. Despite positive annual deposit growth at thrift institutions, their large time deposits are also declining. Furthermore, a significant portion of total thrift deposit growth is said to reflect the accrual of interest, rather than new inflows of cash from depositors.

District farmers face divergent income prospects for 1987. Livestock producers indicate that profits are likely to increase in the second half of the year, while great uncertainty is attached to the income outlook for cotton farmers. With the anticipated decline in beef supplies in the second and third quarters, cattle prices are expected to remain relatively high, spurring the demand for feeder cattle. Adverse late-spring weather hit most major cotton regions of the District, forcing growers to replant almost a million acres in June. Given average yields and a price of $.50 per pound, about $160 million in Texas High Plains gross cash receipts depends crucially on warm weather in September. An index of livestock prices received by Texas farmers and ranchers slipped 1 percent in June, compared with May, but was 19 percent above a year earlier. A comparable index for crop prices showed a 3-percent monthly reduction in June, and it was 4 percent below a year earlier.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

Overall, the Twelfth District economy appears healthy, although wide variations across regions and industries exist. Trade and the services are among the strongest sectors in most areas. Manufacturing activity appears to be picking up, and the forest products industry remains strong despite the rise in interest rates that occurred last spring. The new immigration bill has caused some disruptions in the apparel and agriculture industries, although production levels do not appear to have suffered substantially. Construction activity has slowed markedly, particularly in the multi-family and nonresidential segments of the market. The higher interest rates seen this spring appear to have reduced the overall demand for mortgage financing, and many banks have changed mortgage features in order to boost demand.

Consumer Spending

The trade and service sectors continue to pace economic growth throughout the Twelfth District. In Tacoma, a recent survey found that 41 percent of the area's employers intended to increase staff during July, August, and September, a sharp increase from 11 percent last year. The strong demand has led to wage increases for many categories of office workers in the Puget Sound area. Tourist activity in the Puget Sound area also is reported strong, with the number of ferry passenger trips running 10 percent ahead of last year, and highway traffic up 6.5 percent.

Manufacturing

Several aluminum plants in Washington have come back on line after complete shutdowns, due to a combination of higher output prices, the lower value of the dollar, increased demand generated by economic expansion during the first quarter, and accommodative pricing by the Bonneville Power Administration. In Utah, USX is reopening its Geneva steel plant.

Apparel production in the Los Angeles area reportedly exceeds last year's pace, although the uncertainty generated by the new immigration bill has created problems for some producers. For example, some small apparel firms are operating below full capacity due to labor shortages, while other southern California producers reportedly have moved their plant operations to Mexico to take advantage of easier access to low-priced labor.

Agriculture and Resource Related Industries

In many areas, agricultural labor markets have been affected by uncertainties associated with the new immigration bill, but reports of actual crop losses have been relatively infrequent. The impact has been mitigated in most regions by strong recruiting efforts, changes in enforcement procedures, and wage increases. For example, in Washington, wages reportedly rose from $3-4 per hour to $5-6 per hour. Unusually large strawberry harvests in the Northwest and grape and tree fruit shipments in the San Joaquin Valley confirm that crop losses thus far appear to have been relatively minor. However, one estimate puts crop losses in Oregon due to labor shortages at $300 million to $1 billion. Several growers report that their paperwork and administrative costs have increased substantially, and many are devoting significant resources to providing documentation for workers seeking legal residency. In Washington, the upcoming apple harvest is expected to be larger than usual, which could increase labor demand and, along with possible lower product prices, create a tight squeeze on profit margins. Moreover, an Oregon rancher says that farmers of some labor-intensive crops, such as sugar beets and onions, may cut back on plantings of those crops in future years if difficulty in recruiting good workers continues.

Production and profitability in the Northwest lumber industry appear to be holding up despite concerns regarding the impact of higher interest rates. The low value of the dollar continues to make U.S. exports attractive on world markets. In addition, Northwest producers' competitive positions vis-a-vis Canada have been enhanced by the 15 percent tariff on Canadian lumber exported to the U.S. and by a recent increase in the value of the Canadian dollar relative to the U.S. dollar. The industry continues to operate at or near capacity in Oregon, while strong Japanese demand for pulp is stimulating Alaska's timber industry.

Construction and Real Estate

Construction activity has slowed markedly in most parts of the District, with relatively mild declines in single-family construction activity exacerbating the more severe downturns in multifamily and nonresidential building. In the Seattle area, the number of housing permits currently stands 9 percent below its year-earlier level. In the Phoenix area, construction employment has dropped by about 11 percent during the past year. In Utah, multifamily construction is down 76 percent from last year and single-family starts are down 12 percent. In Alaska, which has been hard hit by oil-related weakness, real estate values reportedly have fallen by some 21 percent over the past year. Finally, in the San Diego area, one of the fastest growing regions of the country, a banker reports that new construction loans dropped 56 percent between March and June.

Financial Sector

The changes in financial conditions during the second quarter have tilted the mix of mortgage lending away from fixed and toward variable-rate instruments for most lenders. One California banker reports that fixed-rate mortgage business has dropped by 50 to 60 percent from the levels of early this year, raising average overhead costs, reducing profit margins, and leading to a virtual price war over ARMs. However, a Seattle-area banker reports no such change, arguing that buyers are doing all they can to qualify for fixed-rate instruments.

The rise in rates has squeezed many banks' profit margins, and the decrease in buying activity has reduced mortgage fee income as well. Some larger banks have developed new mortgage products to boost demand. Innovations include lower mortgage fees, longer loan rate commitments, shorter maturities, balloon mortgages, bimonthly and biweekly payment plans, and ARMs that are convertible to fixed rates at some point early in the life of the mortgage.